NORTH CAROLINA GENERAL ASSEMBLY

LEGISLATIVE FISCAL NOTE

BILL NUMBER: HB 1714 (First Edition)

SHORT TITLE: Eliminate Marriage Penalty

SPONSOR(S): Rep. Decker, et al.

FISCAL IMPACT

Yes (X) **No ( )** **No Estimate Available ( )**

($Million)

	FY 1998-99	**FY 1999-00**	**FY 2000-01**	**FY 2001-02**	**FY 2002-03**
REVENUES					
General Fund	**(134.7)**	**(94.5)**	**(98.3)**	**(102.4)**	**(106.5)**

PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue

EFFECTIVE DATE: This act is effective for taxable years beginning on or after January 1, 1998.

BILL SUMMARY: The bill increases the standard deduction and the income tax brackets for married filing jointly taxpayers equal to twice the amount for single taxpayers.

BACKGROUND: The term "marriage penalty" refers to the income tax situation where married individuals filing jointly pay more in tax than if the two individuals were unmarried filing as single persons. In its 1997 report entitled "For Better or Worse: Marriage and the Federal Income Tax", the Congressional Budget Office estimated that 20 million married couples in the U.S. pay higher taxes than they would if they were single. On the other hand, the report also showed that 25 million American couples enjoyed a marriage bonus because their taxes were lower as a result of marriage. The American Institute of Certified Public Accountants believes the two biggest factors creating the marriage penalty are 1) the stacking of income problem and 2) the different income thresholds and phase-outs for deductions and credits for single versus married taxpayers. The marriage penalty is greatest on couples with two wage earners with similar incomes. In North Carolina, the income tax brackets and the standard deduction favor those filing as single taxpayers rather than those in the married filing jointly category.

ASSUMPTIONS AND METHODOLOGY: One solution eight states have used to eliminate the marriage penalty in their state income tax is to have the married tax brackets double the width of the single tax brackets. This strategy will also work in North Carolina. The current North Carolina tax brackets are as follows:

	Single	Married
6%	0 to $12,750	0 to $21,250
7%	$12,751 to $60,000	$21,251 to $100,000
7.75%	$60,001 >	$100,001 >

Half of the penalty can be reduced by changing the married tax brackets to equal twice the value of the single brackets as proposed by HB 1714 and shown below.

	Married - Proposed
6%	0 to $25,500
7%	$25,501 to $120,000
7.75%	$120,001 >

The remainder of the penalty can be reduced by making the standard deduction for married, filing jointly, equal to twice the single rate. Instead of $5,000 for married filing jointly, HB 1714 proposes a new rate of $6,000 or twice the $3,000 single rate. In effect, this reduces the amount of income added back to federal taxable income. The calculation of state income tax begins with the federal taxable income computed on the federal form 1040. However, before the state income tax can be computed, federal taxable income must be adjusted for state personal exemptions and standard deductions. The state personal exemption and standard deductions have not been indexed to keep pace with inflationary changes in the federal rates. For tax year 1997, the state exemption rate is $2500 and the federal rate is $2650, thus $150 must be added back to taxable income for each dependent. (For the 7.75% tax brackets, $650 per exemption must be added back.) The state standard deduction for singles is $3000, but the federal deduction is $4150 thus $1150 must be added back to taxable income. For married, filing jointly, the state standard deduction is $5000, but the federal deduction is $6900, thus $1900 is added back to taxable income. With a $6,000 standard deduction for married filing jointly, the add-back would be only $900 for the standard deduction and $300 for two personal exemptions, or $1200. Based on the examples below for tax year 1997, the marriage penalty would be replaced with a small marriage bonus, for some couples.

	Two Singles each earn $30,000	**Married** each earn $30,000	**Two Singles** 1 earns $30,000 1 earns $20,000	**Married** 1 earns $30,000 1 earns $20,000	**Two Singles** 1 earns $90,000 1 earns $20,000	**Married** 1 earns $90,000 1 earns $20,000
Fed. Tax Income	$46,400	$47,800	$36,400	$37,800	$96,400	$97,800
Add back	2,600	1,200	2,600	1,200	3,100	1,200
NC Tax Income	49,000	49,000	39,000	39,000	99,500	99,000
NC Tax	$3,175	$3,175	$2,475	$2,475	$6,898	$6,675
Difference		0		0		-$223

Without the proposed change, two of the three married couples in this example would have paid $112 more than unmarried couples with similar incomes. (see below) One married couple has a marriage bonus under current law, but will have a greater benefit under HB 1714.

	Two Singles each earn $30,000	**Married** each earn $30,000	**Two Singles** 1 earns $30,000 1 earns $20,000	**Married** 1 earns $30,000 1 earns $20,000	**Two Singles** 1 earns $90,000 1 earns $20,000	**Married** 1 earns $90,000 1 earns $20,000
Fed. Tax Income	$46,400	$47,800	$36,400	$37,800	$96,400	$97,800
Add back	2,600	2,200	2,600	2,200	3,100	2,550
NC Tax Income	49,000	50,000	39,000	40,000	99,500	100,350
NC Tax	$3,175	$3,287	$2,475	$2,587	$6,898	$6,815
Difference		$112		$112		-$83

The North Carolina Individual Income Tax Model was used to estimate the cost of changing the standard deduction and income tax brackets of married filing jointly to twice that of single filing status. The model projects the tax year cost of eliminating the marriage penalty as follows:

Tax Year 1998	$84.2 million	Tax Year 2001	$100.3 million
Tax Year 1999	$92.6 million	Tax Year 2002	$104.4 million
Tax Year 2000	$96.3 million	Tax Year 2003	$108.6 million

The first year impact in FY 98-99 includes the General Fund revenue loss for tax year 1998 and half the loss for tax year 1999 (January - June 1999) due to taxpayers adjusting their withholding tables and estimated payments. The remaining fiscal years equal half of one tax year plus half of the next tax year.

FY 1998-99	$134.7 million
FY 1999-00	$94.5 million
FY 2000-01	$98.3 million
FY 2001-02	$102.4 million
FY 2002-03	$106.5 million

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