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Advantages and Disadvantages of a Reform of the Marital Splitting System

The taxation of married couples in Germany has long been considered in need of reform. The current marital splitting system provides for married couples to be taxed jointly. There is always an advantage if the partners have different incomes. This is due to the progressive income tax rate: the tax rate rises with increasing income.

From an economic point of view, the most important criticism of this model is that it creates strong incentives for second earners, usually women, not to pursue employment or at best to take on a part-time job – and instead to concentrate on household chores and raising children.

This is because the second earner's income is subject to the couple's marginal tax rate from the first euro under the marital splitting system. The higher the income of the first earner, the higher the marginal tax rate and the less worthwhile it is for the second partner to strive for earned income.

Adaptation to a New Image of Society

However, it is not only the employment effect that is problematic, but also the image of society associated with marital splitting: it sees marriage with a classic division of labor between the spouses as the dominant form of cohabitation. Family structures are more diverse today. More and more couples are living together without a marriage certificate. The number of single parents and patch-work families has increased. Divorce is more frequent.

Equality for women, a fundamental social concern, has a lot to do with employment and economic independence. Individual taxation is a widely discussed alternative to marital splitting. It has the advantage that it provides significantly greater incentives for second earners to work. Rather than taxing the first additional euro earned at the marginal tax rate – the level of which depends on the income of the first earner – an effective marginal tax rate of zero applies, provided the second earner has no other source of income.

Impact on the Labor Market

The consequences for labor supply would be considerable – especially since women react much more strongly to net wage changes than men. Studies estimate that employment could increase by a good 200,000 full-time jobs. This does not take into account the fact that investment in training would probably increase and social conventions would change, so that the long-term effect could be even greater.

However, individual taxation has a considerable disadvantage: it neglects the fact that spouses are obliged to support each other. In this respect, part of the income of one spouse would have to be considered economically as income of the other.

This problem can be alleviated by the concept of real splitting. In principle, individual taxation applies, but the first earner can transfer a certain amount to the second earner for tax purposes.

But real splitting also has a disadvantage. The incentives for the second earner to work are not as limited as with marital splitting. Nonetheless, the tax burden of the second earner is positive from the first euro because the transferred income amount is added. This reduces the employment effects; estimates suggest around 50,000 additional full-time jobs.

Another reform idea comes from the Advisory Board to the German Federal Ministry of Finance. Instead of real splitting, it proposes introducing a “supplementary marital allowance,” the amount of which decreases as the second earner's income increases. This leads to somewhat higher incentives to work than with real splitting. However, the effect is also weaker than with individual taxation.

Employment Effect Only in the Long Term

The problem with all these options is that many married couples would have to pay more taxes. True, the state could use the additional revenue to reduce income tax or other taxes, which would allow for additional employment effects. But the tax increase would be harsh, especially for married couples who have settled on the traditional division of labor in reliance on the current rules and where second earners cannot and will not readily take up employment. For reasons of protection of legitimate expectations, the old rules could continue to apply to existing marriages. However, it would then take many years for the hoped-for employment effects to materialize.

Justifying a reform of the marital splitting system solely in terms of labor market policy ultimately falls short of the mark. Especially with the most realistic option, real splitting, the effect is not big. To increase female employment, tax policy can be only one of several pillars. A package of measures is needed that also further expands childcare and generally improves the compatibility of work and family.

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