

Do High Effective Marginal Tax Rates Punish Low-Income Workers?

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Marginal tax rates

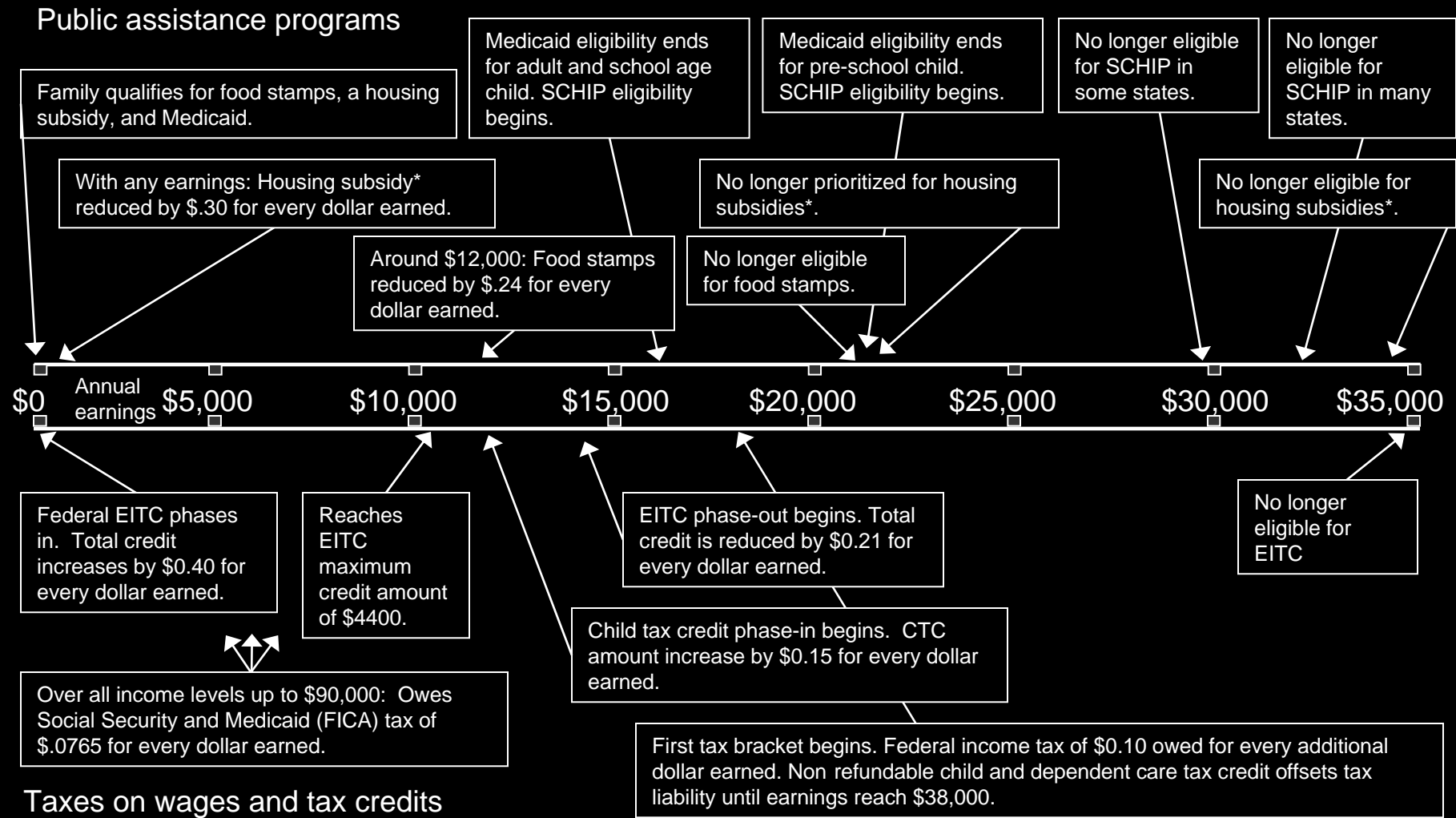
- Marginal tax rate (MTR) – the rate at which an additional dollar of earnings is “taxed”
- Arise from the combination of a progressive tax system and means-tested transfer programs

Research on MTRs and low-income workers

- Sources
- Study 1 – ethnography
- Study 2 - administrative data
- Solutions

Figure 1. Means-tested public assistance, tax credits and tax liability at different income levels.

Based on 2005 figures for a one-adult worker with one pre-school and one school-aged child.

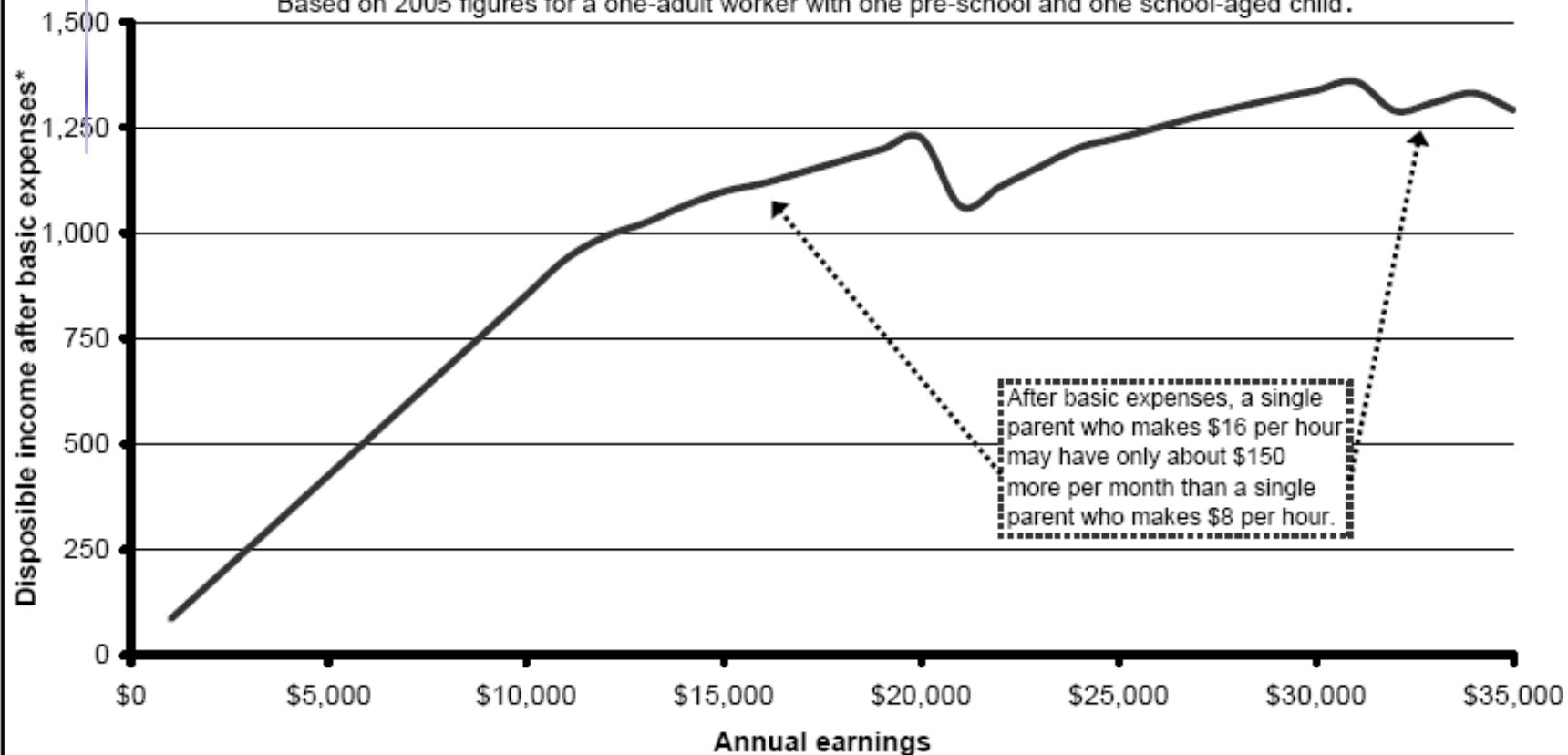


Sources: Food stamp formula from U.S. Department of Agriculture (2005). Medicaid/SCHIP information from Dubai, Hill and Kenney (2002). Housing subsidy information from U.S. Department of Housing and Urban Development (2002). Tax and tax credit information from author calculations using TAXSIM (Feenberg and Coutts 1993; NBER 2001) assuming wages are only income source and child care costs of \$200 per month.

*Housing subsidy rates based on national median income and rental rates. Specific cut-off points vary by location and housing assistance is subject to limited availability. Reductions in subsidy are delayed for 12 months and then phased in at a 50 percent rate for an additional 12 months for housing subsidy recipients who move from unemployment into the labor force.

Figure 2: Annual earnings and disposable income after basic expenses

Based on 2005 figures for a one-adult worker with one pre-school and one school-aged child.



Family experiences of MTRs

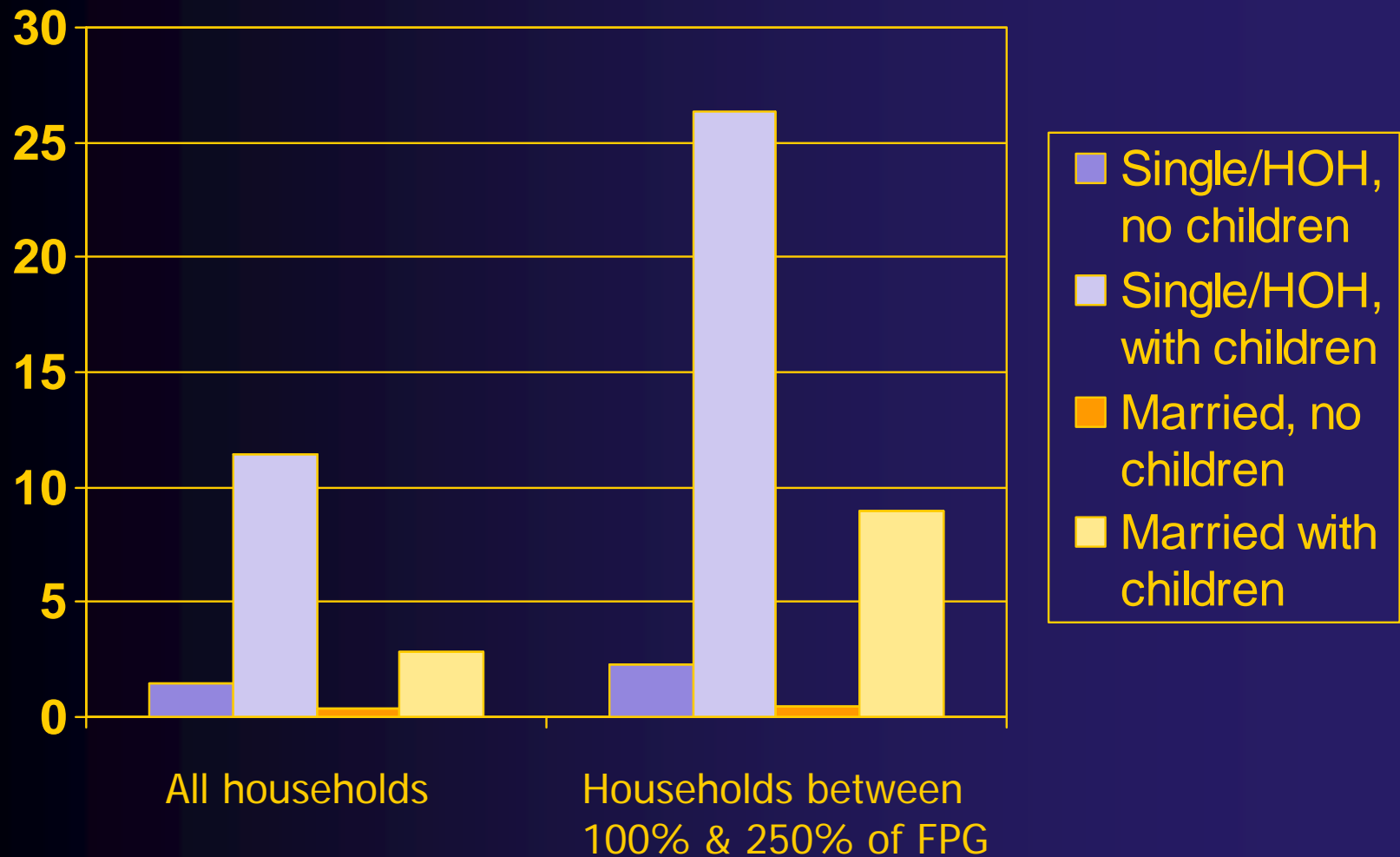
- Ethnographic study of 40 families over 3 years
- Baseline risk varies across families
- Most families experience a MTR event
- Reactions often at odds with “control”

Determining incidence of high MTRs

- Holt & Romich analysis of merged Wisconsin administrative data
- About 74,000 (3% of all) Wisconsin households faced marginal rates of 50% or greater

Incidence of high MTRs

(% households with marginal rate of 50% or greater)



Proposed and possible solutions

- Tax system

Ex: simplified / unified child tax credit

- Program-level tweaks

Ex: Phased disregards

- Fundamental reforms

Ex: Universal health coverage

References:

- Holt, Stephen D. & Jennifer L. Romich. (2007). Marginal tax rates facing low and moderate income workers who participate in means-tested social programs. *National Tax Journal* 60(2): 253-276.
- Romich, Jennifer L. (2006). Difficult calculations: Low-income workers and marginal tax rates. *Social Service Review* 80(1): 27-66.