# Do High Effective Marginal Tax Rates Punish Low-I ncome 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 meanstested transfer programs


## Research on MIRs 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.

## Public assistance programs

Family qualifies for food stamps, a housing subsidy, and Medicaid.

Medicaid eligibility ends for adult and school age child. SCHIP eligibility begins.
 SCHIP eligibility begins.

No longer eligible for SCHIP in some states.

No longer eligible for SCHIP in many states.

No longer eligible for housing subsidies*. subsidies*.
No longer eligible for food stamps.

No longer eligible for EITC

Federal EITC phases
in. Total credit increases by $\$ 0.40$ for every dollar earned.

Reaches EITC maximum credit amount of $\$ 4400$.

EITC phase-out begins. Total credit is reduced by $\$ 0.21$ for every dollar earned.

Child tax credit phase-in begins. CTC amount increase by $\$ 0.15$ for every dollar earned.

Over all income levels up to \$90,000: Owes Social Security and Medicaid (FICA) tax of $\$ .0765$ for every dollar earned.

Taxes on wages and tax credits

First tax bracket begins. Federal income tax of \$0.10 owed for every additional dollar earned. Non refundable child and dependent care tax credit offsets tax liability until earnings reach \$38,000.

Sources: Food stamp formula from U.S. Department of Agriculture (2005). Medicaid/SCHIP information from Dubay, 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 disposible income after basic expenses


## 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 MIRs

- 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. \& J ennifer 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.

