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West Coast Poverty Center
UNIVERSITY OF WASHINGTON
A Partnership of the SCHOOL OF SOCIAL WORK, the DANIEL J. EVANS SCHOOL OF PUBLIC AFFAIRS and the COLLEGE OF ARTS AND SCIENCES

Poverty Research Flash

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When More Work Doesn't Pay:

The Impacts of the Loss of Means-Tested Benefits on Discretionary Income for Low and Middle-Income Families

Background. Progressive federal and state tax structures impose higher tax rates and reduce eligibility for tax credits as earnings increase for all workers. In addition, as their earnings rise, many low and middle-income workers must attempt to replace the value of the benefits they lose from means-tested programs such as food stamps. The amount of every additional dollar earned that is absorbed by such additional expenses as earnings grow, known as the marginal tax rate or MTR, can be particularly high for families who lose multiple means-tested benefits. For example, families using food stamps, public health coverage, and child care subsidies would see little increase in discretionary income between earnings of $10,000 per year and $30,000 if they attempted to replace the value of those lost benefits.

Methods. In this study, Stephen D. Holt and Jennifer L. Romich use a unique data set that combines state administrative data on program participation with earnings and tax records for nearly 2.5 million Wisconsin households headed by a working-age adult in 2000 to study the distribution of MTRs across a large population of working families. The authors use these data to describe families' patterns of participation in means-tested programs and their use of tax credits and to estimate the MTRs sample families would face with a $500 increase in annual earnings (an increase of roughly $0.25 per hour).

Key Findings. The researchers found that the use of means-tested benefits, and the corresponding risk of higher MTRs, was highest among single-parent families with children. Among one-adult families with two dependents, 44 percent used food stamps, subsidized child care, or government-funded health insurance; 15 percent used all three; and 12 percent used all three plus the earned income tax credit. For all families in the sample, the corresponding percentages were 10, 1.5 and 1, respectively.

Estimating the impact on family income of a $500 increase in earnings, the authors calculate a median MTR of 30 percent for all families in the sample, meaning that the median household's financial well-being increased $0.70 for every additional dollar earned. However, estimated MTRs varied substantially by household income, family type, and program participation. Mainly because of earned income tax credits, about one-third of single-parent families with children with earnings below the poverty level gained more than a dollar for every dollar earned. However, for 38 percent of families using earned income tax credits plus all three transfer programs, and for one fourth of single-parent families with children earning between 100 percent and 250 percent of the federal poverty guidelines, half the additional income would be lost to the replacement of lost benefits, for an estimated marginal tax rate of 50 percent.

Because Wisconsin has one of the highest earned income tax credits in the U.S., estimated MTRs may differ for workers in other states. But in light of the concentration of high marginal tax rates revealed by this study among families using multiple means-tested benefits, policy makers may want to focus on reshaping tax incentives or coordinating eligibility limits across programs so that families can realize greater financial gains as their earnings increase.

Highlighting New Poverty Research

by Stephen D. Holt and Jennifer L. Romich

"Marginal Tax Rates Facing Low- and Moderate-Income Workers who Participate in Means-Tested Transfer Programs," published in the *National Tax Journal,* Vol. 60, No. 2 (June 2007).

Stephen D. Holt, JD, is Principal, Holt & Associates Solutions in Milwaukee. Mr. Holt has been exploring the effect of marginal tax rates on low-income workers since 2000, under contract with the New Hope Project. Jennifer L. Romich is an Assistant Professor of Social Work at the University of Washington and a Faculty Affiliate of the West Coast Poverty Center. She studies employment, family processes and use of tax and social benefits by low-income families.

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Poverty Research Flash

Introducing a new poverty research series from the West Coast Poverty Center!

The West Coast Poverty Center serves as a hub for research, education, and policy analysis leading to greater understanding of the causes and consequences of poverty and effective approaches to reducing it in the west coast states. The Center, located at the University of Washington, is one of three regional poverty centers funded by the U.S. Department of Health and Human Services, Office of the Assistant Secretary for Planning and Education (ASPE). More information about the West Coast Poverty Center is available from our website: www. wcpc.washington. edu

Poverty Research Flash 2007-01

When More Work Doesn't Pay:

The Impacts of the Loss of Means-Tested Benefits on Discretionary Income for Low and Middle-Income Families

New research from Stephen D. Holt and Jennifer L. Romich

Key findings:

- When low-income families increase their earnings enough to become ineligible for means-tested benefits, the cost of replacing those benefits can produce high marginal tax rates on additional income, particularly among those who have been dependent on several benefits plus the earned income tax credit.
- A $500 increase in earnings would generate less than $250 in additional discretionary income for three out of every ten Wisconsin families who use food stamps (alone or in conjunction with other supports).
- Even with a generous earned income tax credit such as Wisconsin's, only one-third of Wisconsin single-parent families with children in poverty would see more than a $500 gain from a $500 increase in earnings.

For more information about this study, see inside.