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## The True Tax Rates Confronting Families With Children

By Adam Carasso and C. Eugene Steuerle

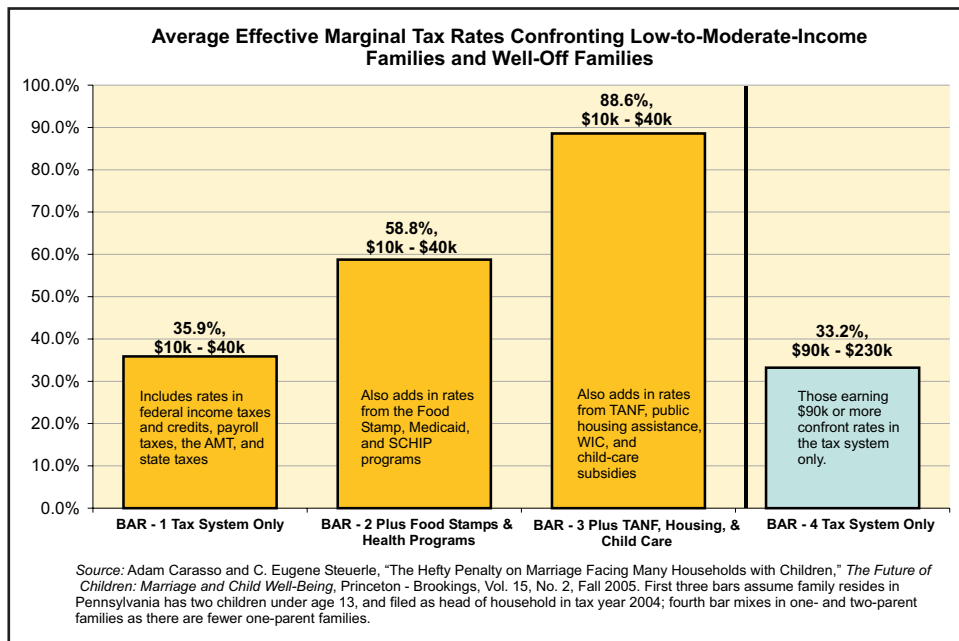
The panoply of U.S. tax and transfer programs often act in concert to penalize low-income families who increase their work effort or marry, by saddling them with higher effective marginal tax rates. Why do those higher tax rates occur? The targeting of benefit programs to groups with less income means that benefits phase out (as if being taxed) as families earn more. The addition of another spouse with earnings often accelerates the loss of benefits that would be faced by a single head of household.

As an example, if family income increases by \$1,000, a household might experience a \$211 loss in the earned income tax credit, a several-hundred-dollar drop in food stamp benefits, or a drop in Medicaid benefits worth

thousands of dollars. In some cases, parents who opt to work more or marry may see little or no additional gain (or actual losses in the case of marriage) in total income as a result. Those program phaseouts, which are often hidden from participating families, combine with statutory federal and state income tax rates to create very high effective marginal tax rates for many moderate-income families.

The chart below compares the average effective marginal tax rates (AMTR) of a low- to middle-income single-parent family with two young children living in Pennsylvania in 2004, with the AMTR of more well-to-do families. The first three bars in the figure focus on the AMTRs of the single-parent family with income (exclusive of program benefits) between \$10,000 and \$40,000. In the first bar, if we consider only the combined tax rates of federal taxes and tax programs (statutory rates, EITC, child credit, and payroll taxes) and state taxes (statutory rates, only), the AMTR is 35.9 percent. However, the effective marginal rate rises appreciably if the family is

also enrolled in transfer programs, as shown in bars 2 and 3. For a family enrolled in universal, non-wait-listed programs like Food Stamps, Medicaid, and the State Children's Health Insurance Program (CHIP), the AMTR would be 58.8 percent. If the family enrolls in additional, wait-listed programs like housing assistance and child care, the AMTR ratchets up to 88.6 percent. The fourth bar, by way of comparison, shows that the AMTR affecting families (lumping one- and two-parent families together) at \$90,000 or above is 33.2 percent — lower than that applying to the lower-earning families.



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