

# What Happens When TANF Recipients Increase Their Earnings? Effective Marginal Tax Rates for Households with TANF Income

## Brief #4 in ASPE Marginal Tax Rate Series

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### Highlights

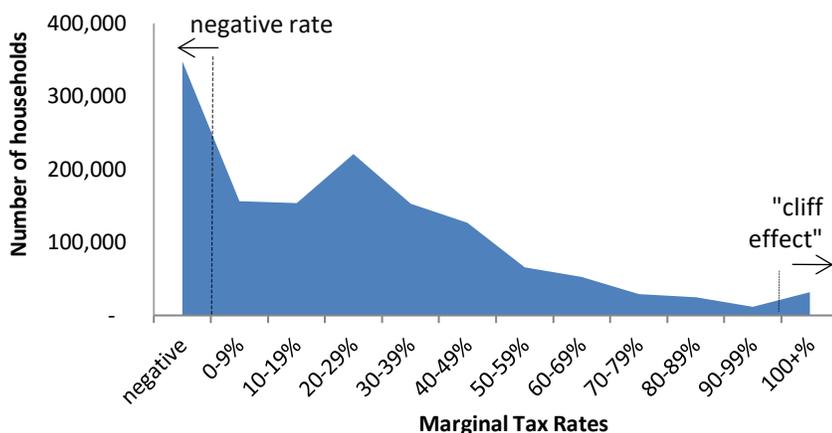
- ✓ About 25 percent of TANF households had a negative marginal tax rate.
- ✓ High marginal tax rates are more likely for TANF households with income just above poverty compared with households in poverty.
- ✓ Overall about two percent of TANF households risk cliff effects.
- ✓ Including cliff effects, about seven percent of TANF households (100,000) were estimated to have marginal tax rates at 70 percent or more.

As part of a series exploring marginal tax rates, this brief focuses on households that receive cash assistance from the Temporary Assistance to Needy Families (TANF) program. TANF provides needy families with employment outreach, job readiness or work-skills training. As a proportion of the overall program, cash aid to poor families is a small component. In 2014, TANF cash aid reached only about one in 1 in 10 householders below 50 percent of poverty.

### Negative Marginal Tax Rates Were More Common than Program Cliffs

Negative marginal tax rates were more common among TANF households than high rates or cliff effects (Figure 1) based on based on a simulated increase in annual earnings of \$2,000. About 350,000 or 25 percent of TANF households had a negative marginal tax rate. For these households, each new dollar earned added *more than* one dollar to resources, a feature of programs such as the Earned Income Tax Credit which serves as a work incentive. Only about one in ten households faced marginal tax rates of 60 percent or higher and fewer still (2.3 percent) faced rates of 100 percent or more known as a “program cliff effect”.

**Figure 1. “Effective” marginal tax rates for households with TANF income, after \$2,000 earnings increase**



Source: ASPE tabulation of microdata from the TRIM3 model, Current Population Survey, ASEC 2015.

### What are marginal tax rates?

“Effective” marginal tax rates refer to how much *new earnings* are effectively reduced by income tax, payroll tax, and especially, a reduction in government benefits. If a hypothetical family earns an additional \$1,000 from extra work hours over the course of a year, the added earnings are taxed (-\$200) and SNAP benefits are likely reduced (-\$200). Altogether, the bite taken out of new earnings by taxes and reduced benefits yields a marginal tax rate of 40 percent. Extra earnings of \$1,000 amount to a resource increase of \$600.

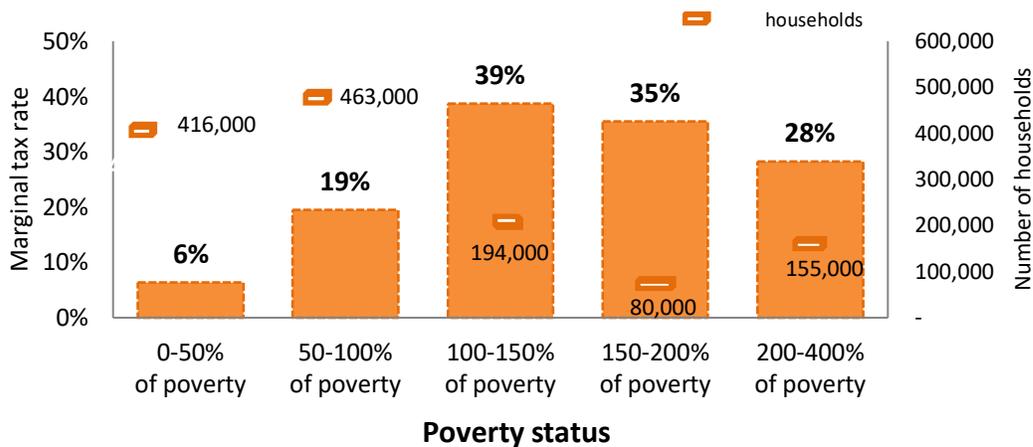
Some level of marginal tax rate is a natural and inevitable consequence of benefit programs targeting low-income households. Program benefits are designed to decline as earnings rise, yet marginal tax rates set too high may discourage work. For the median U.S. household, \$2,000 in increased in earnings yields a marginal tax rate of 34 percent.

We refer readers to the ASPE brief “Marginal Tax Rates: A Quick Overview” <<https://aspe.hhs.gov/system/files/aspe-files/260661/brief1-intromtrs.pdf>>

## Marginal Tax Rates Are Highest for Households Just Above Poverty

Figure 2 depicts marginal tax rates by poverty status for households with TANF cash assistance, based on a simulated increase in annual earnings of \$2,000. Overall, households with TANF income had a median marginal tax rate of 21 percent. About 400,000 households had little or no income (zero to 50 percent of poverty) and a median marginal tax rate of six percent. More than 450,000 households had incomes between 50 and 100 percent of poverty with a median marginal tax rate of 19 percent. For households with more earnings, just above 100 percent of poverty, the median marginal tax rate was 39 percent. For households with more earnings, just above 100 percent of poverty, the median marginal tax rate was 39 percent. For households with more earnings, just above 100 percent of poverty, the median marginal tax rate was 39 percent.

**Figure 2. Median marginal tax rates and number of households by poverty status after \$2,000 earnings increase for households with TANF cash assistance**



Source: ASPE tabulation of microdata from the TRIM3 model, Current Population Survey, ASEC 2015.

## Marginal Tax Rates for TANF Recipients Varied by Geographic Region

Nationally, six percent of households below 200 percent of poverty received TANF cash assistance – but the rate differed by geographic region. For example, the program served 11 percent of low-income households in the West and three percent of such households in the South (see Table 1).

**Table 1. Number of households and marginal tax rates by region for households with TANF cash assistance, 2014**

	Northeast	South	Midwest	West	United States
<b>Below 200% poverty<sup>1</sup></b>	3,020,840	9,500,360	4,644,400	5,298,880	23,186,340
<b>Number TANF cash assistance</b>	254,958	281,027	216,634	598,741	1,375,852
<b>% TANF cash assistance</b>	8.4%	3.0%	4.7%	11.3%	5.9%
<b>Effective MTR</b>	Percent of households with TANF cash assistance in each region				
<b>negative</b>	25.0	29.2	29.0	21.2	25.3
<b>0-29%</b>	43.6	31.3	33.3	42.7	38.6
<b>30-49%</b>	12.8	24.2	20.8	21.7	20.3
<b>50-74%</b>	6.9	11.1	11.2	10.2	10.0
<b>75+ %</b>	11.6	4.2	5.7	4.2	5.8

<sup>1</sup>Regional estimates do not sum to national total because some observations are missing geographic data.

Source: ASPE tabulation of microdata from the TRIM3 model, Current Population Survey, ASEC 2015.

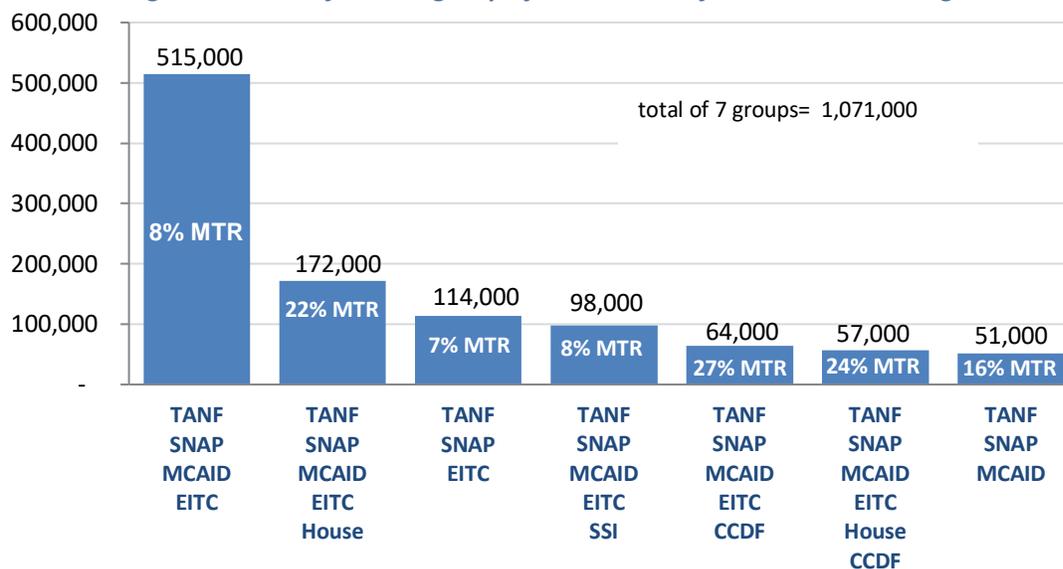
Table 1 shows marginal tax rates by geographic region of the country<sup>1</sup> for households with a TANF benefit. Negative marginal tax rates (likely due to the EITC) were commonplace, estimated to cover 21 and 25 percent of TANF households in the West and Northeast, respectively, and 29 percent of TANF households in the South and Midwest. A smaller fraction of households had fairly high marginal tax rates of 75 percent or more, but this differed across regions—from four to six percent of TANF households in the Midwest, South, and West to nearly 12 percent of TANF households in the Northeast.

### Marginal Tax Rates for TANF Households with Assistance from Other Programs

Most households with income from TANF were enrolled in SNAP *and* had someone in the household covered by Medicaid (79 percent). Nearly two out of three TANF households (62 percent) received the federal EITC, which incentivizes work. With respect to other benefit programs for needy households, about one out of five households that participated in TANF received housing assistance (22 percent) and fewer participated in CCDF child care (13 percent).

Compared with nutrition assistance or health care, TANF income assistance reaches far fewer low-income households. Figure 3 depicts the seven most common (mutually exclusive) program combinations for households with TANF cash assistance and demonstrates how a family's marginal tax rate varies when TANF is combined with other programs. For more marginal tax rate topics see <<https://aspe.hhs.gov/marginal-tax-rate-series>>

**Figure 3. Seven most common program combinations among households receiving TANF income, and median marginal tax rates for each group of households after a \$2,000 earnings increase**



Source: ASPE tabulation of microdata from the TRIM3 model, Current Population Survey, ASEC 2015.

#### Methodology

The analysis relies on the TRIM3 (Transfer Income Model) microsimulation model with calendar year 2014 data from the Current Population Survey. Analysis households (n = 63,493) had a householder or spouse between ages 18 to 64 without disabilities. In separate iterations, earnings increases of \$2,000, \$5,000, and \$10,000 were simulated for each household. The following benefit programs were modeled: TANF, SNAP, CCDF, housing assistance, Medicaid/CHIP, federal incomes taxes and credits (including the EITC and Child Tax Credit), state income taxes and credits, payroll taxes, Supplementary Security Income (SSI), Women Infants and Children (WIC), Low Income Heating and Energy Assistance Program (LIHEAP), child support, and unemployment insurance. Administrative data were used to correct for underreporting of programs and benefit levels, with the exception of Medicaid/CHIP. Full details are described in the technical appendix: <<https://aspe.hhs.gov/system/files/aspe-files/260661/brief5-technicalappendix.pdf>>

<sup>1</sup> A state-by-state analysis of program participation requires multiple years of household data and is beyond the scope of the current analysis.