

Effective Marginal Tax Rates for Households with Child Care Subsidies: What Happens Following an Earnings Increase?

Brief #3 in the ASPE Marginal Tax Rate Series

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Highlights

- ✓ *Marginal tax rates are highest for CCDF households just above poverty. For households between 100 to 149 percent of poverty, a \$5,000 earnings increase is associated with a median marginal tax rate of 73 percent, leaving families with a net increase of only \$1,350.*
- ✓ *Only three percent of CCDF households would lose their entire child care subsidy (i.e., the child care “cliff”) following a \$2,000 earnings increase. However, among families with incomes between 100 and 199 percent of poverty, a larger earnings increase of \$10,000 would cause 37 percent of these families to lose their entire subsidy.*
- ✓ *Among CCDF households, the most common combination of additional programs is **EITC + Child Tax Credits (CTC) + SNAP + Medicaid/Children’s Health Insurance Program (CHIP)**, and these 259,000 CCDF households experience a median marginal tax rate of 51 percent.*
- ✓ *Following a \$2,000 earnings increase, a majority (64 percent) of CCDF households would face one of the following scenarios:*
 - *Negative marginal tax rates¹ (15 percent of CCDF households)*
 - *Moderately high marginal tax rates, defined as between 20 to 49 percent (39 percent of CCDF households)*
 - *Program cliffs² (10 percent of CCDF households)*

As a part of a brief series exploring marginal tax rates, this brief focuses on low-income families who receive Child Care and Development Fund (CCDF) subsidies, which help parents pay for child care so parents can work or participate in education and training activities. Roughly 1.4 million children in 2014 received subsidies through CCDF funding. In 2015, only 15 percent of eligible children received child care assistance from CCDF and related funding streams.³

¹ Negative marginal tax rates mean that benefit dollars actually *increase* following an earnings increase.
² Program cliffs mean all of the new earnings are absorbed by increased taxes and reduced benefits from one or more programs (i.e., a marginal tax rate of 100 percent or higher)
³ Chien, N. (2019). “Factsheet: Estimates of Child Care Eligibility and Receipt for Fiscal Year 2015.” Department of Health and Human Services.

What are marginal tax rates?

“Effective” marginal tax rates refer to how much of *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 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 amounts 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. The median U.S. household faces a marginal tax rate of 34 percent after a \$2,000 earnings increase. We refer readers to the ASPE brief “*Marginal Tax Rates: A Quick Overview*”

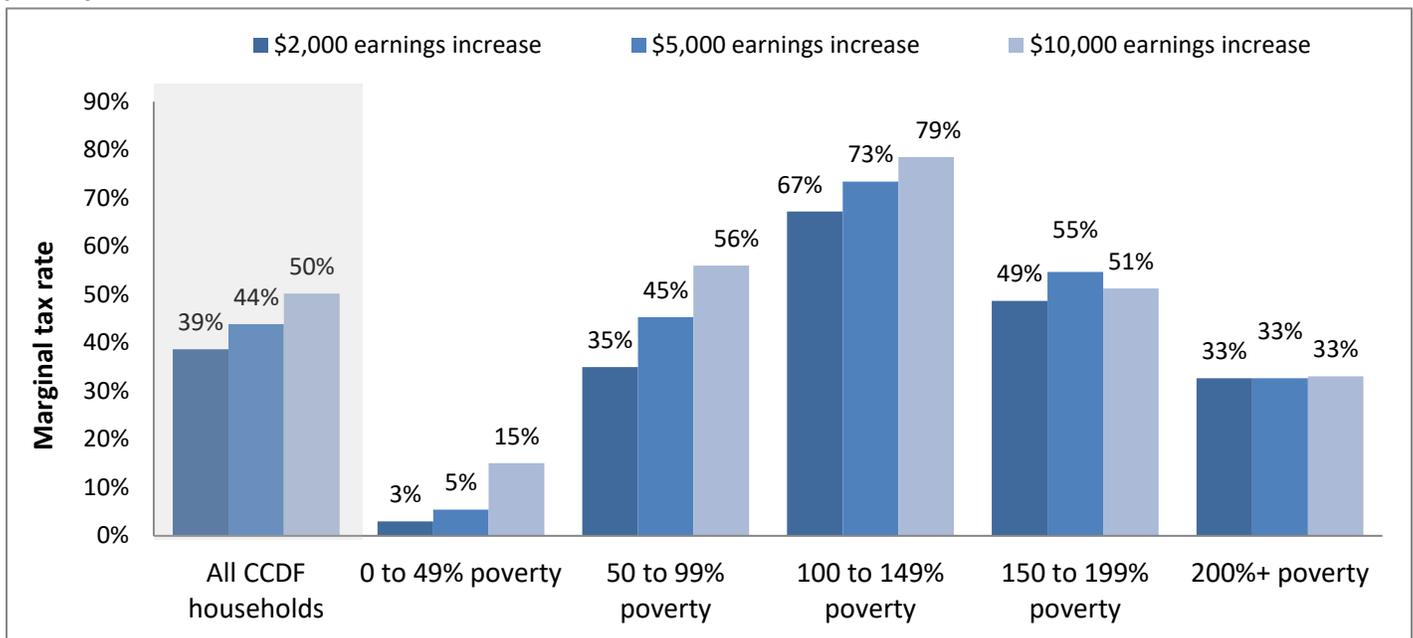
(<https://aspe.hhs.gov/system/files/aspe-files/260661/brief1-intromtrs.pdf>)

Marginal Tax Rates Are Highest for CCDF Households Just above the Poverty Line

Households receiving CCDF subsidies face a median marginal tax rate of 39 percent after a \$2,000 earnings increase (see Figure 1; marginal tax rate is a result of *all* tax and benefit programs a household receives – not only CCDF). In other words, the median household nets \$1,220 after a \$2,000 earnings increase. In addition, among CCDF households, marginal tax rates tend to be higher for larger earnings increases (see Figure 1).

Among CCDF households, marginal tax rates are highest for households between 100 and 149 percent of poverty. These households have a median marginal tax rate of 67 percent after a \$2,000 earnings increase, 73 percent after a \$5,000 increase, and 79 percent after a \$10,000 increase (i.e., the household nets \$2,100 after a \$10,000 increase). Estimated rates are medians, and as such, about half of households in each category face even higher marginal tax rates.

Figure 1: Median marginal tax rates among CCDF households after a \$2000, \$5,000, and \$10,000 earnings increase, by poverty status



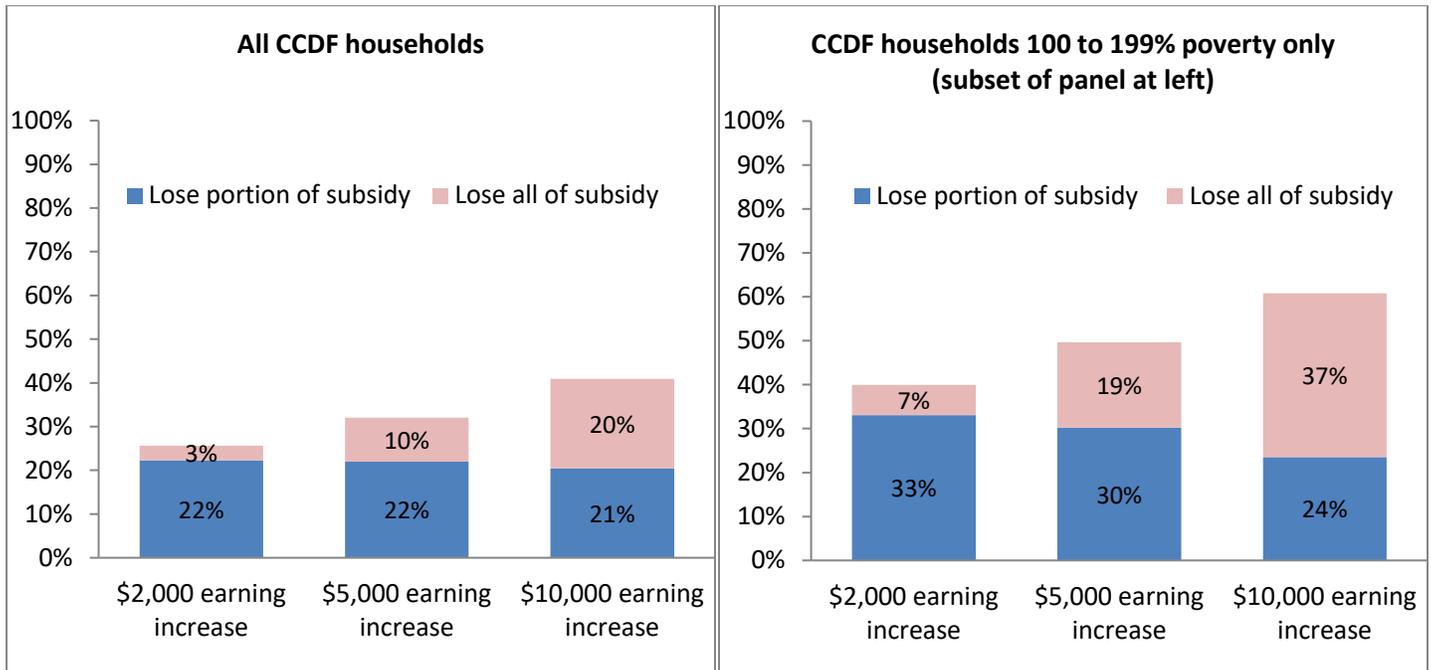
Source: ASPE tabulation of microdata from the TRIM3 model, Current Population Survey, ASEC 2015.

Households above Poverty Are More Likely to Lose Some or All of Their Subsidy

After a \$2,000 earnings increase, three percent of CCDF households would lose their entire subsidy (i.e., a child care cliff), and an additional 22 percent would lose a portion of their subsidy (in the form of higher copayments; see Figure 2, left panel).⁴ With a larger earnings increase, more households would lose their entire subsidy: after a \$10,000 earnings increase, 20 percent of CCDF households would lose their entire subsidy, and an additional 21 percent would lose a portion of their subsidy.

Among just those CCDF households between 100 and 199 percent of poverty, loss of a portion or all of their subsidy is more likely. After a \$2,000 earnings increase, seven percent of such households would lose their entire subsidy, and an additional 33 percent would lose a portion of their subsidy (see Figure 2, right panel). After a \$10,000 earnings increase, 37 percent of such households would lose their entire subsidy, with the median loss being \$4,400 per year (not shown). Note that this captures only the loss of the child care subsidy, and does not include other benefits the family may be simultaneously losing – the topic of the next section.

Figure 2. Percent of CCDF households who would lose a portion or all of their CCDF subsidy, after a \$2,000, \$5,000 and \$10,000 earnings increase



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

⁴ This analysis was conducted on calendar year 2014 data, prior to the implementation of The Child Care and Development Block Grant Act of 2014.

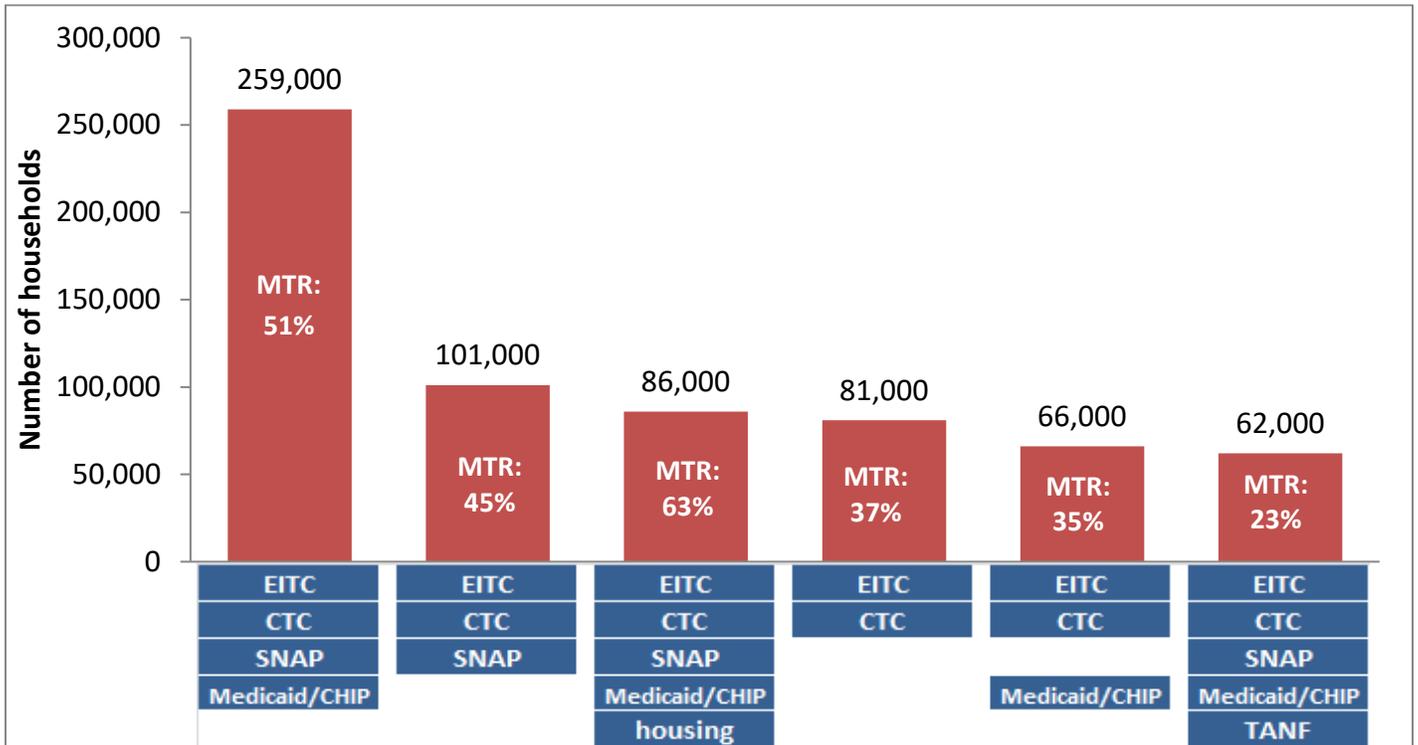
Marginal Tax Rates for CCDF Households Receiving Assistance from Other Programs

Figure 3 shows the six most common (mutually exclusive) program bundles that CCDF households receive.

Approximately 259,000 households receive **CCDF + EITC + Child Tax Credit (CTC) + SNAP (food stamps) + Medicaid/Children’s Health Insurance Program (CHIP)**. This is the most common bundle of programs, and these families experience a median marginal tax rate of 51 percent. Approximately 86,000 CCDF households receive **CCDF + EITC + CTC + SNAP + Medicaid/CHIP + housing**, and these households face a high median marginal tax rate (63 percent).

Approximately 62,000 CCDF households receive **CCDF + EITC + CTC + SNAP + Medicaid/CHIP + TANF**, and these households face a relatively low median marginal tax rate (23 percent). An additional 326,000 CCDF households (not shown) receive a combination of programs other than the six most common combinations captured in Figure 3, and collectively their median marginal tax rate is 29 percent. A family’s marginal tax rate varies according to the family’s income in relation to program phase-out schedules for that household composition (e.g., whether there are children), program income eligibility thresholds, and income tax rates at those income levels.

Figure 3: Median marginal tax rates (MTR) for CCDF households receiving the six most common program combinations (after a \$2,000 earnings increase)



Notes: Programs analyzed are: SSI, SNAP, TANF, Housing, EITC, CTC, CCDF, and Medicaid/CHIP.

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

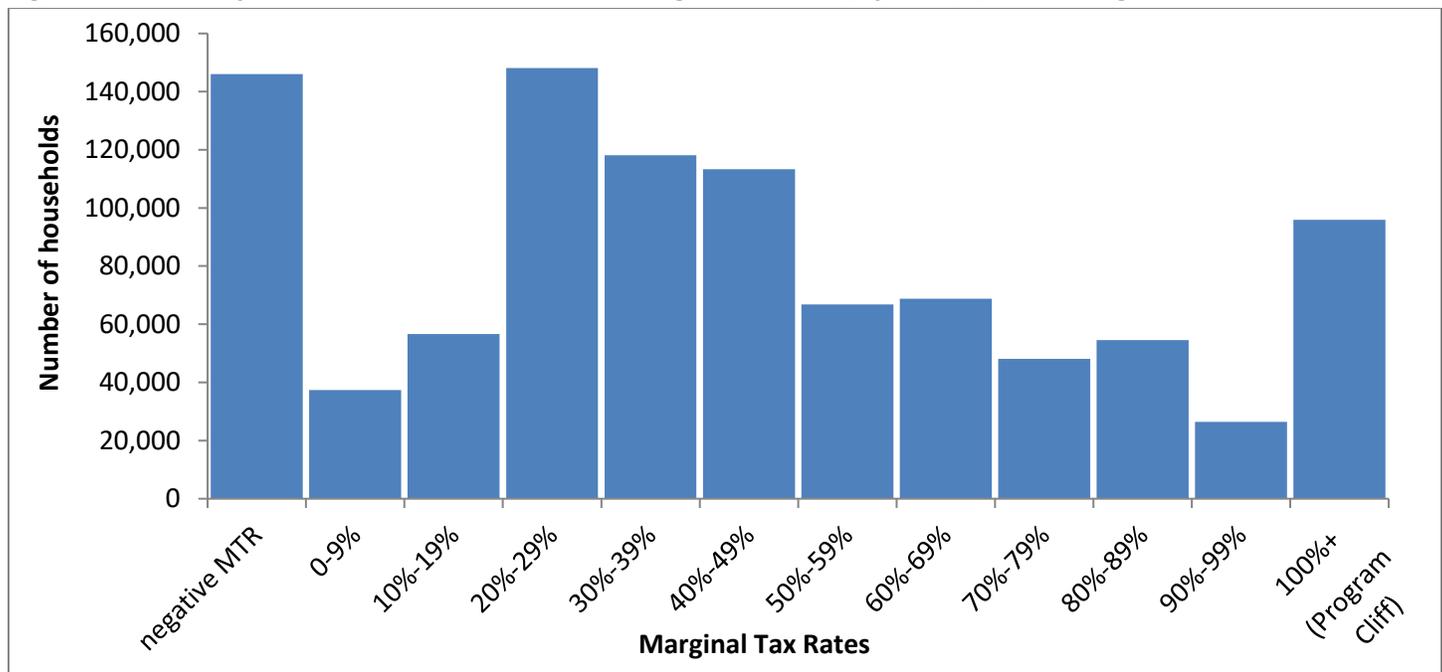
A Camel with Three Humps: Marginal Tax Rates Faced by CCDF Households

After a \$2,000 earnings increase, households receiving CCDF are likely to face one of the following (see Figure 4):

- 1) A **negative marginal tax rate** (146,000 households, or 15 percent of CCDF households), where benefit dollars actually *increase* following an earnings increase. This is due to work incentive programs such as the EITC, which provides low-income taxpayers with refundable tax credits that increase with income.
- 2) A **moderate/moderately high marginal tax rate** (380,000 households, or 39 percent of CCDF households), that is, between 20 and 49 percent.
- 3) A **program cliff** (95,000 households, or 10 percent of CCDF households), that is, a marginal tax rate of 100 percent or greater, where increased earnings actually have the effect of reducing total net resources.

For more marginal tax rate topics see <https://aspe.hhs.gov/marginal-tax-rate-series>.

Figure 4: Number of CCDF households with various marginal tax rates, 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>