# Introduction to “Benefit Cliffs” aka Marginal Tax Rates

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# Defining "Benefit Cliffs"

- Technical definitions:
  - Marginal tax rate:  how benefits change when income increases; can be a slope or a cliff
  - Benefit Cliff: marginal tax rate of 100 percent or more; earnings make a family ineligible for the benefit
- Definitions used in practice:
  - Benefit cliff often is used to refer to the marginal tax rate as well as actual cliffs



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# Why the Interest in "Benefit Cliffs"

- Better understanding of how to best support workers whose earnings fall short of the resources they need to meet their basic needs
- How to better inform benefit recipients about how changes in earnings will impact their benefits
- How to best design economic mobility programs
- Understand the impact of specific policy changes, e.g., an increase in the minimum wage
- Minimize the harm to parents with low incomes who use public benefits to supplement low wages
- Consider tradeoffs between alternative policy choices

# Why Do “Benefit Cliffs” Exist

- Marginal tax rates from benefit phase-downs result from the interaction between two broadly agreed-upon policy goals:

  (1) providing needed assistance to individuals and families who face difficulties making ends meet, and

  (2) cost/funding constraints

- Any serious discussion of “benefit cliffs” must grapple with the fundamental tension between providing adequate help to those in need at a reasonable cost and avoiding high marginal rates



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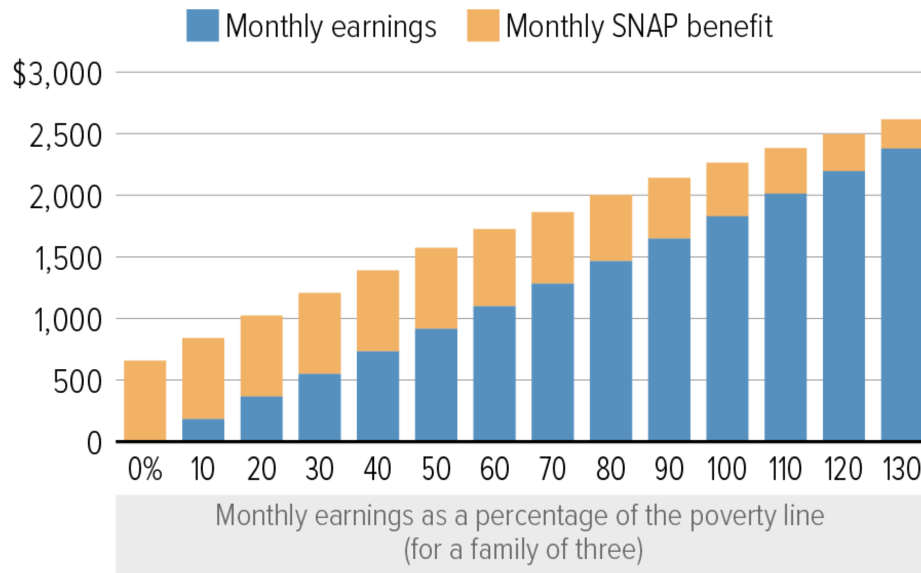
# Key Facts About Benefit Cliffs

- Most public benefits phase out gradually; many families don't experience benefit cliffs, but they may experience a loss of benefits
- Most "benefit cliff" analyses consider benefits on an annual basis, but families usually budget on monthly basis
- The impact of marginal tax rates is highest for families that participate in multiple public benefit programs, but some key programs like housing and child care reach few eligible families
- Marginal tax rates often are highest for families with incomes around and above the federal poverty line (FPL)

# Most Public Benefits Phase Out Gradually: SNAP



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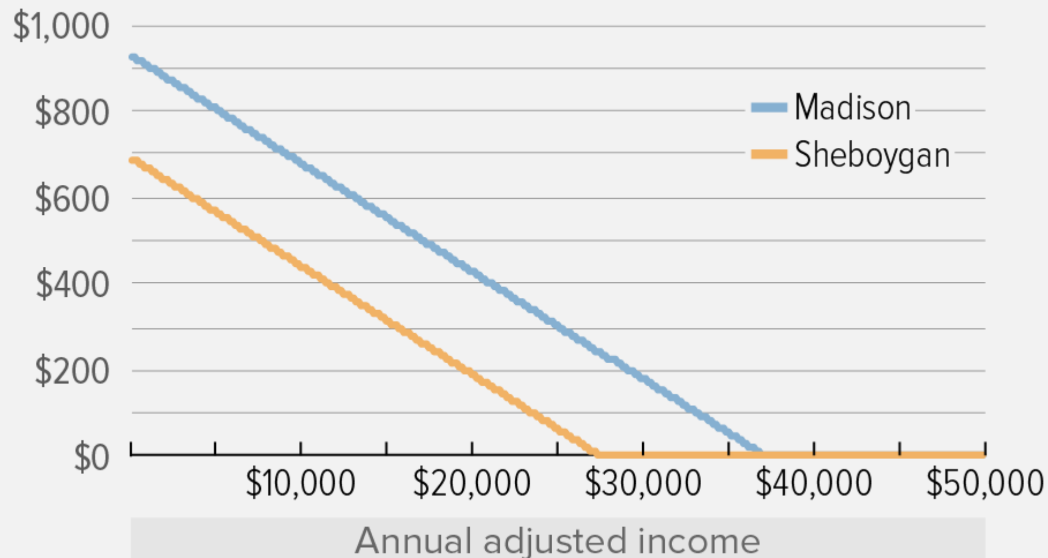
# Most Public Benefits Phase Out Gradually: Housing

## Voucher Assistance Phases Out Gradually as Income Rises

Monthly subsidy for standard two-bedroom unit in Madison and Sheboygan, WI




Note: Madison and Sheboygan represent higher- and lower-cost rental areas, respectively. Graph assumes a maximum subsidy at the Local Fair Market Rent (40th percentile of rents in metro area), a family contribution of at least 30 percent of adjusted income, and unit rent plus utilities at or above the Fair Market Rent.

Source: CBPP calculation based on Housing and Urban Development data

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# Example: $2000 increase in earnings impact on marginal tax rate

- Study completed by ASPE (HHS)
  - SNAP+EITC+CTC+Medicaid/CHIP: 42%
  - Add housing: 63%
  - For families receiving child care assistance:
    - 35% if income is between 50-99% of FPL
    - 67% if between 100-149% of FPL



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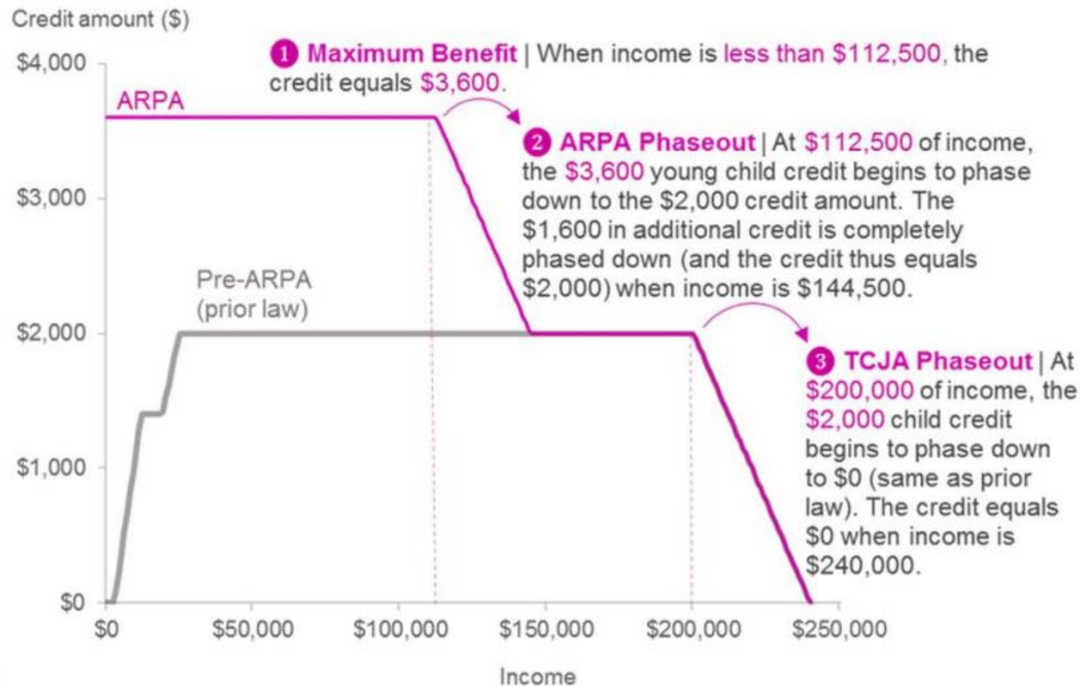
# What Can States/Localities Do to Minimize Benefit Cliffs?

- Child care: find the optimum eligibility cutoff and co-pays
- Temporary Assistance for Needy Families: increase benefit levels and redesign earned income disregards
- State Earned Income Tax Credits: adopt optimum policies; don't have to mirror the federal
- SNAP: adopt categorical eligibility
- Special state-or privately-funded benefit payments: additional payments to offset the loss of federally-funded benefits
- Education: provide recipients with information specific to their situation to help them make informed choices

# Current Opportunities to Make Federal Changes to Address Benefit Cliffs

- **CTC.** Make the full CTC available to children in families with no or very low incomes
- **Child Care**. Expand child care funding
- **Medicaid.** Close the Medicaid coverage gap, i.e., implement Medicaid expansion in all states
- **Health Insurance.** Extend the expansion in the Premium Tax Credits from the Rescue Plan

# Policy Changes Can Make a Difference: CTC Expansion Example




**Sources:** CRS calculations based on Internal Revenue Code §24 and P.L. 117-2.

**Notes:** A stylized example assuming the taxpayer has one qualifying child and all income is earned income, with no other sources of income and no above-the-line deductions claimed. Unmarried taxpayers with child credit-qualifying children are assumed in this example to file as head of household. For more examples, see CRS Insight IN11613, *The Child Tax Credit: Temporary Expansion for 2021 Under the American Rescue Plan Act of 2021* (ARPA; P.L. 117-2).

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