State should make common-sense changes to Wisconsin Earned Income Tax Credit to mitigate marriage penalty

POLICY BRIEF | February 2019

Executive summary

- Research indicates that family structure affects child outcomes.
- Public policy can affect the decisions families make about marriage.
- Wisconsin’s Earned Income Tax Credit (EITC) penalizes some low-income parents for marrying.
- Instituting a “honeymoon” provision in the Wisconsin EITC would mitigate this marriage disincentive.

Families are perhaps the most important institution in our society — and certainly in the lives of children. As Wisconsin’s leaders consider policies focused on child well-being and future success, it is important to acknowledge the important roles that family and family structure play in child outcomes and to recognize the extent to which public policy places a finger on the scale of how families organize themselves. Specifically, federal and state programs too often penalize marriage. Where it is within the purview of state authority to change this, especially for low-income families, it is common sense that our leaders should.

Marriage and child outcomes

Princeton University sociology professor Sara McLanahan and Isabel Sawhill of the center-left Brookings Institution summarize that regarding marriage and family outcomes, “most scholars now agree that children raised by two biological parents in a stable marriage do better than children in other family forms across a wide range of outcomes, (though) there is less consensus about why.”¹ Those outcomes include success in school, future economic success and avoiding behavioral pitfalls, among others.² These outcomes are all things we want for Wisconsin’s children.

Family structure and economic mobility — the extent to which children experience relatively more economic success than their parents did — are also linked. In their 2014 study, “Where is the land of Opportunity?” Harvard University economist Raj Chetty and co-authors found that when it comes to economic mobility of children in a community, “Across all the specifications, the strongest and most robust predictor is the fraction of children with single parents.”³

Boys appear to be disproportionately affected — perhaps because single parents tend to be women, providing a model that translates better for young girls than for young boys. Economist David Autor and others find meaningful differences in kindergarten readiness and absence rates for boys vs. girls depending on family structure and father presence (and other factors, too).⁴

More recent work from Chetty and colleagues finds large gaps in mobility for black vs. white boys (lower for black boys), but a slight advantage for black vs. white girls (conditional on parental income). Here, the authors find ambiguous effects of marriage (hotly debated here), but also that the gap in mobility between black and white boys tends to shrink when more black
fathers, white fathers and higher community marriage rates are present in a child’s neighborhood.\textsuperscript{5}

This doesn’t mean that marriage is a panacea for all problems. It is not meant to suggest that single parents are not doing heroic and hard work raising children without a second parent — many are. And it does not mean that children raised by single parents or in other family structures cannot succeed — many do — or that children raised by married parents always succeed — many don’t. It simply suggests that on average, family structure matters and is an important factor to think carefully about if child outcomes are an objective.

**Public policy and family structure decisions**

The natural next question is whether public policy affects the decisions that families make about how to structure themselves.

Because the decline in marriage rates since the 1970s has disproportionately occurred among low-income and working-class families, it is sensible to look at the public programs in which such families are involved.

Several public programs have “marriage penalties” — situations in which means-tested public benefits are reduced when previously unmarried, cohabiting couples decide to tie the knot. Benefits may be reduced because income for the married couple is considered jointly instead of separately, becomes higher and pushes the married family’s income over the income eligibility threshold for the public program. There are some cases where programs create a marriage “bonus,” but such circumstances are rarer.\textsuperscript{6}

Recent research looking at these groups suggests that public programs modestly discourage marriage among some groups, but not all groups. This research suggests penalties primarily affect decision-making among households at the higher end of eligibility for such programs.

For example, a recent study from University of Virginia sociologist Bradford Wilcox and others found that:

“Couples whose oldest child is two or younger whose income falls closer to the upper threshold of the marriage penalty — couples where each partner’s individual income is near the cut-off for means-tested benefits — are about two to four percentage points less likely to be married if they faced a marriage penalty in Medicaid or food stamps.”\textsuperscript{7} (emphasis added)

A separate study from Syracuse University professor Katherine Michelmore examines the federal Earned Income Tax Credit. The EITC rewards work for low-income parents by providing a refundable credit that grows as a parent earns more through paid employment, then tapers off gradually. The credit amount is determined by both income and number of dependent children, as illustrated in the accompanying chart.

**Federal EITC structure**
A substantial body of academic research indicates that the EITC encourages parents to enter the labor market who might not have considered it otherwise.\textsuperscript{8}

However, the EITC does have a marriage penalty for certain families: If a parent working at low wages is cohabiting with the other parent, and that other parent earns a meaningful amount of money, the couple will be worse off on net because getting married will combine their income for tax purposes and reduce or eliminate the EITC benefit.\textsuperscript{9}

So, the couple experiences an incentive to stay unmarried. It turns out that this does shape behavior. Michelmore finds that:

“Single mothers who expect to lose the federal Earned Income Tax Credit benefits upon marriage are 2.5 percentage points less likely to marry their partners and 2.5 percentage points more likely to cohabit compared to single mothers who expect no change or to gain Earned Income Tax Credit benefits upon marriage.” (emphasis added)

**Marriage penalty in Wisconsin’s EITC**

Because state flexibility is limited in many federally funded public benefit programs, mitigating marriage penalties across all programs in which they exist would be a challenge.

However, there is one area of opportunity where Wisconsin policy-makers have clear authority to address this marriage penalty problem: the state-level Earned Income Tax Credit.

Wisconsin’s EITC is based on the federal EITC, and the state benefits are calculated as a percentage of the federal credit for which filers are eligible. However, the level at which the state matches the federal credit varies by family size: 4 percent of the federal credit for a family with one child, 11 percent for a family with two children and 34 percent for a family with three or more children.

Under the status quo, families with two income-earners may be significantly penalized for marrying via the state EITC. The penalty is as large as $1,000 depending on how many children are in the household and how much the couple earns independently and jointly. If we accept that state public policy should not actively discourage marriage — that a married couple should not be any worse off than an otherwise identical couple that is cohabiting — then the current policy violates those principles.

The accompanying chart displays this penalty for one plausible situation.

Suppose a single parent with two children is working and is earning $18,000 annually. She receives a state credit of $629 because she has minor children, and the credit helps stretch those modest wages further. Suppose the unmarried father of these children is earning $25,000 — he does not have custody of children, so he receives no state EITC. Suppose the family is cohabiting. What happens if they choose to marry, but nothing else changes in their economic circumstances? Their state credit is cut by $433, to $196. Does that make sense?
**How to fix it**

If we accept that public programs should not punish working families for making marital commitments, policy-makers at the state level should consider fixing what is within their control to fix: the state EITC’s marriage penalty. Addressing this problem would not “incentivize” marriage — it merely would attempt to be neutral with respect to marriage and to do no harm.

Wisconsin’s leaders could address this penalty by instating a “honeymoon” policy in the state EITC, which was proposed in the last biennial budget but was not passed. Such a policy would hold families harmless for the first three years of their marriage when determining their state EITC benefit. It would do this by allowing them to take the greater of:

- The credit they would have received had they not married, or
- The credit they normally would receive under the status quo for married filers.

Doing so would come at a modest cost — as proposed in the 2017-’19 budget, it would have cost $1.5 million per year. Such a policy would send a message about our state’s values to low-income parents: When it comes to making the decision to marry, make the best decision for you and your family. The government will not punish you for it.

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**FAQ on Wisconsin Earned Income Credit**

**What is the Wisconsin EIC?**

The Wisconsin Earned Income Credit, like the federal Earned Income Tax Credit, is a special tax benefit for workers who earn low or moderate incomes. It lowers their taxes, supplements their wages and makes work more attractive and affordable. Families with children who qualify for the federal EITC are automatically eligible for the Wisconsin EIC. Qualifying persons who file federal returns get back some or all of the federal income tax withheld from their pay during the year. Like the federal benefit, the Wisconsin EIC is refundable. This means that even workers whose earnings were too small to have taxes withheld can get the EIC.

**Who can get the Wisconsin EIC?**

The EIC is available to workers with low to moderate incomes. The income limit depends on the number of “qualifying children” and on whether the tax filer is married or unmarried.

- The limit for families with one child is $40,320 ($46,010 if married).
- The limit for families with two children is $45,802 ($51,492 if married).
- The limit for families with three or more children is $49,194 ($54,884 if married).
How much can individuals and families get back from the EIC?

The Wisconsin EIC is calculated as a percentage of the federal EIC.

• For workers with one qualifying child, the state EIC equals 4 percent of the federal EIC. Thus, the maximum amount of the credit is $138.

• For workers with two qualifying children, the state EIC equals 11 percent of the federal EIC. Thus, the maximum amount of the credit is $628.

• For workers with three or more children, the state EIC equals 34 percent of the federal EIC. Thus, the maximum amount of the credit is $2,187.

Will getting the EIC affect eligibility for welfare benefits?

The EIC — and other tax credits — do not count as income in determining eligibility for benefits such as W-2, Medicaid, food stamps, SSI or public or subsidized housing.

What is the procedure for claiming the Wisconsin EIC?

Claimants must file a Wisconsin tax return to receive the state EIC, even if no taxes are owed.

The amount of the claimant’s federal EIC is needed to calculate the state EIC.

If your tax return shows you owe taxes, you subtract your EIC credit and you will owe less or get money back. If you owe no taxes but qualify for the EIC, you will get a refund check for your EIC amount.

Source: University of Wisconsin-Madison Division of Extension

Endnotes


6 For a useful brief, see: http://www.welfareacademy.org/pubs/family/Marriage_Penalties_in_the_Modern_Social-Welfare_State.pdf


8 For a good summary of the EITC’s labor supply effects as well as its issues, see Bruce Meyer essay in “A Safety Net that Works,” AEI: http://www.aei.org/spotlight/the-earned-income-tax-credit/

9 There are circumstances where the EITC can create a marriage “bonus” as well — for example, when combining parents’ income moves them into the more generous range of the credit. This requires that the starting income of the custodial parent alone is in the “phase-in” range of the credit.