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Tax Credits, the Minimum Wage, and Inflation

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Relatively straightforward modifications to the child credit could help households earning near the minimum wage and others that face a declining child credit each year.

Two primary wage-support policies help low-income families: the minimum wage and targeted tax credits. The minimum wage serves as a floor on earnings for most low-wage workers, regardless of their family characteristics. The earned income tax credit (EITC) and child tax credit target benefits almost exclusively to families with children and are based on a family's total income rather than an individual worker's. Congress sets the minimum wage; as of December 2006, it had last been raised in 1997 to $5.15 an hour. Since that time, the real value of the minimum wage has fallen about 20 percent because of inflation. A recent proposal would increase the minimum wage to $7.25 an hour. While the minimum wage stagnated, Congress expanded both the EITC and the child credit. Full-time minimum-wage workers received no benefit from the EITC expansions and only benefited from the child credit expansions from 2001 through 2004. The expansions helped workers with higher—though still relatively low—wages much more.

This brief illustrates how current tax rules interact with the minimum wage and considers whether increased tax credits could substitute for minimum-wage increases for those earning the federal minimum wage. Raising the EITC enough to offset the loss in purchasing power of the minimum wage could prove costly. If wages were held constant at $5.15 an hour for a full-time worker,[1] the maximum EITC would have to increase by about $5,000 for a one-earner household to achieve the same after-tax income as an increase in the minimum wage to $7.25; the EITC would have to increase about $6,500 for a two-earner household to achieve the same gains. In 2006, a family does not benefit from the child credit until its earnings exceed $11,300—or $5.43 an hour for one full-time worker. Because that threshold increases each year, families must increase earnings to benefit in future years. To receive the maximum $1,000 per child benefit in 2006, a couple with one child must earn at least $17,970; couples with two children must earn at least $24,180.

This analysis shows that increasing tax credits enough to substitute for raising minimum wage is probably infeasible because of both the cost and the high marginal tax rates required. However, relatively straightforward modifications to the child credit could help households earning near the minimum wage and others that face a declining child credit each year. A more direct route to helping low-wage workers would be to raise the minimum wage and index it to inflation.

Background

Low-income working families receive income support from two federal policies: the minimum wage and targeted tax credits (such as the EITC and child tax credit). These tax credits can provide substantial assistance. However, the design of the child credit hurts low-wage workers whose wages stagnate.

The Minimum Wage

The federal minimum wage law mandates that most workers earn at least $5.15 an hour. The law covers approximately 75 percent of the workforce. Unprotected workers include the self-employed, workers employed on small farms, and restaurant workers and others earning tips. A recent House proposal would increase the minimum wage to $7.25 an hour. According to the Economic Policy Institute, 5.6 million workers would benefit directly from this proposal.[2]

Most workers earn more than the federal minimum wage, in part because 24 states and the District of Columbia mandate a higher minimum wage.[3] Nonetheless, the federal minimum wage can affect wage levels through other channels. Most states with higher minimum wages automatically increase the state minimum wage when the federal one increases.[4] Evidence suggests that the minimum wage affects workers earning above the minimum by setting off a "ripple effect" throughout the low-wage distribution (Card and Krueger 1994; Chasanov 2004).

Economists are divided on the effects of the minimum wage. The predominant argument against increasing the minimum wage posits that an employer hires fewer low-wage, low-skilled workers if it has to pay more for them. Thus, increasing the minimum wage could make some low-skilled workers worse off by decreasing employment (Deere, Murphy, and Welch 1995). Another theory counters that if employers must pay higher wages, these wages will be high enough to retain workers, and the lower staff turnover ultimately lowers labor costs for employers. This theory predicts more people will be employed after modest increases to the minimum wage (Zavodny 1998).

Empirical evidence on the issue is mixed. Most studies find that employment of low-skilled workers declined after the minimum wage increased (Neumark and Wascher 2006). Deere, Murphy, and Welch (1995) estimate that the 1990 minimum-wage increase reduced employment by 1.5 to 7.5 percent among certain low-earning demographic groups. Neumark, Schweitzer, and Wascher (2004) conclude that both the number of workers employed and the average number of hours worked declined for affected groups.

In contrast, several other studies have found insignificant employment effects, and a few have found increased employment following minimum wage increases.[5] For example, Card (1992) finds no evidence that the 1990 rise in the federal minimum wage significantly lowered teenage employment rates or altered school enrollment patterns. A more recent study by Card and Krueger (2000) confirms these results using different data. Modest increases in the minimum wage may thus effectively raise compensation for low-skilled workers with few undesirable side effects.

Tax Credits for Low-Wage Workers

The earned income tax credit boosts the earnings of low-income working families by up to 40 percent. The credit is refundable, so families receive the full amount of the credit for which they qualify, regardless of whether they owe income taxes. The credit increases as a family's wages rise until the maximum credit is reached—$4,536 for a family with two or more children in 2006 and $2,747 for a family with one child. Families continue to receive the maximum credit until earnings reach $14,810 for single parents or $16,810 for married parents, at which point the credit begins to phase out. A single parent with two or more children no longer qualifies for the credit once earnings reach $36,348. Married parents can receive an EITC until earnings reach $38,348 (table 1).

The child tax credit provides a subsidy of up to $1,000 per child. Unlike the EITC, the child credit is only partially refundable. The refundable portion of the credit—that portion available over and above tax liability—equals 15 percent of earnings over $11,300 in 2006. Families with incomes below that level receive no benefit from the credit because they do not owe income tax.[6] Once a family starts to owe taxes, its total child credit equals the sum of the refundable portion and the portion offsetting taxes (the nonrefundable portion) up to a maximum of $1,000 per child. In 2006, couples with two children receive the maximum credit once their earnings reach $24,180; couples with one child hit this point once their earnings reach $17,970. After that, families receive the maximum credit until their earnings reach $110,000 for married couples or $75,000 for single parents. The credit phases out at a 5 percent rate as income exceeds those levels.[7]

The child credit begins to phase in for a family with two children at approximately the point the EITC reaches its maximum. This design allows the increasing child credit to continue increasing a family's after-tax income when the EITC stops doing so, though at a slower pace (figure 1). A single parent with two children can receive a total subsidy of up to $5,062; a married couple with two children can receive a subsidy of up to $5,362. These totals occur right before the EITC begins phasing out at a rate of 21.06 percent. At the same time, the child credit continues to phase in at a rate of 15 percent. Thus, workers lose $6.06 in credits for every additional $100 of earnings in the child credit phase-in range. When a

TABLE 1. EITC and CTC Parameters for Single Parents, 2006

EITC Parameters						
	End phase-in	Maximum credit	Begin phase-out[a]	End phase-out[a]	Credit rate	Phase-out rate
0 children	$5,380	$412	$6,740 ($8,740)	$12,120 ($14,120)	7.65%	7.65%
1 child	$8,080	$2,747	$14,810 ($16,810)	$32,001 ($34,001)	34%	15.98%
2+ children	$11,340	$4,536	$14,810 ($16,810)	$36,348 ($38,348)	40%	21.06%
CTC Parameters						
	Begin phase-in for refundable portion of credit	Maximum credit[b]	Income needed to receive maximum credit	Phase-out begins[b]	Refundable credit rate	Phase-out rate
1 child	$11,300	$1,000	$16,440 ($17,970)	$75,000 ($110,000)	15%	5%
2 children	$11,300	$2,000	$21,760 ($24,180)	$75,000 ($110,000)	15%	5%
3 children	$11,300	$3,000	$27,080 ($29,500)	$75,000 ($110,000)	15%	5%

Sources: Internal Revenue Service, 2006 Form 1040 and Urban–Brookings Tax Policy Center Microsimulation Model.

Note: Parameters indexed for inflation, except where noted. Where different, parameters for married parents are listed in parentheses.

[a] Assumes all income is from earnings.

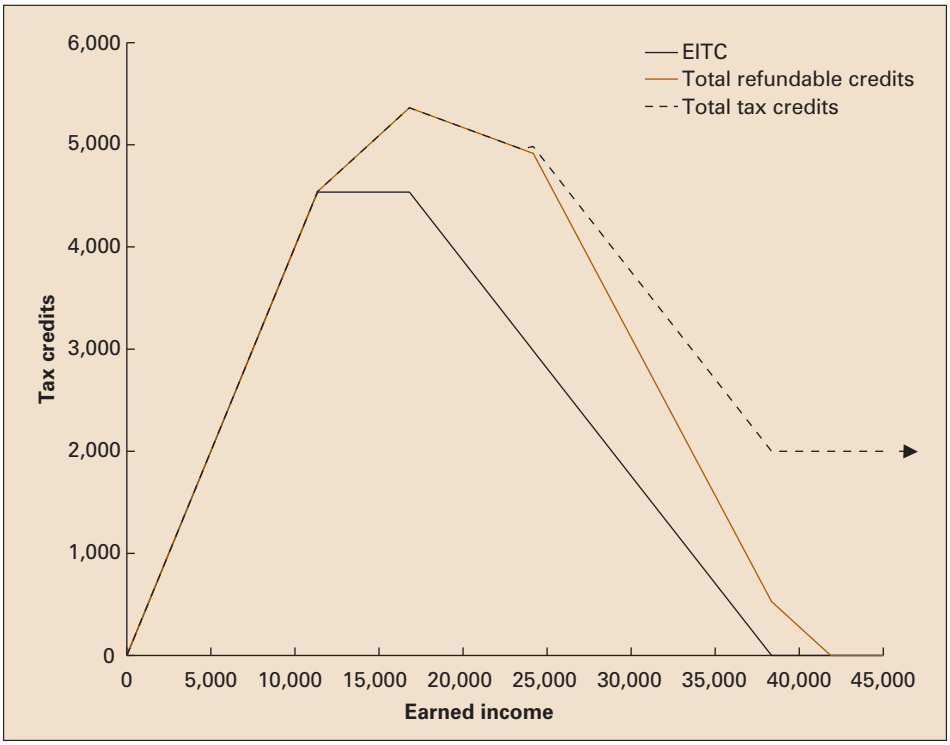
[b] Not indexed for inflation.

family begins to owe tax, it continues to receive the refundable child credit, plus it receives the nonrefundable child credit, which offsets taxes owed. Once the sum of the refundable and nonrefundable child credit reaches its maximum, the family loses $21.06 for every additional $100 of earnings until the EITC is fully phased out. The maximum subsidy for a married couple exceeds that of a single parent because the couple's EITC phases out later. The child credit and EITC do not fit quite as neatly for a family with one child. In this case, a family will begin reaching the maximum EITC before the child credit begins to phase in. As a result, tax credits are flat over a brief income range before increasing once more.

Inflation Can Further Penalize Low-Wage Workers

Inflation erodes the minimum wage and, to a lesser extent, the child credit. In contrast, the EITC is almost

FIGURE 1. Earned Income Tax Credit Plus Child Tax Credit for a Married Couple with Two Children (dollars)



Source: Author's calculations.

Notes: Assumes all income is from wages. Only the EITC and CTC are included in calculations. Other nonrefundable credits may be available as well.

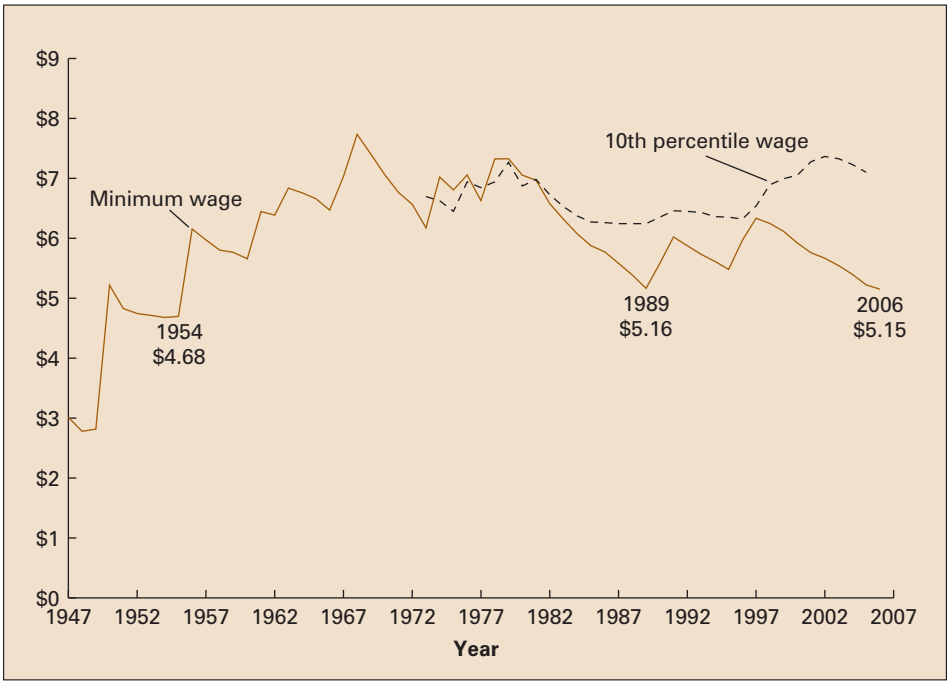
fully indexed for inflation and thus is not affected by rising nominal income.[8] After accounting for inflation, the current minimum wage is at its lowest level since 1954 (figure 2).[9] The minimum wage is not indexed for inflation; Congress must act to raise it and last did so in 1997. Since that time, the minimum wage has steadily eroded in value. In 2006, the wage rate would have to be over $6.30 an hour, or almost 25 percent higher than the current level, to match its 1997 purchasing power. Wages for workers at the 10th percentile of earnings have also stagnated. Between 2000 and 2003, these hourly workers saw no change in their nominal $7.00 hourly wage (Mishel, Bernstein, and Allegretto 2005), suggesting that wage stagnation is a problem even for workers earning more than the minimum wage.

Unlike the minimum wage, the EITC is adjusted to keep pace with inflation. However, since the EITC subsidizes earnings, a low-wage worker whose earnings fail to keep pace with inflation may also see her tax credit fall in real terms. In the EITC phase-in range, a drop in earnings translates into a drop in tax credit. Even if earnings remain the same in nominal terms, the credit remains the same but loses value each year because of inflation. When the maximum credit level is reached, small declines in earnings do not change the credit a family is entitled to. In this plateau range, the EITC increases as a share of earnings when earnings fail to increase with inflation. Finally, in the EITC phase-out range, drops in real earnings actually increase the credit, even after adjusting for inflation.

The child credit is only partially indexed for inflation, and that can hurt low-wage workers whose earnings stagnate. The maximum credit of $1,000 per child is fixed, so it declines in real value from year to year because of inflation.[10] The point at which the child credit starts to phase out is similarly not indexed. However, the income level above which the credit becomes refundable is indexed: set at $10,000 in 2001, the threshold has risen to $11,300 in 2006. That rise has resulted in a reduction in the value of child credits available to minimum-wage workers. In 2001, a family with one worker earning the federal minimum wage received a child credit of $71. As the phase-in threshold increased each year with inflation, the credit declined to $36 in 2002 and to $21 in 2003 before disappearing entirely in 2004 and beyond. The combination of declining real wages and a dwindling nominal child credit thus doubly disadvantaged such families.

The income tax schedule, the personal exemption, and the standard deduction are also indexed for inflation. A household whose income just keeps pace with inflation will face the same real income tax burden (before credits are considered) from year to year.[11] A family whose earnings fail to keep up with inflation will actually owe less tax (before credits) simply because less income exceeds the point at which the family would first owe taxes (the tax filing threshold). Most poor families, however, have incomes below the threshold and thus owe no income tax; indexation of the income tax does not affect them from year to year.

FIGURE 2. Inflation-Adjusted Value of Minimum Wage: 1947–2006



Sources: U.S. Department of Labor and Economic Policy Institute Data Zone (http://www.epi.org/datazone/06/wagecuts_all.pdf).

Note: Minimum wage adjusted for inflation using CPI-U-RS (http://www.bls.gov/cpi/cpiurstx.htm) and CPI-U-X1 (http://www.irp.wisc.edu/faqs/faq5.htm).

How the Child Tax Credit and EITC Interact with the Minimum Wage

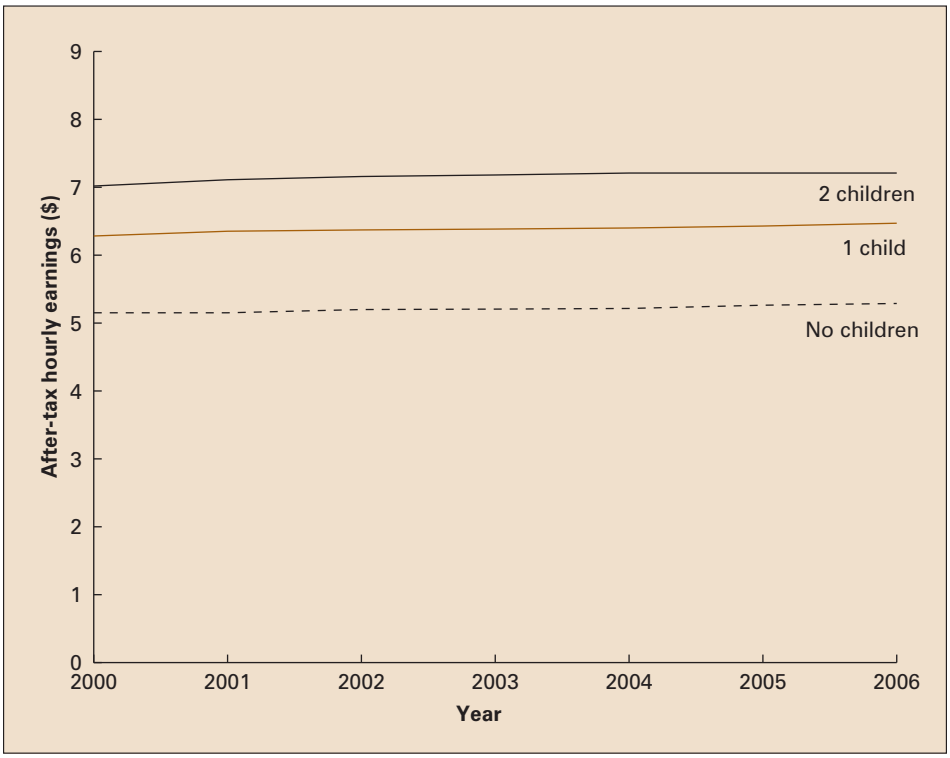
Tax credits can provide significant subsidies to minimum-wage workers, particularly those with children. Childless workers obviously cannot claim the child credit, and, before 2008, those earning the minimum

wage cannot benefit from the EITC. Their after-tax hourly earnings in 2000 equaled their pre-tax hourly earnings of $5.15. Low-income workers with children benefited from tax credits before the 2001 law changes. Legislated increases that year and in 2003 increased their credits. In 2000, tax credits boosted the after-tax hourly earnings of a minimum-wage worker with one or two children to $6.28 and $7.01, respectively (figure 3a). Measured in 2006 dollars, those after-tax hourly earnings equaled $5.92, $7.22, and $8.07 for families with no, one, or two children (figure 3b).

Because the minimum wage is not indexed, inflation affects the value of tax credits for minimum-wage workers. The effect can be positive or negative. Married couples with no children and one full-time minimum-wage worker have seen their after-tax income rise since 2002 as inflation has eroded the value of the minimum wage. In 2002, the EITC raised couples' hourly wage from $5.15 before taxes to $5.20 after. In subsequent years, their EITC increased: their income put them in the phase-out range, and indexing of the EITC for inflation meant less of their income fell into that range over time. In 2006, the EITC increased their after-tax wages from $5.15 to $5.29 an hour, and the wage subsidy provided by the EITC will continue to rise if the minimum wage does not change. That rising wage subsidy will partially offset the continuing decline in the real value of an unchanged minimum wage (table 2).

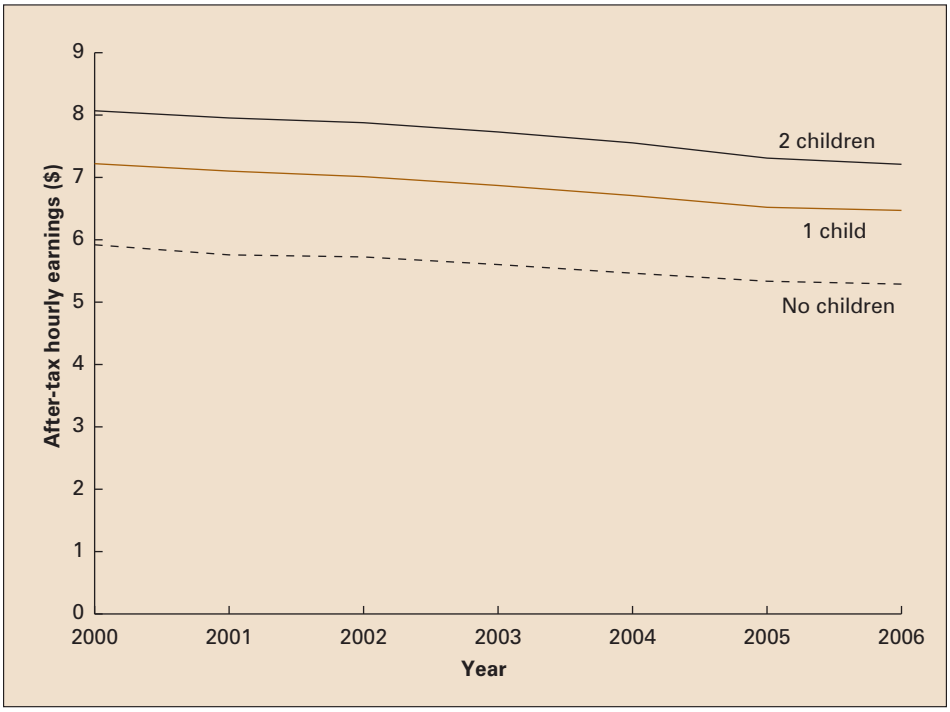
Between 2000 and 2006, after-tax wages also increased for families with children. Families with one child saw their average hourly wages increase from $6.28 to $6.47, and families with two children saw a similar increase from $7.02 to $7.21. Families with one child supported by minimum-wage earnings receive the maximum EITC,

FIGURE 3a. Nominal Hourly After-Tax Earnings for a Married Minimum-Wage Worker, by Number of Children



Source: Urban–Brookings Tax Policy Center Microsimulation Model.

FIGURE 3b. Real Hourly After-Tax Earnings for a Married Minimum-Wage Worker, by Number of Children (2006$)



Source: Urban–Brookings Tax Policy Center Microsimulation Model.

TABLE 2. Effects of Inflation on After-Tax Income, by Various Wages and Number of Children, 2006–10 Law

	Half minimum wage ($5,356)	Minimum wage ($10,712)	$7.00 an hour ($14,560)	Twice minimum wage ($21,424)
No children	EITC constant in nominal terms (declines with inflation); after-tax income declines with inflation. No CTC.	EITC increases; tax credits offset some of the loss of wages due to inflation. No CTC.	No tax credits; after-tax income declines with inflation.	No tax credits; after-tax income declines with inflation.
One child	EITC declines with inflation; after-tax income declines with inflation. No CTC.	EITC remains constant; tax credits offset some losses in after-tax income due to inflation. No CTC.	EITC increases each year; CTC declines each year *more* than inflation; tax credits partially offset loss in after-tax income from inflation.	EITC increases each year; CTC declines each year with inflation; tax credits partially offset losses in after-tax income due to inflation.
Two children	EITC declines with inflation; after-tax income declines with inflation. No CTC.	EITC declines with inflation; after-tax income declines with inflation. No CTC.	EITC increases each year; CTC declines each year *more* than inflation; tax credits partially offset loss in after-tax income from inflation.	EITC increases each year; CTC declines each year *more* than inflation; tax credits partially offset loss in after-tax income from inflation.

Source: Author's calculations.

Note: Shaded area of chart contains families that lose the most from the design of the CTC.

which holds its value over time because of indexing, even as the real value of underlying earnings decrease with inflation.

Families with two children also received the maximum EITC until 2004, when indexation of the EITC moved their earnings into the EITC phase-in range. With a fixed minimum wage, these families will continue to receive the same EITC each year, but it will lose value along with their base earnings because of inflation. Families with children also received a slight bump in after-tax wages from the newly refundable child credit between 2001 and 2004. In 2004, however, families with minimum-wage earnings no longer had earnings that exceeded the child credit's phase-in point—so they no longer benefited from it.

Ultimately, the design of the tax credits—specifically the child credit—means that families with higher incomes receive much larger benefits. In fact, in 2006 the child credit and EITC provide a net wage subsidy to couples with children until their earnings reach $32,538 (if they have one child) or $41,850 (if they have two).[12] That is, their *marginal effective tax rate* (box 1) is negative. Single heads of household face a subsidy over a smaller range of earnings. The subsidy is largest in the phase-in range for the EITC. The child credit was designed to start phasing in at the end of the phase-in range for the EITC for couples with two or more children (although beyond the end of the range for single parents), providing a modest additional subsidy as the EITC phases out. At higher earnings levels, the net effect of the credits and tax rates is to assess positive net taxes on additional earnings. Continuing stagnation of the minimum wage will exacerbate this pattern.

However, few full-time workers earn the minimum wage. If the 10th percentile wage remains fixed at $7.00 an hour ($14,560 a year), couples with no children will receive no benefit from the EITC until 2008; before that, their earnings exceed the credit's limit. The EITC expansion scheduled for 2008 will allow married couples to earn $1,000 more than under 2006 law before the credit phases out.

A family earning an average hourly wage of $7.00 with children qualifies for a child credit of $489 in 2006. While the family's EITC will keep pace with inflation, its child credit will decline over time. Each year, less of the family's earnings will exceed the indexed threshold for refundability, providing the family with a successively smaller credit, the value of which is further reduced by inflation.

Can Tax Credits Substitute for a Minimum Wage Hike?

Concerns about a higher minimum wage stifling employment or raising

BOX 1. Marginal Effective Tax Rates

A person's marginal effective tax rate is the amount of tax paid on the last dollar of income. This can vary depending on the type of income. Examples in this brief assume all income comes from earnings.

A person's marginal effective tax rate affects the incentives to work. A negative marginal effective tax rate implies that work is subsidized, which provides an incentive to work more. In that case, each additional dollar of wages translates into more than a dollar in after-tax income. A positive marginal effective tax rate implies that a dollar of additional earnings translates into less than a dollar in after-tax income.

employers' costs spurred some critics to suggest that expanding wage subsidies such as the EITC would be a better option (Burkhauser, Couch, and Glenn 1995; Hubbard 2006). To achieve the same effect on after-tax incomes as the proposed $7.25 an hour minimum wage, the maximum EITC would have to increase by about $5,000 for a one-earner household. For a couple with two earners at the minimum wage, the required equivalent increase would be about $6,500.[13]

Such an approach poses many issues. The EITC subsidy in the phase-in range would have to be quite high—around 90 percent for a one-earner couple with two or more children, and over 100 percent for a two-earner couple. That would certainly produce a very strong incentive to work, but it would also necessitate a high phase-out rate to limit the budgetary cost. Even so, these increases would be costly. And the very high phase-out rate would create high marginal tax rates on labor earnings that would be unprecedented in recent experience. What's more, if the minimum wage does not change, both the phase-in and phase-out rates would have to increase over time, exacerbating both the incentive effects and the budgetary cost.

Options for Modifying the Child Credit

A modest approach to helping families with children would be to alter the formula for determining the child credit. For example, the refundable credit could be phased in starting at the first dollar of earnings, similar to the EITC. A minimum-wage worker with more than one child would qualify for a child credit of up to $1,607, the equivalent of a $0.77 an hour increase in earnings; a worker earning $7.25 an hour would see her child credit rise from $567 to up to $2,262—an increase of $1,695, the equivalent of an hourly increase of $0.81.[14] Current law lowers the child credit each year for a family with stagnating income as more income falls below the credit's phase-in range for refundability. Over time, a policy change that would allow all earnings to qualify for the child credit would be increasingly valuable.

Starting refundability of the child credit at the first dollar of earnings, with a $1,000 per child credit maximum, would concentrate additional benefits on low-income families. Doing so would cost $244 billion between FY 2007 and FY2016, with almost all the cost coming after 2010 when the child credit is scheduled to revert to its pre-2001 level of $500 and the refundable component of the credit disappears. Assuming that the 2006 law containing the child credit remained in place, the cost of starting refundability at $1.00 would be roughly $80 billion over ten years.[15] In 2010, over three-quarters of all benefits from this change would go to households with incomes below $20,000. Families with incomes below $10,000 would receive an average additional tax credit of $97 a year, and families with incomes between $10,000 and $20,000 would receive an average additional annual credit of $270.

An even more modest change would be to fix the point at which refundability begins at the 2006 level of $11,300, rather than allowing it to increase each year. This would end the phenomenon of declining credits for workers with stagnating earnings. Measured against a baseline where tax law concerning the child credit remains unchanged, this proposal would cost about $9.8 billion between FY 2007 and FY 2016. Because households with earnings below $11,300 would continue to receive no benefit from the child credit, most benefits of this change would accrue to families with incomes between $10,000 and $30,000. The average annual credit increase would be only about $20.

Another alternative would be to make the child credit fully refundable, even for nonworking families (Batchelder, Goldberg, and Orszag 2006). This would guarantee that poor families with children would receive the full value of the subsidy regardless of their work status. For workers, it would be equivalent to a $0.48 an hour increase in the minimum wage for a family with one child, $0.96 an hour for a family with two children, and more for larger families. A drawback of the fully refundable credit that does not take wages into account is that it would

not have the positive work-incentive effects of the phased-in credit. In addition, many nonworking families with children would have to file tax returns solely for the purpose of claiming the child credit, placing additional demands on the IRS.

The simplest alternative may be to increase the minimum wage and index it for inflation. That would guarantee that wages would not decline in real value from year to year. If the minimum wage was increased so a full-time worker had earnings above the child credit threshold ($11,300 in 2006), the child credit as currently designed would automatically increase every year to keep pace with the automatic wage increases.

Conclusions

Failure to index the minimum wage makes workers worse off each year as inflation erodes the purchasing power of each dollar. At present, the minimum wage is worth less than it has been since 1954. Despite proposals to the contrary, using the tax system to augment wages could make workers even worse off.

The design of the child credit renders it a poor substitute for higher wages. Each year, the qualifying threshold for the child credit increases. When the credit was expanded in 2001, full-time workers earning the minimum wage qualified for a small credit. But each year that credit declined. By 2004, these workers no longer received a credit.

Workers at the minimum wage with fewer than two children receive an EITC that increases each year with inflation. Workers at the minimum wage with two or more children get the same EITC each year, which declines with inflation—compounding the smaller child credit and the income declines from inflation. If the current child credit is extended beyond its 2010 expiration date, this same inflation-shrinkage phenomenon will eventually happen to workers at the proposed minimum wage of $7.25. To keep this from happening, legislators could fix the point at which refundability for the child credit begins, rather than increasing it with inflation each year. Or, they could allow all earnings to qualify for refundability, or make the credit fully refundable regardless of wage levels or work status.

Additionally, policymakers could address declining wages for minimum-wage workers by indexing the wage level for inflation. This could be more feasible than attempting to use the tax system to augment wages that decline because of inflation. If tax credits were used, they would require very high phase-in and phase-out rates, which appear infeasible.

Notes

1. All calculations in this brief assume a full-time worker works 40 hours a week, 52 weeks a year.
2. Economic Policy Institute, "Minimum Wage Facts at a Glance," http://www.epi.org/content.cfm/issueguides_minwage_minwagefacts.
3. Six of these states passed minimum wage laws in November 2006. Most state minimum wages are between $6 and $7.
4. U.S. Department of Labor, "Minimum Wage Laws in the States—April 3, 2006," http://www.dol.gov/esa/minwage/america.htm.
5. Reviewed in Burkhauser, Couch, and Glenn (1995).
6. A small number of families with lower incomes can qualify for an alternative refundable child tax credit. Families with three or more children may receive a refundable child credit to the extent that the employee share of Social Security taxes plus individual income taxes exceeds its EITC up to the amount of the full child credit.
7. The phase-out range depends on the number of children. At the 5 percent phase-out rate, the $1,000 maximum credit per child disappears when income increases by $20,000. Thus, for a married couple with one child, the credit phases out between $110,000 and $130,000 of income; with two children, between $110,000 and $150,000; and so on.
8. The only parameter not currently indexed for inflation is the difference between the point at which the credit begins phasing out for married couples and for singles. The difference is set at $2,000 in 2006 and 2007, and at $3,000 in 2008. After that, the difference will be indexed for inflation like other EITC parameters. In 2011, the difference is scheduled to be eliminated when the enacting legislation, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), expires.

9. Author's calculations using CPI-U-RS, http://www.cbo.gov/budget/econproj.xls. In 1989, before the most recent minimum wage increase, its real value was $5.16 in 2006 dollars.
10. The maximum child credit is scheduled to decline from $1,000 to $500 per child when EGTRRA expires in 2011.
11. This assumes that all income is from wages and salaries and that the number of dependents remains the same. Tax burdens on capital income and expense (e.g., interest, dividends, capital gains) can be distorted by inflation (Steuerle 1985).
12. Calculations assume families receive both CTC and EITC. They do not account for credits such as the child and dependent care tax credit, which only a fraction of the population receives, or other nonrefundable credits that offset tax liability but do not provide subsidies beyond that.
13. In 2006, a single parent working full-time for the full year for $7.25 an hour has an after-tax income of $18,351 (assuming all income is from earnings). The same worker earning the minimum wage ($5.15) has an after-tax income of $13,459. In order to increase the minimum-wage worker's after-tax income to equal that of the worker earning $7.25 an hour—keeping the phase-in and phase-out periods of the credit the same—the EITC must increase from $2,747 to $7,639 for this worker. This implies a phase-in rate of 94 percent and a phase-out rate of 44 percent. Many other EITC designs could be explored. Typically, the trade-off is either imposing high marginal rates during the phase-out period or phasing the credit out over a larger swath of income, thus increasing the cost of the EITC dramatically.
14. Under the proposed formula, the child credit would be calculated as 15 percent of all wages, with a maximum $1,000 credit per child. Therefore, a minimum-wage worker with only one child would qualify for a $1,000 credit, not $1,607. ($5.15 an hour × 2,080 hours × 15 percent = $1,607.) In order to receive $1,607, a family would need at least two children. Similarly, in order to receive a child credit of $2,262, a family would need at least three children.
15. Urban–Brookings Tax Policy Center Microsimulation Model. Estimate assumes the child credit continues to be allowed against the AMT (as it is in 2006), remains at $1,000, and phases in at a 15 percent rate.

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