Effects of Recent Tax Cuts on Marginal Tax Rates

By William G. Gale

The tax cuts enacted over the past four years have been motivated in part as a way to stimulate economic growth. Reductions in marginal tax rates (MTRs), holding tax burdens constant, increase work effort and saving, but lower tax burdens, holding MTRs constant, create income effects that reduce labor supply and saving (and the resulting increase in the budget deficit reduces national saving). Hence, how the tax cuts affect growth depends in part on the extent to which they reduce tax burdens versus marginal rates.

The table shows that the tax cuts reduced tax burdens but not MTRS for 37 percent of tax filing units, representing 30 percent of adjusted gross income and 27 percent of taxable income (TI). For those households, the tax cuts likely had *negative* effects on labor supply. The prevalence of those effects peaks in income groups between $30,000 and $75,000, where between 44 percent and 80 percent of filing units and taxpayers' AGI and TI received tax cuts but faced constant or rising MTRs.

Taxpayers who did not receive lower MTRs include those on the alternative minimum tax and those in the current 15 percent bracket. An additional 18 percent of tax filing units do not pay income taxes and so received neither a tax cut nor a reduction in marginal tax rates, presumably creating no net increase in their labor supply either.

The results are consistent with a 2002 study by Treasury economists that found that when the 2001 tax cut would be fully phased in, there would be no reduction in marginal tax rates for 76 percent of tax filing units and 72 percent of filers, and 64 percent of those with positive tax liability, and that these taxpayers account for 38 percent of all taxable income.[1]

[1]Donald Kiefer *et al.* 2002. "The Economic Growth and Tax Relief Reconciliation Act of 2001: Overview and Assessment of Effects on Taxpayers." 55(1) *National Tax Journal* 89-117.

Effect of the 2001-2004 Tax Cuts
Distribution of Marginal Tax Rate Change by Cash Income Class, 2004[1]

Cash Income Class (thousands of 2003 dollars)[2]	Percent of Tax Filing Units With Tax Cut[3]			Percent of AGI With Tax Cut			Percent of TI With Tax Cut		
	Fall in Marginal Rate	Rise in Marginal Rate	Same Marginal Rate	Fall in Marginal Rate	Rise in Marginal Rate	Same Marginal Rate	Fall in Marginal Rate	Rise in Marginal Rate	Same Marginal Rate
Less than 10	6.6	0.1	15.7	15.7	0.1	16.4	93.4	0.2	2.7
10-20	42.1	2.9	23.3	56.8	4.4	23.8	53.6	5.5	38.1
20-30	38.7	6.0	46.5	43.7	7.4	47.0	30.5	5.0	64.3
30-40	25.1	6.3	64.4	26.8	7.2	65.3	20.4	4.8	74.7
40-50	50.0	4.2	44.2	52.3	4.2	43.3	56.0	3.4	40.6
50-75	48.3	2.8	48.6	48.7	2.5	48.7	53.1	2.1	44.8
75-100	82.8	1.8	15.3	84.7	1.9	13.4	87.5	1.7	10.8
100-200	84.5	10.3	5.2	84.3	11.2	4.5	85.9	10.5	3.6
200-500	72.8	9.6	17.6	73.7	9.5	16.7	75.2	9.3	15.4
500-1,000	84.3	3.5	12.1	86.6	2.8	10.6	88.0	2.4	9.6
More than 1,000	86.8	1.7	11.4	89.5	1.0	9.5	90.7	0.8	8.5
All	44.2	4.1	32.7	68.3	5.9	24.3	73.0	5.4	21.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model.
[1]Baseline is pre-EGTRRA law.
[2]Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see http://www.taxpolicycenter.org/TaxModel/income.cfm.
[3]Includes both filing and nonfiling units. Tax units that are dependents of other taxpayers are excluded from the analysis.