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Marginal Tax Rates, 1955-2005

By Elaine M. Maag

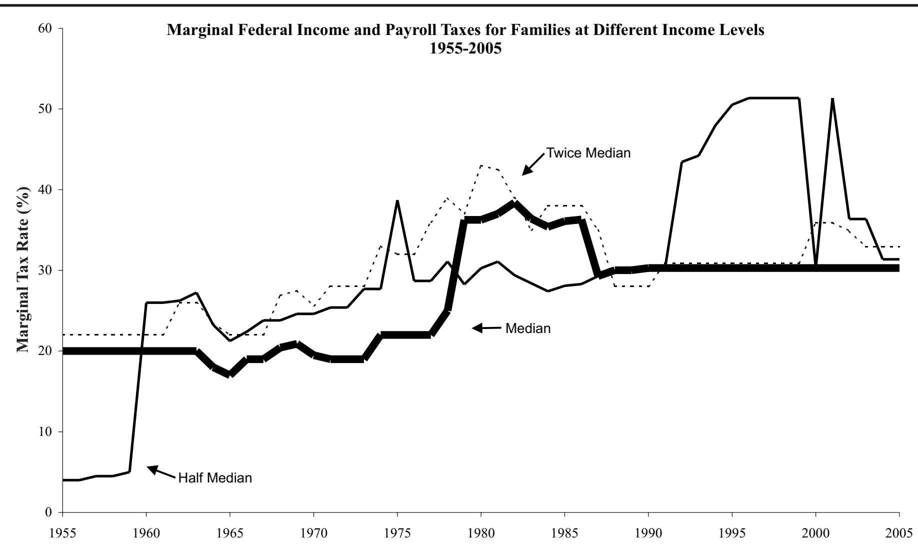
A person's marginal tax rate, the tax rate on her last dollar of income, may influence her decision to work and save. As marginal tax rates increase, the after-tax reward from working an additional hour or saving more decreases. The actual effect on economic decisions is uncertain (some people respond to higher taxes by saving more and working harder to make up for the additional tax hit), but economists view the marginal tax rate as a gauge of the efficiency cost of taxation.

The figure below shows how marginal tax rates on earnings have changed for a typical family of four — that is, one whose income is in the middle of the income distribution — and for similar families at both twice and half that income level from 1955 to 2005. In 2005 the median family earned an estimated $67,839. By comparison, in 1955 the median family earned $4,919 (worth about $35,857 in 2005 dollars).

In these calculations, a family's marginal rate is the sum of the statutory rate (anywhere from 10 percent to 25 percent in 2005), both the employer and employee share of payroll taxes (ranging from 2.9 percent for families with incomes above $90,000 and 13.5 percent for families with incomes below $90,000), and the rate stemming from the phase-in or phaseout of credits like the earned income tax credit and the child tax credit (CTC). For very low-income families in the phase-in range of the EITC, their marginal rate is reduced by 40 percent (they receive an additional 40 cents in EITC with each $1 increase in earnings). For families in the phaseout portion of the EITC, their marginal rate is increased by 21.06 percent (for each dollar of income, they receive 21 cents less in EITC).

Recent changes enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 lowered effective marginal rates for families at both twice and half the median income, while leaving marginal rates for families at the median income level unchanged. If those provisions are allowed to sunset in 2011 as currently scheduled, the marginal rate for families at twice the median income will increase from 32.9 percent to 35.9 percent because the statutory rate those families pay will increase from 25 percent back up to 28 percent. Families at half the median income will also see their statutory rate increase from 10 percent to 15 percent and will lose the 15 percent refundable CTC. Together, the expiration of those provisions will increase their marginal rate from 31.36 percent to 51.36 percent.

This analysis is based on Allen Lerman, ''Average and Marginal Federal Income, Social Security and Medicare, and Combined Tax Rates for Four-Person Families at the Same Relative Positions in the Income Distribution, 1955-1999,'' Office of Tax Analysis, Department of the Treasury, January 15, 1998, which we updated through 2005. The updated version is available at http://www.taxpolicycenter.org.



Source: Lerman (1998) and Tax Policy Center.
Note: Median income information for a family of four comes from Census Bureau publications, series P-60; based on expanded sample used in 2000 Census for 2000 and beyond. To calculate income taxes, income is assumed to be earned by a one-earner couple with two children and itemized deductions equal to 23 percent of income through 1986 and 18 percent of income thereafter; 2005 median income estimated by inflating 2004 median income by CPI-W.

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