TAX FOUNDATION 65 YEARS

SPECIAL REPORT

May 2002
No. 113

The Effect of Temporary Tax Relief on a Typical American Family of Four

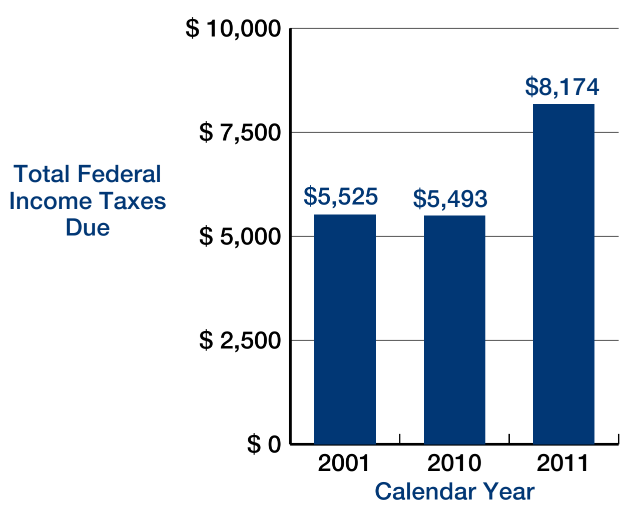
Temporary Tax Cut Will Leave Some Taxpayers With Doubled Tax Bill When Legislation Sunsets After 2010

John S. Barry
Chief Economist
Tax Foundation

The U.S. House of Representatives voted on April 18, 2002, to make the tax cut passed last year permanent. The so-called Bush tax cut signed into law in May of 2001, known officially as the Economic Growth and Tax Reform Reconciliation Act (EGTRRA) will expire on December 31, 2010. Ultimate passage of the measure appears unlikely, however.

As the April 22, 2002 issue of *Tax Notes* reports, Senate Majority Leader Tom Daschle has stated, "We will … never bring up the permanent tax cut the president has advocated. It is bad policy, it is wrong, and it compounds the budget disaster that our country currently faces."

Figure 1
A Typical Family of Four's Federal Income Taxes Will Rise 48.8 Percent When the 2001 Tax Cut Sunsets After 2010



Assumptions: Standard deduction; no credits claimed other than the refundable child credit.
Source: Tax Foundation calculations; see Methodology for details.

The major provisions of EGTRRA, all set to sunset after December 31, 2010, include:

- ♦ The creation of a new 10 percent individual income tax bracket, added to the existing bracket structure;
- ♦ A phased-in reduction of the remaining individual income tax rates over the next five years;
- ♦ A phased-in increase in the Child Tax Credit from its previous level of $500 per child to $1,000 per child in 2010; and
- ♦ Marriage penalty relief phased in primarily between 2004 and 2010.

All of these provisions affect average American families. In fact, if Congress and the President do not act to make the provisions of EGTRRA permanent, a typical family of four earning the median family income can expect its federal income tax bill to increase by $2,681 between 2010 and 2011, a 48.8 percent increase. This will amount to 3.3 percent of the family's adjusted gross income in that year. Figure 1 shows total federal income taxes due in the years 2001, 2010, and 2011. Families with more than two children will experience an even greater increase in their taxes between 2010 and 2011.

To put this increase into context, the average family of four spends roughly $2,070

($2,787 in 2011 dollars) on out-of-pocket health care costs each year according to the Bureau of Labor Statistics' Consumer Expenditure Survey. In other words, the increased federal income taxes owed by a typical family of four due to expiration of EGTRRA will be about as large as the average family of four's annual out-of-pocket medical expenses.

As Table 1 highlights, the effective federal income tax rate for a typical family of four with an income of $64,033 (the median income for families of four in the United States) in 2001 was 8.6 percent. The effective rate is simply total federal income taxes paid divided by income.

Because many of the major provisions of EGTRRA phase-in over the next 10 years, the effective federal income tax rate for this typical family will continue to fall over the next eight years, reaching a low of 6.9 percent in 2010. The expiration of EGTRRA, however, will increase this family's effective rate to 10 percent in 2002, a higher effective rate than they faced in 2001.

The typical family of four faces a top marginal tax rate of 15 percent under current law. However, when EGTRAA sunsets at the end of 2010, this same family's top marginal rate will jump to 28 percent. Specifically, in 2011 the first $54,774 of this family's taxable income will be taxed at the 15 percent rate, and the remaining $3,424 of taxable income will be hit with a 28 percent rate. Therefore, it is noteworthy that the expiration of EGTRRA will not only raise by 48.8 percent the total federal income taxes due from these families but will expose them to a higher marginal tax rate, introducing a significant disincentive for additional labor supply and therefore economic growth.

Table 1
How a Typical Family of Four's Taxes Will Change When the 2001 Tax Cut Sunsets After 2010

				2001–2010		2010–2011	
	2001	2010	2011	Absolute Change	Percentage Change	Absolute Change	Percentage Change
Adjusted gross income	$ 64,033	$ 79,422	$ 81,407	+ $ 15,389	+ 24.0%	+ $ 1,986	+ 2.5%
Standard deduction	$ 7,600	$ 10,811	$ 9,210	+ $ 3,211	+ 42.3%	– $ 1,602	– 14.8%
total personal exemptions	$ 11,600	$ 13,800	$ 14,000	+ $ 2,200	+ 19.0%	+ $ 200	+ 1.4%
Taxable Income	$ 44,833	$ 54,810	$ 58,198	+ $ 9,978	+ 22.3%	+ $ 3,387	+ 6.2%
Tax before credits	$ 6,725	$ 7,493	$ 9,174	+ $ 768	+ 11.4%	+ $ 1,681	+ 22.4%
Total child tax credits	$ 1,200	$ 2,000	$ 1,000	+ $ 800	+ 66.7%	– $ 1,000	– 50.0%
Total income taxes due	$ 5,525	$ 5,493	$ 8,174	– $ 32	– 0.6%	+ $ 2,681	+ 48.8%
Effective tax rate (total fed. inc. taxes paid divided by inc.)	8.6%	6.9%	10.0%	– 1.7%	– 19.8%	+ 3.1%	+ 45.2%

Assumptions: Standard deduction; no credits claimed other than the refundable child credit.
Source: Tax Foundation calculations; see Methodology for details.

Why Tax Relief Sunsets After 2010

As signed by the President, EGTRRA contains 108 mid-course corrections including numerous phase-ins, phase-outs, changes in rates, scale-ups, scale-downs, phase-outs of existing phase ins, accelerations of existing phase outs, and sunsets. All of these unnecessary complexities were incorporated for budget scoring reasons and to comply with arcane legislative rules, not because they are sound tax policy.

The fact that the entire bill sunsets after December 31, 2010, is due to an arcane but extremely important Senate rule. The Byrd rule, named for Senator Robert C. Byrd (D-WV) who introduced the measure as part of the Consolidated Omnibus Budget Reconciliation Act of 1985, is meant to prevent "extraneous matter" from being introduced into reconciliation bills.

One of the six tests by which matters are judged extraneous or not is whether provisions of the bill would "increase net outlays or decrease revenue during a fiscal year after the years covered by the reconciliation bill unless the provision's title, as a whole, remains budget neutral." [1] In other words, any tax-related

[1] The other 5 types of provisions subject to a Byrd rule point of order, according to the House Rules Committee (http://www.house.gov/rules/byrd_rule.htm), are those that: "do not produce a change in outlays or revenues; produce changes in outlays or revenue which are merely incidental to the non-budgetary components of the provision; are outside the jurisdiction of the committee that submitted the title or provision for inclusion in the reconciliation measure; increase outlays or decrease revenue if the provision's title, as a whole, fails to achieve the Senate reporting committee's reconciliation instructions; and contain recommendations regarding the OASDI (social security) trust funds."

provision in a reconciliation bill that permanently affects federal receipts is subject to a point of order under the Byrd rule. Any senator can raise a point of order. If the point of order is not waived, then the provision in question is removed from the bill under consideration.

By standard Senate rules, sixty votes are required to waive a point of order. This means that if a senator raises a point of order under the Byrd rule, a sixty-vote majority is required to waive the point of order and retain the provision in question. Nearly every provision of EGTRRA, if permanent, would have been

Table 2
How a Typical Family of Four's Taxes Will Change in Each State When the 2001 Tax Cut Sunsets After 2010

	AGI for Family of Four with Median Income			Federal Income Taxes Due			Effective Federal Income Tax Rate			2001–2010		2010–2011	
	2001	2010	2011	2001	2010	2011	2001	2010	2011	Tax Change	Percent Change	Tax Change	Percent Change
United States	$ 64,033	$ 79,422	$ 81,407	$ 5,525	$ 5,493	$ 8,174	8.6%	6.9%	10.0%	– $ 32	– 0.6%	+ $ 2,681	+ 48.8%
Alabama	$ 52,943	$ 65,667	$ 67,309	$ 3,861	$ 3,430	$ 5,615	7.3%	5.2%	8.3%	– $ 431	– 11.2%	+ $ 2,185	+ 63.7%
* Alaska	68,813	85,352	87,485	6,794	6,383	9,876	9.9	7.5	11.3	– 411	– 6.0	+ 3,494	+ 54.7
Arizona	57,277	71,043	72,819	4,512	4,236	6,441	7.9	6.0	8.8	– 275	– 6.1	+ 2,205	+ 52.0
Arkansas	45,829	56,843	58,264	2,794	2,106	4,258	6.1	3.7	7.3	– 688	– 24.6	+ 2,152	+ 102.2
* California	65,039	80,670	82,687	5,756	5,680	8,533	8.8	7.0	10.3	– 75	– 1.3	+ 2,852	+ 50.2
* Colorado	$ 68,556	$ 85,032	$ 87,158	$ 6,723	$ 6,335	$ 9,785	9.8%	7.4%	11.2%	– $ 388	– 5.8%	+ $ 3,450	+ 54.5%
† Connecticut	85,100	105,553	108,192	11,273	11,080	15,674	13.2	10.5	14.5	– 193	– 1.7	+ 4,594	+ 41.5
* Delaware	71,371	88,524	90,738	7,497	6,859	10,787	10.5	7.7	11.9	– 639	– 8.5	+ 3,928	+ 57.3
Florida	56,956	70,645	72,411	4,463	4,177	6,380	7.8	5.9	8.8	– 287	– 6.4	+ 2,203	+ 52.8
Georgia	61,214	75,926	77,824	5,102	4,969	7,192	8.3	6.5	9.2	– 133	– 2.6	+ 2,223	+ 44.7
* Hawaii	$ 67,782	$ 84,073	$ 86,175	$ 6,510	$ 6,191	$ 9,509	9.6%	7.4%	11.0%	– $ 319	– 4.9%	+ $ 3,318	+ 53.6%
Idaho	55,280	68,566	70,280	4,212	3,865	6,060	7.6	5.6	8.6	– 347	– 8.2	+ 2,196	+ 56.8
* Illinois	70,092	86,938	89,111	7,145	6,621	10,332	10.2	7.6	11.6	– 525	– 7.3	+ 3,711	+ 56.1
* Indiana	63,879	79,232	81,212	5,502	5,465	8,120	8.6	6.9	10.0	– 37	– 0.7	+ 2,655	+ 48.6
Iowa	59,601	73,925	75,773	4,860	4,669	6,884	8.2	6.3	9.1	– 191	– 3.9	+ 2,216	+ 47.5
Kansas	$ 58,431	$ 72,474	$ 74,285	$ 4,685	$ 4,451	$ 6,661	8.0%	6.1%	9.0%	– $ 234	– 5.0%	+ $ 2,210	+ 49.7%
Kentucky	52,735	65,409	67,045	3,830	3,391	5,575	7.3	5.2	8.3	– 439	– 11.5	+ 2,184	+ 64.4
Louisiana	48,737	60,450	61,961	3,230	2,647	4,813	6.6	4.4	7.8	– 583	– 18.0	+ 2,165	+ 81.8
Maine	57,815	71,710	73,503	4,592	4,337	6,544	7.9	6.0	8.9	– 256	– 5.6	+ 2,207	+ 50.9
† Maryland	79,811	98,993	101,467	9,818	9,440	13,791	12.3	9.5	13.6	– 378	– 3.9	+ 4,352	+ 46.1
† Massachusetts	$ 80,288	$ 99,584	$ 102,073	$ 9,949	$ 9,588	$ 13,961	12.4%	9.6%	13.7%	– $ 362	– 3.6%	+ $ 4,373	+ 45.6%
* Michigan	70,733	87,733	89,926	7,322	6,740	10,560	10.4	7.7	11.7	– 582	– 7.9	+ 3,820	+ 56.7
† Minnesota	72,599	90,047	92,298	7,835	7,203	11,224	10.8	8.0	12.2	– 631	– 8.1	+ 4,021	+ 55.8
Mississippi	47,675	59,132	60,611	3,071	2,450	4,610	6.4	4.1	7.6	– 621	– 20.2	+ 2,160	+ 88.2
* Missouri	62,947	78,075	80,027	5,362	5,291	7,788	8.5	6.8	9.7	– 71	– 1.3	+ 2,497	+ 47.2
Montana	$ 47,480	$ 58,891	$ 60,363	$ 3,042	$ 2,414	$ 4,573	6.4%	4.1%	7.6%	– $ 628	– 20.7%	+ $ 2,159	+ 89.5%
Nebraska	58,694	72,800	74,620	4,724	4,500	6,712	8.0	6.2	9.0	– 224	– 4.7	+ 2,212	+ 49.1
* Nevada	61,343	76,086	77,988	5,121	4,993	7,217	8.3	6.6	9.3	– 129	– 2.5	+ 2,224	+ 44.5
† New Hampshire	73,739	91,461	93,748	8,148	7,557	11,630	11.1	8.3	12.4	– 591	– 7.3	+ 4,073	+ 53.9
† New Jersey	80,838	100,266	102,773	10,101	9,758	14,157	12.5	9.7	13.8	– 342	– 3.4	+ 4,399	+ 45.1
New Mexico	$ 48,686	$ 60,387	$ 61,897	$ 3,223	$ 2,638	$ 4,803	6.6%	4.4%	7.8%	– $ 585	– 18.1%	+ $ 2,165	+ 82.1%
* New York	66,391	82,347	84,406	6,128	5,932	9,014	9.2	7.2	10.7	– 196	– 3.2	+ 3,082	+ 52.0
North Carolina	58,862	73,008	74,834	4,749	4,531	6,744	8.1	6.2	9.0	– 218	– 4.6	+ 2,212	+ 48.8
North Dakota	54,681	67,823	69,518	4,122	3,753	5,946	7.5	5.5	8.6	– 369	– 8.9	+ 2,193	+ 58.4
* Ohio	64,056	79,451	81,437	5,528	5,498	8,183	8.6	6.9	10.0	– 31	– 0.6	+ 2,685	+ 48.8
Oklahoma	$ 49,864	$ 61,848	$ 63,395	$ 3,400	$ 2,857	$ 5,028	6.8%	4.6%	7.9%	– $ 542	– 16.0%	+ $ 2,170	+ 76.0%
Oregon	60,006	74,428	76,288	4,921	4,744	6,962	8.2	6.4	9.1	– 177	– 3.6	+ 2,218	+ 46.7
* Pennsylvania	67,308	83,484	85,571	6,380	6,103	9,340	9.5	7.3	10.9	– 277	– 4.3	+ 3,238	+ 53.1
* Rhode Island	70,402	87,322	89,505	7,231	6,678	10,442	10.3	7.6	11.7	– 552	– 7.6	+ 3,764	+ 56.4
South Carolina	57,927	71,848	73,644	4,609	4,357	6,565	8.0	6.1	8.9	– 252	– 5.5	+ 2,208	+ 50.7
South Dakota	$ 56,749	$ 70,388	$ 72,148	$ 4,432	$ 4,138	$ 6,341	7.8%	5.9%	8.8%	– $ 294	– 6.6%	+ $ 2,203	+ 53.2%
Tennessee	56,491	70,068	71,819	4,394	4,090	6,291	7.8	5.8	8.8	– 304	– 6.9	+ 2,201	+ 53.8
Texas	55,065	68,299	70,006	4,180	3,825	6,019	7.6	5.6	8.6	– 355	– 8.5	+ 2,195	+ 57.4
Utah	58,697	72,804	74,624	4,725	4,501	6,712	8.0	6.2	9.0	– 224	– 4.7	+ 2,212	+ 49.1
Vermont	60,840	75,461	77,348	5,046	4,899	7,121	8.3	6.5	9.2	– 147	– 2.9	+ 2,222	+ 45.3
* Virginia	$ 70,028	$ 86,858	$ 89,029	$ 7,128	$ 6,609	$ 10,309	10.2%	7.6%	11.6%	– $ 519	– 7.3%	+ $ 3,700	+ 56.0%
* Washington	65,411	81,132	83,160	5,858	5,750	8,665	9.0	7.1	10.4	– 108	– 1.9	+ 2,916	+ 50.7
West Virginia	47,612	59,055	60,531	3,062	2,438	4,598	6.4	4.1	7.6	– 624	– 20.4	+ 2,160	+ 88.6
* Wisconsin	68,660	85,161	87,290	6,752	6,354	9,822	9.8	7.5	11.3	– 397	– 5.9	+ 3,468	+ 54.6
Wyoming	57,479	71,293	73,075	4,542	4,274	6,480	7.9	6.0	8.9	– 268	– 5.9	+ 2,206	+ 51.6
* Dist. of Columbia	$ 65,245	$ 80,925	$ 82,948	$ 5,812	$ 5,719	$ 8,606	8.9%	7.1%	10.4%	– $ 94	– 1.6%	+ $ 2,887	+ 50.5%

* Typical families of four in 17 states and the District of Columbia will face an increase in their top marginal rate from 15% in 2010 to 28% in 2011.
† Typical families of four in these 6 states will face an increase in their top marginal rate from 25% in 2010 to 28% in 2011.
Assumptions: Standard deduction; no credits claimed other than the refundable child credit.
Source: Tax Foundation calculations; see Methodology for details.

subject to a point of order under the Byrd rule. Senate Republicans did not think that they had the necessary sixty votes to waive these points of order. Therefore, they set every provision to expire after December 31, 2010, thus eliminating the applicability of the Byrd rule and the necessity of a sixty vote majority to bring the bill to a final vote.

If Congress and the President do not act to make the provisions of the 2001 tax cut permanent, a typical family of four earning the median family income can expect its federal income tax bill to increase by $2,681 between 2010 and 2011, a 48.8 percent increase.

State-by-State Figures

Because the median family income varies from state to state, the expiration of EGTRRA after 2010 will affect typical families of four in the various states differently. Specifically, typical families in relatively low-income states will see a disproportionately large increase in their federal income tax bill between 2010 and 2011. This is true for two primary reasons:

The absolute dollar amount of the federal standard deduction, personal exemption level, and child tax credit are standard across the entire country and across incomes. Therefore, these tax "benefits" will be of relatively greater value to families with lower incomes because they offset a greater percentage of their total taxable income.

Secondly, federal tax rate brackets are standard across the country. Therefore, a family of four earning the median income in one state may be in a higher marginal tax bracket than a family of four earning the median income in another state.

Table 2 lists the impact of EGTRRA's expiration on a typical family of four in each state. Measured as a percentage increase in federal income taxes due, a typical family of four in Arkansas will be hit the hardest as their total federal income tax bill will increase by 102 percent between 2010 and 2011. Typical families of four in five additional states (Louisiana, Mississippi, Montana, New Mexico, and West Virginia) will experience an increase in their federal income taxes of greater than 80 percent.

Table 2 also indicates that in 17 states and the District of Columbia, the typical family of four's income is in a range that will face a jump in the top marginal rate from 15 percent in 2010 to 28 percent in 2011. As previously noted, an increase in a taxpayer's top marginal rate is particularly harmful economically, as it discourages increased labor and therefore has the potential to limit economic growth. In an additional six states, the family of four with a median income will see a smaller hike in its top tax rate rise — from 25 percent in 2010 to 28 percent in 2011. A family of four with the median income in the remaining 27 states will continue to face a top marginal rate of 15 percent through 2010 and 2011.

Methodology

This analysis is based on the federal income tax liability faced by a family of four that files as "married filing jointly," claims the standard deduction, and claims only the child tax credit. It is assumed that this family has no other deductions or credits. To the extent that these families are able to take advantage of the other deductions and credits created or increased by EGTRRA, the impact of the law's expiration will only increase.

The median family income used in this report is that reported by the Bureau of the Census at http://www.census.gov/hhes/income/4person.html. This is the figure used by the Department of Health and Human Services for the Low Income Home Energy Assistance Program. The latest figure available is for the year 2000. The base, national figure, $62,228, and all the base levels for the states, were inflated by the Consumer Price Index (CPI-U) to reach median family income levels for the years 2001 through 2011. The Actual CPI-U measure was used for 2001 and the Congressional Budget Office's (CBO) projections of CPI-U were used for 2002–2011. CBO's CPI-U was used to inflate wages and income growth rather than the GDP deflator because growth in income typically exceeds the rate of inflation.

All tax rate brackets, personal exemptions, and the standard deduction were inflated from their actual 2001 levels based on CBO's projected GDP deflators.

TAX FOUNDATION 65 YEARS

SPECIAL REPORT (ISSN 1068-0306) is published at least 6 times yearly by the Tax Foundation, an independent 501(c)(3) organization chartered in the District of Columbia.

4–20 pp.
Annual subscription: $50
Individual issues: $10

The Tax Foundation, a nonprofit, nonpartisan research and public education organization, has monitored tax and fiscal activities at all levels of government since 1937.

Editor and Communications Director, Bill Ahern

Tax Foundation
1250 H Street, NW, Suite 750
Washington, DC 20005
(202) 783-2760
(202) 783-6868 fax
www.TaxFoundation.org
TF@TaxFoundation.org