



Inflation Adjustments for Tax Brackets Will Be Significantly Smaller in 2008 than in 2007

Fiscal Fact No. 105

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While the Internal Revenue Service does not officially release its inflation adjustments for Tax Year 2008 until December, they will base the adjustments on the average of the Consumer Price Index from September 2006 to August 2007. The final August 2007 number was recently released by the Bureau of Labor Statistics. The relevant inflation rate for Tax Year 2008 based on the average CPI values over the past 12 months is 2.29 percent, which is significantly smaller than the change that occurred last year, which was nearly 4 percent. Table 1 looks at the changes in various recent tax years.

Table 1: Inflation Tax Adjustments Have Varied Widely over Past Ten Years

Old Tax Year - New Tax Year	Change in Average CPI
Tax Year 1998 - 99:	1.69%
Tax Year 1999 - 00:	1.82%
Tax Year 2000 - 01:	3.11%
Tax Year 2001 - 02:	3.29%
Tax Year 2002 - 03:	1.59%
Tax Year 2003 - 04:	2.28%
Tax Year 2004 - 05:	2.30%
Tax Year 2005 - 06:	3.11%
Tax Year 2006 - 07:	3.90%
Tax Year 2007 - 08:	2.29%

Bureau of Labor Statistics; Tax Foundation calculations

Below we present a projection of the most important parameters in the federal individual income tax system for Tax Year 2008, and we compare them to Tax Year 2007, for which tax returns will be filed in spring 2008 (April 15th deadline). Current tax year is in parenthesis.

Table 2: Tax Year 2008 Will See Small Change from 2007 Due to Inflation

Key Tax Variable	Single Filers	Married Filing Jointly Filers	Married Filing Singly Filers	Head of Household Filers
Personal Exemption	\$3,500 (3,400)	\$3,500 (3,400)	\$3,500 (3,400)	\$3,500 (3,400)
Standard Deduction	\$5,450 (5,350)	\$10,900 (10,700)	\$5,450 (5,350)	\$8,000 (7,850)
15% Bracket Kicks In	\$8,025 (7,825)	\$16,050 (15,650)	\$8,025 (7,825)	\$11,450 (11,200)
25% Bracket Kicks In	\$32,550 (31,850)	\$65,100 (63,700)	\$32,550 (31,850)	\$43,650 (42,650)
28% Bracket Kicks In	\$78,850 (77,100)	\$131,450 (128,500)	\$65,725 (64,250)	\$112,650 (110,100)
33% Bracket Kicks In	\$164,550 (160,850)	\$200,300 (195,850)	\$100,150 (97,925)	\$182,400 (178,350)
35% Bracket Kicks In	\$357,700 (349,700)	\$357,700 (349,700)	\$178,850 (174,850)	\$357,700 (349,700)

Source: Bureau of Labor Statistics; Tax Foundation calculations; and James C. Young, "Inflation Adjustments Affecting Individual Taxpayers in 2006: Analysis and Commentary," *Tax Analysts Special Report*, Oct. 3, 2005, available at http://taxprof.typepad.com/taxprof_blog/files/2005-19011-1.pdf.

How much will this inflation adjustment save people? Assume we have a single filer who makes \$50,000 in both 2007 and 2008 (i.e. he receives no pay increase) and he takes the standard deduction and has no dependents. In 2007, that person would pay \$6,736.25. In 2008, he would pay \$6,606.25. Compare that to 2006, which gave us a very large inflation number, and the person earning \$50,000 would have been paying \$6,945.

These automatic, annual bracket adjustments were enacted as part of the so-called Reagan tax cut in 1981 but with a four-year delay so that they didn't start until 1985. They can amount to an invisible, annual tax cut, or merely keep a person's real tax bill the same. Before 1985, the opposite occurred each year. A large, annual tax hike occurred as inflation pushed people up into

higher tax brackets even if their purchasing power hadn't increased at all. Bracket levels were never adjusted unless Congress passed a tax law, and with inflation as high as it was during the 1970s, those annual tax hikes were huge. However, not all tax parameters are adjusted for inflation. The child tax credit amount of \$1,000 is not adjusted, and the AMT exemption amounts are not annually indexed for inflation.

Conclusion

The time period of September 2006 through August 2007 had relatively mild inflation compared to the previous two periods, resulting in much smaller inflation adjustments for tax year 2008 than we saw in the previous two adjustments.

Note: For a complete detail of this complicated adjustment process, see Prof. James C. Young's article last year on the topic, available at http://taxprof.typepad.com/taxprof_blog/files/2005-19011-1.pdf.

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