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## **Inflation Adjustment of Tax Brackets Almost Zero for Next Year**

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### **Introduction**

Today, the Bureau of Labor Statistics (BLS) released its August estimate of the Consumer Price Index (CPI). That August figure is the final statistic used by the IRS in calculating important tax parameters for tax year 2010. Even though these tax returns won't be filed until spring 2011, this information is necessary because employers will use these parameters to estimate withholding in 2010.

The numbers released today indicate that this year will mark the smallest inflation adjustment on record (since the IRS began adjusting tax parameters for inflation on an annual basis in the mid-1980s). While last year saw some of the largest year-over-year increases in most inflation-adjusted tax parameters (4.26%), year-over-year inflation for the purposes of this year's adjustment was less than 0.2 percent (see Table 1 below).

### **How the IRS Calculates Inflation Adjustment**

The IRS uses the average CPI-U monthly value from the previous 12 months (September through August) and compares it to a "base year" CPI-U average for each tax variable. Here's a simple example:

For the personal exemption (base year of 1988), the initial personal exemption value was \$2,000 in a year with a 12-month CPI-U average of 116.61666 (period of Sept. 1987 through Aug. 1988). Given this morning's BLS release, the average CPI-U value for the 12-month period of Sept. 2008 through Aug. 2009) will be 214.0023. Therefore, the ratio of the 2009 CPI-U average to the 1988 CPI-U average equals 1.83509, and we multiply that ratio by \$2,000 (the initial personal exemption

amount) in order to obtain our amount for tax year 2010. (Note that the IRS rounds most tax parameters *down* to the nearest \$50.)

This procedure is done to all inflation-adjusted tax parameters, albeit some with different "base years" than others. For example, the base year for the 10% bracket is 2002.

### **Smallest Adjustment Since Inflation Adjustments by IRS Began**

Table 1 shows the annual inflation rates for every year since inflation adjustments became part of the individual income tax in the mid-1980s. As one can see, the past two years are two extremes: one high and one low. That means last year, tax parameters like the standard deduction and tax brackets increased substantially in value, while this year, they are either increasing very little or not at all. For workers, this means they won't receive as large an increase in take-home pay this January as they did last January given the automatic inflation adjustments (assuming pre-tax wages stay the same).

<b>Tax Year Adjustment</b>	<b>Inflation Rate</b>
1984-85	3.99%
1985-86	3.78%
1986-87	2.57%
1987-88	2.64%
1988-89	4.14%
1989-90	4.74%
1990-91	4.84%
1991-92	5.28%
1992-93	3.05%
1993-94	3.06%
1994-95	2.60%
1995-96	2.84%
1996-97	2.76%
1997-98	2.74%
1998-99	1.69%
1999-00	1.82%
2000-01	3.11%
2001-02	3.29%
2002-03	1.59%
2003-04	2.28%
2004-05	2.30%
2005-06	3.11%
2006-07	3.90%
2007-08	2.29%
2008-09	4.26%
2009-10	0.19%

The previous lowest annual inflation amount (as measured by changes in 12-month CPI average) was 1.59 percent. That was following the previous recession. But it's not even close to the near-zero inflation for 2009-10.

### Projected Inflation Parameters for 2010

In the tables below, we present our projected amounts for each of the major tax parameters for tax year 2010, including every taxable income bracket threshold, personal exemption, standard deduction, and phase-in and phase-out ranges for the limitations on personal exemptions and itemized deductions. The IRS will release its official figures later this fall, but rarely are there any differences and never anything significantly different.

As one can see from the table, the personal exemption will remain unchanged for this year, along with the standard deduction for some taxpayers. This marks the first time that no increase in these parameters has taken place.

<b>Tax Parameter</b>	<b>Tax Year 2010 Amount</b>	<b>Tax Year 2009 Amount</b>
Standard Deduction - Singles	5,700	5,700
Standard Deduction - Married Filing Jointly (MFJ)	11,400	11,400
Standard Deduction - Head of Household (HOH)	8,400	8,350
Standard Deduction - Married Filing Separately (MFS)	5,700	5,700
Personal Exemption	3,650	3,650
10% Rate - Single	0	0
15% Rate - Single	8,375	8,350
25% Rate - Single	34,000	33,950
28% Rate - Single	82,400	82,250
33% Rate - Single	171,850	171,550
35% Rate - Single	373,650	372,950
10% Rate - MFJ	0	0
15% Rate - MFJ	16,750	16,700
25% Rate - MFJ	68,000	67,900
28% Rate - MFJ	137,300	137,050
33% Rate - MFJ	209,250	208,850
35% Rate - MFJ	373,650	372,950
10% Rate - HOH	0	0
15% Rate - HOH	11,975	11,950
25% Rate - HOH	45,550	45,500
28% Rate - HOH	117,650	117,450
33% Rate - HOH	190,550	190,200
35% Rate - HOH	373,650	372,950

10% Rate - MFS	0	0
15% Rate - MFS	8,375	8,350
25% Rate - MFS	34,000	33,950
28% Rate - MFS	68,650	68,525
33% Rate - MFS	104,625	104,425
35% Rate - MFS	186,825	186,475
Phaseout of Itemized Deductions Begins (AGI) Single, MFJ, HOH	167,100	166,800
Phaseout of Itemized Deductions Begins (AGI) MFS	83,550	83,400
Phaseout of Personal Exemptions Begins (AGI) Single	167,100	166,800
Phaseout of Personal Exemptions Begins (AGI) MFJ	250,650	250,200
Phaseout of Personal Exemptions Begins (AGI) HOH	208,850	208,500
Phaseout of Personal Exemptions Begins (AGI) MFS	104,425	125,100

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