



FISCAL FACT

September 17, 2010
No. 245

Tax Foundation Projects 2011 Tax Parameters Following Release of August CPI Data

By Mark Robyn and Gerald Prante

Summary

This morning, the Bureau of Labor Statistics (BLS) released its August 2010 estimate for the Consumer Price Index (CPI), including the estimate for urban consumers (CPI-U). This CPI-U statistic is typically the final piece of information needed to calculate federal tax parameters such as the standard deduction, personal exemption, and tax bracket thresholds. The IRS will use these to set withholding rates on wages throughout 2011 and for 2011 tax forms to be filed in early 2012.

Unfortunately, the rates and brackets that taxpayers will face in 2011 are currently unknown. The expiring Bush tax cuts have not been addressed by the Congress, and several different outcomes are possible. All the most likely scenarios are addressed by the Tax Foundation's online calculator of 2011 income tax liability at www.MyTaxBurden.org, and this morning the calculator has been updated to reflect the new inflation adjustments.

Inflation Relatively Low

Inflation has been lower over the past 12 months (September 1, 2009 through August 31, 2010) than the historical average, although it did rise faster over the past year than it did during the previous 12-month period. Table 1 shows the year-over-year inflation rates since 1992 for the statistic that is used to calculate tax parameters. For the 2011 tax year, the inflation rate is 1.48%. A year ago, that figure was 0.19%.

Even though taxpayers will not start filing their 2011 tax returns until January 2012, tax year 2011 parameters are needed in advance of 2011 so that the IRS can produce instructions for 2011 income tax withholding which will begin in January. Therefore, the inflation adjustments for any tax year must be based on CPI-U data from portions of the previous two years.

Mark Robyn is staff economist and Gerald Prante, Ph.D., senior economist at the Tax Foundation.

Table 1 Year-over-Year Change in Monthly CPI-U Average September - August		
Tax Year	Inflation Rate	Time Period for Calculation
2011	1.48%	Avg. monthly CPI for Sept. 2009 through Aug. 2010 divided by Avg. monthly CPI for Sept. 2008 through Aug. 2009
2010	0.19%	Avg. monthly CPI for Sept. 2008 through Aug. 2009 divided by Avg. monthly CPI for Sept. 2007 through Aug. 2008
2009	4.26%	Avg. monthly CPI for Sept. 2007 through Aug. 2008 divided by Avg. monthly CPI for Sept. 2006 through Aug. 2007
2008	2.29%	Avg. monthly CPI for Sept. 2006 through Aug. 2007 divided by Avg. monthly CPI for Sept. 2005 through Aug. 2006
2007	3.90%	Avg. monthly CPI for Sept. 2005 through Aug. 2006 divided by Avg. monthly CPI for Sept. 2004 through Aug. 2005
2006	3.11%	Avg. monthly CPI for Sept. 2004 through Aug. 2005 divided by Avg. monthly CPI for Sept. 2003 through Aug. 2004
2005	2.30%	Avg. monthly CPI for Sept. 2003 through Aug. 2004 divided by Avg. monthly CPI for Sept. 2002 through Aug. 2003
2004	2.28%	Avg. monthly CPI for Sept. 2002 through Aug. 2003 divided by Avg. monthly CPI for Sept. 2001 through Aug. 2002
2003	1.59%	Avg. monthly CPI for Sept. 2001 through Aug. 2002 divided by Avg. monthly CPI for Sept. 2000 through Aug. 2001
2002	3.29%	Avg. monthly CPI for Sept. 2000 through Aug. 2001 divided by Avg. monthly CPI for Sept. 1999 through Aug. 2000
2001	3.11%	Avg. monthly CPI for Sept. 1999 through Aug. 2000 divided by Avg. monthly CPI for Sept. 1998 through Aug. 1999
2000	1.82%	Avg. monthly CPI for Sept. 1998 through Aug. 1999 divided by Avg. monthly CPI for Sept. 1997 through Aug. 1998
1999	1.69%	Avg. monthly CPI for Sept. 1997 through Aug. 1998 divided by Avg. monthly CPI for Sept. 1996 through Aug. 1997
1998	2.74%	Avg. monthly CPI for Sept. 1996 through Aug. 1997 divided by Avg. monthly CPI for Sept. 1995 through Aug. 1996
1997	2.76%	Avg. monthly CPI for Sept. 1995 through Aug. 1996 divided by Avg. monthly CPI for Sept. 1994 through Aug. 1995
1996	2.84%	Avg. monthly CPI for Sept. 1994 through Aug. 1995 divided by Avg. monthly CPI for Sept. 1993 through Aug. 1994
1995	2.60%	Avg. monthly CPI for Sept. 1993 through Aug. 1994 divided by Avg. monthly CPI for Sept. 1992 through Aug. 1993
1994	3.06%	Avg. monthly CPI for Sept. 1992 through Aug. 1993 divided by Avg. monthly CPI for Sept. 1991 through Aug. 1992
1993	3.05%	Avg. monthly CPI for Sept. 1991 through Aug. 1992 divided by Avg. monthly CPI for Sept. 1990 through Aug. 1991
1992	5.28%	Avg. monthly CPI for Sept. 1990 through Aug. 1991 divided by Avg. monthly CPI for Sept. 1989 through Aug. 1990

Source: Bureau of Labor Statistics

How the IRS Calculates New Tax Parameters

When calculating the values for the next tax year's parameters, the IRS does not merely adjust the parameters based on inflation from one calendar year to the next. Instead, they have a somewhat

complicated formula that involves a base-year amount for each parameter (typically the year it was first enacted) and an annual average CPI-U for the base year and the current year. The amount for the coming tax year is calculated by multiplying the base year amount by the ratio of the CPI-U in the current year to the CPI-U in the base year. It is then rounded down to the nearest 50 dollars.

The calculation is further complicated by the fact that the CPI-U amounts used to calculate the next year's parameters are not simply the CPI-U averages for the relevant calendar years. Instead, for both the current year and the base year the IRS must use the CPI-U average for the 12 month period covering September of the previous year through August of the current year. For example, the 2011 tax parameters will be based on the average monthly CPI-U from September 2009 through August 2010 (with the same method being used for the base year of the tax parameter to be adjusted). The ratio of these two averages (the current year 12-month average divided by the base year 12-month average) is multiplied by the base year parameter amount to yield the next tax year's tax parameter.

For example, as cited above, the CPI-U amount for the purposes of calculating 2011 tax parameters was 217.163 (Sep. 2009 – Aug. 2010). The reference year for the personal exemption is 1989, a year in which the CPI-U 12-month average for September through August of the previous year (Sep. 1987 – Aug. 1988) was 116.617. The amount of the personal exemption in 1989 was \$2,000. Therefore, the personal exemption amount in 2011 equals \$2,000 times the ratio of 217.163 to 116.617, or \$3,724. Rounding down the \$3,724 figure to the nearest \$50 dollars yields us a personal exemption amount for 2011 of \$3,700.

Most but not all tax parameters have been indexed for inflation since 1985, thereby eliminating bracket creep that is solely the result of inflation. Two well-known tax laws that are not adjusted each year by law are the child tax credit, which has been \$1,000 since 2003, and the alternative minimum tax (AMT) exemption level. The failure to adjust the AMT exemption level for inflation has caused an increasing number of tax filers to owe more under the AMT than under the regular income tax, and that in turn has inspired Congress to annually enact an AMT "patch," a colloquial term for a temporary rise in the exemption level.

Projecting 2011 Tax Parameters in a Time of Uncertain Tax Law

Upon release of the August CPI-U, the Tax Foundation would normally be able to project with a high degree of certainty what next year's tax parameters would look like.¹ However, due to the pending expiration of the Bush-era tax cuts the fate of some tax parameters is not known. Some will have different base years or base amounts and others may not exist at all. For example, the 10 percent bracket threshold would be irrelevant if the Bush tax cuts expire because there would be no more 10 percent bracket. Also, the Democrats' plan calls for changes to be made to where the 36 percent bracket begins, as well as to where the phase-outs of itemized deductions and personal exemptions begin. Thus, the table below must include various policy scenarios if we are to provide readers with the appropriate information.

The tax parameter values in the policy scenarios below are the same as those used in the Tax Foundation's 2011 online calculator at www.MyTaxBurden.org, which has now been updated to reflect these new CPI numbers released by BLS. The calculator has also been updated to include the new proposal put forth by Senate Republicans earlier this week (S. 3773, or the "Tax Hike Prevention Act of 2010"). The Democratic proposal in the table below refers to the tax policies outlined in the Statutory Pay-As-You-Go Act of 2010 as interpreted by the Joint Committee on Taxation (JCT).

To see a more detailed list of the 2011 tax parameters under various scenarios, visit this website:
<http://mytaxburden.org/parameterstable.htm>

Tax Year	2010 Amount	2011 Amount		
		GOP Plan	Dem Plan	Expiration
Standard Deduction				
For singles	\$ 5,700	\$5,800	\$5,800	\$5,800
For married filing jointly	\$ 11,400	\$11,600	\$11,600	\$9,650
For heads of households	\$ 8,400	\$8,500	\$8,500	\$8,500
For married filing separately	\$ 5,700	\$5,800	\$5,800	\$4,825
Personal Exemption				
	\$ 3,650	\$3,700	\$3,700	\$3,700
Tax Bracket Thresholds for Single Filers				
10% Rate	\$ 0	\$ 0	\$ 0	N/A
15% Rate	\$ 8,375	\$8,500	\$8,500	\$0
25% Rate	\$ 34,000	\$34,500	\$34,500	N/A
28% Rate	\$ 82,400	\$83,600	\$83,600	\$34,500
31% Rate	N/A	N/A	N/A	\$83,600
33% Rate	\$ 171,850	\$174,400	\$174,400	N/A
35% Rate	\$ 373,650	\$379,150	N/A	N/A
36% Rate	N/A	N/A	\$193,800	\$ 174,400
39.6% Rate	N/A	N/A	\$379,150	\$379,150
Tax Bracket Thresholds for Married Filing Jointly				
10% Rate	\$ 0	\$ 0	\$ 0	N/A
15% Rate	\$ 16,750	\$17,000	\$17,000	\$0
25% Rate	\$ 68,000	\$69,000	\$69,000	N/A
28% Rate	\$ 137,300	\$139,350	\$139,350	\$57,650
31% Rate	N/A	N/A	N/A	\$139,350
33% Rate	\$ 209,250	\$212,300	\$212,300	N/A
35% Rate	\$ 373,650	\$379,150	N/A	N/A
36% Rate	N/A	N/A	\$ 235,150	\$212,300
39.6% Rate	N/A	N/A	\$379,150	\$379,150
Tax Bracket Thresholds for Heads of Households				
10% Rate	\$ 0	\$ 0	\$ 0	N/A
15% Rate	\$ 11,950	\$12,150	\$12,150	\$0
25% Rate	\$ 45,550	\$46,250	\$46,250	N/A
28% Rate	\$ 117,650	\$119,400	\$119,400	\$46,250
31% Rate	N/A	N/A	N/A	\$119,400
33% Rate	\$ 190,550	\$193,350	\$193,350	N/A
35% Rate	\$ 373,650	\$379,150	N/A	N/A
36% Rate	N/A	N/A	\$214,450	\$193,350
39.6% Rate	N/A	N/A	\$379,150	\$379,150

Table 2 (continued)				
Key Tax Parameter Amounts for 2011 under Various Key Scenarios				
Tax Parameter	2010 Amount	2011 Amount		
		GOP Plan	Dem Plan	Expiration
Tax Bracket Thresholds for Married Filing Separately				
10% Rate	\$ 0	\$ 0	\$ 0	N/A
15% Rate	\$ 8,375	\$8,500	\$8,500	\$0
25% Rate	\$ 34,000	\$34,500	\$34,500	N/A
28% Rate	\$ 68,650	\$69,675	\$69,675	\$34,500
31% Rate	N/A	N/A	N/A	\$69,675
33% Rate	\$ 104,625	\$106,150	\$106,150	N/A
35% Rate	\$ 186,825	\$189,575	N/A	N/A
36% Rate	N/A	N/A	\$117,550	\$106,150
39.6% Rate	N/A	N/A	\$189,575	\$189,575
AGI Level at which the Phase-out of Personal Exemptions Begins				
Single	N/A ² (\$167,100)	N/A	\$203,300	\$169,550
Married Filing Jointly	N/A ² (\$167,100)	N/A	\$254,150	\$169,550
Head of Household	N/A ² (\$167,100)	N/A	\$228,700	\$169,550
Married Filing Separately	N/A ² (\$83,550)	N/A	\$127,050	\$84,775
AGI Level at which the Phase-out of Itemized Deductions Begins				
Single	N/A ² (\$167,100)	N/A	\$202,950	\$169,550
Married Filing Jointly	N/A ² (\$250,650)	N/A	\$253,650	\$254,350
Head of Household	N/A ² (\$208,850)	N/A	\$228,300	\$211,950
Married Filing Separately	N/A ² (\$125,325)	N/A	\$126,800	\$127,175
¹ Technically, the August 2010 CPI number may be revised in October by BLS, but such revisions are rarely large enough to significantly change tax parameters. ² The phase-out of personal exemptions and the phase-out of itemized deductions were fully repealed in 2010 as part of the Bush tax cuts, but will automatically come back at their original levels in 2011 if the Bush tax cuts expire. They would come back at different income levels under the Democrats' plan. The full repeal would remain under the Republican plan. The numbers in parentheses for 2010 represent what the levels would be if the phase-outs had been in effect for 2010. Source: Tax Foundation calculations using BLS CPI-U Data				

© Tax Foundation
National Press Building
529 14th Street, N.W., Suite 420
Washington, DC 20045

202.464.6200
www.TaxFoundation.org

About the Tax Foundation

The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., the Foundation's economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.