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Family Tax Returns in Doubt As Expiration Approaches for Bush and Obama Tax Cuts: Three Likely Policy Scenarios

By Mark Robyn

The fight is heating up in Washington over how to handle the approaching expiration of the Bush-era tax cuts. A great deal continues to be said both in support of and in opposition to various features of the Bush-era tax policies. Some of this information is accurate and helpful, but much of it is buried deep in political rhetoric, obscuring the facts and making an often perplexing topic even more difficult to grasp.

Here we clarify the impact for taxpayers by calculating the tax bills of several hypothetical families in 2011 under the three likeliest policy scenarios.

- *Full Expiration:* the Bush tax cuts fully expire at the end of 2010, as scheduled in current law. This is the 'default' policy if Congress takes no action on the Bush-era tax cuts. It is essentially the law that prevailed before President Bush was elected.
- *Republican Plan:* permanent extension of all of the Bush tax cuts, as proposed by many Congressional Republicans
- *Democratic Plan:* extension of the Bush tax cuts for taxpayers making under $200,000 (single) or $250,000 (married), and expiration of the Bush tax cuts for those over the stated thresholds, as proposed by Congressional Democrats.

The specific set of proposals laid out in the Obama Administration's 2011 budget appears to be effectively dead as both parties in Congress have laid out their own set of tax policy priorities.

What the Different Proposals Mean

The Bush-era personal income tax cuts that expire at the end of 2010 include reductions for low-income, middle-income and high-income earners. Some provisions helped just low-income people, some helped low- and middle-income, some middle- and high-income, and some just high-income people. Proceeding roughly up the income spectrum, then, they:

Note: This update of *Tax Foundation Fiscal Fact*, No 227, "Taxpayers Face Uncertainty in 2011 As Bush and Obama Tax Cuts Expire," May 26, 2010, includes the parties' new policy proposals and revised tax parameters based on new inflation data from the Bureau of Labor Statistics.

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- made more married taxpayers eligible for the earned income tax credit (EITC);
- created the 10-percent income tax bracket;
- raised the standard deduction for couples to double the single amount;
- increased the child tax credit from $500 to $1,000 per child and made it refundable;
- raised the ceiling of the 15-percent bracket to double what it is for singles;
- lowered the 28-percent rate to 25 percent;
- lowered the 31-percent rate to 28 percent;
- lowered the 36-percent rate to 33 percent;
- lowered the 39.6-percent rate to 35 percent; and
- reduced and finally repealed the phase-out of itemized deductions and personal exemptions for high income earners.

Congressional Democrats have proposed extending or making permanent most of the Bush-era tax cuts, that is, all those for families making less than $250,000 ($200,000 for a single filer). For all provisions that reduce tax liability on income above those thresholds, they propose expiration or an alternative tax hike. They have also proposed keeping some, but not all, of President Obama's tax policies that were enacted as part of the American Reinvestment and Recovery Act of 2009. Specifically, they propose to:

- keep the lower AGI threshold for the refundable portion of the child tax credit (this provision expanded eligibility for the refundable child tax credit);
- keep the expanded eligibility limits for married taxpayers claiming the EITC;
- allow the increased EITC for taxpayers with 3 or more children to expire as scheduled;
- allow the making-work-pay tax credit to expire as scheduled; and
- allow the American Opportunity credit (for college education expenses) to expire as scheduled. Taxpayers would still be able to claim the Hope credit, the Lifetime Learning credit, or the tuition and fees deduction if they have qualifying higher education expenses.

On two other key provisions, President Obama's budget proposal differs from the Congressional Democrats' proposal. In one case the congressional plan raises more tax revenue, and in the other the President's budget would raise more revenue.

President Obama's budget would have allowed the lower Bush-era 33-percent tax rate to revert to 36 percent, but only for taxpayers making over $200,000 (single) or $250,000 (married); on taxable income below those thresholds that is currently taxed at 33 percent, the 28-percent rate would apply. The Democratic plan is similar, but instead of allowing the tax rate on some income to fall from 33 percent to 28 percent, it creates an additional tax bracket at the rate of 33 percent so that no taxable income is taxed at a lower rate than it is currently. This would raise slightly more revenue than the President's proposal.

President Obama proposed to limit the benefit that high-income taxpayers could receive from their itemized deductions to the benefit received in the 28-percent tax bracket. The Democratic proposal does not include this provision which would have slightly increased revenue.

For more details on specific tax policies, including tax brackets and other thresholds, see our table [Outline of Major Tax Law Provisions in 2011 under Multiple Scenarios].

Here we are highlighting the more 'automatic' tax provisions built into the tax code that depend only on income and family structure. Some more narrowly applicable tax credits and deductions that a taxpayer might qualify for, such as education tax credits, are excluded from these calculations. Unless otherwise noted, all income is assumed to be in the form of wages. A negative tax liability represents a tax refund, that is, a check from the federal government to the taxpayer. An AMT patch is assumed for all policy scenarios, and the tax increases enacted as part of health insurance reform do not apply to 2011, so they are excluded here.

Finally, all of the tax parameters (brackets, exemptions, etc.) have been projected using the latest inflation data from the Bureau of Labor Statistics. For more information see *Tax Foundation Fiscal Fact*, No. 245.

For other Tax Foundation material on tax cut expiration, see:

- The MyTaxBurden.org calculator that allows users to calculate how their own 2011 tax bills would vary depending upon what policies end up being enacted;
- A detailed table showing how various policy scenarios would affect tax parameters like the standard deduction, child tax credit, tax brackets, exemption levels, etc.; and
- A Frequently Asked Questions page that answers many of the important questions relating to the expiring tax cuts.

Table 1
Summary of Taxes Owed (+ or –) on Typical Tax Returns
2011

	Full Expiration	Republican Plan	Democratic Plan
Single Parent, One child, $25,000	–$901	–$1,856	–$1,856
Married couple, three children, $45,000	$1,028	–$1,510	–$1,713
Married couple, two children, $50,000	$2,833	$690	$690
Married couple, two children, $85,000	$7,235	$5,385	$5,385
Single, no children, $60,000	$8,255	$7,500	$7,500
Single, no children, $150,000 w/ investment income	$28,340	$25,071	$25,071
Married couple, two children, $150,000 w/ investment income	$21,602	$17,800	$17,800
Married couple, two children, $300,000	$76,616	$64,971	$68,392
Married couple, no children, $420,000 w/ investment income	$106,815	$95,554	$98,591
Married couple, no children, $1,000,000 w/ investment income	$293,106	$231,900	$260,871
Retired couple, $60,000 w/ investment income	$3,444	$768	$768

Table 2
Summary of Effective Tax Rates (Taxes as a Percentage of Income) Paid on Typical Tax Returns
2011

	Full Expiration	Republican Plan	Democratic Plan
Single Parent, One child, $25,000	–3.6%	–7.4%	–7.4%
Married couple, three children, $45,000	2.3%	–3.4%	–3.8%
Married couple, two children, $50,000	5.7%	1.4%	1.4%
Married couple, two children, $85,000	8.5%	6.3%	6.3%
Single, no children, $60,000	13.8%	12.5%	12.5%
Single, no children, $150,000 w/ investment income	18.9%	16.7%	16.7%
Married couple, two children, $150,000 w/ investment income	14.4%	11.9%	11.9%
Married couple, two children, $300,000	25.5%	21.7%	22.8%
Married couple, no children, $420,000 w/ investment income	25.4%	22.8%	23.5%
Married couple, no children, $1,000,000 w/ investment income	29.3%	23.2%	26.1%
Retired couple, $60,000 w/ investment income	5.7%	1.3%	1.3%

Table 3
Typical Tax Return: Single Parent, Low Income
2011

Filing Status	=	Head of Household
Children	=	1
Income	=	$25,000

		Full Expiration	Republican Plan	Democratic Plan
Standard deduction	−	$8,500	$8,500	$8,500
Personal exemptions	−	$7,400	$7,400	$7,400
Taxable income	=	$9,100	$9,100	$9,100
Tax on taxable income		$1,365	$910	$910
Child credit (non-refundable portion)	−	$500	$910	$910
Earned income tax credit	−	$1,766	$1,766	$1,766
Additional child tax credit	−	$0	$90	$90
Tax liability	=	–$901	–$1,856	–$1,856

Table 4
Typical Tax Return: Family of 5, Two Earners, Low Income
2011

Filing Status	=	Joint		
Children	=	3		
Income	=	$45,000		
		Full Expiration	Republican Plan	Democratic Plan
Standard deduction	–	$9,650	$11,600	$11,600
Personal exemptions	–	$18,500	$18,500	$18,500
Taxable income	=	$16,850	$14,900	$14,900
Tax on taxable income	=	$2,528	$1,490	$1,490
Child credit (non-refundable portion)	–	$1,500	$1,490	$1,490
Earned income tax credit	–	$0	$0	$203
Additional child tax credit	–	$0	$1,510	$1,510
Tax liability	=	$1,028	–$1,510	–$1,713

Table 5
Typical Tax Return: Family of 4, One Earner, Low-Middle Income
2011

Filing Status	=	Joint		
Children	=	2		
Income	=	$50,000		
		Full Expiration	Republican Plan	Democratic Plan
Standard deduction	–	$9,650	$11,600	$11,600
Personal exemptions	–	$14,800	$14,800	$14,800
Taxable income	=	$25,550	$23,600	$23,600
Tax on taxable income		$3,833	$2,690	$2,690
Child credit (non-refundable portion)	–	$1,000	$2,000	$2,000
EITC	–	$0	$0	$0
Additional child tax credit	–	$0	$0	$0
Tax liability	=	$2,833	$690	$690

Table 6
Typical Tax Return: Family of 4, Two Earners, Middle Income
2011

Filing Status	=	Joint		
Children	=	2		
Income	=	$85,000		
		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$15,300	$15,300	$15,300
Personal exemptions	–	$14,800	$14,800	$14,800
Taxable income	=	$54,900	$54,900	$54,900
Tax on taxable income		$8,235	$7,385	$7,385
Child credit (non-refundable portion)	–	$1,000	$2,000	$2,000
Earned income tax credit	–	$0	$0	$0
Additional child tax credit	–	$0	$0	$0
Tax liability	=	$7,235	$5,385	$5,385

Table 7
Typical Tax Return: Single Individual, Above-Average Income
2011

Filing Status	=	Single		
Children	=	0		
Income	=	$60,000		
		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$10,800	$10,800	$10,800
Personal exemptions	–	$3,700	$3,700	$3,700
Taxable income	=	$45,500	$45,500	$45,500
Tax on taxable income		$8,255	$7,500	$7,500
Tax liability	=	$8,255	$7,500	$7,500

Table 8
Typical Tax Return: Single Individual, High Income
2011

Filing Status	=	Single		
Children	=	0		
Income	=	$150,000 ($135,000 in wages, $15,000 in long-term capital gains)		
		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$27,000	$27,000	$27,000
Personal exemptions	–	$3,700	$3,700	$3,700
Taxable income	=	$119,300	$119,300	$119,300
Tax on taxable income		$28,340	$25,071	$25,071
Tax liability	=	$28,340	$25,071	$25,071

Table 9
Typical Tax Return: Family of 4, Two Earners, Upper-Middle Income
2011

Filing Status	=	Joint		
Children	=	2		
Income	=	$150,000 ($135,000 in wages, $15,000 in long-term capital gains)		
		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$27,000	$27,000	$27,000
Personal exemptions	–	$14,800	$14,800	$14,800
Taxable income	=	$108,200	$108,200	$108,200
Tax on taxable income		$21,602	$17,800	$17,800
Alternative minimum tax	+	$0	$0	$0
Child credit (non-refundable portion)	–	$0	$0	$0
Tax liability	=	$21,602	$17,800	$17,800

Table 10 Typical Tax Return: Family of Four, High Income 2011				
Filing Status	=	Joint		
Children	=	2		
Income	=	$300,000 (Itemized deductions: $20,000 in mortgage interest)		
		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$16,087	$20,000	$18,625
Personal exemptions (b)	–	$9,176	$14,800	$9,176
Taxable income	=	$274,738	$265,200	$272,200
Tax on taxable income		$76,616	$64,971	$68,392
Alternative minimum tax	+	$0	$0	$0
Tax liability	=	$76,616	$64,971	$68,392

Table 11 Typical Tax Return: Married Couple, Two Earners, High Income 2011				
Filing Status	=	Joint		
Children	=	0		
Income	=	$420,000 ($400,000 in wages, $20,000 in long-term capital gains; Itemized deductions: $20,000 state and local taxes, $20,000 mortgage interest, $20,000 charitable contributions)		
		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$52,487	$60,000	55,025
Personal exemptions (b)	–	$0	$7,400	$0
Taxable income	=	$367,514	$352,600	364,976
Tax on taxable income		$106,815	$90,213	98,591
Alternative minimum tax	+	$0	$5,342	$0
Tax liability	=	$106,815	$95,554	$98,591

Table 12
Typical Tax Return: Married Couple, Two Earners, Very High Income
2011

Filing Status	=	Joint
Children	=	0
Income	=	$1,000,000 ($700,000 in wages, $200,000 in long-term capital gains, $100,000 in qualified dividends; Itemized deductions: $75,000 state and local income taxes, $20,000 mortgage interest)

		Full Expiration	Republican Plan	Democratic Plan
Itemized deductions (a)	–	$70,087	$95,000	$72,625
Personal exemptions (b)	–	$0	$7,400	$0
Taxable income	=	$929,914	$897,600	$927,376
Tax on taxable income		$293,106	$224,032	$260,871
Alternative minimum tax	+	$0	$7,869	$0
Tax liability	=	$293,106	$231,900	$260,871

Table 13
Typical Tax Return: Retired Couple With Retirement Income, Wages, and Investment Income
2011

Filing Status	=	Joint
Children	=	0
Income	=	$60,000 ($10,000 in wages, $5,000 in long-term capital gains, $10,000 in qualified dividends, $25,000 in Social Security benefits, $10,000 in 401(k) distributions)

		Full Expiration	Republican Plan	Democratic Plan
Standard deduction (c)	–	$11,950	$13,900	$13,900
Personal exemptions	–	$7,400	$7,400	$7,400
Taxable income	=	$24,625	$22,675	$22,675
Tax on taxable income		$3,444	$768	$768
Tax liability	=	$3,444	$768	$768

Notes

(a) Unless otherwise noted, the taxpayer is assumed to take the standard deduction until his income increases to the point where 18 percent of his income exceeds the standard deduction. Above that threshold, all taxpayers are assumed to be itemizers. Itemized deductions are split evenly between the deduction for state and local taxes paid and the mortgage interest deduction. The phase-out of itemized deductions for high-income filers, the so-called Pease provision, is in full effect under the Full Expiration scenario and under the Democratic proposal, although the Democratic proposal increases the income thresholds where Pease begins to take effect from

$169,550 (single and married) to $203,300 (single)/$254,150 (MFJ). As part of the 2001/2003 tax cuts, President Bush ultimately eliminated the Pease provision for 2010, allowing high-income taxpayers to deduct the full value of their itemized deductions. The Republican proposal would continue to allow all taxpayers to deduct the full value of their itemized deductions. The amounts listed for itemized deductions represent itemized deductions after any applicable limitation under Pease.

(b) The personal exemption phase-out (PEP) for high-income filers is in full effect under the Full Expiration scenario and under the Democratic proposal, although the Democratic proposal changes the income thresholds where the personal exemptions begin to phase out from $169,550 (single)/$254,350 (MFJ) to $203,300 (single)/$254,150 (MFJ). President Bush temporarily eliminated the PEP provision, allowing high-income taxpayers to deduct the full value of their personal exemptions. The Republican proposal would continue to allow all taxpayers to deduct the full value of their personal exemptions.

(c) Includes additional standard deduction for taxpayers over age 65.

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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.