



# Fiscal Fact

September 15, 2011

No. 282

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## Tax Foundation Projects 2012 Tax Parameters Following Release of August CPI Data

*By*

*Nick Kasprak and Mark Robyn*

### Summary

The Bureau of Labor Statistics (BLS) recently released its August 2011 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 2012 and for 2012 tax forms to be filed in early 2013.

Last year's projection of this year's tax brackets was complicated by the uncertainty over the potential expiration of the Bush tax cuts, and the need to predict the bracket thresholds for a number of possible scenarios. Fortunately, this year's projection is comparatively simple: last year's tax compromise extended the Bush tax cuts for two years, so there is no doubt they'll be in effect during the next tax year. Therefore, the Tax Foundation can project next year's parameters with a high degree of certainty.<sup>1</sup>

### Inflation Is Average

Inflation over the past twelve months (September 1, 2010 through August 31, 2011) averaged 2.43 percent, which is slightly under the historical average since 1992, but significantly higher than the previous 12-month average of 1.48 percent. Table 1 shows the year-over-year inflation rates since 1992 for the statistics that are used to calculate tax parameters.

Even though taxpayers will not start filing their 2012 tax returns until January 2013, tax year 2012 parameters are needed in advance of 2012 so that the IRS can produce instructions for 2012 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.

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*Nick Kasprak is an analyst and programmer, and Mark Robyn an economist, at the Tax Foundation.*

<sup>1</sup> Technically, the August 2011 CPI number may be revised on October by BLS, but such revisions are rarely large enough to significantly change tax parameters.

**Table 1**  
**Year-over-Year Change in Monthly CPI-U Average**  
**September – August**

<b>Tax Year</b>	<b>Inflation Rate</b>	<b>Calculation Based on Avg. Monthly CPI for:</b>
<b>2012</b>	2.43%	Sept. 2010 through Aug. 2011 divided by Sept. 2009 through Aug. 2010
<b>2011</b>	1.48%	Sept. 2009 through Aug. 2010 divided by Sept. 2008 through Aug. 2009
<b>2010</b>	0.19%	Sept. 2008 through Aug. 2009 divided by Sept. 2007 through Aug. 2008
<b>2009</b>	4.26%	Sept. 2007 through Aug. 2008 divided by Sept. 2006 through Aug. 2007
<b>2008</b>	2.29%	Sept. 2006 through Aug. 2007 divided by Sept. 2005 through Aug. 2006
<b>2007</b>	3.90%	Sept. 2005 through Aug. 2006 divided by Sept. 2004 through Aug. 2005
<b>2006</b>	3.11%	Sept. 2004 through Aug. 2005 divided by Sept. 2003 through Aug. 2004
<b>2005</b>	2.30%	Sept. 2003 through Aug. 2004 divided by Sept. 2002 through Aug. 2003
<b>2004</b>	2.28%	Sept. 2002 through Aug. 2003 divided by Sept. 2001 through Aug. 2002
<b>2003</b>	1.59%	Sept. 2001 through Aug. 2002 divided by Sept. 2000 through Aug. 2001
<b>2002</b>	3.29%	Sept. 2000 through Aug. 2001 divided by Sept. 1999 through Aug. 2000
<b>2001</b>	3.11%	Sept. 1999 through Aug. 2000 divided by Sept. 1998 through Aug. 1999
<b>2000</b>	1.82%	Sept. 1998 through Aug. 1999 divided by Sept. 1997 through Aug. 1998
<b>1999</b>	1.69%	Sept. 1997 through Aug. 1998 divided by Sept. 1996 through Aug. 1997
<b>1998</b>	2.74%	Sept. 1996 through Aug. 1997 divided by Sept. 1995 through Aug. 1996
<b>1997</b>	2.76%	Sept. 1995 through Aug. 1996 divided by Sept. 1994 through Aug. 1995
<b>1996</b>	2.84%	Sept. 1994 through Aug. 1995 divided by Sept. 1993 through Aug. 1994
<b>1995</b>	2.60%	Sept. 1993 through Aug. 1994 divided by Sept. 1992 through Aug. 1993
<b>1994</b>	3.06%	Sept. 1992 through Aug. 1993 divided by Sept. 1991 through Aug. 1992
<b>1993</b>	3.05%	Sept. 1991 through Aug. 1992 divided by Sept. 1990 through Aug. 1991
<b>1992</b>	5.28%	Sept. 1990 through Aug. 1991 divided by 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.

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 2012 tax parameters will be based on the average monthly CPI-U from September 2010 through August 2011 (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 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 parameter.

For example the CPI-U index for the purposes of calculating the 2012 tax parameters is 222.4325 (Sept. 2010 – Aug. 2011). The reference year for the personal exemption is 1989, a year in which the same statistic (based on Sept. 1987 – Aug. 1988) was 116.617. The amount of the personal exemption in 1989 was \$2,000. Therefore, the personal exemption amount in 2012 equals \$2,000 times the ratio of 222.4325 to 116.617, or \$3,814. Rounding down the \$3,814 figure to the nearest \$50 yields a personal exemption amount for 2012 of \$3,800.

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, since 2001, to annually enact an AMT "patch," a colloquial term for a temporary rise in the exemption level. Congress has not passed an AMT patch for 2012, and the exemption level is typically set such that the same percentage of taxpayers are subject to the AMT each year, rather than tied to inflation.

**Table 2**  
**Key Tax Parameter Amounts for 2012**

Tax Parameter	2011 Amount	2012 Amount	Tax Parameter	2011 Amount	2012 Amount
<b>Standard Deduction</b>					
For singles	\$5,800	\$5,950			
For married filing jointly	\$11,600	\$11,900			
For heads of households	\$8,500	\$8,700			
For married filing separately	\$5,800	\$5,950			
<b>Personal Exemption</b>	<b>\$3,700</b>	<b>\$3,800</b>			
<b>Tax Bracket Thresholds for Single Filers</b>			<b>Tax Bracket Thresholds for Married Filing Jointly</b>		
10% rate	\$0	\$0	10% rate	\$0	\$0
15% rate	\$8,500	\$8,700	15% rate	\$17,000	\$17,400
25% rate	\$34,500	\$35,350	25% rate	\$69,000	\$70,700
28% rate	\$83,600	\$85,650	28% rate	\$139,350	\$142,700
33% rate	\$174,400	\$178,650	33% rate	\$212,300	\$217,450
35% rate	\$379,150	\$388,350	35% rate	\$379,150	\$388,350
<b>Tax Bracket Thresholds for Heads of Households</b>			<b>Tax Bracket Thresholds for Married Filing Separately</b>		
10% rate	\$0	\$0	10% rate	\$0	\$0
15% rate	\$12,150	\$12,400	15% rate	\$8,500	\$8,700
25% rate	\$46,250	\$47,350	25% rate	\$34,500	\$35,350
28% rate	\$119,40	\$122,300	28% rate	\$69,675	\$71,350
33% rate	\$193,35	\$198,050	33% rate	\$106,150	\$108,725
35% rate	\$379,15	\$388,350	35% rate	\$189,575	\$194,175

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](http://www.TaxFoundation.org)

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