

Fiscal Fact

Next Year's Tax Brackets

By

Nick Kasprak

Introduction

The Bureau of Labor Statistics recently released its August 2012 consumer price index (CPI) figure. This number is typically the final piece of information needed to determine next year's tax brackets, which are adjusted for inflation based on CPI figures from September to August of the previous year. Given that the CPI-U (consumer price index for all urban consumers) average for the previous twelve months is 2.57% higher than the previous year, we can expect tax year 2013's parameters to be roughly 2.57% higher than 2012's.¹

Even though taxpayers will not start filing their 2013 tax returns until January 2014, tax year 2013 parameters are needed in advance of 2013 so that the IRS can produce instructions for 2013 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.

Projecting 2013's brackets is more complicated than usual given the uncertainty surrounding the potential expiration of the Bush tax cuts (originally enacted in 2001 and 2003) and some more recent stimulus bill tax cuts (originally passed in 2009), but since tax parameters are adjusted for inflation in more or less the same way, the Tax Foundation can project next year's parameters under a variety of scenarios with a high degree of certainty.

Brackets and Rates

Unless Congress acts, the marriage penalty relief, new 10% bracket, and marginal rate reductions enacted in 2001 and 2003 will expire at the end of the year. If that were to happen, next year's brackets would look like this:

¹ See Table A1 in the appendix.

Table 1. 2013 Taxable Income Brackets and Rates Under Full Expiration of Bush Tax Cuts

Rate	Single Filers	Married Joint Filers	Head of Household Filers
15%	\$0 to \$36,250	\$0 to \$60,550	\$0 to \$48,600
28%	\$36,250 to \$87,850	\$60,550 to \$146,400	\$48,600 to \$125,450
31%	\$87,850 to \$183,250	\$146,400 to \$223,050	\$125,450 to \$203,150
36%	\$183,250 to \$398,350	\$223,050 to \$398,350	\$203,150 to \$398,350
39.6%	\$398,350+	\$398,350+	\$398,350+

However, Republicans in Congress have proposed to extend the Bush tax cuts into 2013 in H.R. 8, the Job Protection and Recession Prevention Act of 2012.² If this bill were to become law, 2013's tax brackets would be roughly 2.57% higher than 2012's but otherwise the same:

Table 2. 2013 Taxable Income Brackets and Rates Under H.R. 8

Rate	Single Filers	Married Joint Filers	Head of Household Filers
10%	\$0 to \$8,950	\$0 to \$17,900	\$0 to \$12,750
15%	\$8,950 to \$36,250	\$17,900 to \$72,500	\$12,750 to \$48,600
25%	\$36,250 to \$87,850	\$72,500 to \$146,400	\$48,600 to \$125,450
28%	\$87,850 to \$183,250	\$146,400 to \$223,050	\$125,450 to \$203,150
33%	\$183,250 to \$398,350	\$223,050 to \$398,350	\$203,150 to \$398,350
35%	\$398,350+	\$398,350+	\$398,350+

Another possibility is that President Obama's 2013 budget is passed, which would allow the Bush tax cuts to expire only for upper-income taxpayers:

Table 3. 2013 Taxable Income Brackets and Rates Under President Obama's 2013 Budget

Rate	Single Filers	Married Joint Filers	Head of Household Filers
10%	\$0 to \$8,950	\$0 to \$17,900	\$0 to \$12,750
15%	\$8,950 to \$36,250	\$17,900 to \$72,500	\$12,750 to \$48,600
25%	\$36,250 to \$87,850	\$72,500 to \$146,400	\$48,600 to \$125,450
28%	\$87,850 to \$183,250	\$146,400 to \$223,050	\$125,450 to \$203,150
33%	\$183,250 to \$203,600	\$223,050 to \$247,000	\$203,150 to \$227,300
36%	\$203,600 to \$398,350	\$247,000 to \$398,350	\$227,300 to \$398,350
39.6%	\$398,350+	\$398,350+	\$398,350+

Standard Deduction and Personal Exemption

This year, the personal exemption is \$3,800. Next year it will rise to \$3,900 regardless of what happens with the Bush tax cuts.

The standard deduction for single filers is currently \$5,950, and it will rise to \$6,100 next year regardless of what happens with the Bush tax cuts. For married filers, it's currently \$11,900, and next year it will be \$12,200 if the Bush tax cuts are extended and \$10,150 if they aren't.

² Job Protection and Recession Prevention Act of 2012, H.R. 8, 112th Cong. (2012), <http://thomas.loc.gov/cgi-bin/bdquery/z?d112:h.r.8:>

Earned Income Tax Credit

A variety of different things could happen with the EITC. This refundable credit for lower income working people was expanded both by the Bush tax cuts (by increasing the length of the “plateau” for married filers) as well as the 2009 stimulus bill (which added a new category for three or more children and increased the married “plateau” even further). H.R. 8 would extend only the Bush tax cuts expansion, whereas the Obama budget extends the stimulus bill expansions as well.

Table 4. 2013 EITC Parameters Under Multiple Scenarios

		Full Expiration		H.R. 8 (Republican Bill)		Obama Budget	
		Married Filing Jointly	Other	Married Filing Jointly	Other	Married Filing Jointly	Other
No Children	Credit Rate	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
	Phase-out Rate	7.65%	7.65%	7.65%	7.65%	7.65%	7.65%
	Plateau Starts At	\$6,370	\$6,370	\$6,370	\$6,370	\$6,370	\$6,370
	Maximum Credit	\$487	\$487	\$487	\$487	\$487	\$487
	Phase-Out Starts At	\$7,970	\$7,970	\$11,390	\$7,970	\$13,310	\$7,970
	Phase-Out Ends At	\$14,340	\$14,340	\$17,760	\$14,340	\$19,680	\$14,340
One Child	Credit Rate	34%	34%	34%	34%	34%	34%
	Phase-out Rate	15.98%	15.98%	15.98%	15.98%	15.98%	15.98%
	Plateau Starts At	\$9,560	\$9,560	\$9,560	\$9,560	\$9,560	\$9,560
	Maximum Credit	\$3,250	\$3,250	\$3,250	\$3,250	\$3,250	\$3,250
	Phase-Out Starts At	\$17,530	\$17,530	\$20,950	\$17,530	\$22,870	\$17,530
	Phase-Out Ends At	\$37,870	\$37,870	\$41,290	\$37,870	\$43,210	\$37,870
Two Children	Credit Rate	40%	40%	40%	40%	40%	40%
	Phase-out Rate	21.06%	21.06%	21.06%	21.06%	21.06%	21.06%
	Plateau Starts At	\$13,430	\$13,430	\$13,430	\$13,430	\$13,430	\$13,430
	Maximum Credit	\$5,372	\$5,372	\$5,372	\$5,372	\$5,372	\$5,372
	Phase-Out Starts At	\$17,530	\$17,530	\$20,950	\$17,530	\$22,870	\$17,530
	Phase-Out Ends At	\$43,038	\$43,038	\$46,458	\$43,038	\$48,378	\$43,038
Three or More Children	Credit Rate					45%	45%
	Phase-out Rate					21.06%	21.06%
	Plateau Starts At					\$13,430	\$13,430
	Maximum Credit	Same as credit for 2 or more children.				\$6,044	\$6,044
	Phase-Out Starts At					\$22,870	\$17,530
	Phase-Out Ends At					\$51,567	\$46,227

PEP and Pease

PEP and Pease are two provisions that phase out tax benefits for upper income taxpayers—PEP (Personal Exemption Phase-out) reduces the value of personal exemptions for high income taxpayers, and Pease (named for former Senator Donald Pease) reduces the value of itemized deductions. Both PEP and Pease were themselves phased out by the Bush tax cuts and fully disappeared in 2010; their absence from the tax code was continued through 2012 by the two-year extension of the Bush tax cuts in December 2010. If the Bush tax cuts expire, both provisions would return next year. Obama’s 2013 budget also proposes their reinstatement but changes the income thresholds they would apply to.

Filing Status	Tax Cuts Expire	H.R. 8 (Republican Proposal)	Obama Budget
Single	\$178,150	-	\$213,600
Married	\$267,200	-	\$267,000
Head of Household	\$222,700	-	\$213,600

Filing Status	Tax Cuts Expire	H.R. 8 (Republican Proposal)	Obama Budget
Single	\$178,150	-	\$213,600
Married	\$178,150	-	\$267,000
Head of Household	\$178,150	-	\$213,600

Alternative Minimum Tax

The AMT is not indexed for inflation and must be “patched” from time to time by Congress. Currently, no patch is in place for 2012 (let alone 2013) though Congress will likely pass a retroactive patch at the end of the year before the IRS finalizes 2012 tax forms. Usually, the only AMT parameter that is patched each year is the exemption level; the boundary between the 26% and 28% brackets (\$175,000) and the exemption phase-out thresholds (\$112,500 for single filers, \$150,000 for married filers) have remained constant for some time. H.R. 8 would set the AMT exemption at \$50,600 for single filers and \$79,850 for married filers; Alternatively, President Obama’s budget would permanently index the AMT for inflation using 2011 as a base year. Under this proposal the 2013 exemption would be \$48,450 for single filers and \$74,450 for married filers.

If the AMT is not patched at all, the exemptions would revert to year 2000 levels: \$33,750 for single filers and \$45,000 for married filers.

Appendix

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 (usually down) to the nearest \$50 (or sometimes \$10, depending on the parameter).

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 2013 tax parameters will be based on the average monthly CPI-U from September 2011 through August 2012 (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.

Table A1: Monthly CPI-U For the Previous Two Years

Tax Year 2012 Adjustment			Tax Year 2013 Adjustment		
Year	Month	CPI-U	Year	Month	CPI-U
2010	September	218.439	2011	September	226.889
	October	218.711		October	226.421
	November	218.803		November	226.23
	December	219.179		December	225.672
2011	January	220.223	2012	January	226.665
	February	221.309		February	227.663
	March	223.467		March	229.392
	April	224.906		April	230.085
	May	225.964		May	229.815
	June	225.722		June	229.478
	July	225.922		July	229.104
	August	226.545		August	230.379
Average		222.433	Average		228.149

For example, the CPI-U index for the purposes of calculating the 2013 tax parameters is 228.149 (Sept. 2011-Aug. 2012). 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 228.149 to 116.617, or \$3,913. Rounding down the \$3,913 figure to the nearest \$50 yields a personal exemption amount for 2012 of \$3,900.