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Federal Income Tax Thresholds for Selected Years: 1996 Through 2006

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Summary

One principle of tax fairness or equity accepted by many is that households at the low end of the income spectrum, especially those near the poverty threshold, should not be subject to the federal income tax. Federal income tax thresholds are high enough that, with the exception of single taxpayers, the equity principle of exempting poverty level households from income taxation has been achieved over time. The introduction and subsequent increase in the child tax credit, however, have significantly increased the income tax thresholds for households with children. For households with children, the income tax thresholds are now substantially higher than the comparable poverty thresholds. In fact, the child tax credit represents a departure from past policy practices because it is not designed primarily as a means of differentiating between families of different size at or near the poverty threshold, but rather is designed to provide general tax reductions to middle and upper income taxpayers with dependent children under the age of 17.

The recent increases in the child tax credit are scheduled to sunset (expire) in 2011. As a result, it is likely that Congress will revisit the issue of the child tax credit because, absent legislative action, the credit will decline from its current law level of $1,000 to $500 in 2011.

This report will be updated as new data become available or as events warrant.

The major structural components of the income tax code which influence the income levels at which households become subject to federal income tax include the standard deduction, the personal exemption, the child tax credit, and the earned income tax credit (EITC). Each of these items increases the income level at which an individual or family incurs an out-of-pocket federal income tax liability.[1]

[1] The child and dependent care tax credit might also influence a household's federal income tax threshold, but it is not addressed in this report because it is not widely used by households at the lowest end of the income spectrum.

For instance, consider the case of a married couple with one dependent child under the age of 17. In 2006, the standard deduction for a married couple filing a joint return will be $10,300, each personal exemption will be worth $3,300, and the child tax credit will be $1,000. This family would reach the basic income tax threshold (the point at which they have an actual out-of-pocket tax payment) for their filing status and family size at an income level of $20,200 (standard deduction of $10,300 plus three personal exemptions of $3,300 each). Income under this amount would not be subject to tax while any income over this amount would be taxed.

Although income over $20,200 would be subject to tax, the child tax credit would offset the first $1,000 of this couple's income tax liability. At this taxable income level the marginal tax rate is 10%. That means that tax on income up to $30,200 would be offset by the $1,000 child tax credit.

At this point, the EITC would come into play. The maximum EITC for 2006 for families with one child will be $2,747. The maximum credit will be phased out for families filing joint returns with incomes above $16,810, and will be reduced to zero for families whose incomes exceeded $34,001. The income tax threshold for the family in this example will be the point at which the EITC is just enough to offset any pre-EITC income tax liability, so that the net tax liability of the family is zero. In the case of a couple with one dependent child filing a joint return the income level, in 2006, will be $32,537. At this income level, the family's pre-EITC (and post child tax credit) income tax liability would be $233 and the family's EITC would also be $233. The two would offset each other, and the family would not have any net income tax liability.

The federal income tax thresholds for singles, joint returns, and head of households for selected years between 1996 and 2006 are shown in Table 1. (The derivation of these values is detailed in the appendix.)

The data in Table 1 show that the biggest increases in income tax thresholds, in both dollar and percentage terms, over the 1996 to 2006 period occurred for households who had dependent children under the age of 17. For example, married couples with children experienced increases in their income tax thresholds ranging from 64% for married couples with one child to140% for married couples with four children. The increase in the income tax thresholds for head of households between 1996 and 2006 ranged from 55% for households with one child to123% for households with four children.

The increases in income tax thresholds for single individuals and married couples without children were more moderate than those experienced by households with children. Tax thresholds for single individuals only increased by 33% between 1996 and 2006, while tax thresholds for married couples with no children increased by 43%.

Income tax thresholds change over time because of two factors. First, they change because of the annual inflation adjustments to personal exemptions, standard deductions, tax rate brackets, and the EITC. Second, they change because of legislative changes to the tax system.

Table 1. Federal Income Tax Thresholds: 1996 to 2006

	1996	2000	2002	2004	2005	2006
Single Individuals						
Eligible for EITC	$7,547	$8,276	$9,156	$9,484	$9,739	$10,045
Not eligible for EITC	$6,550	$7,200	$7,700	$7,950	$8,200	$8,450
Married Couples						
No Children	$11,800	$12,950	$13,850	$15,900	$16,400	$16,900
One Child	$19,883	$23,380	$27,370	$30,435	$31,709	$32,537
Two Children	$23,672	$28,683	$33,210	$40,200	$41,000	$41,867
Three Children	$24,732	$31,350	$38,850	$49,967	$50,866	$51,833
Four Children	$25,793	$37,483	$45,850	$59,733	$60,733	$61,800
Head of Households						
One Child	$18,260	$21,589	$24,857	$26,988	$27,553	$28,321
Two Children	$22,277	$27,143	$30,704	$33,939	$34,620	$35,524
Three Children	$23,336	$29,695	$34,233	$42,953	$43,587	$44,333
Four Children	$24,400	$33,783	$41,233	$52,713	$53,453	$54,300

Calculations by CRS. Assumes all children qualify for the child tax credit.

The relatively large changes in the tax thresholds for households with children can be traced to three main legislative changes that occurred over the 1996 to 2006 time period. These changes included establishment and subsequent increases in the child tax credit, an increase in the size of the standard deduction for joint returns, and an increase in the width of the 15% tax bracket for joint returns.[2]

The Taxpayer Relief Act of 1997 established the child tax credit. Initially, the credit was set at $500 for each qualifying child under the age of 17. Additional legislative changes under the Economic Tax Relief and Reconciliation Act of 2001 increased the child tax credit to $1,000. The 2001 Act also increased the width of the 15% tax bracket and increased the standard deduction for joint returns. Although these changes were originally scheduled to be phased in over a number of years, subsequent legislation in 2003 and 2004 accelerated implementation and made these provisions effective in full through 2010.

The end result of these legislative actions has been a significant increase in the income tax thresholds for households with children. Economic theory does not provide

[2] For more information on the child tax credit see: CRS Report RS21860, *The Child Tax Credit*, by Gregg Esenwein.

an answer to the question of how the costs of child rearing should be accounted for under an income tax. However, one principle of tax fairness or equity accepted by many is that households at the low end of the income spectrum, especially those near the poverty threshold, should not be subject to the federal income tax. It has been argued that given the precarious financial position of these households, they should not be compelled to pay federal income tax, an action that would further reduce their level of subsistence.

The Tax Reform Act of 1986 explicitly cited this principle of eliminating income tax burdens for families with incomes near the poverty level as the reason for increasing the dollar amounts of standard deductions and personal exemptions. This act increased the value of personal exemptions and raised the standard deductions for joint returns and head of households such that, in combination with the EITC, the income tax thresholds for these taxpayers would be above their respective poverty thresholds.

Given this principle, one can compare income tax thresholds to poverty thresholds to see if this equity goal has been achieved over time. Table 2 shows the 1996 and 2004 poverty thresholds for singles and households with children.[3]

Comparisons of the data in these two tables reveals several trends. First, the income tax threshold for single individuals was below their respective poverty threshold in both 1996 and 2004.[4]

On the other hand, the tax threshold for married couples without children exceeded their respective poverty thresholds in both 1996 and 2004. In addition, the amount by which their tax threshold exceeded their poverty threshold increased over the period. In 1996, the tax threshold for married couples without children exceeded their poverty threshold by about 12%, but by 2004 the difference had increased to 33%.

A more significant trend, however, occurred for families with children. In 1996, the federal income tax thresholds for families with children exceeded their respective poverty thresholds by relatively comfortable margins. By 2004, these margins had increased substantially, especially for larger families. For example, in 1996, the income tax threshold for a married couple with four children was $25,763, while the poverty threshold for this same size/type family was $20,965. So the tax threshold was about 23% higher than the poverty threshold. By 2004, the income tax threshold for this family had increased to $61,800, while the poverty threshold had only increased to $25,241. In this instance, the income tax threshold increased to 145% of the poverty threshold. The income tax thresholds for head of households show similarly large increases relative to their corresponding poverty levels.

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[3] 2004 represents the most recent poverty threshold data available.

[4] The 1986 act explicitly excluded single individuals from the goal of establishing tax thresholds in excess of their respective poverty thresholds. Two reasons were given for excluding singles. First, increasing the standard deduction for singles would have introduced larger marriage tax penalties into the tax system. Second, it was felt that the income level of singles did not represent a good measure of whether or not the living conditions of these taxpayers was impoverished. For more information see: Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, May 1987, p. 16.

Table 2. Poverty Thresholds: 1996 and 2004

	1996	2004
Single Individual	$8,163	$9,827
Two Adults		
-No children	$10,564	$12,649
-One child	$12,629	$15,205
-Two children	$15,911	$19,157
-Three children	$18,725	$22,543
-Four children	$20,965	$25,241
One Adult		
-One child	$10,815	$13,020
-Two children	$12,641	$15,219
-Three children	$15,967	$19,223
-Four children	$18,438	$22,199

Source: U.S. Census Bureau.

As these tables demonstrate, with the exception of single taxpayers, the equity principle of exempting poverty level households from income taxation has been achieved over time. In addition, however, there have been significant increases in the tax thresholds for households with children. These changes in the relationship between income tax and poverty thresholds for households with children can be attributed primarily to the introduction and subsequent increases in the child tax credit. In fact, the child tax credit represents a departure from past policy practices because it is not designed primarily as a means of differentiating between families of different size at or near the poverty threshold, but rather is designed to provide general tax reductions to middle and upper income taxpayers with dependent children under the age of 17.

The recent increases in the child tax credit are scheduled to sunset (expire) in 2011. As a result, it is likely that Congress will revisit the issue of the child tax credit because, absent legislative action, the credit will decline from its current law level of $1,000 to $500 in 2011.

APPENDIX
Derivation of Federal Tax Thresholds

(1) FT = PT - CT - EITC

Where:

FT	=	Final tax liability
PT	=	Pre-tax credit tax liability
CT	=	Child tax credit
EITC	=	Earned income tax credit

(2) PT = B + t(Y - SD - PE - LB)

Where:

B	=	Base tax amount
t	=	Marginal tax rate
Y	=	Income
SD	=	Standard deduction
PE	=	Personal exemptions
LB	=	Marginal tax bracket lower income limit

(3) CT =NC * CA

Where:

NC	=	Number of qualifying children
CA	=	Child credit amount

(4) EITC = MC - r(Y- Th)

Where:

MC	=	Maximum credit amount
r	=	Credit phase-out rate
TH	=	Credit phase-out threshold

Combining equations 1, 2, 3, and 4 yields:

(5) FT = (B + t(Y - SD - PE - LB)) - (QC * CA) - (MC - r(Y - TH))

Setting FT to zero and solving for Y yields:

(6) Yth = (tSD + tPE + tLB - B + QC * CA + MC + rTH) / (t +r)

Where:

Yth	=	Federal income tax threshold