FEDERAL TAX TREATMENT OF INDIVIDUALS

Scheduled for a Public Hearing
Before the
SENATE COMMITTEE ON FINANCE
on September 14, 2011

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

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INTRODUCTION AND SUMMARY

The Committee on Finance has scheduled a public hearing on September 14, 2011, entitled "Reform Options: Marginal Rates on High Income Taxpayers, Capital Gains and Dividends." This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary of the present law Federal income and employment tax rules applicable to individuals and a discussion of relevant background economic data**.**

I. Present Law

A. Individual income tax

- The income tax is imposed on individual citizens and residents of the United States.
- It applies to gross income "from whatever source derived" with many adjustments (exclusions, exemptions, deductions, credits, etc.).
- Adjusted gross income ("AGI") is determined by subtracting certain "above-the-line" deductions from gross income.
- Taxable income is determined by subtracting either the applicable standard deduction or itemized deductions (at the election of the taxpayer) and personal exemptions from AGI.
- Standard deduction is determined by the taxpayer's filing status. Personal exemption amounts and standard deduction amounts are adjusted for inflation annually.
- Statutory rates are also determined by taxpayer's filing status.
- Special lower rates may apply to capital gains and dividends.
- Tax credits may apply to reduce individual income tax liability.
- The alternative minimum tax applies to some taxpayers in excess of regular income tax liability.

B. Employment tax

FICA

- Federal Insurance Contributions Act ("FICA") imposes a tax on employers. The tax is comprised of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base of $106,800 (for 2011) ; and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages.

[1] This document may be cited as follows: Joint Committee on Taxation, *Federal Tax Treatment of Individuals* (JCX-43-11), September 12, 2011. This document can be found on the website at www.jct.gov.

- In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer. The employee tax generally must be withheld and remitted to the Federal government by the employer.
- For the year 2011, the FICA tax rate for employees is reduced by two percentage points. Specifically, the employer OASDI rate remains at 6.2 percent of covered wages while the employee rate is reduced to 4.2 percent of covered wages.

SECA

- Self-employed taxpayers are subject to employment tax under the Self-Employment Contributions Act ("SECA"). The SECA tax is imposed on the same wage amounts as the FICA tax and is composed of the same OASDI and HI components, but the rate is equal to 15.3 percent of covered earnings (of which OASDI makes up 12.4 percent, and HI makes up 2.9 percent).
- For the year 2011, the SECA rate is 13.3 percent (of which OASDI makes up 10.4 percent, and HI makes up 2.9 percent).

Additional hospital insurance tax on certain high-income individuals

- For remuneration received in taxable years beginning after December 31, 2012, the employee portion of the HI tax is increased by an additional tax of 0.9 percent on wages received in excess of the threshold amount. However, unlike the general 1.45 percent HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

Income taxation of Social Security benefits

- Under present law, Social Security benefits are taxed under a two-tier system. Taxpayers receiving Social Security benefits are not required to include any portion of such benefits in gross income if their provisional income does not exceed a first-tier threshold, which is $25,000 in the case of unmarried individuals, or $32,000 in the case of married individuals filing jointly. For purposes of these computations, a taxpayer's provisional income is defined as adjusted gross income plus: (1) tax-exempt interest; (2) excludable interest on educational savings bonds; (3) adoption assistance payments; (4) certain deductible student loan interest; (5) certain excludable foreign-source earned income; (6) certain U.S. possession income; and (7) one-half of the taxpayer's Social Security benefits. A second-tier threshold for provisional income is $34,000 in the case of unmarried individuals, or $44,000 in the case of married individuals filing joint returns. The thresholds are not indexed for inflation.
- If the taxpayer's provisional income exceeds the first-tier threshold but does not exceed the second-tier threshold, then the amount required to be included in income is the lesser of (1) 50 percent of the taxpayer's Social Security benefits, or

(2) 50 percent of the excess of the taxpayer's provisional income over the first-tier threshold.

- If the amount of provisional income exceeds the second-tier threshold, then the amount required to be included in income is the lesser of: (1) 85 percent of the taxpayer's Social Security benefits; or (2) the sum of (a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold, plus (b) the smaller of (i) the amount of benefits that would have been included in income if the 50 percent inclusion rule (described in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and first-tier threshold.

Tax on net investment income

- For taxable years beginning after December 31, 2012, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

II. Background Data and Analysis

Criteria for analysis of a tax system

Analysts generally judge tax systems in terms of how well the tax system addresses three different issues:

- First, does the tax system promote or hinder economic efficiency? That is, to what extent does the tax system distort taxpayer behavior by imposing high marginal tax rates on labor, saving, or other activities? Does the tax system create a bias against the domestic production of goods and services? To what extent does it promote economic growth?
- Second, is the tax system fair? Does the tax system treat similarly situated individuals similarly? Does the tax system account for individuals' different capacities to bear the burden of taxation?
- Third, is the tax system simple? Is it costly for taxpayers to determine their tax liability and file their taxes? Can the tax system be easily administered by the government and can it induce compliance by all individuals? Is enforcement costly? Can some individuals successfully avoid their legal liabilities?

Background data

- Sources of gross income for individual taxpayers in 2011 include: wages and salaries (70.8 percent); Social Security and pensions and individual retirement arrangements ("IRAs") (10.6 percent); business, farm and schedule E income (e.g., rents) (7.7

percent); capital gains (4.7 percent); dividend income (2.4 percent); interest income (2.3 percent); and other income (1.4 percent).

- Different maximum marginal tax rates apply to different sources of income.
- A taxpayer's average tax rate (total tax paid divided by total income) is generally less than the taxpayer's marginal tax rate (the increased tax that accrues from an additional dollar of income).
- Refundable credits may reduce income tax liability below zero.

I. PRESENT LAW

A. Individual Income Tax

In general

An income tax is imposed on individual citizens and residents of the United States.[2] The tax is based on an individual's taxable income. An individual computes his or her taxable income by reducing gross income by the sum of (i) the deductions allowable in computing adjusted gross income, (ii) the standard deduction (or itemized deductions, at the election of the taxpayer), and (iii) the deduction for personal exemptions. Graduated tax rates are then applied to a taxpayer's taxable income to determine his or her income tax liability. Lower rates apply to net capital gain and qualified dividend income. A taxpayer may also be subject to an alternative minimum tax. A taxpayer may reduce his or her income tax liability by certain tax credits.

Gross income

Gross income means "income from whatever source derived" other than certain items specifically excluded from gross income. Sources of gross income generally include, among other things, compensation for services, interest, dividends, capital gains, rents, royalties, alimony and separate maintenance payments, annuities, income from life insurance and endowment contracts (other than certain death benefits), pensions, gross profits from a trade or business, income in respect of a decedent, and income from S corporations, partnerships,[3] and trusts or estates.[4] Exclusions from gross income include death benefits payable under a life insurance contract, interest on certain tax-exempt State and local bonds, employer-provided health insurance, employer-provided pension contributions, and certain other employer-provided benefits.

Adjusted gross income

An individual's adjusted gross income ("AGI") is determined by subtracting certain "above-the-line" deductions from gross income. These deductions include, among other things, trade or business expenses, losses from the sale or exchange of property, deductions attributable

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[2] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A nonresident alien generally is subject to the U.S. individual income tax only on income with a sufficient nexus to the United States.

[3] In general, partnerships and S corporations are treated as pass-through entities for Federal income tax purposes. Thus, no Federal income tax is imposed at the entity level. Rather, income of these entities is passed through and taxed to the partners and shareholders.

[4] In general, estates and trusts (other than grantor trusts) pay an individual income tax on the taxable income of the estate or trust. Items of income which are distributed or required to be distributed under governing law or under the terms of the governing instrument generally are included in the income of the beneficiary and not the estate or trust. Estates and trusts determine their tax liability using a special tax rate schedule and may be subject to the alternative minimum tax. Certain trusts are treated as being owned by grantors in whole or in part for tax purposes; in such cases, the grantors are taxed on the income of the trust.

to rents and royalties, contributions to pensions and other retirement plans, certain moving expenses, and alimony payments.

Taxable income

In order to determine taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. In 2011, the personal exemption amount is $3,700.

In tax years beginning after 2012, the personal exemption phase out ("PEP") will reduce a taxpayer's personal exemption by two percent for each $2,500 by which the taxpayer's AGI exceeds a certain threshold. JCT staff estimates of the PEP thresholds in 2013 are $172,250 (single) and $258,350 (married filing jointly).

A taxpayer may also reduce AGI by the amount of the applicable standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. Tables 1a and 1b, below, show the amount of the personal exemption and standard deductions for 2011. Also, an additional standard deduction is allowed with respect to any individual who is elderly or blind.[5]

Table 1a.−Personal Exemption and Standard Deduction in 2011

Personal Exemption	$3,700
Standard Deduction	
Single Individual	$5,800
Head of Household	$8,500
Married Couples Filing Jointly	$11,600
Married Individual Filing Separately	$5,800

[5] For 2011, the additional amount is $1,150 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,450. If an individual is both blind and aged, the individual is entitled to two additional standard deductions, for a total additional amount (for 2011) of $2,300 or $2,900, as applicable.

Table 1b.−Personal Exemption and Standard Deduction in 2013

Personal Exemption	$3,800
Standard Deduction	
Single Individual	$5,950
Head of Household	$8,750
Married Couples Filing Jointly	$9,950
Married Individual Filing Separately	$4,975

In lieu of taking the applicable standard deduction, an individual may elect to itemize deductions. The deductions that may be itemized include State and local income taxes (or, in lieu of income, sales), real property and certain personal property taxes, home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5 percent of AGI), casualty and theft losses (in excess of 10 percent of AGI and in excess of $100 per loss), and certain miscellaneous expenses (in excess of two percent of AGI). Generally, the total amount of most itemized deductions allowed is reduced for taxpayers with incomes over a certain threshold amount, which is indexed annually for inflation.

In tax years beginning after 2012, the limitation on itemized deductions will reduce a taxpayer's itemized deductions by three percent of the amount by which the taxpayer's AGI exceeds certain thresholds.[6] JCT staff estimates of these limitation thresholds in 2013 are $172,250 for both single taxpayers and those who are married filing jointly.

Tax liability

In general

A taxpayer's net income tax liability is the greater of (1) regular individual income tax liability reduced by credits allowed against the regular tax, or (2) tentative minimum tax reduced by credits allowed against the minimum tax.

Regular tax liability

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status. Table 2a shows the individual income tax rate schedule for 2011, and Table 2b shows the individual income tax rate schedule for 2013 when individual income tax rates will increase from the current rates of 10, 15, 25, 28, 33, and 35 percent to the rates of 15, 28, 31, 36, and 39.6 percent.

[6] This limitation is commonly called the "Pease" limitation.

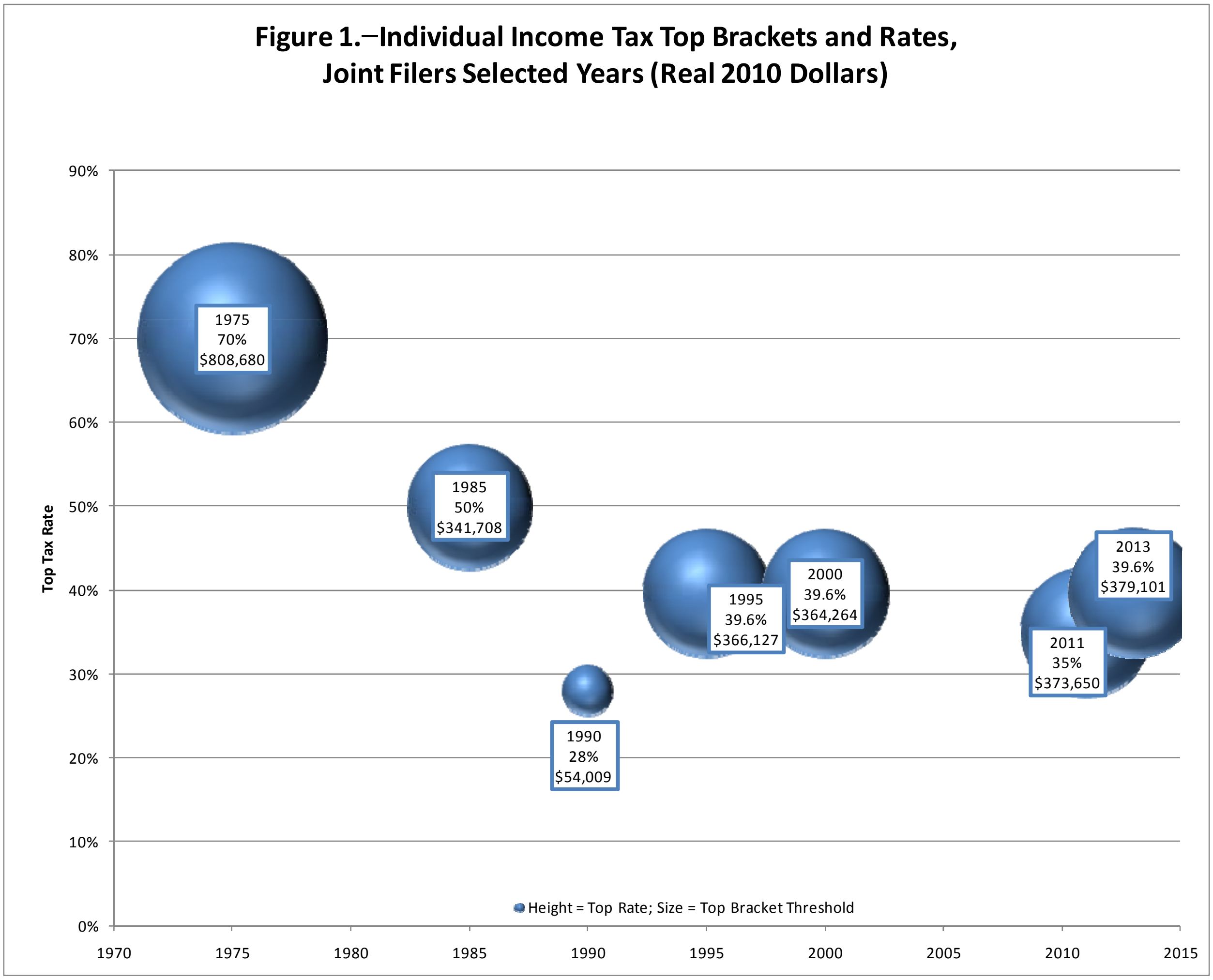
Table 2a.–Federal Individual Income Tax Rates for 2011

Single Individuals	
If taxable income is:	*Then income tax equals:*
Not over $8,500	10% of the taxable income
Over $8,500 but not over $34,500	$850 plus 15% of the excess over $8,500
Over $34,500 but not over $83,600	$4,750 plus 25% of the excess over $34,500
Over $83,600 but not over $174,400	$17,025 plus 28% of the excess over $83,600
Over $174,400 but not over $379,150	$42,449 plus 33% of the excess over $174,400
Over $379,150	$110,016.50 plus 35% of the excess over $379,150
Heads of Households	
Not over $12,150	10% of the taxable income
Over $12,150 but not over $46,250	$1,215 plus 15% of the excess over $12,150
Over $46,250 but not over $119,400	$6,330 plus 25% of the excess over $46,250
Over $119,400 but not over $193,350	$24,617.50 plus 28% of the excess over $119,400
Over $193,350 but not over $379,150	$45,323.50 plus 33% of the excess over $193,350
Over $379,150	$106,637.50 plus 35% of the excess over $379,150
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $17,000	10% of the taxable income
Over $17,000 but not over $69,000	$1,700 plus 15% of the excess over $17,000
Over $69,000 but not over $139,350	$9,500 plus 25% of the excess over $69,000
Over $139,350 but not over $212,300	$27,087.50 plus 28% of the excess over $139,350
Over $212,300 but not over $379,150	$47,513.50 plus 33% of the excess over $212,300
Over $379,150	$102,574 plus 35% of the excess over $379,150
Married Individuals Filing Separate Returns	
Not over $8,500	10% of the taxable income
Over $8,500 but not over $34,500	$850 plus 15% of the excess over $8,500
Over $34,500 but not over $69,675	$4,750 plus 25% of the excess over $34,500
Over $69,675 but not over $106,150	$13,543.75 plus 28% of the excess over $69,675
Over $106,150 but not over $189,575	$23,756.75 plus 33% of the excess over $106,150
Over $189,575	$51,287 plus 35% of the excess over $189,575

Table 2b.–Federal Individual Income Tax Rates for 2013

Single Individuals	
If taxable income is:	*Then income tax equals:*
Not over $35,500	15% of the taxable income
Over $35,500 but not over $86,000	$5,325 plus 28% of the excess over $35,500
Over $86,000 but not over $179,400	$19,465 plus 31% of the excess over $86,000
Over $179,400 but not over $390,050	$48,419 plus 36% of the excess over $179,400
Over $390,050	$124,253 plus 39.6% of the excess over $390,050
Heads of Households	
Not over $47,600	15% of the taxable income
Over $47,600 but not over $122,850	$7,140 plus 28% of the excess over $47,600
Over $122,850 but not over $198,900	$28,210 plus 31% of the excess over $122,850
Over $198,900 but not over $390,050	$51,785.50 plus 36% of the excess over $198,900
Over $390,050	$120,599.50 plus 39.6% of the excess over $390,050
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $59,300	15% of the taxable income
Over $59,300 but not over $143,350	$8,895 plus 28% of the excess over $59,300
Over $143,350 but not over $218,450	$32,429 plus 31% of the excess over $143,350
Over $218,450 but not over $390,050	$55,710 plus 36% of the excess over $218,450
Over $390,050	$117,486 plus 39.6% of the excess over $390,050
Married Individuals Filing Separate Returns	
Not over $29,650	15% of the taxable income
Over $29,650 but not over $71,675	$4,447.50 plus 28% of the excess over $29,650
Over $71,675 but not over $109,225	$16,214.50 plus 31% of the excess over $71,675
Over $109,225 but not over $195,025	$27,855 plus 36% of the excess over $109,225
Over $195,025	$58,743 plus 39.6% of the excess over $195,025

Figure 1, below, shows the top tax bracket rate and the income level at which it begins to apply for married taxpayers filing jointly for selected years.



Note: For 1975 the maximum rate on earned income was 50 percent.

Capital gains

In general

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual generally is taxed at rates lower than rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Tax rates before 2013

Under present law, for taxable years beginning before January 1, 2013, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero rate. These rates apply for purposes of both the regular tax and the AMT.

Under present law, the "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the excess of the sum of the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

An individual's unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

Tax rates after 2012

For taxable years beginning after December 31, 2012, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. Any adjusted net capital gain which otherwise would be taxed at the 15-percent rate is taxed at a 10-percent rate.

In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent capital gain rate is taxed at an eight-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which began after December 31, 2000, that would otherwise have been taxed at a 20-percent rate is taxed at an 18-percent rate.

The tax rates on 28-percent gain and unrecaptured section 1250 gain are the same as for taxable years beginning before 2013.

Dividends

In general

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits.

Tax rates before 2013

An individual's qualified dividend income is taxed at the same rates that apply to net capital gain. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, for taxable years beginning before 2013, an individual's qualified dividend income is taxed at rates of zero and 15 percent. The zero-percent rate applies to qualified dividend income which otherwise would be taxed at a 10- or 15-percent rate if the special rates did not apply.

Qualified dividend income generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

Special rules apply in determining a taxpayer's foreign tax credit limitation under section 904 in the case of qualified dividend income. For these purposes, rules similar to the rules of section 904(b)(2)(B) concerning adjustments to the foreign tax credit limitation to reflect any capital gain rate differential will apply to any qualified dividend income.

If a taxpayer receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the reduced rates with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of dividends qualifying for reduced rates that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

The reduced rates do not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.[7]

Tax rates after 2012

For taxable years beginning after 2012, dividends received by an individual are taxed at ordinary income tax rates.

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[7] In addition, for taxable years beginning before 2013, amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of applying the reduced rates; the tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 15 percent; and the collapsible corporation rules (sec. 341) are repealed.

Tables 3 and 4, below, detail the tax rates applicable to income from different investments yielding income from dividends and capital gains.

Table 3.–Tax Rates Applicable Under Present Law to Certain Categories of Income, 2011-2012

	Regular Tax Rate Bracket						Minimum Tax Rate Bracket	
Category of income	**10%**	**15%**	**25%**	**28%**	**33%**	**35%**	**26%**	**28%**
Qualified dividend income	0	0	15	15	15	15	same as regular tax	
Non-qualified dividend income and short-term capital gain[1]	10	15	25	28	33	35	26	28
Long-term capital gain[2]	0	0	15	15	15	15	same as regular tax	
Section 1250 gain[3]	10	15	25	25	25	25	25	25
Collectible gain	10	15	25	28	28	28	26	28
Small business stock[4]	0	0	12.5	14	14	14	13.91	14.98
Empowerment zone small business stock[5]	0	0	10	11.2	11.2	11.2	11.592	12.376
D.C. Enterprise Zone stock/Renewal Community stock	0	0	0	0	0	0	0	0

See notes to Tables 3 and 4, below.

Table 4.–Tax Rates Applicable Under Present Law to Certain Categories of Income, 2013 and Thereafter

	Regular Tax Rate Bracket					Minimum Tax Rate Bracket	
Category of income	**15%**	**28%**	**31%**	**35%**	**39.6%**	**26%**	**28%**
All dividend income	15	28	31	35	39.6	26	28
Short-term capital gain[1]	15	28	31	35	39.6	26	28
Long-term capital gain[2]	10	20	20	20	20	same as regular tax	
Section 1250 gain[3]	15	25	25	25	25	25	25
Collectible gain	15	28	28	28	28	26	28
Small business stock issued before February 18, 2009 or after December 31, 2011.[4]	7.5	14	14	14	14	18.46[7]	19.88[7]
Empowerment zone small business stock issued before February 18, 2009, or after December 31, 2011.[5]	6	11.2	11.2	11.2	11.2	14.768	15.904
Small business stock issued after February 17, 2009, and before September 28, 2010.[6]	3.75	7	7	7	7	11.76	12.88
Five-year gain acquired before 2001	8	20	20	20	20	same as regular tax	
Five-year gain acquired after 2000	8	18	18	18	18	same as regular tax	
Small business stock issued after September 27, 2010, and before January 1, 2012; D.C. Enterprise Zone stock/Renewal Community stock	0	0	0	0	0	0	0

Notes to Tables 3 and 4:

1 Gain from assets held not more than one year.

2 Gain from assets held more than one year not included in another category.

3 Capital gain attributable to depreciation on section 1250 property (i.e., depreciable real estate).

4 Effective rates after application of 50-percent exclusion for small business stock held more than five years.

5 Effective rates after application of 60-percent exclusion for small business empowerment zone stock held more than five years.

6 Effective rates after application of 75-percent exclusion for small business stock held more than five years.

7 If the holding period for the stock begins after 2000, the rates are 16.64 percent and 17.92 percent respectively.

Tax credits

In general.−The individual may reduce his or her tax liability by any available tax credits. Tax credits are allowed for certain business expenditures, certain foreign income taxes paid or accrued, certain dependent children and child care expenditures, and for certain elderly or disabled individuals. In addition, a refundable earned income tax credit ("EITC") is available to low-income workers who satisfy certain requirements.

A brief description of the most widely used credits follows.

Earned income tax credit.−The EITC generally equals a specified percentage of wages up to a maximum credit amount. The maximum credit amount applies over a certain income range and then diminishes to zero over a certain income range. In 2011, the maximum EITC is $5,751 for taxpayers with more than two qualifying children, $5,112 for taxpayers with two qualifying children, $3,094 for taxpayers with one qualifying child, and $464 for taxpayers with no qualifying children.

The EITC is phased out along certain phase-out ranges. In 2011, the phase-out range is $7,590 to $13,660 for no qualifying children, $16,690 to $36,052 for one qualifying child, $16,690 to $40,964 for two qualifying children, and $16,690 to $43,998 for three or more qualifying children. Also for 2011, the phase-out threshold for married couples filing a joint return is increased by $5,080.

After 2012 the larger EITC for three or more qualifying children is repealed and the higher phase-out threshold for married couples filing a joint return is repealed. Additionally, certain of the rules of the credit return to pre-2001 law.

Child tax credit.−For 2011, the child tax credit generally is $1,000 for each qualifying child.[8] The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2012, is allowed against the AMT.

The child tax credit is phased-out for individuals with income over certain thresholds. The phase out rate is $50 for each $1,000 of modified AGI[9] (or a fraction thereof) in excess of the threshold. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

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[8] A qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendant of either), a stepson or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer.

[9] For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded under Code sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Marina Islands; and residents of Puerto Rico, respectively).

To the extent the child tax credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the "earned income" formula). For 2011, the child tax credit is refundable up to the greater of: (1) 15 percent of the taxpayer's earned income in excess of $3,000; or (2) for families with three or more children, the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income.

After 2012, the maximum child tax credit is $500 for each qualifying child and is only refundable for families with three or more children if the taxpayer's social security taxes exceed the taxpayer's earned income.

Alternative minimum tax liability

In general

An alternative minimum tax is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. The tentative minimum tax is the sum of: (1) 26 percent of so much of the taxable excess as does not exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are also used in computing the tentative minimum tax. AMTI is the taxpayer's taxable income increased by the taxpayer's "tax preference items" and adjusted by redetermining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The exemption amounts for 2011 are: (1) $74,450 in the case of married individuals filing a joint return and surviving spouses; (2) $48,450 in the case of unmarried individuals other than surviving spouses; (3) $37,225 in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust.[10] The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds: (1) $150,000 in the case of married individuals filing a joint return and surviving spouses; (2) $112,500 in the case of other unmarried individuals; and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Among the preferences and adjustments applicable to the individual alternative minimum tax are accelerated depreciation on certain property used in a trade or business, circulation expenditures, research and experimental expenditures, certain expenses and allowances related to oil and gas and mining exploration and development, certain tax-exempt interest income, and a portion of the amount of gain excluded with respect to the sale or disposition of certain small business stock. In addition, personal exemptions, the standard deduction, and certain itemized

[10] The exemption amounts for 2012 are: (1) $45,000 in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 in the case of unmarried individuals other than surviving spouses; (3) $22,500 in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust.

deductions, such as State and local taxes, interest on home equity loans, and miscellaneous deductions items, are not allowed to reduce alternative minimum taxable income.

Credits.–Nonrefundable personal credits are allowed on a temporary basis to offset the AMT. The most recent extension of the credit will expire at the end of 2011.

Nonrefundable personal credits include the foreign tax credit, child and dependent care credit, education credits, retirement savings contributions credit, child tax credit, residential energy efficient property credit, nonbusiness energy property credit, and expenses of elderly or disabled.

B. Employment Taxes

In general

Social security benefits and certain Medicare benefits are financed primarily by employment taxes on covered wages. The Federal Insurance Contributions Act ("FICA") imposes a tax on employers based on the amount of wages paid to an employee during the year. The tax is comprised of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base of $106,800 (for 2011) ; and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages. The HI tax applies to all wages.

In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer. The employee tax generally must be withheld and remitted to the Federal government by the employer.[11] For the year 2011, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010[12] reduced the FICA tax rate for employees by two percentage points. Specifically, the employer OASDI rate remains at 6.2 percent of covered wages while the employee rate is reduced to 4.2 percent of covered wages.

Self-employed taxpayers are subject to employment tax under the Self-Employment Contributions Act ("SECA"). The SECA tax is imposed on the same wage amounts as the FICA tax and is composed of the same OASDI and HI components, but the rate is equal to 15.3 percent of covered earnings (of which OASDI makes up 12.4 percent, and HI makes up 2.9 percent). In 2011 the rate is 13.3 percent (of which OASDI makes up 10.4 percent, and HI makes up 2.9 percent).

The OASDI earnings base is indexed each year automatically according to a statutory formula. Any increase in the earnings base is based on the increase in average wages in the economy.[13]

Additional hospital insurance tax on certain high-income individuals

For remuneration received in taxable years beginning after December 31, 2012, the employee portion of the HI tax is increased by an additional tax of 0.9 percent on wages[14]

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[11] The OASDI and HI employment tax is generally collected as a single tax with portions of it allocated by statute among three separate trust funds (OASI, DI and HI).

[12] Pub. L. No. 111-312 (2010).

[13] The earnings base can only increase in a year in which there was an increase in benefits under the cost-of-living adjustment (COLA) formula. If there was no increase in benefits, the earnings base is prohibited from increasing. Sec. 230(a) of the Social Security Act. Because there was no increase in benefits from 2009 through 2011, the earnings base remained constant from 2009 through 2011.

[14] Sec. 3121(a).

received in excess of a specific threshold amount.[15] However, unlike the general 1.45 percent HI tax on wages, this additional tax is on the combined wages of the employee and the employee's spouse, in the case of a joint return. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case (unmarred individual or head of household).

Income taxation of Social Security benefits

Under present law, Social Security benefits are taxed under a two-tier system. Taxpayers receiving Social Security benefits are not required to include any portion of such benefits in gross income if their provisional income does not exceed a first-tier threshold, which is $25,000, in the case of unmarried individuals, or $32,000, in the case of married individuals filing jointly.[16] For purposes of these computations, a taxpayer's provisional income is defined as adjusted gross income plus: (1) tax-exempt interest; (2) excludable interest on educational savings bonds; (3) adoption assistance payments; (4) certain deductible student loan interest; (5) certain excludable foreign-source earned income; (6) certain U.S. possession income; and (7) one-half of the taxpayer's Social Security benefits. A second-tier threshold for provisional income is $34,000, in the case of unmarried individuals, or $44,000, in the case of married individuals filing joint returns.[17] The thresholds are not indexed for inflation.

If the taxpayer's provisional income exceeds the first-tier threshold but does not exceed the second-tier threshold, then the amount required to be included in income is the lesser of (1) 50 percent of the taxpayer's Social Security benefits, or (2) 50 percent of the excess of the taxpayer's provisional income over the first-tier threshold.

If the amount of provisional income exceeds the second-tier threshold, then the amount required to be included in income is the lesser of: (1) 85 percent of the taxpayer's Social Security benefits; or (2) the sum of (a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold, plus (b) the smaller of (i) the amount of benefits that would have been included in income if the 50 percent inclusion rule (described in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and first-tier threshold.[18] Tables 5 and 6 below summarize the income taxation of Social Security benefits.

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[15] Patient Protection and Affordable Care Act ("PPACA"), Pub. L. No. 111-148.

[16] In the case of a married individual who files a separate return, the first-tier threshold is generally zero. However, if the individual lives apart from his or her spouse for the entire year, the first-tier threshold is $25,000.

[17] In the case of a married individual who files a separate return, the second-tier threshold is generally zero. However, if the individual lives apart from his or her spouse for the entire year, the second-tier threshold is $34,000.

[18] Special rules apply in some cases under present law. Tier I Railroad Retirement benefits are similar to Social Security benefits and are taxed in the same manner as Social Security benefits. In the case of nonresident individuals who are not U.S. citizens, 85 percent of Social Security benefits are includible in gross income and subject to the 30-percent withholding tax (sec. 871(a)(3)). The taxation of Social Security benefits may also be specified in income tax treaties between the United States and other countries.

Table 5.–Summary of the Taxation of Social Security Benefits for Unmarried Taxpayers

<table>
<tr><th>Provisional income level</th><th colspan="3">Amount included in taxable income</th></tr>
<tr><td>$24,999 and below</td><td colspan="3">0%</td></tr>
<tr><td rowspan="2">$25,000 to $33,999</td><td colspan="3">First-tier inclusion is the lesser of…</td></tr>
<tr><td>(1) 50% of Social Security benefit</td><td colspan="2">(2) 50% of provisional income exceeding $25,000</td></tr>
<tr><td rowspan="3">$34,000 and above</td><td colspan="3">Second-tier inclusion is the lesser of…</td></tr>
<tr><td rowspan="2">(1) 85% of Social Security benefit</td><td colspan="2">(2) 85% of the amount of provisional income exceeding $34,000 plus the lesser of…</td></tr>
<tr><td>(2a) $4,500</td><td>(2b) amount of Social Security benefit that would have been included if the 50% rule applied</td></tr>
</table>

Table 6.–Summary of the Taxation of Social Security Benefits for Married Taxpayers

<table>
<tr><th>Provisional income level</th><th colspan="3">Amount included in taxable income</th></tr>
<tr><td>$31,999 and below</td><td colspan="3">0%</td></tr>
<tr><td rowspan="2">$32,000 to $43,999</td><td colspan="3">First-tier inclusion is the lesser of…</td></tr>
<tr><td>(1) 50% of Social Security benefit</td><td colspan="2">(2) 50% of provisional income exceeding $32,000</td></tr>
<tr><td rowspan="3">$44,000 and above</td><td colspan="3">Second-tier inclusion is the lesser of…</td></tr>
<tr><td rowspan="2">(1) 85% of Social Security benefit</td><td colspan="2">(2) 85% of the amount of provisional income exceeding $44,000 plus the lesser of…</td></tr>
<tr><td>(2a) $6,000</td><td>(2b) amount of Social Security benefit that would have been included if the 50% rule applied</td></tr>
</table>

Revenues from the first-tier inclusion of Social Security benefits are dedicated to the Social Security Trust Funds (i.e., the Federal Old-Age and Survivors Insurance Trust Fund and Federal Disability Insurance Trust Fund). Revenues from the second-tier inclusion are dedicated to the Medicare Trust Funds (i.e., the Federal Hospital Insurance Trust Fund and Supplementary Medical Insurance Trust Fund).

Tax on net investment income

For taxable years beginning after December 31, 2012, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount.[19] The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

For purposes of the unearned income Medicare contribution tax, modified adjusted gross income is adjusted gross income increased by the amount excluded from income as foreign earned income under section 911(a)(1) (net of the deductions and exclusions disallowed with respect to the foreign earned income).

In the case of an estate or trust, the tax is 3.8 percent of the lesser of undistributed net investment income or the excess of adjusted gross income (as defined in section 67(e)) over the dollar amount at which the highest income tax bracket applicable to an estate or trust begins.[20]

Net investment income

Net investment income is investment income reduced by the deductions properly allocable to such income. Investment income is the sum of (i) gross income from interest, dividends, annuities, royalties, and rents (other than income derived from any trade or business to which the tax does not apply), (ii) other gross income derived from any business to which the tax applies, and (iii) net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in a trade or business to which the tax does not apply.[21]

In the case of a trade or business, the tax applies if the trade or business is a passive activity with respect to the taxpayer or the trade or business consists of trading financial instruments or commodities (as defined in section 475(e)(2)). The tax does not apply to other trades or businesses conducted by a sole proprietor, partnership, or S corporation.

In the case of the disposition of a partnership interest or stock in an S corporation, gain or loss is taken into account only to the extent gain or loss would be taken into account by the partner or shareholder if the entity had sold all its properties for fair market value immediately

[19] The tax is subject to the individual estimated tax provisions. The tax is not deductible in computing any tax imposed by subtitle A of the Internal Revenue Code (relating to income taxes).

[20] The tax does not apply to a non-resident alien or to a trust all the unexpired interests in which are devoted to charitable purposes. The tax also does not apply to a trust that is exempt from tax under section 501 or a charitable remainder trust exempt from tax under section 664.

[21] Gross income does not include items, such as interest on tax-exempt bonds, veterans' benefits, and excluded gain from the sale of a principal residence, which are excluded from gross income under the income tax.

before the disposition. Thus, only net gain or loss attributable to property held by the entity which is not property attributable to an active trade or business is taken into account.[22]

Income, gain, or loss on working capital is not treated as derived from a trade or business. Investment income does not include distributions from a qualified retirement plan or amounts subject to SECA tax.

[22] For this purpose, a business of trading financial instruments or commodities is not treated as an active trade or business.

II. BACKGROUND DATA AND ANALYSIS

A. Criteria for Analysis of Tax Systems

In general

Analysts generally judge tax systems in terms of how well the tax system addresses three different issues:

- First, does the tax system promote or hinder economic efficiency? That is, to what extent does the tax system distort taxpayer behavior by imposing high marginal tax rates on labor, saving, or other activities? Does the tax system create a bias against the domestic production of goods and services? To what extent does it promote economic growth?
- Second, is the tax system fair? Does the tax system treat similarly situated individuals similarly? Does the tax system account for individuals' different capacities to bear the burden of taxation?
- Third, is the tax system simple? Is it costly for taxpayers to determine their tax liability and file their taxes? Can the tax system be easily administered by the government and can it induce compliance by all individuals? Is enforcement costly? Can some individuals successfully avoid their legal liabilities?

The design of a tax system involves tradeoffs among these different goals. Measures designed to promote economic growth may alter the distribution of the tax burden. Measures designed to ensure compliance with the tax law may increase the complexity of taxation for individual filers. Measures designed to promote simplicity may create distortions in individual choice of investments.

Issues of efficiency

In general, any system of raising revenue alters the prices that taxpayers face with respect to consumption of goods, or supply of labor or capital, and will distort economic decision making and lead to economic inefficiencies.[23] In analyzing tax systems, economists often emphasize the importance of marginal tax rates because, they argue, it is marginal tax rates that affect incentives for taxpayers to work, to save, or to take advantage of various tax preferences.[24] These incentives may distort taxpayer choice, which in turn may promote an inefficient allocation of society's labor and capital resources. A less efficient allocation of labor and capital

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[23] An exception to this is a "head tax" or "lump sum" tax, which imposes a fixed tax on all individuals without regard to any behavior. Such a tax reduces the after-tax resources available to the individual, but does not change prices and thus does not distort choices a consumer faces in the absence of the tax.

[24] A *marginal tax rate* is the rate applied to income in a particular tax bracket. The highest marginal rate typically applies to the last dollar earned. As a result of phase-outs phase-ins of tax preference items (such as income exclusions or deductions and credits), a taxpayer's *effective marginal tax rate* may differ from the taxpayer's statutory marginal tax rate. By contrast with marginal tax rates, a taxpayer's *average tax rate* is the taxpayer's total tax paid as a percentage of the taxpayer's total income.

resources leaves society with a lower level of output of goods and services than it would otherwise enjoy in the absence of tax-system induced economic distortions.

Economists have shown that the efficiency loss from taxation increases as the marginal tax rate increases. That is, a one percentage point increase in a marginal tax rate from 40 percent to 41 percent creates a greater efficiency loss per dollar of additional tax revenue than a one percentage point increase in a marginal tax rate from 20 percent to 21 percent.[25] Thus, in order to minimize economic inefficiency, economists in general have long recommended a broad base of taxation in order to keep marginal tax rates as low as possible subject to revenue needs.

Some analysts have suggested that high marginal tax rates may alter taxpayers' decisions to work and alter economic output. For example, assume a taxpayer in the 35 percent tax bracket is considering working on an overtime assignment which pays $1,000, and which the taxpayer would certainly choose to undertake if he or she received the full $1,000. However, the taxpayer's net of tax remuneration for the project is $650. The taxpayer may feel the net remuneration of $650 is insufficient to offset the loss of leisure time and the effort that would be expended to complete the project. If the taxpayer chooses not to work, society loses the benefit of his or her labor.

There is disagreement among economists on the extent to which labor supply decisions are affected by the marginal tax rate on labor income. Empirical evidence indicates that taxpayer response is likely to vary depending upon a number of taxpayer-specific factors. In general, findings indicate that the labor supply of so called "primary earners" tends to be less responsive to changes in marginal tax rates than is the labor supply of "secondary earners."[26] Some have suggested that the labor supply decision of the lower earner or "secondary earner" in married households may be quite sensitive to the household's effective marginal tax rate.[27] Other evidence suggests the decision to work additional hours may be less sensitive to changes in the

[25] The magnitude of the efficiency loss from taxation depends upon a measure of the taxpayer's behavioral response, or the elasticity, and the square of the total effective marginal tax rate. Hence, a small change in an effective tax rate can create an efficiency loss that is large in relation to the change in revenue. For a detailed discussion of this point, see Joint Committee on Taxation, *Methodology and Issues in Measuring Changes in the Distribution of Tax Burdens* (JCS-7-93), June 14, 1993, pp. 20–31 and Harvey S. Rosen, *Public Finance*, seventh edition, (Boston MA: McGraw-Hill), 2004.

[26] The phrase "primary earner" refers to the individual in the household who is responsible for providing the largest portion of household income. "Secondary earners" are earners other than the primary earner.

[27] For a review of econometric studies on labor supply of so-called primary and secondary earners, see United States Congress, Congressional Budget Office Memorandum, "Labor Supply and Taxes," 2006, and Charles L. Ballard, John B. Shoven, and John Whalley, "General Equilibrium Computations of the Marginal Welfare Costs of Taxes in the United States," *American Economic Review*, 75, March 1985. See also John Pencavel, "A Cohort Analysis of the Association between Work Hours and Wages Among Men," *Journal of Human Resources* 37(2), 2002, pp. 251-274; and Francine D. Blau and Lawrence M. Kahn "Changes in the Labor Supply Behavior of Married Women: 1980 -2000," *Journal of Labor Economics*, July 2007.

marginal tax rate than the decision to enter the labor force.[28] That is, there may be more effect on an individual currently not in the labor force than on an individual already in the labor force.

The distorted choices that may result from increased marginal tax rates are not limited to decisions to work. By reducing the net return to saving, increased marginal tax rates may distort taxpayers' decisions to save. Substantial disagreement exists among economists as to the effect on saving of changes in the net return to saving. Empirical investigation of the responsiveness of personal saving to after tax returns provides no conclusive results. Some studies have argued that one should expect substantial increases in saving from increases in the net return.[29] Other studies have argued that large behavioral responses to changes in the net return need not occur.[30] Empirical investigation of the responsiveness of personal saving to the taxation of investment earnings provides no conclusive results.[31] Some find personal saving responds strongly to increases in the net return to saving,[32] while others find little or a negative response.[33] Studies of retirement savings incentives follow a similar pattern, with some finding an increase in saving as a result of the incentives,[34] while others find little or no increase as retirement plan savings substitute for other saving.[35] With respect to the tax advantaged forms of saving, the revenue loss to the Federal government represents a decline in government saving (unless offset by equal

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[28] Robert K. Triest, "The Effect of Income Taxation on Labor Supply in the United States," *The Journal of Human Resources*, 25, 1990. Also, Nada Eissa, "Tax Reforms and Labor Supply," in James M. Poterba, editor, *Tax Policy and the Economy*, 10, (Cambridge: The MIT press), 1996, reviews this literature with particular emphasis on the labor supply of women. Her evidence suggests that marginal tax rates may be an important determinant of labor force participation.

[29] Lawrence H. Summers, "Capital Taxation and Accumulation in a Life Cycle Growth Model," *American Economic Review*, 71, September 1981.

[30] David A. Starrett, "Effects of Taxes on Saving," in Henry J. Aaron, Harvey Galper, and Joseph A. Pechman (eds.), *Uneasy Compromise: Problems of a Hybrid Income-Consumption Tax*, (Washington, D.C.: Brookings Institution), 1988.

[31] See Douglas W. Elmendorf, "The Effect of Interest-Rate Changes on Household Saving and Consumption: a Survey," *Finance and Economics Discussion Series,* 96-27, (Washington D.C.: Board of Governors of the Federal Reserve System), 1996.

[32] Michael Boskin, "Taxation, Saving, and the Rate of Interest," *Journal of Political Economy*, 86, April 1978.

[33] George von Furstenberg, "Saving," in Henry Aaron and Joseph Pechman (eds.), *How Taxes Affect Economic Behavior*, (Washington, D.C.: Brookings Institution), 1981.

[34] Daniel J. Benjamin, "Does 401(k) Eligibility Increase Saving? Evidence from Propensity Score Subclassification," *Journal of Public Economics,* Volume 87, Issues 5-6, May 2003, pages 1259-1290; James M. Poterba, Steven F. Venti, and David A. Wise, "Do 401(k) Contributions Crowd Out Other Personal Saving?," *Journal of Public Economics,* Volume 58, Issue 1, September 1995, pages 1-32; James M. Poterba, Steven F. Venti, and David A. Wise, "How Retirement Saving Programs Increase Saving," *The Journal of Economic Perspectives*, Vol. 10, No. 4 (Autumn, 1996), pages 91-112.

[35] Karen M. Pence, "401(k)s and Household Saving: New Evidence from the Survey of Consumer Finances" (December 2001), FEDS Working Paper No. 2002-06; William G. Gale and John Karl Scholz, "IRAs and Household Saving," *The American Economic Review*, Vol. 84, No. 5 (Dec., 1994), pages 1233-1260.

spending cuts), and thus must be accounted for to determine net national saving. If saving is reduced by its treatment under the income tax, future productivity and income is lost to society.

In addition to labor supply and saving effects, increased marginal tax rates may encourage taxpayers to seek compensation in the form of tax free fringe benefits rather than taxable compensation and to engage in other tax avoidance activities, including deductible expenses or deductible consumption, or even illegal tax evasion. Such distortions in consumption represent an efficiency loss to the economy. Increased marginal tax rates also may alter taxpayers' decisions regarding when to recognize income or to claim expenses. Any such tax motivated changes in the timing of income or expense generally require time and expense by the taxpayer. Such time and expense represents an efficiency loss to the economy.

A large literature exists on the combined responsiveness of taxpayers to marginal tax rates, as represented by changes in reported taxable income. Taxpayers' reported taxable income will depend on the combined behaviors discussed above with respect to labor supply, saving, and form of compensation, as well as other factors including tax evasion and consumption of tax favored goods. In some sense, this combined responsiveness, or the elasticity of taxable income with respect to marginal tax rates, may be thought of as capturing all of the inefficiencies of the income tax. Estimates of the elasticity of taxable income have varied considerably, with later studies finding lower estimates, though higher than what would be calculated if the sole behavioral response to marginal tax rates was labor supply. The studies generally find that the elasticity of taxable income is much higher for higher income groups, who may have greater ability to control their labor supply, including the form in which they receive compensation, and have greater ability to engage in tax avoidance, including deductible expenses. A recent review of this literature characterizes the more reliable long-run estimates of the elasticity of taxable income as being between 0.12 and 0.4.[36] The estimate at the high end of this range means that if taxpayers' after-tax return to reporting taxable income increased by 10 percent, there would be an increase in reported taxable income of four percent.

Issues of equity

Policymakers are not concerned only with efficiency issues in designing a tax system, but are also concerned with establishing an "equitable" tax code with respect to the distribution of the tax burden. Whether a tax system is viewed as equitable is in the eye of the beholder, and economic analysis cannot define an equitable tax. In general, most individuals and policymakers require that an equitable income tax system would tax individuals with equal ability-to-pay equally, and would tax individuals with a greater ability to pay in greater amounts. However, there is no agreement on the appropriate standard by which to judge a taxpayer's ability to pay. Many also view the progressive rate structure as an equitable feature of the code, wherein individuals with greater ability to pay do not simply pay more tax, but experience an increasing average tax rate as income rises. Many who view a progressive tax structure as equitable would also view excessively high marginal tax rates as inequitable.

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[36] See Emmanuel Saez, Joel B. Slemrod, Seth H. Giertz, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review," National Bureau of Economic Research Working Paper 15012, 2009 (Forthcoming, *Journal of Economic Literature*, 2011).

In general, the goals of equity and efficiency are in conflict. In order to keep rates low for efficiency reasons, the progressivity of the rate schedule should be minimized, but this conflicts with the desire to have more progressive rates for equity reasons. Similarly, a broad base of tax will allow lower rates for an efficiency gain, but broadening the base by eliminating personal exemptions, standard deductions, deductions for medical expenses, etc.,[37] tends to conflict with the desire to measure ability to pay accurately for equity reasons. Policymakers must weigh tradeoffs between these two goals in designing tax systems.

Issues of simplicity, administration, and compliance

One of the common complaints about the current income tax system is that it is extremely complex. The complexity leads to tax compliance costs from the use of resources in order to learn the tax rules and to prepare returns for tax collection.

Individuals, businesses, and the government all use resources in the process of collecting the tax revenue. Expenditures by the government show up in the staffing and budget requirements for tax collection. For fiscal year 2010, Internal Revenue Service expenditures totaled 12.4 billion,[38] with over 94,000 full-time equivalent employees.[39] During fiscal year 2010, the IRS processed over 230 million returns.[40] The IRS also processed 2.7 billion information returns in the information reporting program.[41] These information returns relate to items such as wage, dividend, and interest receipts and are matched against individual income tax returns to identify income reporting discrepancies, unsubstantiated deductions, and nonfiling of returns. During fiscal year 2010, the IRS examined almost one percent of all returns filed in calendar year 2009, 1.1 percent of all individual income tax returns filed in calendar year 2009, and 1.4 percent of corporation income tax returns (excluding S corporation returns) filed in calendar year 2009.[42]

A simpler income tax system would reduce the resource costs of individuals and businesses to comply with the tax, and would reduce the revenue needs for government administration and enforcement efforts. While the tax code has become much more complex since the last major simplification of the code in the Tax Reform Act of 1986, some argue that the complexity is necessary to achieve other worthwhile objectives. Others believe that the existence of tax preparation software has made tax code complexity less of a concern. However,

[37] Not all adjustments to gross income or other reductions in tax through credits are justified on equity grounds, but exist to achieve other policy goals that Congress has deemed meritorious. Credits for the purchase or manufacture of certain energy-efficient products and deductions or exclusions for retirement savings are examples of such adjustments.

[38] IRS Data Book 2010 (Pub. 55B), March 2011, page 63 (hereafter, "IRS Data Book").

[39] IRS Data Book, Table 30.

[40] IRS Data Book, Table 3.

[41] IRS Data Book, Table 14.

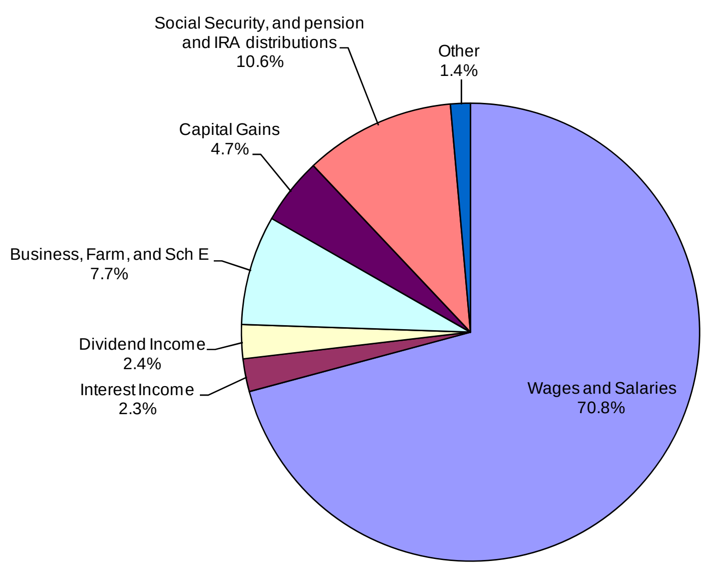
[42] IRS Data Book, page 21 and Table 9a.

an overly complex code may undermine the effect of tax preferences intended to provide incentives for certain activities if the complexity makes it difficult to determine one's eligibility for the preference and, if eligible, what the magnitude of the tax benefit is. Additionally, the complexity of the code may undermine voluntary compliance if it undermines respect for the code.

B. Background Data

Figure 2, below, shows the distribution of the sources of gross income for all individual taxpayers for 2011. Wages and salaries are the largest single component, accounting for over 70 percent of gross income. Social security payments and pension and individual retirement arrangement ("IRA") distributions represent the next largest source of income, accounting for just over 10 percent of the total.

Figure 2.–Sources of Gross Income for All Individual Taxpayers 2011



Source: Staff of the Joint Committee on Taxation.

As discussed in the present law section of this pamphlet, different rates of tax apply to different sources of income. Wages and salaries are currently taxed at a top marginal income tax rate of 35 percent, rising to 39.6 percent in 2013. Additionally, in 2013, the additional HI tax of 0.9 percent applies at certain income levels as discussed earlier. Social insurance taxes also apply to wage income, at a maximum combined employer and employee rate of 13.3 percent in 2011, rising to 15.3 percent in 2012 and beyond. Social security, pension, and IRA distributions are currently taxed at a top marginal rate of 35 percent, rising to 39.6 percent in 2013, though social security benefits are only partially included in income, with a maximum inclusion of 85 percent of benefits, reducing the effective maximum rate that applies to these benefits (Thus the maximum rate applicable to social security benefits in 2013 is 39.6 x 0,85 = 33.66 percent). Net long-term capital gains are currently taxed at a maximum rate of 15 percent, rising to 20 percent in 2013. Qualified dividends are currently taxed at a maximum rate of 15 percent, rising to 39.6 percent in 2013 when they become taxed at ordinary rates. Interest income is currently taxed at a top marginal rate of 35 percent, rising to 39.6 percent in 2013. Additionally, in 2013 capital gain income, dividend income, and interest face an additional unearned income Medicare contribution tax of 3.8 percent at certain higher income levels. Business, farm, and Schedule E income are currently taxed at a top marginal rate of 35 percent, rising to 39.6 percent in 2013. Additionally, business income may be subject to self employment tax at a maximum rate of 13.3 percent in 2011, rising to 15.3 percent in 2012 and beyond. Business income that is unearned business income is subject to an additional unearned income Medicare contribution tax of 3.8 percent at certain higher income levels, beginning in 2013.

In 2011, a high income person whose total income places them in the top individual income tax bracket has effective marginal tax rates of 37.9 percent on wages (35 percent income tax plus 2.9 percent HI tax). In 2013, the same person has a 43.4 percent effective marginal tax rate (39.6 percent income tax, 2.9 percent HI, plus 0.9 percent additional HI) on wages, 43.4 percent on dividends and interest (39.6 percent income tax plus 3.8 percent unearned income Medicare contribution), and 23.8 percent on capital gains (20 percent capital gain income tax plus 3.8 percent unearned income Medicare contribution)

Figure 3, below, like Figure 2, shows the components of adjusted gross income for certain earlier years, in constant 2005 dollars.

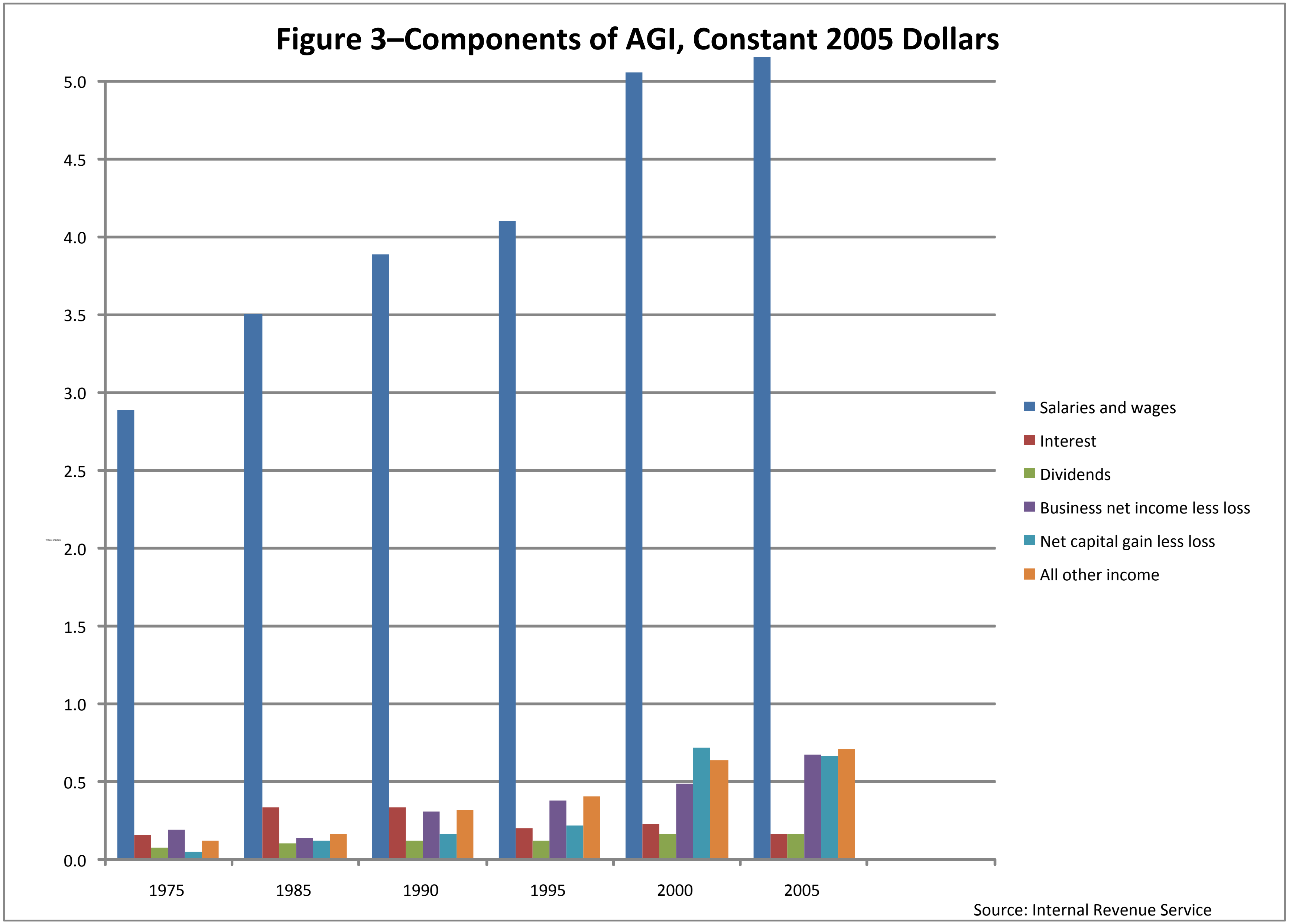
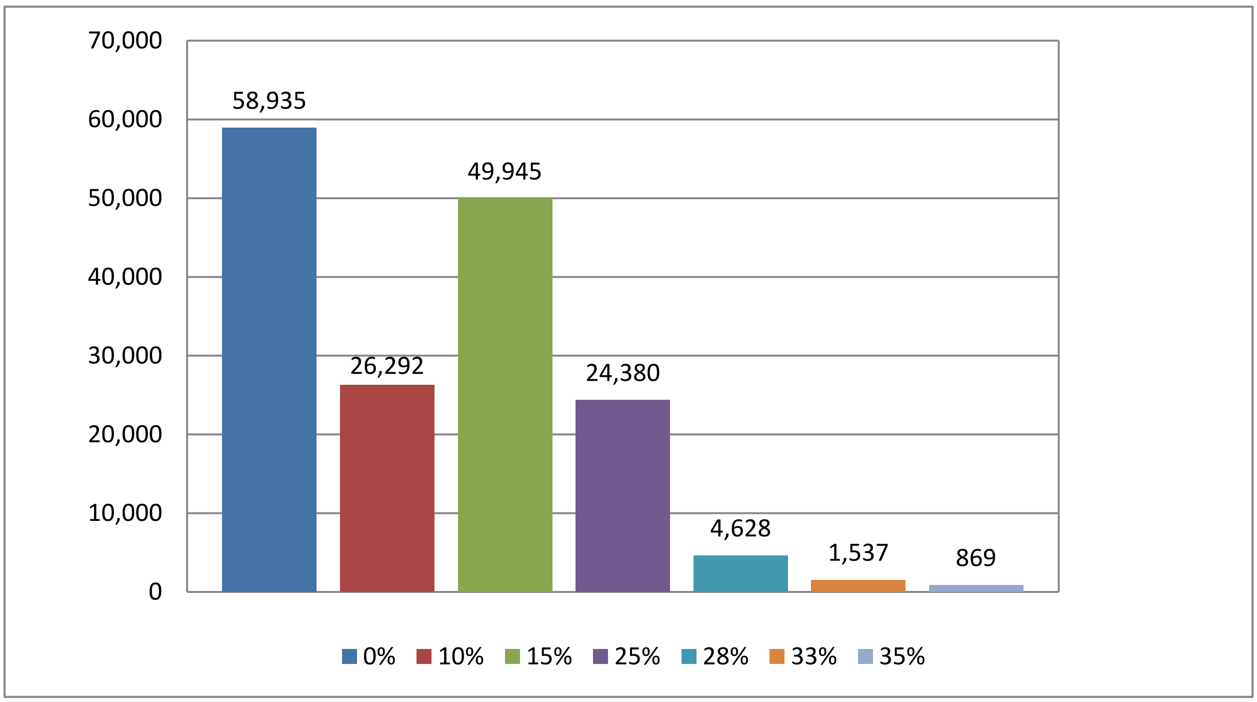


Figure 3–Components of AGI, Constant 2005 Dollars
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
1975
1985
1990
1995
2000
2005
Salaries and wages
Interest
Dividends
Business net income less loss
Net capital gain less loss
All other income
Source: Internal Revenue Service

Figure 4, below shows the number of taxpayers by statutory marginal tax bracket for 2011.[43] The largest single group, of slightly fewer than 59 million returns,[44] or about 36 percent of all returns, has a statutory marginal rate of zero. In contrast, slightly fewer than 870,000 returns have a statutory marginal tax rate of 35 percent, the top marginal rate. Taxpayers with positive statutory marginal tax rates do not necessarily pay positive income taxes after credits. For example, a taxpayer could be in the phase-out range of the earned income credit and be in the 10 percent statutory marginal tax bracket such that an additional 100 dollars of income caused the taxpayer's regular tax liability to rise 10 dollars and his earned income credit fall 16 dollars due to the phase-out of the earned income credit, for a net decline rise in taxes or lost credits of 26 dollars. Such a taxpayer has an effective marginal tax rate of 26 percent. If such taxpayer had previously received $1,000 in refundable earned income credits, he would now receive $974 in refundable credits. Thus, though the taxpayer is in the 10 percent tax bracket and has a positive effective marginal tax rate, the taxpayer still does not pay income taxes on net. This taxpayer's average tax rate would be less than zero.

Figure 4.–Number of Tax Returns (thousands) by Marginal Statutory Tax Rate in 2011



Source: Staff of the Joint Committee on Taxation.

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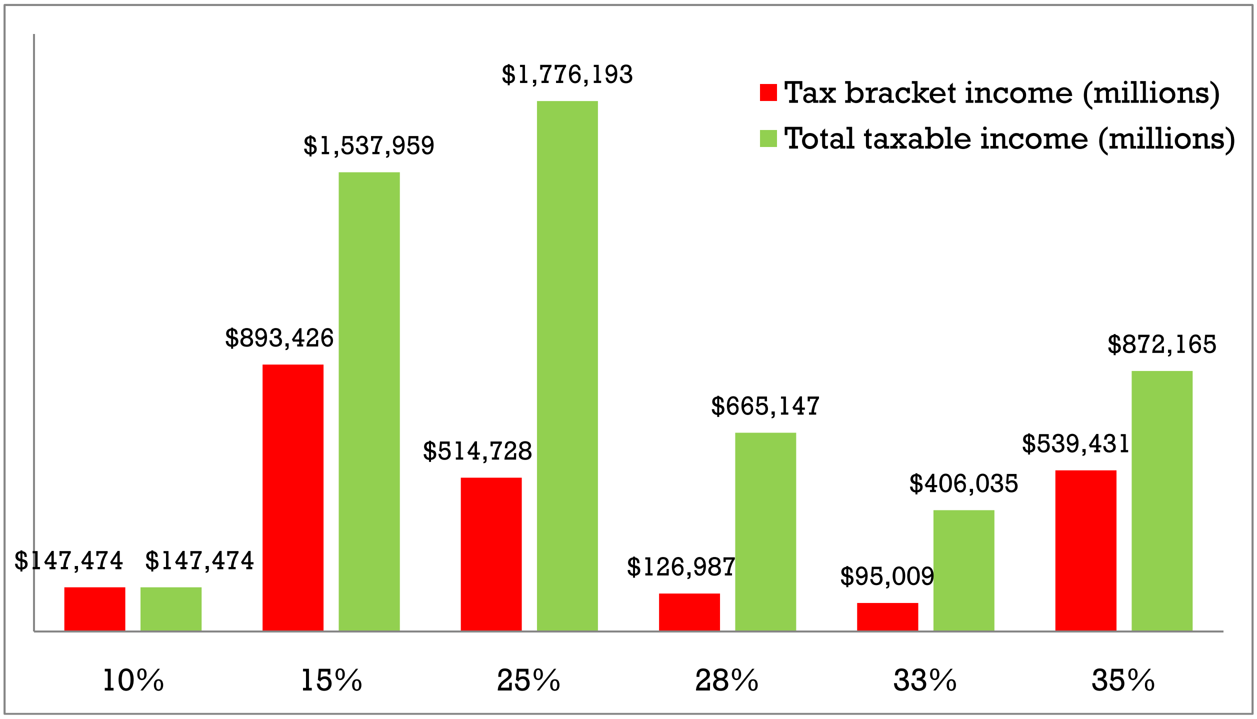
[43] Distribution of combined income, social insurance, and excise taxes under present law is presented below at Table 10.

[44] "Returns" includes filers and nonfilers.

Figure 5, below, sorts taxpayers by their marginal tax bracket (the bracket at which their last dollar of income is taxed), and shows total taxable income of taxpayers in each marginal rate bracket, as well as the taxable income in the marginal bracket alone, for 2011. Thus, for example, taxpayers with a marginal rate bracket of 28 percent have total taxable income of $665.1 billion, of which $127 billion is taxed at the marginal bracket of 28 percent, with the rest taxed at the lower rates of 25, 15 and 10 percent.

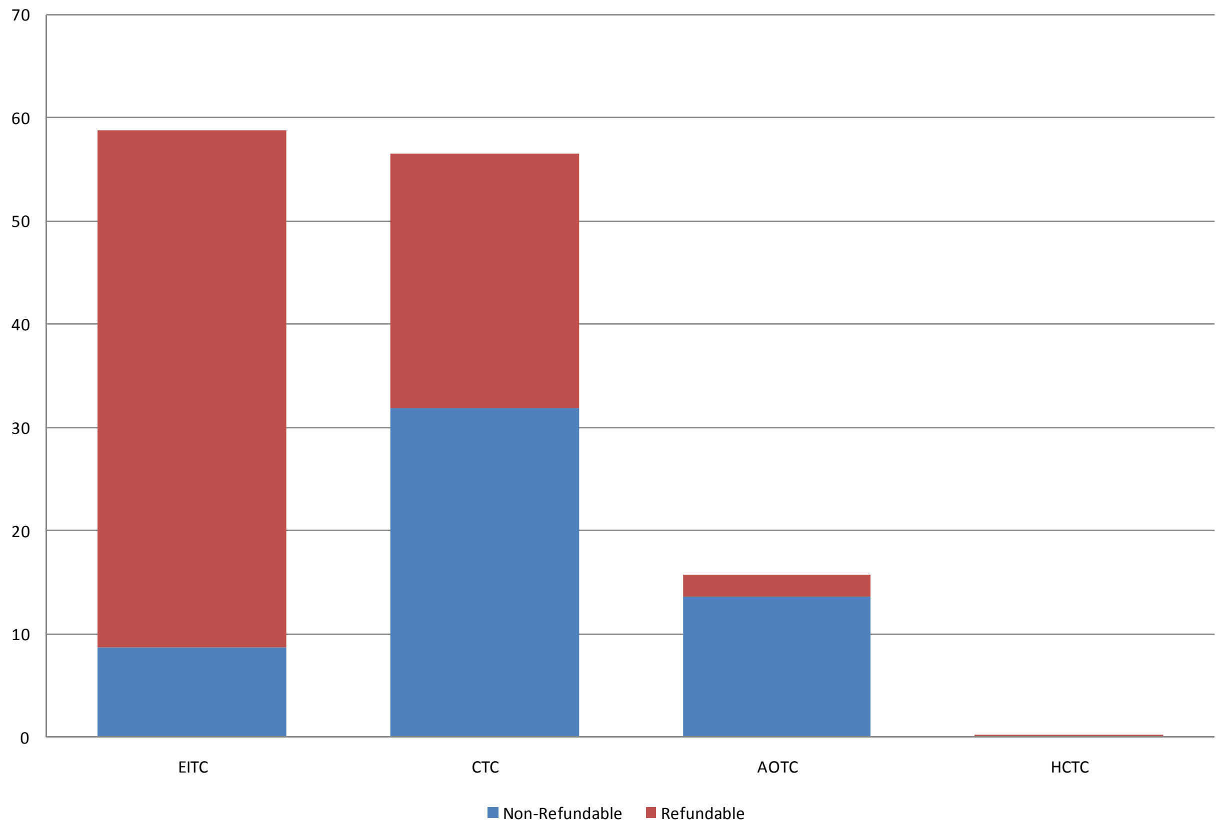
Figure 5.–Total Taxable Income of Taxpayers in Each Individual Tax Rate Bracket in 2011



Note: Capital gains and qualified dividends are excluded from these calculations.
Source: Staff of the Joint Committee on Taxation.

Figure 6 shows the refundable credits for 2011. Three principal refundable individual income tax credits are available in 2011: the earned income tax credit, the child tax credit, and the American opportunity tax credit. Additionally, a health coverage tax credit is available to certain individuals. All but the child tax credit and the American opportunity tax credit are fully refundable credits. In 2011, the aggregate amount of all refundable credits claimed is estimated to be $131.7 billion, of which $77.1 billion is estimated to represent the refundable portion.

Figure 6.–Refundable Credit in Billions of Dollars in Calendar Year 2011



Source: Joint Committee on Taxation.

Data related to the distribution of income and taxes[45]

Table 7, below, shows the projected distribution of income and taxes by income category for 2011 tax returns.[46] For example, tax returns with $30,000 to $40,000 of income constitute 9.8 percent of all returns, 5.0 percent of all income, 2.5 percent of total taxes, 0.0 percent of individual income taxes and 5.1 percent of social insurance taxes. Similarly, tax returns with

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[45] See Table 7 footnote 1, below, for the definition of income used herein.

[46] The income categories and measures of income used in the staff of the Joint Committee models are not directly comparable to the historical data presented earlier in this pamphlet. Additionally, the staff of the Joint Committee on Taxation does not estimate the distribution of the corporate income taxes on account of the uncertainty in the incidence of the corporate income tax. See footnotes to Table 7 for the definition of income used by the staff of the Joint Committee on Taxation.

$100,000 to $200,000 of income constitute 14.1 percent of all returns, 27.6 percent of all income, 31.7 percent of total taxes, 29.8 percent of individual income taxes, and 34.8 percent of social insurance taxes

Table 7 also shows average tax rates by income category for the individual income tax, social insurance taxes, and for total taxes (including the individual income tax, social insurance taxes and excise taxes, but not the corporate income tax). Note that the average tax rate reported here is the tax collected by the relevant tax, divided by total income (not only income subject to the relevant tax). The average tax rate for social insurance taxes is similar across most tax returns, ranging between 7.1 and 10.0 percent for tax returns with income below $500,000, with substantially lower average rates for those with income above $500,000. Because the social insurance tax rates are constant, the variation in the average rate reflects the variation in the different income groups' share of income that is subject to social insurance taxes. The average tax rate under the income tax varies widely, from a negative 10.4 percent to 22.6 percent, reflecting the existence of refundable tax credits and progressive statutory rates of tax.

Table 7.−Distribution of Income and Taxes, and Average Tax Rates in 2011

INCOME CATEGORY (1)	Number of Returns (2) (Thousands)	Share of Returns	Income (Millions of Dollars)	Share of Income	COMBINED INCOME, SOCIAL INSURANCE, AND EXCISE TAXES UNDER PRESENT LAW (3)			INDIVIDUAL INCOME TAXES			EMPLOYMENT TAXES		
					$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate
Less than $10,000................	20,429	13.1%	83,306	0.8%	4.4	0.2%	5.3%	-8.7	-0.9%	-10.4%	8.3	1.1%	10.0%
$10,000 to $20,000..............	16,910	10.8%	258,398	2.4%	1.6	0.1%	0.6%	-24.1	-2.5%	-9.3%	21.3	2.7%	8.3%
$20,000 to $30,000..............	18,400	11.8%	457,489	4.2%	23.9	1.3%	5.2%	-13.5	-1.4%	-2.9%	31.7	4.0%	6.9%
$30,000 to $40,000..............	15,387	9.8%	538,090	5.0%	46.2	2.5%	8.6%	0.3	0.0%	0.1%	40.2	5.1%	7.5%
$40,000 to $50,000..............	13,602	8.7%	610,307	5.7%	64.3	3.5%	10.5%	13.3	1.4%	2.2%	45.4	5.8%	7.4%
$50,000 to $75,000..............	26,719	17.1%	1,650,375	15.3%	212.1	11.7%	12.8%	73.6	7.8%	4.5%	125.4	15.9%	7.6%
$75,000 to $100,000.............	16,955	10.8%	1,466,089	13.6%	218.6	12.1%	14.9%	91.8	9.7%	6.3%	116.8	14.8%	8.0%
$100,000 to $200,000............	22,128	14.1%	2,967,912	27.6%	574.1	31.7%	19.3%	282.8	29.8%	9.5%	274.2	34.8%	9.2%
$200,000 to $500,000............	4,945	3.2%	1,355,166	12.6%	327.2	18.1%	24.1%	224.9	23.7%	16.6%	96.8	12.3%	7.1%
$500,000 to $1,000,000.........	631	0.4%	423,207	3.9%	113.3	6.2%	26.8%	95.9	10.1%	22.6%	16.0	2.0%	3.8%
$1,000,000 and over.............	330	0.2%	960,890	8.9%	226.9	12.5%	23.6%	213.3	22.5%	22.2%	12.8	1.6%	1.3%
Total, All Taxpayers..........	156,435	100.0%	10,771,229	100.0%	1,812.4	100.0%	16.8%	949.6	100.0%	8.8%	789.0	100.0%	7.3%

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EIC), employment tax (attributed to employees), and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

Source: Staff of the Joint Committee on Taxation.

Table 8, below, shows the income distribution of major sources of income.

Table 8.−Distribution of Selected Sources of Income in 2011

INCOME CATEGORY (1)	Wages	Capital Gains in AGI	Dividend Income	Interest Income	Schedule C Income	Schedule E Income
	$ Billions	$ Billions	$ Billions	$ Billions	$ Billions	$ Billions
Less than $10,000...................................	46.7	0.3	1.2	2.3	15.4	-2.6
$10,000 to $20,000...................................	128.0	0.3	1.9	2.1	30.6	-1.7
$20,000 to $30,000...................................	215.5	0.5	2.4	3.7	18.6	-0.7
$30,000 to $40,000...................................	279.7	0.7	4.6	7.2	15.5	0.7
$40,000 to $50,000...................................	317.3	1.5	6.4	9.4	13.5	1.7
$50,000 to $75,000...................................	878.6	6.7	20.9	26.5	28.8	6.4
$75,000 to $100,000.................................	814.3	9.6	19.1	23.6	24.2	9.0
$100,000 to $200,000................................	1,984.4	32.0	39.9	37.0	57.8	42.9
$200,000 to $500,000...............................	910.9	42.9	26.6	21.3	48.0	100.7
$500,000 to $1,000,000.............................	231.5	34.2	16.1	10.0	13.6	84.0
$1,000,000 and over..................................	224.4	257.2	60.5	42.8	13.1	312.2
Total, All Taxpayers.............................	6,031.3	385.9	199.5	186.0	279.0	552.6

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

Table 9, below, shows, by income class, the number of tax returns paying income or social insurance taxes for which the social insurance taxes are greater than income taxes in 2011. Because of the progressive income tax structure and the generally flat structure of social insurance taxes, the likelihood social insurance taxes will exceed income taxes increases as income levels decline. Thus, for example, in the $40,000 to $50,000 income group, 80.5 percent of tax returns have social insurance taxes greater than income taxes, while in the $100,000 to $200,000 group 55.2 percent of returns have social insurance taxes greater than income taxes

Table 9.−Tax Returns with Income or Social Insurance Taxes in 2011

INCOME CATEGORY (1)	Millions of Returns	Individual Income Taxes	Employment Taxes	Returns with Employment Taxes Greater than Income Taxes	Returns with Employment Taxes Less than Income Taxes	Fraction of Returns with Employment Taxes Greater than Income Taxes
		$ Billions	$ Billions	Millions of Returns	Millions of Returns	
Less than $10,000................	13.4	-8.7	8.3	13.4	0.0	99.9%
$10,000 to $20,000..............	13.7	-24.1	21.3	13.3	0.4	97.3%
$20,000 to $30,000..............	13.3	-13.5	31.7	12.8	0.6	95.7%
$30,000 to $40,000..............	13.1	0.3	40.2	11.6	1.5	88.8%
$40,000 to $50,000..............	12.4	13.3	45.4	10.0	2.4	80.5%
$50,000 to $75,000..............	24.9	73.6	125.4	18.2	6.7	73.1%
$75,000 to $100,000..............	16.7	91.8	116.8	10.4	6.3	62.3%
$100,000 to $200,000............	22.1	282.8	274.2	12.2	9.9	55.2%
$200,000 to $500,000............	4.9	224.9	96.8	0.3	4.7	5.6%
$500,000 to $1,000,000..........	0.6	95.9	16.0	0.0	0.6	1.9%
$1,000,000 and over..............	0.3	213.3	12.8	0.0	0.3	1.5%
Total, All Taxpayers.........	135.5	949.6	789.0	102.2	33.3	75.4%

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Less than 50,000.

Source: Staff of the Joint Committee on Taxation.

Table 10, below, shows the average marginal tax rates for labor income and for long-term capital gain income by income category for 2011. A taxpayer's marginal tax rate is the rate of tax that is owed on the last dollar of income of the taxpayer. Table 10 reports the average of the marginal tax rates of each taxpayer in the income category.

The marginal tax rates on labor income reflect the effects of the individual income tax and the social insurance taxes. They generally rise with income, reflecting the progressive nature of the individual income tax. The social insurance tax is flat to regressive,[47] reflecting the fact that the single rate of tax for the Old Age and Survivors Disability Insurance portion of social insurance taxes does not apply to earnings above an annual cap ($106,800 in 2011).[48] The

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[47] Note that this statement reflects only the tax side of social insurance, and not the linked benefits. Many analysts think it is important to consider the tax and benefits of social insurance together.

[48] As table 6 shows, the marginal social insurance tax rate is 12.4. percent rather than the sum of the employer (7.65 percent) and employee share (5.65 percent), or 13.3 percent, for taxpayers who are below he FICA wage cap. The reason for this is that comprehensive income includes the employer share of social insurance tax liability. Hence the marginal social insurance rate is .133 divided by 1.0765, or12.4 percent for taxpayers at the

marginal tax rates on long-term capital income are lower than those for labor income, reflecting both the lower statutory rates of tax applicable to long-term capital gains and the fact that social insurance taxes do not apply to capital gain income. Marginal tax rates on long-term capital gains still generally rise with the level of income, reflecting the statutory structure of the maximum rates of tax on long-term capital gain income, as well as the interaction of capital gain income with other provisions of the income tax that phase out certain tax benefits as income increases.

Table 10.−Marginal Tax Rates on Labor Income and Long-Term Capital Gain, by Income Category in 2011

	Labor Income			Capital Gains Income
	Average Marginal Income Tax Rate (2)	Average Marginal Employment Tax Rate (2)	Average Combine Marginal Income and Employment Tax Rate	Average Marginal Tax Rate
Less than $10,000....................	-9.3%	12.4%	3.0%	0.1%
$10,000 to $20,000..................	-1.5%	12.4%	10.9%	0.2%
$20,000 to $30,000..................	8.6%	12.4%	21.0%	0.5%
$30,000 to $40,000..................	13.0%	12.4%	25.4%	7.9%
$40,000 to $50,000..................	15.0%	12.3%	27.3%	3.3%
$50,000 to $75,000..................	16.6%	12.3%	29.0%	7.8%
$75,000 to $100,000.................	16.4%	12.3%	28.7%	8.6%
$100,000 to $200,000................	22.1%	11.0%	33.1%	13.8%
$200,000 to $500,000................	29.7%	7.3%	37.0%	18.3%
$500,000 to $1,000,000.............	29.1%	6.0%	35.1%	15.0%
$1,000,000 and over.................	30.9%	6.0%	36.9%	14.7%
Total, All Taxpayers...............	14.0%	11.7%	25.7%	14.4%

(1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 2011 levels.

(2) For individual income and employment taxes, the average marginal tax rate is equal to the change in taxes from an additional $100 of wages to each spouse with positive wages. For long-term capital gain, the average marginal tax rate equals the change in taxes from an additional 1% increase in long-term capital gains to each taxpayer with positive long-term capital gains.

Source: Staff of the Joint Committee on Taxation.

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lower end of the expanded income scale as most taxpayers in those income ranges will have wage income below the FICA wage cap.