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A Brief History of the Top Tax Rate

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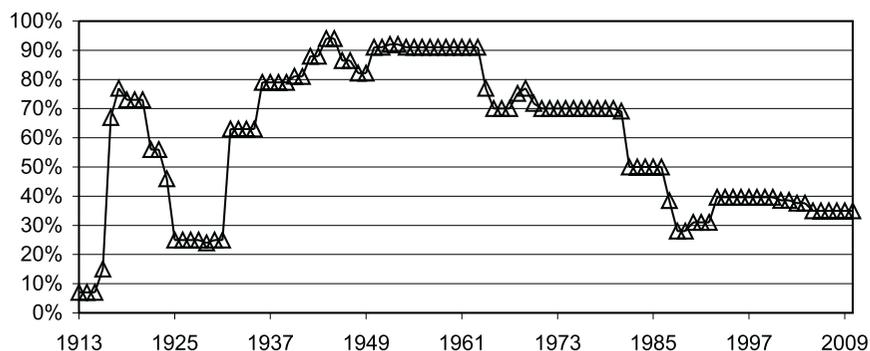
When the income tax was first introduced in 1913, it boasted a top rate of a mere 7 percent on those earning above \$500,000 (close to \$9 million in 2002 dollars). For the nation's wealthiest taxpayers, this was as good as it was ever going to get — this state of affairs lasted just three years. The nation's entrance into World War I prompted an explosion in the top rate to 67 percent by 1917, or a 950 percent increase in a two-year span (the threshold for the top rate jumped four-fold to \$2 million). The top rate would remain around 70 percent until 1925, when it fell to 25 percent.

Although this reprieve lasted through the roaring 1920s, it was temporary. After the Depression hit, the top tax rate again jumped to 63 percent in 1932 (under President Hoover). With the continuation of the Depression and beginning of World War II, it jumped into the 70s, 80s, and 90s percentile ranges, peaking in 1945 at 94 percent for incomes of \$200,000 or more (an historically low threshold, although still about \$2 million in 2002 dollars). Just four years prior, in 1941, the threshold for the top rate of 81 percent had been \$5 million, or 25 times higher.

High rates persisted through the 1950s (especially during the Korean War). The Kennedy round of tax cuts in

1964 reduced the top rate to 70 percent for incomes over \$200,000 (about \$1 million in 2002 dollars). Outside of some very temporary surcharges for the Vietnam War, the top rate remained at 70 percent until Reagan-sponsored tax legislation in 1981 lowered it to 50 percent (although there already was a maximum tax on "earned" income of 50 percent). Tax reform in 1986 further dropped the 50 percent rate to 28 percent by 1988 — the lowest since 1931 — although the meaning of "top rate" was confused by the intermediate or "bubble" rate of 33 percent. The 1990 budget agreement under President George H.W. Bush raised the top rate to 31 percent, while the 1993 budget agreement under President Clinton pushed the top rate to 39.6 percent (on incomes over \$250,000 or \$309,000 in 2002 dollars). The rate was cut through 2001 legislation to 38.6 percent in 2002, with further scheduled drops to 37.6 percent in 2004, and 35 percent in 2006, before rising again to 39.6 percent in 2011. Interestingly, the 35 percent rate is the same as originally proposed in Treasury's 1984 landmark study that led to the Tax Reform Act of 1986.

Top Tax Rate on Individual Income, 1913-2010



Note: This table contains a number of simplifications and ignores a number of factors, such as a maximum tax on earned income of 50 percent when the top rate was 70 percent and the current increase in rates due to income-related reductions in the value of itemized deductions. Perhaps most importantly, it ignores the large increase in the percentage of returns that were subject to this top rate.

Sources: Eugene Steuerle, The Urban Institute; Joint Committee on Taxation; Joseph Pechman, *Federal Tax Policy*, 1987, Appendix Table A-1.



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