



tax facts

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A Brief History of Marginal Tax Rates

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A person's marginal tax rate, the tax rate on their last dollar of income, may influence their decision to work and save. As marginal tax rates increase, the after-tax reward from working an additional hour or saving more decreases. Although the actual effect on economic decisions is uncertain (some people respond to higher taxes by saving more and working harder to make up for the additional tax hit), economists view the marginal tax rate as a gauge of the efficiency cost of taxation.

The figure below shows how marginal tax rates on earnings have changed for a family of four whose income is in the middle of the income distribution — and for similar families at twice and half that income level from 1955 to 2003. In 2003, the median family earned \$65,507. By comparison, in 1955, the median family earned \$4,919 (worth about \$33,754 in 2003 dollars).

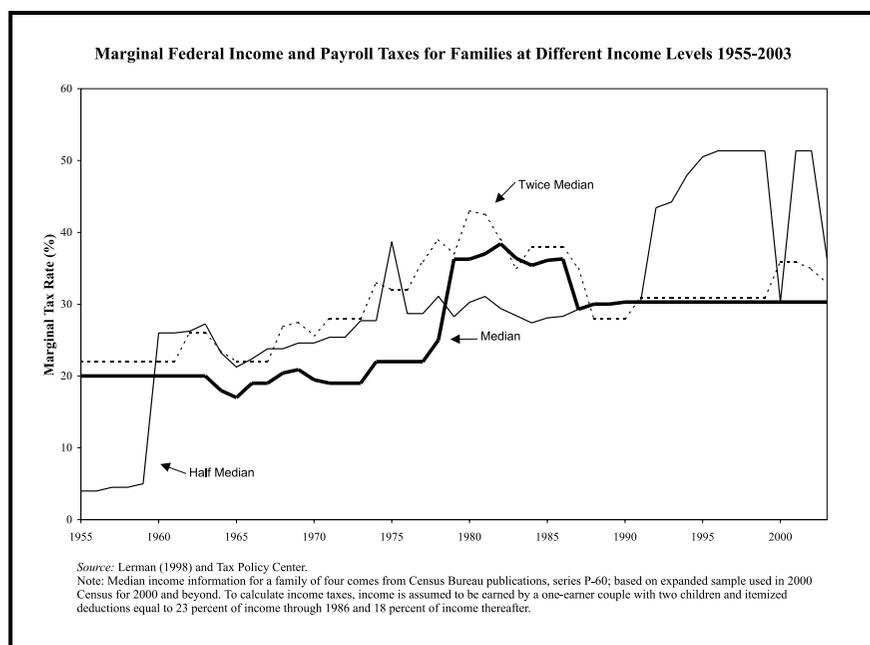
Increasingly, lawmakers have used the income tax system to target benefits for low-income families. Since the benefits phase out with income, they can create large implicit surtaxes in certain income ranges. Low- and middle-income households also face higher effective marginal rates stemming from payroll taxes, which make up the majority of taxes for three-quarters of filers (see this column, Jan. 6, 2003, p. 119). Earnings over a certain threshold are exempted from the remaining tax, which adds 12.3 percent to marginal tax rates. In 2003, this threshold was \$87,000.¹

Comparing families at the same point in the income distribution from 1955 through 2003, we find that those families at one-half the median income face generally increasing marginal tax rates — from 4 percent in 1955 to 51.36 percent in 2002. In 2003, the introduction of the refundable child tax credit (effectively a negative income tax in the phase-in range) and the expansion of the 10 percent bracket reduced marginal rates for this group to 36.36 percent, a rate higher than that faced by families at the median and twice the median income level.

Recent tax law changes enacted in 2001 and 2003 lowered effective marginal rates for families at twice the median income, while leaving marginal rates for families at the median income level unchanged.

This analysis is based on Allen Lerman, "Average and Marginal Federal Income, Social Security and Medicare, and Combined Tax Rates for Four-Person Families at the Same Relative Positions in the Income Distribution, 1955-1999," Office of Tax Analysis, Department of the Treasury, January 15, 1998, which we updated from 1997-2003. The updated version is available at <http://www.taxpolicycenter.org>.

¹These calculations and the figure assume that employers pass on their portion of payroll taxes to workers in the form of lower wages. The full analysis on our Web site also presents estimates assuming that employers do not pass on payroll taxes.



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