Income Taxes and Tax Rates for Sample Families, 2006

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This article examines how much income tax families pay in different situations, as well as the effective marginal tax rates they would pay on additional earnings, for tax year 2006. Although the examples represent very simple tax situations, they illustrate several key aspects of our personal income tax system. For example,

- Effective tax rates often differ substantially from statutory tax rates because of phase-ins and phase-outs of deductions and credits and because of the individual alternative minimum tax.
- Average tax rates are always less than statutory tax rates because tax schedules are progressive and because deductions and credits reduce tax liability compared with a flat tax with no exemptions.
- The individual alternative minimum tax substantially changes effective marginal tax rates (and tax liability) for upper-income households and those with many children. However, millionaires with relatively simple tax situations are exempt from the tax.

Introduction

The tables in this article illustrate the variations in tax liability and tax rates confronting typical families as income and the number of children change. Table 1 shows total taxes and average tax. Taxpayers subject to the individual alternative minimum tax (AMT) are indicated by dark shading.[1] The AMT rate and AMT liability for taxpayers subject to the AMT are presented in table 2. The statutory income tax rate (the tax bracket) and the effective marginal tax rate for the same families are shown in table 3. Last, table 4 lists the effective marginal rates presented in table 3 and shows how interactions in the tax code combine to create them.

The families presented in this paper are assumed to file relatively simple returns. Filers are neither blind nor elderly; income is comprised solely of earnings, capital gains, and dividends; potential itemized deductions equal 21 percent of income, and the taxpayer claims the larger of their itemized deductions or standard deduction and no other deductions; all children are potentially eligible for dependency exemptions, the earned income tax credit (EITC) and the child credit (CTC); and the filer claims no other credits. Though many of the complexities in the individual tax return have been assumed away in this analysis, most households file relatively simple returns like those described here, and plenty of interactions remain to create large variations in tax liability and the effective tax rates on such returns.

Tax Liability and Average Tax Rates

For families with low incomes, income tax liability (shown in the top panel of table 1) is often negative because of the refundable EITC and the CTC. Refundable tax credits like these are paid out as refunds even if the tax filer has no income tax liability. Both of these credits are designed to reward work and assist families with children. Up to a point, families can get larger credits the

more they earn. (A much smaller earned income credit is also available for low-income filers without children.)

High-income families face substantial positive income tax liability. Because of the progressive rate structure in the U.S. income tax, tax liability trends upward at a much faster rate than income. Since tax brackets, credit amounts, and other elements of the tax code differ with filing status and the number of children present, the income levels at which families face positive income tax liability vary widely. A single filer will have a positive income tax liability with income of just over $10,000 while a head of household with three children will still receive a net refund with $35,000 of income and a married family with three children will receive a refund with $50,000 of income.

The average tax rate (shown in the bottom panel of table 1) is the total tax liability expressed as a percentage of total income. Because tax rates rise with income, the average tax rate is always significantly lower than the top statutory tax rate of 35 percent—even for taxpayers with $1 million of income. The average tax rate for households with income of $1 million is about 21 percent for joint filers and 22 percent for singles and heads of household. The average tax rate differs from the statutory tax rate because only a portion of income is taxed at the taxpayer's top statutory tax rate; the rest is taxed at lower rates or not at all because of deductions and exclusions. The average tax rate may also differ from the statutory tax rate because of tax credits that reduce tax liability and preferential rates applied to capital income.

For low- and moderate-income families, having children reduces average tax rates substantially because of dependent exemptions, child tax credits, and the earned income tax credit. However, for high-income households, the tax benefits of children are significantly reduced. At incomes above $110,000 ($75,000 for heads of household and singles), the child tax credit starts to phase out; it is phased out entirely at an income of $129,001 for a family with one child, $149,001 for a family with two children, and so on.[2] In addition, for households with income above $225,750 ($150,500 for single filers and $188,150 for heads of household) the value of personal exemptions is reduced.[3] As a result, people with high incomes will pay similar tax regardless of their family size. In addition, personal exemptions are not allowed under the AMT. If a household is caught by the AMT and the child credit has already phased out, the family will owe the same tax with six children as it would with none.

Table 2 presents the statutory AMT tax rate and AMT liability, including lost credits and reduced deductions, for sample families subject to the tax in 2006. Since the sample families, by assumption, have the same preference items limited by the AMT at each income level, the variation in AMT liability in the table is driven by the different tax brackets for each filing status in the regular income tax and the variation in the number of children in the sample family. Because the AMT does not allow personal exemptions, as the number of children increases the income at which families become subject to the AMT decreases sharply. A head of household with only one child will not be affected by the AMT even with income well over $100,000 while a head of household with six children will be subject to the AMT with income of only $75,000 even though total tax liability will remain negative. The families subject to the AMT will, of course, still pay less in tax than the families with the same income and filing status not affected by the AMT.

Statutory and Marginal Tax Rates

Table 3 shows the effective marginal and statutory tax rates for the sample families. In the federal income tax system, the effective marginal tax rates vary significantly from the statutory income tax rates. Approximately one in three tax-filing units (34 percent) have an effective marginal tax rate different from their statutory tax rate. These differences are important since they influence the incentives to work, save, and comply with the tax system.

The statutory tax rate for a given level of taxable income is the highest income tax rate under the regular income tax that applies to that income before income tax credits. The effective marginal tax rate is the additional tax liability incurred if an individual's income were to increase by a dollar.[4] Note that the marginal rates vary depending on the kind of income. For this analysis, all marginal tax rates are in terms of labor income (wages). Due to the phase-in and phase-out of tax credits and other provisions of the tax system, the effective marginal tax rate may differ from the statutory tax rate. For 2006, statutory rates of 0, 10, 15, 25, 28, 33, and 35 percent apply at steadily higher income levels. However, because of the interaction of other features of the tax law, the effective marginal tax rate of a tax filer with a statutory rate of zero percent, for example, might be 8 percent or –40 percent depending on income, family composition, and other factors.

The effective marginal rates for high-income households are usually higher than their statutory rates because they lie in the phase-out regions of tax credits, itemized deductions, and personal exemptions. In contrast, low-income households, especially those with children, often face subsidies because the households are in the phase-in region of tax credits.

Phase-ins of tax credits cause the effective marginal tax rates to be lower than statutory rates. The EITC is one of the main reasons why the effective marginal tax rate differs from the statutory tax rate for low-income tax filers. In 2006, the phase-in rate for filers with two or more children is 40 percent up to $11,340 in income. In other words, a tax filer with two or more children will be refunded 40 cents for every additional dollar earned until income reaches $11,340. This subsidy reduces the effective marginal tax rate by 40 percentage points.

In contrast, phase-outs of tax credits, itemized deductions, and personal exemptions increase the marginal tax rate of a tax filer. The phase-out of the EITC for married filers with two or more children is 21.06 percent for income levels above $16,810 ($14,810 for heads of household and single filers). Thus, for every dollar they earn, in addition to the tax liability on that dollar, their EITC will decrease by 21.06 cents. Their effective marginal tax rate is increased by 21.06 percentage points.

Often, these hidden taxes and subsidies interact, making the marginal tax rate an amalgam of different effects. The nearly endless array of possible marginal tax rates is an indicator of the complexity of our tax system. Table 4 shows the components of each of the effective marginal tax rates in table 3.

Discussion

Many low-income families receive subsidies from the earned income tax credit and the child tax credit. For example, households with $10,000 of income and two or more children face a negative tax liability (receive a net refund), a negative average tax rate, and a negative effective marginal tax rate despite the fact that their statutory rate is zero percent. If the same families earned $15,000, their effective marginal tax rate jumps from –40 percent to 6.1 percent for single heads of household and –15 percent for married filers. The –40 percent marginal rate corresponds to the phase-in of the EITC. At the higher income level, the EITC starts to phase out at a 21.06 percent rate for single heads of household, but that tax is partially offset by the phase-in of the child credit at a 15-percent rate, producing a net effective rate of 6.06 percent (21.06 minus 15 percent).[5] A married couple, however, is not yet in the phase-out range of the EITC so its effective marginal tax rate is simply the –15 percent corresponding to the phase-in of the CTC.

Despite being on the EITC, a married couple with $10,000 in AGI and one child faces an effective marginal tax rate of 0 percent. A $5,000 increase in AGI will result in an effective marginal rate of –15 percent while a $15,000 increase in AGI results in a rate of 26 percent. Initially, with AGI of $10,000, the family has sufficient income to receive the full value of the EITC, but has not yet reached the income threshold at which the credit begins to phase out. With an additional $5,000 the family is able to claim the refundable child credit, which phases in at a 15 percent rate, still without reaching the EITC's phase-out threshold. However, when the household's AGI reaches $25,000 the members face a positive statutory rate (10 percent) for the first time, as the standard deduction and personal exemptions are no longer sufficient to offset all of their income, they are subject to the 15.98 percent EITC phase-out rate for a family with one child, and their child credit has phased in fully.

Effective marginal tax rates exceed statutory rates for most high-income families, because their income is in the phase-out region of personal exemptions or itemized deductions. For example, a single filer with an AGI of $1 million has a 35 percent statutory rate. However, her effective marginal tax rate is 35.7 percent because of the two-percent phase-out rate of itemized deductions.[6] A dollar of additional income raises taxable income by $1.02, because two cents of deductions are lost. Since the individual is in the phase-out region of itemized deductions, the effective marginal rate is 35.7 percent = 1.02 * 35 percent. Some taxpayers, such as a single filer with an AGI of $150,000, face a simultaneous phase-out of both itemized deductions and personal exemptions.

Some high-income families have effective marginal tax rates lower than their statutory rates because of the AMT. For example, families with $500,000 of AGI face an alternative minimum tax rate of 28 percent instead of the regular tax rate of 33 percent (see table 3).[7] (However, it should be realized that families on the AMT facing a lower rate still pay more in actual tax than they would under the regular tax system—the lower rate gets assessed on a bigger portion of the taxpayer's income.)

Finally, figure 1 illustrates what the effective marginal tax schedule looks like for a married couple with two children. (Note that the income breaks in the figure are much finer than in the tables.) The figure bears little resemblance to the statutory tax schedule. Some low-income

families face negative effective tax rates because of the phase-in of the EITC whereas others can face very high effective tax rates because of the credit's phase-out.[8] The high effective tax rates among those with moderately high incomes are attributable to the AMT and the phase-out of the AMT exemption, which can push effective tax rates as high as 35 percent. People with very high incomes face a drop in their effective marginal tax rates because of the end of the AMT phase-out. Eventually, at very high incomes, they return to the regular income tax, with its top effective tax rate of 35.7 percent.

Notes

Greg Leiserson is a research assistant at the Urban-Brookings Tax Policy Center. This analysis is an update of Burman and Saleem (2004). Views expressed are those of the author alone and do not necessarily reflect the views of the Urban Institute, its board, or its funders. The author thanks Len Burman and Bob Williams for helpful comments and suggestions.

1. The AMT is an alternative tax that applies to many upper-income taxpayers. The tax is calculated by adding a number of preference items to taxable income, subtracting an exemption, and calculating tax according to the AMT rate schedule. Formally, AMT liability is the excess of this alternative tax liability above regular tax liability. See Burman, Gale, and Rohaly (2003) for additional details.
2. The child credit is reduced by $50 for each $1,000 (or fraction thereof) of income above the threshold.
3. Prior to 2006, personal exemptions were entirely eliminated for those with high incomes. The value of the exemption was reduced by 2 percent for each $2,500 (or fraction thereof) of income above the threshold. However, the Economic Growth and Taxpayer Relief and Reconciliation Act of 2001 eliminates the personal exemption phase-out between 2006 and 2010. In 2006 and 2007, taxpayers lose a maximum of two-thirds of the original exemption; in 2008 and 2009, they lose a maximum of one-third; and in 2010 they lose nothing.
4. In practice, marginal tax rates are calculated by adding more than one dollar in order to avoid discontinuities in the tax code. For example, the child credit phases out in discrete steps for each $1,000 of income over the phase-out thresholds. Consider a taxpayer with income exactly equal to the phase-out threshold. A $1 increase in income will increase taxes dramatically because $50 in tax credits will be lost. In the calculations presented here, the marginal increase in income is the maximum of $100 and the minimum of one percent of AGI and $1,000.
5. The child credit starts to phase in at $11,300 of earnings in 2006.
6. Like the phase-out of personal exemptions, the phase-out of itemized deductions is being eliminated between 2006 and 2010. Before 2006, itemized deductions phased out at a 3 percent rate for taxpayers with incomes above a certain threshold. In 2008 and 2009, they will phase out at a 1 percent rate and there is no phase-out in 2010. Like all other provisions of EGTRRA, the itemized deduction phase-out is scheduled to be reinstated in 2011 after EGTRRA expires.
7. Many upper-middle class families also face higher effective tax rates because of the AMT. Note that, in Table 3, families with incomes less than $200,000 on the AMT (indicated with a black background) have effective tax rates considerably higher than their statutory rates. Moreover, since the number of upper-middle income families on the AMT is expected to explode over time barring a change in law, the vast majority of AMT taxpayers will face higher marginal tax rates under the AMT than under the regular income tax by 2010. See Leiserson and Rohaly (2006) for additional details.
8. See Carasso and Steuerle (2002) for a discussion.

References

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Table 1. Income Tax Liability of Sample Families by Type of Filer for Tax Year 2006

AGI	Single	Head of Household				Married Filing Joint				
# of kids	0	1	2	3	6	0	1	2	3	6
# of filers	48.3 mil	10.2 mil	5.6 mil	1.3 mil	0.01 mil	25.4 mil	10.1 mil	10.9 mil	4.3 mil	0.10 mil
Tax Liability (in Dollars)										
$10,000	(7)	(2,747)	(4,000)	(4,000)	(4,000)	(315)	(2,747)	(4,000)	(4,000)	(4,000)
$15,000	655	(3,272)	(5,051)	(5,051)	(5,051)	0	(3,302)	(5,091)	(5,091)	(5,091)
$25,000	2,090	(1,029)	(3,635)	(4,445)	(4,445)	810	(1,958)	(4,661)	(4,866)	(4,866)
$35,000	3,275	1,590	(189)	(1,684)	(3,839)	1,960	480	(1,555)	(2,885)	(4,260)
$50,000	5,518	3,308	1,813	318	(4,167)	4,090	2,595	1,100	(395)	(4,735)
$75,000	10,388	7,363	5,538	3,713	(338)	6,985	5,490	3,995	2,500	(1,985)
$100,000	15,203	13,178	11,603	9,778	6,616	10,935	9,110	7,285	5,460	855
$125,000	20,391	17,883	17,058	16,291	13,291	15,640	14,565	12,740	10,915	6,328
$150,000	25,593	23,404	23,404	23,404	21,154	20,325	19,500	18,675	16,850	12,982
$200,000	36,798	36,798	36,798	36,798	36,798	30,123	29,199	29,147	29,147	27,647
$500,000	108,525	108,525	108,525	108,525	108,525	108,525	108,525	108,525	108,525	108,525
$1,000,000	220,722	217,341	216,956	216,571	215,416	214,440	214,440	214,440	214,440	214,440
$1,500,000	325,073	321,691	321,306	320,921	319,766	318,078	317,693	317,308	316,923	315,768
$2,000,000	436,623	433,241	432,856	432,471	431,316	429,628	429,243	428,858	428,473	427,318
Average Tax Rates (in Percent)										
$10,000	(0.1)	(27.5)	(40.0)	(40.0)	(40.0)	(3.2)	(27.5)	(40.0)	(40.0)	(40.0)
$15,000	4.4	(21.8)	(33.7)	(33.7)	(33.7)	0.0	(22.0)	(33.9)	(33.9)	(33.9)
$25,000	8.4	(4.1)	(14.5)	(17.8)	(17.8)	3.2	(7.8)	(18.6)	(19.5)	(19.5)
$35,000	9.4	4.5	(0.5)	(4.8)	(11.0)	5.6	1.4	(4.4)	(8.2)	(12.2)
$50,000	11.0	6.6	3.6	0.6	(8.3)	8.2	5.2	2.2	(0.8)	(9.5)
$75,000	13.9	9.8	7.4	5.0	(0.5)	9.3	7.3	5.3	3.3	(2.6)
$100,000	15.2	13.2	11.6	9.8	6.6	10.9	9.1	7.3	5.5	0.9
$125,000	16.3	14.3	13.6	13.0	10.6	12.5	11.7	10.2	8.7	5.1
$150,000	17.1	15.6	15.6	15.6	14.1	13.6	13.0	12.5	11.2	8.7
$200,000	18.4	18.4	18.4	18.4	18.4	15.1	14.6	14.6	14.6	13.8
$500,000	21.7	21.7	21.7	21.7	21.7	21.7	21.7	21.7	21.7	21.7
$1,000,000	22.1	21.7	21.7	21.7	21.5	21.4	21.4	21.4	21.4	21.4
$1,500,000	21.7	21.4	21.4	21.4	21.3	21.2	21.2	21.2	21.1	21.1
$2,000,000	21.8	21.7	21.6	21.6	21.6	21.5	21.5	21.4	21.4	21.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

Notes: Households on the AMT are indicated by a dark background. Number of filers excludes dependent returns. Kids includes only children in the home for whom an exemption may be claimed.

Assumptions:

(1) All children qualify for the dependency exemption, the earned income tax credit, and the child tax credit.

(2) Households do not claim any other tax credits (such as the dependent care credit, adoption credit, or education tax credits).

(3) Itemized deductions are assumed to be 21 percent of adjusted gross income (AGI), which was the average ratio for itemizers in 2004. For purposes of calculating the AMT, tax preference items are assumed to be 40% of itemized deductions.

(4) The fraction of AGI composed of capital gains and dividends at each AGI level is based on current law tabulations from the TPC tax model. AGI under $50,000 is assumed to be wages only. The fractions are as follows (the first percentage is for capital gains and the second is for dividends): $50,000: 0.8% and 1.0%; $75,000: 1.1% and 1.0%; $100,000: 1.7% and 1.1%; $125,000: 2.7% and 1.4%; $150,000: 3.5% and 1.6%; $200,000: 5.4% and 2.1%; $500,000: 13.8% and 2.1%; $1,000,000: 17.6% and 3.0%; $1,500,000: 22.6% and 3.6%; $2,000,000: 23.6% and 3.6%. All capital gains are assumed to be long-term gains and all dividends qualifying dividends.

Table 2. AMT Tax Rate and AMT Liability for Sample Families Affected by the AMT

AGI	Single	Head of Household				Married Filing Joint				
# of kids	0	1	2	3	6	0	1	2	3	6
AMT Tax Rate (in Percent)										
$75,000					26					
$100,000					26					
$125,000				26	26					26
$150,000		26	26	26	26					26
$200,000	26	26	26	26	26			26	26	26
$500,000	28	28	28	28	28	28	28	28	28	28
$1,000,000						28	28	28	28	28
AMT Liability (including direct liability, lost credits, and reduced deductions)										
$75,000					935					
$100,000					2,314					
$125,000				559	3,034					888
$150,000		836	1,661	2,486	4,961					1,607
$200,000	576	3,778	4,640	5,502	8,090			872	1,796	4,384
$500,000	3,950	7,309	7,672	8,035	9,124	10,923	11,286	11,649	12,012	13,100
$1,000,000						713	1,098	1,483	1,868	3,022

See notes at end of Table 1. Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

Table 3. Statutory Tax Rates and Marginal Tax Rates by Type of Filer for Tax Year 2006, in Percent

AGI	Single	Head of Household				Married Filing Joint				
# of kids	0	1	2	3	6	0	1	2	3	6
Statutory Tax Rates (regular income tax only)										
$10,000	10	0	0	0	0	0	0	0	0	0
$15,000	10	10	0	0	0	0	0	0	0	0
$25,000	15	15	10	10	0	10	10	10	0	0
$35,000	15	15	15	15	10	15	10	10	10	0
$50,000	25	15	15	15	15	15	15	15	15	10
$75,000	25	25	25	25	15	15	15	15	15	15
$100,000	25	25	25	25	25	25	25	25	15	15
$125,000	28	25	25	25	25	25	25	25	25	25
$150,000	28	25	25	25	25	25	25	25	25	25
$200,000	28	28	28	28	28	28	28	28	28	25
$500,000	33	33	33	33	33	33	33	33	33	33
$1,000,000	35	35	35	35	35	35	35	35	35	35
$1,500,000	35	35	35	35	35	35	35	35	35	35
$2,000,000	35	35	35	35	35	35	35	35	35	35
Effective Marginal Tax Rates										
$10,000	17.7	0	-40	-40	-40	7.7	0	-40	-40	-40
$15,000	10	1	6.1	6.1	6.1	0	-15	-15	-15	-15
$25,000	15	31	31.1	6.1	6.1	10	26	31.1	6.1	6.1
$35,000	15	15	36.1	36.1	6.1	15	13.5	31.1	31.1	6.1
$50,000	25	15	15	15	15	15	15	15	15	10
$75,000	25	30	30	30	31	15	15	15	15	15
$100,000	25	25	30	30	31	25	25	25	25	15
$125,000	28	25	30	31	31	25	30	30	30	31
$150,000	29.5	32.5	32.5	32.5	37.5	25.3	25.3	25.3	30.3	31
$200,000	32.5	32.5	32.5	32.5	32.5	28.6	28.6	32.5	32.5	37.5
$500,000	28	28	28	28	28	28	28	28	28	28
$1,000,000	35.7	35.7	35.7	35.7	35.7	28	28	28	28	28
$1,500,000	35.7	35.7	35.7	35.7	35.7	35.7	35.7	35.7	35.7	35.7
$2,000,000	35.7	35.7	35.7	35.7	35.7	35.7	35.7	35.7	35.7	35.7

See notes at end of Table 1. Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).

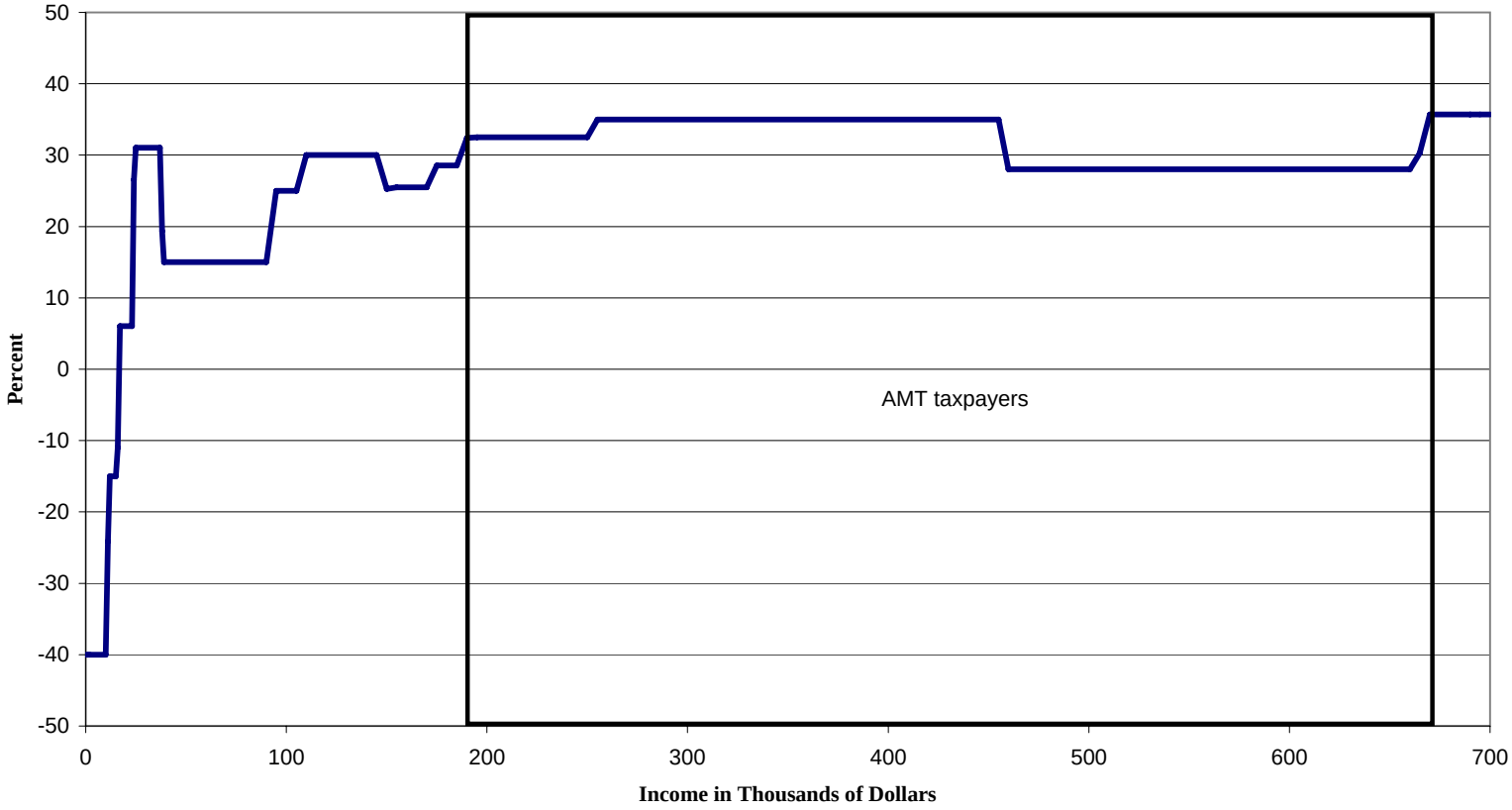
Table 4. Derivation of Effective Marginal Tax Rates Where They Differ from Statutory Rates

Category	Rate (%)	Reason
$10,000 to $50,000	(40)	0% (statutory) – 40% EITC phase-in (2 children)
	(15)	0% (statutory) – 15% refundable Child Credit phase-in
	1.0	0% (statutory) + 15.98% EITC phase-out (1 child) – 15% refundable Child Credit phase-in
	6.1	0% (statutory) + 21.06% EITC phase-out (2 children) – 15% refundable Child Credit phase-in
	7.7	0% (statutory) + 7.65% EITC phase-out (no children)
	13.5	Marginal increase in income ($1000) partially taxed at 10% and partially taxed at 15%
	17.7	10% (statutory) + 7.65% EITC phase-out (no children)
	26	10% (statutory) + 15.98% EITC phase-out (1 child)
	31	15% (statutory) + 15.98% EITC phase-out (1 child)
	31.1	10% (statutory) + 21.06% EITC phase-out (2 children)
	36.1	15% (statutory) + 21.06% EITC phase-out
$75,000 to $1,000,000	25.3	Marginal increase in income ($1000) partially taxed at 25% and partially taxed at 25.5%, 25% (statutory) + 0.5% (=.02*25%) phase-out of itemized deductions
	28	28% (AMT)
	28.6	28% (statutory) + 0.56% (=0.02*28%) phase-out of itemized deductions
	29.5	Marginal increase in income ($1000) partially taxed at 28% and partially taxed at 29.7%, 28% (statutory) + 0.56% (=.02*28%) phase-out of itemized deductions + 1.232% (=44/1000*28%) phase-out of personal exemptions[a]
	30	25% (statutory) + 5% (=50/1000) Child Credit phase-out[a]
	30.3	Marginal increase in income ($1000) partially taxed at 30%, 25% (statutory) + 5% (=50/1000) child credit phase-out, and partially taxed at 30.5%, 25% (statutory) + 5% (=50/1000) child credit phase-out + 0.5% (=.02*25%) phase-out of itemized deductions
	31	26% (AMT) + 5% (=50/1000) Child Credit phase-out
	32.5	26% (AMT) + 6.5% (0.25*26%) phase-out of AMT exemptions
	33.7	33% (statutory) + 0.66% (=0.02*33%) phase-out of itemized deductions
	35.7	35% (statutory) + 0.70% (=0.02*35%) phase-out of itemized deductions
	37.5	26% (AMT) + 6.5% (0.25*26%) phase-out of AMT exemptions + 5% (=50/1000) Child Tax Credit phase-out

Notes: Marginal tax rates are calculated by increasing income by a small amount and calculating the increment in tax liabilities after credits per dollar of additional income. The marginal increase in income is the maximum of $100 and the minimum of one percent of AGI and $1,000. The effective marginal tax rates might not add up exactly because of rounding or because the formulae for them are not exactly continuous.

a. The child credit phases out at a rate of $50 per $1,000 of income. The marginal effective tax rate created by this phase-out can be larger than five percent for a small income change if it pushes the taxpayer over one of the discrete phase-out steps. For example, a couple earning $111,950 would lose $50 in tax credits if their income increased by $51, for an effective marginal tax rate of almost 100 percent. Similarly, personal exemptions phase out at a rate of 2 percent of the original value of the exemption per $2,500 of income. Our formula for the marginal change in income attempts to smooth out these kinks.

Figure 1. Effective Marginal Tax Rates on Wage Income For Married Filing Joint Returns with 2 Children, by Income in 2006



See notes at end of table 1. For the calculations in this figure only, income consists solely of wages. Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 1006-1).