# CBO MEMORANDUM

**IMPLICIT MARGINAL TAX RATES:
COMPARING THE HEALTH SECURITY ACT
AND THE MANAGED COMPETITION ACT
WITH CURRENT LAW**

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SECOND AND D STREETS, S.W.
WASHINGTON, D.C. 20515

This Congressional Budget Office (CBO) memorandum examines implicit marginal tax rates under the Health Security Act (H.R. 3600) and the Managed Competition Act (H.R. 3222) and compares them with rates under current law. It was prepared by David Weiner of CBO's Tax Analysis Division under the supervision of Rosemary Marcuss, Rick Kasten, and Frank Sammartino. Len Burman, Doug Elmendorf, Nancy Gordon, Bob Dennis, Bill Randolph, Murray Ross, Ralph Smith, and Bob Williams of CBO and Billy Jack of the Joint Committee on Taxation provided useful comments and suggestions. The final manuscript was edited by Christian Spoor and prepared for publication by Simone Thomas.

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## INTRODUCTION AND SUMMARY

One primary goal of broad-based efforts to restructure the health care system is to cover many, if not all, of the 39 million people who now lack health insurance. Proposals that would maintain the private market for health insurance would require subsidies for low-income families in order to achieve this broad coverage. Such proposals could succeed, however, only if the level of new subsidies was sustainable. Therefore, subsidies for low-income families would have to be phased out as family income rose.

Phasing out subsidies increases "implicit" marginal tax rates on earnings because the subsidy is reduced as earnings rise. In the case of restructuring the health care system, these increases could be high enough to limit the incentives to work for families whose income fell within the range in which subsidies were phased out. Other aspects of some health proposals, such as a payroll tax or employer premium charges based on payroll, could also increase implicit marginal tax rates, reducing incentives to work.

This Congressional Budget Office (CBO) memorandum compares the implicit marginal tax rates that would apply under the Health Security Act (H.R. 3600) and the Managed Competition Act (H.R. 3222) with those under current law. The calculations presented here focus only on this aspect of the proposals. Although marginal incentives can be important, many other issues could dominate the analysis of health care plans (coverage, cost, and the effect

on employment and the budget deficit, for example). For further descriptions and analysis of these two health proposals, see the CBO studies *An Analysis of the Administration's Health Proposal* (February 1994) and *An Analysis of the Managed Competition Act* (April 1994).

Both the Health Security Act (proposed by the Clinton Administration) and the Managed Competition Act (introduced by Congressman Jim Cooper) would subsidize the purchase of qualifying health insurance plans by low-income families. The Health Security Act would require that both employers and employees pay for health insurance premiums. This obligation would be reduced by several subsidies designed to assist low-income families and many employers. The subsidies would be available only for coverage obtained through regional health care alliances; employers that instead established corporate alliances could not get subsidies and would have to hold the amounts paid by their low-income workers below certain limits.

Under the Health Security Act, the phaseout of individual subsidies would increase implicit marginal tax rates for eligible people by 3 to 4 percentage points over most of the affected income range. Increases of between 6 and 11 percentage points would occur over part of that range. In addition, workers in firms that were subject to a cap on insurance payments would experience a rise in marginal tax rates as high as 16 percentage points

when both family and employer subsidies are included. The exact rates and income ranges would depend on the size of the family and the health insurance premium for that family type.

The Managed Competition Act would provide subsidies for health insurance premiums and cost sharing for families with income below 200 percent of the poverty level.[1] (In order to be eligible for subsidies, a family would have to purchase insurance in the form of a qualifying plan.) Subsidies would be based on the premium cost of the least expensive plan enrolling a specified proportion of eligible residents in a health plan purchasing cooperative (the reference premium). Families with income below the poverty level would receive a subsidy equal to the reference premium. The subsidy would then start to be phased out as income rose, ceasing at 200 percent of the poverty level.

Such a phaseout range would increase marginal rates by as much as 19 percentage points for an individual and 30 percentage points for a couple with no children. The actual rates would depend on the cost of health insurance premiums.

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1. The poverty levels used in this memorandum under both the Health Security Act and the Managed Competition Act are Office of Management and Budget poverty guidelines estimated for 1995 using CBO economic assumptions. The estimated levels are $7,520 for a one-person family, $10,080 for a two-person family, $12,640 for a three-person family, and $15,200 for a four-person family.

In short, both proposals would increase implicit marginal tax rates for some people. Higher marginal rates reduce incentives to work and discourage individuals from entering the labor force. The actual effect of these higher rates, however, is uncertain. The largest increase in implicit marginal rates would come under the Managed Competition Act for workers whose income was in the phaseout range of the premium subsidy. But other elements of the Managed Competition Act might provide stronger work incentives for people considering entering the labor force. The increase in rates under the Health Security Act, by contrast, would be smaller but would apply to more workers. In the end, higher implicit marginal rates must be weighed against the value of the subsidies that underlie them. They must also be weighed against the many other components of restructuring the health care market.

## REASONS FOR IMPLICIT MARGINAL TAX RATES

For purposes of this analysis, a marginal tax rate is defined as the fraction of an additional dollar of income that is paid in higher taxes or reduced government benefits. Because higher marginal tax rates reduce the amount of disposable income that a family receives from an additional dollar of earnings, they reduce the incentive to work. Implicit marginal tax rates are derived from two sources: the structure of the tax system and the phaseout of benefits in government programs.

## The Tax System

Most workers are familiar with the explicit marginal tax rates associated with taxes withheld by their employer. Social Security taxes are withheld at a rate of 7.65 percent, and income taxes are withheld for most people at rates of 15 percent or 28 percent, depending on which income tax bracket they are in.

The Internal Revenue Code creates additional marginal tax rates besides those for the statutory tax brackets. Various aspects of the tax code are phased in and out over specified income ranges. The earned income tax credit (EITC), for example, is available to low-income families, with the amount of the credit depending on family income and number of children. For instance, in 1995, a family with two children and earnings of less than $8,650 (and no other income) will receive 36 cents of credit for each additional dollar of earnings. In this case, the government pays more money to the wage earner as earnings increase. In other words, the EITC creates a *negative* marginal tax rate of 36 percent for families in this range. For families with income over $11,290, the phaseout of the credit produces a positive marginal tax rate: for each dollar of earnings in excess of $11,290, a family with two children loses 20 cents of its credit until the credit is completely eliminated at an income of $26,691. Over this range, a family would face a positive marginal tax rate of 20 percent from the credit. Other elements of the tax code, such as the

taxation of Social Security benefits and the phaseout of deductions for individual retirement accounts (IRAs), produce other marginal rates for affected taxpayers.

The marginal tax rates from the individual income tax or the employee share of the Social Security payroll tax result from direct taxation of a person's income. But individuals may face additional marginal tax rates as a result of taxation of their employer. Economists generally agree that wage earners ultimately pay for their employers' payroll taxes through lower wages. In other words, in the absence of the employer share of the payroll tax, wages (or other forms of compensation) would be higher by the amount of the tax.

The marginal tax rates calculated in this memorandum assume that an employee bears the burden of both the employee and employer shares of Social Security payroll taxes and also bears the marginal rates associated with both shares. To facilitate the comparison of health care proposals, all marginal tax rates here are calculated on an additional dollar of compensation measured before the payment of employer payroll taxes. The employee, of course, actually pays taxes on income measured after the employer share of payroll taxes has been deducted from compensation. Table 1 illustrates the interaction between payroll and income taxes. For this example, all compensation other than the payment of the employer payroll tax is assumed to be cash wages.

Suppose an employer pays a single individual $20,000 in total compensation. This amount consists of $1,421 for the employer share of Social Security taxes and $18,579 in actual wages paid to the worker (see Table 1). The individual also pays $1,421 for the employee share of payroll taxes and $1,827 in federal income taxes, leaving him or her with $15,331 after all taxes have been paid. Now suppose the employer considers spending an additional $1,000 in total compensation for this employee as a result of increased work effort. The last column of Table 1 shows that to pay an additional $1,000, the employer must set aside $71 to pay its share of the payroll tax. That leaves an extra $929 for the employee, who must pay an additional $71 in payroll taxes and $139 in income taxes. From that additional $1,000 of compensation, therefore, the federal government receives $281 in taxes--that is, the marginal tax rate is 28.1 percent. This rate is less than the sum of all of the tax rates (7.65 + 7.65 + 15 = 30.3 percent) because the employee pays tax on the income after the employer payroll tax has been deducted.

## The Phaseout of Benefit Programs

Federal programs outside the tax system that provide benefits to low-income people produce an effect similar to a tax as the benefit is phased out for people

TABLE 1. INTERACTION OF EMPLOYER PAYROLL TAXES AND EMPLOYEE INCOME TAXES FOR A SINGLE INDIVIDUAL UNDER CURRENT LAW (In dollars)

| | Base Salary | Increased Salary | Change |
|---|---|---|---|
| **Employer Costs** | | | |
| Total Compensation | 20,000 | 21,000 | 1,000 |
| Employer Share of OASDI and HI Taxes (7.65 percent of wages paid) | 1,421 | 1,492 | 71 |
| Wages Paid to Employee | 18,579 | 19,508 | 929 |
| **Employee Costs** | | | |
| Employee Share of OASDI and HI Taxes (7.65 percent of wages paid) | 1,421 | 1,492 | 71 |
| Employee's Taxable Income (Single filer in 1995) | | | |
| Wages paid to employee | 18,579 | 19,508 | 929 |
| Personal exemption | -2,500 | -2,500 | 0 |
| Standard deduction | -3,900 | -3,900 | 0 |
| Total Taxable Income | 12,179 | 13,108 | 929 |
| Federal Income Tax (15 percent tax rate) | 1,827 | 1,966 | 139 |
| Income After All Taxes Have Been Paid | 15,331 | 16,050 | 719 |
| **Total** | | | |
| Total Taxes Paid by Employee and Employer | 4,669 | 4,950 | 281 |

SOURCE: Congressional Budget Office.

NOTES: Out of $1,000 additional compensation paid by the employer, the employee would get $719 and the federal government would receive a total of $281. In other words, the federal government would receive an additional 28.1 percent in taxes on each additional dollar of compensation paid.

OASDI = Old-Age, Survivors, and Disability Insurance; HI = Hospital Insurance.

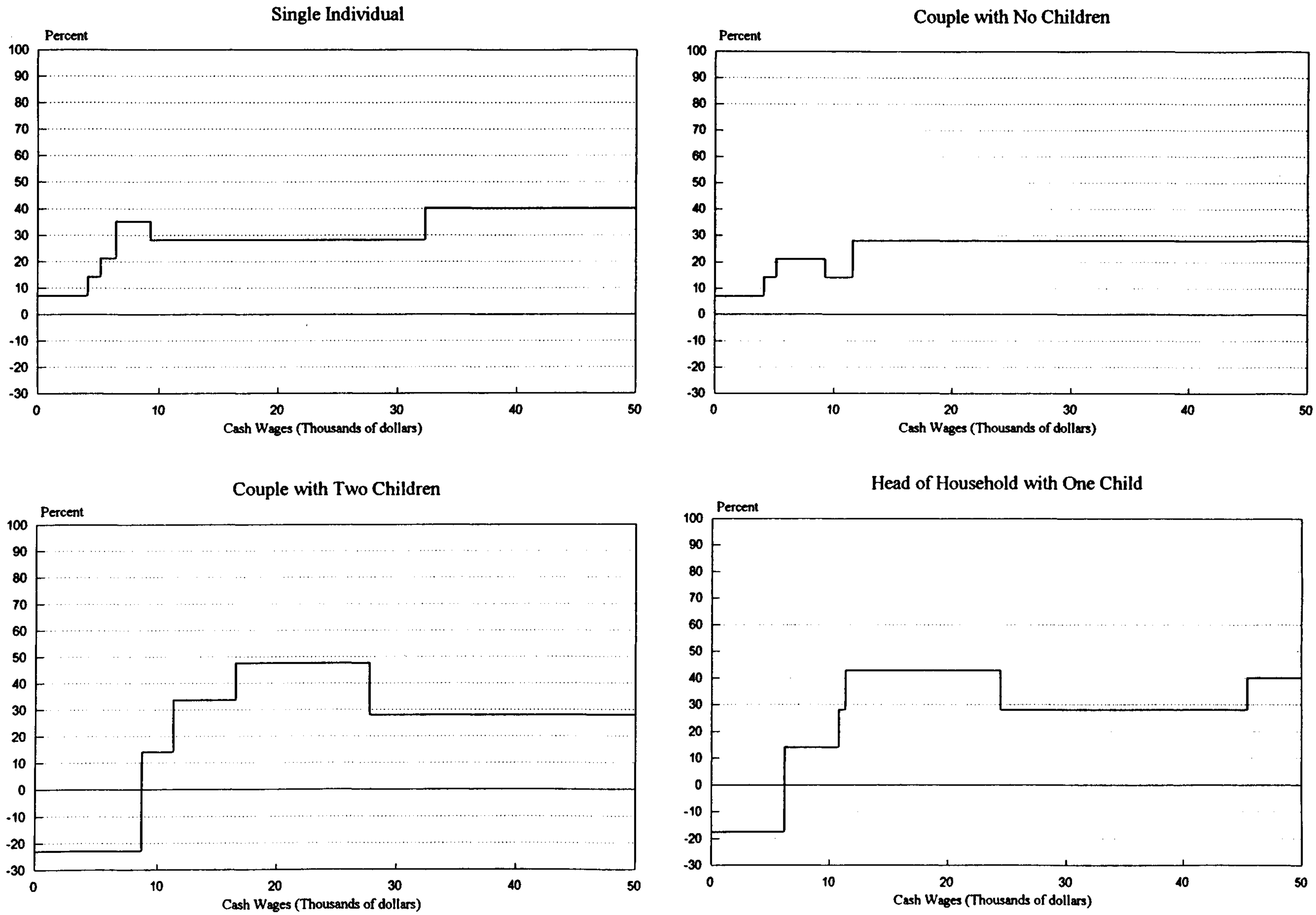
with higher income. The reduction in benefits is equivalent to a tax: beneficiaries of these programs are better off as a result of the benefits, but because benefits are phased out as income increases, some beneficiaries face a "tax" on each additional dollar of income. These disincentives typically occur for programs that are means-tested--that is, in which benefits are based on the level of family income or wealth. For example, eligible food stamp recipients at certain income levels lose 24 cents of their food stamp benefits for each additional dollar of wages until their benefits have been exhausted. In 1995, a wage earner in a family of four would face this additional 24 percent rate for income between $1,775 and $21,370. Of course, the wage earner is still better off with the additional wages and the reduced food stamp benefits than if he or she received no food stamps at all.

Various ways to phase out benefits exist that would lower implicit marginal tax rates, but they have other disadvantages. One alternative, the elimination of benefits at a specified dollar level (as is now the case in the Medicaid program), would have an even more distorting effect on behavior for individuals with income near this level. Families whose income rose above the threshold would be worse off than if they were just below the threshold. Other options, such as phasing out benefits over a wider income range or not phasing them out at all, could be very costly and would provide benefits to people other than the most needy.

As noted before, taxpayers now face a variety of implicit marginal tax rates, depending on income level and family type (see Figure 1 and Table 2). For example, for an individual with wages of $20,000, an additional dollar of compensation results in taxes of almost 30 cents. At a wage level of $50,000, an additional dollar of compensation for an individual results in taxes of about 40 cents. Above that level, rates are even higher. When taxable income exceeds $250,000 (at a wage level of about $313,000), the implicit marginal tax rate totals 43.1 percent (see Appendix Table A-1).

CBO's calculations of marginal rates reflect the federal individual income tax, including the earned income tax credit, and both the employee and employer shares of the Old-Age, Survivors, and Disability Insurance (OASDI) and Health Insurance (HI) payroll taxes. They do not include the effects of state or local income taxes or the phaseout of Aid to Families with Dependent Children (AFDC) payments or food stamp benefits. Both state and local income taxes and AFDC vary significantly from state to state, and this variation cannot be captured in the few examples presented in the memorandum. In addition, the phaseout of AFDC benefits does not overlap with the phaseout of subsidies for the two health care proposals examined here. Similarly, food stamp recipients are not included because relatively few workers in the income ranges relevant for these proposals receive food stamps.

FIGURE 1. IMPLICIT MARGINAL TAX RATES FOR 1995 UNDER CURRENT LAW




SOURCE: Congressional Budget Office.

NOTE: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. All marginal rates include the income tax and the Social Security payroll tax. The earned income tax credit is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

TABLE 2. IMPLICIT MARGINAL TAX RATES FOR 1995, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER CURRENT LAW

| | Wage Level (Dollars) | Marginal Rate (Percent) |
|---|---|---|
| **Single Individual** | | |
| Start of EITC and Payroll Tax | 0 | 7.1 |
| End of EITC Phase-in | 4,110 | 14.2 |
| Start of EITC Phaseout | 5,130 | 21.3 |
| Start of 15 Percent Bracket | 6,400 | 35.3 |
| End of EITC Phaseout | 9,240 | 28.1 |
| Start of 28 Percent Bracket | 32,313 | 40.2 |
| **Couple with No Children** | | |
| Start of EITC and Payroll Tax | 0 | 7.1 |
| End of EITC Phase-in | 4,110 | 14.2 |
| Start of EITC Phaseout | 5,130 | 21.3 |
| End of EITC Phaseout | 9,240 | 14.2 |
| Start of 15 Percent Bracket | 11,550 | 28.1 |

(Continued)

TABLE 2. CONTINUED

| | Wage Level (Dollars) | Marginal Rate (Percent) |
|---|---|---|
| **Couple with Two Children** | | |
| Start of EITC and Payroll Tax | 0 | -22.9 |
| End of EITC Phase-in | 8,650 | 14.2 |
| Start of EITC Phaseout | 11,290 | 33.8 |
| Start of 15 Percent Bracket | 16,550 | 47.7 |
| End of EITC Phaseout | 27,719 | 28.1 |
| **Head of Household with One Child** | | |
| Start of EITC and Payroll Tax | 0 | -17.4 |
| End of EITC Phase-in | 6,160 | 14.2 |
| Start of 15 Percent Bracket | 10,750 | 28.1 |
| Start of EITC Phaseout | 11,290 | 43.0 |
| End of EITC Phaseout | 24,396 | 28.1 |
| Start of 28 Percent Bracket | 45,375 | 40.2 |

SOURCE: Congressional Budget Office.

NOTE: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

The rates shown in Figure 1 and Table 2 for 1995 have been adjusted to take into account changes enacted in the 1993 Omnibus Budget Reconciliation Act. Thus, the EITC has been calculated with the fully implemented 1996 rates rather than the transitional rates that will actually be in effect in 1995. The figures do not reflect provisions that may produce higher implicit marginal tax rates over certain ranges for certain individuals, such as phasing out the deductibility of IRAs or phasing in taxation of Social Security benefits. These tax provisions affect a relatively small percentage of workers and in general do not affect the same people who would face higher marginal tax rates under the two health care proposals. The effect of the phaseout of the child care credit is also not included; fewer than 20 percent of families with children living at home claim the credit.

The marginal tax rates have been calculated as a percentage of compensation including the employer share of payroll taxes (but excluding any fringe benefits), as mentioned above. However, to make the income levels in the figures consistent with those specified in the Internal Revenue Code, the tax rates shown here are plotted against cash wages, which exclude the employer share.

Under the Health Security Act (H.R. 3600), employers would be responsible for paying at least 80 percent of their workers' health insurance premiums, with employees and their families responsible for the rest.[2] Subsidies would be provided for both the employer and family shares of the premium. Beneficiaries of AFDC or Supplemental Security Income and people whose income was below a very low threshold ($1,025 in 1995) would not have to pay the family portion of the premium for plans with premiums at or below the weighted average for that type of family.

Families with income above $1,025 would be required to pay some or all of their share of the premium. Those with income equal to the poverty level would have to pay 3 percent of family income toward the family share; therefore, between income of $1,025 and the poverty level, a family's obligation for the premium would rise by slightly more than 3 percent of wages in excess of $1,025. Families with income equal to 150 percent of the poverty level would be required to pay the entire family premium. Thus, between 100 percent and 150 percent of the poverty level, the family share would increase at a rate that would fully pay the family obligation (20 percent of the weighted

2. Overall, employers within a regional alliance would pay 80 percent of the premium costs for full-time workers. The actual employer share for a particular type of family would depend on the number of workers in that family type within the regional alliance. Employers would pay a smaller share of premiums for part-time workers. For a further description of the calculation of premium contributions, see Congressional Budget Office, *An Analysis of the Administration's Health Proposal*, pp. 9-10.

average premium) at 150 percent of the poverty level. However, the family's actual obligation would be capped at 3.9 percent of income for families earning less than $41,000 in 1995. As a result, most families with income equal to 150 percent of the poverty level would still receive some subsidy for the family portion of the premium. The act would also provide cost-sharing subsidies for some families below 150 percent of the poverty level.

This subsidy schedule could result in three marginal rates for subsidized families at different income levels. For example, in 1995 a single individual would face a marginal rate of just over 3 percent on income between $1,025 and $7,520 (the estimated one-person poverty level for 1995) as a result of the subsidy mechanism. For wages between $7,520 and $10,751, the individual would face a marginal rate of approximately 6 percent. Because the family share would be capped at 3.9 percent of income, the marginal rate would fall to 3.9 percent at $10,751, the point at which the cap would take effect. The marginal rate from the subsidy schedule would fall to zero at an income of $11,564, when the family would have paid its entire share of the premium.[3]

Other provisions of the Health Security Act would add to the implicit marginal tax rates for some workers, but these provisions vary with the

3. In this example, the individual premium is assumed to be $2,255, and the family share of the premium is 20 percent, or $451. At the poverty level, the individual would have paid $226 of the family share. At wages of $10,751, the individual would have paid an additional $194. At $11,564, the individual would have paid the remaining $31.

characteristics of the employer rather than those of particular employees. For example, firms in a corporate alliance would pay a tax equal to 1 percent of their payroll. Under the assumption that employers would pass on the tax to their workers in the form of lower wages, all employees in such firms would face tax rates higher than those caused by the phaseout of the family subsidy. (In the case of a worker whose firm was in a corporate alliance, the tax rate would not rise by a full percentage point because the compensation that would no longer be paid in cash would no longer be subject to other taxes.) The rates calculated in this memorandum do not include this 1 percent tax. Workers are assumed to be in firms that have not established corporate alliances.

The Health Security Act would also provide subsidies to employers based on the size of the firm and its average wage level. The smallest, lowest-wage firms would receive the largest subsidies. These subsidies would guarantee that employers' health insurance costs did not exceed specified shares of their total payroll. The maximum cap on health expenses would be 7.9 percent of wages paid, with lower caps applying to smaller firms.

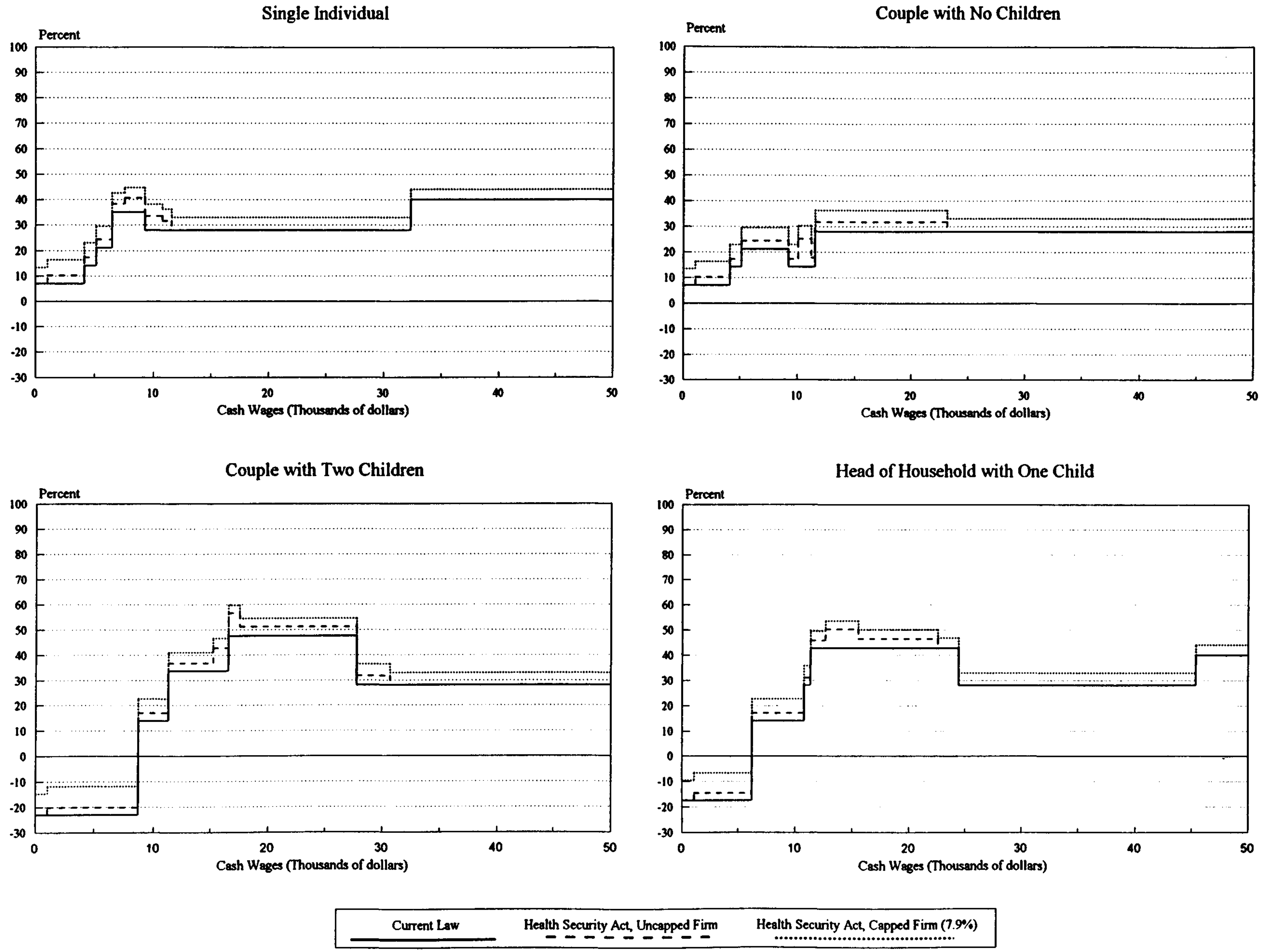
The implicit marginal tax rates in the Health Security Act that would be generated by the phaseout of subsidies are functions of the applicable poverty level for a family and its health insurance premium. (The calculations here do not include any effects of cost-sharing subsidies.) In the examples shown in

Figure 2 and Table 3, the poverty levels are based on family size, except for the case of the head of household with one child--which, under the Health Security Act, is considered a family of three for the purpose of calculating the subsidy.

The phaseout of the family subsidy under the proposal would increase marginal tax rates by about 3 percentage points in 1995 for income between $1,025 and the poverty level (see Figure 2 and Table 3). Between the poverty level and the point at which the family share of the premium equaled 3.9 percent of income, the rate would increase by amounts ranging from 6 to 11 percentage points for the four family types CBO examined. This higher rate would apply over a relatively narrow income range. Above this range, an additional marginal rate of nearly 4 percentage points would apply, up to the point where the subsidy ends (where 3.9 percent of income is equal to the family share).

Other workers who would face a higher marginal tax rate are those whose employer had health insurance costs higher than the 7.9 percent of payroll cap specified by the bill (see Figure 2 and Table 3). These employers would have to pay an additional 7.9 cents for health insurance if they raised an employee's wages by one dollar. Small or low-wage firms would have lower caps on health insurance costs. About half of all employees work for firms in

FIGURE 2. IMPLICIT MARGINAL TAX RATES FOR 1995 UNDER CURRENT LAW AND THE HEALTH SECURITY ACT




SOURCE: Congressional Budget Office.

NOTE: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. All marginal rates include the income tax and the Social Security payroll tax. The earned income tax credit is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

TABLE 3. IMPLICIT MARGINAL TAX RATES FOR 1995, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER THE HEALTH SECURITY ACT

| | Wage Level (Dollars) | Marginal Rate Under Current Law (Percent) | Marginal Rate Under Health Security Act (Percent) Uncapped Firm | Capped Firm[a] |
|---|---|---|---|---|
| | | **Single Individual** | | |
| Start of EITC and Payroll Tax | 0 | 7.1 | 7.1 | 13.5 |
| H.R. 3600 Threshold Amount | 1,025 | 7.1 | 10.3 | 16.5 |
| End of EITC Phase-in | 4,110 | 14.2 | 17.4 | 23.1 |
| Start of EITC Phaseout | 5,130 | 21.3 | 24.5 | 29.7 |
| Start of 15 Percent Bracket | 6,400 | 35.3 | 38.5 | 42.7 |
| Poverty Level | 7,520 | 35.3 | 40.8 | 44.9 |
| End of EITC Phaseout | 9,240 | 28.1 | 33.7 | 38.2 |
| 3.9 Percent Limit on Premium Share | 10,751 | 28.1 | 31.8 | 36.4 |
| Premium Share Fully Paid | 11,564 | 28.1 | 28.1 | 33.1 |
| Start of 28 Percent Bracket | 32,313 | 40.2 | 40.2 | 44.3 |
| **Memorandum:** | | | | |
| Assumed Premium | 2,255 | n.a. | n.a. | n.a. |
| | | **Couple with No Children** | | |
| Start of EITC and Payroll Tax | 0 | 7.1 | 7.1 | 13.5 |
| H.R. 3600 Threshold Amount | 1,025 | 7.1 | 10.2 | 16.3 |
| End of EITC Phase-in | 4,110 | 14.2 | 17.3 | 23.0 |
| Start of EITC Phaseout | 5,130 | 21.3 | 24.4 | 29.6 |
| End of EITC Phaseout | 9,240 | 14.2 | 17.3 | 23.0 |
| Poverty Level | 10,080 | 14.2 | 25.3 | 30.4 |
| 3.9 Percent Limit on Premium Share | 11,214 | 14.2 | 17.8 | 23.5 |
| Start of 15 Percent Bracket | 11,550 | 28.1 | 31.8 | 36.4 |
| Premium Share Fully Paid | 23,128 | 28.1 | 28.1 | 33.1 |
| **Memorandum:** | | | | |
| Assumed Premium | 4,510 | n.a. | n.a. | n.a. |

(Continued)

TABLE 3. CONTINUED

| | Wage Level (Dollars) | Marginal Rate Under Current Law (Percent) | Marginal Rate Under Health Security Act (Percent): Uncapped Firm | Marginal Rate Under Health Security Act (Percent): Capped Firm[a] |
|---|---|---|---|---|
| | | **Couple with Two Children** | | |
| Start of EITC and Payroll Tax | 0 | -22.9 | -22.9 | -14.5 |
| H.R. 3600 Threshold Amount | 1,025 | -22.9 | -20.0 | -11.8 |
| End of EITC Phase-in | 8,650 | 14.2 | 17.2 | 22.9 |
| Start of EITC Phaseout | 11,290 | 33.8 | 36.8 | 41.1 |
| Poverty Level | 15,200 | 33.8 | 42.8 | 46.7 |
| Start of 15 Percent Bracket | 16,550 | 47.7 | 56.7 | 59.7 |
| 3.9 Percent Limit on Premium Share | 17,548 | 47.7 | 51.3 | 54.7 |
| End of EITC Phaseout | 27,719 | 28.1 | 31.8 | 36.4 |
| Premium Share Fully Paid | 30,646 | 28.1 | 28.1 | 33.1 |
| **Memorandum:** | | | | |
| Assumed Premium | 5,976 | n.a. | n.a. | n.a. |
| | | **Head of Household with One Child** | | |
| Start of EITC and Payroll Tax | 0 | -17.4 | -17.4 | -9.3 |
| H.R. 3600 Threshold Amount | 1,025 | -17.4 | -14.3 | -6.5 |
| End of EITC Phase-in | 6,160 | 14.2 | 17.2 | 22.9 |
| Start of 15 Percent Bracket | 10,750 | 28.1 | 31.2 | 35.9 |
| Start of EITC Phaseout | 11,290 | 43.0 | 46.0 | 49.7 |
| Poverty Level[b] | 12,640 | 43.0 | 50.3 | 53.7 |
| 3.9 Percent Limit on Premium Share | 15,474 | 43.0 | 46.6 | 50.3 |
| Premium Share Fully Paid | 22,549 | 43.0 | 43.0 | 46.9 |
| End of EITC Phaseout | 24,396 | 28.1 | 28.1 | 33.1 |
| Start of 28 Percent Bracket | 45,375 | 40.2 | 40.2 | 44.3 |
| **Memorandum:** | | | | |
| Assumed Premium | 4,397 | n.a. | n.a. | n.a. |

SOURCE: Congressional Budget Office.

NOTES: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

n.a. = not applicable.

a. Firm's expenses for health insurance are capped at 7.9 percent of payroll.

b. The Health Security Act considers a head of household with one child a family of three for the purpose of setting the poverty level.

which employer health care costs would be capped as a percentage of payroll. Since 7.9 percent is the maximum rate for the cap, the dotted lines in Figure 2 show the upper bound for implicit marginal rates that would affect these workers. Employees in small or low-wage firms would have lower rates because of the lower caps that would apply to these firms.[4]

The 7.9 percent cap would interact with other marginal tax rates in a manner similar to the employer share of the Social Security payroll tax (see Table 4). Again, consider an employee paid $20,000 in total compensation, including the payroll tax and, in this example, the employer share of health insurance premiums. In order to pay that worker an additional $1,000 in compensation, the employer would have to set aside $66 for Social Security taxes and $68 for health insurance premiums. After the employee had paid Social Security and income taxes, he or she would be left with $669 out of the $1,000, thus facing an implicit marginal tax rate of 33.1 percent. This rate compares with the marginal rate under current law of 28.1 percent (see Table 1).[5] (The additional marginal rate of 5 percentage points in this example is less than 7.9 percent because taxes would be paid after the 7.9 percent charge had been deducted.)

4. Not all workers in a firm would necessarily benefit from the payroll cap. A high-wage worker in a firm with low average wages could generate a payroll surcharge in excess of any health insurance benefit.

5. The examples are designed to show the different implicit marginal tax rates that apply with and without the payroll cap. Because the first example does not include employer-provided health insurance, other comparisons may not be meaningful. For example, the levels of cash wages and after-tax income in Table 4 have been calculated after the payment for health insurance premiums, and Table 1 contains no such provision for health insurance.

TABLE 4. INTERACTION OF EMPLOYER PAYROLL TAXES AND EMPLOYEE INCOME TAXES UNDER THE HEALTH SECURITY ACT FOR A SINGLE INDIVIDUAL EMPLOYED BY A CAPPED FIRM (In dollars)

| | Base Salary | Increased Salary | Change |
|---|---|---|---|
| **Employer Costs** | | | |
| Total Compensation | 20,000 | 21,000 | 1,000 |
| Employer Share of OASDI and HI Taxes (7.65 percent of wages paid) | 1,324 | 1,390 | 66 |
| Employer Share of Premiums (7.9 percent of wages paid) | 1,367 | 1,436 | 68 |
| Wages Paid to Employee | 17,309 | 18,174 | 865 |
| **Employee Costs** | | | |
| Employee Share of OASDI and HI Taxes (7.65 percent of wages paid) | 1,324 | 1,390 | 66 |
| Employee's Taxable Income (Single filer in 1995) | | | |
| Wages paid to employee | 17,309 | 18,174 | 865 |
| Personal exemption | -2,500 | -2,500 | 0 |
| Standard deduction | -3,900 | -3,900 | 0 |
| Total Taxable Income | 10,909 | 11,774 | 865 |
| Federal Income Tax (15 percent tax rate) | 1,636 | 1,766 | 130 |
| Income After All Taxes Have Been Paid | 14,349 | 15,018 | 669 |
| **Total** | | | |
| Total Taxes Paid by Employee and Employer Plus Employer Premium | 5,651 | 5,982 | 331 |

SOURCE: Congressional Budget Office.

NOTES: Firm's expenses for health insurance are capped at 7.9 percent of payroll. This employee would receive no direct subsidy because the cash wages are above CBO's estimated eligibility level for 1995 of $11,564.

Out of $1,000 additional compensation paid by the employer, the employee would get $669 and the federal government and the regional health alliance would receive a total of $331. In other words, the federal government and the regional health alliance would receive an additional 33.1 percent in taxes and premium contributions on each additional dollar of compensation paid.

OASDI = Old-Age, Survivors, and Disability Insurance; HI = Hospital Insurance.

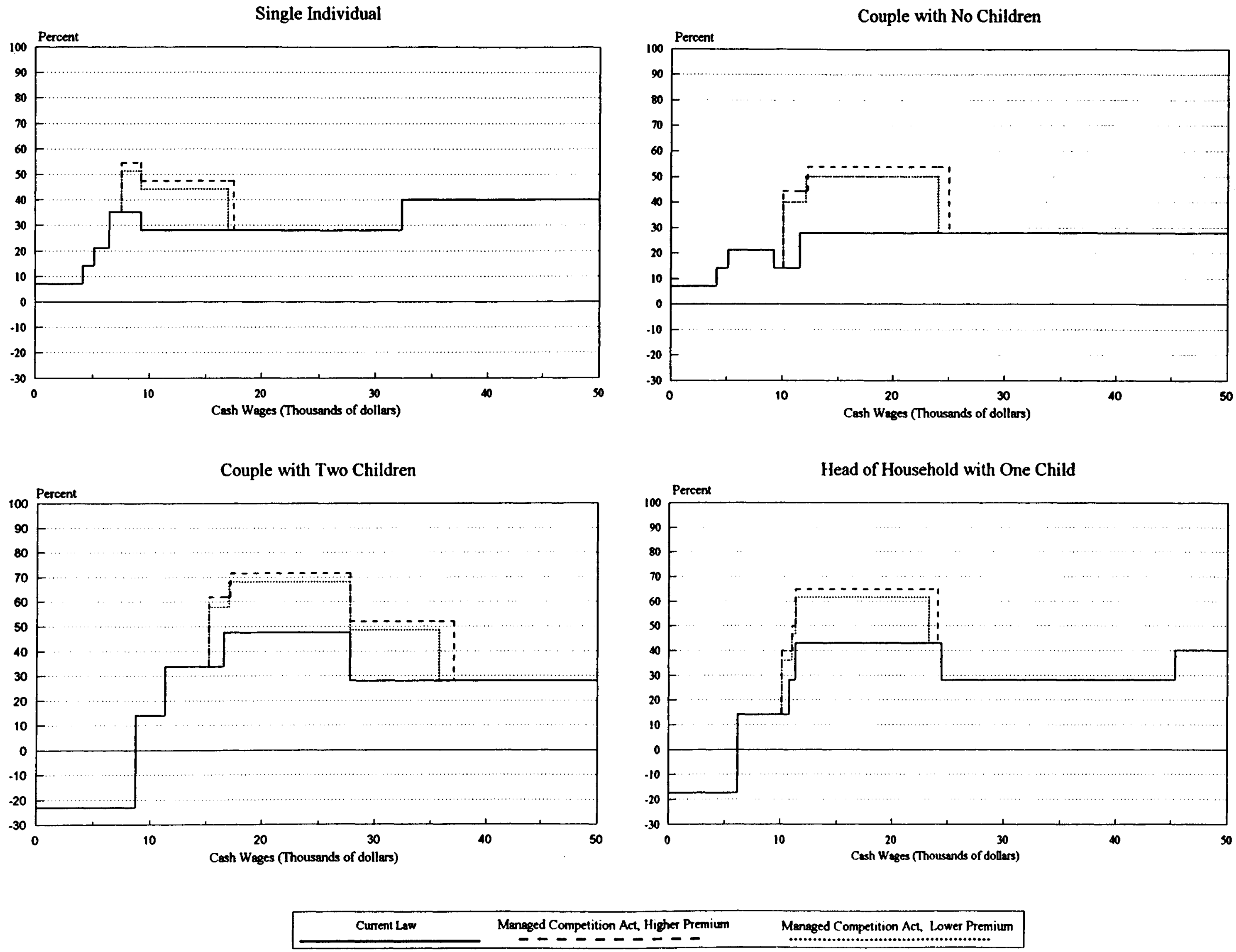
## IMPLICIT MARGINAL TAX RATES UNDER THE MANAGED COMPETITION ACT

Under the Managed Competition Act (H.R. 3222), individuals and families below the poverty level would have their premiums fully subsidized up to the amount of the lowest premium charged by a qualifying health plan (the so-called reference premium). The subsidy would be reduced if financing fell short. These subsidies would be phased out between 100 percent and 200 percent of the poverty level for each family size.[6] Premiums paid by an individual or family would be fully deductible for income tax purposes up to the level of the reference premium.

Figure 3 and Table 5 show implicit marginal tax rates under the Managed Competition Act compared with those under current law. These implicit rates take into account the interaction between the subsidy rate and the deductibility of premiums paid. (As with the Health Security Act, the effect of cost-sharing subsidies is not included.) All of the examples assume that the individual or family obtains insurance through a health plan purchasing cooperative and that the employer does not pay any portion of the health

6. The proposal indicates that the poverty level would be adjusted on a state-by-state basis. The examples calculated by CBO use the national poverty levels estimated for 1995.

FIGURE 3. IMPLICIT MARGINAL TAX RATES FOR 1995 UNDER CURRENT LAW AND THE MANAGED COMPETITION ACT




SOURCE: Congressional Budget Office.

NOTE: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. All marginal rates include the income tax and the Social Security payroll tax. The earned income tax credit is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax.

TABLE 5. IMPLICIT MARGINAL TAX RATES FOR 1995, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER THE MANAGED COMPETITION ACT

| | Wage Level (Dollars) | Marginal Rate Under Current Law (Percent) | Marginal Rate Under Managed Competition Act (Percent): Higher Premium | Marginal Rate Under Managed Competition Act (Percent): Lower Premium |
|---|---|---|---|---|
| **Single Individual** | | | | |
| Start of EITC and Payroll Tax | 0 | 7.1 | 7.1 | 7.1 |
| End of EITC Phase-in | 4,110 | 14.2 | 14.2 | 14.2 |
| Start of EITC Phaseout | 5,130 | 21.3 | 21.3 | 21.3 |
| Start of 15 Percent Bracket | | | | |
| Under Current Law | 6,400 | 35.3 | 35.3 | 35.3 |
| Start of Subsidy (Poverty level) | 7,520 | 35.3 | 54.6 | 51.5 |
| End of EITC Phaseout | 9,240 | 28.1 | 47.5 | 44.4 |
| End of Subsidy | | | | |
| Higher premium | 16,995 | 28.1 | 47.5 | 28.1 |
| Lower premium | 17,484 | 28.1 | 28.1 | 28.1 |
| Start of 28 Percent Bracket | 32,313 | 40.2 | 40.2 | 40.2 |
| **Memorandum:** | | | | |
| Assumed Premium | | | | |
| Higher | 2,444 | n.a. | n.a. | n.a. |
| Lower | 1,955 | n.a. | n.a. | n.a. |
| **Couple with No Children** | | | | |
| Start of EITC and Payroll Tax | 0 | 7.1 | 7.1 | 7.1 |
| End of EITC Phase-in | 4,110 | 14.2 | 14.2 | 14.2 |
| Start of EITC Phaseout | 5,130 | 21.3 | 21.3 | 21.3 |
| End of EITC Phaseout | 9,240 | 14.2 | 14.2 | 14.2 |
| Start of Subsidy (Poverty level) | 10,080 | 14.2 | 44.5 | 40.2 |
| Start of 15 Percent Bracket | | | | |
| Current law | 11,550 | 28.1 | 44.5 | 40.2 |
| Lower premium | 12,120 | 28.1 | 44.5 | 50.2 |
| Higher premium | 12,263 | 28.1 | 53.9 | 50.2 |
| End of Subsidy | | | | |
| Lower premium | 24,069 | 28.1 | 53.9 | 28.1 |
| Higher premium | 25,046 | 28.1 | 28.1 | 28.1 |
| **Memorandum:** | | | | |
| Assumed Premium | | | | |
| Higher | 4,886 | n.a. | n.a. | n.a. |
| Lower | 3,909 | n.a. | n.a. | n.a. |

(Continued)

TABLE 5. CONTINUED

| | Wage Level (Dollars) | Marginal Rate Under Current Law (Percent) | Marginal Rate Under Managed Competition Act (Percent): Higher Premium | Marginal Rate Under Managed Competition Act (Percent): Lower Premium |
|---|---|---|---|---|
| **Couple with Two Children** | | | | |
| Start of EITC and Payroll Tax | 0 | -22.9 | -22.9 | -22.9 |
| End of EITC Phase-in | 8,650 | 14.2 | 14.2 | 14.2 |
| Start of EITC Phaseout | 11,290 | 33.8 | 33.8 | 33.8 |
| Start of Subsidy | 15,200 | 33.8 | 62.0 | 57.8 |
| Start of 15 Percent Bracket | | | | |
| Current law | 16,550 | 47.7 | 62.0 | 57.8 |
| Lower premium | 17,022 | 47.7 | 62.0 | 68.2 |
| Higher premium | 17,140 | 47.7 | 71.7 | 68.2 |
| End of EITC Phaseout | 27,719 | 28.1 | 52.2 | 48.6 |
| End of Subsidy | | | | |
| Lower premium | 35,713 | 28.1 | 52.2 | 28.1 |
| Higher premium | 37,041 | 28.1 | 28.1 | 28.1 |
| **Memorandum:** | | | | |
| Assumed Premium | | | | |
| Higher | 6,641 | n.a. | n.a. | n.a. |
| Lower | 5,313 | n.a. | n.a. | n.a. |
| **Head of Household with One Child** | | | | |
| Start of EITC and Payroll Tax | 0 | -17.4 | -17.4 | -17.4 |
| End of EITC Phase-in | 6,160 | 14.2 | 14.2 | 14.2 |
| Start of Subsidy | 10,080 | 14.2 | 40.1 | 36.1 |
| Start of 15 Percent Bracket | | | | |
| Current law | 10,750 | 28.1 | 40.1 | 36.1 |
| Lower premium | 10,957 | 28.1 | 40.1 | 46.8 |
| Higher premium | 11,008 | 28.1 | 50.1 | 46.8 |
| Start of EITC Phaseout | 11,290 | 43.0 | 65.0 | 61.6 |
| End of Subsidy | | | | |
| Lower premium | 23,268 | 43.0 | 65.0 | 43.0 |
| Higher premium | 24,045 | 43.0 | 43.0 | 43.0 |
| End of EITC Phaseout | 24,396 | 28.1 | 28.1 | 28.1 |
| Start of 28 Percent Bracket | 45,375 | 40.2 | 40.2 | 40.2 |
| **Memorandum:** | | | | |
| Assumed Premium | | | | |
| Higher | 3,885 | n.a. | n.a. | n.a. |
| Lower | 3,108 | n.a. | n.a. | n.a. |

SOURCE: Congressional Budget Office.

NOTES: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates. The rate calculated is on total compensation including the employer share of the payroll tax. n.a. = not applicable.

insurance premium.[7] CBO has estimated the effects of the Managed Competition Act under two different benefit packages and levels of premiums (see *An Analysis of the Managed Competition Act*, April 1994). Figure 3 and Table 5 present marginal rates generated under both sets of premiums.

The implicit marginal rates caused by phasing out the subsidy in the Managed Competition Act would apply for families with adjusted gross income (AGI) between the poverty level and twice that amount. The actual amount of the subsidy would be based on the family's AGI. (A family at or below the poverty level would receive a subsidy equal to the premium for a low-cost plan; a family at 200 percent of poverty would receive no subsidy.) In addition, the unsubsidized portion of the premium would be tax-deductible in calculating AGI. Thus, the subsidy would be a function of AGI, and AGI would be a function of the subsidy. When wages rose, out-of-pocket premium costs would increase, but so would the deduction for these out-of-pocket expenses. The increased deduction would reduce AGI, which in turn would lower out-of-pocket premium expenses.

A stable formula exists for computing the subsidy. The formula depends on the ratio of the premium to the poverty level ($R$). When wages are greater

7. Subsidies would be reduced dollar for dollar by employer contributions for health insurance. Thus, excluding other considerations, neither the employer nor its low-income workers would see any advantage in having the employer pay for health insurance.

than the poverty level and are the only source of income, the formula would be:

$$\text{Nonsubsidized portion} = \frac{R}{1+R} \times (\text{wages - poverty level})$$

$$\text{Subsidy} = \text{Premium - nonsubsidized portion}$$

$$\text{where } R = \frac{\text{premium}}{\text{poverty level}}$$

For example, in the case of a single individual with $10,000 in wages and a premium of $2,444, the subsidy would be calculated as follows:

$$\text{Nonsubsidized portion} = 0.2452 \times (\$10{,}000 - 7{,}520)$$

$$= \$608$$

$$\text{Subsidy} = \$2{,}444 - 608 = \$1{,}836.$$

As a taxpayer's wages rose above the poverty level, he or she would lose the subsidy at rate $R/(1+R)$. This loss would introduce an additional implicit marginal tax rate of that amount. The single individual in the above example would lose 24.5 cents of subsidy for each additional dollar of wages. However, the individual would get an additional 24.5 cent deduction from taxable income; at a 15 percent marginal tax rate, income taxes would fall by 3.7 cents. The net

change in subsidy and taxes is 20.8 cents--a 20.8 percent additional marginal rate on wages. The additional marginal rate on compensation would be 19.3 percent.

The deductibility of the unsubsidized portion of premiums has two effects on measured marginal rates, which are presented in terms of wages rather than AGI (see Figure 3). Deductibility raises the wage level at which the 15 percent bracket begins because, as compared with current law, the deductible portion would produce lower taxable income for the same level of wages. Also, the subsidy would end when AGI equals 200 percent of the poverty level. Since the taxpayer would get a full deduction for the premium at that point, the subsidy, when presented in terms of wages, ends at twice the poverty level plus the value of the premium.

In the examples shown in Figure 3 and Table 5, the phaseout of the subsidy would raise marginal tax rates on compensation from 17 percentage points for a single individual under the lower premium to a maximum of 33 percentage points for a couple with no children under the higher premium. Because premium amounts are expected to grow faster than the poverty thresholds, which are indexed to the consumer price index, the implicit marginal tax rate from the subsidy phaseout would grow over time.

The rates shown here were calculated with the two premium levels assumed by CBO in *An Analysis of the Managed Competition Act*--the premium for the comprehensive benefit package and the premium for the 20 percent less comprehensive, or "limited," benefit package. The different premium levels would produce similar changes in marginal tax rates, although with two variations. First, in each example, the lower assumed premium results in a lower marginal rate since less of a subsidy would be phased out. Second, that premium also lowers the income level at which the phaseout of the subsidy would end. The phaseout is supposed to stop when AGI equals 200 percent of the poverty level. Since the unsubsidized premium would be fully deductible, the phaseout of the lower premium ends at a lower level of wages.

## PUTTING MARGINAL TAX RATES UNDER THE TWO PROPOSALS IN CONTEXT

The phaseout of subsidies in the Health Security Act and the Managed Competition Act would increase implicit marginal tax rates over certain income ranges, including ranges in which some people are already subject to high implicit marginal tax rates because of the phaseout of other benefits.

The actual impact of these rates on employment and work effort is uncertain. For one thing, workers would respond to the higher rates only to

the extent they were aware that their return from working had decreased. The elements of these proposals that produce higher rates would have varying degrees of visibility to workers. For another thing, the two proposals would provide incentives for firms to react in ways that would maximize subsidies to both the employers and their employees. The Health Security Act would create incentives for workers and firms to reorganize--sorting workers by level of wage--because of its subsidies to firms. The Managed Competition Act would also create incentives for sorting because workers receiving subsidies would be better off paying for their insurance directly, whereas unsubsidized workers would prefer to have employers pay for insurance. The amount of sorting that would take place under a new health care system is unknown. But the degree to which it occurred would affect the number of workers receiving subsidies and the implicit marginal rates they would face.

Marginal tax rates would generally be higher under the Managed Competition Act than under the Health Security Act. Although higher marginal rates would increase work disincentives, three other factors should be considered in evaluating their relative importance.

First, the higher marginal tax rates of the Managed Competition Act would apply to fewer workers than would those of the Health Security Act. CBO estimates that approximately half of all workers would be in firms with

payroll caps under the Health Security Act. All such workers would face higher additional marginal rates from these caps, regardless of their income. Under the Managed Competition Act, the implicit marginal tax rates would apply only to workers in families with income between the poverty level and twice the poverty level--fewer than 15 percent of all employees.

Second, factors other than marginal tax rates would affect work incentives. The Managed Competition Act might provide stronger incentives for workers to enter the labor force than the Health Security Act. Individuals wanting health insurance would have no obligation to pay for it under the Managed Competition Act as long as their family income was less than the poverty level. Subsidies for health insurance would be a function of family income rather than work status. Under the Health Security Act, a low-income individual outside the work force would pay little or nothing for insurance. A decision by that individual to enter the labor force would trigger the payment by the employer of its share of the premium, and this payment would be borne by most workers in the form of lower cash wages or other fringe benefits. Relative to the Managed Competition Act, this additional cost would produce a disincentive for workers to enter the labor force.

Third, the reduced economic efficiency associated with higher marginal rates must be weighed against the benefits of the subsidies associated with

those rates. The benefits of a larger subsidy could outweigh the negative effects of a higher marginal rate on work incentives. For example, single individuals with wages at the poverty level and no other source of income would face a marginal rate on compensation of 40.8 percent under the Health Security Act and 54.6 percent under the Managed Competition Act with the higher assumed premium. Under the Managed Competition Act, such people could have the value of their premiums fully subsidized. Under the assumption of a higher premium, the subsidy would be worth $2,444 in 1995. Under the Health Security Act, a working individual in an uncapped firm with income at the poverty level would receive a subsidy only on the family share of the premium, worth about $225 in 1995. In this particular case, the higher marginal tax rate under the Managed Competition Act would result from the phaseout of a significantly higher subsidy.[8] In other cases, subsidies (and implicit marginal rates) would be greater under the Health Security Act.[9]

As mentioned earlier, this memorandum focuses on only one aspect of the subsidies that would be provided under proposals to restructure the health insurance market. Work disincentives created by higher marginal tax rates

8. The exact amount of the subsidy under the Health Security Act would depend on the demographic characteristics of a particular regional alliance. Some cross-subsidization would occur from families with more than one worker to families with one worker, so the number of families and the number of workers within the alliance would determine the extent of such subsidization.

9. For example, a worker with income just above 200 percent of the poverty level would receive no subsidy under the Managed Competition Act. If that same worker was employed in a firm subject to the payroll cap, the employer and ultimately the worker would receive a subsidy and face a higher marginal rate as a result of the payroll cap.

should be compared not only with the value of subsidies, which clearly make their recipients better off, but also with all of the other components of the restructured system. High marginal tax rates by themselves should not disqualify a proposal. If desired, such rates can be reduced by lowering the amount of subsidies provided or expanding the range of income over which the subsidies are phased out.

# APPENDIX: ADDITIONAL TABLES

TABLE A-1. IMPLICIT MARGINAL TAX RATES FOR 1995 ON WAGES AND COMPENSATION, AND WAGE LEVELS AT WHICH RATES CHANGE, UNDER CURRENT LAW

| | Wage Level (Dollars) | Marginal Income Tax Rate on Wages (Percent) | Marginal Income and Payroll Tax Rate on Compensation (Percent) |
|---|---|---|---|
| | **Single Individual** | | |
| Start of EITC and Payroll Tax | 0 | -7.7 | 7.1 |
| End of EITC Phase-in | 4,110 | 0 | 14.2 |
| Start of EITC Phaseout | 5,130 | 7.7 | 21.3 |
| Start of 15 Percent Bracket | 6,400 | 22.7 | 35.3 |
| End of EITC Phaseout | 9,240 | 15.0 | 28.1 |
| Start of 28 Percent Bracket | 32,313 | 28.0 | 40.2 |
| Maximum Wages Subject to OASDI Tax | 62,100 | 28.0 | 30.5 |
| Start of 31 Percent Bracket | 73,813 | 31.0 | 33.4 |
| Start of Exemption and Deduction Limit | 114,750 | 32.6 | 34.9 |
| Start of 36 Percent Bracket | 148,515 | 37.8 | 40.1 |
| End of Exemption Limit | 239,750 | 37.1 | 39.4 |
| Start of 39.6 Percent Bracket | 313,304 | 40.8 | 43.1 |
| | **One-Earner Couple with No Children** | | |
| Start of EITC and Payroll Tax | 0 | -7.7 | 7.1 |
| End of EITC Phase-in | 4,110 | 0 | 14.2 |
| Start of EITC Phaseout | 5,130 | 7.7 | 21.3 |
| End of EITC Phaseout | 9,240 | 0 | 14.2 |
| Start of 15 Percent Bracket | 11,550 | 15.0 | 28.1 |
| Start of 28 Percent Bracket | 55,000 | 28.0 | 40.2 |
| Maximum Wages Subject to OASDI Tax | 62,100 | 28.0 | 30.5 |
| Start of Deduction Limit | 114,750 | 28.8 | 31.3 |
| Start of 31 Percent Bracket | 123,786 | 31.9 | 34.3 |
| Start of Exemption Limit | 172,100 | 33.2 | 35.6 |
| Start of 36 Percent Bracket | 182,789 | 38.5 | 40.8 |
| End of Exemption Limit | 297,100 | 37.1 | 39.4 |
| Start of 39.6 Percent Bracket | 313,304 | 40.8 | 43.1 |

(Continued)

TABLE A-1. CONTINUED

| | Wage Level (Dollars) | Marginal Income Tax Rate on Wages (Percent) | Marginal Income and Payroll Tax Rate on Compensation (Percent) |
|---|---|---|---|
| **One-Earner Couple with Two Children** | | | |
| Start of EITC and Payroll Tax | 0 | -40.0 | -22.9 |
| End of EITC Phase-in | 8,650 | 0 | 14.2 |
| Start of EITC Phaseout | 11,290 | 21.1 | 33.8 |
| Start of 15 Percent Bracket | 16,550 | 36.1 | 47.7 |
| End of EITC Phaseout | 27,719 | 15.0 | 28.1 |
| Start of 28 Percent Bracket | 61,250 | 28.0 | 40.2 |
| Maximum Wages Subject to OASDI Tax | 62,100 | 28.0 | 30.5 |
| Start of Deduction Limit | 114,750 | 28.8 | 31.3 |
| Start of 31 Percent Bracket | 129,810 | 31.9 | 34.3 |
| Start of Exemption Limit | 172,100 | 34.4 | 36.8 |
| Start of 36 Percent Bracket | 187,814 | 40.0 | 42.2 |
| End of Exemption Limit | 297,100 | 37.1 | 39.4 |
| Start of 39.6 Percent Bracket | 313,304 | 40.8 | 43.1 |
| **Head of Household with One Child** | | | |
| Start of EITC and Payroll Tax | 0 | -34.0 | -17.4 |
| End of EITC Phase-in | 6,160 | 0 | 14.2 |
| Start of 15 Percent Bracket | 10,750 | 15.0 | 28.1 |
| Start of EITC Phaseout | 11,290 | 31.0 | 43.0 |
| End of EITC Phaseout | 24,396 | 15.0 | 28.1 |
| Start of 28 Percent Bracket | 45,375 | 28.0 | 40.2 |
| Maximum Wages Subject to OASDI Tax | 62,100 | 28.0 | 30.5 |
| Start of 31 Percent Bracket | 107,250 | 31.0 | 33.4 |
| Start of Deduction Limit | 114,750 | 31.9 | 34.3 |
| Start of Exemption Limit | 143,450 | 33.2 | 35.6 |
| Start of 36 Percent Bracket | 166,702 | 38.5 | 40.8 |
| End of Exemption Limit | 268,450 | 37.1 | 39.4 |
| Start of 39.6 Percent Bracket | 313,304 | 40.8 | 43.1 |

SOURCE: Congressional Budget Office.

NOTES: All income is assumed to be from wages. All adults are assumed to be under age 65. The taxpayer claims the greater of the standard deduction or 20 percent of wages as itemized deductions. Marginal rates include the income tax and Social Security payroll tax. The earned income tax credit (EITC) is calculated at 1996 rates.

OASDI = Old-Age, Survivors, and Disability Insurance.

TABLE A-2. PROJECTED 1995 TAX PARAMETERS, BY FILING STATUS (In dollars)

| | Filing Status | | |
|---|---|---|---|
| | Single | Joint | Head of Household |
| Personal Exemption | 2,500 | 2,500 | 2,500 |
| Standard Deduction | 3,900 | 6,550 | 5,750 |
| Taxable Income Bracket | | | |
| 28 percent starting point | 23,350 | 39,000 | 31,300 |
| 31 percent starting point | 56,550 | 94,300 | 80,800 |
| 36 percent starting point | 118,000 | 143,700 | 130,850 |
| 39.6 percent starting point | 256,600 | 256,600 | 256,600 |
| Level of Adjusted Gross Income at Which Deduction Limit Begins | 114,750 | 114,750 | 114,750 |
| Level of Adjusted Gross Income at Which Exemption Limit Begins | 114,750 | 172,100 | 143,450 |

SOURCE: Congressional Budget Office.

NOTE: Based on January 1994 economic assumptions.

TABLE A-3. PROJECTED 1995 PARAMETERS FOR THE EARNED INCOME TAX CREDIT (In dollars)

| | Number of Children in Household | | |
|---|---|---|---|
| | None | One | Two or More |
| Maximum Earnings Eligible for the Credit | 4,110 | 6,160 | 8,650 |
| Maximum Credit | 314 | 2,094 | 3,460 |
| Credit Rate (Percent)[a] | 7.65 | 34.00 | 40.00 |
| Start of Phaseout | 5,130 | 11,290 | 11,290 |
| Phaseout Rate (Percent)[a] | 7.65 | 15.98 | 21.06 |
| End of Phaseout[a] | 9,240 | 24,396 | 27,719 |

SOURCE: Congressional Budget Office.

NOTE: Based on January 1994 economic assumptions.

a. Value in 1996 when credit is fully phased in.