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Overview of the Federal Tax System in 2020

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Summary

This report describes the federal tax structure and system in effect for 2020. The report also provides selected statistics on the tax system as a whole. Historically, the largest component of the federal tax system, in terms of revenue generated, has been the individual income tax. For FY2020, an estimated $1.5 trillion, or 47% of the federal government's revenue, will be collected from the individual income tax. The corporate income tax is estimated to generate another $151 billion in revenue in FY2020, or approximately 5% of total revenue. Social insurance or payroll taxes will generate an estimated $1.3 trillion, or 36% of revenue in FY2020. For 2019, it was estimated that revenues will be 16.3% of gross domestic product (GDP), slightly below the post-World War II average of 17.2% of GDP.

The largest source of revenue for the federal government is the individual income tax. The federal individual income tax is levied on an individual's taxable income, which is adjusted gross income (AGI) less deductions. Tax rates based on filing status (e.g., married filing jointly, head of household, or single individual) determine the amount of tax liability. Income tax rates in the United States are generally progressive, such that higher levels of income are typically taxed at higher rates. Once tentative tax liability is calculated, tax credits can be used to reduce tax liability. Tax deductions and tax credits are tools available to policymakers to increase or decrease the after-tax price of undertaking specific activities. Individuals with high levels of deductions and credits relative to income may be required to pay the alternative minimum tax (AMT).

The federal government also levies taxes on corporations, wage earnings, and certain other goods. Corporate taxable income is subject to tax at a flat rate of 21%. Social Security and Medicare tax rates are, respectively, 12.4% and 2.9% of earnings. In 2020, Social Security taxes are levied on the first $137,700 of wages. Medicare taxes are assessed against all wage income. Federal excise taxes are levied on specific goods, such as transportation fuels, alcohol, and tobacco.

Looking at the tax system as a whole, several observations can be made. Notably, the composition of revenues has changed over time. Corporate income tax revenues have become a smaller share of overall tax revenues over time, while social insurance revenues have trended upward as a share of total revenues. Social insurance revenues are a sizable component of the overall federal tax system. Most taxpayers pay more in payroll taxes than income taxes. Many taxpayers pay social insurance taxes but do not pay individual income taxes, having incomes below the amount that would generate a positive income tax liability. From an international perspective, the U.S. federal tax system tends to collect less in federal revenues as a percentage of GDP than other OECD countries.

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The U.S. federal tax system includes several elements. Income taxes are the primary component, and the United States has an income tax that applies to the income of individuals and a separate income tax for corporations. Payroll taxes are levied on earned income, with most of this revenue used to finance social insurance programs. The U.S. tax system also includes an estate and gift tax, as well as various excise taxes.

At the end of 2017, President Trump signed into law P.L. 115-97, which substantially changed the U.S. federal tax system. Consequently, the federal tax system in effect for 2020 differs from what was in effect for 2017.[1] Most of the changes to the individual income tax system in P.L. 115-97 are temporary and scheduled to expire at the end of 2025. Thus, under current law, after 2025, the individual income tax system is slated to look like the system that was in effect for 2017. In contrast, many of the changes made in P.L. 115-97 affecting corporations are permanent.

This report provides an overview of the federal tax system, including the individual income tax, corporate income tax, payroll taxes, estate and gift taxes, and federal excise taxes, as in effect for 2020. Information on changes to the tax system enacted in the 2017 tax revision (P.L. 115-97) can be found in CRS Report R45092, *The 2017 Tax Revision (P.L. 115-97): Comparison to 2017 Tax Law*, coordinated by Molly F. Sherlock and Donald J. Marples.

The Federal Income Tax System

The federal income tax system has several components. The largest component, in terms of revenue generated, is the individual income tax. In FY2019, the individual income tax generated $1.7 trillion in federal revenue (**Figure 1**). The Congressional Budget Office (CBO) has projected that federal income tax revenues in FY2020 will be $1.5 trillion, with the decline due to the economic effects of and policy response to the COVID-19 pandemic.[2] In FY2019, nearly 50% of federal revenue came from the individual income tax. In FY2020, it is projected that about 47% of federal revenue will be generated through the individual income tax. Similar to the individual income tax, corporate tax revenues are expected to decline in FY2020, relative to FY2019 levels. In FY2019, corporate tax receipts were $230 billion, or nearly 7% of federal revenue. In FY2020, corporate tax receipts are expected to be $151 billion, less than 5% of federal revenue.[3]

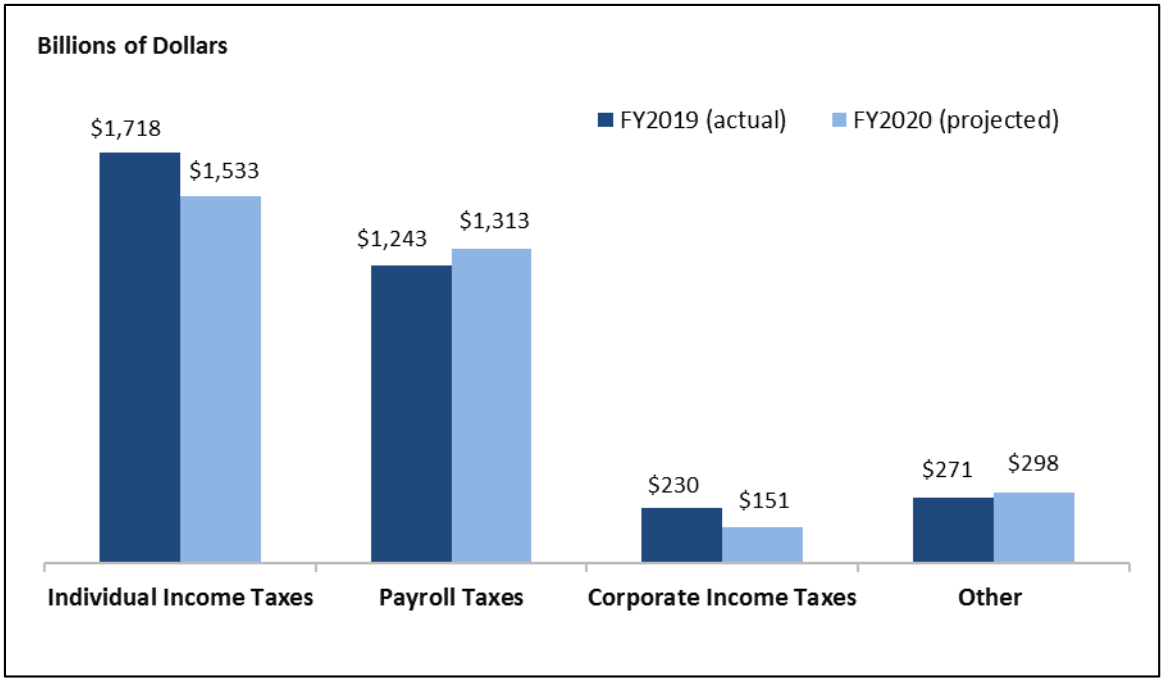
The second-largest source of federal revenue is payroll taxes. In FY2019, payroll taxes generated $1.2 trillion in federal revenue (36% of the total revenue). This figure is projected to increase in FY2020, to $1.3 trillion (40% of total revenue). Receipts from other sources are also projected to increase in FY2020 to $298 billion, from $271 billion in FY2019 (rising to 9% of total revenue from 8%).

[1] See CRS Report R45053, *The Federal Tax System for the 2017 Tax Year*, by Molly F. Sherlock and Donald J. Marples.

[2] Before the COVID-19 pandemic, the Office of Management and Budget estimated that for FY2020, approximately $1.8 trillion, or 49% of the federal government's revenue, would come from the individual income tax. It was estimated the corporate income tax would generate another $264 billion in revenue in FY2020, or just over 7% of total revenue. Social insurance or payroll taxes were expected generate an estimated $1.3 trillion, or 35% of revenue in FY2020. Estimates indicate that the remainder of federal revenue collected in FY2020 was expected to come from excise taxes (3%) or other sources (6%). Other sources include estate and gift taxes, customs duties and fees, and deposits of earnings by the Federal Reserve System. Historical data on federal receipts by source can be found in Table 2.1 of the Historical Tables published by the Office of Management and Budget (OMB), available at https://www.whitehouse.gov/omb/historical-tables/.

[3] FY2019 and FY2020 data can be found in Congressional Budget Office (CBO), *An Update to the Budget Outlook: 2020 to 2030*, September 2, 2020, available at https://www.cbo.gov/publication/56517.

Figure 1. Federal Receipts by Source: 2019 and 2020



Source: Congressional Budget Office (CBO), *An Update to the Budget Outlook: 2020 to 2030*, September 2, 2020, available at https://www.cbo.gov/publication/56517.

Notes: CBO's projections of FY2020 revenues are based on federal receipts through July 2020. Other receipts include excise taxes, Federal Reserve deposits, customs duties, estate and gift taxes, and miscellaneous fees.

The Individual Income Tax

The individual income tax is the largest source of revenue in the federal income tax system. Most of the income reported on individual income tax returns is wages and salaries. CBO projects that in 2020, 64% of total income reported on individual income tax returns will be from salaries and wages.[4] A substantial portion of business income in the United States is taxed in the individual income tax system. Pass-through businesses, including sole proprietorships, partnerships, S corporations, and limited liability companies, generally pass business income through to the business's owners, where that income is taxed at individual income tax rates.[5] Projections indicated that in 2020, 9% of total income reported by individual taxpayers would be net business income, including pass-through business income, farm, or Schedule E income.[6] Another 13% of taxable income is retirement-related, in the form of taxable pensions, annuities, IRA distributions or taxable Social Security Benefits.[7]

[4] Congressional Budget Office (CBO), *An Update to the Budget Outlook: 2020 to 2030*, September 2, 2020, available at https://www.cbo.gov/publication/56517. See specifically the "Detailed Individual Income Tax Projections in CBO's September 2020 Baseline."

[5] See CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

[6] In addition to business income, Schedule E income includes income or losses from rental property, royalties, estates, and trusts.

[7] Congressional Budget Office (CBO), *An Update to the Budget Outlook: 2020 to 2030*, September 2, 2020, available at https://www.cbo.gov/publication/56517. See specifically the "Detailed Individual Income Tax Projections in CBO's September 2020 Baseline."

Gross Income and Adjustments

To levy an income tax, income must first be defined. As a benchmark, economists often turn to the Haig-Simons comprehensive income definition, which can differ from the measure of income used in computing a taxpayer's taxes. Under the Haig-Simons definition, taxable resources are defined as changes in a taxpayer's ability to consume during the tax year.[8] Using this definition of income, an employer's contributions toward employee health insurance, for example, would be counted toward the employee's income. This income, however, is not included in the employee's taxable income under current tax law.

In practice, the individual income tax is based on gross income individuals accrue from a variety of sources. Included in the individual income tax base are wages, salaries, tips, taxable interest and dividend income, business and farm income, realized net capital gains, income from rents, royalties, trusts, estates, partnerships, and taxable pension and annuity income.

Gross income for tax purposes excludes certain items, which may deviate from the Haig-Simmons definition of income. For example, employer-provided health insurance, pension contributions, and certain other employee benefits are excluded from income subject to tax.[9] Employer contributions to Social Security are also excluded from wages. Amounts received under life insurance contracts are excluded from income. Another exclusion from income is the interest received on certain state and local bonds.[10] Some forgiven debts and various other items are also excluded from income for tax purposes.[11]

There are special rules for income earned as capital gains or dividends.[12] Capital gains (or losses) are realized when assets are sold.[13] The tax base excludes unrealized capital gains.[14] There are reduced tax rates for certain capital gains and dividends (discussed below in the "Tax Rates" section).[15] As with ordinary income, there may be exclusions. For example, certain capital gains on sales of primary residences are excluded from income.

Income from operating a business through a proprietorship, partnership, or small business corporation that elects to be treated similarly to a partnership (Subchapter S corporation), or income from rental property, is also subject to the individual income tax.[16] This income is the net

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[8] The Haig-Simons comprehensive income definition was first developed in Robert Murray Haig, "The Concept of Income–Economic and Legal Aspects," in *The Federal Income Tax*, ed. Robert Murray Haig (New York, NY: Columbia University Press, 1921), pp. 1-28; and Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago, IL: University of Chicago Press, 1938). An overview of the concept can be found in Jonathan Gruber, *Public Finance and Public Policy*, 2nd ed. (New York, NY: Worth Publishers, 2007).

[9] Exclusions are a form of "tax expenditure." Tax expenditures are revenue losses associated with targeted provisions that move the income tax away from a "theoretical normal" tax system.

[10] See CRS Report RL30638, *Tax-Exempt Bonds: A Description of State and Local Government Debt*, by Grant A. Driessen.

[11] See CRS In Focus IF11535, *The Tax Treatment of Canceled Mortgage Debt*, by Mark P. Keightley.

[12] See CRS Report 96-769, *Capital Gains Taxes: An Overview*, by Jane G. Gravelle; and CRS Report R43418, *The Taxation of Dividends: Background and Overview*, by Jane G. Gravelle and Molly F. Sherlock.

[13] Capital losses are generally deductible against capital gains. Taxpayers can also deduct up to $3,000 of capital losses from ordinary income per tax year (the deduction is limited to $1,500 for married taxpayers filing separately).

[14] Unrealized capital gains are also excluded at death. This is discussed further in the "Estate and Gift Taxes" section below.

[15] Qualified dividends, which are generally dividends that have met certain holding period requirements, are taxed at the same reduced rate as capital gains.

[16] See CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

of gross receipts reduced by such deductible costs as payments to labor, depreciation, costs of goods acquired for resale and other inputs, interest, and taxes.

A taxpayer's adjusted gross income (AGI), the basic measure of income under the federal income tax, is determined by subtracting "above-the-line" deductions from gross income.[17] Above-the-line deductions are available to taxpayers regardless of whether they itemize deductions or claim the standard deduction. Above-the-line deductions may be claimed for, among other items, contributions to qualified retirement plans by self-employed individuals, contributions to individual retirement accounts (IRAs),[18] interest paid on student loans, higher education tuition expenses, and contributions to health savings accounts.[19] Temporarily, in 2020, there is a $300 above-the-line deduction for charitable contributions.[20]

Filing Status and Deductions

Tax liability depends on the filing status of the taxpayer. There are four main filing categories: married filing jointly, married filing separately, head of household, and single individual. The computation of taxpayers' tax liability depends on their filing status, as discussed further below. The amount of the standard deduction also depends on filing status. Deductions are subtracted before determining taxable income.

Taxpayers have a choice between claiming the standard deduction or claiming the sum of their itemized deductions. The standard deduction amount depends on filing status. The 2020 standard deduction for single filers is $12,400, while the standard deduction for married taxpayers filing jointly is twice that amount, or $24,800. The standard deduction for a head of household is $18,650. There is an additional standard deduction for the elderly (taxpayers age 65 and older) and the blind.[21] The standard deduction amount is indexed for inflation.[22]

When the sum of taxpayers' itemized deductions exceeds the standard deduction, taxpayers may choose to itemize. Deductions may be allowed for mortgage interest[23] and charitable contributions.[24] Taxpayers may also claim up to $10,000 ($5,000 for married taxpayers filing separately) in total deductions for state and local taxes (income, sales, or property taxes).[25]

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[17] A list of "above the line" deductions can be found in the Internal Revenue Code (IRC) §62.

[18] See CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by Elizabeth A. Myers.

[19] See CRS Report R45277, *Health Savings Accounts (HSAs)*, by Ryan J. Rosso.

[20] See CRS Insight IN11420, *Temporary Enhancements to Charitable Contributions Deductions in the CARES Act*, by Jane G. Gravelle.

[21] The additional standard deduction for married taxpayers filing jointly is $1,300 per spouse that is either blind or elderly (or $2,600 if both blind and elderly). For single and head of household taxpayers, the additional standard deduction is $1,650 (or $3,300 if both blind and elderly).

[22] Beginning after 2018, the standard deduction will be indexed for inflation using the Chained Consumer Price Index (C-CPI-U). For background information, see CRS Report R43347, *Budgetary and Distributional Effects of Adopting the Chained CPI*, by Donald J. Marples.

[23] See CRS In Focus IF11540, *The Mortgage Interest Deduction*, by Mark P. Keightley.

[24] The Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136), for the 2020 tax year, suspends limits on certain individual cash contributions to charities and allows a $300 deduction for nonitemizers. See CRS In Focus IF11022, *The Charitable Deduction for Individuals*, by Margot L. Crandall-Hollick and Molly F. Sherlock; CRS Insight IN11420, *Temporary Enhancements to Charitable Contributions Deductions in the CARES Act*, by Jane G. Gravelle; and CRS Report R45922, *Tax Issues Relating to Charitable Contributions and Organizations*, by Jane G. Gravelle, Donald J. Marples, and Molly F. Sherlock. The CARES Act also relaxes limitations for corporate charitable giving in 2020.

[25] See CRS Report R46246, *The SALT Cap: Overview and Analysis*, by Grant A. Driessen and Joseph S. Hughes.

TCJA Changes in Personal Exemptions and Deductions

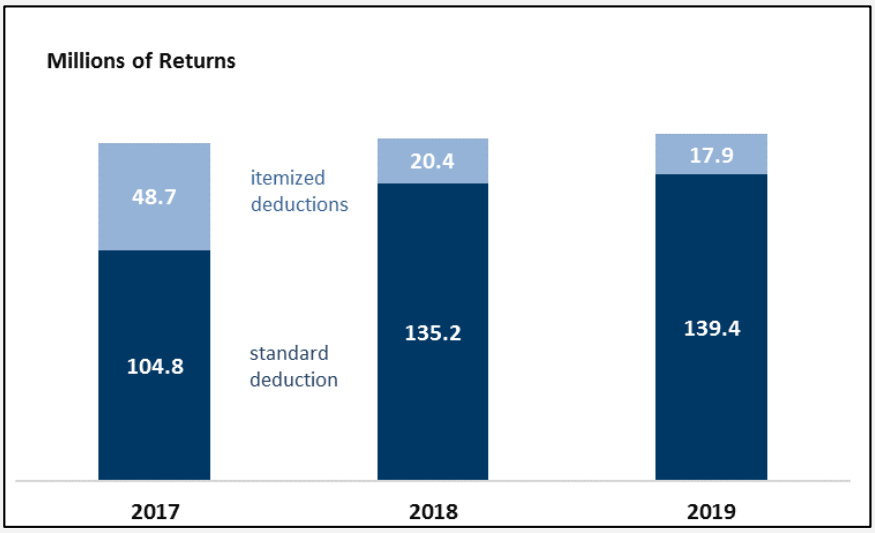
The 2017 Tax Revision (P.L. 115-97) substantially changed the individual income tax system by eliminating personal exemptions and nearly doubling the standard deduction.

Before 2018, taxpayers deducted personal exemptions from their AGI when calculating taxable income. Personal exemptions were allowed for taxpayers, their spouse, and any dependents. For 2020, the personal exemption amount would have been $4,300 per exemption, had the exemption not been temporarily eliminated in P.L. 115-97.

Standard deduction amounts for 2018 would have been $6,500 for single filers, and $13,000 for married taxpayers filing jointly, had P.L. 115-97 not been enacted. Nearly doubling the standard deduction meant that fewer taxpayers itemized deductions. Additional limitations imposed on the deduction for state and local taxes and mortgage interest deduction in P.L. 115-97 may have also contributed to fewer taxpayers claiming these deductions.

The share of taxpayers itemizing deductions fell substantially between 2017 and 2018, with lower itemization rates continuing in 2019 (see **Figure 2**). For 2017, the Joint Committee on Taxation (JCT) estimated that 48.7 million (32%) tax filers would itemize deductions. For 2019, the JCT estimated that 17.9 million (11%) tax filers would itemize deductions.

Figure 2. Tax Returns Filed with Standard and Itemized Deductions, Estimates for 2017, 2018, and 2019



Source: CRS and Joint Committee on Taxation.

Some deductions can only be itemized and claimed in excess of a floor. For example, medical expenses can be deducted to the extent they exceed 7.5% of AGI.[26] Casualty and theft losses attributable to federally declared disasters can also be deducted in excess of 10% of AGI.[27]

[26] The Taxpayer Certainty and Disaster Tax Relief Act of 2019, enacted as Division Q of the Further Consolidated Appropriations Act, 2020 (P.L. 116-94), lowered the floor from 10% to 7.5% for all taxpayers for 2019 and 2020. After 2020, under current law, the floor is scheduled to increase to 10% of AGI for all taxpayers, but may be extended as part of "tax extenders."

[27] The Taxpayer Certainty and Disaster Tax Relief Act of 2019 (P.L. 116-94, Division Q) modified the casualty loss deduction for losses attributable to 2018 or 2019 disasters. The modifications (1) waived the 10% of AGI floor; (2) increased the $100 floor for each casualty to $500; and (3) allowed taxpayers not itemizing deductions to add the deduction to their standard deduction. See CRS Report R45864, *Tax Policy and Disaster Recovery*, by Molly F. Sherlock and Jennifer Teefy.

Deduction for Qualified Business Income

The deduction for qualified business income is also taken in determining taxable income.[28] Individual taxpayers can deduct 20% of qualified business income from a partnership, S corporation, or sole proprietorship. Individual taxpayers can also deduct 20% of qualified Real Estate Investment Trust (REIT) dividends, publicly traded partnership income, and cooperative dividends. For certain taxpayers, the deduction is subject to two limitations. First, above threshold amounts, the deduction begins to phase out for income from certain services, including health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or investing and investments management services. These threshold amounts are $315,000 for married taxpayers filing joint returns (adjusted for inflation to $326,600 in 2020), and $157,500 for all other taxpayers (adjusted for inflation to $163,300 in 2020). Second, the deduction is also subject to limitation based on the taxpayer's share of wages paid and depreciable assets of the associated business. Specifically, the deduction is limited to the greater of 50% of W-2 wages, or 25% of W-2 wages plus 2.5% of the cost of qualified property. This second limitation phases in over the same thresholds as the first limitation.

Tax Rates

The income tax system is designed to be progressive, with statutory marginal tax rates increasing as income increases.[29] At a particular statutory marginal tax rate, all individuals subject to the regular income tax, regardless of their overall level of earnings, pay the same tax rate on taxable income within the bracket.[30] Once taxpayers' incomes surpass a threshold level, placing them in a higher marginal tax bracket, the higher marginal tax rate is only applied on income that exceeds that threshold value. In 2020, the individual income tax system has seven marginal income tax rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%.[31] These marginal income tax rates are applied to taxable income to arrive at a taxpayer's gross income tax liability.[32] Threshold levels associated with the rate brackets depend on filing status. Tax rates for 2020 are summarized in **Table 1**.

For most taxpayers, their average tax rate (individual income taxes paid divided by income) is less than their statutory tax rate. This is due to the progressive nature of the tax system, coupled with a variety of tax preference items (credits, deductions, exclusions, etc.). Many taxpayers, particularly lower-income taxpayers, have negative average tax rates. Refundable tax credits, such as the earned income tax credit (EITC) (discussed below), can lead to negative average tax rates.

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[28] See CRS Report R46402, *The Section 199A Deduction: How It Works and Illustrative Examples*, by Gary Guenther; and CRS In Focus IF11122, *Section 199A Deduction for Pass-through Business Income: An Overview*, by Gary Guenther.

[29] A marginal tax rate is the tax rate on the last dollar earned. For a discussion of various tax rate metrics, see CRS Report R44787, *Statutory, Average, and Effective Marginal Tax Rates in the Federal Individual Income Tax: Background and Analysis*, by Molly F. Sherlock.

[30] See CRS Insight IN11530, *The Federal Income Tax: How Do Marginal Income Tax Rates Work in 2020?*, by Margot L. Crandall-Hollick.

[31] For historical perspective on marginal tax rates, see CRS Report RL34498, *Individual Income Tax Rates and Other Key Elements of the Federal Individual Income Tax: 1988 to 2019 Tax Years*, by Gary Guenther.

[32] Take, for example, a single taxpayer with taxable income of $50,000. That taxpayer would fall in the 22% statutory rate bracket. However, that taxpayer's tax liability would be the sum of taxes applied to income falling within the first three brackets, the 10%, 12%, and 22% brackets. Specifically, the taxpayer would pay $987.50 (or 10%) on the first $9,875 in taxable income, $3,630 (or 12%) on the next $30,250 in taxable income, and $2,172.50 (or 22%) on the last $9,875 in income. Thus, the taxpayer's total tax bill would be $6,790 on $50,000 in taxable income. Even though this taxpayer is in the 22% tax bracket, their average tax rate is 13.6%.

Table 1. Statutory Marginal Tax Rates, 2020

Tax Schedules by Filing Status

Married Filing Jointly			
If taxable income is:			Then, *tax* is:
$0	to	$19,750	10% of the amount over $0
$19,750	to	$80,250	$1,975 plus 12% of the amount over $19,750
$80,250	to	$171,050	$9,235 plus 22% of the amount over $80,250
$171,050	to	$326,600	$29,211 plus 24% of the amount over $171,050
$326,600	to	$414,700	$66,543 plus 32% of the amount over $326,600
$414,700	to	$622,050	$94,735 plus 35% of the amount over $414,700
$622,050	plus		$167,307.50 plus 37% of the amount over $622,050
Single			
If taxable income is:			Then, *tax* is:
$0	to	$9,875	10% of the amount over $0
$9,875	to	$40,125	$987.50 plus 12% of the amount over $9,875
$40,125	to	$85,525	$4,617.50 plus 22% of the amount over $40,125
$85,525	to	$163,300	$14,605.50 plus 24% of the amount over $85,525
$163,300	to	$207,350	$33,271.50 plus 32% of the amount over $163,300
$207,350	to	$518,400	$47,367.50 plus 35% of the amount over $207,350
$518,400	plus		$156,235 plus 37% of the amount over $518,400
Heads of Households			
If taxable income is:			Then, *tax* is:
$0	to	$14,100	10% of the amount over $0
$14,100	to	$53,700	$1,410 plus 12% of the amount over $14,100
$53,700	to	$85,500	$6,162 plus 22% of the amount over $53,700
$85,500	to	$163,300	$13,158 plus 24% of the amount over $85,500
$163,300	to	$207,350	$31,830 plus 32% of the amount over $163,300
$207,350	to	$518,400	$45,926 plus 35% of the amount over $207,350
$518,400	plus		$154,793.50 plus 37% of the amount over $518,400

Source: Internal Revenue Code.

Certain higher-income individuals may be subject to the alternative minimum tax (AMT). There are two marginal tax rates under the AMT, 26% and 28%, that are applied to an expanded income base. The AMT is discussed in further detail below.

Tax Rates on Capital Gains and Dividends

As was noted above, income earned from long-term capital gains and qualified dividends may be taxed at lower rates. The rate on long-term capital gains and qualified dividends can be 0%, 15%, or 20%, depending on the taxpayer's taxable income and filing status. The rates are linked to the statutory rate brackets that were in effect before P.L. 115-97 was enacted, such that the 20% rate applies to taxpayers that would have been in the 39.6% bracket (under the pre-P.L. 115-97 rate

structure). Taxpayers that would have been in the 25%, 28%, 33%, and 35% tax brackets under the former rate structure face a 15% tax rate on long-term capital gains and qualified dividends, whereas the rate is 0% for taxpayers that would have been in the 10% and 15% tax brackets under the former rate structure. The taxable income thresholds for long-term capital gains and qualified dividends in 2020 are summarized in **Table 2**.

Table 2. Maximum Tax Rate on Long-Term Capital Gains and Qualified Dividends, 2020

Married Filing Jointly		Single		Heads of Households	
Taxable Income	**Tax Rate**	**Taxable Income**	**Tax Rate**	**Taxable Income**	**Tax Rate**
Less than $80,000	0%	Less than $40,000	0%	Less than $53,600	0%
$80,000 to $496,600	15%	$40,000 to $441,450	15%	$53,600 to $469,050	15%
Above $496,600	20%	Above $441,450	20%	Above $469,050	20%

Source: Internal Revenue Code.

Net Investment Income

Certain higher-income individuals may be subject to an additional 3.8% tax on net investment income. Specifically, the tax applies to the lesser of (1) net investment income, or (2) the amount by which modified AGI exceeds fixed threshold amounts.[33] The fixed threshold amounts are $250,000 for taxpayers filing jointly and $200,000 for other filers.[34] The net-investment-income tax increases the maximum tax rate on capital gains and dividends to 23.8%. The maximum rate on other investment income, including interest, annuities, royalties, and rent, is 40.8%.

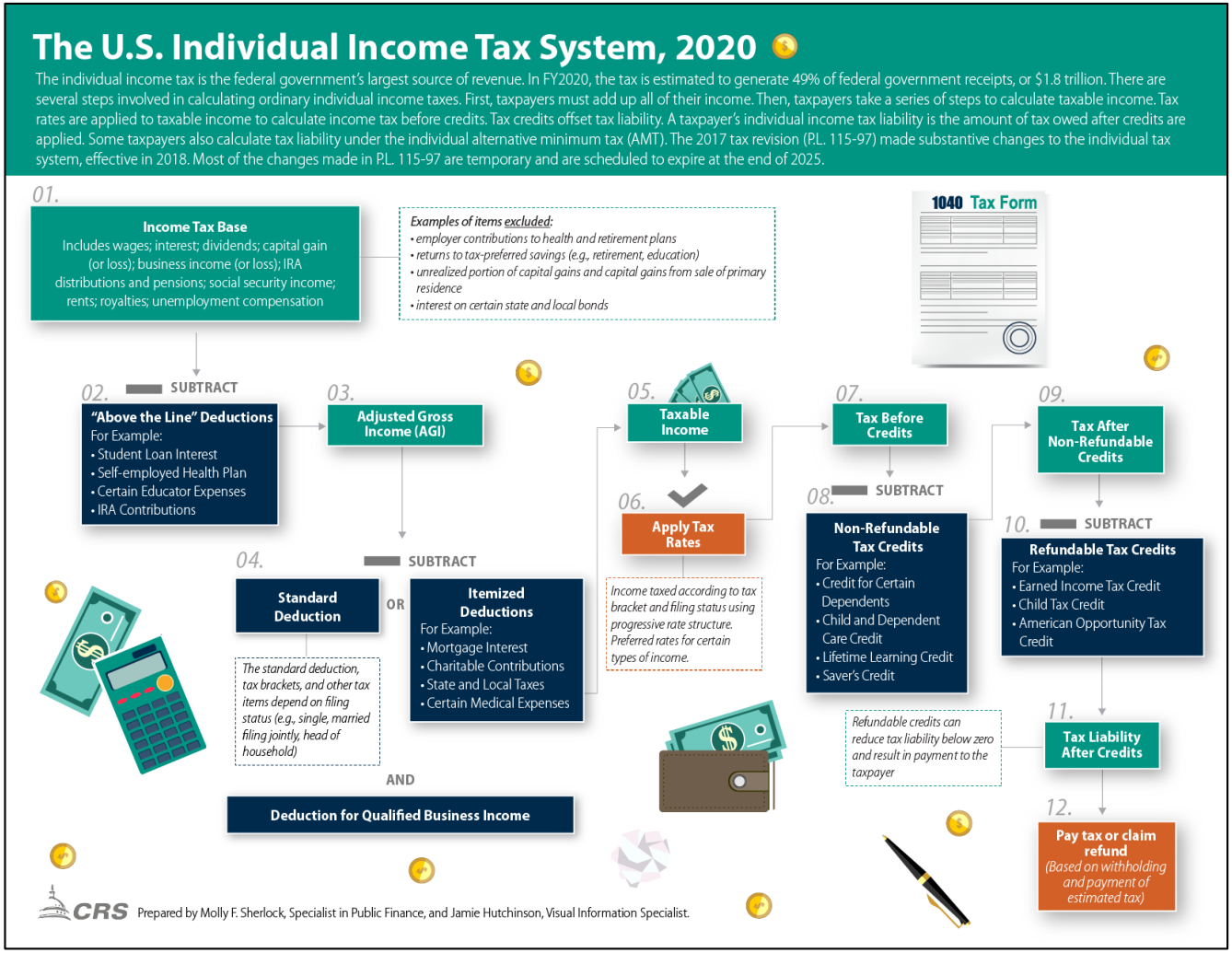
Tax Credits

After a taxpayer's tax liability has been calculated, tax credits are subtracted from gross tax liability to arrive at a final tax liability (see **Figure 3**). Tax credits offset tax liability on a dollar-for-dollar basis. There are two different types of tax credits: refundable and nonrefundable. If a tax credit is refundable, and the credit amount exceeds tax liability, a taxpayer receives the credit (or a portion of the credit) as a refund. If credits are not refundable, then the credit is limited to the amount of tax liability. In most cases, unused credits cannot be carried forward to offset tax liability in future tax years. Some credits are phased out as income rises to limit or eliminate benefits for higher-income taxpayers.

[33] Modified AGI is AGI increased by the amount excluded from income as foreign earned income.

[34] The threshold amount is $125,000 for married taxpayers filing separate returns. These threshold amounts are not adjusted for inflation.

Figure 3. Visualization of the U.S. Individual Income Tax System



Source: This graphic was previously published as CRS Infographic IG10020, *The U.S. Individual Income Tax System, 2020*, by Molly F. Sherlock.

Tax credits that are refundable or have a refundable portion include the earned income tax credit (EITC)[35] and the child tax credit (CTC).[36] The American Opportunity Tax Credit (AOTC), a tax credit for tuition expenses, also has a refundable portion.[37] The health insurance premium tax credit is another refundable credit.[38] Temporary law enacted as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) created a one-time refundable tax credit—the 2020 Recovery Rebate.[39]

A nonrefundable tax credit can be claimed for child and dependent care expenses.[40] There are also tax credits for other purposes, such as education.[41]

Tax credits add to the complexity of the tax system for various reasons. For one, tax credits can cause effective marginal tax rates to differ from statutory marginal tax rates for many taxpayers.[42] For example, the earned income tax credit (EITC) phases in as income increases, reducing a taxpayer's marginal tax rate. At higher income levels, as the credit phases out, the taxpayer faces a higher marginal tax rate during that phaseout range. Thus, effective marginal tax rates can be less than or greater than statutory rates. Tax credits can also pose administrative challenges.[43]

Alternative Minimum Tax

Individuals may also pay tax under the alternative minimum tax (AMT). The AMT applies lower tax rates to a broader income base. The policy goal of the AMT is to prevent certain higher-income taxpayers from using the graduated personal income tax rate structure and tax preferences to avoid paying sufficient amounts of taxes.[44]

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[35] See CRS Report R43805, *The Earned Income Tax Credit (EITC): How It Works and Who Receives It*, by Margot L. Crandall-Hollick, Gene Falk, and Conor F. Boyle; CRS Report R44057, *The Earned Income Tax Credit (EITC): An Economic Analysis*, by Margot L. Crandall-Hollick; CRS Report R44825, *The Earned Income Tax Credit (EITC): A Brief Legislative History*, by Margot L. Crandall-Hollick; and CRS Report R43873, *The Earned Income Tax Credit (EITC): Administrative and Compliance Challenges*, by Margot L. Crandall-Hollick.

[36] See CRS Report R41873, *The Child Tax Credit: Current Law*, by Margot L. Crandall-Hollick; CRS In Focus IF11077, *The Child Tax Credit*, by Margot L. Crandall-Hollick; and CRS Report R45124, *The Child Tax Credit: Legislative History*, by Margot L. Crandall-Hollick.

[37] See CRS Report R42561, *The American Opportunity Tax Credit: Overview, Analysis, and Policy Options*, by Margot L. Crandall-Hollick.

[38] See CRS Report R44425, *Health Insurance Premium Tax Credits and Cost-Sharing Subsidies*, by Bernadette Fernandez.

[39] See CRS Insight IN11282, *COVID-19 and Direct Payments to Individuals: Summary of the 2020 Recovery Rebates/Economic Impact Payments in the CARES Act (P.L. 116-136)*, by Margot L. Crandall-Hollick; and CRS Insight IN11270, *COVID-19 and Direct Payments to Individuals: Estimated Impact of Recovery Rebates in H.R. 748 on Family Incomes*, by Conor F. Boyle and Jameson A. Carter.

[40] See CRS Report R44993, *Child and Dependent Care Tax Benefits: How They Work and Who Receives Them*, by Margot L. Crandall-Hollick.

[41] See CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*, by Margot L. Crandall-Hollick.

[42] See CRS Report R44787, *Statutory, Average, and Effective Marginal Tax Rates in the Federal Individual Income Tax: Background and Analysis*, by Molly F. Sherlock.

[43] See CRS Report R43873, *The Earned Income Tax Credit (EITC): Administrative and Compliance Challenges*, by Margot L. Crandall-Hollick.

[44] See CRS Report R44494, *The Alternative Minimum Tax for Individuals: In Brief*, by Donald J. Marples.

To calculate the AMT, an individual first adds back various tax items, including certain itemized deductions and business tax preferences, to regular taxable income.[45] This grossed-up amount becomes the income base for the AMT.

The AMT exemption is subtracted from the AMT's income base. For 2020, the AMT exemption is $113,400 for married taxpayers filing a joint return, $56,700 for married taxpayers filing separate returns, and $72,900 for all other individual tax filers.[46] These exemption amounts are indexed for inflation. The AMT exemption is reduced by 25% of the amount by which a taxpayer's AMT taxable income exceeds certain threshold amounts. In 2020, the AMT exemption amount begins to phase out at $1,036,800 for married taxpayers filing a joint return and $518,400 for all other individual tax filers.

A two-tiered rate structure of 26% and 28% is assessed against AMT taxable income.[47] The taxpayer compares his AMT tax liability to his regular tax liability and pays the greater of the two. Most nonrefundable personal tax credits are allowed against the AMT. Few taxpayers are subject to the individual AMT. For 2019, JCT estimated that roughly 200,000 tax filers paid the AMT (nearly 174 million return were filed).[48]

The Corporate Income Tax

The corporate income tax generally only applies to C corporations (also known as regular corporations). These corporations—named for Subchapter C of the Internal Revenue Code (IRC), which details their tax treatment—are generally treated as taxable entities separate from their shareholders.[49] That is, corporate income is taxed once at the corporate level according to the corporate income tax system. When corporate dividend payments are made or capital gains are realized, income is taxed again at the individual-shareholder level according to the individual tax system (discussed above). In contrast, noncorporate businesses, including S corporations[50] and partnerships,[51] pass their income through to owners who pay taxes. Collectively, these noncorporate business entities are referred to as pass-throughs. For these types of entities, business income is taxed only once, at individual income tax rates. As discussed above, taxpayers may be allowed to claim a 20% deduction from certain income earned by pass-through businesses.

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[45] For example, the income tax base for the AMT does not allow a deduction for state and local taxes paid.

[46] Internal Revenue Service, *Internal Revenue Procedure 2019-44*, November 8, 2019, available at https://www.irs.gov/pub/irs-drop/rp-19-44.pdf.

[47] The 28% rate bracket threshold for 2019 is $97,400 for married taxpayers filing separate returns and $194,800 for all other taxpayers.

[48] Joint Committee on Taxation, *Overview Of The Federal Tax System As In Effect For 2019*, JCX-9-19, Washington, DC, March 9, 2019.

[49] See CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

[50] An S corporation is a closely held corporation that elects to be treated as a pass-through entity for tax purposes. S corporations are named for Subchapter S of the IRC, which details their tax treatment. By electing S corporation status, a business is able to combine many of the legal and business advantages of a C corporation with the tax advantages of a partnership. See CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

[51] A partnership is a joint venture consisting of at least two partners organized to operate a trade or business with each partner sharing profits, losses, deductions, credits, and the like. The most common partnerships include general partnerships, limited liability partnerships, limited partnerships, publicly traded partnerships, and electing large partnerships. For more information, see CRS Report R43104, *A Brief Overview of Business Types and Their Tax Treatment*, by Mark P. Keightley.

The corporate income tax is designed as a tax on corporate profits (also known as net income). Broadly defined, corporate profit is total income minus the cost associated with generating that income.[52] Business expenses that may be deducted from income include employee compensation; the decline in value of machines, equipment, and structures (i.e., depreciation); general supplies and materials; advertising; and interest payments (subject to certain limitations).[53] Businesses may also be allowed 100% first-year depreciation or to expense the costs of certain property.[54] The corporate income tax also allows for a number of other special deductions, credits, and tax preferences that reduce taxes paid by corporations. Oftentimes, these provisions are intended to promote particular policy goals (promoting charitable giving or encouraging investment in renewable energy, for example). A corporation's tax liability can be calculated as follows:

$$\text{Taxes} = [(\text{Total Income} - \text{Deductible Expenses}) \times \text{Tax Rate}] - \text{Tax Credits}.$$

Some corporations experience net operating losses (NOLs), which occur when total income less expenses is negative.[55] Under permanent law, losses arising after 2017 can generally be "carried forward" indefinitely, and used to offset future tax liability. The NOL deduction is generally limited to 80% of taxable income.[56] Temporary law enacted as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) allows for NOLs generated in taxable years beginning after December 31, 2017, and before January 1, 2021, to be carried back for up five years and suspends the limit to 80% of taxable income for taxable years beginning before January 1, 2021.[57]

The corporate income tax rate is a flat 21%. Thus, tax liability before applying tax credits is generally calculated as 21% of taxable income. Corporate tax liability can be reduced by claiming corporate tax credits. Credits claimed by corporations include the research credit,[58] the low-

[52] The primary components of business income are revenues generated from the sale of goods and services. Other income sources include investment income, royalties, rents, and capital gains.

[53] The 2017 tax revision (P.L. 115-97) limits interest payments, with the limitation generally set at 30% of adjusted taxable income. The limitation does not apply to small businesses with average gross receipts of $25 million or less or to certain regulated public utilities. Temporary law enacted as part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136) relaxes the limitation to 50% of adjusted taxable income for tax years 2019 and 2020. See CRS Insight IN11287, *Limits on Business Interest Deductions Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act*, by Jane G. Gravelle.

[54] See CRS Report RL31852, *The Section 179 and Section 168(k) Expensing Allowances: Current Law and Economic Effects*, by Gary Guenther.

[55] See CRS Report R46377, *The Tax Treatment and Economics of Net Operating Losses*, by Mark P. Keightley.

[56] There are special rules for farming and insurance company losses.

[57] See CRS Insight IN11296, *Tax Treatment of Net Operating Losses (NOLs) in the Coronavirus Aid, Relief, and Economic Security (CARES) Act*, by Jane G. Gravelle.

[58] See CRS Report RL31181, *Research Tax Credit: Current Law and Policy Issues for the 114th Congress*, by Gary Guenther; and CRS In Focus IF10757, *The 2017 Tax Law (P.L. 115-97) and Investment in Innovation*, by Gary Guenther.

income housing tax credit,[59] certain energy credits,[60] the new markets tax credit,[61] the work opportunity tax credit,[62] and an employer credit for paid family and medical leave.[63]

In broad economic terms, the base of the corporate income tax is the return to equity capital. Income produced by corporate capital investment includes that produced by corporate investment of borrowed funds (debt), and that produced by investment of equity, or funds provided by stockholders. The deductibility of certain items makes it such that the corporate income tax applies largely to equity capital. Specifically, wages are tax deductible, so labor's contribution to corporate revenue is excluded from the corporate tax base. Additionally, profits from debt-financed investment are paid out as interest, which is partially deductible. To the extent that interest is deductible, the return to debt capital is excluded from the corporate tax base. Equity investments are financed by retained earnings and the sale of stock. The income equity investment generates is paid out as dividends and the capital gains that accrue as stock increases in value. Neither form of equity income is generally deductible. Thus, the base of the corporate income tax is largely the return to equity capital.

With the base of the corporate tax being largely equity income, the flow of capital out of the corporate sector and other economic adjustments probably cause the burden of the tax to spread to all owners of capital: owners of unincorporated business, bondholders, and homeowners. In analyzing the incidence of the corporate tax, the Congressional Budget Office (CBO) and JCT generally distribute most of the burden to owners of capital, with a smaller portion falling on labor income.[64] Since owners of capital tend to be in higher income groups, and most of the corporate tax burden falls on capital, the corporate tax is widely viewed as being progressive.

Corporate Income Earned Abroad[65]

There are a number of rules governing the taxation of foreign-source income earned by U.S. corporations. The United States has a quasiterritorial tax system (pure territorial tax systems tax only income earned within a country's borders). In general, dividends received by U.S. corporate shareholders from their controlled foreign corporations (CFCs) are eligible for a 100% dividends-received deduction. However, certain forms of passive or easily shifted income are taxed in the year earned—under subpart F. In addition, global intangible low-taxed income (GILTI) is taxed at 10.5%.[66] A deduction is allowed for the foreign derived intangible income (FDII)—roughly the share of intangible income that is attributed to foreign activity.

[59] See CRS Report RS22389, *An Introduction to the Low-Income Housing Tax Credit*, by Mark P. Keightley; and CRS In Focus IF11335, *The Low-Income Housing Tax Credit: Policy Issues*, by Mark P. Keightley.

[60] See CRS Report R43453, *The Renewable Electricity Production Tax Credit: In Brief*, by Molly F. Sherlock; CRS In Focus IF10479, *The Energy Credit: An Investment Tax Credit for Renewable Energy*, by Molly F. Sherlock; and CRS In Focus IF11455, *The Tax Credit for Carbon Sequestration (Section 45Q)*, by Angela C. Jones and Molly F. Sherlock.

[61] See CRS Report RL34402, *New Markets Tax Credit: An Introduction*, by Donald J. Marples and Sean Lowry.

[62] See CRS Report R43729, *The Work Opportunity Tax Credit*, by Benjamin Collins and Sarah A. Donovan.

[63] This credit is available for wages paid in 2018, 2019, and 2020. See CRS In Focus IF11141, *Employer Tax Credit for Paid Family and Medical Leave*, by Molly F. Sherlock.

[64] See CRS In Focus IF10742, *Who Pays the Corporate Tax?*, by Jane G. Gravelle.

[65] See CRS Report R45186, *Issues in International Corporate Taxation: The 2017 Revision (P.L. 115-97)*, by Jane G. Gravelle and Donald J. Marples.

[66] The GILTI tax rate is 10.5% in 2018 and through 2025. After 2025, the GILTI tax rate is scheduled to increase to 13.125%.

Current law also contains a general antiabuse provision whose focus is primarily on U.S. subsidiaries of foreign parents, although it applies in general to all related parties. Unlike Subpart F or the GILTI provision, the base erosion and antiavoidance tax (BEAT) is not aimed at including income but at disallowing deductions for certain "base erosion" payments made by U.S. parents to their foreign subsidiaries that historically have been used to shift profits out of the United States. BEAT imposes a minimum tax which is equal to 10%, in 2020, of the sum of taxable income and base erosion payments on corporations with average annual gross receipts of at least $500 million over the past three tax years and with deductions attributable to outbound payments exceeding 3% of overall deductions.[67]

Social Insurance and Retirement Payroll Taxes

Payroll taxes are used to fund specific programs, largely Social Security and Medicare.[68] Social Security and Medicare taxes are generally paid at a combined rate of 15.3% of wages, with 7.65% being paid by the employee and employer alike.[69]

The Social Security part of the tax, or the old age, survivors, and disability insurance (OASDI) tax, is 6.2% for both employees and employers (12.4% in total).[70] In 2020, the tax applies to the first $137,700 in wages. This wage base is adjusted annually for inflation.

The Medicare portion of the tax, or the Medicare hospital insurance (HI) tax, is 1.45% for both employees and employers (2.9% in total).[71] There is no wage cap for the HI tax (the Medicare HI tax applies to all wage earnings). Certain higher-income taxpayers may be subject to an additional HI tax of 0.9%. For married taxpayers filing jointly, combined wages above $250,000 are subject to the additional 0.9% HI tax.[72] The threshold for single and head of household filers is $200,000. These threshold amounts are not indexed for inflation.

Employers may also be subject to a federal unemployment insurance payroll tax.[73] This tax is 0.6% on the first $7,000 of wages.[74] Federal unemployment insurance payroll taxes are used to pay for the administrative costs of the unemployment insurance (UI) program. State UI taxes generally pay for UI benefits.[75]

Most taxpayers pay more in payroll taxes than income taxes. For 2020, the Tax Policy Center estimates that 66% of tax filing units will have a payroll tax liability that exceeds income tax liability.[76] Taxpayers closer to the top of the income distribution are more likely to have an income tax liability that exceeds payroll tax liability (see **Figure 4**).

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[67] The BEAT tax rate increased from 5% in 2018 to 10% in 2019, and is scheduled to increase to 12.5% after 2025.

[68] The taxes are also known as Federal Insurance Contributions Act (FICA) taxes.

[69] Self-employed taxpayers pay both the employer and employee share.

[70] See CRS Report R42035, *Social Security Primer*, by Dawn Nuschler.

[71] See CRS Report R40425, *Medicare Primer*, coordinated by Patricia A. Davis.

[72] The threshold amount for married taxpayers filing separately is $125,000.

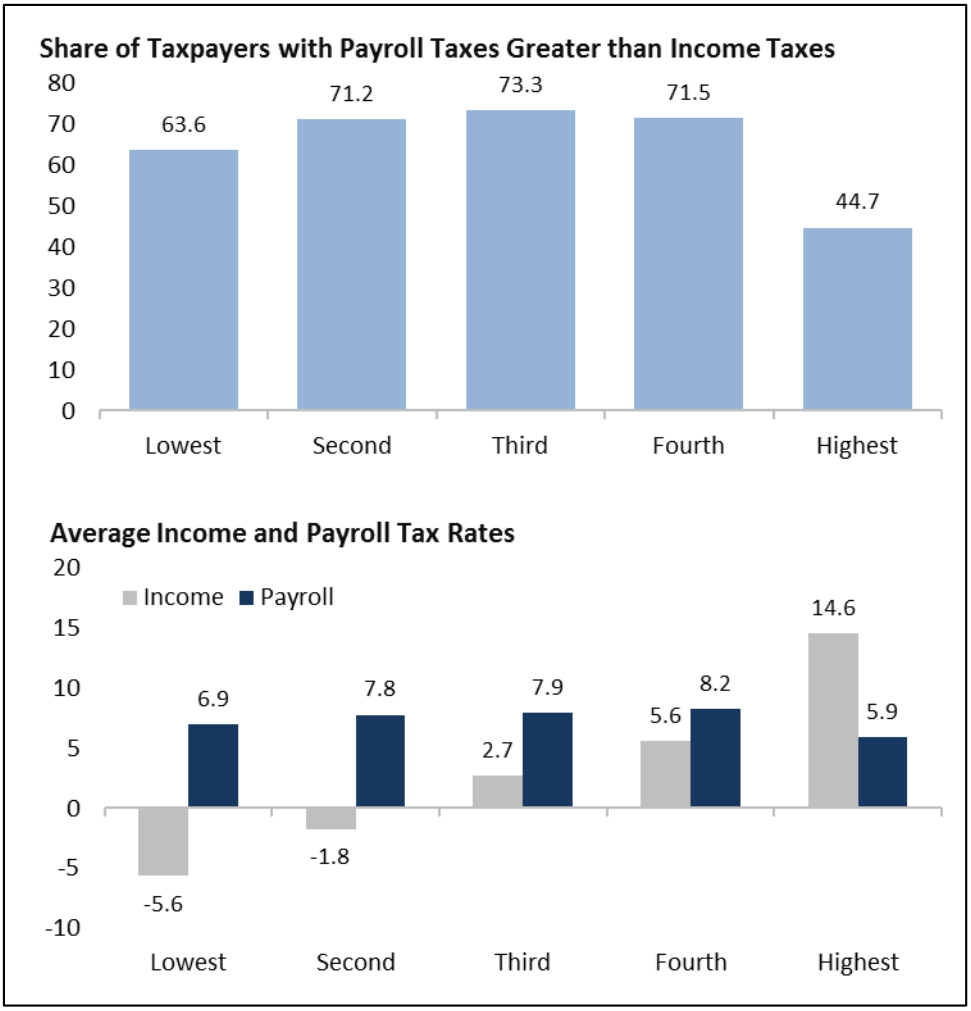
[73] See CRS In Focus IF10336, *The Fundamentals of Unemployment Compensation*, by Julie M. Whittaker and Katelin P. Isaacs; and CRS Report R44527, *Unemployment Compensation: The Fundamentals of the Federal Unemployment Tax (FUTA)*, by Julie M. Whittaker.

[74] The tax rate is 6% of total wages for each employee, up to $7,000. However, there is a federal credit of 5.4% for state unemployment taxes, making the effective federal tax rate 0.6%.

[75] See CRS Report RL33362, *Unemployment Insurance: Programs and Benefits*, by Julie M. Whittaker and Katelin P. Isaacs.

[76] Tax Policy Center, *T20-0096 - Distribution of Federal Payroll and Income Taxes by Expanded Cash Income Level*,

Figure 4. Share of Taxpayers with Payroll Taxes Greater Than Income Taxes and Average Payroll and Income Tax Rates, by Income Quintile 2020



Source: CRS graphic using Tax Policy Center Data.

Notes: Income quintile breaks are 20% at $25,800, 40% at $51,500, 60% at $92,700, and 80% at $167,600 in 2019 dollars. Income groups are determined using expanded cash income.

Most low- and middle-income taxpayers pay more in payroll taxes than in income taxes.[77] The average payroll tax rate across all taxpayers is estimated to be 6.9% for 2020. The average rate is higher in the middle of the income distribution, and lower at the top of the income distribution. The lower average payroll tax rate at the top of the income distribution is largely a consequence of the wage base limit for the OASDI tax. Average income tax rates, in contrast, increase across the income distribution. Refundable tax credits (discussed above) result in negative average

2020, March 17, 2020, available at https://www.taxpolicycenter.org/model-estimates/distribution-federal-payroll-and-income-taxes-march-2020/t20-0096-distribution.

[77] Tax Policy Center, *T20-0103 - Distribution of Federal Payroll and Income Taxes by Expanded Cash Income percentile, 2020*, March 17, 2020, available at https://www.taxpolicycenter.org/model-estimates/distribution-federal-payroll-and-income-taxes-march-2020/t20-0103-distribution.

income tax rates in the lowest two income quintiles. Only in the highest quintile does the average income tax rate exceed the average payroll tax rate (see **Figure 4**).

Estate and Gift Taxes

Upon death, an individual's estate may be subject to tax.[78] The base of the federal estate tax is generally property transferred at death, less allowable deductions and exemptions. An unlimited marital deduction is allowed for property transferred to a surviving spouse. Other allowable deductions include estate administration expenses and charitable bequests. The effective estate tax exemption is $11.58 million for 2020.[79] The value of the estate over the exemption amount is generally taxed at a rate of 40%.[80]

The federal gift tax operates alongside the estate tax to prevent individuals from avoiding the estate tax by transferring property to heirs before dying. For 2020, the first $15,000 of gifts from one individual to another is excluded from taxation and does not apply to the lifetime exemption.[81] Any amount over this annual exclusion lowers the effective lifetime estate tax exemption.

The gift tax and estate tax are unified in that the same lifetime exemption amount applies to both taxes ($11.58 million in 2020). Being unified, taxable gifts reduce the exemption amount that is available for estate tax purposes. The gift tax rate is 40%, the same as the top rate for the estate tax, for gifts beyond the exemption amount.

Few taxpayers pay the estate tax. Through 2025, an estimated 0.06% of decedents will pay the estate tax.[82] The estate tax is also progressive, up to the very top of the income distribution. For taxpayers in the 95th to 99th percentile, the estate tax has been estimated to be 0.2% of cash income in 2020.[83] For taxpayers in the top 1% and top 0.1% of the income distribution, the estate tax has been estimated to be 0.3% of cash income in 2020.

Excise Taxes

Excise taxes are levied on the consumption of goods and services rather than income. Unlike sales taxes, they apply to particular commodities, rather than to broad categories. Historically, the federal government has levied excise taxes, but not a broad-based sales tax, instead leaving sales taxes to the states as a revenue source.

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[78] See CRS Report R42959, *Recent Changes in the Estate and Gift Tax Provisions*, by Jane G. Gravelle.

[79] Although estate tax rates are graduated, the exemption is applied in the form of a credit and offsets taxes applied at the lower rates.

[80] The exemption amount is adjusted for inflation. For the most recent exemption level, see https://www.irs.gov/businesses/small-businesses-self-employed/estate-tax.

[81] A married couple could each give a child $15,000 for a total gift of $30,000. This $30,000 in gifts would not apply to the lifetime exemption. Gifts can also be made to more than one child. The exemption amount is indexed for inflation in $1,000 increments.

[82] Tax Policy Center, *T17-0308 - Estate Tax Returns and Liability Under Current Law and the House and Senate Versions of the Tax Cuts and Jobs Act, 2018-2027*, December 6, 2017, available at http://www.taxpolicycenter.org/model-estimates/estate-tax-and-tax-cuts-and-jobs-act-dec-2017/t17-0308-estate-tax-returns-and.

[83] Tax Policy Center, *T20-0039—Average Effective Federal Tax Rates—All Tax Units, By Expanded Cash Income Percentile, 2020*, February 26, 2020, available at https://www.taxpolicycenter.org/model-estimates/baseline-share-federal-taxes-february-2020/t20-0039-average-effective-federal-tax.

Federal excise taxes are levied on a variety of products. The collection point of the tax varies across products. For some goods, taxes are collected at the production level. Other excise taxes are collected on retail sales. In terms of receipts, the single largest tax is the excise tax on gasoline.[84] Other prominent excise taxes are those on diesel and other fuels; trucks, trailers, and tractors; aviation-related taxes and fees;[85] excise taxes on beer, wine, and distilled spirits;[86] taxes on tobacco products; Affordable Care Act (ACA) taxes and fees[87] (e.g., insurance provider fee,[88] branded pharmaceuticals fee); and taxes on firearms and ammunition.[89]

Most federal excise taxes are paid into federal trust funds devoted to specific federal activities, as opposed to remaining in the federal budget's general fund. Estimates for 2020 indicate that of the $95 billion in anticipated excise tax revenue, approximately 68% will support trust funds, with the remainder being general fund revenue.[90] The largest trust fund is the Highway Trust Fund. Devoted revenue sources include excise taxes on fuels, trucks, and tires. Aviation-related excise taxes support the Airport and Airway Trust Fund, the second-largest of the excise-tax-supported trust funds.[91] General fund excise taxes include taxes on alcohol and tobacco and ACA-related excise taxes.

Excise taxes can result in consumers paying higher prices for goods and services. Overall, households from the lower part of the income distribution tend to pay a larger share of their income in excise taxes than higher-income households.[92] Thus, taken as a whole, federal excise taxes are generally believed to be regressive. The degree of regressivity can vary for different types of excise taxes. For example, tobacco excise taxes are estimated to be more regressive than aviation-related excise taxes.[93]

Tax Statistics

Taxes as a Share of the Economy

Federal revenues are derived from several sources and have collectively ranged from roughly one-fifth to one-seventh the size of the economy. **Figure 5** displays total federal tax revenues and major sources of federal tax revenue as percentages of gross domestic product (GDP) since 1945.

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[84] Congressional Budget Office, *Revenue Projections, by Category*, August 2019, available at https://www.cbo.gov/about/products/budget-economic-data#3.

[85] See CRS Report R44749, *The Airport and Airway Trust Fund (AATF): An Overview*, by Rachel Y. Tang and Bart Elias.

[86] See CRS Report R43350, *Alcohol Excise Taxes: Current Law and Economic Analysis*, by Sean Lowry.

[87] See CRS In Focus IF10591, *Taxes and Fees Enacted as Part of the Affordable Care Act*, by Sean Lowry.

[88] See CRS Report R43225, *Patient Protection and Affordable Care Act: Annual Fee on Health Insurers*, by Suzanne M. Kirchhoff.

[89] See CRS Report R45123, *Guns, Excise Taxes, Wildlife Restoration, and the National Firearms Act*, by R. Eliot Crafton, Jane G. Gravelle, and William J. Krouse.

[90] Office of Management and Budget, Historical Tables, Table 2.4, available at https://www.whitehouse.gov/omb/budget/Historicals.

[91] See CRS Report R44749, *The Airport and Airway Trust Fund (AATF): An Overview*, by Rachel Y. Tang and Bart Elias.

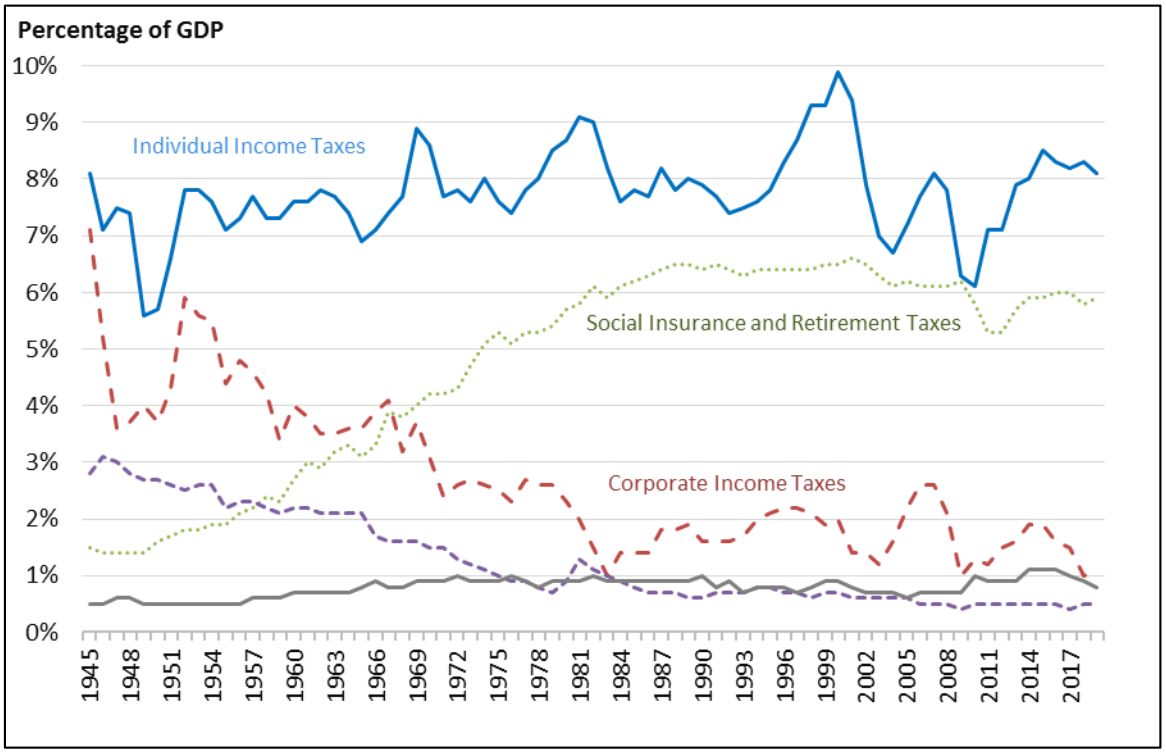
[92] Tax Policy Center Briefing Book, "Who Bears the Burden of Federal Excise Taxes?" available at http://www.taxpolicycenter.org/briefing-book/who-bears-burden-federal-excise-taxes. The distribution of federal excise taxes is estimated for the 2018 tax year.

[93] Ibid.

For 2019, it was estimated that revenues would be 16.7% of GDP, slightly below the post-World War II average of 17.2% of GDP.

Since the mid-1940s, the individual income tax has been the largest single source of federal revenue (business income may also be taxed under the individual income tax system, as previously discussed in "The Individual Income Tax"). Between 2000 and 2010, however, the individual income tax receipts decreased relative to the size of the economy, falling from nearly 10% of GDP in 2000 to just over 6% in 2010. Individual income tax receipts have subsequently increased to 8% of GDP in 2019. Over time, the corporate income tax has fallen from the second- to the third-largest source of revenue. In the late 1960s, corporate taxes were replaced by social insurance and retirement taxes as the second-leading revenue source. Corporate receipts as a share of GDP have fallen further in recent years. Excise taxes have also decreased as a share of GDP over time.

Figure 5. Federal Revenue as a Percentage of GDP, 1945-2019



Source: CRS calculations using data from U.S. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2021, Historical Tables* (Washington: GPO, 2020).

Composition of Tax Revenue

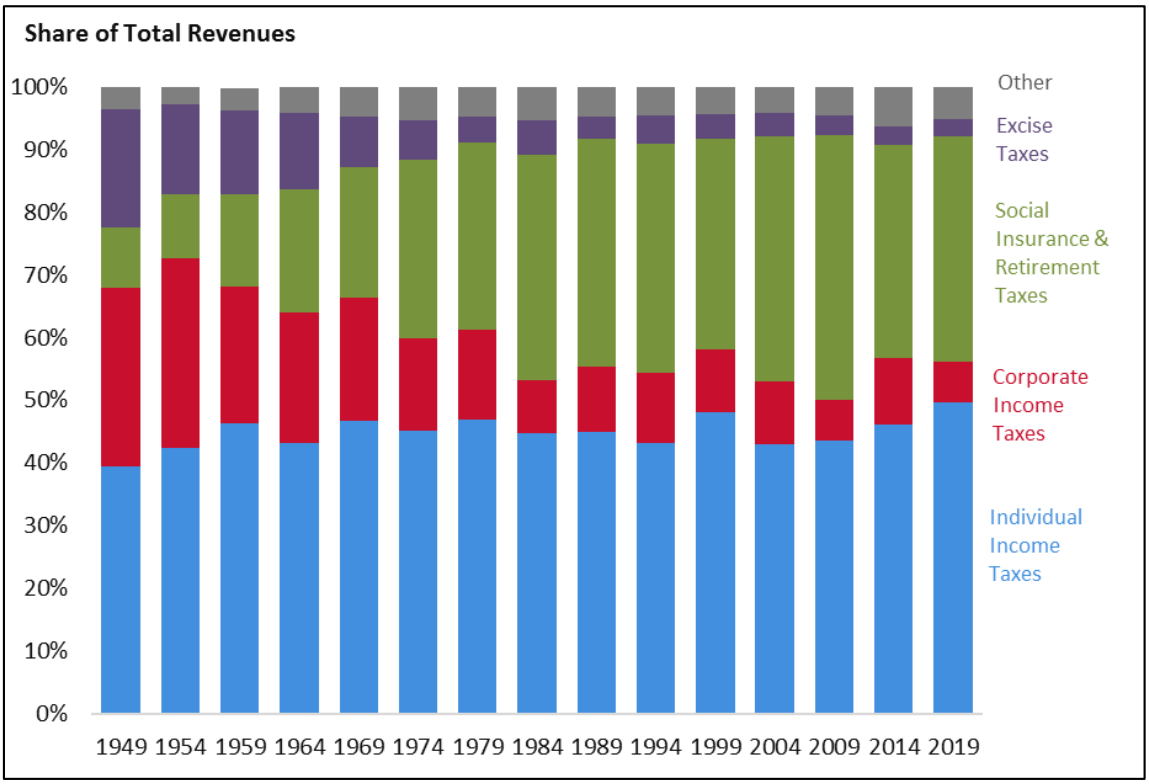
The changing shares of federal revenues over time are more clearly shown in **Figure 6**. For example, the corporate income tax accounted for roughly 28% of federal revenue in 1949, but less than 7% in 2019.[94] Excise tax revenue was roughly 3% of federal receipts in 2019, down from 19% in 1949. In contrast, receipts for social insurance and retirement taxes have risen post-

[94] See CRS Report R42113, *Reasons for the Decline in Corporate Tax Revenues*, by Mark P. Keightley. Historical data on federal receipts by source can be found in Table 2.1 of the Historical Tables published by the Office of Management and Budget (OMB), available at https://www.whitehouse.gov/omb/historical-tables/.

World War II with the enactment of Social Security and Medicare and are now the second-largest source of federal receipts at approximately 36% of federal revenue.

Figure 6. Composition of Federal Revenue

(Selected Years 1949-2019)



Source: CRS calculations using data from U.S. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2021, Historical Tables* (Washington: GPO, 2020).

The Distribution of the Tax Burden

The U.S. individual income tax system is generally progressive. As shown in **Figure 7**, taxpayers with lower incomes tend to have a proportionally smaller share of the overall individual income tax burden. JCT projections indicate that in 2019, taxpayers in lower income categories, on average, had a negative share of individual income taxes.[95] Thus, on average, these groups receive more in refundable tax benefits than they pay in federal individual income taxes.[96] For taxpayers in income groups above $200,000, projections for 2019 show that their share of taxes paid exceeds their share of income earned. About 50% of taxpayers fall into an income category below $50,000. In contrast, just over 7% of filers fall into an income category above $200,000. Since higher-income taxpayers pay a larger share of income taxes relative to their share of income, the

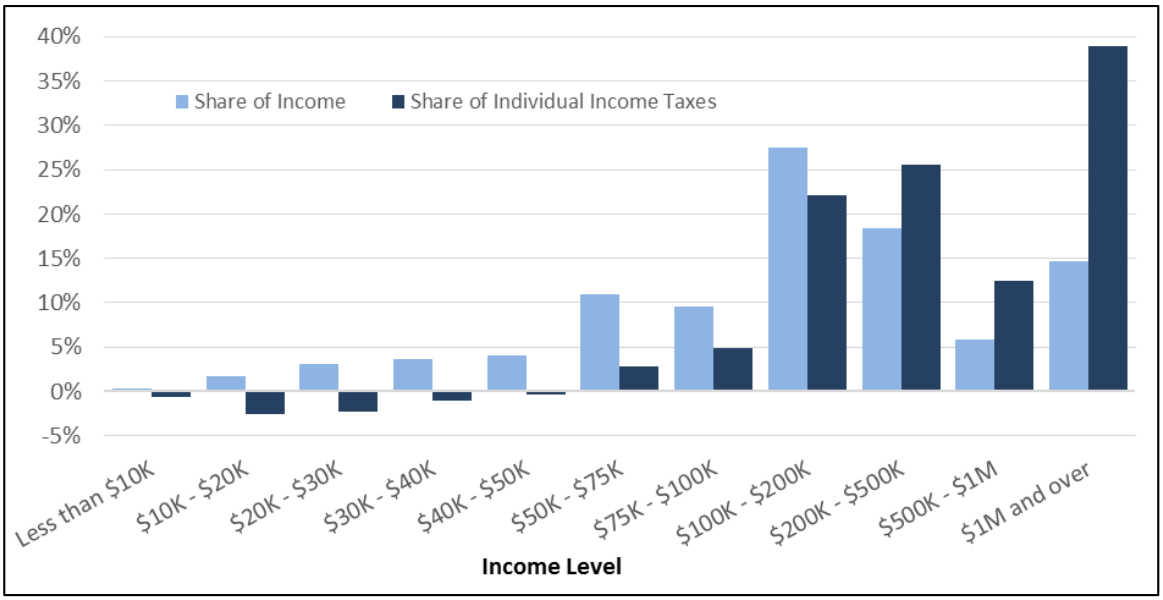
[95] Projections of the distribution of income and income taxes in 2019 can be found in Table A-8 of Joint Committee on Taxation, *Overview Of The Federal Tax System As In Effect For 2019*, JCX-9-19, Washington, DC, March 20, 2019.

[96] Refundable tax benefits are the primary mechanism in the tax code that can reduce poverty. See CRS Report R45971, *The Impact of the Federal Income Tax Code on Poverty*, by Margot L. Crandall-Hollick, Gene Falk, and Jameson A. Carter.

system is generally progressive, and causes after-tax income to be more equally distributed than before-tax income.

The tax system as a whole is progressive, but not as progressive as the individual income tax system. Payroll taxes and excise taxes tend to be regressive, with higher average tax rates paid by taxpayers in lower income groups. Thus, taken together in evaluating the federal tax system as a whole, payroll taxes and excise taxes offset some of the progressivity of the individual income tax.[97]

Figure 7. Shares of Income and Individual Income Taxes by Income Level, 2019 Projections



Source: CRS and Joint Committee on Taxation (JCT).

Notes: The income concept used by JCT is AGI adjusted to more closely measure cash income.

International Comparisons

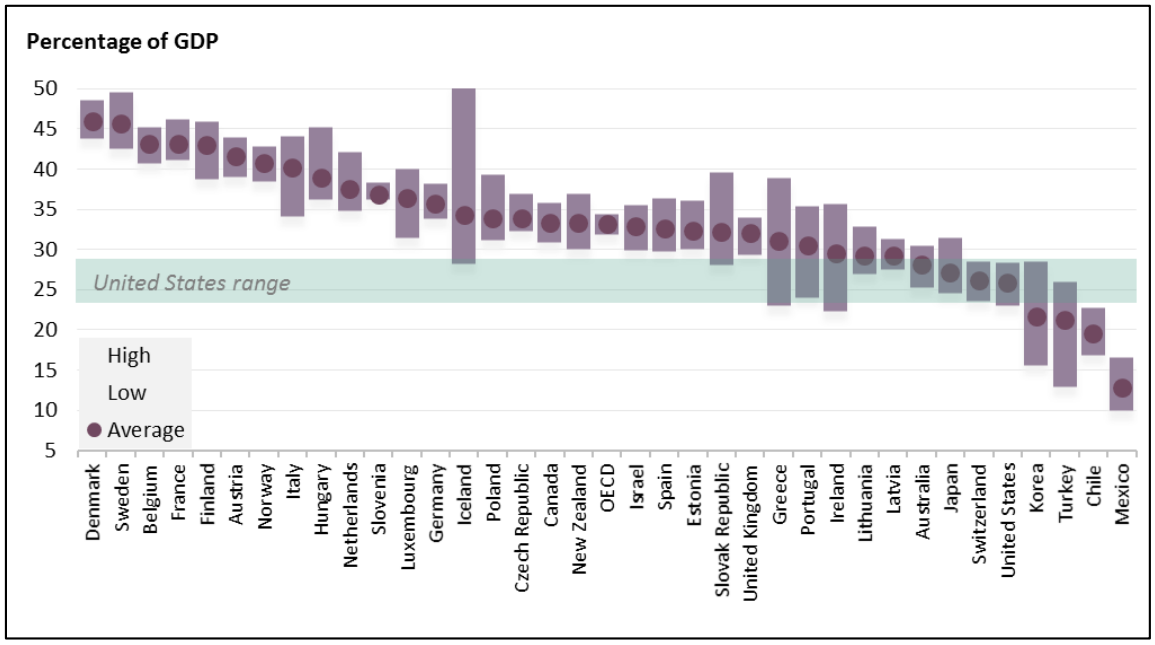
How the U.S. tax system compares to those in other countries is a perennial tax policy question. **Figure 8** shows revenue as a percentage of GDP for OECD countries. The average over the 1987-2018 time period is shown, inside the band illustrating the high and low for the period. Total U.S. taxes as a percentage of GDP have historically been below the average for OECD countries.[98] Four countries have tended to have lower taxes as a percentage of GDP than the United States, with most others tending to have higher taxes relative to the size of the economy. Note that such a direct comparison can be difficult to interpret, as it does not take into account government spending that reflects each country's policy preferences or deficit/surplus levels that provide more context.

[97] Congressional Budget Office, *The Distribution of Household Income, 2016*, October 2020, available at https://www.cbo.gov/publication/56575.

[98] Organisation for Economic Co-operation and Development, *Revenue Statistics 2019, Tax Revenue Trends in the OECD*, December 5, 2019.

Figure 8. Government Tax Revenue as a Percentage of GDP

OECD Countries, 1987-2018



Source: OECD Revenue Statistics.

Note: Government revenue includes all federal, state, and local tax collections. The bars for each country illustrate the range over the 1987 through 2018 time period (range spanning from high to low).

Table 3 provides this additional context for the United States and the other major democratic countries in the G-7. Among the G-7 countries, the United States has both the lowest revenue and spending as a percentage of GDP and the highest deficit level in 2020.[99]

Table 3. U.S. Fiscal Position Compared to Other Industrialized Nations, 2019

	Government Revenues as a % of GDP	Government Expenditures as a % of GDP	Surplus/Deficit as a % of GDP
Canada	40.7	40.9	-0.2
France	52.1	54.4	-2.3
Germany	44.9	44.2	0.8
Italy	47.1	50.0	-2.9
Japan	36.1	38.2	-2.0
United Kingdom	39.0	41.0	-2.0
United States	31.4	38.1	-6.7

Source: OECD Economic Outlook Annex Tables.

Note: Government revenue and expenditures includes all federal, state, and local collections (tax and nontax) and spending.

[99] The relatively low level of revenue collections in the United States may be partially explained by the lack of a federal-level consumption tax (like a Value-Added Tax), which is a feature of the other countries' tax systems. Similarly, the level of government spending may be partially explained by the lack of federal provision of health care that occurs in the other G-7 countries.

Concluding Remarks

The U.S. federal tax system in 2020 looks substantively different than it did in 2017. The changes enacted in P.L. 115-97 affected most parts of the tax system. Over the longer term, as tax policies that were temporary in P.L. 115-97 expire, and delayed tax policies begin to phase in, Congress may choose to consider whether expirations, phase-ins, or other delayed policies in P.L. 115-97 should be modified.

This report provides an overview of the federal tax system, as in effect in 2020. Information on taxes relative to the size of the economy, the distribution of the tax burden, and how the U.S. tax system compares to tax systems globally may provide context for consideration of future tax policy changes.

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