1. Basics of the income tax
   A. tax “base” – income that is subject to tax
      many exclusions, deductions, exemptions, loopholes, etc.
   B. marginal tax rates – tax rates that apply “at the margin”
      (“progressive” tax system has rising marginal tax rates)
      ➔ Ronald Reagan’s story about high marginal tax rates and Hollywood

2. 1986 Tax Reform Act
   A. Reduced marginal tax rates
      broadened tax base (loopholes, deductions and exemptions eliminated)
      removed 6m low-income people from income tax rolls
   B. reduced corporate marginal tax rate
      repealed tax benefits for new investments (broadened base)
   C. problem: many political deals, compromises, etc.
      made the tax law even more complicated (e.g., 17 categories of
      interest expenses; charitable deduction for college sports tickets (!))
   D. many smaller tax acts enacted since 1986
   E. however, average rate of personal income tax has been 8-10% of GDP,
      and corporate income tax has been about 2% of GDP,
      since at least the 1980’s – with very little change
3. Changes in the individual income tax
   A. EIC/EITC: $39b. for 22m. taxpayers
      “refundable” credit (must file to get it),
      based on age, family size and earnings (not income)
      e.g., for family with two children, pays 40% of earnings up to $10,510;
      then constant up to $14,730;
      then phased out as earnings rise to $34,692
   B. Child Tax Credit: $500 credit per child ($32b. total amount)
   C. EIC and CTC have removed most people below the poverty line
      (and even some moderate-income people) from the tax rolls
   D. targeted tax breaks (many overlaps, complicated eligibility criteria, etc.)
      * higher education: two tax credits, three deductions, three exclusions (!)
        HOPE credit: 100% nonrefundable credit for first $1,000 and
        50% credit for next $1,000 for first two years of college
        (convicted felons barred)
        Lifetime Learning credit: 20% for first $10K of any/all post-12^{th} grade
        (convicted felons NOT barred)
        both credits fall as income exceeds $80K (for married couple)
        only one credit available in any given year
   E. AMT: broader base, lower rates than regular tax schedule
      first $40K of income is exempt, but isn’t indexed – so more and more
      people have to pay the AMT over time (1.4% in 2002, 20% in 2010)
4. Changes in tax rates (bottom rate usually 10-15%)
   A. pre-1981: top rate 70% (50% max on “earned income”)
   B. Reagan (1981): top rate dropped to 50%
       1986: dropped to 28%, with “bubble” of 33%
   C. Bush I (1990): 31%
   D. Clinton (1993): 39.6%
   E. Bush II (2001): 35%
   F. capital gains tax rate usually much lower than rate on other income
      e.g., currently 15% (vs. top rate of 35% for other income)