

Tax Time

Week 2: Marginal tax rate increases

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Economic Snapshot is a weekly feature provided by the



Effective tax rate a better measure of actual income taxes paid

President Barack Obama's tax-reform proposal includes increases in the marginal federal income tax rates for higher-income households. The top two marginal rates for married couples would increase from 33 percent to 36 percent for taxable income between \$208,851 and \$372,950, and from 35 percent to 39.6 percent for all taxable income over \$372,950.

The marginal income tax rate is the tax rate levied on the highest income bracket for each taxpayer. For example, a married couple with taxable income (line 43, Form 1040) of \$75,000 in 2009 will pay will pay \$11,125 in federal income taxes. Their total tax is comprised of \$1,670 or 10 percent on their first \$16,700 in taxable income, plus \$7,680 or 15 percent on the next \$51,200 in income, plus \$1,775 or 25 percent of the

remaining \$7,100 in taxable income. In this example, the marginal rate is 25 percent.

Marginal income tax rates are useful as they provide taxpayers with information about the taxes they will pay on the next (marginal) dollar they earn.

However, the effective tax rate provides a more complete picture of the actual tax rates paid in each income category. The effective tax rate is calculated by dividing the total income taxes paid in each income category by taxable income. In the above example, the effective tax rate for the married couple is 14.8 percent ($\$11,125 \div \$75,000$).

The following chart provides the effective tax rate by major income category for 2007. Similar and more detailed data is available at: www.irs.gov/taxstats.

Effective tax rate by taxable income, 2007

Taxable income (line 43, form 1040)	Marginal tax rates	Effective tax rate
< \$50,000	10 to 15%	11.5%
\$50,000 to \$100,000	15 to 25%	13.3%
\$100,000 to \$200,000	25 to 28%	17.4%
\$200,000 to \$500,000	33 to 35%	24.0%
\$500,000 to \$1 million	35%	26.9%
\$1 million to \$5 million	35%	27.0%
> \$5 million	35%	23.2%

Source: IRS 2007 Tax Stats Table 1.1, www.irs.gov