

The Opacity of Marginal Tax Rates

By Rosanne Altshuler and
Jacob Goldin

Suppose that a taxpayer earns an additional dollar of income. How much tax would she owe on that dollar? A natural way to answer this question would be to look up the taxpayer's statutory tax rate — the tax rate corresponding to her tax bracket and filing status.

But that approach would yield the wrong answer for half of all taxpayers in 2009. The *actual* tax rate on an extra dollar of earnings — the effective marginal tax rate (EMTR) — is higher than the statutory marginal tax rate (SMTR) for 32 percent of taxpayers and lower than the SMTR for almost 18 percent of taxpayers. The discrepancy is especially striking for taxpayers subject to the alternative minimum tax — more than 80 percent face an EMTR above their SMTR. Moreover, the two rates can differ a lot.

On average, taxpayers whose effective rate is higher than their statutory rate face an average discrepancy of almost 6 percentage points. For those with lower effective rates, the difference averages 11 percentage points.

These large differences result from the numerous income limits on tax preferences. Phase-ins and phase-outs of income tax credits, deductions, and exemptions can drive a wedge between a taxpayer's statutory and effective rates. For example, the EMTR drops below the SMTR for taxpayers in the phase-in range of the earned income tax credit where earning an additional dollar boosts the credit and reduces tax liability.

Although we often discuss tax policy in terms of statutory rates, the EMTR is what should shape incentives to work, save, and comply with the tax system. But statutory and effective rates differ so haphazardly that most taxpayers would probably not be able to identify how much tax they would owe on an additional dollar of income. And that can't be good for any tax system.

		Percentage of tax filing units with effective rate different from statutory rate, 2009				Average percentage point difference between rates, all tax filing units, 2009	
		All tax filing units		AMT tax filing units		Effective rate less than statutory rate	Effective rate greater than statutory rate
		Less	Greater	Less	Greater		
All filers		17.5%	32.2%			-10.9%	5.8%
AMT taxpayers		2.3%	81.6%	2.3%	81.6%	-6.7%	7.1%
Non-AMT taxpayers		17.9%	30.7%			-11.2%	5.5%
By filing status	Single	18.6%	19.4%	2%	70.6%	-14.5%	4.5%
	Married filing jointly	14%	40.2%	2.6%	84.1%	-6.1%	5.2%
	With dependents	11.1%	45.6%	2.4%	85.5%	-7.5%	6.1%
	With no dependents	17.7%	33.4%	3.1%	81.3%	-4.3%	3.5%
Head of household		23.7%	43.4%	0.7%	73.6%	-28.2%	11.4%
By cash income level	Under \$30,000	37.2%	18.4%	*	*	-20.95	13.4%
	\$30,000-\$50,000	6.2%	36%	*	*	-11.3%	14.7%
	\$50,000-\$75,000	6.3%	29.1%	2%	22.2%	-5.1%	4.9%
	\$75,000-\$100,000	5.4%	35.8%	2.1%	70.8%	-3%	3.5%
	\$100,000-\$200,000	5.6%	49.3%	3.6%	80.5%	-2.6%	4.6%
	\$200,000-\$500,000	2.7%	85.1%	0.7%	94.2%	-13.1%	5.6%
	\$500,000-\$1,000,000	6%	53.3%	5.2%	41.4%	-16.2%	2.6%
Over \$1,000,000		7.6%	63.7%	15.1%	27.7%	-13.1%	0.7%

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-2)

Notes: The effective marginal tax rate is determined by calculating individual income tax, adding \$100 to wages and salaries and recomputing tax; the effective marginal rate is the resulting change in tax divided by \$100. The statutory tax rate is the rate on non-gain income. Tabulation is restricted to tax units reporting a non-zero value of earnings. Calculations treat rates as different if difference exceeds 0.25 percentage points. The average difference between tax rates is weighted by wages and salaries. Cash income is measured in 2009 dollars. * denotes insufficient data. Calendar year. Current law.



Tax Policy Center
Urban Institute and Brookings Institution

The Tax Policy Center, a joint venture of the Urban Institute and the Brookings Institution, provides independent, timely, and accessible analysis of current and emerging tax policy issues for the public, journalists, policymakers, and academic researchers. For more tax facts, see <http://www.taxpolicycenter.org/taxfacts>.