

## How Federal Income Tax Rates Work

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**B**oth [President-elect Donald Trump](#) and [House Republicans](#) have proposed collapsing individual income tax brackets and lowering income tax rates. While the two tax plans differ significantly on other issues, they agree on the new, lower rates. Each plan's proposed income tax rate schedule would be a big departure from the current one, but Washington has often changed individual income tax brackets and rates.

This year, Congress will consider what may be the biggest tax bill in decades. This is one of a series of briefs the Tax Policy Center has prepared to help people follow the debate. Each focuses on a key tax policy issue that Congress and the Trump administration may address.

### CURRENT INCOME TAX RATES AND BRACKETS

The federal individual income tax now has seven tax rates ranging from 10 percent to 39.6 percent (table 1). The rates apply to taxable income, a filer's income subject to tax after exclusions and some exemptions (that is, adjusted gross income) minus [deductions and exemptions](#).

Federal income tax rates are progressive: As taxable income increases, it is taxed at higher rates. Different tax rates are levied on different income ranges (or brackets)

depending on the payer's filing status. In 2016, the top rate (39.6 percent) applies to taxable income over \$415,050 for single filers and over \$466,950 for married couples filing jointly. [Additional tax schedules and rates](#) apply to taxpayers who file as heads of household and married individuals filing separate returns. Tax brackets are [adjusted annually for inflation](#).

**TABLE 1**

## 2016 Tax Schedule and Rates



Single filers			Married couples filing jointly		
Taxable income (\$)		Current marginal rate (%)	Taxable income (\$)		Current marginal rate (%)
Over	But not over		Over	But not over	
0	9,275	10	0	18,550	10
9,275	37,650	15	18,550	75,300	15
37,650	91,150	25	75,300	151,900	25
91,150	190,150	28	151,900	231,450	28
190,150	413,350	33	231,450	431,350	33
413,350	415,050	35	413,350	466,950	35
415,050	and over	39.6	466,950	and over	39.6

**Source:** IRS tax brackets

### THE BASICS OF MARGINAL INCOME TAX RATES

When you look at tax schedules and rates, always remember that each additional dollar you make is taxed at its *marginal* rate. If you earn enough to reach a new bracket with a higher tax rate, your total income is not taxed at that rate, just the income in that bracket. Even if you're in the top bracket, your first dollar of taxable income is taxed at the lowest rate (and so on through the tax schedule).

For example, a single filer with \$50,000 in taxable income is in the 25 percent bracket but does not owe \$12,500 in tax (25 percent of \$50,000). Instead, he or she owes \$7,343.75 (10 percent of \$9,275 + 15 percent of \$37,650 + 25 percent of \$3,075).

### LOOMING FEDERAL CHANGES

Both [Trump's campaign tax plan](#) and the [House Republicans' tax plan](#) would reduce the number of tax rates from seven to three: 12, 25, and 33 percent. However, the plans would apply the rates on different levels of taxable income.

The House GOP plan uses the same income tax bracket breaks as current law for the 25 percent and 33 percent tax rates (table 2).

So for married filers, the 25 percent rate would still begin at \$75,301 of taxable income and the 33 percent rate at \$231,451. The 12 percent rate would apply to all taxable income below the 25 percent rate bracket. That means some income currently taxed at 10 percent would be taxed at 12 percent (figure 1). However, because the House GOP's plan uses a higher [standard deduction](#) than current law, more income would also become exempt. The bottom bracket for married taxpayers would be twice the size of that for singles, but the 25 percent bracket would be less than twice as large. That would maintain the kind of [marriage penalty](#) we have in the current income tax: some couples would pay more tax filing a joint tax return than they would if each spouse could file as a single person.

The Trump plan applies the same three rates but over different income ranges (table 3). Trump's brackets for single filers are exactly half of his proposed brackets for married filers, so the brackets themselves would not

**TABLE 2**

## House GOP Proposed Tax Schedule and Rates



Single filers			Married couples filing jointly		
Taxable income (\$)		Proposed marginal rate (%)	Taxable income (\$)		Proposed marginal rate (%)
Over	But not over		Over	But not over	
0	37,650	12	0	75,300	12
37,650	190,150	25	75,300	231,450	25
190,150	and over	33	231,450	and over	33

**Sources:** House GOP tax plan and IRS tax brackets.

**Note:** Table uses tax year 2016 income tax brackets.

create marriage penalties. But Trump would eliminate the [head of household](#) filing status and require taxpayers currently using this status to use the less generous tax brackets for single filers.

Today, [nearly 80 percent](#) of households are in the 15 percent bracket or lower—including those with no taxable income and those who do not file tax returns. Less than 1 percent of Americans earn enough taxable income to reach the current 33 percent bracket.

### ARGUMENTS FOR REDUCING THE NUMBER OF TAX BRACKETS AND LOWERING RATES

Supporters of lower rates make two main arguments. First, reducing the number of rates [simplifies the income tax system](#). Having fewer brackets would help more filers know their marginal tax rates and thus [make more informed decisions](#) about work, charitable giving, and other matters that affect their federal income taxes. However, the [individual income tax is complex](#) mostly because it treats income from various sources differently and because it contains countless deductions and other special benefits, not because it has multiple tax rates. (Plus, most of us don't do our taxes by hand—about 90 percent of us either use computer software or

hire someone to complete our returns.) Reducing the number of rates could be a part of a reform package, but eliminating preferences would be a far more significant step toward a simpler system.

Second, lower individual income tax rates may promote economic growth. The [effect of income tax rate cuts on the economy](#) is complicated. For example, lower tax rates on wages can increase incentives to work, but they can also make taxpayers feel richer and thus reduce incentives to work. Furthermore, lower tax rates can raise budget deficits if they aren't offset with spending reductions or paring back tax preferences. Higher deficits can reduce net national saving, increase interest rates, and depress economic growth. (Our full reports on [Trump's](#) and the [House GOP's](#) tax plans discuss each plan's macroeconomic effects.)

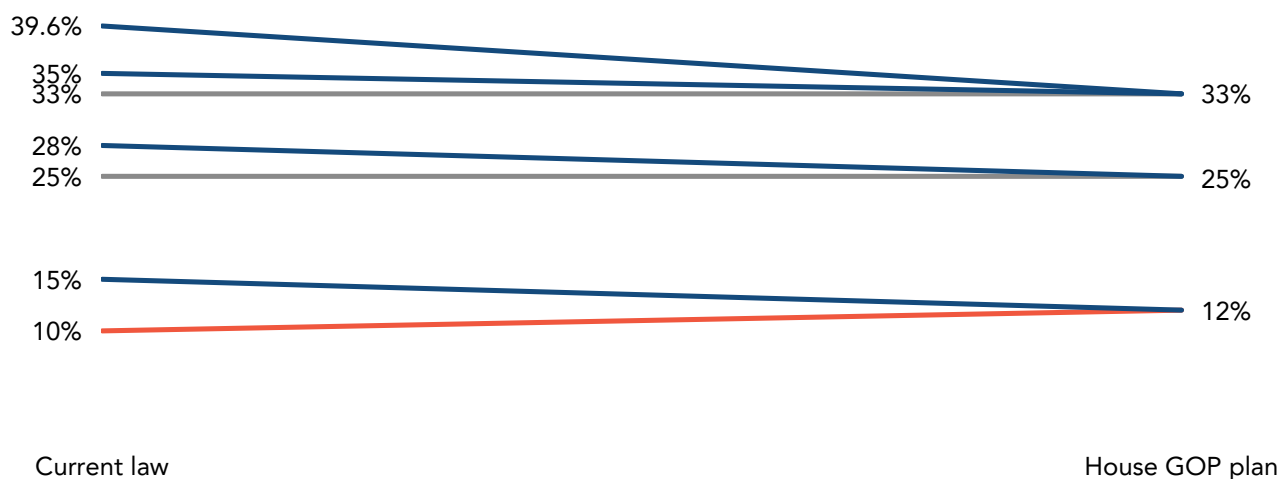
### HISTORY OF FEDERAL INCOME TAX BRACKETS AND RATES

Over the [100-plus year history](#) of the modern federal income tax (short-lived income taxes existed before the [16th Amendment](#)), the number of brackets and rates has changed dramatically and frequently. The federal income tax began with seven brackets but that number



**FIGURE 1**

## Tax Rates: Current Law versus House GOP Plan



**Source:** IRS tax brackets and House GOP plan.

**Note:** Rate comparison is for tax year 2016. The House GOP's plan has a higher standard deduction than currently allowed by law so some income now taxable under the lowest rate (10%) becomes exempt.

exploded to more than 50 by 1920 (figure 2). From then until the late 1970s, we never had fewer than 20 brackets. The last major federal tax reform, the [Tax Reform Act 1986](#), reduced the number of brackets from 16 to two, but that number has crept up to the current seven over the last three decades.

The top marginal federal income tax rate has varied widely over time (figure 3). The top rate was 91 percent in the early 1960s before the Kennedy tax cut dropped it to

70 percent. In 1981, the first Reagan tax cut further reduced the top rate to 50 percent, and the 1986 reform brought it down to 28 percent. Subsequent legislation increased it to 31 percent in 1991 and to 39.6 percent in 1993. George W. Bush's tax cuts lowered the top rate to 35 percent, but it reverted to 39.6 percent when the [American Taxpayer Relief Act of 2012](#) let the reduced rate expire as scheduled.

**TABLE 3**

## Trump Proposed Tax Schedule and Rates

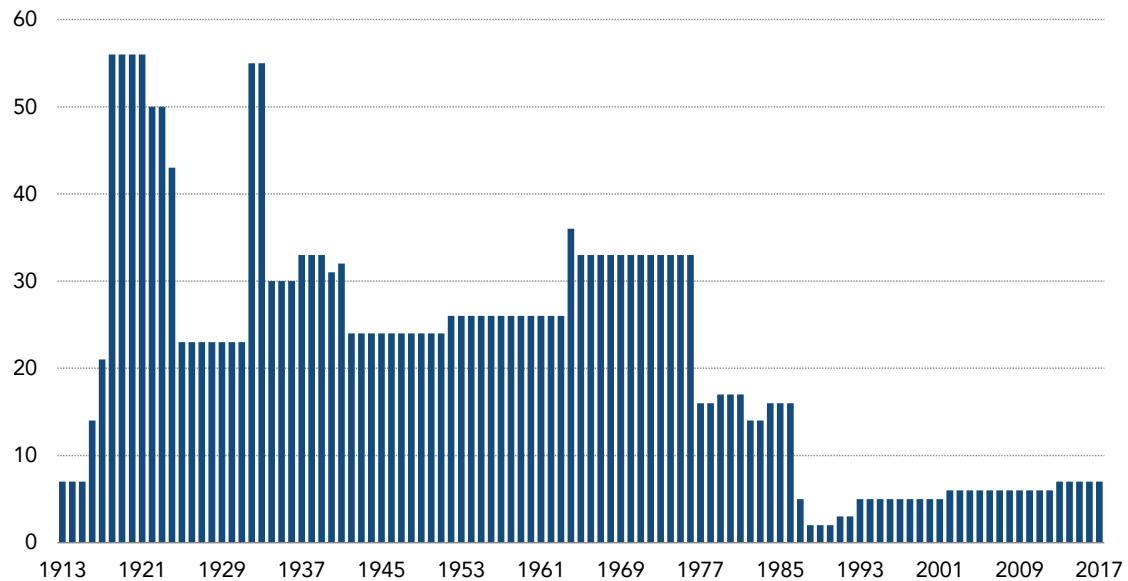


Single filers			Married couples filing jointly		
Taxable income (\$)		Proposed marginal rate (%)	Taxable income (\$)		Proposed marginal rate (%)
Over	But not over		Over	But not over	
0	37,500	12	0	75,000	12
37,500	112,500	25	75,000	225,000	25
112,500	and over	33	225,000	and over	33

**Sources:** Trump tax plan.

FIGURE 2

## Number of Federal Income Tax Brackets: 1913-2017

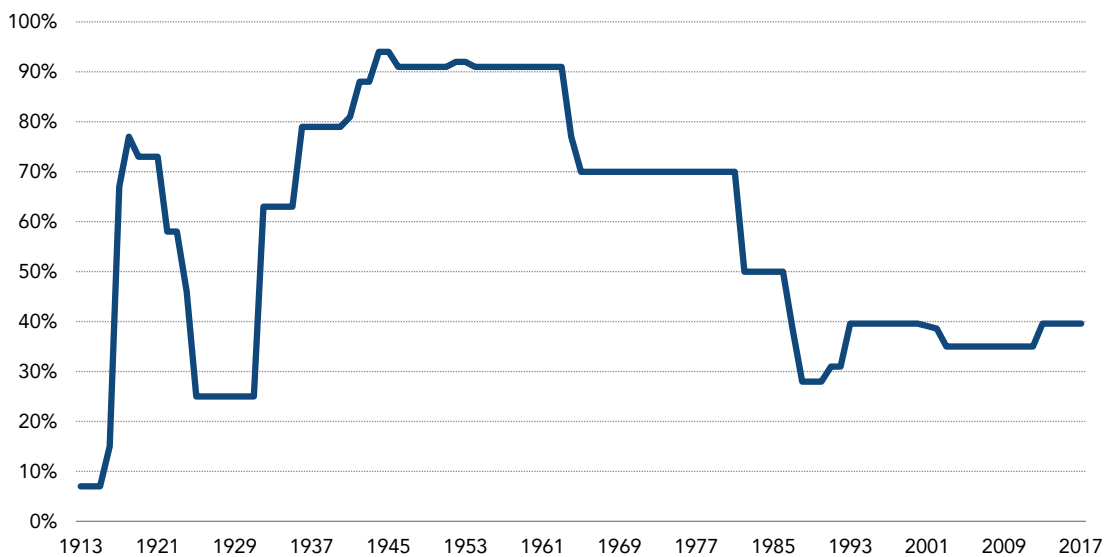


Source: US Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted Brackets)," Tax Foundation (blog), October 17, 2013.

Note: If filing statuses had different numbers of brackets for a given year, the table shows the larger number.

FIGURE 3

## Top Marginal Federal Individual Income Tax Rates: 1913-2017



Source: US Federal Individual Income Tax Rates History, 1862-2013 (Nominal and Inflation-Adjusted brackets)," Tax Foundation (blog), October 17, 2013.