As Tax Day 2019 approaches, there is continuing discussion about the United States tax code — and especially marginal income tax rates. The 2017 Tax Cuts and Jobs Act (TCJA) made important changes to marginal tax rates and millions of individual filers will be dealing with those changes directly for the first time as they submit their 2018 taxes next month. Let’s look at how marginal tax rates and brackets work, and what the system — and potential changes to it — mean for Americans.

How is income taxed in the United States?

The federal government collects roughly half of its revenues by taxing individuals based on their incomes. The amount of income tax that is owed by each individual is partially determined by a series of tax brackets and marginal tax rates.

Individuals are taxed on income from a variety of sources, such as wages from a job, Social Security benefits, and capital gains. Most people derive the majority of their income from wages and salaries. Wealthier individuals tend to have capital gains, dividends, and interest earnings that account for a larger share of their total income.
Some income is not subject to taxation. For example, 87 percent of taxpayers take the standard deduction, which allows them to reduce their income by a fixed amount — currently $12,000 for single taxpayers and $24,000 for married couples. The remaining 13 percent of taxpayers itemize their deductions, which means that their taxable income is adjusted based on specific financial activities such as charitable contributions and mortgage interest payments.

**What is a tax bracket?**

Tax brackets are ranges of taxable income that are subject to tax at a specified rate. The rate applied to each range of taxable income is referred to as the “marginal” rate. For example, in 2018, taxable income from $9,525 to $38,700 was taxed at a marginal rate of 12 percent for single individuals. A single individual with taxable income of $39,000 would pay 10 percent on the first $9,525, 12 percent on the next $29,175, and 22 percent on the last $300 (see table).

**What are the current marginal tax rates?**

There are seven marginal tax rates in the current individual income tax system. Brackets that cover higher ranges of taxable income apply higher marginal rates. That design contributes to the progressivity of the federal income tax — individuals with higher incomes pay a larger share in taxes than do lower-income individuals.

For single taxpayers in 2018, the seven marginal rates ranged from 10 percent on the first $9,525 of income to 37 percent on the portion of income above $500,000. Those marginal rates reflect adjustments made in late 2017 as part of the TCJA. While all taxpayers face the same seven marginal rates, the taxable income ranges that are associated with each marginal rate vary across the four types of taxpayer (see table below).
How do current marginal tax rates compare to those in U.S. history?

Marginal tax rates have changed significantly over time. For instance, the top marginal rate declined from 91 percent in 1962 to a low of 28 percent in the late 1980s. Since then, the top rate has fluctuated between 31 percent and 39.6 percent.

Changes to the top rate have been accompanied by changes to the level of income to which it applies. The top rate of 31 percent applied to incomes above $86,768 in 1992, whereas it applies to incomes above $12,000 today. In both cases, the top rate was 31 percent, but the bracket thresholds were different.

The total number of brackets has also changed over time. For much of the 1960s and 1970s, there were more than 20 brackets in the federal income tax code, but the number of brackets was reduced to three in 1992 and 1993. Brackets were then gradually added back until the present number of seven was reached in 2013.

The role of tax expenditures

Tax expenditures — sometimes referred to as "tax breaks" — are provisions in the tax code that can reduce the amount that individuals and businesses pay in federal income taxes. For example, the home mortgage interest deduction allows individual taxpayers to deduct the interest on their mortgage from their taxable income. Tax expenditures are a significant way to reduce tax liabilities. In 2018, the six largest tax expenditures were the home mortgage interest deduction, the state and local tax deduction, the retirement savings plan deduction, the domestic production activities deduction, the active business income deduction, and the child tax credit.

The six largest tax expenditures for 2018 are shown in the table below.

<table>
<thead>
<tr>
<th>Tax Expenditure</th>
<th>2018 Spending (in billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home mortgage interest deduction</td>
<td>124.6</td>
</tr>
<tr>
<td>State and local tax deduction</td>
<td>103.6</td>
</tr>
<tr>
<td>Retirement savings plan deduction</td>
<td>88.0</td>
</tr>
<tr>
<td>Domestic production activities deduction</td>
<td>32.2</td>
</tr>
<tr>
<td>Active business income deduction</td>
<td>30.4</td>
</tr>
<tr>
<td>Child tax credit</td>
<td>27.6</td>
</tr>
</tbody>
</table>

Tax expenditures further complicate historical comparisons of taxes because lawmakers have made significant changes to the tax code. For example, tax expenditures in 1962 were far different than tax expenditures in 1992 and 1993, even though tax expenditures with similar names were likely present in both years. Tax expenditures in 1962 and 1992 were fundamentally different — despite the fact that they were both top brackets.

Average tax rates

One way to compare the effect of income taxes over time is to compare average federal income tax rates for different income levels. The average income tax rate for taxpayers with incomes of $100,000 or less rose from 14.2 percent in 1992 to 19.3 percent in 1993. The average income tax rate for taxpayers with incomes above $100,000 fell from 34.1 percent in 1992 to 31.2 percent in 1993. The total average income tax rate increased slightly — from 22.6 percent to 24.0 percent (see chart). The increase was due to a rise in the average income tax rate for incomes above $100,000. The decrease in the average income tax rate for incomes below $100,000 partly offset the increase in the average income tax rate for incomes above $100,000.

How does the top marginal rate in the U.S. compare to top marginal rates in OECD countries?

The Organisation for Economic Co-operation and Development (OECD) provides data that compares the top marginal tax rates in its member countries. The chart below shows the top marginal tax rates for 2018 for all members of the OECD and some non-member countries. The top rates range from a low of 11 percent in Indonesia to a high of 49 percent in France.

The top marginal rate does not tell the whole story. OECD countries not only have varying top rates, but those rates are applied to different levels of income. For example, high-income individuals might have their income taxed at a higher rate in the United States than in some other OECD countries. In the United States, the top marginal income tax rate applies to incomes above $86,768 at 31 percent (as in 1992) are fundamentally different — despite the fact that they were both top brackets.

What could be the effects of raising marginal tax rates on high-income taxpayers?

A small increase in top marginal tax rates would raise revenues. For example, the Congressional Budget Office estimated that a 0.4 percent increase in the top marginal income tax rate would raise revenue by $123 billion (0.3 percent) from 2019 to 2028. A larger percentage increase would boost revenues by larger amounts.

A larger increase in top marginal income tax rates would, not surprisingly, yield more revenues. The Tax Foundation estimated that a 73 percent marginal tax rate would raise revenue by $117 billion (an increase of 0.4 percent) over the next 10 years, after incorporating the effects of the change on economic growth.

On the other hand, academic economists Peter Diamond and Emmanuel Saez calculated that a 73 percent marginal tax rate would yield even more revenues. They predicted that a 73 percent marginal tax rate would raise revenue by $135 billion (an increase of 0.5 percent) over the next 10 years, after incorporating the effects of the change on economic growth.

Other economists question the assumptions used by Diamond and Saez. They claim that Diamond and Saez might not have accounted for all the economic effects of a higher marginal tax rate. For example, they might not have accounted for the effects of a higher marginal tax rate on the economic growth of high-income taxpayers.

Two other factors could mitigate the revenue gains from making substantial increases to top marginal income tax rates. First, high-income taxpayers might respond to a higher marginal tax rate by changing their behavior. For example, high-income taxpayers might avoid earning more income by taking on less work, or they might use more of their income for charitable contributions.

Second, high-income taxpayers might respond to a higher marginal tax rate by shifting their income from taxable income to tax-exempt income. For example, they might shift their income from wages and salaries to interest income from tax-exempt bonds.

Conclusion

The individual income tax is an important source of revenue for the federal government. As such, marginal income tax rates are a key area of policy debate. The current top marginal income tax rate is 37 percent for single taxpayers and 35 percent for married taxpayers filing jointly. Higher marginal income tax rates might be used to raise revenues, but they might also reduce the incentives for high-income taxpayers to work and save.

Related: Who Pays Taxes?

Want analysis to help you understand the latest fiscal news? Sign up for our bimonthly email newsletter.