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Marginal versus Effective tax rates.
By Mary T. Go, Go Forward Insights, LLC, February 1, 2019

Consider the following tax table for 2018 supplied by www.irs.gov:

| Tax Rate | Taxable income, Single | Taxable income, Married Filing Jointly |
|---|---|---|
| 10% | $0 – $9,525 | $0 – $19,050 |
| 12% | $9,526 – $38,700 | $19,051 – $77,400 |
| 22% | $38,701 – $82,500 | $77,401 – $165,000 |
| 24% | $82,501 – $157,500 | $165,001 – $315,000 |
| 32% | $157,501 – $200,000 | $315,001 – $400,000 |
| 35% | $200,001 – $500,000 | $400,001 – $600,000 |
| 37% | $500,001 or more | $600,001 or more |

First a simple example:
Let's say you're filing as Single with $10,000 of taxable income. Reviewing the first two columns above, $9,525 of the income will be taxed at 10%, and the remaining $475 will be taxed at 12%. The math is:

- ($9,525 x 10%) + ($475 x 12%) = total tax due
- $952.50 + $57.00 = $1,009.50
- **Effective tax rate = $1,009.50/$10,000 = 10.1%** (NOT the marginal rate of 12%)

This is intuitive, as the large majority of the income is taxed at 10%, with only those dollars over $9,525 taxed at 12%.

Now a more complicated example:
Let's say you're Married Filing Jointly with $80,000 of taxable income. While people may call this "the 22% tax bracket," the effective tax rate is much lower. The math here is:

- ($19,050 x 10%) + [($77,400-19,051) x 12%] + [($80,000-77,401) X 22%] = total tax due
- ($19,050 x 10%) + ($58,349 x 12%) + ($2,599 x 22%) = total tax due
- $1,905 + $7,001.88 + $571.78 = $9,478.66
- **Effective tax rate = $9,478.66/$80,000 = 11.8%** (NOT the marginal rate of 22%)

This is also intuitive, as most of the income falls within the 12% marginal rate, with some in the 10% rate, and a small amount in the 22% rate.

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<u>So what does this all mean?</u>

- Added income will fall into a new, higher, **marginal** tax bracket, but that does NOT mean the ENTIRE income is taxed at that higher rate.
- If a married couple with one income making $270K adds a second income of $50K, the marginal rate on the last dollars does indeed go from 24% (the marginal tax rate on $270K) to 32% (the marginal tax rate on $320K), but remember only a small amount of the new income and an even smaller amount of the total income – the dollars over $315,001 in this case - will be taxed at that 32%.
- Upon review of the “marginal versus effective” tax concepts, you may conclude “going into the next tax bracket” is not as material as you may have originally thought.

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*Mary’s financial coaching clients have included mid-career Individuals working to get into better financial shape, individuals looking to re-gain their financial confidence during life transitions, and parents looking to guide college-age children in financial skills. She can be counted on for encouragement and confidential guidance with a strong dose of action-orientation and accountability. Visit her at www.goforwardinsights.com.*