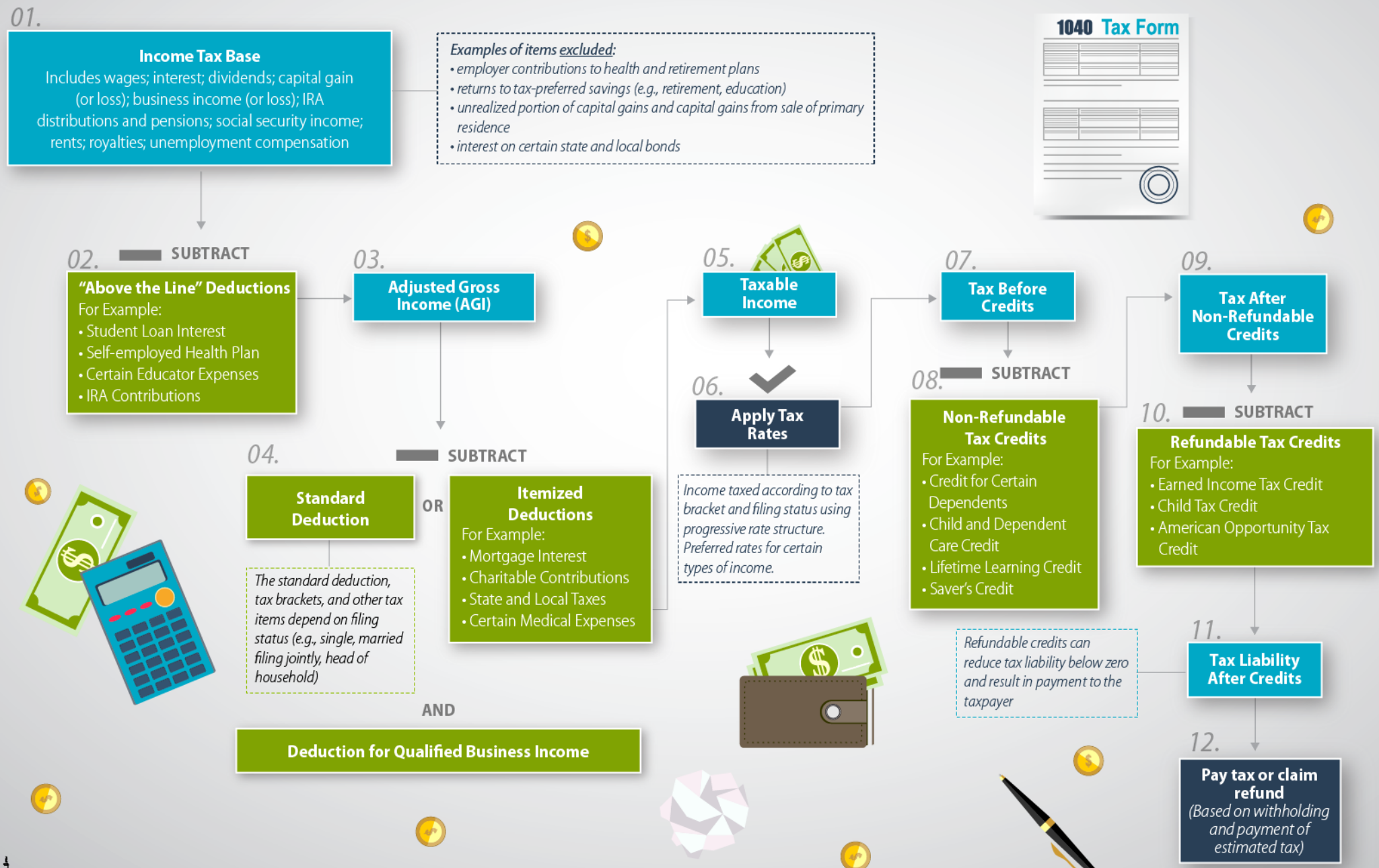# The U.S. Individual Income Tax System, 2019

The individual income tax is the federal government's largest source of revenue. In FY2019, the tax is estimated to generate 49% of federal government receipts, or $1.7 trillion. There are several steps involved in calculating ordinary individual income taxes. First, taxpayers must add up all of their income. Then, taxpayers take a series of steps to calculate taxable income. Tax rates are applied to taxable income to calculate income tax before credits. Tax credits offset tax liability. A taxpayer's individual income tax liability is the amount of tax owed after credits are applied. Some taxpayers also calculate tax liability under the individual alternative minimum tax (AMT). The 2017 tax revision (P.L. 115-97) made substantive changes to the individual tax system, effective in 2018. Most of the changes made in P.L. 115-97 are temporary and are scheduled to expire at the end of 2025.

01. Income Tax Base
Includes wages; interest; dividends; capital gain (or loss); business income (or loss); IRA distributions and pensions; social security income; rents; royalties; unemployment compensation

Examples of items excluded:
- employer contributions to health and retirement plans
- returns to tax-preferred savings (e.g., retirement, education)
- unrealized portion of capital gains and capital gains from sale of primary residence
- interest on certain state and local bonds

1040 Tax Form

SUBTRACT

02. "Above the Line" Deductions
For Example:
- Student Loan Interest
- Self-employed Health Plan
- Certain Educator Expenses
- IRA Contributions

03. Adjusted Gross Income (AGI)

SUBTRACT

04. Standard Deduction
The standard deduction, tax brackets, and other tax items depend on filing status (e.g., single, married filing jointly, head of household)

OR

Itemized Deductions
For Example:
- Mortgage Interest
- Charitable Contributions
- State and Local Taxes
- Certain Medical Expenses

AND

Deduction for Qualified Business Income

05. Taxable Income

06. Apply Tax Rates
Income taxed according to tax bracket and filing status using progressive rate structure. Preferred rates for certain types of income.

07. Tax Before Credits

SUBTRACT

08. Non-Refundable Tax Credits
For Example:
- Credit for Certain Dependents
- Child and Dependent Care Credit
- Lifetime Learning Credit
- Saver's Credit

09. Tax After Non-Refundable Credits

SUBTRACT

10. Refundable Tax Credits
For Example:
- Earned Income Tax Credit
- Child Tax Credit
- American Opportunity Tax Credit

Refundable credits can reduce tax liability below zero and result in payment to the taxpayer

11. Tax Liability After Credits

12. Pay tax or claim refund
(Based on withholding and payment of estimated tax)

Author Information

Molly F. Sherlock
Specialist in Public Finance

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