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INSIGHT

Taxpayers in the Top Income Tax Bracket: Statistics and Observations

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President Joe Biden has proposed increasing the top marginal income tax rate on ordinary income to 39.6%. The top marginal income tax rate was reduced from 39.6% to 37% in the 2017 tax revision (commonly referred to as the "Tax Cuts and Jobs Act" or TCJA; P.L. 115-97). TCJA's changes to individual income tax rates were enacted on a temporary basis, and are scheduled to expire after 2025. For 2021, the top marginal tax rate of 37% applies to income above $628,300 for married taxpayers filing joint returns and income above $523,600 for single filers and head of household filers. This Insight uses data from the Internal Revenue Service's Statistics of Income to examine taxpayers filing income tax returns that were subject to the top marginal income tax rate of 37% in 2018, as well as data and information from other sources to address questions about how raising the top marginal tax right might affect federal tax revenues and taxable income.

How many taxpayers are subject to the top marginal income tax rate?

Nearly 154 million tax returns were filed for the 2018 tax year. Of those, 0.5% were subject to the top marginal tax rate of 37%. By tax filing status, a greater share of married taxpayers were subject to the top rate compared to unmarried filers. In 2018, 1.2% of married taxpayers filing a joint return were subject to the 37% rate. For single and head of household filers, 0.1% of returns were subject to the top rate.

How much income is subject to the top marginal income tax rate?

Total adjusted gross income (AGI) on 2018 individual income tax returns was $11.6 trillion, while taxable income was $9.0 trillion. Nearly $1.6 trillion in taxable income was reported on tax returns subject to the top marginal tax rate of 37% in 2018. However, not all of that income was subject to the top marginal tax rate, since *all taxpayers* pay taxes according to a progressive, marginal income tax rate schedule. Other income is taxed at lower rates because it is attributable to capital gains or dividends (dividends and capital gains are generally taxed at a top rate of 20%, with high-income taxpayers also subject to the 3.8% net investment income tax). Of the $1.6 trillion in taxable income reported on returns subject to the top marginal income tax rate of 37% in 2018, $780 billion was taxed at the 37% rate. Out of all taxable income ($9.0 trillion), 8.7% was taxed at the top tax rate of 37%.

Another way to examine the amount of income subject to the top marginal tax rate is to look at tax rates imposed on the income of high-income taxpayers. In 2018, $2.3 trillion in taxable income was reported on returns with AGI of $500,000 or more ($1.6 trillion was reported on returns with AGI of $1 million or more). Of total taxable income reported on returns with AGI of $500,000 or more, 34.2% was subject to the 37% top marginal income tax rate (45.4% for returns with $1 million or more in AGI).

What is the income level of taxpayers subject to the top marginal income tax rate?

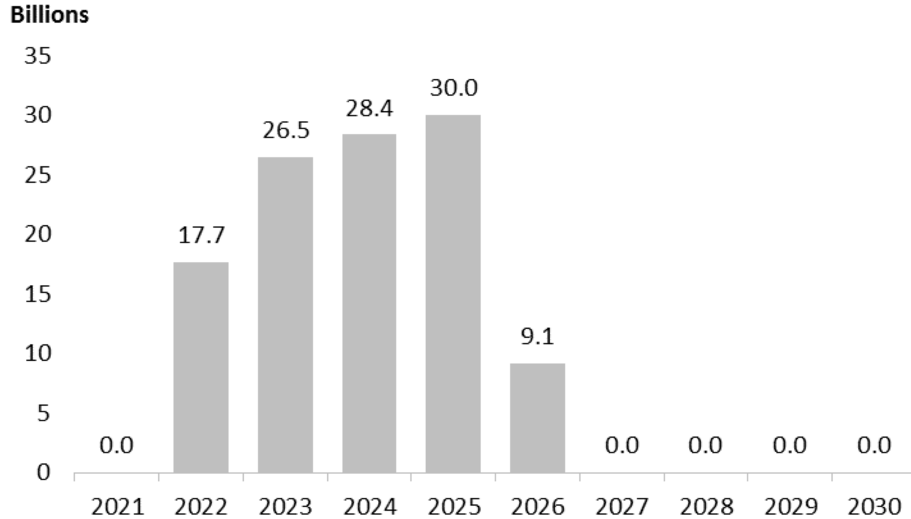
More than half (52%) of taxpayers that were subject to the top marginal income tax rate of 37% in 2018 had an AGI of $1 million or more. Another 47% had AGI in the $500,000 to $1 million range.

How much revenue would be generated by increasing the top marginal tax rate to 39.6%?

The Joint Committee on Taxation has not released an official revenue estimate for the amount of additional revenue that would be raised by increasing the top marginal individual income tax rate from 37% to 39.6%. Analysis by the Tax Policy Center estimates that restoring the pre-TCJA rates for taxpayers with incomes over $400,000 would generate $111.8 billion in additional tax revenue between FY2022 and FY2026 (see **Figure 1**) (less revenue would be raised if the top tax rates only applied above a higher income threshold). Note that there would be no revenue gain after FY2026, as the 37% top marginal tax rate enacted in the TCJA is scheduled to expire at the end of 2025.

Figure 1. Estimated Revenue from Restoring pre-TCJA Tax Rates above $400,000 of Taxable Income

(FY2021-FY2030 Totals in Billions of Dollars)



Source: Tax Policy Center.

How Might Taxpayers Respond to Higher Top Marginal Tax Rates?

Economists use the *elasticity of taxable income* concept to estimate how much reported taxable income is expected to change in response to changes in tax rates. Mathematically, the elasticity of taxable income is measured as the percentage change in taxable income relative to the percentage change in the marginal net-of-tax rate (1 minus the tax rate, or the amount of taxable income remaining after subtracting tax liability). Increasing the top marginal individual income tax rate from 37% to 39.6% is a 7% increase in tax rates, or a 4% change in the marginal net-of-tax rate. In a 2017 publication, the Joint Committee on Taxation highlighted academic work that put the elasticity of taxable income in the 0.12 to 0.40 range. This would mean that a 7% increase in the top marginal tax rate could reduce taxable income, for taxable income subject to this rate, by an estimated 0.5% to 1.7%. Taxable income might change as taxpayers adjust their work hours, change their form of compensation (i.e., seek additional nontaxable compensation), or otherwise adjust their tax reporting behavior.

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