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IN FOCUS

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How Do Marginal Income Tax Rates Work in 2021?

Calculating Income Tax Liability

For many individuals and families, calculating federal income tax liability can be broken down into three main steps.

1. Calculate the amount of income subject to marginal tax rates (i.e., taxable income). Generally, this means adding up income from all sources (unless specifically excluded from taxation), and then subtracting any deductions (e.g., above-the-line deductions and either the standard deduction or sum of itemized deductions).
2. Apply marginal income tax rates to taxable income to determine their "precredit" income tax liability.
3. Subtract any tax credits from precredit income tax liability to determine final income tax liability.

This In Focus focuses on the *second step* in this process—applying marginal tax rates to taxable income. The examples below use marginal tax rates in effect in 2021 (i.e., associated with 2021 income tax returns, generally filed in 2022).

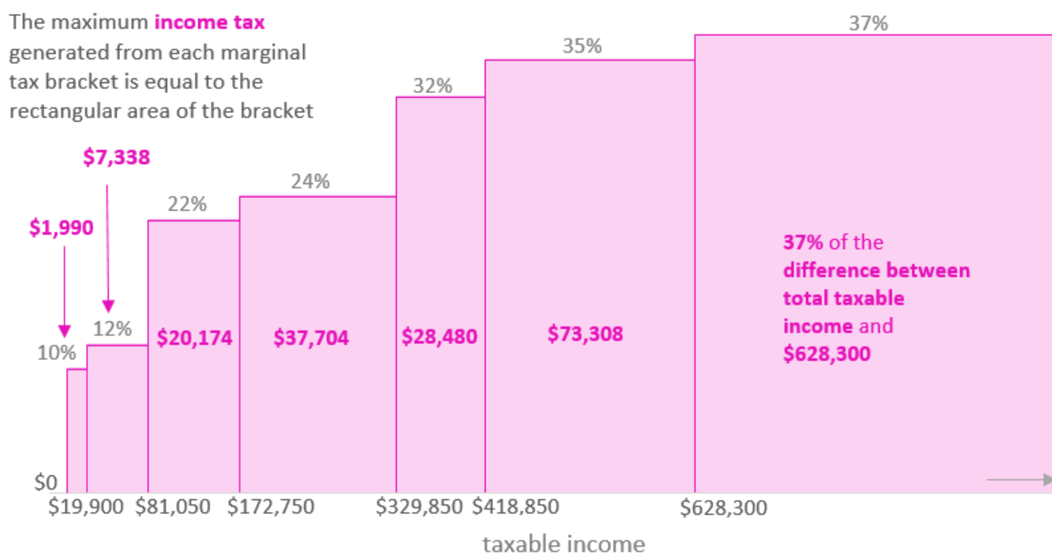
The In Focus examines the mechanics of statutory marginal tax rates and does not analyze the taxpayer's *effective* marginal tax rates, which may differ. Effective marginal tax rates reflect the amount of tax paid on the next dollar of income, taking into account interactions with other features of the tax system. Thus, effective marginal tax rates are a function of (1) a taxpayer's statutory marginal tax rate; and (2) interactions with credits, deductions, exemptions, and special provisions in the tax code.

Some taxpayers with more complex tax situations, including those who are subject to the alternative minimum tax (AMT) and those who have income from capital gains and dividends, will have to perform additional steps to calculate their income tax liability. These cases are not discussed.

Applying Marginal Income Tax Rates

For the purposes of this In Focus, it is assumed that the taxpayer has a relatively simple tax situation: they are a married couple who file their taxes jointly with only earned income (e.g., wages and salaries). In addition, they claim only one deduction—the standard deduction—and claim no tax credits. In reality, the calculation of taxable income for a taxpayer may not be so simple and will depend on a variety of factors, including the taxpayer's sources of income, family structure, and eligibility for a variety of deductions; i.e., subtractions from their income. For 2021, the standard deduction for a married couple filing jointly is $25,100.

Figure 1. 2021 Marginal Income Tax Brackets for a Married Taxpayer Filing Jointly



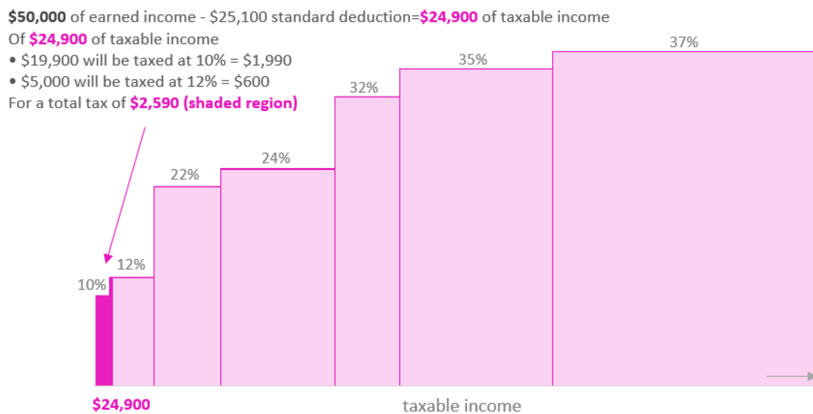
Source: CRS

Once a taxpayer has calculated their taxable income, marginal tax rates are applied to taxable income. There are currently seven marginal tax rates, and the associated income ranges over which they apply ("tax brackets") differ based on the taxpayer's filing status. Tax filing status is a way to categorize taxpayers that is closely tied to marital status, and in the case of unmarried taxpayers, whether they have any dependents. Tax filing status determines not only the tax brackets, but the amount and eligibility of a variety of other tax provisions, including the amount of the standard deduction.

The federal income tax is considered a progressive tax by economists because as taxable income increases, income above a given bracket threshold is taxed at a higher marginal rate. The 2021 tax brackets are presented graphically for a married couple filing a joint return in **Figure 1**. Due to space limitations, the graphics in this In Focus only display taxable income up to $1 million.

Importantly, these tax rates apply only to the income in a specific income range or bracket, not the entire taxable income, as illustrated in the subsequent examples of married taxpayers with different levels of income. For example, if a married couple filing jointly has $750,000 of taxable income, only the amount above $628,300—or $121,700—is subject to a marginal rate of 37%, not the entire $750,000.

Figure 2. Married Taxpayer Filing Jointly with $50,000 of Earned Income



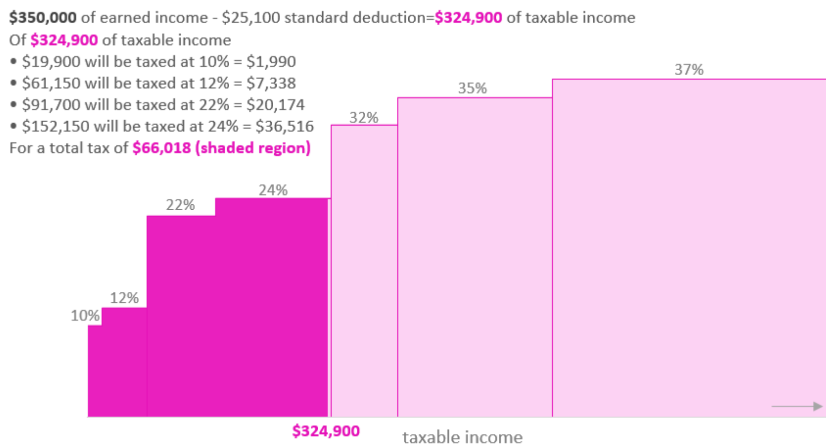
Source: CRS

Example 1: Married couple with $50,000 of earned income

First, the taxpayer will subtract $25,100 from their $50,000 of income to calculate their taxable income of $24,900.

As shown in **Figure 2**, this taxpayer has a total income tax liability of $2,590. The taxpayer's statutory marginal tax rate is 12%, and the taxpayer's last dollar of income was taxed at that rate. However, most of the taxpayer's income is taxed at a rate of 10%, since most of the taxpayer's income falls within the lowest (10%) income tax bracket.

Figure 3. Married Taxpayer Filing Jointly with $350,000 of Earned Income



Source: CRS

Example 2: Married couple with $350,000 of earned income

First, the taxpayer will subtract $25,100 from their $350,000 of income to calculate their taxable income of $324,900.

As shown in **Figure 3**, this taxpayer has a total income tax liability of $66,018. The taxpayer's statutory marginal tax rate is 24%, and the taxpayer's last dollar of income was taxed at that rate. However, more than half of the taxpayer's taxable income is taxed at a rate lower than 24% (taxed at 10%, 12%, or 22%), since it falls in one of these lower tax brackets.

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