tax rate overview

The Tax Cuts and Jobs Act of 2017 is the largest tax reform for over 30 years, which has significant impacts on individual taxpayers. Under the TCJA, the effective rate of federal tax on income was reduced, certain deductions were eliminated and credits were enhanced. The effective rate of federal tax on income ranges from 0% to 50% for the tax year 2018 and 2019.

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The rate of tax you pay on your income — as well as the benefit you receive from your deductions — can vary from no tax at all to a rate of approximately 50% in 2018 and 2019 depending on many factors, including:

- What is the nature of your income? Is it ordinary income, qualifying dividend income or net long-term capital gain income?
- Are you losing the advantage of the lower long-term capital gains rate because of netting rules?
- Are you subject to the AMT?
- Are you subject to the Medicare Contribution Tax on net investment income?
- Are you subject to the Medicare Wage Surcharge?
- Is any of your income subject to self-employment tax?
- Are you taking the itemized deductions or the standard deduction?
- Should you accelerate your charitable contributions and certain deductions in a particular year to meet the itemized deduction threshold?
- Is any of your income eligible to be excluded from your taxable base?
- Are credits available to offset your tax?

The most common federal tax rates (exclusive of the Medicare Contribution Tax on net investment income) are:

- For 2018, the 20% tax rate for net long-term gains and qualified dividends are applicable to taxpayers with taxable income over $479,000 ($488,850 in 2019) for married filing joint and $425,800 ($434,550 in 2019) for single individual taxpayers. Under the TCJA, the preferential tax rates for the net long-term capital gains and qualified dividends are based on their own tax bracket and they are no longer tied to the ordinary income tax rates.
- 28% for ordinary income subject to the AMT.
- For 2018, the 37% highest rate for ordinary income, such as short-term capital gains for married filers with taxable income over $600,000 ($612,350 in 2019) and for single taxpayers with taxable income over $500,000 ($510,300 in 2019).
- For 2018, the top rate for the first $128,400 ($132,900 for 2019) of wages is approximately 46% and 50% for self-employment income. The portion of Social Security FICA tax that employees pay remains unchanged at 6.2% on the first income listed herein (12.4% for self-employed individuals). The Medicare portion of the FICA tax remains unchanged at 1.45% on all income earned for employees. For the self-employed, the rate is 2.9% of all self-employment income. Also, there is another 0.9% Additional Medicare Tax (or Hospital Insurance Tax) paid by those earning more than $200,000 ($250,000 for married taxpayers and $125,000 for married taxpayers filing separately).

ORDINARY INCOME RATES

Ordinary income primarily includes wages, business and self-employment income, interest income, nonqualifying dividend income, taxable retirement plan distributions, rental income, taxable Social Security benefits, alimony, and your distributive share of ordinary income passing through to you from a partnership, LLC or S corporation.

For 2018 and 2019, net short-term capital gains are subject to the same rate as ordinary income and, therefore, could be taxed at a rate as high as 40.80%, inclusive of the Medicare Contribution Tax on net investment income. Chart 1 shows the different tax brackets that apply to ordinary income in 2018 and 2019 for married filing jointly and single taxpayers.

CAPITAL GAIN AND DIVIDEND INCOME RATES

Long-term capital gains and qualified dividend income are eligible to be taxed at lower maximum tax rates than ordinary income. This is discussed in detail in the chapter on capital gains and dividend income. But here are the basic rules:

- Net long-term capital gains are taxed at a maximum rate of 20% (if your taxable income exceeds certain thresholds) for both the regular tax and the AMT — with several notable exceptions to be discussed in the chapter on capital gains and dividend income. In some cases, the former 15% rate may still apply. To benefit from long-term capital gains treatment, you must have held the asset for more than 12 months. There is an additional 3.8% Medicare Contribution Tax on net investment income, including net long-term capital gains.
- For 2019, dividends received from most domestic corporations and qualified foreign corporations are taxed at the same 15% rate that applies to net long-term capital gains (20% for married taxpayers with taxable income over $488,850 and $434,550 for single filers). Dividends that do not qualify for the preferential rate of 15% (or 20%), such as dividends from a money market fund or nonqualified

chart 1

2018 AND 2019 FEDERAL TAX RATE SCHEDULES

2018 FEDERAL TAX RATE SCHEDULES

Taxable Income	Base Tax	Marginal Tax Rate (Tax on Next Dollar)
Married Filing Jointly or Qualifying Widow(er)		
$ 0	$ 0	10%
19,050	1,905.00	12%
77,400	8,907.00	22%
165,000	28,179.00	24%
315,000	64,179.00	32%
400,000	91,379.00	35%
600,000	161,379.00	37%
Single		
$ 0	$ 0	10%
9,525	952.50	12%
38,700	4,453.50	22%
82,500	14,089.50	24%
157,500	32,089.50	32%
200,000	45,689.50	35%
500,000	150,689.50	37%

2019 FEDERAL TAX RATE SCHEDULES

Taxable Income	Base Tax	Marginal Tax Rate (Tax on Next Dollar)
Married Filing Jointly or Qualifying Widow(er)		
$ 0	$ 0	10%
19,400	1,940.00	12%
78,950	9,086.00	22%
168,400	28,765.00	24%
321,450	65,497.00	32%
408,200	93,257.00	35%
612,330	164,709.50	37%
Single		
$ 0	$ 0	10%
9,700	970.00	12%
39,475	4,543.00	22%
84,200	14,382.50	24%
160,725	32,748.50	32%
204,100	46,628.50	35%
510,300	153,798.50	37%

Note: *See Appendix B for detailed 2018 tax rate schedules, including tax rates for married taxpayers filing separately and taxpayers filing as head of household. See Appendix C for detailed 2019 tax rate schedules, including tax rates for married taxpayers filing separately and taxpayers filing as head of household.*

foreign corporations, are subject to the higher ordinary income tax rates. There is an additional 3.8% Medicare Contribution Tax on net investment income that may also apply to dividend income.

ALTERNATIVE MINIMUM TAX

Ordinary income subject to the AMT is taxed at a maximum rate of 28%. As mentioned above, the 15% or 20% rate on net long-term capital gains and qualified dividends also applies to the AMT. While the AMT rate on ordinary income is lower than the highest regular tax rate of 37%, if it applies to a higher taxable income base, it should result in a greater tax. For tax years beginning 2018 through 2025, the AMT exemption and exemption phase out threshold amounts have increased significantly, which means, less taxpayers will be subject to AMT. See the chapter on the AMT for a more detailed discussion.

KIDDIE TAX

The TCJA has simplified the "kiddie tax." For tax years 2018 through 2025, the "kiddie tax" is simplified by applying the ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. The child's net taxable unearned income is taxed at the trusts and estates tax brackets and rates, whereas the taxable earned income portion of the child is being taxed at the single individual's tax brackets and rates. Therefore, the "kiddie tax" calculation is no longer affected by the parent's or siblings' tax situations.

For 2018, the unearned income of a child under age 19, or a full-time student under age 24, is no longer taxed at the parents' tax rate. For 2018, the first $2,100 of the child's unearned income is tax-free. Any excess of unearned income above $2,100 ($2,200 for 2019) is taxed at the ordinary and capital gains rates that are applicable to the trusts and estates. For 2018, unearned income in excess of $12,500 will be taxed at 37% the maximum rate. To the extent that the child has earned income such as wages, that income is taxed at the single taxpayer's tax brackets and rates. Unearned income such as net long-term capital gains and qualifying dividend income is eligible for the preferential tax rate of 15% or 20% to the extent that rate applies to trusts and estates. The child may also be subject to the Medicare Contribution Tax on net investment income (see below).

EMPLOYMENT TAXES

Your wages and self-employment income are also subject to Social Security and Medicare taxes. The amount of income subject to the Social Security tax is limited (see Chart 2), but all earned income is subject to the Medicare Contribution Tax.

If you are self-employed, your share of Social Security and Medicare taxes almost doubles because you pay both the employer's and

chart 2

SOCIAL SECURITY AND MEDICARE TAXES FOR 2018 AND 2019

Maximum Income Subject to Tax			Tax Rates/Maximum Tax Cost	
			Employer and Employee Portion	Self-Employed
Social Security	2018	$128,400	6.2%/$7,960.80 each	12.4%/$15,921.60
	2019	$132,900	6.2%/$8,239.80 each	12.4%/$16,479.60
Medicare	2018	No limit	1.45%/No limit 2.35%/No limit**	2.678%/No limit* 3.578%/No limit**
	2019	No limit	1.45%/No limit 2.35%/No limit**	2.678%/No limit* 3.578%/No limit**

** The tax rate is actually 2.9%, but only 92.35% of self-employment income is subject to the Medicare Tax.*
***Includes 0.9% Hospital Insurance Tax for amounts above certain income thresholds.*

employee's portions of these taxes. As a result, for 2018 and 2019, the federal effective tax rate on self-employment income can be as high as 50% on the first $128,400 ($132,900 for 2019) of such income, compared to about 46% for income from wages (after including your employee share of Social Security and Medicare taxes). The reason there is not a greater spread is primarily because you receive a deduction against AGI for 50% of the self-employment tax you pay.

MEDICARE WAGE SURTAX

An additional 0.9% Hospital Insurance Tax applies to earned income. This tax applies to wages and/or self-employment income in excess of $250,000 for married couples filing joint returns, $125,000 for married filing separate returns and $200,000 for all other taxpayers. The threshold amounts are not indexed for inflation.

MEDICARE CONTRIBUTION TAX ON NET INVESTMENT INCOME

The Health Care and Education Reconciliation Act of 2010 provided for a 3.8% tax on net investment income of higher income taxpayers for years beginning in 2013.

The additional 3.8% tax will apply if your AGI (with certain modifications) is in excess of $250,000 for a joint return (and qualifying widow(er) with dependent child), $200,000 if single, and $125,000 if married filing separate. The tax will apply to the lesser of your net investment income or your AGI in excess of the applicable threshold amounts stated above. Net investment income includes interest, dividends, capital gains, annuities, royalties, rents, income from passive business activities and income from trading in financial instruments or commodities. The amount of gross investment income may be reduced by expenses associated with earning that income. Such expenses include directly allocable state and local taxes, and investment interest expenses. For 2018 through 2025, the miscellaneous itemized deductions are suspended due to the TCJA.

The maximum federal tax rate on long-term capital gains and qualified dividends will be 23.8% (20% plus 3.8% additional Medicare Contribution Tax on net investment income). The threshold amounts are not indexed for inflation.

ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTIONS

The TCJA has made modifications to itemized deductions for tax years from 2018 through 2025, such as limiting the non-business state/local income taxes and property taxes to a maximum of $10,000 for married or single filers and $5,000 for married filing separately. The taxpayers have the option to deduct either the actual state and local sales tax paid or the state and local income taxes paid. It also temporarily eliminates all miscellaneous itemized deductions that are subject to 2% AGI floor limitations. In addition, the itemized deductions are not subject to phase out for any tax year after December 31, 2017 and before January 1, 2026.

Suspension of miscellaneous itemized deductions

One of the major changes due to the TCJA is the miscellaneous itemized deductions subject to the 2% "haircut" are suspended from January 1, 2018 through December 31, 2025. The deductions subject to the 2% disallowance such as investment advisory fees, unreimbursed employee business expenses, professional dues and subscriptions, tax return preparation fees and deductible legal expenses are temporarily eliminated for the tax year beginning after December 31, 2017 and before January 1, 2026.

Personal exemptions

The personal exemption is eliminated from 2018 through 2025 as a result of the TCJA.

Standard deductions

The standard deduction amounts for individual taxpayers have increased for tax years from 2018 through 2025. In 2018, the standard deductions amount for married filing joint taxpayers (or surviving spouse) is $24,000 ($24,400 for 2019), for single taxpayer (or married filing separately) is $12,000 ($12,200 for 2019) and for heads of household taxpayer is $18,000 ($18,350 for 2019). The standard deduction amounts are adjusted for inflation annually.

As a result of the changes in itemized deductions and the increased standard deduction amounts, more taxpayers may be claiming the standard deduction instead of itemized deductions.