

Federal Taxes

In the United States, there are three big types of Federal taxes on individuals:

- 1. Payroll Taxes** These are for Social Security and Medicare. Only wages are taxed. There are no deductions or credits.

Income	Social Security Tax	Medicare Tax	Total Payroll Taxes
\$0 - \$101,100	4.2%	1.45%	5.65%
\$101,100+	0%	1.45%	1.45%

- 2. Income Taxes** Income Taxes rates are broken up into tax brackets. For a single earner in 2012, the brackets are:

Income	Tax Rate
\$0 - \$8,025	10%
\$8,025 - \$32,550	15%
\$32,550 - \$78,850	25%
\$78,850 - \$164,550	28%
\$164,550 - \$357,700	33%
\$372,951+	35%

Note: these rates are only paid on taxable income, which is actually the income minus deductions. The standard deduction for a single earner is \$5,950.

- 3. Investment Taxes** Taxes on Capital Gains and Dividends are taxed at a flat 15%.

How Much Would an Average College Grad Pay?

The median starting salary of a college graduate is about \$42,000 in 2012.

Payroll Taxes

1. 1.45% of \$42,000 is \$609 in Medicare taxes.
2. 4.2% of \$42,000 is \$1764 in Social Security taxes.

Income Taxes With the standard deduction of \$5,950 there is only \$36,050 in taxable income.

Income	Tax Rate	Taxes
First \$8,025	10%	\$802.5
Next \$24,525	15%	\$3678.75
Last \$3,500	25%	\$875
	total	\$5356.25

Investment Taxes The average college grad does not have enough money in stocks to worry about dividends or capital gains.

So out of \$42,000, our recent grad pays a total of \$7,729.25 which is 18.4% of his income.

How Tax Brackets Work

Some people worry that if they earn too much, they will get bumped into a higher tax bracket, and will actually end up with less money.

That is not how tax brackets work.

When you go up to a higher tax bracket **only the income above the new bracket is taxed at the higher rate.**

How Do 47% of Americans Not Pay Income Tax?

- Most retired people don't pay income tax.
- With the tax credit for children, many lower/middle income families with children do not pay Federal income tax. They still pay 5.65% of their income in payroll taxes.
- Because of the Earned Income Tax Credit (EITC) the very poor also don't pay income taxes (but they still pay payroll taxes).

An Example

Image a family with two parents and three children that earns \$40,000 a year.

Payroll Taxes

1. 1.45% of \$40,000 is \$580 in Medicare taxes.
2. 4.2% of \$40,000 is \$1680 in Social Security taxes.

Income Taxes With the standard deduction of \$11,900 there is only \$28,100 in taxable income.

Income	Tax Rate	Taxes
First \$16,050	10%	\$1,605
Other \$12,050	15%	\$1,807.50
	total	\$3412.50

Investment Taxes Most families making \$50,000 don't have significant capital gains or dividends.

With the Child Tax Credit each dependent child takes \$1000 off the tax bill. With 3 kids, they would only pay \$412.50 in income tax. But they still pay \$2260 in payroll taxes for a total of \$2672.50 in Federal taxes.

Average Versus Marginal Taxes

Average Tax Rate

$$\text{Average Tax Rate} = \frac{\text{Total Taxes Paid}}{\text{Total Income}}$$

Marginal Tax Rate

Marginal Tax Rate = % of a small raise that will be taxed

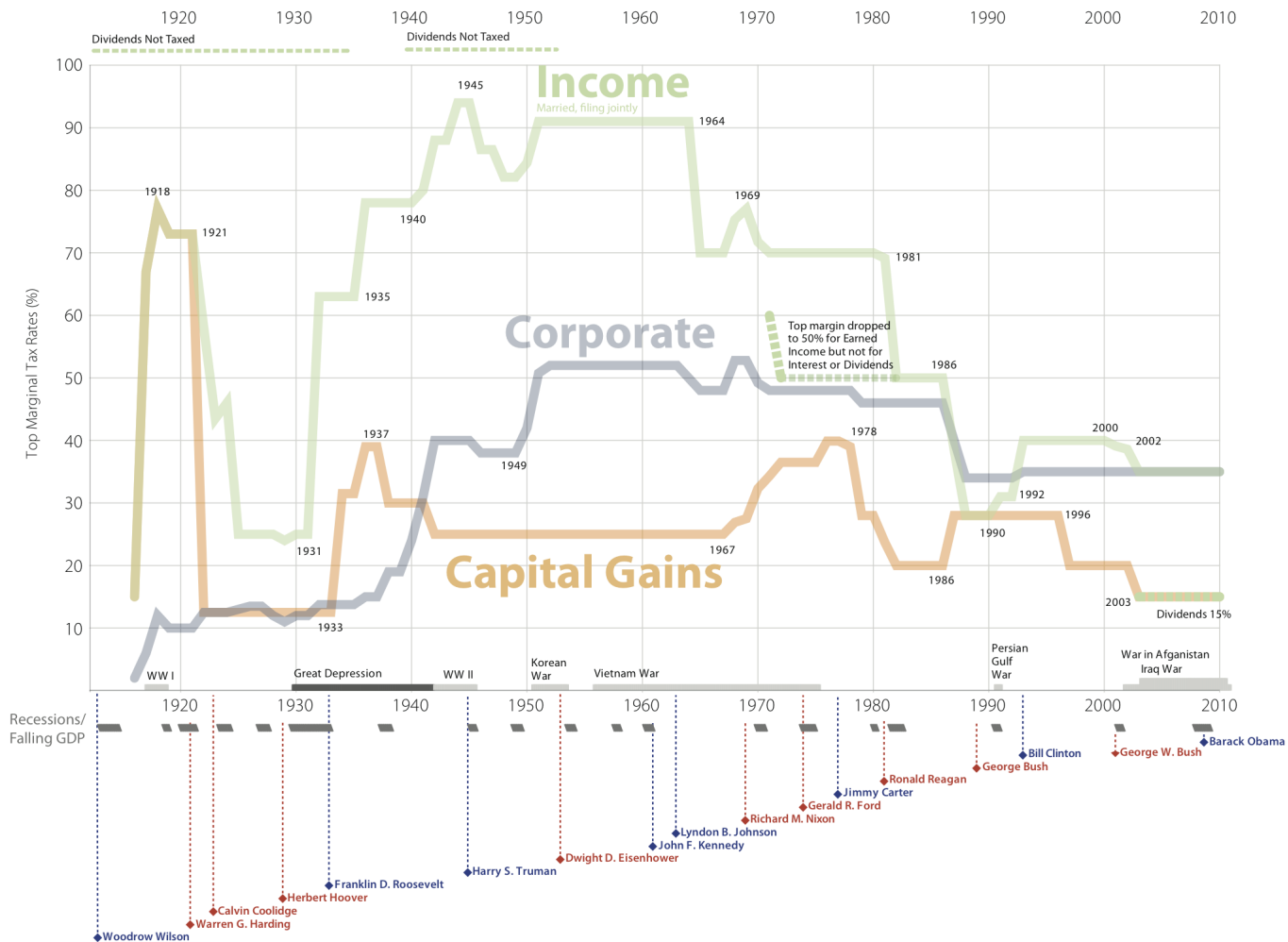
1. What is the average tax rate of our family that pays \$2672.50 out of their total \$40,000 income.
2. If Mom or Dad gets a \$1000 pay raise, what percent of that extra money will be taxed?

Questions about Marginal Rates

1. At what income level are marginal Federal taxes the highest?
2. What is the highest combined marginal Federal tax rate?
3. Which are usually higher, marginal tax rates or average tax rates?

Top Marginal Tax Rates: 1916-2010

Personal Income, Capital Gains and Corporate Tax Rates

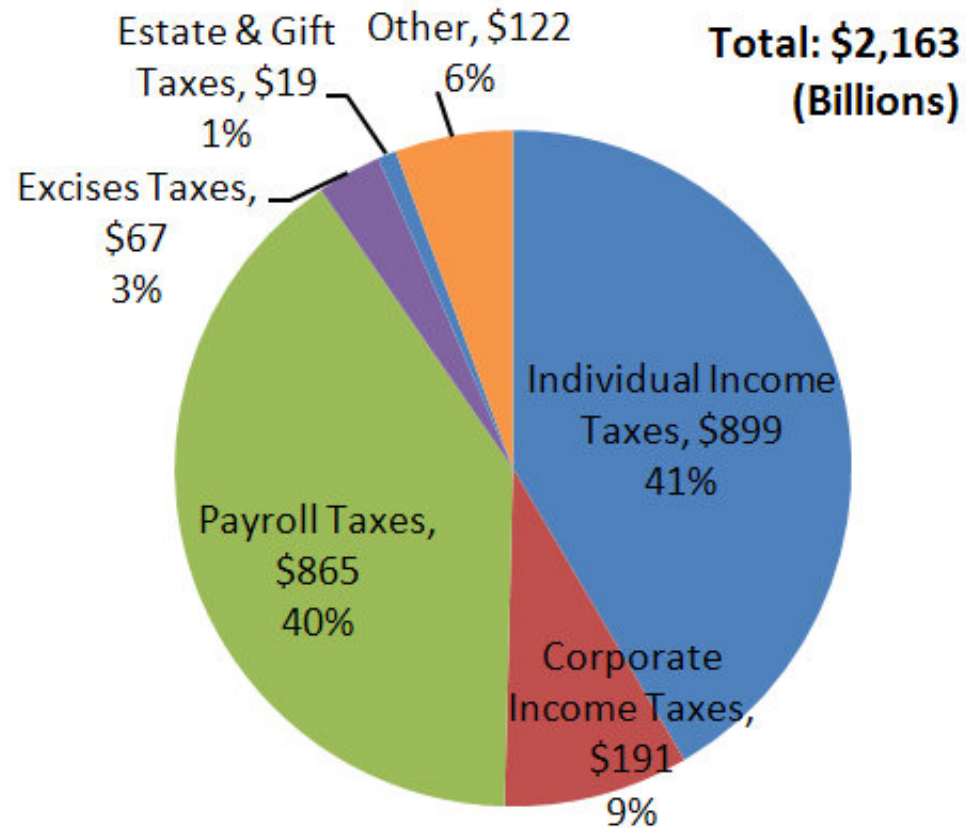


Tax Data Tables: TaxPolicyCenter.org, TruthandPolitics.org and Citizens for Tax Justice (ctj.org)

VisualizingEconomics.com

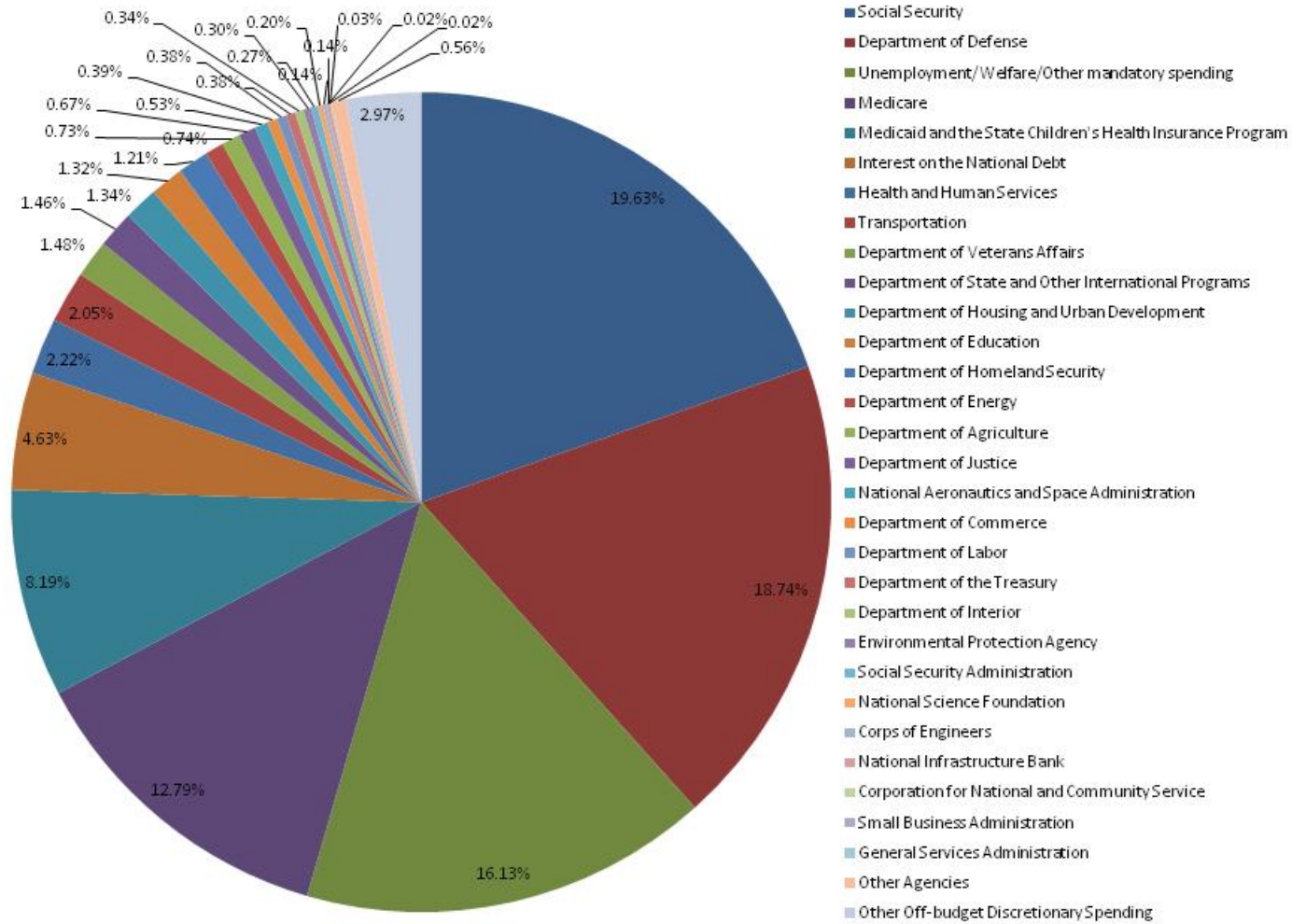
Where Taxes Come From

Federal Receipts by Source, 2010



Source: Joint Committee on Taxation

Where Taxes Go To



Questions About Federal Revenue and Spending

1. If you paid \$5000 in Federal taxes, then how much of that goes to the Department of Defense?
2. How much goes to NASA?
3. If 40% of Federal tax receipts are Social Security and Medicare taxes, but the government only spends 32% of its budget on Social Security and Medicare combined, then why do people say those two programs are going to run out of money?