

MOOREINSIGHTS

Tax Time: Marginal Income Tax Rates

The key to successful financial management lies in understanding the underlying factors involved. Income tax rates are one such element that has a significant impact on the amount of income that ends up in your pocket.

Understanding how income tax rates work is essential to financial planning, especially when it comes to large purchases, such as a new home or investment property, or landmark life events, such as retirement.

High-income or high-net-worth people need to understand how their income is taxed so they can make more effective and educated financial decisions. The system isn't as complicated as it might seem at first, and a little familiarity with how income tax rates apply goes a long way.

Understanding Marginal Income Tax Rates

The U.S. uses a progressive income tax system, meaning people are taxed at incrementally higher rates as the amount of their income increases. The amount of total income is divided into segments determined by dollar amounts.

Each segment is taxed at a different rate, so only earnings above a certain figure are taxed at a higher rate than the base tax rate. The rate applied to each segment that is higher than the last is what's called the marginal income tax rate.

How Marginal Tax Brackets Work

This table offers an illustration of how the IRS defines tax brackets with their own particular rates. For income for the 2024 tax year (taxed in April of 2025), the tax brackets are as follows:

Tax rate	Single	Married filing jointly	Married filing separately	Head of household
10%	\$0 to \$11,600	\$0 to \$23,200	\$0 to \$11,600	\$0 to \$16,550
12%	\$11,601 to \$47,150	\$23,201 to \$94,300	\$11,601 to \$47,150	\$16,551 to \$63,100
22%	\$47,151 to \$100,525	\$94,301 to \$201,050	\$47,151 to \$100,525	\$63,101 to \$100,500
24%	\$100,526 to \$191,950	\$201,051 to \$383,900	\$100,526 to \$191,950	\$100,501 to \$191,950
32%	\$191,951 to \$243,725	\$383,901 to \$487,450	\$191,951 to \$243,725	\$191,951 to \$243,700
35%	\$243,726 to \$609,350	\$487,451 to \$731,200	\$243,726 to \$365,600	\$243,701 to \$609,350
37%	\$609,351 or more	\$731,201 or more	\$365,601 or more	\$609,351 or more

While this may seem counterintuitive at first, it helps to understand that only each segment of earned income is taxed at its corresponding rate. A single person earning an annual income of \$100,000 would be taxed at 10% on the first \$11,600, 12% on the next \$35,549 (totaling \$47,501), and so on. The portion of income that falls into lower marginal brackets is taxed at the applicable lower rate.

Calculating Tax Liability with Marginal Rates

Planning for your tax liability when accounting for marginal rates might seem complex at first, but while it requires a bit of math, it's actually fairly straightforward.

Take the hypothetical example of a married couple that earns a combined \$200,000 a year and is filing jointly:

- The first \$23,200 of their income is taxed at 10%, which incurs a liability of \$2,320.

- The next \$71,101 (the amount of income between the already taxed \$23,200 and the next higher \$94,301 bracket) is taxed at 12% for a subsequent tax liability of \$8,532.
- The remaining \$105,699 of combined income over the \$94,300 bracket is taxed in the 22%, for an additional tax liability of \$23,254.

The couple's total tax liability on a combined income of \$200,000 is the total of the liability of every applicable bracket combined. In the illustration above, this would be:

	\$2,320
+	\$8,532
+	\$23,254
=	\$34,106 total

In other words, even though the highest applicable marginal income tax rate is 22%, not all earned income will be taxed at this rate. Rather, only the amount falling within that specific bracket is taxed at 22%.

Understanding Effective Tax Rate

While it's important to understand marginal tax rates, it's only a part of the overall picture when it comes to effective financial planning. You also must know how to calculate the effective tax rate on total taxable income.

Knowing this rate can simplify planning, as it provides a convenient way to, in effect, average out the amounts of the various applicable tax bracket percentages involved.

Referring to the example above, the effective tax rate could be expressed as the formula:

$$\text{Effective Tax Rate} = \text{Total Tax Liability} / \text{Total Income}$$

For instance, the hypothetical couple with a total tax liability of \$34,106 on a combined income of \$200,000 would have an effective tax rate of 17%. This means that while the 22% marginal income tax rate applies to some of their income, the effective tax rate on the entirety of their income is only 17%.

Why This Is Important for Retirement Planning

When planning for retirement, be careful to examine every angle and make the most of every opportunity to maximize your nest egg. Understanding the finer points of how

income can be taxed provides clarity on whether strategies like tax-free municipal bonds or Roth IRA conversions are suitable.

Knowing your marginal tax rate also makes it possible to calculate the applicable effective tax rate. This goes a long way toward being able to accurately predict how much to set aside for taxes and how much income can be put toward savings and investments.

Leveraging Deductions and Credits

A good option for dealing with the increased tax burden of income in higher brackets is to take steps to reduce your taxable income – and thereby lower your marginal and effective tax rates. Using the standard deduction or itemizing specifics such as interest paid on mortgages, charitable contributions, applicable medical deductions, and so on is a sound approach.

Tax credits can also directly reduce tax liability by reducing the amount of taxable income in higher marginal rate brackets by lowering a tax bill on a dollar-for-dollar basis.

The Benefits of Understanding Marginal and Effective Tax Rates

Understanding how income is taxed is an indispensable part of effective financial planning, especially as you approach retirement or other significant life events. Not only does this understanding provide a clear and accurate picture of your tax obligations, but it also gives you the information you need to optimize tax and retirement strategies.

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