

WHEN ORDINARY INCOME TAX RATES OUTSHINE CAPITAL GAINS RATES

Some say it's an accepted rule of thumb that taxes on long-term capital gains* are "always" significantly lower than taxes on ordinary income. With the Tax Cuts and Jobs Act,[†] effective in 2018, it's time to take a fresh look.

Long-term capital gains rates in 2018 were substantially similar to those in 2017. In 2019, the rates remain the same, and thresholds have been indexed up slightly.[‡]

There are situations where a filer's effective ordinary income rate is lower than the filer's capital gains rate. For example, at an income level of \$125,000 for married couples filing jointly, the effective ordinary income tax rate is 11.08 percent while the capital gains rate is 15 percent[§].

The illustration at right highlights long-term capital gains rates and ordinary income rates at various thresholds. The callouts in the gray bars highlight three different income levels where effective ordinary income rates may be lower than capital gains rates.

*For the purposes of this piece, all references to "capital gains" are long-term capital gains rates, and do not include short-term capital gains.

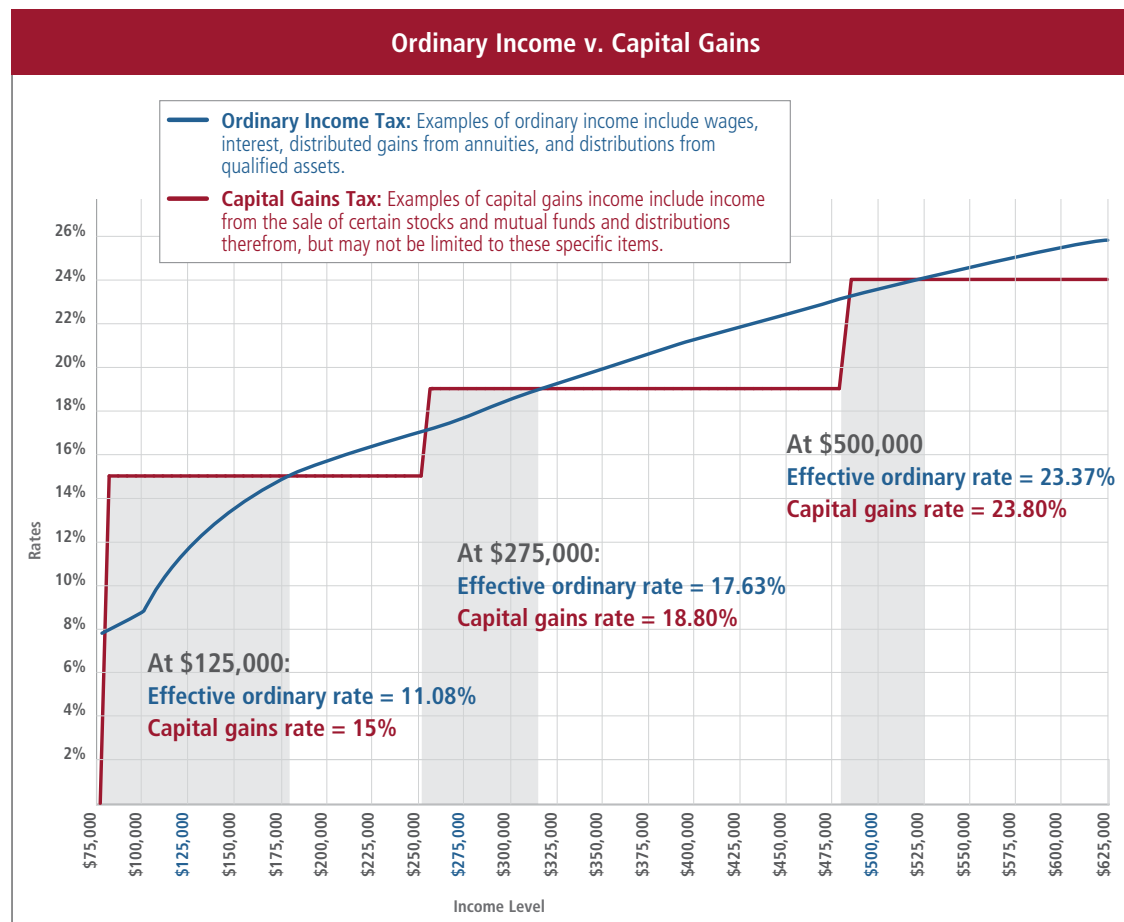
[†]Tax Cuts and Jobs Act, Conference Report to accompany H.R. 1, December 15, 2017.

[‡]Ibid; and Tax Foundation - 2019 Federal Income Tax Brackets.

[§]Jackson calculated rates using data contained in the Tax Foundation 2019 Federal Income Tax Brackets, and IRS Topic No. 559 Net Investment Income Tax.

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Jackson calculated the information in the chart using data contained in the Tax Foundation – 2019 Federal Income Tax Brackets and IRS Topic No. 559 Net Investment Income Tax. Note: Tax rates depicted reflect the effective 2019 taxation rates for a married couple filing jointly, less the standard deduction, and do not include any additional credits or deductions. Capital gains rates reflect long-term capital gains rates, plus the Net Investment Income Tax where applicable.

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COMPARING ORDINARY INCOME AND CAPITAL GAINS, TAX BRACKETS AND TAX RATES

Marginal Tax Rate vs. Effective Tax Rate

In a basic sense, the marginal rate is the tax bracket into which an individual's income falls. The effective tax rate for individuals is the average rate at which their earned income is taxed, calculated by dividing total tax expense by taxable income, and represents an individual's actual tax obligation.¹

Other Tax Considerations

Beyond rates, there are other tax factors to consider to keep your money working for you. For example, some investments allow you to defer taxes on growth to a later date. By deferring taxes, some research shows you can achieve an increase in additional returns ranging from 0.7 to 2.7 percent each year.²

Tax deferral offers no additional value if an annuity is used to fund a qualified plan, such as a 401(k) or IRA. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

Ordinary Income vs. Capital Gains at Certain Income Levels			
Gross Income	Ordinary Income Rates		Capital Gains Rate
	Marginal Tax Rate	Effective Tax Rate	
\$125,000	22%	11.08%	15%
\$175,000	24%	14.20%	15%
\$225,000	24%	16.22%	15%
\$275,000	24%	17.63%	18.80%
\$325,000	32%	18.61%	18.80%
\$405,000	32%	20.85%	18.80%
\$500,000	35%	23.37%	23.80%

The information in this chart is summarized from Tax Foundation - 2019 Federal Income Tax Brackets, and IRS Topic No. 559 Net Investment Income Tax. Note: Tax rates depicted reflect the effective 2018 taxation rates for a married couple filing jointly, less the standard deduction, and do not include any additional credits or deductions.

¹ Michael Kitces, Kitces.com, "Understanding Marginal Tax Rate Vs Effective Tax Rate And When To Use Each," January 30, 2013.

² Aaron Brask, Alpha Architect, "Quantifying the Value of Retirement Accounts," April 19, 2018.

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