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Marginal Tax Rate Report: Net Investment Income Tax

Cody Kallen | June 5, 2017 | AEI Tax Brief Series

1 Current Policy

For an individual, the effective marginal tax rate (EMTR) is the percentage of tax owed on an additional amount of income. This measure includes the statutory rates as well as the phase-ins and phase-outs of tax deductions and credits. For individuals, the EMTR is a good measure of the tax system's disincentive to earn additional income. When we take a weighted average of the marginal tax rates for all taxpayers, we get a measure of the aggregate disincentive. For the EMTR on wage and salary income, this is a measure of the aggregate disincentive to work more or harder. For the EMTRs on investment income, this measures the aggregate disincentive to save and invest.

The Net Investment Income Tax (NIIT) is a 3.8 percent surtax on interest, dividends, capital gains, rent and royalty income, certain annuities, and income from businesses that trade financial instruments or are passive business entities, in excess of $250,000 for married couples and $200,000 for unmarried filers. It was enacted as part of the Affordable Care Act in 2010. The proposed American Health Care Act would repeal the NIIT.

2 Reform Options

Using the open-source B-Tax model, I present the results of eliminating bonus depreciation. For details on the implementation and calculation of the EMTRs, see the Modeling Notes section.

Income Type	Current Law	Repealing the NIIT	Doubling the NIIT
Wage and Salary Income	35.3	35.2	35.3
Long-term Capital Gains	22.6	19.4	25.5
Short-Term Capital Gains	38.6	35.4	41.7
Interest Income	31.3	29.7	32.5
Qualified Dividends	18.3	16.1	20.5

3 Comments

- Repealing the NIIT causes 0.8 million people to face higher marginal tax rates on labor income and 1.7 million people to face lower marginal tax rates.
- Doubling the NIIT causes 1.4 million people to face higher marginal tax rates on labor income and 1.1 million people to face lower marginal tax rates.

4 Modeling Notes

4.1 Tax-Calculator

Tax-Calculator is an open source microsimulation tax model that computes federal individual income taxes and Federal Insurance Contribution Act (FICA) taxes for a sample of tax filing units for years beginning with 2013. The model can be used to simulate changes to federal tax policy to conduct revenue scoring, distributional impacts, and reform analysis. As an open source model, Tax-Calculator is under constant development and improvement. Therefore, the results reported in this paper will change as improvements are made. The model relies on data from the 2009 IRS Public Use File (PUF). These results are generated using Tax-Calculator Version 0.8.3.

4.2 Modeling Assumptions

In Table 1, interest is specifically taxable interest and excludes interest from state and municipal bonds. Marginal tax rates on each filing unit are estimated by adding $0.01 to the relevant income type. The aggregates MTRs for wage/salary income, interest, and dividends are the weighted average of all the individual MTRs, weighting by the relevant income type. The aggregate MTRs for long-term and short-term capital gains are weighted by taxable gains, which includes the effect of the loss limitations and capital gain distributions not reported on Schedule D.

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