Simplicity of 2 tax rates not evident to 1988 filers

WASHINGTON (AP) — Think back to 1986, when Congress passed and President Reagan signed a sweeping overhaul of the income tax. Remember all the crowing about how there would be only two simple tax rates? Forget it.

Look at the 1988 tax rate schedules in your package of tax forms and you'll actually see four marginal rates: 15 percent, 28 percent, 33 percent and 28 percent again.

Where simplicity is concerned, as long as there is more than one rate, it makes little difference whether there are two or 20.

That is because the great majority of taxpayers have no contact with tax rates when they fill out their returns. Unless you have taxable income — which is what is left after subtracting personal exemptions and deductions from your income — of $50,000 or more, you simply look at the tax tables, find your income, read across the page to your filing status and see what you owe.

About four of every five taxpayers will pay only the lowest rate, 15 percent, on money earned last year. These people have taxable incomes of up to $17,850 if single and up to $29,750 if married and filing joint returns.

When President Reagan proposed across-the-board tax cuts in 1981, his goal was to give people incentive to work more and save more in ways that would improve the economy. He proposed to do this by making "marginal tax rates" as low as possible. Congress and the president had the same thought in mind when they approved the 1986 overhaul.

A marginal rate is what you would pay on any additional dollars you earned. For example, if you are married and have taxable income of $27,000, your top marginal rate is 15 percent; you are said to be in the 15 percent bracket. Earn another $1 or $1,000 and it still is 15 percent.

But earn $3,000 more and your top rate jumps to 28 percent. You would pay 15 percent on the first $29,750 and 28 percent on the excess — that is, on $250. You have jumped into the 28 percent bracket.

When Reagan took office, the top marginal rate was 70 percent. Now it is 33 percent, although backers of the overhaul like to claim it is 28 percent.

Here's how that works:

Remember that for a single person, for example, the first $17,850 of income subject to taxation is taxed at 15 percent. Any additional income between $17,850 and $43,150 is taxed at 28 percent. Anything between $43,150 and $89,560 is taxed at 33 percent — and then comes the complication: The $89,560 upper limit is increased by $10,920 for each personal exemption claimed. Thus, a single person with a dependent child pays 33 percent on taxable income between $43,150 and $111,400.

And finally, any additional dollars above the top limit are taxed at 28 percent.

Why jump from a 28 percent rate to 33 percent and back to 28 percent again? The answer is that congressional tax writers wanted to have what appeared to be a top rate of 28 percent but did not like the idea of having a person with $20,000 of taxable income pay the same top rate as one with $2 million.

The solution was to deny wealthier Americans any benefit of the bottom rate of 15 percent and any benefit from the personal exemption. The net result was to impose a flat tax rate of about 28 percent — it can be more, depending on the number of exemptions — on every taxable dollar earned by these people.

As a side-effect, the well-to-do taxpayers who fall into this category are facing a 33 percent marginal tax rate on some of the extra dollars they earn above the 28 percent bracket. For a single person with no dependents, this surcharge applies on up to $57,330 of income — that is, on everything between $43,150 and $100,480; for a couple with two children, the higher rate applies to $121,030 — everything between $71,900 and $192,930.

The more children in the family, the more income that is taxed at the 33 percent rate.

Tax overhaul makes more young taxpayers

WASHINGTON (AP) — Tax overhaul is making taxpayers — or at least first-time return filers — of many younger Americans.

The 1986 law, while lowering rates and raising exemptions, bars a child from taking any exemption if he or she can be claimed as a dependent by a parent or someone else. In many cases it reduces the standard deduction for dependents. And it requires any dependent with interest, dividends or other unearned income totaling as little as $501 to file a return.

Each personal exemption means a $1,950 reduction in 1988 income subject to taxation. For most taxpayers, that is a saving of $292.50 in taxes; for those in the 28 percent tax bracket, it is a saving of up to $546.

Five tests must be met for you to claim a person as your dependent:

- The dependent must be a resident or citizen of the United States or a resident of Canada or Mexico.
- He or she must not have filed a joint return with a spouse.
- The dependent must be your child, grandchild, parent, grandparent, brother, sister, nephew, niece, uncle, aunt, son- or daughter-in-law, parent-in-law, brother- or sister-in-law, or any person who is a member of your household and lived with you throughout the year.
- The dependent's gross income for 1988 must have been less than $1,950. This does not apply to your dependent child who either was under 19 at the end of the year or was a full-time student.
- You must have furnished more than half the dependent's support during the year. (There are exceptions if you are divorced.) Support includes foot, lodging, clothing, education, medical care, transportation, toys, pocket money, etc.

If all those conditions are met, you may take an exemption for a dependent. But that dependent cannot take an exemption on his or her personal tax return — even if you don't actually claim it.

So, how are your family's taxes affected if your 17-year-old daughter had a part-time job and a small savings account last year? She earned $2,500 in the job and $200 interest.

You, the parent, are allowed to claim her as a dependent. For that reason, and because her gross income exceeds $500, she must file a return as well. Her standard deduction is her total earned income or $3,000 (the usual standard deduction for a single person), whichever is smaller. Since her earned income — wages, tips, fees and the like — was $2,500, that also is her standard deduction.

She should file the simplest form, 1040EZ. Only $200 of her income would be taxable and her tax liability (from the tax table on page 37 in the instructions) would be $32.

In the unlikely event that your daughter had itemized deductions exceeding $2,500, it would be to her advantage to itemize rather than take the standard deduction. She then would have to file Form 1040 and Schedule A, rather than 1040EZ.

If she had no unearned income — such as interest and dividends — she would not have to file a return unless her earned income exceeded $3,000.

But she should file to get a refund of any income tax that was withheld from her earnings.

In any case, the standard deduction for a person who can be claimed as a dependent of another may not exceed $500 of the dependent's earned income — whichever is greater.

The real complications occur when your child is under 14 and has unearned income of more than $1,000. In that case, some of the child's income will be taxed at your, presumably higher, maximum tax rate.

You should read the instructions for Form 8615, which may have to be attached to your child's return.

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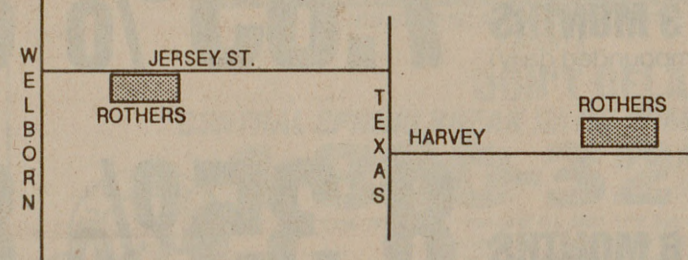

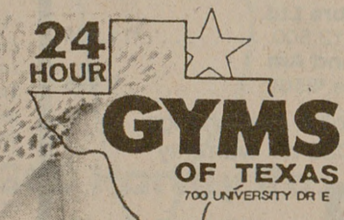

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