1440

Good morning. It's Thursday, April 10, and today, in honor of tax day coming up on Tuesday, we're covering how income taxes work.

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—Phoebe Bain, 1440 Business & Finance Section Editor

Investigating Income Taxes

Background
Income taxes are taxes that governments levy on money that individuals and businesses earn. What's more, they're also many countries' largest source of revenue: In the US, individual income taxes made up nearly half of the federal government's revenue in 2024, while corporate income taxes added another 11% (see a detailed **breakdown**).

Because income taxes' primary purpose is financing government operations—such as funding public programs like food stamps that benefit lower-income households—these taxes are also seen as an economic tool to **redistribute resources** and reduce inequality.

But taxation is historically contentious: Critics argue that income taxes can discourage career advancement and push payers to move to areas with lower rates.

History
Enshrined in the 16th Amendment, the individual income tax the US uses today was **enacted** in 1913. Wisconsin created the first state-level income tax in 1911. America also briefly had an income tax during the Civil War, when the agency now known as the Internal Revenue Service was **established**.

Over a century ago, fewer than 1% of Americans paid income taxes. World War II prompted the federal government to greatly expand the number of people required to pay income taxes, from about 5% of American workers in 1939 to 90% submitting tax forms and 60% paying income taxes by the end of the war.

While US taxpayers filed nearly 154 million returns in 2022 (meaning that a much greater share of Americans pay taxes now than did a century ago), the tax code has evolved so that top earners still pay proportionally more. The top 50% of earners paid 97% of all federal income taxes in 2022.

How They're Calculated
Federal income taxes are calculated using marginal tax rates, the percentage of taxes applied to different income ranges. Taxpayers pay a certain percentage of taxes on each dollar earned within each tax bracket that their income falls into.

For instance, a single filer will owe a 10% tax on the first $11,925 of their income, 12% on the next chunk of their income up to $48,475, and so on until all their income is accounted for. The US' highest marginal tax rate is 37%, but in the past, it's been as **high as 94%**. (Watch **a video** explaining marginal tax rates.)

At the state level, 14 states have moved away from bracket-defined taxes to a flat tax that's the same percentage for all income levels, and nine states don't levy any wage-related taxes (**see these states here**).

The vast majority of taxpayers don't pay taxes on their entire income because of deductions (also called **deductibles**): expenses filers subtract from their adjusted gross income to lighten their total tax burden. Businesses can deduct operational expenses such as rent, while individuals can deduct contributions to some retirement accounts, including **IRAs**, under specific circumstances.

Instead of individually listing their deductions, most Americans take the "standard deduction," an amount based on filing status (single, head of household, **and so on**) introduced in 1944 to simplify taxes. If someone makes less than the standard deduction, they generally don't have to file taxes. Taxpayers can also claim tax credits to reduce taxes they owe—**more on those here**.

Corporate income taxes are calculated differently—learn more **here**.

Future

In 2025, about half of Americans will be able to file their taxes directly with the IRS for free online for the first time (listen to **a podcast** about this).

It's estimated that the average US taxpayer spends more than $200 per year on tax preparation services like TurboTax and H&R Block, which act as intermediaries between themselves and the IRS.