

The big drop-off between 2002 and 2003 was the result of the 2003 reduction of the capital gains rate from 20% to 15% and the extension of that rate to dividends (which had previously been subject to ordinary income rates)—each described in Chapter 3.

These trends have not only continued since 2009 but have become more dramatic. In 2011, those with income between \$500,000 and \$10 million paid an effective Federal tax rate (including all Federal taxes, not merely the individual income tax) of 24.5%, while those with income exceeding \$10 million paid an effective tax rate that was 4.2 percentage points lower—20.4%—the largest gap between these two groups since the IRS began calculating this data in 2000.<sup>24</sup>

Additional data is provided in Chapter 3, where we shall delve into tax policy questions more deeply, but we are getting ahead of ourselves. The main reason for the discussion here was to explore the difference between marginal and effective tax rates. Before diving further into tax policy debates, we need to explore various forms of consumption taxation (Chapter 2). First, however, try your hand at applying the material that you learned in this section to the following problems.

### **Problems**

1. David and Daphne are married and have no children. David is a police sergeant who earns \$65,000 in 2015, and Daphne is a registered nurse who earns \$75,000 in 2015. They earn no investment income in 2015, but they did receive a \$10,000 gift from Daphne's mom. *See* § 102(a). David and Daphne file a joint return in 2015 and take the Standard Deduction.

- a. What is Daphne's and David's Adjusted Gross Income (AGI) and Taxable Income for 2015?
- b. What is Daphne's and David's marginal tax rate? Their effective tax rate (using AGI)?

2. Sheila and Shane are married and have two children: Erik, age 17, who is a junior in high school, and Becky, age 10. Sheila does not work outside the home, and Shane is an electrical engineer who earns \$130,000 working as an employee of Tectronics, Inc., in 2015. Together, they also receive \$10,000 in interest on corporate bonds and \$5,000 in interest on Ohio state bonds. In Chapter 2, you will learn that the interest on the Ohio state bonds is excludable from Gross Income under the authority of § 103. They contribute \$5,000 to the Cleveland Orchestra, which is a deductible contribution under § 170. They pay \$7,000 in real property taxes on their personal residence to their local Ohio county jurisdiction, and they pay \$8,000 in Ohio state income taxes for 2015, both payments of which are deductible under § 164(a). They also pay \$6,000 in interest on their home mortgage, which satisfies the definition of "qualified residence interest" within the meaning of § 163(h)(3) and is thus deductible (as explored more fully in Chapter 18). Finally, Shane pays professional dues and travels to several professional association meetings in the field of electrical engineering out of his own pocket in order to keep up to date on the latest information in his field, even though Tectronics, Inc., does not reimburse these costs to Shane. The total amount

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<sup>24</sup> Floyd Norris, *Merely Rich and Super Rich: The Tax Gap is Narrowing*, at [www.nytimes.com/2014/04/18/business/merely-rich-and-superrich-the-tax-gap-is-narrowing.html?\\_r=2](http://www.nytimes.com/2014/04/18/business/merely-rich-and-superrich-the-tax-gap-is-narrowing.html?_r=2) (describing how this gap may begin to narrow at least a bit beginning in 2013 for two reasons described in Chapter 3: (1) the restoration of the highest capital gains rate to 20% from 15% for married couples with Taxable Income exceeding \$450,000 and individuals with Taxable Income exceeding \$400,000 and (2) the extension of the 3.9% Medicare Tax to investment income for the first time for married couples with Taxable Income exceeding \$250,000 and individuals with Taxable Income exceeding \$200,000).

that is deductible by Shane under § 162 is \$2,500. Sheila and Shane file a joint tax return for 2015.

- a.** What is Sheila and Shane's AGI for 2015?
- b.** What is Sheila and Shane's Taxable Income for 2015?
- c.** Tectronics has already announced that there will be no employee raises for 2016 because of sluggish growth. Nevertheless, do you have any advice to Shane in negotiating next year's salary arrangement with Tectronics, Inc.?
- d.** Now for your first attempt at meaty statutory reading. Read §§ 24(a), (b)(1), (2), and (c)(1) very carefully. How much is Sheila's and Shane's child tax credit under § 24 for 2015?