

## Sources of Variation in Average Tax Rates

There are two main sources of variation in average tax rates across income classes:

- The variation in income combined with a progressive tax system leads to, in general, higher-income families having high tax rates and lower-income families having lower tax rates.
- The adjustment for family sizes may cause two families with similar incomes and similar tax rates to be assigned to two different income classes.

There are a number of sources of variation in average tax rates within income classes:

- The adjustment for family size may cause two families with different incomes and different tax rates to be assigned to the same income class.
- Tax rates may depend on the source of income.
  - The preferential treatment of capital gains and dividends, as well as tax-exempt interest income, nontaxable pension income and government transfers may cause two families with the same income to have different tax rates.
  - Foreign income may be eligible for the foreign tax credit due to taxes paid abroad, reducing U.S. tax liability.
- Some types of income are exempt from tax. Tax exemptions may cause two families with the same income and even the same family size to have different tax rates. For example, employer-provided health insurance and certain contributions to employer-sponsored pension plans are tax exempt. Most transfer payments including the majority of social security income is also exempt from tax.
- Certain activities and expenditures may make a family eligible to claim deductions from taxable income and credits against tax.
  - Itemized deductions include charitable deductions, casualty and theft losses, real estate taxes, state and local taxes, mortgage interest and certain business expenditures.
  - Examples of such tax credits include the American Opportunity Tax Credit (AOTC) for certain education expenses, the premium tax credit and the saver's credit for certain retirement savings.
- The presence of older persons and children and other dependents in the family may make a family eligible for certain and/or increased tax credits, such as the child and dependent care credit, the additional child tax credit, and an increased Earned Income Tax Credit (EITC). The tax code also allows an additional standard deduction for age and/or blindness and a credit for the elderly and disabled.

