[< Back to The Advisor Institute]

# Coach's Corner

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After-Tax Advisor

## A More Effective Way to Measure Tax Impact

*By: Holly Swan | April 4, 2024*

Many clients look to their highest marginal bracket when measuring tax impact, yet there's a more accurate way to understand tax impact—the effective tax rate.

The effective tax rate is a measure of the average tax burden. It represents the percentage of income or profits paid in taxes after accounting for all applicable deductions, exemptions and credits.

You can help clients calculate their effective tax rate in three steps:

1. Determine taxable income. This is the income subject to taxation after subtracting all eligible deductions such as business expenses, mortgage interest and charitable contributions. Taxable income can be found on line 15 of form 1040 for 2023.
2. Calculate total tax paid. You will need to know the total amount due for federal taxes before you can determine the effective federal tax rate. The effective federal tax rate can be found on line 24 of Form 1040 for 2023.
3. Divide taxes paid by taxable income and multiply by 100. This will give you a percentage that represents the portion of income that goes toward taxes.

Suppose a single person has a taxable income of $50,000 and pays a total of $7,500 in taxes. Divide the tax paid ($7,500) by the taxable income ($50,000) and multiple by 100, which yields an effective tax rate of 15%. This is a far more accurate representation of the total taxes paid than their highest marginal rate of 22%.

**Bottom Line:** Helping your clients understand their effective tax rate can lead to better, more informed financial planning decisions.

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