



Inflation is Not a Hidden Tax – It's a Very Real Tax

Bracket Creep accounts for a real tax increase in about half of the 50 states

We've all heard the saying that inflation is a hidden tax. But depending on which state you live in, it should simply be called a tax – because that's what it is. If you live in a state that fails to adjust its tax brackets (or the standard deductions or personal exemptions) because of inflation, then you end up paying more in taxes. It's appropriately called "Bracket Creep."

Simply defined: Bracket Creep occurs when more of your income is in a higher tax bracket because of inflation rather than higher real earnings.

- **Inflation-Adjusted or Not?**

As you probably know, the Bureau of Labor Statistics recently reported that the Consumer Price Index for All Urban Consumers stands at 5.4% over the past 12 months, which is the highest we've seen in over a decade. Then on October 13th, the Social Security Administration announced that

Social Security and Supplemental Security Income benefits for tens of millions of Americans will increase by 5.9% in 2022, the largest increase in almost 40 years.

The good news is that over the same period of time, wages are up about 7%, which helps offset inflation somewhat. But what about those who have not seen their income increase over the past year? And what about those who live in states where tax brackets, personal exemptions or standard deductions are not inflation-adjusted? The answer is simple – the tax burden in real terms goes up.

- **What is Your State's Tax Rate?**

Let's start from this place: we all hate paying taxes. Did you know that there are nine states that don't have an income tax? They are: Alaska, Florida,

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Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming.

That leaves 41 states (and the District of Columbia) that tax wage income. Of these:

- 15 states and D.C. fail to adjust brackets for inflation;
- 10 states leave their standard deduction (if they have one at all) unadjusted; and
- 18 have an unindexed personal exemption.

Combined, almost half of our states (22 + the District of Columbia) have at least one unindexed provision.

▪ **A Real Tax Increase**

Let's say you are a resident in one of those 22 states who made \$60,000 in taxable income in 2019, but you saw your income increase to \$64,000 the next year. While it's great that you saw a raise last year, you really haven't seen an increase in your purchasing power due to inflation. But it gets worse.

If your state's income tax brackets are not inflation-indexed, since your top marginal rate was previously 5.55% (on income between \$25,000 and \$60,000), you now have \$4,000 taxed at the higher rate of 6.6%. Your tax bill goes up by \$264 even though your purchasing power remained the same.

Saying inflation is a hidden tax is simply not true. It's a very real tax that you have to pay with very real dollars.

▪ **Tax Planning is Important**

For most people, tax strategies can be overwhelming, especially given that the federal and state tax codes are thousands upon thousands of pages long. Throw in the emotional toll of figuring out what Congress and state legislatures are going to do next and it's no wonder tax worries can be paralyzing, pushing you to do nothing.

So, before you go down a path that might not be in your best interest long-term, make sure you consult with your financial advisor to determine how your tax decisions and changes to tax law might impact you and your family.

Your advisor can model out different scenarios with different tax assumptions so you can see how a few tweaks – or a few more significant changes – might help you keep more of your hard-earned money.

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