

## Why Nearly Half of Americans Pay No Federal Income Tax

By Roberton Williams

During the recent tax filing season, cable news and talk radio repeatedly discussed the Tax Policy Center's (TPC's) estimate that 47 percent of Americans would pay no federal income tax for 2009 (*Tax Notes*, June 29, 2009, p. 1583, *Doc 2009-14138*, 2009 TNT 122-14). However, much of the commentary failed to explain why. The deep recession is one cause — incomes are down and so are tax liabilities. But a much larger factor is that Congress has chosen to deliver large portions of social policy through the tax code.

The income tax has long used itemized deductions to encourage activities such as homeownership and charitable giving. For more than three decades, the earned income tax credit has supplemented the wages of low-earning workers. More recently Congress has substantially increased the EITC and introduced new tax credits for children, college expenses, and retirement saving. The proliferation of those tax expenditures, now totaling nearly \$1 trillion annually, has reduced income taxes for most Americans and pushed many off the tax rolls entirely. TPC estimates that 45 percent of households will owe no federal income tax in 2010 (see table) and that more than 90 percent of them will get government payments through refundable tax credits. Most nonpayers have relatively low income: Six in 10 make less than \$20,000.

More than two-thirds of people who pay no income tax do pay Medicare and Social Security payroll taxes and about half owe payroll taxes that exceed their refundable tax credits. Counting income plus payroll tax liabilities, less than a quarter owe no tax.

To examine how tax preferences move people off the income tax rolls, TPC simulated what would happen if we remove all dependent exemptions, itemized deductions, and personal credits. Dropping those features reduced the percentage of non-income-taxpayers to 27 percent, four-fifths of whom make less than \$20,000. Most would pay no income tax because of personal exemptions for the taxpayer and spouse, the standard deduction, and the tax exemption of Social Security benefits for low-income recipients.

Counting both income and payroll taxes, less than 13 percent of households would not pay tax; 94 percent of them would either be elderly or have incomes less than \$20,000. Get rid of tax preferences and tax benefits for dependents and it's pretty much just the poor and elderly who don't pay federal income or payroll taxes. And even they likely pay federal excise taxes on gas, alcoholic beverages, and other goods.

Is it a bad thing that some Americans pay no income taxes? Some argue that everyone should pay some income tax so they have a visible stake in what our government does. Others say that administering social policy should not be the IRS's job. However, the tax system does provide an efficient means of delivering cash benefits to low-income families without creating a new bureaucracy.

Finally, a handful of people with very high income pay no income or payroll tax. How? IRS studies show that high-income households that owe no income tax most commonly get much of their income from tax-exempt bonds or from overseas sources for which they get foreign tax credits. They may not pay taxes to the U.S. government but they nonetheless bear a burden from the lower interest rates they receive on tax-exempt bonds or the income taxes they pay to other countries.

**Percentage of Tax Units With Zero or Negative Federal Tax Liability by Cash Income Level, Current Law, and a Simplified Tax System, 2010**

Cash Income Level	Percentage of All Tax Units	Current Law		Simplified System	
		Income Tax Only	Income Plus Payroll Tax	Income Tax Only	Income Plus Payroll Tax
Less than \$20,000	29.7%	89.9%	51.6%	72.1%	30.8%
\$20,000-\$50,000	31.5%	48.2%	22.2%	15.2%	10.2%
\$50,000-\$100,000	22.7%	12.5%	2.0%	2.7%	1.4%
More than \$100,000	16.2%	2.0%	0.6%	0.7%	0.3%
All tax units	100.0%	45.0%	22.9%	27.0%	12.7%

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0509-4).

Note: The simplified tax system allows no dependent exemptions, itemized deductions, or personal credits.



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