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## Amid Grim Census Data on Poverty, Congress Should Reject Calls to Raise Taxes on Low-Income Families

The 15.1 percent of individuals and 11.7 percent of families living in poverty in 2010 according to newly released Census data are the Americans most likely to be harmed by calls in Congress to address the large numbers of people who allegedly are “paying no taxes.”<sup>1</sup>

Aside from recipients of Social Security benefits (which are largely untaxed), all but the poorest Americans do pay federal income taxes or federal payroll taxes or both. We estimate that in 2010, only 15 percent of non-Social Security taxpayers paid zero dollars or less in combined federal income and payroll taxes.<sup>2</sup> These families and individuals pay other types of taxes, as this report explains.

Fifty-seven percent of those who paid zero or less in combined federal income and payroll taxes had incomes below \$15,000, and 76 percent had incomes below \$20,000. This tells us that the vast majority of these taxpayers were quite poor because the average poverty threshold for 2010 was \$14,218 for a household of two individuals and \$22,314 for a household of four individuals.<sup>3</sup>

Some commentators and lawmakers have recently expressed alarm at the number of Americans not paying federal income taxes, often ignoring the other types of federal, state and local taxes that people pay. For example, the Washington Post informed us on “tax day” that

There are so many breaks that 45 percent of U.S. households will pay no federal income tax for 2010, according to estimates by the Tax Policy Center, a Washington think tank. “It’s the fact that we are using the tax code both to collect revenue, which is its primary purpose, and to deliver these spending benefits that we run into the situation where so many people are paying no taxes,” said Roberton Williams, a senior fellow at the center.<sup>4</sup>

The first problem with this way of thinking is that it focuses on just one tax, the federal income tax. The reality is that it’s virtually impossible to live in America without paying any taxes. The second problem is that lawmakers acting on this misinformation may reduce or eliminate provisions like the Earned Income Tax Credit and the Child Tax Credit that relieve some low-income working people of federal income taxes, and the results will make today’s poverty data look rosy in comparison.

Income Group	Percent of Taxpayers	Share of Total
Under \$5,000	59%	22%
\$5,000—\$10,000	41%	16%
\$10,000—\$15,000	39%	19%
\$15,000—\$20,000	36%	19%
\$20,000—\$30,000	20%	19%
\$30,000—\$40,000	4%	4%
\$40,000—\$50,000	0%	0%
\$50,000 or more	0%	0%
<b>ALL</b>	<b>15%</b>	<b>100%</b>

Source: ITEP tax model, September 2011

## **Refundable Federal Income Tax Credits Help the Working Poor**

It is true that some people are too poor to pay federal income taxes, but that is just one of the many types of taxes that Americans pay. Some taxpayers have negative federal income liability, but this essentially serves to offset the other types of taxes that people pay. Negative federal income tax liability results when taxpayers can claim refundable income tax credits that exceed the amount of income tax liability they would otherwise have.

The refundable federal income tax credits that can result in negative federal income tax liability have received attention lately from those who claim that many Americans are “not paying taxes.” These refundable credits include the Earned Income Tax Credit (EITC), the Child Tax Credit (which for some poor families is partially, but not completely, refundable) and the Making Work Pay Credit (which was available only for 2009 and 2010).<sup>5</sup> *All of these credits are based on earnings, and therefore available only for people who work.*

These credits and other features of the federal income tax make it a progressive tax. Most of the other taxes that Americans pay (and which these refundable credits help offset) are regressive, meaning they take a larger share of a poor family’s budget than they take from a rich family.

Any efforts to make more poor people pay the federal income tax (by reducing or eliminating these refundable credits) would make the tax system regressive overall and would push many working poor families further into poverty.

## **The Other Types of Taxes Americans Pay**

Most state and local taxes are regressive. Analyses that factor together all the state and local taxes paid in a given state find that only a few states have tax systems that are “flat,” meaning they take roughly the same share of income from taxpayers in each income group. No state has a tax system that is progressive.<sup>6</sup>

Everyone pays state and local taxes. Property taxes are levied by local governments in every state, and some states have state-level property taxes, too. Anyone who owns or rents a home pays property taxes. (Landlords pass part of the tax on in the form of higher rents.) Every state except Alaska, Delaware, Montana, New Hampshire and Washington has sales taxes, which affect everyone who shops. Every state levies gasoline taxes, which affect everyone who drives. Most state also levy income taxes. But many state income taxes are not particularly progressive.

There are also other federal taxes besides the federal income tax. Some federal taxes are relatively small, like the federal gas tax and other federal excise taxes. Federal gift and estate taxes are more significant, but these only affect the wealthy.

On the other hand, federal payroll taxes, which apply to wages only, are very significant and affect everyone who works. The federal payroll tax has two parts, the 12.4 percent tax on earnings (up to a capped level) to fund Social Security and the 2.9 percent tax on all earnings to fund Medicare.<sup>7</sup>

Employed people directly pay half of these taxes while employers directly pay the other half. But economists agree that the entire tax is ultimately born by workers because the employer half is passed on in the form of reduced compensation. (Self-employed people pay the entire tax directly.)

The larger payroll tax, the Social Security tax, is regressive for two reasons. First, it only applies to wages and exempts the types of investment income that are concentrated at the highest income levels. Second, the amount of wages that are subject to the Social Security payroll tax is capped at a level that increases automatically with overall wage growth. For example, in 2010, the Social Security payroll tax applied only to the first \$106,800 of wages that an individual earns during the year.

### America's Tax System as a Whole Is Just Barely Progressive

The provisions of the federal income tax that result in zero or negative income tax liability for low-income people generally offset the regressive impact of other taxes. As a result, America's tax system as a whole is just barely progressive, as illustrated by the nearby table.<sup>8</sup>

The share of total taxes (all federal, state and local taxes) paid by each income group is very similar to the share of income received by that income group.

For example, in 2010, the richest one percent of taxpayers paid 21.5 percent of total taxes in the U.S., but also received 20.3 percent of total income in the U.S.

On the other hand, the poorest fifth of taxpayers paid 2 percent of total taxes in 2010, but received just 3.5 percent of total income that year.

	Average cash income	Shares of		Taxes as a % of Income		
		Total income	Total taxes	Federal taxes	State & local taxes	Total taxes
Lowest 20%	\$ 12,500	3.5%	2.0%	3.9%	12.3%	<b>16.2%</b>
Second 20%	25,300	7.1%	5.2%	9.1%	11.6%	<b>20.7%</b>
Middle 20%	40,700	11.6%	10.3%	13.9%	11.2%	<b>25.1%</b>
Fourth 20%	66,300	19.0%	19.0%	17.3%	11.1%	<b>28.5%</b>
Next 10%	100,000	14.3%	15.1%	19.0%	11.0%	<b>30.0%</b>
Next 5%	140,000	10.2%	11.2%	20.5%	10.6%	<b>31.1%</b>
Next 4%	241,000	14.2%	15.6%	21.4%	9.9%	<b>31.3%</b>
Top 1%	1,254,000	20.3%	21.5%	22.1%	7.9%	<b>30.0%</b>
<b>ALL</b>	<b>68,200</b>	<b>100.0%</b>	<b>100.0%</b>	<b>18.1%</b>	<b>10.3%</b>	<b>28.4%</b>
<b>Addendum:</b>						
<b>Bottom 99%</b>	<b>\$ 56,200</b>	<b>79.8%</b>	<b>78.4%</b>	<b>16.9%</b>	<b>10.9%</b>	<b>27.9%</b>

**Notes:**  
1. Taxes include all federal, state & local taxes (personal and corporate income, payroll, property, sales, excise, estate etc.).  
2. For calculations of income shares and taxes as a % of income, income includes employer-paid FICA taxes and corporate profits net of taxable dividends, neither of which is included in the average cash income figures shown.  
Source: Institute on Taxation and Economic Policy Tax Model, April 2011  
**Citizens for Tax Justice, April 2011**

America's tax system is doing the bare minimum to address income inequality and poverty. The last thing we need is to change the system so that it taxes working poor families further into poverty.

<sup>1</sup> According to the U.S. Census Bureau, the percentage of individuals in poverty increased from 14.3 percent in 2009 to 15.1 in 2010, and the number of families in poverty increased from 11.1 percent in 2009 to 11.7 percent in 2010.

<sup>2</sup> The percentage of non-Social Security taxpayers paying zero or less dollars in combined federal income taxes would have been smaller (14 percent rather than 15 percent) if not for the temporary Making Work Pay tax credit that was in effect in 2010. This refundable credit, which was designed to boost consumer demand by putting spending money in the hands of low- and middle-income people, decreased federal income taxes for many people, some of whom had zero or negative federal income tax liability as a result.

<sup>3</sup> The poverty threshold for a household of a given size varies by the degree to which individuals in the household are children or adults. The poverty thresholds given here are the weighted averages for households of a given size according to the U.S. Census Bureau.

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<sup>4</sup> Stephen Ohlemacher, “For Richest, Federal Taxes Have Gone Down; For Some in U.S., They’re Nonexistent,” *Washington Post*, April 17, 2011.

<sup>5</sup> The income tax cuts enacted under President George W. Bush doubled the child tax credit from \$500 to \$1,000 and made it partially refundable and reduced the “marriage penalty” in the EITC. Laws enacted under President Obama increased the portion of the Child Tax Credit that is refundable, further reduced the “marriage penalty” in the EITC, and increased the EITC for families with three or more children. (The size of the EITC is already adjusted for families with zero, one or two children.) All of these changes expire at the end of 2012 if Congress does not extend them.

<sup>6</sup> Institute on Taxation and Economic Policy, “Who Pays? A Distributional Analysis of the Tax Systems in All 50 States?” November 2009.

<sup>7</sup> A provision in the health care reform law enacted in 2010 changes taxes financing Medicare, starting in 2013, so that they will become more progressive and apply to investment income for wealthy taxpayers in addition to earnings.

<sup>8</sup> The figures in this table were first published in a previous report. See Citizens for Tax Justice, “America’s Tax System Is Not as Progressive as You Think,” April 15, 2011.