



Who Pays No Taxes – and Why They’re No Pot of Gold

By **MICHELLE HIRSCH**, The Fiscal Times August 31, 2011

Nearly half of American households won't pay any federal income tax this year. That doesn't mean there's a big pot of revenue waiting to be tapped.

Decades of tax policy decisions have created a complicated system that vulnerable populations have grown to depend upon. The lowest-earning Americans have been taken off income tax rolls completely, and the tax bills of low-income workers, the elderly, and families raising children have been reduced through a series of tax credits, deductions and exclusions that have crept into the code and grown more generous with time. Only a small portion of the non-taxpayers are in the **upper income brackets** with lots of tax breaks.

This puts politicians on both sides of the aisle in a tight spot. While they promise not to raise taxes and to shrink government, the leading Republican contenders for the **2012 presidential nomination** cite the recent report from the nonpartisan Tax Policy Center that **46 percent of American households** won't pay federal income taxes in 2011 to argue that more Americans should help pay for government programs.

When Texas Gov. Rick Perry **declared his candidacy** earlier this month, he said he is “dismayed at the injustice that nearly half of all Americans don't even pay income tax.” In Iowa, he said, “Let everybody, as many people as possible... [help] pay for the government we have in this country.” Former Massachusetts Gov. Mitt Romney said in mid-August in Nashua, N.H., “We want to make sure people do pay their fair share. Half the people in this country pay no income tax at all.” Michele Bachmann said in July, “We need to broaden the (tax) base so that everybody pays something, even if it's a dollar,”

President Obama is among those calling for lower tax rates in exchange for eliminating **loopholes** and tax breaks for individuals and corporations. In a speech last week at an Arkansas Rotary Club, Sen. Mark Pryor, D-Ark., complained that tax breaks have taken too many people off the tax rolls. “It's hard to have a fair tax system where only about half the people are paying,” he said.

The Tax Policy Center's estimate means that some 76 million households won't pay federal income tax in 2011. But they still owe other taxes. About two-thirds pay payroll taxes, and most pay state and local income and sales taxes as well as excise taxes on gas, tobacco, cigarettes and alcohol. Of the one third who don't pay payroll taxes, more than half are elderly who no longer work, and just under half are families with incomes under \$20,000. Only about 1 percent of the population pays neither income nor payroll taxes and earns more than \$20,000 a year, according to the Tax Policy Center.

- **For 50 percent** of those that don't pay federal income taxes, standard deductions and personal exemptions are enough to counteract their taxable earnings. A couple with two children earning less than \$26,400, for example, will pay no federal income tax in 2011 because their \$11,600 standard deduction and four exemptions of \$3,700 cuts their taxable income to nil.
- **22 percent** are senior citizens who get a more generous standard deduction, can exclude some or all of their Social Security income and may have tax-exempt interest from mutual funds and municipal bonds. For those who itemize, charitable contributions and medical expense deductions also subtract from their tax liability.
- **15 percent** are working families, many of them low-income, who qualify for one or all of the Earned Income tax credit, the Child tax credit, the Child and Dependent Care tax credit. The earned-income credit is fully refundable, and the Child credit is partially refundable this year, meaning **some households may get refunds** from the government even if they owe no income taxes.
- **The remaining 13 percent** are a mix of mostly higher-income individuals with enough itemized **deductions** for items like mortgage interest, health payments, or charitable contributions, education tax credits, or tax exempt interest to zero out their income taxes.

“It's wrong to rail on the 46 percent of people who don't pay income tax,” said Paul Caron, a tax professor at the University of Cincinnati College of Law. “A fairer analysis takes into account all taxes paid—and by this measure, everyone has tax skin in the game,” he said.

It will be hard to change or eliminate the social policy-related tax provisions that knock millions of Americans off the federal income tax rolls, said Robertson Williams, a senior fellow at the Tax Policy Center. Not only would it risk alienating key voting blocs, such as senior citizens, but it could have a serious economic impact, he said. “It’s going to hurt the economy more if you raise taxes on the poor than the rich, because the poor spend every penny they’ve got,” Williams said. “If you take a dollar away from them in tax credits, that’s a dollar they don’t spend.”

Not everyone considers these tax breaks untouchable, however. “This proliferation of credits and benefits at the bottom has really gone too far,” said Chris Edwards, a senior fellow at the libertarian Cato Institute. “There are all kinds of pro-market policies the government can do to offset any harm caused to these people if it’s going to withdraw benefits,” he said. Repealing tariffs on goods from China and other countries would lower the cost of clothing and food for low-income Americans to balance the absence of tax credits, he said.