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## WHO PAYS TAXES?

### The Poor, the Rich, and Everyone In Between

BY ALEXANDRA FORTER SIROTA<sup>1</sup>

#### KEY FINDINGS

- Every household pays taxes. Even the poorest fifth of American households paid an average of one-sixth (16 percent) of their total income in federal, state, and local taxes in 2009.
- The wealthiest 1 percent of households in the country, with annual incomes averaging more than \$1.3 million, paid less than one-third (30.7 percent) of their incomes in total taxes in 2009. In 1970, the wealthiest 1 percent of households paid more than two-fifths (42 percent) of their income in federal taxes alone.
- Even if Congress lets the Bush tax cuts for the wealthiest Americans expire at the end of this year, they would still pay lower tax rates than they have for most of the last half-century.

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#### Wealthy, Middle-Class, and Poor Households All Pay Federal Taxes

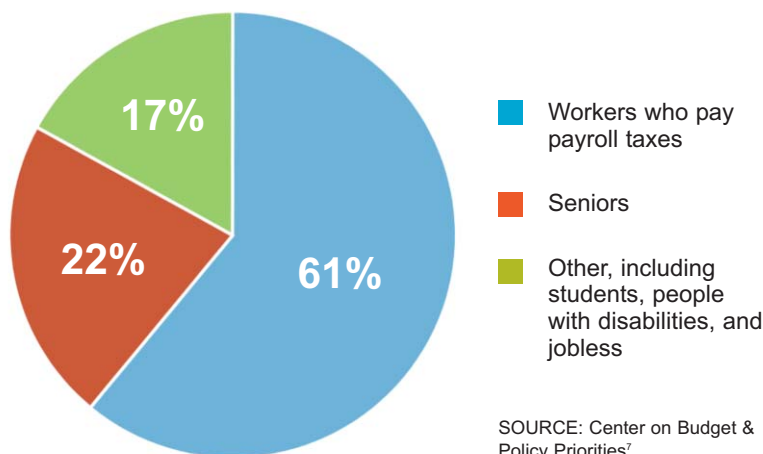
In recent days, there has been renewed discussion of who pays taxes. This discussion is especially important in light of upcoming federal decisions regarding what to do about the tax cuts passed under Presidents Bush and Obama (commonly known as the Bush tax cuts), which expire on December 31, 2012, as well as upcoming state efforts to reform North Carolina's revenue system, which will likely begin in 2013.

Americans who did not pay federal income taxes are front and center in this debate. While an estimated 46 percent of Americans did not pay *federal income tax* in 2011,<sup>2</sup> they contributed a very significant amount in other federal, state, and local taxes. Among those households that paid no federal income tax, two-thirds paid payroll taxes. And of those households that did not pay payroll taxes,

22 percent were seniors and 17 percent were students, people with disabilities and those who lost their jobs (See Figure 1).<sup>3</sup>

The combination of the tax cuts included in the American Recovery and Reinvestment Act of 2009 and the recession-induced loss of household income increased the share of households paying no federal income tax from 38 percent in 2007 to 46 percent in

**FIGURE 1:**  
**Who Doesn't Pay Federal Income Taxes?**



SOURCE: Center on Budget & Policy Priorities<sup>7</sup>

2011.<sup>4</sup> That is because many of the provisions of the Recovery Act were aimed at helping low- and moderate-income families maintain a minimum level of consumer spending during an otherwise steeply depressed economy, thus stimulating economic growth in their communities.

These policies were also intended to address the fact that lower-income households often pay a

larger share of their incomes in total taxes than the wealthiest people in the country do. If one accounts for all federal taxes—including income, payroll, excise, and corporate taxes—households with earnings in the bottom fifth of all households (with an average income of \$12,400 from all sources) paid almost 4 percent of their income in federal taxes<sup>5</sup> and an average 16 percent of their total income in federal, state, and local taxes.<sup>6</sup>

### State and Local Taxes Hit Low-Income Families Hardest

In nearly all states, limiting the discussion to federal taxes distorts the facts about who pays taxes. That's because low- and middle-income families pay a greater share of their incomes in state and local taxes than high-income families. Only two states require their best-off residents to pay as much of their incomes in state and local taxes as their very poorest taxpayers pay.<sup>8</sup>

The federal tax system plays an important role in bringing greater balance to taxes overall—the relative progressivity in the federal tax system offsets to some extent the regressivity of the state and local tax system. The share of total taxes paid across income groups is similar to the distribution of total income across income groups. The real-world impact of the country's current tax policies is that families in poverty are forced to forgo some basic necessities to pay their taxes, while the wealthiest households merely reduce their savings rate.<sup>9</sup>

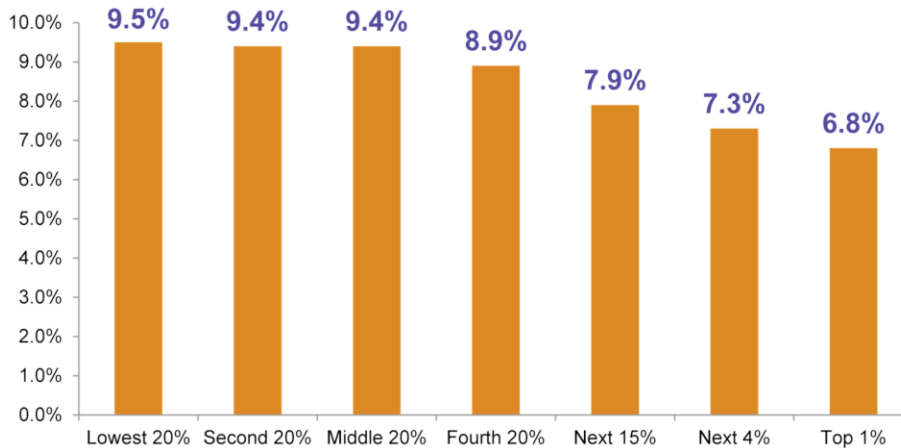
A historical perspective provides further evidence that the richest Americans are much better off today than in the past. Research by economists Thomas Piketty and Emmanuel Saez and data from Institute on Taxation and Economic Policy show that the wealthiest 1 percent of households paid nearly 45 percent of their income in

## WHO PAYS TAXES IN NORTH CAROLINA?

In North Carolina, the most recent available data on who pays taxes demonstrates that the poorest fifth of North Carolinians pay an average of 9.5

**FIGURE 2: Low- and Middle-Income Families Pay Greater Share of Income in State and Local Taxes than Wealthy**

State and Local Taxes as a Share of Household Income in North Carolina



SOURCE: Institute on Taxation and Economic Policy – November 2009  
Includes “federal offset” for reduced federal income taxes for state and local taxes deducted from federal taxable income.

percent—almost one of every 10 dollars—of their incomes in taxes. The richest 1 percent of households in North Carolina, with annual incomes averaging more than \$1.3 million, pay \$1 of every \$14 in income.<sup>10</sup>

The over-reliance on contributions from low-income households in North Carolina is problematic for the long-term adequacy of the state’s revenue collections.

Because low- and moderate-income households have seen their wages and income stagnate and even decline in recent decades, while upper-income households have continued to see growth, it will be difficult to maintain revenue levels based on greater contributions for those least able to pay.

federal taxes in the 1960s and 70s versus a mere 22.3 percent of their income in 2009. For the wealthiest 0.01 percent of households, federal tax rates of more than 70 percent in the 1960s and 70s declined to only 31.5 percent in 2005 (data from 2005 are the most recent available for top 0.01 percent<sup>11</sup>).<sup>12</sup> Ironically, these reductions in the federal tax rates for the wealthiest households occurred during the same 30-year time period that the incomes of the wealthiest 1 percent nearly tripled, while incomes of the bottom 90 percent remained virtually stagnant.<sup>13</sup>

The statistics demonstrate that the wealthiest households—not the middle and working classes—have benefited disproportionately from the economic and tax policies pursued by the country’s political leaders during the past three decades. Congress will soon decide whether to allow tax rates on these wealthiest households—those with annual incomes of more than \$250,000—to revert to the levels of the 1990s. And policymakers in North Carolina will soon review the state’s tax code and should consider ways to ensure that those with the most income

contribute the greatest amount as a share of their incomes. It is critical that such decisions be based on the reality that everyone pays taxes and the principle that both the federal and state tax system should be based on ability to pay.

- 1 Special thanks to Edwin McLenaghan whose earlier publication on this topic from November 2010 served as the foundation for this product.
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