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BTC Brief

▶ NC BUDGET & TAX CENTER

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WHO PAYS TAXES? The Poor, the Rich, and Everyone In Between

Timely, accessible, and credible analysis of state and local budget and tax issues

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KEY FINDINGS:

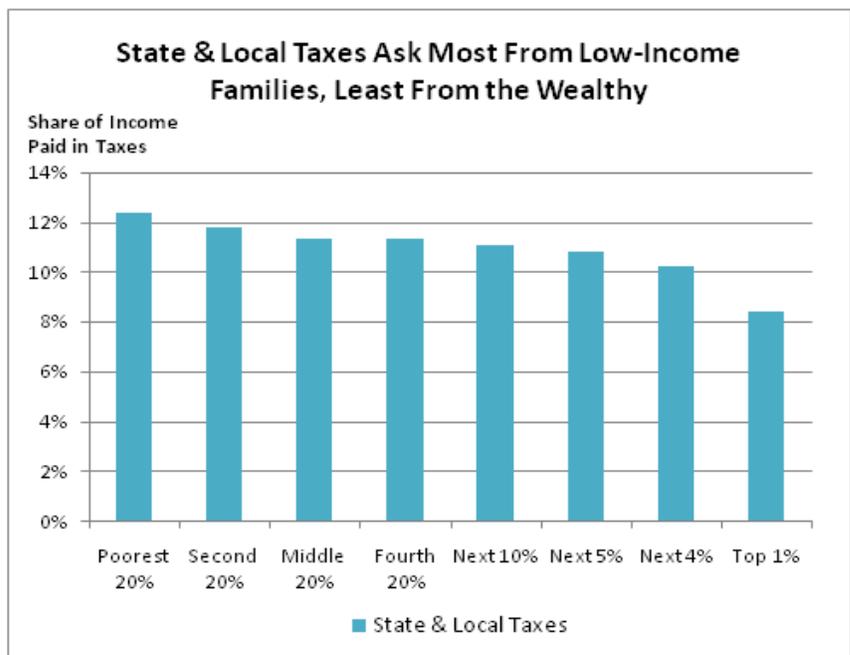
- **Every household pays taxes, and even the poorest fifth of American households paid an average of one-sixth (16 percent) of their total income in federal, state, and local taxes in 2009.**
- **The wealthiest 1 percent of households in the country, with annual incomes averaging over \$1.3 million, paid under one-third (30.7 percent) of their income in total taxes in 2009. In 1970, the wealthiest 1 percent of households paid over two-fifths (42 percent) of their income in federal taxes alone.**
- **Low- and middle-income families with stagnating and declining incomes often forgo basic necessities to pay their federal, state, and local taxes. The wealthy pay their taxes by reducing their savings rate.**
- **Letting the Bush tax cuts for the wealthiest expire and using the revenue for pro-jobs policies would still leave the wealthiest paying lower tax rates than they have for most of the last half-century and put the economy on the path to recovery.**

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

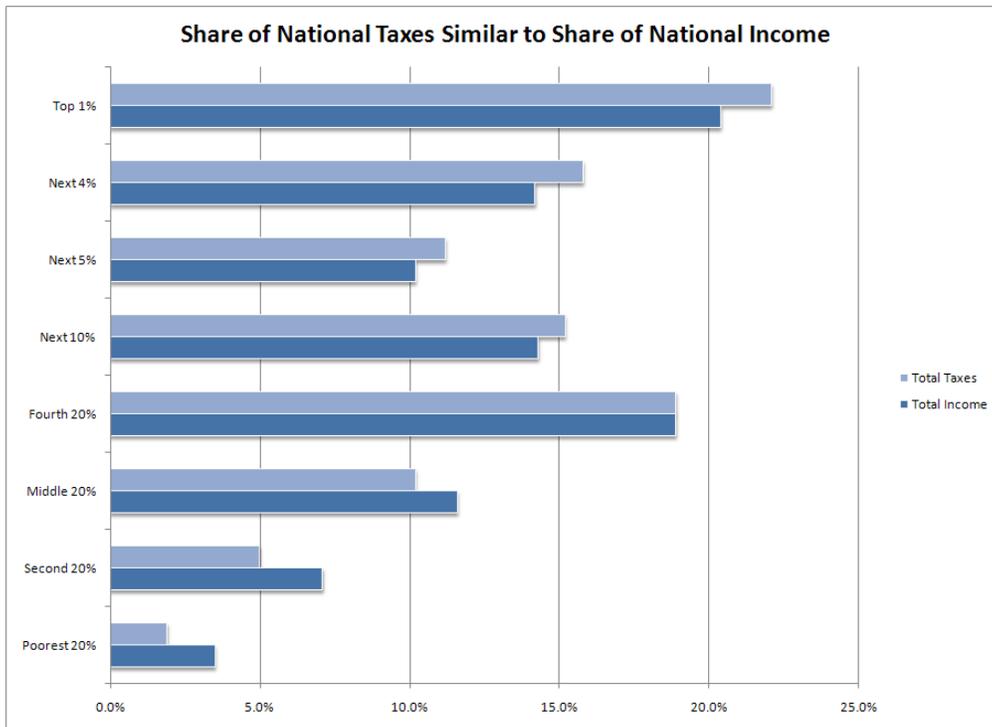
With the Bush tax cuts set to expire in 52 days, there are likely to be a lot of myths popping up about the state of taxation in the country.

One myth that is almost sure to reappear is the claim that half of American households don't pay taxes. The truth is that virtually every household pays taxes, and even the poorest fifth of American households pay an average 16 percent of their total income in federal,

FIGURE 1



SOURCE: Source: Citizens for Tax Justice, April 2010

FIGURE 2

SOURCE: Source: Citizens for Tax Justice, April 2010

state, and local taxes.¹ And not only do the poorest households pay taxes, the taxes they pay—by forcing these families to cut back on basic necessities—have a much greater impact on their quality of life than the taxes paid by higher-income households.

It is true that the combination of the tax cuts included in the federal Recovery Act plus the recession-induced loss of income increased the share of households paying no federal income tax from 38 percent in 2007 to 47 percent in 2009.² Among those households that paid no federal income tax, however, two-thirds paid payroll taxes. And of those households that did not pay payroll taxes, most were either elderly households or households earning less than \$20,000 per year.³

And that's only looking at two types of federal taxes. If one accounts for all federal taxes— income, payroll, excise, and corporate—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.⁴ That's right: even families with incomes inadequate to provide a meager standard of living and below the federal poverty line for a family of three or more still pay federal taxes.

State and Local Taxes Hit Low-Income Families Hardest

Yet limiting the discussion to federal taxes distorts the fact of who really pays taxes. That's because low- and middle-income families pay a greater share of their income in state and local taxes than high-income families.⁵

If one accounts for all taxes paid by American households, it becomes obvious that no one gets a free ride. Data from the Institute on Taxation and Economic Policy (ITEP, see Figure 1) shows that the poorest fifth of American families pay an average of 16 percent—almost one of every six dollars—of their income in taxes. Even the wealthiest 1 percent of households in the country, with annual incomes averaging over \$1.3 million, paid under one-third of their income in total taxes.⁶ Figure 2 shows furthermore that the share of distribution of taxes paid across income groups is similar to the distribution of 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.⁷

Taking a historical perspective, it's clear that the wealthy—especially the super-rich—are much better off today than in the past. Research by economists Thomas Piketty and Emmanuel Saez and data from ITEP show that the wealthiest 1 percent of households paid nearly 45 percent of their income in 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 over 70 percent in the 1960s and 70s have declined to only 31.5 percent in 2005 (data from 2005 are the most recent available for top 0.01 percent⁸; see Figure 3).⁹ Ironically, these reductions in the federal tax rates for the wealthiest households have occurred during the same 30-year time period that the incomes of the wealthiest 1 percent have nearly tripled while incomes of the bottom 90 percent have remained virtually stagnant (See Figure 4).¹⁰

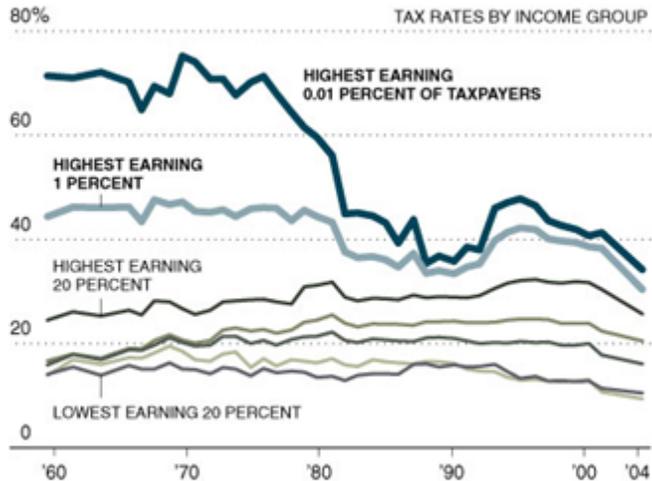
The statistics demonstrate that the wealthiest households—not the middle and working classes—have benefited disproportionately from the economic and tax policies pursued by the country's political leaders during the past three decades. Congress will soon decide whether to allow tax rates on these wealthiest households—those with annual incomes above \$250,000—to revert to the levels of the 1990s.

Members of Congress should base their decision on the reality of who pays taxes, not on myths. The reality is that many low- and middle-income families with stagnating and declining incomes forgo basic necessities to pay their

FIGURE 3

Shifting the Tax Burden

Compared with the 1960s, the highest and the lowest earners pay a smaller share of their income in federal taxes, while those in the middle pay somewhat more.



Numbers include income taxes, capital gains taxes, payroll taxes, estate taxes, gift taxes and corporate taxes (which are effectively paid by stockholders). 2004 tax rates are based on 2004 tax law applied to 2000 income adjusted for income growth.

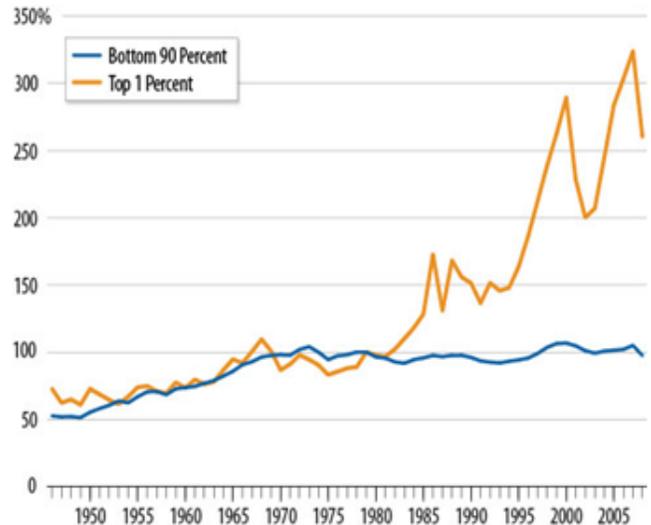
SOURCE: Thomas Piketty and Emmanuel Saez

THE NEW YORK TIMES

FIGURE 4

Uneven Distribution of Gains Contrasts with Earlier Era, When Growth Was Widely Shared

Average income between 1946 and 2008, as a percent of 1979 level



SOURCE: CBPP calculations based on data from Piketty and Saez.

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federal, state, and local taxes. For the wealthiest households, paying their tax bills has arguably never been so easy. Furthermore, extending the Bush tax cuts for the wealthiest households is, compared to nearly a dozen other policy options, the least cost-effective for creating jobs.¹¹ Letting the Bush tax cuts for the wealthiest expire and using the revenue for pro-jobs policies would still leave the wealthiest paying lower tax rates than they have for most of the last half-century and put the economy on the path to recovery.

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- 4 Citizens for Tax Justice. Ibid.
- 5 Institute on Taxation and Economic Policy. "Who Pays." November 2009. <http://www.itepnet.org/whopays.htm>
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- 8 Congressional Budget Office. "Historical Effective Tax Rates, 1979 to 2005: Supplement with Additional Data on Sources of Income and High-Income Households," December 2008. <http://www.cbo.gov/publications/collections/collections.cfm?collect=13>
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