TAX FOUNDATION Since 1937

TAX FEATURES

www.taxfoundation.org March/April 2004 Volume 48, Number 2

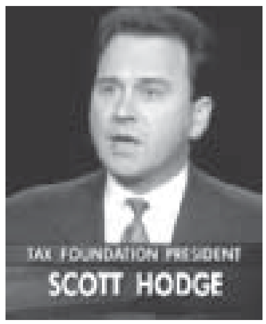
44 Million Will File Tax Returns But Pay Nothing

Tax Foundation Project to "Put a Face on America's Tax Returns" Describes the People Behind the Tax Returns

As reported on Fox-News' *Special Report with Brit Hume*, a new Tax Foundation study shows that 44 million American tax returns are filed by people who owe nothing for the whole year.

The number of these "zero-tax filers" is up dramatically since the passage of the $500 child tax credit in 1997, which the 2001 Bush tax cut doubled to $1,000 per child.

People who over-withheld during the year and just get a small refund are not counted among the 44 million.



On the April 15 Fox News Special Report, Major Garrett's interview of Scott Hodge broke the story that 44 million taxpayers file their 1040s with a valid request that every dollar withheld from them during the year be returned.

Almost a Third of All Tax Filers Owe Nothing for the Year

By midnight on April 15, 2005, less than a year from now, Americans will have filed roughly 132 million tax returns with the IRS. While most of the tax day stories will focus on how much less people are paying because of the 2001 and 2003 tax cuts, little attention will be given to the millions of Americans who will have no income tax liability at all.

Tax Foundation economists estimate that for tax year 2004, a record 44 million tax filers will be correctly demanding the return of every dollar (or more) that is being withheld from their paychecks during the year. In other words, after taking all the available credits and deductions, they will owe no

Table 1: Growing Share of Zero-Tax Filers

	Number of Zero-Tax Filers (in Millions)	Zero-Tax Filers as a Percentage of All Filers
1980	18.6	19.8%
1985	16.7	16.5%
1990	21.5	19.0%
1995	26.7	22.6%
2000	29.9	23.1%
2004 est.	44.0	33.0%

Source: Tax Foundation Individual Income Tax Model, based on data from IRS.

See Zero-Tax Filers on page 8

In this issue:

FRONT & CENTER

Why We Need Permanent Repeal of the Death Tax

Jennifer Dunn, U.S. Representative from the 8th District of Washington

6-7

Tax Freedom Day in 2004 Is April 11

Earliest Date Since 1967 Reflects Remarkable Drop in Tax Burden

Tax Freedom Day® in 2004 was celebrated on April 11, the earliest Tax Freedom Day in 37 years.

Each year in early April, the Tax Foundation uses the latest available government data on income and taxes to calculate Tax Freedom Day for the nation and the 50 states.

April 11 is three days earlier than 2003's Tax Freedom Day of April 14 and an amazing 21 days earlier than in 2000, when the boom and bubble pushed tax burdens to a record high, and Tax Freedom Day was postponed until May 2 (see Figure 1).

"Federal tax cuts have made the average American tax burden lighter in 2004," said Tax Foundation President Scott Hodge. "Because the bubble in 1999 and 2000 boosted tax collections to artificially high levels, the drop since then is all the more dramatic. In fact, it is the biggest drop in America's tax burden for at least a century."

The report is No. 129 in the *Tax Foundation Special Report* series, titled "America Celebrates Tax Freedom Day®," by Scott Hodge and Foundation Senior Economist Scott Moody. The report traces the course of America's tax burden since 1900, examines the composition of today's tax burden by type of tax, projects the future course of Tax Freedom Day and compares tax payments to other typical consumer expenditures.

What is Tax Freedom Day?

Tax Freedom Day is the day when Americans will have earned enough money to pay off their total tax bill for the year. Every dollar that's officially called income by the government is counted, and every payment to the government that is officially considered a tax is counted. Taxes at all levels of government are included, whether levied by Uncle Sam or state and local governments.

Tax Freedom Day gives Americans an easy way to gauge the overall tax take, a task that can be quite daunting due to the multiplicity of taxes at each level of government, especially the

> ***"Despite the dramatically lower tax burden in 2004, Americans will still spend more on taxes than they spend on food, clothing and medical care combined."***
>
> ***— Foundation President Scott Hodge***

Figure 1: Tax Freedom Day, 1963–2004

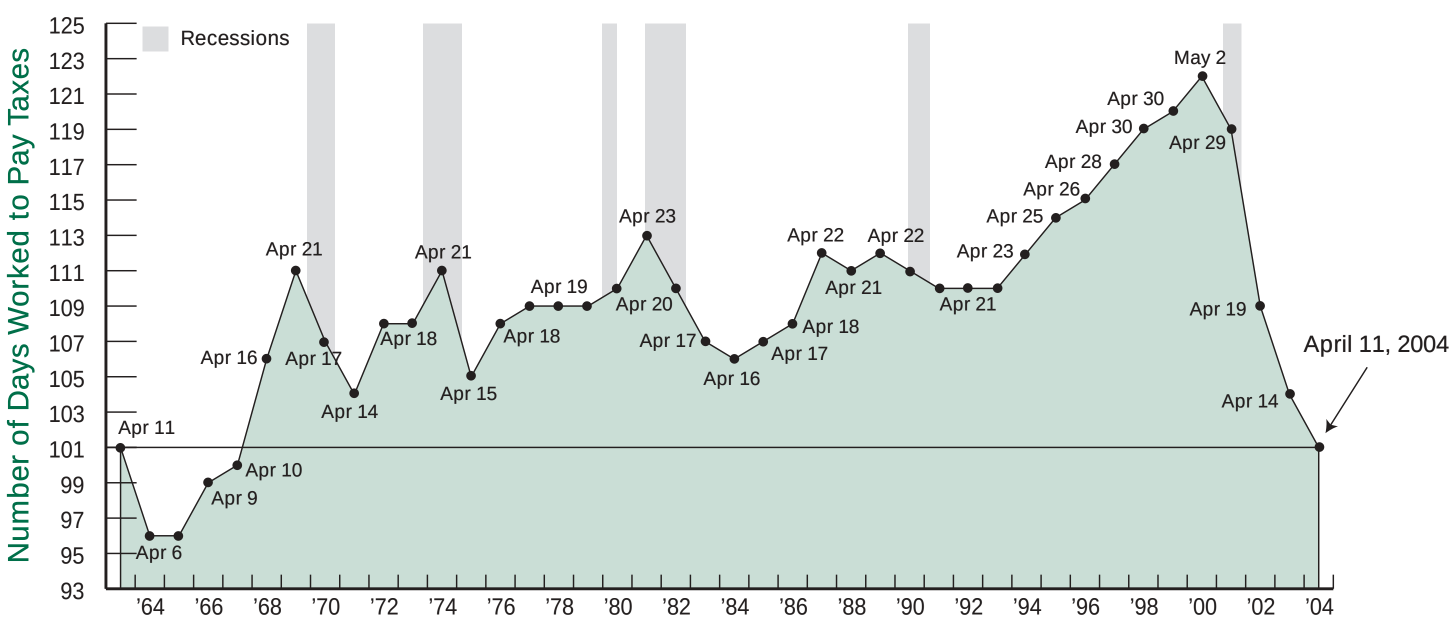


Figure 2: How Long Americans Work to Pay Taxes Compared to Other Major Spending Categories, 2004

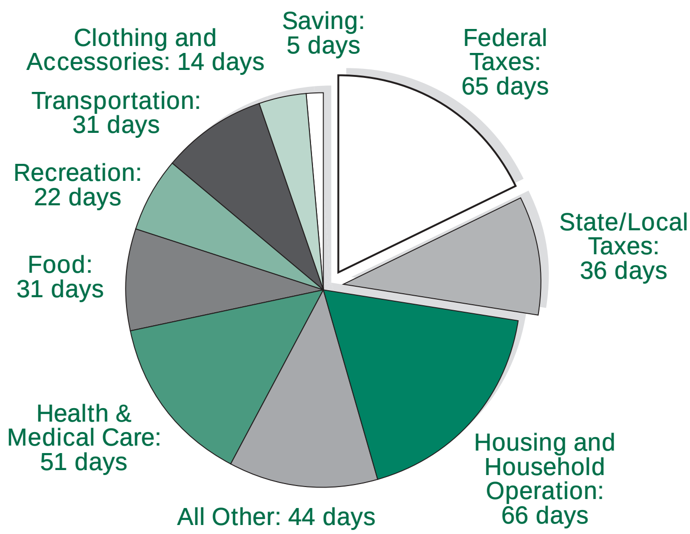
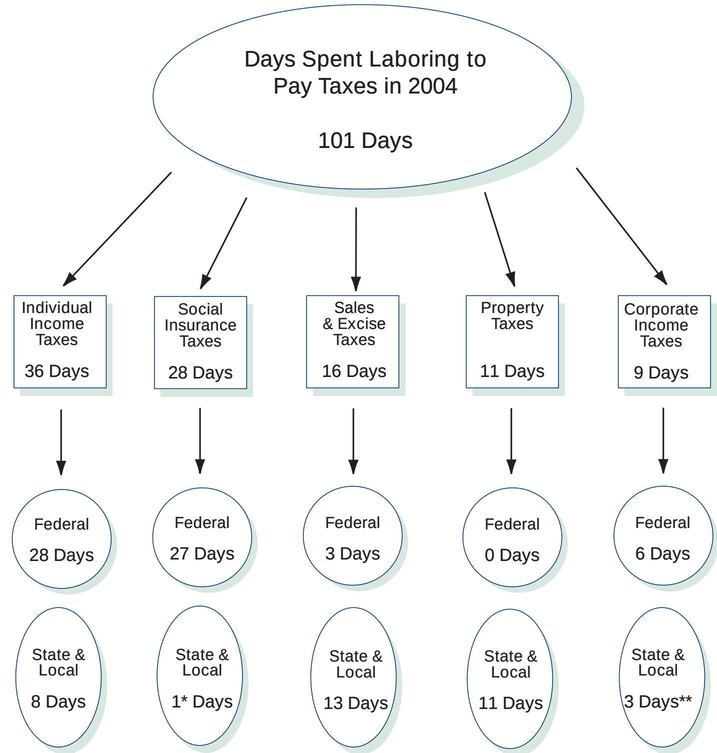


Figure 3: Days Worked by Type of Tax



"hidden" taxes and fees that are often buried in the cost of living. In effect, Tax Freedom Day provides taxpayers with a tax barometer that measures the total tax burden over time and by state.

The Origin and Popularity of Tax Freedom Day

The concept of Tax Freedom Day was invented in 1948 by Florida businessman Dallas Hostetler. He copyrighted the name and calculated Tax Freedom Day himself for many years. Upon retirement in 1972, he assigned the intellectual property rights to the Tax Foundation which has promoted the concept ever since.

The idea has spread around the world, with independent research groups in India, Great Britain, Canada, and several other nations calculating their national Tax Freedom Day.

How the Date Is Computed

Tax Foundation economists project the nation's effective tax rate, 27.8 percent this year, then apply that percentage to a calendar year, providing a graphic illustration of how long Americans work for government.

The income figure used is Net National Product (NNP), computed annually by the Commerce Department's Bureau of Economic Analysis (BEA). BEA revises its entire historical series frequently, so the new report on Tax Freedom Day is the only valid source for historical or current data used to calculate Tax Freedom Day, either at the national or state level.

The Projected Course of Tax Freedom Day

Tax legislation being debated right now will affect the course of future Tax Freedom Days. The President wants to keep such popular tax cuts as the child tax credit, the 10-percent bracket, and the marriage penalty relief at their most generous levels, which they have reached in 2004, rather than let them dip as they are scheduled to do under current law. Senator Kerry also speaks out in favor of those tax cuts but promises repeal of tax cuts for higher-income taxpayers.

If current law prevails, the tax burden will start growing again, and Tax Freedom Day will fall later in April.

Taxes and Other Expenses

The report also compares the number of days Americans work to pay taxes to the number of days they work to support themselves.

"Despite the dramatically lower tax burden in 2004, Americans will still spend more on taxes than they spend on food, clothing and medical care combined," said Hodge.

In 2004, Americans will work 65 days to afford their federal taxes and 36 more days to afford state and local taxes. Other categories of spending that require many days of labor to afford are housing and household operation (66 days), health and medical care (51 days), food (31 days), transportation (31 days), recreation (22 days), clothing and accessories (14 days), saving (5 days) and all other (44 days). See Figure 2.

Tax Freedom by Type of Tax

As most taxpayers are aware, income taxes are the type of tax that we work longest for — 36 days, with 28 of those days worked for Uncle Sam and 8 more days to pay off state and local income taxes. Social insurance taxes which along with income taxes are deducted directly from most people's paychecks, require 28 days' worth of work to pay for. Sales and excise taxes require 16 days of work, property taxes 11 days and business taxes 9 days. See Figure 3.

Tax Freedom Day by State

Tax burdens vary considerably from state to state, not only because of different state and local taxes, but because of divergent federal tax payments. Therefore, the report includes a separate calculation of Tax Freedom Day for each state.

Of the ten states with the heaviest tax burdens and who therefore wait the longest for Tax Freedom Day, many are in the northeast: Connecticut (April 28), New York (April 27), New Jersey (April 19), Massachusetts (April 18), Rhode Island (April 16), Maine (April 15), Washington (April 15), Wyoming (April 14), Nevada (April 13) and California (April 13).

Because the cost of living is higher in these states, and salaries are commensurately higher, more taxpayers bump up into the higher tax rates. Because the dollar amounts that define tax brackets are fixed nationwide, taxpayers in the northeast and other high-cost regions pay much more in federal income taxes, even if they don't have more disposable income.

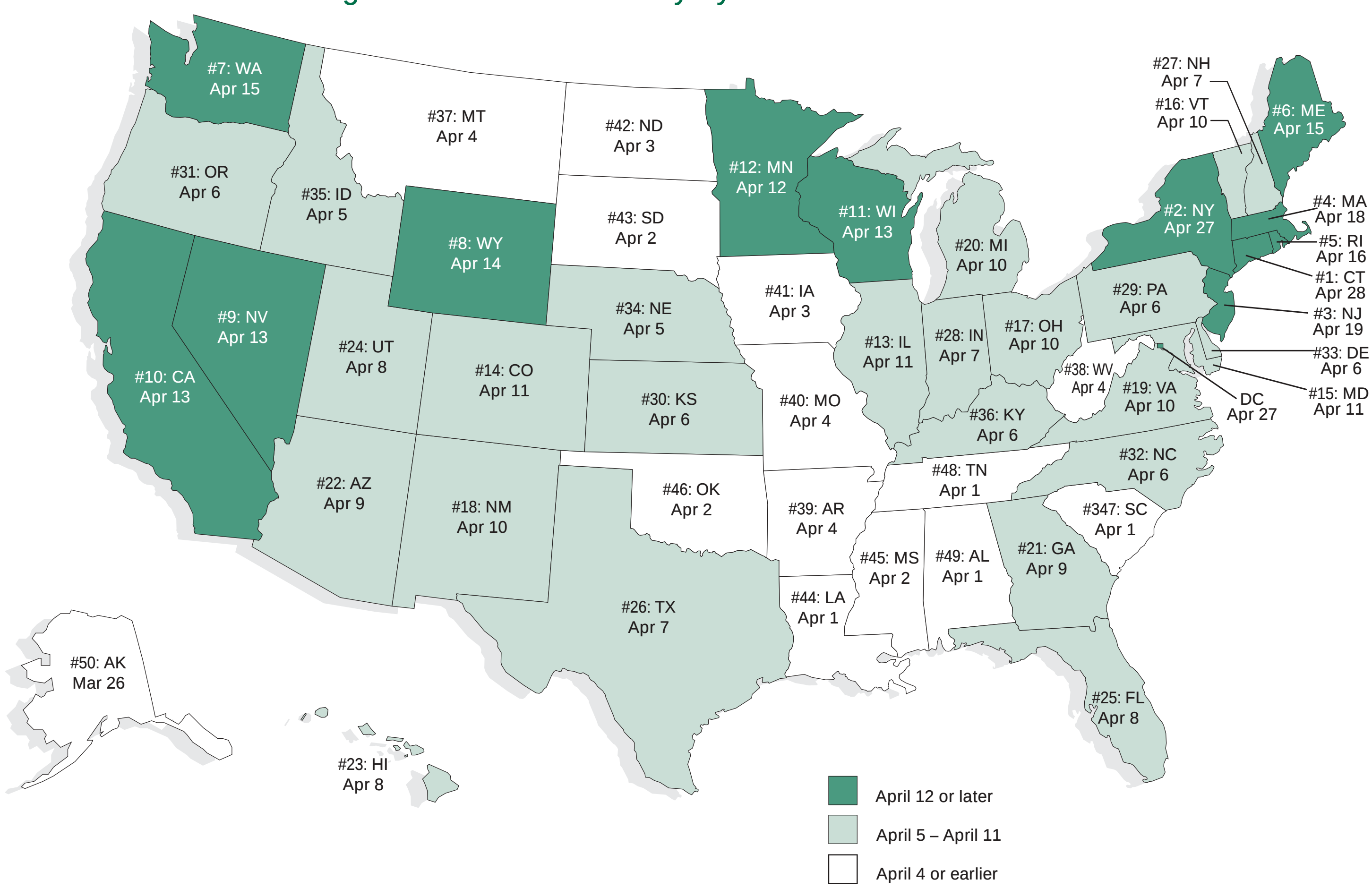
For example, a childless couple living in Boston has to make $100,000 a year to live the median lifestyle. A similar couple in Atlanta can maintain the median lifestyle by earning just $71,000. In San Francisco the couple would have to make $132,000, and in Manhattan, $159,000. These couples all live roughly the same lifestyle, and they all have about the same amount of savings left at the end of the year, but the amount Uncle Sam will be expecting in April is quite different.

In Atlanta, the couple would pay the 10-percent or 15-percent tax rates on most of its income, with a small fraction of its income taxed at 25 percent. The Boston couple's income would fall into the same three brackets, but a much larger share would be taxed at 25 percent. The San Francisco couple not only pay at the 10 percent, 15-percent and 25-percent rates, but they would break into the 28-percent bracket for a small amount of their income. The Manhattan couple would pay at those same rates, but they would pay the 28-percent rate on a much greater fraction of their income.

In total, the federal income tax liability for this couple would vary from about $7,600 in Atlanta, to $14,800 in Boston, to $22,800 in San Francisco, and $30,500 in Manhattan.

The states with the lightest total tax burdens celebrate Tax Freedom

Figure 4: Tax Freedom Day by State and Rank in 2004



Day the earliest. March 26 is the earliest of all; that's when Alaskans will celebrate. Alabama, Tennessee and South Carolina have the second, third and fourth lightest total tax burdens, and they were all done working for government on April 1. Four states celebrated tax freedom on April 2: Oklahoma, Mississippi, Louisiana and South Dakota. North Dakota and Iowa celebrated April 3. See Figure 4 for each state's Tax Freedom Day.

Comparing State/Local Tax Burdens

To facilitate comparisons of state-local tax burdens, the report includes a state-by-state ranking of tax burdens with federal taxes excluded. This year, the nation's average state-local tax burden is 10.0 percent of residents' income, with the highest being New York's 12.9 percent and the lowest being Alaska's 6.3 percent.

For historical comparison, the Tax Foundation has posted on its website new estimates of combined state-local tax burdens for years 1970–2004. See the State Finance section of the Foundation's web site.

Publication Summary

General: Special Report No. 129; ISSN 1068-0306; 16pp.; $10 or $50/yr. for at least 6 Special Reports on varied fiscal issues

Title: America Celebrates Tax Freedom Day®

Authors: J. Scott Moody & Scott Hodge

Date: April 2004

Subject: Calculation of the total effective tax rate for the United States, and for each of the 50 states plus the District of Columbia

Tables: Tax Freedom Day & Total Effective Tax Rate by Level of Government, 1900–2004; Tax Freedom Day by State and Rank, 1970–2004; Tax Freedom Day by State, by Rank, 2004; Days Spent Working to Pay All Taxes in Each State, Total Taxes as a Percentage of Income, Per Capita and Rank, 2004; Days Spent Working to Pay Federal Taxes in Each State, Federal Taxes as a Percentage of Income, Per Capita and Rank, 2004; Days Spent Working to Pay State/Local Taxes in Each State, Per Capita and Rank, 2004; State and Local Tax Incidence Results by State, 2004

Table 1: Days Spent Working for State-Local Taxes in Each State, State-Local Taxes as a Percentage of Income, Per Capita and Rank

Calendar Year 2004

	State-Local Tax Burden Rank (1 is Highest)	Days Spent Working to Pay State and Local Taxes	State-Local Tax Burden as a Percentage of Income	State-Local Tax Burden Per Capita	Income Per Capita
United States	-	36	10.0%	$ 3,490	$ 35,039
Alabama	41	33	9.1%	$ 2,612	$ 28,798
Alaska	50	23	6.3	2,287	36,267
Arizona	20	36	10.0	2,935	29,491
Arkansas	25	35	9.8	2,638	26,788
California	26	35	9.8	3,676	37,456
Colorado	40	33	9.1%	$ 3,391	$ 37,154
Connecticut	9	38	10.6	5,119	48,489
Delaware	48	29	8.2	3,008	36,665
Florida	45	32	8.8	2,938	33,322
Georgia	18	36	10.0	3,242	32,457
Hawaii	4	41	11.3%	$ 3,865	$ 34,173
Idaho	11	37	10.4	2,956	28,474
Illinois	32	35	9.7	3,661	37,695
Indiana	16	36	10.1	3,241	32,127
Iowa	27	35	9.8	3,211	32,777
Kansas	22	36	9.9%	$ 3,273	$ 32,999
Kentucky	17	36	10.0	2,938	29,343
Louisiana	23	36	9.9	2,882	29,107
Maine	2	44	12.3	3,907	31,885
Maryland	24	36	9.9	4,059	41,079
Massachusetts	36	34	9.4%	$ 4,177	$ 44,410
Michigan	13	37	10.2	3,495	34,222
Minnesota	10	38	10.5	4,066	38,829
Mississippi	19	36	10.0	2,573	25,814
Missouri	38	33	9.3	3,058	32,840
Montana	28	35	9.8%	$ 2,796	$ 28,666
Nebraska	14	37	10.2	3,512	34,499
Nevada	30	35	9.7	3,289	33,770
New Hampshire	49	27	7.5	2,906	38,918
New Jersey	15	36	10.1	4,567	45,099
New Mexico	29	35	9.7%	$ 2,671	$ 27,407
New York	1	46	12.9	5,230	40,685
North Carolina	31	35	9.7	3,009	30,899
North Dakota	33	35	9.7	3,093	31,917
Ohio	3	41	11.3	3,777	33,370
Oklahoma	39	33	9.2%	$ 2,646	$ 28,667
Oregon	34	34	9.5	3,044	32,162
Pennsylvania	35	34	9.4	3,432	36,401
Rhode Island	5	40	11.1	3,976	35,704
South Carolina	43	32	9.0	2,584	28,772
South Dakota	42	32	9.0%	$ 2,880	$ 32,052
Tennessee	47	30	8.5	2,630	31,112
Texas	46	31	8.7	2,797	31,967
Utah	7	39	10.8	2,915	27,094
Vermont	12	37	10.4	3,527	33,981
Virginia	37	34	9.3%	$ 3,453	$ 37,044
Washington	21	36	9.9	3,729	37,502
West Virginia	8	38	10.6	2,842	26,882
Wisconsin	6	40	11.1	3,807	34,292
Wyoming	44	32	8.9	3,162	35,461
District of Columbia	-	46	12.8%	$ 6,418	$ 50,126

Note: Measure of income is net state product.

Sources: Bureau of Economic Analysis and Tax Foundation calculations.

Why We Need Permanent Repeal Of the Death Tax

FRONT & CENTER

by Rep. Jennifer Dunn (R-WA)

Einstein said that "God does not play dice with the universe." Unfortunately, Congress is doing just that with the death tax. An untold number of taxpayers — as well as the states in which they reside — are losing as a result.

One of the most under-reported and remarkable stories about the tax policy debates of the last three years is the success of our effort to repeal the death tax. Over the last several years, a grassroots coalition of small businessmen and women, minority entrepreneurs, family farmers, local chambers of commerce, automobile dealers, contractors and family-owned newspapers has worked tirelessly to educate the public and legislators about the detrimental effects of this tax. In large part, they have achieved their goal.

Public opinion polls show that an overwhelming majority of Americans oppose the death tax. They recognize it as both an unfair burden and poor public policy. And they would like to see it repealed.

That public support has translated directly into support on Capitol Hill and in the Bush Administration. The President has repeatedly stressed his desire to get rid of this tax once and for all. In his economic speeches, he underscores the importance not only of repealing the tax, but of making repeal permanent.

On Capitol Hill there is similar support. My legislation, HR 8, which would make repeal of the death tax permanent, passed the House of Representatives last June on a strong bipartisan vote of 264-163, slightly better than the vote that we received in 2002. That is not only a strong vote; it is a convincing repudiation of the notion put forward by some that support for repeal is fading and that it is time to compromise.

The death tax favors spending over saving, consumption over thrift, bureaucracy over family, federal programs over private farms and businesses, government over private enterprise. In short, it goes against the grain of just about every principle Americans believe in.

That is why this story is under-reported. The press focuses on the fact that the tax declines over the next several years, is repealed in 2010, but springs back on 2011. They rarely point out that support for repeal is strong, unwavering and growing.

Equally under-reported is why the tax has not been repealed permanently.

Our success in the House has not been duplicated in the Senate for a simple reason: the Senate is a separate body, and its own set of rules provides tremendous ability to the minority to obstruct and delay legislation. It is those rules — not the policy of repealing the tax — that has stalled our issue.

There is a bipartisan majority in the Senate today that would vote to repeal the death tax permanently. When votes have been taken in that body, over 50 Senators vote consistently in favor of making repeal permanent. But the Senate has its own ways of doing business. To pass a bill requires 51 votes. To defeat a filibuster requires 60 votes. We know that the coalition has the votes to pass the bill. There may be 51 or 55 or even 57 "yeas." But there are not yet the 60 votes to defeat a filibuster.

The effect of this is that Senate rules prevent us from getting a vote on the substance of the issue. Those rules protect the right of the minority to filibuster. We have seen the same tactic used on judicial nominations. We have seen it on tort reform. We have seen it on legislation updating our charitable giving laws. We also see it, unfortunately, on permanently repealing the death tax.

There is no dispute over the fact that proponents of repeal have won the day. Congress and the President are on record — we not only want this tax repealed, we have repealed it for one year, 2010. In fact, in its budget resolution adopted last month the Senate added an additional year of repeal. There can be no question, and there should be no debate, about the fact that the American people, the Congress and the President are in agreement: we should repeal the death tax.

But HR 8 is blocked because of a filibuster. It is unfortunate that an obstructionist minority is holding hostage an important piece of legislation. But we should never lose sight of the fact that it is a minority.

Some people do lose sight. They become discouraged and they are tempted to turn the last few years of legislative success on its head. Instead of looking at what we have won, they lose patience.

I believe we must not forget what our coalition has achieved, nor should we give in when we have come so far. The issue is too important.

Jennifer Dunn has announced her retirement from the House of Representatives at the end of this term. She has represented Washington's 8th District, just east of Seattle, since 1993. She received the Tax Foundation's Distinguished Service Award in 2000.

It is important because the policy choices we make surrounding the death tax go to the heart not just of our tax system but of who we are as a society. How should we tax? What should we tax? What are the implications of taking more capital out of the economy and turning it over to the Federal government? What values does our tax system reflect?

On issue after issue, the death tax fails such an examination. Look at the arguments of those who want to keep it.

"Responsible Wealth," as they call themselves, has gained notoriety through press conferences, editorials and other publications. The themes they strike in support of retaining the death tax are remarkable. They sometimes make good sound bites. But they make poor tax policy.

This group claims the estate tax spreads wealth. They say it creates economic opportunity. They say it promotes charitable giving. They say it prevents the accumulation of large private fortunes.

They are wrong on every count.

The tax doesn't create wealth; it diminishes it. It doesn't create economic opportunity; it reduces it. In two separate reports, in 1998 and 2003, the Joint Economic Committee looked at the policy implications of the tax and found that it should be repealed. In very clear terms, the Committee stated that "the estate tax generates costs to taxpayers, the economy, and the environment that far exceed any potential benefits that it might arguably produce."

Despite the rhetoric of some who say that this is only a tax felt by the wealthy, this year's Economic Report of the President made a salient point. The report (page 115) noted that "the reduction in estate building induced by the tax is likely to take the form of a reduction in capital accumulation. Because the estate and gift taxes are taxes on capital, part of their long-run burden is likely to be shifted to workers through a reduction in wage rates.... Part of the burden is therefore likely borne by ordinary workers who never receive a bequest or taxable gift." This fundamental fact of the incidence of the tax is rarely if ever acknowledged by the special interests that want to keep it.

But there are a number of things you can say about the death tax. It favors spending over saving. Consumption over thrift. Bureaucracy over family. Federal programs over private farms and businesses. Government over private enterprise. In short, it goes against the grain of just about every principle Americans believe in.

There can be no question, and there should be no debate, about the fact that the American people, the Congress and the President are in agreement: we should repeal the death tax.

That's why Americans oppose it. Naturally, our tax system is not neutral to social values. We make choices and judgments, and the tax code reflects those judgments, as they do for instance with respect to marriage, children, and homeownership. But look at the values that are penalized when a government imposes a death tax: Thrift. Conservation. Entrepreneurship. Ingenuity. Family businesses. Family farms. Families.

Those who want to retain the tax maintain that an individual's success is due at least in part to our society, and he or she ought to repay that debt. They don't acknowledge that the incidence of the tax falls on the heirs, not the decedent.

But when you look behind their arguments, the debate is much simpler. You only have to go to those who are advocating retaining the tax.

In their book, "Wealth and Commonwealth," Chuck Collins and Bill Gates, Sr. say: "Our basic assumption in opposing repeal of the estate tax is that we will continue to have a federal government that will require substantial revenue."

So much for tax policy. They want money. But why should we target money that comes about as a result of individual success? That accumulates through thrift? That is achieved through wise, productive economic investment? Or that is produced through ingenuity, risk and entrepreneurship? What proponents advocate is keeping a tax that forces literally billions of dollars a year to be diverted from productive capital and labor to be spent on compliance — on lawyers, accountants, financial planners, insurance policies and other planning tools to prevent the tax from breaking up the family farm or business.

The death tax is bad tax policy. It deserves to be struck from the tax code completely and forever.

The Tax Foundation invites national leaders from all perspectives to contribute columns to Tax Features. *The opinions expressed are not always those of the Tax Foundation.*

Zero-Tax Filers

from page 1

income taxes and Uncle Sam may well owe them. Of course, this is quite different from the situation of people who have paid a great deal in income taxes throughout the year but are getting a small refund because the government withheld even more than the amount due.

The group of zero-tax filers is growing rapidly because of the Bush tax cuts. It was 29 million in 2000, and it will be 44 million in 2004, a 50 percent increase (see Table 1).

In addition to these zero-tax filers, roughly 14 million individuals and families will earn some income but not enough to be required to file a tax return. When these non-filers are added to the zero-tax filers, they add up to 58 million income-earning households who will be paying no income taxes.

Even 58 million is not the actual number of people because one tax return often represents several people. When all of the dependents of these income-producing households are counted, roughly 122 million Americans — 44 percent of the U.S. population — are outside of the federal income tax system.

Considering how fast this population of zero-tax filers is rising, it is important for lawmakers to have a better understanding of who they are. To gain a better insight into the economic and demographic profiles of these Americans, Tax Foundation economists have constructed a database that combines IRS tax return data with Census household data.

A Portrait of Zero-Tax Filers

Many individuals and families who will earn enough to file a tax return will nevertheless be able to eliminate their tax liability by taking advantage of credits and deductions in the tax code. Many of these are familiar to all tax filers: the personal exemption is worth $3,050 in 2003, and the standard deduction is worth $4,750 for singles and $9,500 for married couples. These will all be adjusted slightly upward for 2004 to account for inflation.

Taxpayers with children can subtract $1,000 from what they owe for every dependent child under 17, and if they've paid for child care, they can take the child care credit. For tax filers who have itemized deductions that exceed the standard deduction, there are the amounts paid for mortgage interest or given to charity as well as various education-related deductions. State income taxes are deductible, and business owners can take advantage of an even wider array of credits and deductions to reduce their tax liability.

Less familiar, and much more difficult to understand is the Earned Income Tax Credit (the IRS instructions for filling out the form are 93 pages long). Uncle Sam sends out about $40 billion in checks to the families and single individuals who qualify for this "refundable tax credit." Of the 44 million tax returns that pay no income taxes, 34 percent claim the EITC and 50 percent claim the child credit. The recent expansion of the child credit alone knocked 5.8 million families with children off the tax rolls.

Broadly speaking, the 44 million zero-tax filers are: low-income, young, female-headed households, part-time workers, and beneficiaries of the $1,000 per-child tax credit (see Table 2).

Income

The 44 million zero-tax filers will be largely low-income. Indeed, 75 percent of will earn less than $20,000 per year and 97 percent will earn less than $40,000. Fewer than 1 percent will earn more than $75,000 per year — a group comprised largely of business owners whose tax liabilities will be erased due to business losses, carry-overs from prior year AMT payments, or foreign tax credits.

Age and Gender

Zero-tax filers in 2004 will be overwhelmingly young. Looking at the age of the primary breadwinner on these tax returns, only 22 percent are 45 years old or older. More than one-third (36 percent) are younger than age 25, and 56 percent are younger than age 35. Interestingly, there is a large cluster of households (22.4 percent) where the principal wage earner is between the ages of 35 and 44. Most

Table 2: Demographic Profile of Zero-Tax Filers and Non-Filers

	Distribution of 44 Million Zero-Tax Filers	Distribution of 14 Million Non-Filers	Distribution of Combined Non-Paying Population
Income			
$1 – $19,999	75.3%	97.1%	90.4%
$20,001 – $39,999	18.5%	2.4%	4.7%
$40,000 – $74,999	5.7%	0.5%	4.5%
$75,000 +	0.5%	0.0%	0.4%
Age			
18 – 24	35.9%	9.9%	29.8%
25 – 34	20.0%	7.7%	17.2%
35 – 44	22.4%	9.7%	19.4%
45 – 54	11.1%	10.0%	30.3%
55 +	10.6%	62.8%	22.7%
Gender of Major Earner			
Male	46.4%	37.4%	44.3%
Female	53.6%	62.6%	55.7%
Filing Status*			
Single	43.5%	39.8%	-
Married Filing Jointly	27.7%	20.7%	-
Married Filing Separately	1.2%	7.1%	-
Head of Household	27.6%	-	-
Widow(er)	0.1%	32.3%	-
Working Status			
Full-Time, 50-52 Weeks	37.9%	1.5%	29.4%
Full-Time, Less than 50 Weeks	20.4%	1.7%	16.%
Part-Time, More than 13 Weeks	31.6%	3.6%	20.9%
Part-Time, Less than 13 Weeks	10.1%	93.3%	33.7%

* Filing status of non-filers assigned using Census definitions, not strictly comparable to IRS definitions used for all filers.

Source: Tax Foundation Individual Tax Model likely, these are modest-income families who are benefitting most from the increased value of the child credit to $1,000.

Some 54 percent of 2004's zero-tax filers will be single women or families with children where the principal wage earner is a woman.

Marital Status

The overwhelming majority of tax returns that will pay no income taxes will be filed by single individuals or heads of household (an unmarried individual with children). Due in large part to their young age, 43.5 percent of these filers are single, while 27.6 percent are single parents.

Work Status and Occupation

Zero-tax tax filers tend to work either part-time or full-time but just for part of the year. Just 38 percent of zero-tax filers will be working full-time for all of 2004.

Government statistics on categories of employment are hard to interpret in this income range. Significantly though, 20.2 percent of these filers are classified as "children" or "students" rather than by an occupation. The other leading categories of occupations are "other services" (17.2 percent), "administrative support" (11.8 percent), "sales" (11.4 percent), and "precision production" (7.6 percent).

Business Income

Surprisingly, one of every five tax returns (20.9 percent) that paid no income taxes claimed some form of business income. Some 15 percent of all zero-tax tax returns claimed Schedule C (sole proprietorship) or farm income. Another 5.6 percent claimed Schedule E income, which includes S-Corporations (limited shareholder companies), real estate, or partnerships.

Who Doesn't Have to File?

Americans are required to file a tax return if their income is over a certain amount. For single individuals under 65, that amount is $7,800. For those 65 or older, the amount is $8,950 (Social Security benefits are not included). Married couples must file if their gross income is at least $15,600. Heads of households (single parents) must file if they earn at least $10,050.

Broadly, people who won't be filing a tax return for 2004 are college students, retirees and single parents. They have part-time jobs but earn less than the minimum amounts that are required to file a tax return.

Income, Age and Gender

Of the 14 million income-earning households that do not file a tax return, more than 97 percent earn less than $20,000 and 99.4 percent earn less than $30,000.

While the zero-tax tax filers tend to be young, two-thirds (or 8.8 million) of the non-filers are older than age 55. As Table 2 shows, when zero-tax filers and non-filers are combined, more than half of all households that will pay no income taxes are either younger than age 25 or older than age 55.

Among the population of non-filers, female-headed households are even more dominant. Roughly two-thirds of these households are headed by women, whereas 37 percent are headed by men.

Work Status

Not surprisingly, 93 percent of non-filing households are considered non-workers — meaning they worked less than 13 weeks out of the year. Only 1.46 percent of non-filers will have worked full-time during 2004.

Conclusion

This year, a record 44 million tax returns, one-third of all returns filed, will have no income tax liability because of the available credits and deductions in the tax code. In addition, 14 million individuals or households will not earn enough to file a tax return. Overall, some 58 million taxable households are outside of the income tax system.

Are any future tax cuts or reforms possible when the lion's share of the tax burden is increasingly borne by a shrinking pool of taxpayers who — at least on paper — appear to be "upper-income"? And will the expanding pool of non-payers demand even higher income taxes? These are questions lawmakers must begin to debate.

Putting a Face on America's Tax Returns

During this year's presidential campaign, Senator Kerry has often accused President Bush's tax policy of favoring "the rich," and he promises to repeal any tax cut that benefitted people making $200,000 in adjusted gross income (AGI).

This sort of AGI cutoff is clearly an inaccurate way to define someone as undeserving of tax relief. After all, a tax return can represent an individual, a couple with no children, a large family or a person's business.

For example, a family of five living near San Francisco or New York could make $250,000 but still have far less disposable income than a family of three making $150,000 in Grand Rapids or Knoxville or Omaha, just because of the cost of living. In these examples, the family that would lose its tax cut is less well off than the families who would keep it.

A businessman who is part-owner of a firm that employs 20 people may declare $500,000 in profits on his tax return in a good year, but if he loses his tax cut, it is likely to be the employees of his firm that suffer as much as his own bottom line.

In these and many other ways, it is simply wrong to define "the rich" based on sterile tax return data. Yet that is typically what politicians do.

Over the past eighteen months, Tax Foundation economists have developed sophisticated tax models and databases that allow us to "put a face on America's tax returns." In practice, that means we have managed to match some demographic data published by the Census Bureau with the IRS's data on tax returns, enabling us to describe the people who are punished or rewarded by our bizarre tax code in terms that people understand.

This issue's lead article on "zero-tax filers" is just one example. Also see the page 10 article on the marriage penalty. Stories on the 10-percent tax bracket and the child tax credit are on the web site.

House Votes to Extend Marriage Penalty Relief Into 2005; 30 Million Couples Would Benefit

As part of a series of votes to extend various provisions of the Bush tax cuts, the House voted in late April to extend the full benefits of marriage penalty relief into 2005. If the Senate defeats it, 30 million married couples will see an average tax increase of $369 next year, according to the Tax Foundation's Individual Income Tax Model.

The fixing of the "marriage penalty" was one of the biggest parts of the original Bush tax cut. Because of its size, Congress originally postponed marriage penalty relief until 2005 and even then phased it in slowly so that it didn't take full effect until 2009.

In 2003, Congress thought better of that long delay, and at the President's suggestion, "accelerated" marriage penalty relief, making the maximum benefit that would have occurred in 2009 effective in 2003 and 2004. However, the marriage penalty is scheduled to return on January 1, 2005. It will not be as bad as it was in 2000, but married couples filing jointly would again face a tax disadvantage.

Foundation economists have been able to build a basic demographic profile of the 30 million couples, representing 85 million individuals, who currently benefit from the marriage penalty relief, and who would face a tax hike if the extension to 2005 fails.

Demographic Profile

The tables below display income and tax data, as well as some basic demographic information about the couples who benefit from the marriage penalty relief.

♦ Seventeen percent of the beneficiaries make between $50,000 and $75,000 annually, and their average tax increase, should the extension fail, would be $260 in 2005, a 5.6% tax increase.

♦ Eighteen percent of the beneficiaries make between $75,000 and $100,000 annually, and their average tax increase, should the extension fail, would be $573 in 2005, a 6.9% tax increase.

♦ Twenty-two percent of the beneficiaries make between $100,000 and $200,000 annually, and their average tax increase, should the extension fail, would be $601 in 2005, a 3.4% tax increase.

Table 1: How Much Would a Failure to Extend Full Marriage Penalty Relief Cost Taxpayers in Different Income Brackets?

Income Range	Avg. Current Income Tax Liability	Avg. Tax Increase	Percent Increase in Tax Burden
$10K to $15K	$6	$33	562.7%
$15K to $20K	$168	$116	69.1%
$20K to $25K	$592	$126	21.2%
$25K to $30K	$954	$127	13.4%
$30K to $40K	$1,525	$178	11.7%
$40K to $50K	$2,466	$188	7.6%
$50K to $75K	$4,645	$260	5.6%
$75K to $100K	$8,274	$573	6.9%
$100K to $200K	$17,585	$601	3.4%
$200K and over	$337,855	$619	0.2%

Source: Tax Foundation Individual Tax Model

Table 2: Most Couples Who Benefit from Marriage Penalty Relief Earn Less than $100,000

Income Bracket	Percentage of Beneficiaries in Each Income Bracket
$10,000 to $25,000	10%
$25,000 to $40,000	15%
$40,000 to $50,000	11%
$50,000 to $75,000	17%
$75,000 to $100,000	18%
$100,000 to $200,000	22%
Over $200,000	7%

Source: Tax Foundation Individual Tax Model

Table 3: Age Ranges of Those Who Benefit from Marriage Penalty Relief

Age Range	Percentage of Beneficiaries In Each Age Range
18 to 24	10%
25 to 34	15%
35 to 44	11%
45 to 54	17%
55 to 64	18%
65 and over	22%

Source: Tax Foundation Individual Tax Model

What is the "Marriage Penalty"?

For many years, when a single man and a single woman made similar salaries, contemplating marriage meant confronting higher income tax payments. This was the so-called marriage penalty. Many couples planning a wedding even noticed that if they waited until New Year's Day, they would save enough money in taxes to pay for the honeymoon.

Eliminating this inequity completely is harder than it sounds because more than 60 provisions of the tax code vary with marital status, some causing higher taxes and some lower. But the two provisions most often responsible were the standard deduction and the fact that the ceiling of the 15 percent tax bracket was not twice as high for married taxpayers as for singles.

In 2000, for example, the standard deduction for singles was $4,400. But when two people married and filed their tax return together, they weren't allowed to deduct double that amount, $8,800, but only $7,350.

Also, every taxpayer filing an individual return in 2000 could pay the modest tax rate of 15 percent on income up to $26,250, but when two people combined their incomes, they discovered that the 15-percent rate did not apply to double that amount, $52,500, but only to $43,850, after which the painful-28 percent rate kicked in.

President Bush promised that his tax cut would remove the penalty from these two provisions. The 2001 tax cut made a long-term commitment to the idea, and the 2003 tax cut "accelerated" the relief, making full marriage penalty relief a reality in 2003 and 2004 but not beyond. Now the President and the House are campaigning to make full marriage penalty relief permanent.

FOUNDATION MESSAGE

In "Battleground" Ohio Tax Politics Are Local

Scott A. Hodge
President
Tax Foundation

Among President Bush's domestic policies, none are more controversial than his tax cuts. Senator Kerry assails them in every speech, claiming that they have hurt the country, promising to repeal any that benefit taxpayers with high incomes.

As the economy has grown throughout the spring, adding about a million jobs nationally in February, March and April, the tax argument is becoming easier and easier for President Bush to win. In some states, though, the local debate over tax policy overwhelms the debate over national tax policy, and Ohio might be one of those states.

A fiscal mess caused by years of overspending has trapped Ohio in a vicious cycle of tax hikes and deficits. A recent poll conducted for the Buckeye Institute found that 78 percent of Ohioans would favor a proposal to limit state spending to no more than the rate of inflation. An even more overwhelming majority (86% to 9%) favored spending cuts over tax increases if the state confronts another budget deficit, as it is now predicted to do.

If not for the recent federal tax cuts, Ohio taxpayers would be even more hard-pressed to finance their burgeoning state and local governments. In 2004, Ohio's federal tax burden of 16.2 percent of income is 37th highest in the nation. As recently as 2000, Uncle Sam was taking 21.1 percent of Ohioans' income. That's approximately $12.3 billion that the Bush tax cuts have spared Ohioans in federal tax payments over the last four years.

But the story at the state-local level is quite different. In the Tax Foundation's recently released ranking of combined state-local tax burdens in the 50 states, Ohio ranked third highest, taking 11.3 percent of its citizens' income compared to a national average of 10.0 percent (see the article on page 5 and check our web site at www.taxfoundation.org/ohio/state-local.html and for tax burden data by state for the 1970-2004 period). Only the state and local governments of New York and Maine will be taking a larger fraction this year.

Ohio's neighboring states' tax burdens in 2004 were all lower: Indiana – 10.1% (16th highest), Pennsylvania – 9.4% (35th highest), West Virginia – 10.6% (8th highest), Kentucky – 10.0% (17th highest) and Michigan – 10.2% (13th highest).

This high-tax environment in Ohio is fairly new. In 1990 Ohio's state-local tax burden ranked not 3rd but 30th, well below average (9.8% of income compared to a national average of 10.3%). By 1997 Ohio ranked 20th, and in 2000, 13th. State rankings rarely change this rapidly, but over the course of the last 14 years, Ohio's state-local tax burden has risen significantly faster than individual income.

Sometimes a state can prosper with a heavy tax burden if its tax system is arranged in a way that's unusually favorable for business. That's certainly not the case in Ohio. On the Tax Foundation's State Business Tax Climate Index, Ohio ranked 4th worst. Only Mississippi, California and Arkansas had tax systems more inimical to economic development.

The State Business Tax Climate Index measures the impact of each state's tax system by comparing it to the other states on five issues: sales tax rates, personal income tax rates, corporate income tax rates, the balance over time between tax growth and spending growth, and the complexity of the state tax system.

Ohio scores poorly on every component of the index, but it was the state's corporate income tax that really stood out, with only 4 states tally a lower score. Ohio's corporate income tax rate is 8.5 percent on all income above $50,000.

The personal income tax system isn't much better. It affects many small businesses as well as all individuals and is one of the nation's most complex, composed of nine separate tax brackets (only Missouri and Montana have more). Along with this complexity comes a fairly high top rate of 7.5 percent — only 9 states have a higher rate.

However, Ohio's sales tax rate has gotten most of the attention lately. It stands at 6 percent, compared to national median of 5 percent. Ohio was at the median until the summer of 2003, when a tax hike passed, raising it from 5 percent to 6 percent. (Local sales taxes are additional, with 77 of Ohio's 88 counties adding on between 1 and 2 cents.)

The state-level increase is currently scheduled to expire after two years, with the rate reverting to 5 percent. Secretary of State Ken Blackwell is campaigning to repeal it earlier by referendum, but forces in favor of making the tax permanent have created legal obstacles that may derail the referendum. This referendum issue is keeping the tax issue before the public's attention, which is exactly where it should be. No state is more clearly in need of tax reform than Ohio.

TAX FEATURES©

Tax Features© (ISSN 1069-711X) is published bi-monthly by the Tax Foundation, an independent 501(c)(3) organization chartered in the District of Columbia. Annual subscriptions are $15.

Tax Foundation
(202) 464-6200
(202) 464-6201 Fax
www.TaxFoundation.org
TF@TaxFoundation.org

During Tax Season Reporters Turn to The Tax Foundation

As usual during tax season, reporters ramped up their tax-related stories to match the interest of readers who have been reminded by their 1040s just how important taxes are. As a result, quotations from Tax Foundation reports and experts appeared in over 200 papers during the first two weeks of April.

On April 4, the *Orange County Register's* Steven Greenhut wrote a column entitled, "State Gets the Gold Mine, You Get the Shaft." He cited California's poor ranking in the Foundation's State Business Tax Climate Index (8th worst) as a reason to resist tax increases.

On April 7, we announced that Tax Freedom Day would fall on April 11 in 2004 (see page 2 article). In addition to a TV report on Fox News, this annual measurement of the national tax burden was reported by *The Miami Herald, Investors' Business Daily, Denver Post, Newark Star-Ledger, The Oklahoman, Seattle Times, Mobile Register, Arizona Republic, Boston Globe, Dallas Morning News, San Francisco Chronicle, Florida Times-Union, Kansas City Star,* and many more.

The next day, April 8, was also a big news day for the Tax Foundation. *The Wall Street Journal* carried our estimates of each state's combined state-local tax burden (see page 5), and Rob Wells of Dow Jones published his interview with Tax Foundation President Scott Hodge. Both stories were carried in papers throughout the nation.

Leave a Legacy to The Tax Foundation

In 1937, at the height of the New Deal, when federal spending had increased 170 percent over a ten-year period, the Tax Foundation was founded to monitor the growth of government. From its founding day over 67 years ago, the Tax Foundation's mission has remained the same — to tell the truth about taxes and how tax policies impact all taxpayers.

This mission could not be accomplished without your support. All of the programs at the Tax Foundation are solely funded by contributions from contributors such as you and we appreciate your generous support.

The Tax Foundation also understands the importance of planning your estate to support those you love and uphold the values that you have dedicated your life to. As you make these considerations, please know that the Tax Foundation staff is available to discuss a planned giving option such as a bequest, stock gift or endowed gift to further the work of the Tax Foundation.

For more information on the ways you can ensure that the work of the Tax Foundation continues, call Julie Burden, Director of Development, at (202) 464-5102.

Tax Foundation
1900 M Street, NW Suite 550
Washington, DC 20036-3508