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Number of Americans Paying Zero Federal Income Tax Grows to 43.4 Million

by Scott A. Hodge

With the April 17th deadline for federal tax returns looming, Americans are sharply aware of their federal income tax liabilities. However, one aspect of federal income taxes they may not be aware of is the growing number of Americans who pay zero federal income tax after taking advantage of deductions and credits.

During 2006, Tax Foundation economists estimate that roughly 43.4 million tax returns, representing 91 million individuals, will face a zero or negative tax liability. That's out of a total of 136 million federal tax returns that will be filed. Adding to this figure the 15 million households and individuals who file no tax return at all, roughly 121 million Americans—or 41 percent of the U.S. population—will be completely outside the federal income tax system in 2006.¹ This total includes those who pay no tax, and those who pay some tax upfront and are later refunded the full amount of the tax paid or more.

Who Are the Non-Payers?

Using IRS data, we are able to create a profile of these individuals who are outside the federal income tax system. As Table 1 shows, those who file as single or head-of-household are much more likely to be non-payers. One-third of single filers pay nothing in federal income taxes, and almost two-thirds of those who file as head of household pay nothing. In contrast, just 22 percent of married filers are non-payers.

Why do many single filers face zero tax liability? One reason is that single filers tend to be younger and earn lower incomes than married filers—especially single parents who file as head-of-household. As a result, married taxpayers pay roughly 75 percent of all federal income taxes, despite filing only 40 percent of returns.

Table 1. Projection of Filing Status of Non-Payers, Tax Year 2006

Filing Status	Percent of Returns in Filing Status That Are Non-Payers	Percent of All Non-Payers Who Are in Filing Status
Single	33.1%	42.2%
Married filing jointly	21.5%	29.8%
Married filing separately	21.6%	1.2%
Head of household	65.7%	26.6%

Source: Internal Revenue Service, Tax Foundation.

Non-Payers by State

The number of Americans who face zero federal income tax liability varies widely by state. Table 2 illustrates the number of projected non-payers for 2006 by state. There are two primary reasons why some states have a disproportionate share of non-payers. First is that average household income varies by state, and those with lower-than-average incomes will have a larger share of non-payers. Second, some states have a high number of single parents—who typically file as head-of-household—whose tax liabilities are reduced through tax credits such as the \$1,000 per child tax credit and the Earned Income Tax Credit. The estimates in Table 2 do not take into account the likely increase in the number of non-payers in Gulf Coast states as a result of Hurricanes Katrina and Rita.

Table 2. Residents of Some States are More Likely to Pay Zero Federal Income Tax than Others (2006 Estimate)

	Number of Returns Filed	Returns with Zero or Negative Tax Liability	Percentage of Returns in Each State with Zero or Negative Tax Liability	Rank by Percentage of "Non-Payers"
<i>U.S. Total</i>	135,660,228	43,362,718	32%	-
Alabama	1,945,483	734,157	38%	5
Alaska	354,271	71,740	20%	50
Arizona	2,360,197	776,590	33%	18
Arkansas	1,158,262	439,675	38%	3
California	15,668,908	5,105,168	33%	20
Colorado	2,147,160	613,696	29%	35
Connecticut	1,707,972	408,945	24%	48
Delaware	401,010	105,916	26%	44
Florida	8,106,717	2,782,600	34%	13
Georgia	3,830,840	1,363,353	36%	10
Hawaii	610,450	177,201	29%	32
Idaho	596,861	209,808	35%	12
Illinois	5,910,250	1,810,128	31%	26
Indiana	2,908,813	885,744	30%	27
Iowa	1,368,283	393,833	29%	34
Kansas	1,258,504	393,007	31%	24
Kentucky	1,797,892	599,028	33%	17
Louisiana	1,941,234	777,004	40%	2
Maine	635,244	182,943	29%	33
Maryland	2,687,104	696,489	26%	45
Massachusetts	3,151,680	749,325	24%	49
Michigan	4,695,299	1,411,601	30%	28
Minnesota	2,461,914	630,657	26%	46
Mississippi	1,207,967	516,757	43%	1
Missouri	2,647,896	834,018	31%	22
Montana	447,726	162,773	36%	7
Nebraska	829,008	253,951	31%	25
Nevada	1,078,230	306,409	28%	36

New Hampshire	655,447	157,466	24%	47
New Jersey	4,215,850	1,148,262	27%	39
New Mexico	840,391	318,744	38%	4
New York	8,871,365	2,838,370	32%	21
North Carolina	3,801,408	1,299,289	34%	14
North Dakota	312,334	92,486	30%	30
Ohio	5,622,504	1,588,793	28%	37
Oklahoma	1,508,808	547,112	36%	8
Oregon	1,623,370	510,012	31%	23
Pennsylvania	5,960,865	1,760,123	30%	31
Rhode Island	514,381	136,883	27%	42
South Carolina	1,863,934	667,601	36%	9
South Dakota	369,160	121,027	33%	19
Tennessee	2,649,084	901,139	34%	15
Texas	9,603,456	3,575,431	37%	6
Utah	1,001,586	354,270	35%	11
Vermont	312,110	87,224	28%	38
Virginia	3,544,201	945,257	27%	41
Washington	2,900,573	771,846	27%	43
West Virginia	768,830	260,437	34%	16
Wisconsin	2,674,696	714,104	27%	40
Wyoming	248,894	74,394	30%	29
D.C.	284,676	80,853	28%	-

Note: Figures do not take into account the likely increase in Gulf Coast non-payers resulting from 2005 hurricane damage.

Source: Internal Revenue Service, Tax Foundation.

Large Number of Non-Payers Make Tax Reform Difficult

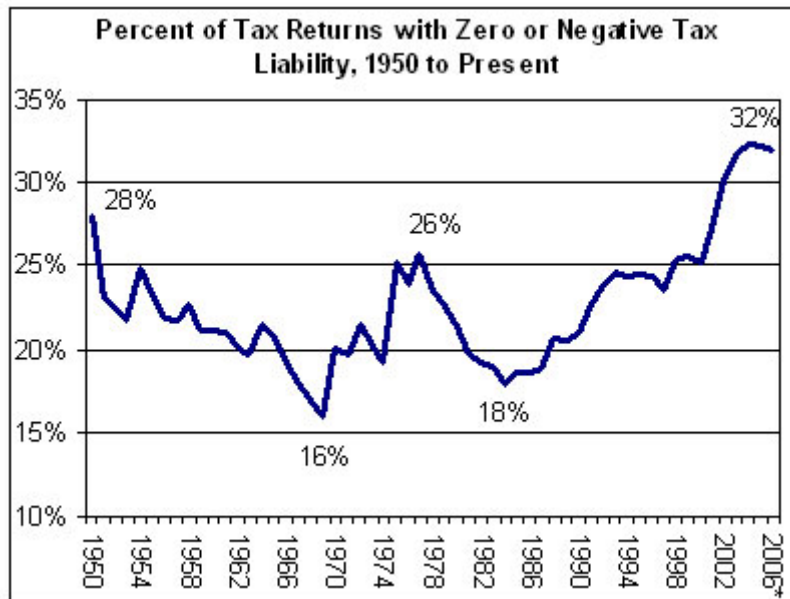
Federal tax reform requires that the base of the federal income tax be widened, so that overall tax rates can be reduced. However, because of the large number of Americans currently paying zero federal income tax, any attempt to broaden the tax base will be a difficult sell for lawmakers. The millions of Americans who have no federal income tax liability will either be indifferent about tax reform or will positively oppose it, as it would require bringing them into the federal tax base.

The Effect of Recent Tax Cuts on Non-Payers

As President Bush pushed through his two major tax bills in 2001 and 2003, opponents focused on the dollar amounts saved by high-income individuals. What many critics have ignored is the number of people who were removed from the tax rolls as a result of the expansion of the child tax credit, which was a key provision of the President's Economic Growth and Tax Relief Reconciliation Act of 2001.

As Figure 1 illustrates, the number of tax returns with zero or negative tax liability has risen steadily over the past decade. However, it accelerated sharply between 2000 and 2004 due to the effects of tax changes during President Bush's first term of office.

Figure 1. Percent of Tax Returns with Zero or Negative Tax Liability, 1950 to Present



Source: Internal Revenue Service, Tax Foundation.

Conclusion

These findings raise serious questions about the future of the U.S. income tax system, and the possibility of base-broadening tax reform when the majority of the federal tax burden is borne by a shrinking pool of taxpayers. As Congress considers tax reform proposals during the coming year, this is an issue lawmakers should begin to debate.

Footnotes

1. Those who are claimed as dependents on a tax return with positive tax liability are defined as “in the tax system.”

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Tax Foundation
2001 L Street NW Suite 1050
Washington, DC 20036
Ph: (202) 464-6200
Fax: (202) 464-6201
www.taxfoundation.org