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To: Revenue and Transportation Interim Committee
From: Dan Dodds, Senior Economist
Date: December 6, 2011
Subject: Fraction of Households that Pay Federal and State Income Taxes

Before and during the 2011 legislative session, several legislators asked me whether figures being quoted on the percent of people who did not pay federal taxes were accurate, and if so, what the percentage was for Montana. This is an update of a memo I wrote during the session to answer these questions. It includes information for an additional year, and I have changed one of the tables to make it more readable.

My conclusions are as follows:

- Several organizations have estimated the percent of the population that does not pay *federal income tax*. These estimates are in the range of 40% to 50%, and this appears to be the right range.
- The largest source of federal tax revenue is the payroll tax that funds social security and medicare. Many people pay this tax who do not pay the income tax.
- The percent of the population that does not pay Montana income tax is between 30% and 35%.
- The percentage that does not pay income tax is lower for Montana primarily because Montana's personal exemption and standard deduction are smaller than their federal equivalents and because there are federal tax credits, such as the earned income credit and the child credit, that have no state equivalent.
- The largest source of state and local tax revenue in Montana is the property tax. Everyone pays the property tax, either directly if they own a home, or indirectly through rent.

The rest of this memo explains how the percent of adults paying income tax was calculated and presents some information on the reasons people may not pay income tax.

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Percent of Adults Paying Federal and State Income Tax

If all adults paid income tax, there would be a return with tax liability from each family and from each adult not living with their family. An estimate of this number can be derived for the U.S. and Montana from the Census Bureau's annual American Community Survey. The number of income tax returns with tax liability is available for Montana through 2009, but the latest year for which the IRS has published national data is 2009.

The following table shows the number of families and single adults who could have potentially filed a tax return, the number of Montana and federal tax returns, and the number of those returns with positive tax liability after all adjustments and credits. Most married couples file a joint federal return but separate Montana returns. To make the state and federal numbers comparable, I have counted a married couple who filed separate returns on the same form as filing a single return.

Percent of Families and Single Adults Who Paid Income Tax

	Number of Families and Single Adults	Number of Returns	Returns with Tax After Credits	% Adults Who Paid Income Tax
Montana 2008	484,650	438,450	343,140	71%
Montana 2009	507,648	433,046	333,529	66%
Montana 2010	506,372	433,853	337,390	67%
United States 2008	154,263,859	142,450,569	90,659,908	59%
United States 2009	162,128,063	140,494,129	81,890,190	51%

Reasons Individuals Pay No Income Tax

There are several reasons why someone may pay Montana income tax and not federal income tax or vice versa.

Montana's personal exemption and standard deduction are lower than the federal ones so that the Montana income tax begins at a lower income. The following table shows personal exemptions and standard deductions for 2010. Montana's standard deduction is 20% of adjusted gross income with upper and lower limits. The table shows the minimum standard deductions.

Exemptions and Standard Deductions, 2010

	Federal	Montana
Exemption	\$3,650	\$2,130
Standard Deduction		
Single or Married Person Filing Separate Return	\$5,700	\$1,770
Married Couple Filing Joint Return	\$11,400	\$3,540
Head of Household	\$5,700	\$3,540

State and federal income taxes allow different credits. In particular, federal law has an earned income credit and child credit, which have no Montana equivalents. These credits reduce or eliminate federal income taxes for many low-income taxpayers.

Some income that is subject to tax at one level is not at the other. For example, the federal government does not tax interest on municipal bonds, while Montana does not tax interest on some federal bonds.

Federal law imposes an alternative minimum tax, and Montana does not. Because of this, some higher-income taxpayers who pay federal tax only because they pay alternative minimum tax may not pay Montana income tax.

The following table shows information on Montana income tax returns with no tax liability, by income group. The left side of the table shows the total number of returns in each income range and the number and percent with no tax liability. Income is measured by total income as it would be reported on the federal tax return plus state additions to federal income.

The right side of the table shows why taxpayers have no tax liability. The fourth column from the right shows the number of returns with positive items of income less than the total of exemptions and deductions. A household may be in this position because they

may have low income, because part or all of their income is tax-exempt, or because they have large deductions.

The third column from the right shows the number of returns with losses that offset their income. These households may have positive items of income but also have losses from business or asset sales that make their net income less than the total of exemptions and deductions.

The second column from the right shows the number of returns that had positive tax liability but had a capital gains credit that was more than their tax liability.

The right-hand column shows the number of returns that had positive tax liability after the capital gains credit but other credits that completely offset this tax liability.

2010 Montana Income Tax Returns With No Tax Liability

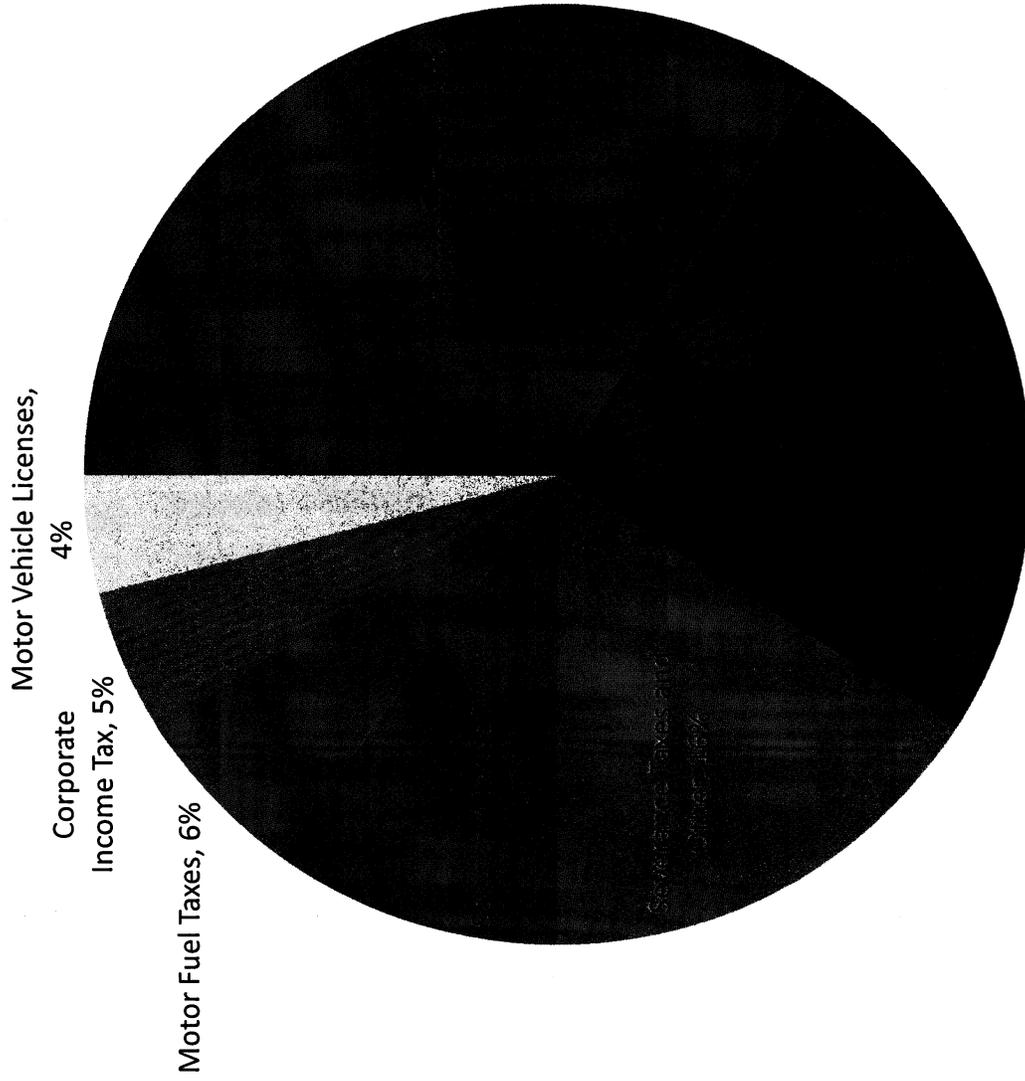
Income Range		Number With No Tax Liability After Credits	% of Income Group	Income Less Than Exemptions and Deductions	Losses Offset Income	Capital Gains Credit More than Tax	Other Credits More Than Tax After Capital Gains Credit
\$0 or Less	6,636	6,628	100%	5,075	1,553	0	0
\$1 to \$5,740	42,721	34,229	80%	32,773	1,231	158	66
\$5,741 to \$11,150	42,722	16,538	39%	14,522	1,051	324	641
\$11,151 to \$16,844	42,722	12,643	30%	10,161	948	322	1,212
\$16,845 to \$23,152	42,721	9,232	22%	6,842	816	312	1,262
\$23,153 to \$30,882	42,722	6,861	16%	4,815	680	290	1,076
\$30,883 to \$41,112	42,722	4,278	10%	2,849	476	242	711
\$41,113 to \$54,440	42,721	2,555	6%	1,631	317	143	464
\$54,441 to \$72,046	42,722	1,553	4%	1,058	162	87	246
\$72,047 to \$99,465	42,722	1,087	3%	740	111	59	177
\$99,466 to \$116,437	14,240	302	2%	194	35	21	52
\$116,438 to \$155,687	14,241	254	2%	136	34	22	62
\$155,688 or More	14,241	303	2%	75	63	29	136
All	433,853	96,463	22%	80,871	7,477	2,009	6,105

The next table shows similar information from the IRS for federal tax returns. In this table, income ranges are defined in terms of federal adjusted gross income. The columns are the same as in the state table, except that the IRS data does not give the number of returns with no taxable income that had business losses.

2009 Federal Returns with No Tax Liability after Credits

Income Range	Total Returns in Income Range	No Tax Liability After Credits	% of Income Group	AGI <	
				Exemptions and Deductions	Credits > Tax Liability
No adjusted gross income	2,511,925	2,508,105	100%	2,504,466	3,639
\$1 under \$5,000	10,447,635	10,141,048	97%	10,129,773	11,275
\$5,000 under \$10,000	12,220,335	10,321,003	84%	9,860,547	460,456
\$10,000 under \$15,000	12,444,512	9,560,606	77%	6,339,919	3,220,687
\$15,000 under \$20,000	11,400,228	6,532,178	57%	4,177,892	2,354,286
\$20,000 under \$25,000	10,033,887	5,394,802	54%	1,975,927	3,418,875
\$25,000 under \$30,000	8,662,392	4,058,629	47%	854,497	3,204,132
\$30,000 under \$40,000	14,371,647	4,781,802	33%	605,221	4,176,581
\$40,000 under \$50,000	10,796,412	2,415,395	22%	224,853	2,190,542
\$50,000 under \$75,000	18,694,893	2,245,499	12%	201,323	2,044,176
\$75,000 under \$100,000	11,463,725	476,624	4%	62,458	414,166
\$100,000 under \$200,000	13,522,048	147,495	1%	46,720	100,775
\$200,000 under \$500,000	3,195,039	16,619	1%	6,492	10,127
\$500,000 under \$1,000,000	492,568	2,664	1%	929	1,735
\$1,000,000 under \$1,500,000	108,096	680	1%	221	459
\$1,500,000 under \$2,000,000	44,273	258	1%	66	192
\$2,000,000 under \$5,000,000	61,918	383	1%	145	238
\$5,000,000 under \$10,000,000	14,322	86	1%	25	61
\$10,000,000 or more	8,274	63	1%	18	45
Total	140,494,129	58,603,939	42%	36,991,492	21,612,447

Montana State and Local Tax Revenue, FY 2008



Source: U.S. Census Bureau and Montana Department of Revenue

U.S. Federal Tax Revenue, FY 2010



Source: IRS Data Book, 2010