



# FISCAL FACT

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## Record Numbers of People Paying No Income Tax; Over 50 Million "Nonpayers" Include Families Making over \$50,000

*By Scott A. Hodge*

### Introduction

Tax Day, April 15, is looming for the nearly 142 million Americans who will file a tax return for income earned in 2009. While most taxpayers worry about paying the correct amount and even pay for professional assistance to make sure they do, many millions of tax filers will be “nonpayers.”

A nonpaying tax return is one filed by an individual or couple who, thanks to legal credits and deductions, owes nothing. Most people who get a refund after filing their tax returns are not nonpayers; they have overpaid their taxes through paycheck withholding and are being refunded just a tiny portion of that payment.

But during 2008, more than a third of all tax returns resulted in complete nonpayment; that is, people got back every dollar that was withheld from their paychecks during the year. Many got quite a bit more, turning Tax Day into a payday.

### Two Records Set in 2008: Most Nonpayers and Highest-Earning Nonpayers

Nonpaying status used to be a sure sign of poverty or near-poverty, but Congress and the President have changed the tax laws to pull much of the middle class into the growing pool of nonpayers. The income level at which a typical family of four will owe no income taxes has risen rapidly, now topping \$51,000.

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As a result, recently released IRS data for the 2008 tax year show that a record 51.6 million filers had no income tax obligation.<sup>1</sup> That means more than 36 percent of all Americans who filed a tax return for 2008 were nonpayers, raising serious doubts about the ability of the income tax system to continue funding the federal government's ballooning expenditures.

## The Growth of the Nonpaying Population

Since it was enacted in 1913, the income tax code has contained provisions that exempt low-income workers or greatly reduce their income tax burden. These provisions include the standard deduction, personal exemption, dependent exemption, and the earned income tax credit (EITC). Between 1950 and 1990, the percentage of tax filers whose entire tax liability was wiped out by these provisions averaged 21 percent.

Since the early 1990s, however, lawmakers have increasingly used the tax code instead of government spending programs to funnel money to groups of people they want to reward. Credits have been enacted to subsidize families with children, college students, and purchasers of hybrid cars, just to name a few of the most well known. In terms of tax revenue, the most significant of these socially targeted credits was the \$500 per-child tax credit enacted in 1997. The 2001 and 2003 tax bills doubled the value of the credit to \$1,000 and added a refundable component.

Most tax credits can only reduce a taxpayer's amount due to zero, but the EITC and the child tax credit are also refundable, meaning that taxpayers are eligible to receive a check even if they have paid no income tax during the year. Those tax returns have become, in effect, a claim form for a subsidy delivered through the tax system in much the same way that a traditional government program sends out a welfare check or a farm support check.

In 2008, 25 million tax filers received \$51.6 billion in EITC benefits. Of this amount, \$50.5 billion was refundable in excess of their income tax liability. Also in 2008, some 25.3 million filers received \$30.7 billion in child tax credit benefits, with more than 18 million of these filers getting \$20.5 billion in refundable checks. Many families are eligible for both the EITC and the child credit. These are not refunds of overpaid tax; they are payments to people who have already gotten back everything that was withheld from their paychecks during the year.

Quite aside from the fact that these refundable credits remove millions of people from the roster of Americans who support the government by paying the income tax, these credits have other undesirable effects such as added tax complexity.

According to the annual report of the IRS's National Taxpayer Advocate, about 62 percent of all taxpayers use tax return preparers, and the percentage climbs to about 73 percent for those claiming the EITC.<sup>2</sup> Moreover, the complexity of EITC eligibility is a contributing factor to the estimated \$10 billion to \$12 billion in erroneous overpayments out of nearly \$44 billion of total EITC claims in 2006.<sup>3</sup>

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<sup>1</sup> Table 1. Individual Income Tax Returns, Tax Year 2008 Preliminary Data: Selected Income and Tax Items, by Size of Adjusted Gross Income. Internal Revenue Service.

<http://www.irs.gov/pub/irs-soi/08in01pl.xls>

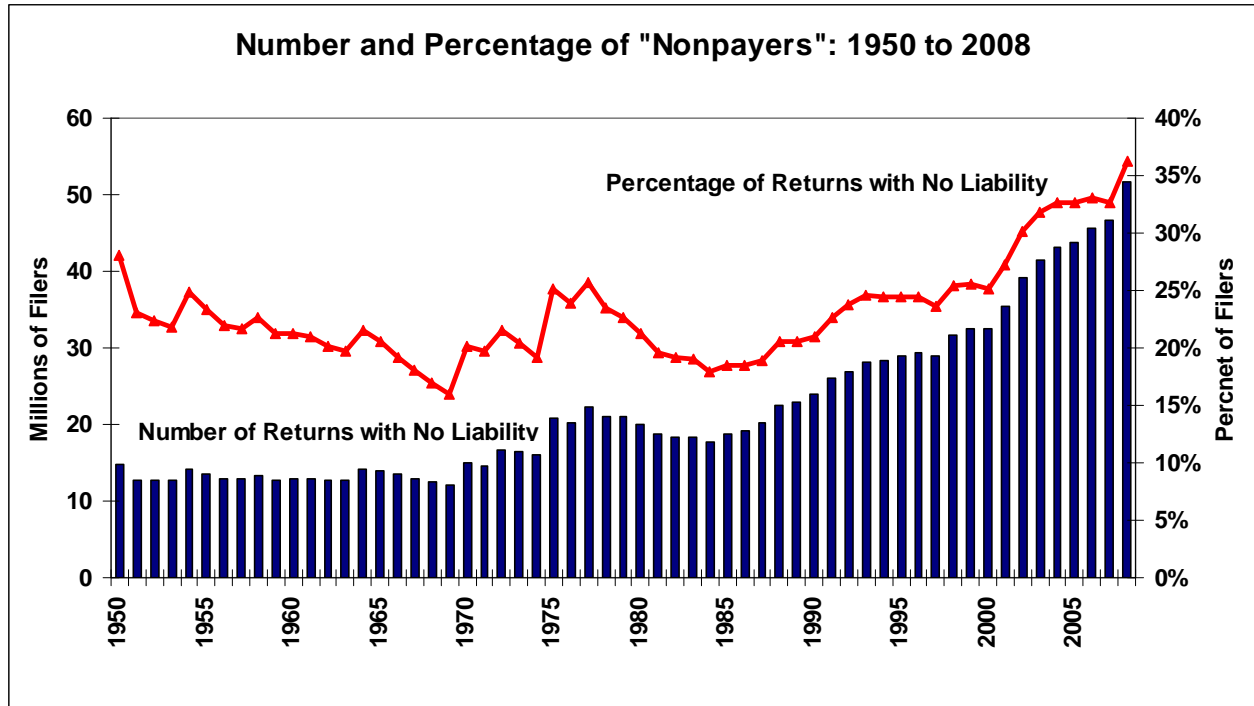
<sup>2</sup> National Taxpayer Advocate, *Report to Congress: Fiscal 2010 Objectives*, June 30, 2009, p. xxii.

[http://www.irs.gov/pub/irs-utl/fy2010\\_objectivesreport.pdf](http://www.irs.gov/pub/irs-utl/fy2010_objectivesreport.pdf)

<sup>3</sup> Ibid. p. xix.

Figure 1 shows the fluctuation in the number and percentage of nonpayers since 1950 and how that has soared over the past decade. The percentage of tax returns with no liability was fairly low in the 1960s and again in the early 1980s. The recent growth in the number of nonpayers was accelerated by two major tax changes enacted during the 1990s, followed by the Bush tax cuts in 2001 and 2003.

**Figure 1**



**Source:** Tax Foundation calculations based on IRS data

**Note:** These preliminary data represent estimates of income and tax items based on a sample of individual income tax returns filed between January and late September of a given processing year. These returns are then weighted to represent a full year of taxpayer reporting. In general, some of the returns processed during the remainder of the year may have somewhat different characteristics compared to these earlier ones. Therefore, these preliminary data are best utilized by comparisons made to the preliminary estimates from the prior year. When available, the estimates from the Complete Year Data should be used in place of the preliminary data.

This two-decade period of growth in nonpayers was kicked off by the Omnibus Budget Reconciliation Act of 1993 which expanded the earned income tax credit. The second change was the Taxpayer Relief Act of 1997 which created a \$500 per-child tax credit for families earning less than \$110,000.

In 1990, there were 23.8 million nonpayers, but as a result of these legislative changes, 2000 arrived with 32.5 million nonpayers. That was a percentage increase of 36 percent while the total number of tax filers in the nation grew by only 13 percent.

### *59 Percent Increase in Nonpayers Since 2000*

Entering the 2000s with one in four tax filers owing nothing, the nonpayers pool was supercharged by the Bush tax cuts in 2001 and 2003 – especially by the doubling of the child credit to \$1,000. By 2004, when the credit expansion was fully phased in, the number of nonpayers increased by 10.5 million, a 32-percent jump in the space of four years.

In tax year 2008, the major tax change that created a record number of nonpayers was the Economic Stimulus Act of 2008, which included a tax rebate of \$300 per person, \$600 per couple. A family of four was eligible for a rebate of \$1,200. These tax rebates boosted the number of nonpayers to nearly 52 million, 19 million more than the number of nonpayers in 2000 when President Bill Clinton left office. This represents a 58.6 percent increase in the number of nonpayers in less than a decade. By contrast, the total number of tax filers grew by only 10 percent during the same period.

Tax year 2009 is likely to be a repeat of 2008. President Obama's newly created making-work-pay credit, first-time homebuyer credit, and American Opportunity tax credits have expanded the number of opportunities for people to erase their income tax obligation. As a result of these measures, the percentage of nonpayers is likely to again exceed 35 percent in tax year 2009.

### **Income Ceiling for Nonpayer Families at Record Level**

Table 1 shows how the various tax changes since 1993 have increased the maximum income level that a typical family of four can earn and still have no income tax liability after credits and deductions. These estimates assume that the family would take the standard deduction and the basic credits such as the child credit, but not the EITC which now phases out well below this maximum threshold.

In the years leading up to the enactment of the child tax credit in 1997, the top threshold held steady below roughly \$24,000 in today's dollars. Following the enactment of the child credit, the threshold immediately jumped 30 percent to more than \$31,000 in 1998, then grew to \$32,790 in 1999.

When the value of the child credit was increased to \$600 in 2001 – as the first phase of the doubling from \$500 to \$1,000 – the nonpayer threshold jumped by more than \$6,500, an increase of 20 percent. The threshold topped \$47,000 when the child credit reached \$1,000 after 2003. Because the value of the child credit is fixed and not indexed to inflation, the threshold actually began to decline in real terms until 2008 when the stimulus plan was enacted.

The major elements of the Economic Stimulus Act of 2008 boosted the maximum income for nonpayers to more than \$56,700. In the absence of the rebates, the threshold would have been roughly \$44,500.

President Obama's temporary making-work-pay credit has a maximum value of \$800 per couple and will keep the nonpayer threshold over \$50,000 for tax years 2009 and 2010 if there are no further changes in the tax code in 2010.

**Table 1**  
**Maximum Income a Married Couple with Two Children Can Earn and Yet Pay No Federal Income Tax, Assuming No Unusual Tax Situations (Nominal and 2010 Dollars)**

Tax Year	Notes	Top Nonpayer Threshold (Unadjusted)	Top Nonpayer Threshold (2010 Dollars)
1993		\$15,600	\$23,717
1994		\$16,150	\$23,940
1995		\$16,550	\$23,857
1996		\$16,900	\$23,663
1997		\$17,500	\$23,953
1998	Child tax credit introduced, \$400 per child	\$23,233	\$31,313
1999	Child tax credit increased to \$500	\$24,867	\$32,790
2000		\$25,217	\$32,170
2001	Child tax credit increased to \$600; 10% tax rate introduced	\$31,200	\$38,702
2002		\$31,850	\$38,894
2003	Child tax credit increased to \$1,000	\$39,700	\$47,400
2004		\$40,200	\$46,752
2005		\$41,000	\$46,119
2006		\$41,867	\$45,623
2007		\$42,850	\$45,401
2008	Excluding the 2008 stimulus checks	\$43,583	\$44,471
	Including the 2008 stimulus checks; maximum \$1,200 for married couples, plus \$300 per child.	\$55,583	\$56,715
2009	Making-work-pay credit introduced; maximum \$800 for married couples	\$50,233	\$51,439
2010	(assuming no retroactive changes made during 2010)	\$50,250	\$50,250

Source: Tax Foundation calculations based on IRS data.

## Conclusion

Over the past two decades, Washington lawmakers have increasingly turned to the tax code to deliver social benefits, incentivize behaviors, and funnel money to targeted groups, which they always refer to as “helping the middle class.” These measures have not only added complexity to an already Byzantine tax system, they have also eliminated the income tax obligation for millions of tax filers and their families. As a result, a record 51.6 million tax filers – 36 percent of all filers – had little or no connection with the basic costs of government in 2008.

Tax years 2009 and 2010 are likely to produce a number of nonpayers equal to or greater than in 2008 because of Obama’s new tax credits targeted at lower- and middle-income taxpayers. As the number of refundable tax credits continues to grow, more and more tax filers are seeing the IRS as a source of income, not something to which taxes are paid. The consequences of these trends deserve a broader national discussion than either party in Washington seems willing to engage in.

**Table 2****Federal Individual Income Tax Returns with Zero or Negative Tax Liability**

<b>Year</b>	<b>Number of Returns Filed</b>	<b>Returns with Zero or Negative Tax Liability</b>	<b>Percentage of Returns with Zero or Negative Tax Liability</b>
1950	53,060,098	14,873,416	28.0%
1951	55,447,009	12,798,399	23.1%
1952	56,528,817	12,652,544	22.4%
1953	57,838,184	12,615,033	21.8%
1954	56,747,008	14,113,948	24.9%
1955	58,250,188	13,561,123	23.3%
1956	59,197,004	12,938,358	21.9%
1957	59,825,121	12,959,806	21.7%
1958	59,085,182	13,433,048	22.7%
1959	60,271,297	12,774,384	21.2%
1960	61,027,931	12,966,946	21.2%
1961	61,499,420	12,916,655	21.0%
1962	62,712,386	12,620,023	20.1%
1963	63,943,236	12,620,015	19.7%
1964	65,375,601	14,069,263	21.5%
1965	67,596,300	13,895,506	20.6%
1966	70,160,425	13,451,349	19.2%
1967	71,651,909	12,978,971	18.1%
1968	73,728,708	12,440,000	16.9%
1969	75,834,388	12,112,994	16.0%
1970	74,279,831	14,962,460	20.1%
1971	74,576,407	14,660,035	19.7%
1972	77,572,720	16,703,713	21.5%
1973	80,692,587	16,425,425	20.4%
1974	83,340,190	16,005,423	19.2%
1975	82,229,332	20,738,595	25.2%
1976	84,670,389	20,249,022	23.9%
1977	86,634,640	22,253,502	25.7%
1978	89,771,551	21,083,246	23.5%
1979	92,964,302	20,999,319	22.6%
1980	93,902,469	19,996,225	21.3%
1981	95,396,123	18,671,399	19.6%
1982	95,337,432	18,302,132	19.2%
1983	96,321,310	18,304,987	19.0%
1984	99,438,708	17,799,199	17.9%
1985	101,660,287	18,813,867	18.5%
1986	103,045,170	19,077,757	18.5%
1987	106,996,270	20,272,474	18.9%
1988	109,708,280	22,572,948	20.6%
1989	112,135,673	22,957,318	20.5%

1990	113,717,138	23,854,704	21.0%
1991	114,730,123	25,996,536	22.7%
1992	113,604,503	26,872,557	23.7%
1993	114,601,819	28,166,452	24.6%
1994	115,943,131	28,323,685	24.4%
1995	118,218,327	28,965,338	24.5%
1996	120,351,208	29,421,858	24.4%
1997	122,421,991	28,950,791	23.6%
1998	124,770,662	31,722,764	25.4%
1999	127,075,145	32,529,065	25.6%
2000	129,373,500	32,555,897	25.2%
2001	130,255,237	35,491,707	27.2%
2002	130,076,443	39,112,547	30.1%
2003	130,423,626	41,501,722	31.8%
2004	132,226,042	43,124,108	32.6%
2005	134,372,678	43,802,114	32.6%
2006	138,394,754	45,681,047	33.0%
2007	143,030,461	46,655,760	32.6%
2008	142,350,256	51,631,917	36.3%
Source: Tax Foundation calculations base on IRS Data			

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