

WHO PAYS AMERICA'S TAXES?

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“Almost half of all Americans pay no taxes!” That’s the claim bandied about in elections and overheated television talk-fests. It refers only to federal income taxes, from which various groups are exempt. But many other taxes are also collected at the federal, state, and local levels. When all kinds of taxes are added up, almost all Americans pay substantial amounts. In fact, poor and middle-income people frequently fork over higher shares of their incomes than the very rich.

Federal Income and Payroll Taxes

The U.S. federal government relies on two big taxes collected from large numbers of Americans: the federal income tax and payroll taxes regularly deducted from wages and salaries to cover Social Security and Medicare benefits. Income and payroll taxes each contribute about 40% of federal revenues. Almost half of U.S. households currently do not owe federal income taxes, but over three-fifths of these “non-filers” are workers who contribute very substantial payroll taxes. For example, Americans making the lowest incomes pay nearly 9% of their wages in payroll taxes, about the same percentage as middle-income workers pay.

Only about 17% of American households pay neither income nor payroll taxes, because they are headed by people in special sub-groups:

- Elderly men and women living on their Social Security benefits, who previously contributed payroll taxes during their working lives.
- Students or disabled individuals.
- Workers unable to find jobs. During the recent recession, the numbers of long-term unemployed people not filing income tax returns went up.
- Active-duty members of the U.S. military, who do not have to pay taxes on their combat pay and do not owe income tax after having been deployed.

Looking at the Whole Tax Picture

Although payroll and income taxes are the primary sources of federal government revenue, other taxes are crucial to state and local budgets. Property taxes are important for local governments. Overall, the states get about half their revenue from sales taxes; and about a third from states’ income tax charges. Taking all of these taxes into account, how much are people paying? Let’s consider typical sorts of American households living at different levels of income in recent years.

- **The Lowes** are among the poorest Americans, in the bottom fifth with an average income of \$18,400, wages typical for a fast-food server. They pay about 16% of their income in taxes, including 4% in federal taxes and more in local and state charges.

- **The Middletons** are in the middle fifth, where the average income is \$42,900 – about the earnings taken home by an appliance repair worker. They pay about 14% of their income to the federal government and about 11% more to their state and local governments.
- **The Highsmiths** make enough in salaries to put them at the top 1% of Americans (roughly \$762,000 as a married couple). Because the Highsmiths’ total income comes from salaries – if both are, for example, anesthesiologists making \$325,000 apiece per year– they will pay about 8% in state and local taxes and about 30% in federal income and payroll charges.
- Our final family could be called **the Trulyriches**, who pay a tax percentage considerably below both the Middletons and Highsmiths. The Trulyriches, like the Highsmiths, fall in the top one percent but make much of their income from sources other than annual salaries.

Income at the Very Top is Usually Not Just from Salaries

At the very high end of the U.S. income ladder, calculating a typical tax rate becomes complicated. That is because most people like the Trulyriches, who make as much or more money as the Highsmiths, receive both salaries and other forms of compensation taxed at much lower rates than wages and salaries. Investment income is taxed at 15%, well below the highest bracket for income taxes on salaries.

The average income of households in the top one percent is almost \$1.8 million annually, approximately the amount taken home each year by a CEO of a small- to mid-sized corporation. But much of that money comes from stock options, not salaries. The CEO of Columbia Sportswear, for instance, made \$1.9 million in 2011, with salary making up about half of that amount, while the CEO of JetBlue made \$1.6 million, only \$600,000 of which was in the form of a salary. The CEO of Staples had a salary of \$1.1 million, but total compensation of \$8.8 million.

Because so little of the Trulyriches’ annual income comes from salaries – and because, like many wealthy people, they hire lawyers and accountants to take advantage of loopholes in the tax code – their tax rates are often lower than the nominal rate they appear to owe. They may pay at rates similar to those owed by former Massachusetts Governor and 2012 Republican presidential candidate Mitt Romney. He earned almost \$14 million in 2011, yet paid only about 14% in federal income taxes, less than the Middletons, who live on an appliance repair worker’s salary.

Busting the Myths about Taxes

Clearly, there is a lot of misdirection and false information about the taxes that fund U.S. governments at all levels, and who pays them. It is simply not the case that “half of Americans don’t pay taxes.” People at the low end of the income spectrum usually pay a great deal, particularly in federal payroll charges and in sales taxes and various other levies. High earners pay a high federal income tax rate on paper. But the well-to-do who actually pay the highest income tax rates are mostly salaried professionals. Most top earners – and of course the very richest Americans – get most of their money from investments and make elaborate use of loopholes and credits sprinkled throughout U.S. tax codes. Most end up paying lower percentages of their income in taxes than middle-income people and even many of the poor.

This brief draws especially on reports from Citizens for Tax Justice, the Center for Budget and Policy Priorities, and the Tax Policy center.