Montana Department of Revenue

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To: Senator Art Wittich

From: Dan Dodds, Senior Economist

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Subject: Fraction of Households that Pay Federal and State Taxes

You asked how the fraction of the population paying Montana taxes compares to the fraction of the population paying federal taxes.

For the Individual Income Tax

- About 59% of adults in the United States paid federal income tax for 2008.
- About 70% of adults in Montana paid state income tax for 2008. For 2009, it fell to 65%, as some people who paid tax in 2008 had lower incomes or losses and did not owe tax for 2009.

Other taxes

- Most individuals pay one or more of a number of other state and federal taxes.
- Most individuals who are employed or self-employed pay social security and unemployment insurance taxes.
- The largest source of state and local tax revenue in Montana is the property tax. Almost all households pay property taxes, either directly as homeowners, or indirectly as renters.
- Montana levies several selective sales taxes. Some, such as the telecommunications excise tax, are paid by almost all households.

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.

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 for 2009, but the latest year for which the IRS has published national data is 2008.

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	339,939	70%
Montana 2009	507,648	433,046	330,182	65%
United States 2008	154,263,859	142,450,569	90,659,908	59%

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 income.

The right side of the table illustrates reasons why taxpayers may have no tax liability. The third column from the right shows the number of returns with no taxable income, i.e. with adjusted gross income less than the total of exemptions and deductions. There are several things that may put a household in this position. They may have low income, they may have tax exempt income, they may have large deductions, or they may have business losses offsetting other income. The second column from the right shows the number of households with no taxable income who had business losses.

The right-hand column shows the number of returns with tax liability that was completely offset by credits.

2009 Montana Income Tax Returns With No Tax Liability

				AGI < Exemptions & Deductions		
Income Range	Total Returns in Income Range	No Tax Liability After Credits	% of Income Group	Number	Number with Business Losses	Credits > Tax Liability
$ or Less	7,503	7,497	100%	7,494	6,653	0
$1 to $5,451	42,554	34,862	82%	34,424	4,758	83
$5,452 to $10,601	42,554	16,686	39%	15,631	3,360	682
$10,602 to $16,163	42,554	13,075	31%	11,393	2,892	1,306
$16,164 to $22,277	42,555	9,872	23%	8,022	2,150	1,482
$22,278 to $29,635	42,554	7,549	18%	5,712	1,576	1,508
$29,636 to $39,380	42,554	4,989	12%	3,474	969	1,255
$39,381 to $52,280	42,555	3,251	8%	2,054	569	1,027
$52,281 to $69,306	42,554	2,101	5%	1,199	324	820
$69,307 to $95,908	42,554	1,496	4%	882	253	559
$95,909 to $112,420	14,185	456	3%	231	76	201
$112,420 to $148,299	14,185	419	3%	165	63	237
$148,300 or More	14,185	611	4%	125	82	463
All	433,046	102,864	24%	90,806	23,725	9,623

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.

2008 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	2,489,989	2,486,494	100%	2,484,057	2,437
$1 under $5,000	11,638,707	11,136,285	96%	11,117,506	18,779
$5,000 under $10,000	12,139,638	9,527,869	78%	8,950,075	577,794
$10,000 under $15,000	11,702,056	7,466,833	64%	5,669,107	1,797,726
$15,000 under $20,000	11,076,002	5,781,549	52%	3,534,221	2,247,328
$20,000 under $25,000	9,866,247	4,435,466	45%	1,605,610	2,829,856
$25,000 under $30,000	8,743,581	3,416,951	39%	708,912	2,708,039
$30,000 under $40,000	14,554,280	3,799,304	26%	591,752	3,207,552
$40,000 under $50,000	11,087,123	1,778,563	16%	247,756	1,530,807
$50,000 under $75,000	19,196,461	1,534,417	8%	200,706	1,333,711
$75,000 under $100,000	11,729,485	294,617	3%	80,770	213,847
$100,000 under $200,000	13,851,341	110,055	1%	48,774	61,281
$200,000 under $500,000	3,476,747	16,848	0%	7,861	8,987
$500,000 under $1,000,000	577,618	3,355	1%	1,344	2,011
$1,000,000 under $1,500,000	140,635	792	1%	359	433
$1,500,000 under $2,000,000	59,460	408	1%	179	229
$2,000,000 under $5,000,000	86,329	594	1%	272	322
$5,000,000 under $10,000,000	21,390	154	1%	69	85
$10,000,000 or more	13,480	106	1%	42	64
Total	142,450,569	51,790,660	36%	35,249,372	16,541,288