



JOINT ECONOMIC COMMITTEE

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RESEARCH REPORT #109-21
October, 2005



MILLIONS OF TAXPAYERS HAVE ZERO OR NEGATIVE FEDERAL INCOME TAX LIABILITY

Tax distribution tables purport to show who wins or loses from tax legislation. These tables are a typical source of controversy during tax reform debates. Such tables typically use averages to indicate the size and direction of the tax effect. However, the use of averages alone is inappropriate because averages cannot accurately show the impact on most taxpayers within the same income classification.

Focusing on the average tax cut, for example, presents the false impression that the average properly typifies each taxpayer. It is also important to note that more than one-quarter (27.3 percent) of federal income tax returns cannot receive further tax relief because these taxpayers effectively do not pay federal income taxes.

In the context of tax distribution analysis, the average is actually the *least* representative measure. Millions of families, many in the first quintile, have either zero tax liability or receive a net transfer from the government due to the

refundable portion of the Earned Income Tax Credit (EITC). Hence, many of the returns in the bottom quintile do not actually pay federal income taxes and, due to the refundable portion of the EITC, many do not effectively pay payroll taxes.

The table below provides the most recent available public-use file data. It shows that for tax year 2001, 27.3 percent of all tax returns reported zero or negative federal income tax liability. This amounts to 35.6 million tax returns.

It is also interesting to note that there are actually taxpayers in each quintile who reported zero tax liability in 2001. For example, almost 76 percent of all tax returns in the first quintile reported zero federal income tax liability, or received a net transfer from the government. This amounts to almost 20 million tax returns. In the second quintile, 41 percent or over 10 million tax returns reported zero or negative income tax liability. Although a much smaller number, 78,500 tax returns in the fifth quintile reported zero tax liability.

Returns With Zero or Negative Federal Income Tax Liability										
	Returns with Zero or Negative Tax Liability		Returns with Negative Tax Liability		Returns Receiving Less than \$500 in Refundable Credits		Returns Receiving \$500 to \$999 in Refundable Credits		Returns Receiving \$1,000 or More in Refundable Credits	
	Returns	% of Returns In Category	Returns	% of Returns In Category	Returns	% of Returns In Category	Returns	% of Returns In Category	Returns	% of Returns In Category
All Returns	35,573,709	27.3%	16,735,133	12.8%	3,597,407	2.8%	1,688,049	1.3%	11,449,677	8.8%
Quintile 1	19,666,838	75.5%	6,477,619	24.9%	2,538,742	9.7%	505,104	1.9%	3,433,773	13.2%
Quintile 2	10,656,505	40.9%	7,326,617	28.1%	241,731	0.9%	476,564	1.8%	6,608,322	25.4%
Quintile 3	4,567,212	17.5%	2,930,897	11.3%	816,934	3.1%	706,381	2.7%	1,407,582	5.4%
Quintile 4	604,616	2.3%	-	0.0%	0	0.0%	0	0.0%	0	0.0%
Quintile 5	78,537	0.3%	-	0.0%	0	0.0%	0	0.0%	0	0.0%

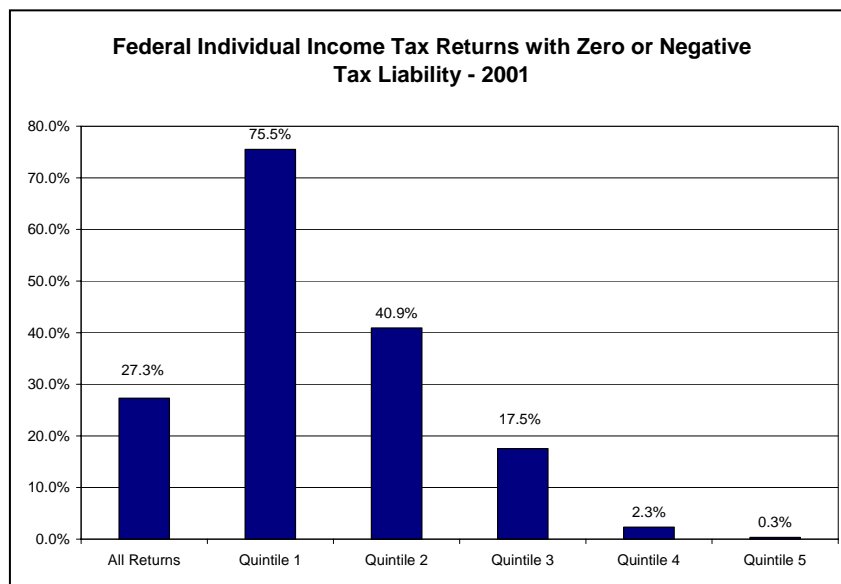
Notes: Data may not add due to rounding (rounded to hundreds), weighting and disclosure requirements of IRS-SOI
Federal Income Tax Liability Includes AMT and Refundable Credits
Total Number of Returns = 130,255,200 with approximately 26.05 million returns per quintile
Source: Joint Economic Committee estimates based on SOI Public Use File Tax Year 2001

It is also interesting to note the number of returns that receive a net transfer from the government of \$1,000 or more. The returns in this category not only pay zero federal income taxes, but many do not effectively pay payroll taxes, as the check from the government cancels the payroll tax liability for many. For all returns in 2001, over 11.4 million received a net transfer from the government of \$1,000 or more, or 8.8 percent of all returns. In the first quintile, almost 3.4 million returns, or 13.2 percent, received a check of \$1,000 or more.

What may be a surprise to many is that over 6.6 million returns in the second quintile, or 25.4 percent of returns in the second quintile, received a net transfer from the government of \$1,000 or more. The greater number of returns receiving \$1,000 or more from the government in the second quintile over the first quintile is

due to the many people in the second quintile who qualify for the Earned Income Tax Credit.

The existence of 35.6 million returns, or more than one-quarter of all federal income tax returns (27.3 percent), that pay zero or negative income tax skews the average tax liability and makes the use of averages misleading. Further, since tax distribution tables predominantly focus on the “average tax cut” for each income group, the debate over the benefits of a tax reduction are clouded when more than one-quarter (27.3 percent) of federal income tax returns cannot receive further tax relief because these taxpayers effectively do not pay federal income taxes. The data in the table further places into context how the use of averages in distribution analysis is an inappropriate measure to represent all taxpayers in a given group.



For further information please see the following Joint Economic Committee studies by visiting the JEC website www.house.gov/jec, or contacting the JEC at (202) 226-3234.

For further information please see:

- *A Guide to Tax Policy Analysis: Problems with Distributional Tax Tables* (January 2000)
- *A Guide to Tax Policy Analysis: The Central Tendency of Federal Income Tax Liabilities in Distributional Analysis* (May 2000)
- *The Misleading Effects of Averages in Tax Distribution Analysis* (September 2003)
- *A Comparison of Tax Distribution Tables: How Missing or Incomplete Information Distorts Perspectives* (December 2003)
- *Treasury Department Estimates of Tax Changes: A Review and Analysis* (July 1997)