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No Easy Answer on Tax Issue

By JONATHAN WEISMAN

After two decades of bipartisan tax policy, nearly half of all American households don't pay federal income taxes. Now, Republican presidential candidates are making a politically challenging case to change that fact.



GOP presidential candidates are campaigning on raising income taxes but become vague over whom exactly they want to tax, WSJ Washington reporter Jonathan Weisman tells the News Hub. AP Photo.

Most working Americans do pay Social Security and Medicare payroll taxes. But because of tax breaks for seniors and inducements for work and raising children, among other accumulated changes to the tax code, many manage to avoid income taxes altogether. The nonpartisan Tax Policy Center in July pegged that number at 46% of U.S. households for this year.

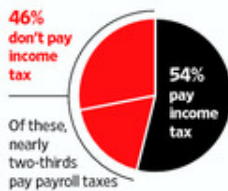
As a result, a 2012 election campaign that has featured vows against raising taxes also has produced the parallel critique that too many Americans pay no income tax at all, a point made by Minnesota Rep. Michele Bachmann in July and more recently by former Massachusetts Gov. Mitt Romney and Texas Gov. Rick Perry.

"We're approaching nearly half of the United States population that doesn't pay any income taxes," Mr. Perry said in Iowa, when asked about combating an "entitlement culture" in the U.S. "And I think one of the ways is to let everybody, as many people as possible...be able to be helping pay for the government that we have in this country." In Nashua, N.H., Mr. Romney hit a similar theme: "We want to make sure people do pay their fair share."

Zero Sum

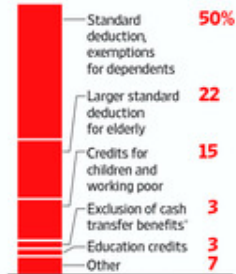
About 76 million taxpayers pay no federal income tax, although most pay Social Security and Medicare taxes.

Percentage of tax units by federal tax liability, 2011



Among those who pay neither, more than half are elderly; more than one-third are nonelderly earning less than \$20,000 a year

Percentage with no tax liability due to each tax provision



*Benefits other than Social Security and unemployment, such as Temporary Assistance to Needy Families and Supplemental Security Income
Source: Tax Policy Center

Broadening the tax base, simplifying the tax code and lowering tax rates have long been prescriptions for a more efficient tax system, notably from the right. The idea is likely to be a major

issue as a congressional supercommittee seeks at least \$1.2 trillion in deficit reduction by Thanksgiving.

Of the poorest 20% of American households, those earning less than \$16,812 a year, 93.4% pay no income tax. But even 30% of the middle class earning between \$33,542 and \$59,386 are exempt. Some Republican economists say the tax policies that cause this phenomenon have gone too far, contending that people who don't pay income taxes have an incentive to support politicians who promise more federal programs, since they aren't paying for them.

Moreover, they argue the tax code has become too dependent on too few people. Sixty percent of the income tax is paid by 5% of U.S. households, said Douglas Holtz-Eakin, a former Congressional Budget Office director who led domestic policy for John McCain's 2008 campaign. "We're going to have to have tax reform," he said. "The system is broken."

But the politics of change are not clear cut. About half of the households that pay no income tax do so simply because the standard deductions for tax filers and dependents are large enough to negate taxable earnings. In addition, nearly half of the remainder who were knocked off the tax rolls because of other tax measures are seniors, according to the Tax Policy Center.

The elderly who do not itemize their taxes get a larger standard deduction and most can exclude some or all of their Social Security from being counted as income. Repealing those benefits would subject 16.3 million more households to income taxation.

The next-largest group of non-taxable households that had no taxable income because of tax policy will be exempted from the income tax rolls because they qualify for the earned-income credit for the working poor or their per-child tax credits were large enough to eliminate their income tax hit.

The earned-income credit was Ronald Reagan's answer to welfare, a way to make even low-wage jobs pay better than the dole. The child credit, another Republican idea, was doubled in President George W. Bush's 2001 tax cut and is a favorite of religious conservatives.

Addressing the Republican lament about too few income tax payers likely would require a broad revamp of the entire tax code. But the chances of getting that done in an election season and with Washington bitterly divided on tax policy seem small.

Pressed on how they would bring more people into the tax system, none of the top three campaigns offered details. Alice Stewart, a spokeswoman for Mrs. Bachmann, said the Minnesotan "believes that the tax code is too complicated and must be reformed to be fairer and flatter."

Campaign spokeswoman Gail Gitcho said Mr. Romney "is opposed to tax increases," adding he would produce his economic plan in the fall.

"Governor Perry wants more people on the tax rolls not by raising taxes or expanding the tax base, but by putting people to work," said Perry spokesman Mark Miner.

Kevin Hassett, director of economic policy at the conservative American Enterprise Institute, said the GOP candidates were wrong to assume that working-class voters support government programs because they are free.

Poorer households pay disproportionate shares of what Mr. Hassett calls stealth taxes on gasoline, alcohol and cigarette, even lottery tickets. They may get back in Social Security and Medicare benefits more than they pay in payroll taxes, but that is cold comfort for struggling young workers trying to buy a house, he said.

Write to Jonathan Weisman at jonathan.weisman@wsj.com

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