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Got Skin in the Game?

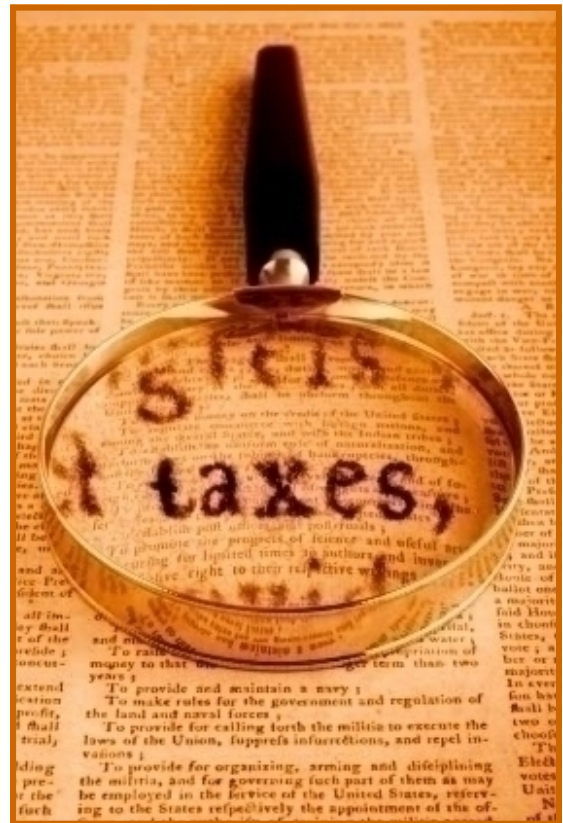
“But in this world nothing can be said to be certain, except death and taxes.”

—Benjamin Franklin

by **Melissa K. Smith**
Senior Policy Analyst

It is often said that families who receive government assistance do not have any “skin in the game,” meaning that they use government-funded programs but do not contribute to the revenue that funds these programs. But, as Benjamin Franklin said, the only things that are certain are death and taxes and everybody pays taxes.

Wealth and earnings are fluid. People experience income changes throughout their lives. While they may not be subject to income tax in any given year, they likely paid income tax in other years. And, of course, everyone pays sales tax, and anyone who works is subject to payroll taxes. One way or another, we all have some “skin in the game.”



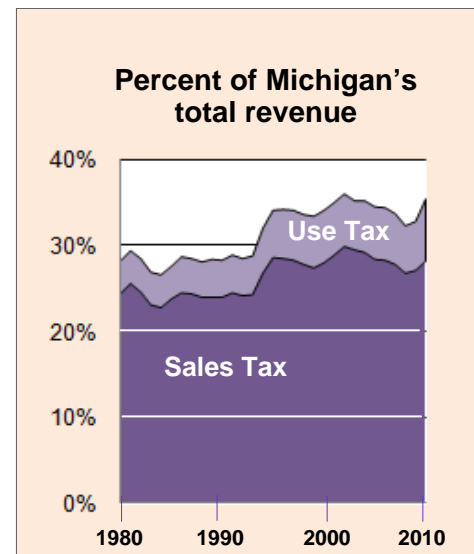
Michigan League for Human Services

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Sales and Excise Taxes Make Up More of Michigan's Revenue than Income Taxes

The income tax is often thought of as the main source of state revenue, but it only makes up about 20% of total state tax revenue in Michigan. In Tax Year 2011, consumption taxes (sales, use and excise taxes) made up 33% of Michigan tax revenue.¹ Unlike income tax, everybody pays consumption taxes, which have progressively been making up a larger percent of total state tax revenue over the past 30 years.²



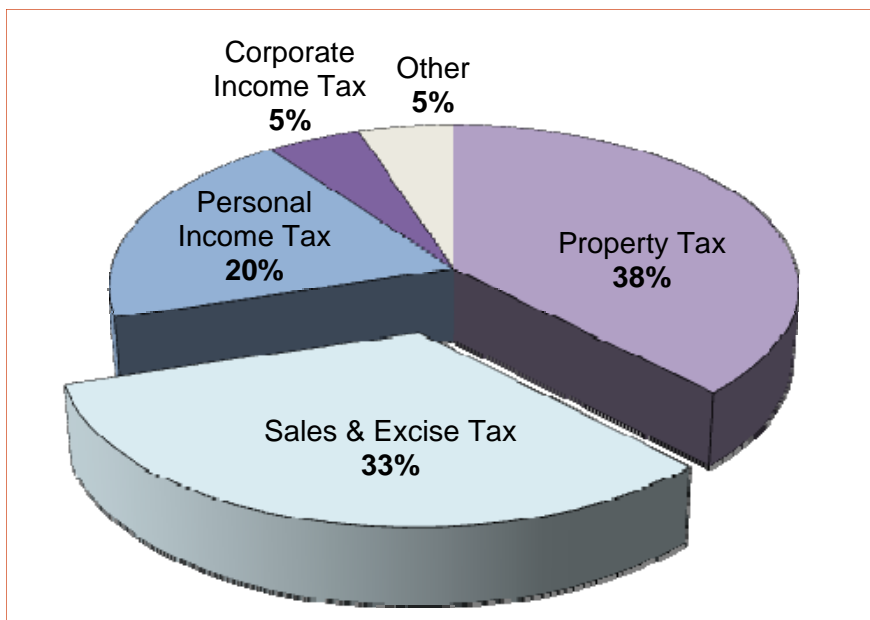
Source: Michigan's Sales and Use Taxes 2010. Tax Analysis Division, Office of Revenue and Tax Analysis, MI Department of Treasury, Aug., 2011.

Consumption Taxes refer to taxes on the items people purchase. There are three main consumption taxes in Michigan:³

Sales Tax: applies to the total amount that is paid for all goods and services subject to the tax. Things like automobiles and shoes are subject to the sales tax. In Michigan, the state sales tax rate is 6%.

Use Tax: applies to purchases that are not subject to Michigan sales tax. It is leveraged on purchases made in other states or countries that are brought into Michigan, as well as on vehicles, telecommunications and lodging. The use tax is also 6%.

Excise tax: applies to particular products. It is typically leveraged on things like tobacco, alcohol and fuel. The excise tax varies depending on the product.



1/3rd
of Michigan's
state revenue
comes from
sales and
use taxes

Source: *The ITEP Guide to Fair State and Local Taxes*, 2011. Institute on Taxation and Economic Policy.

Low-Income Households Pay a Proportionate Share of Their Income in Taxes

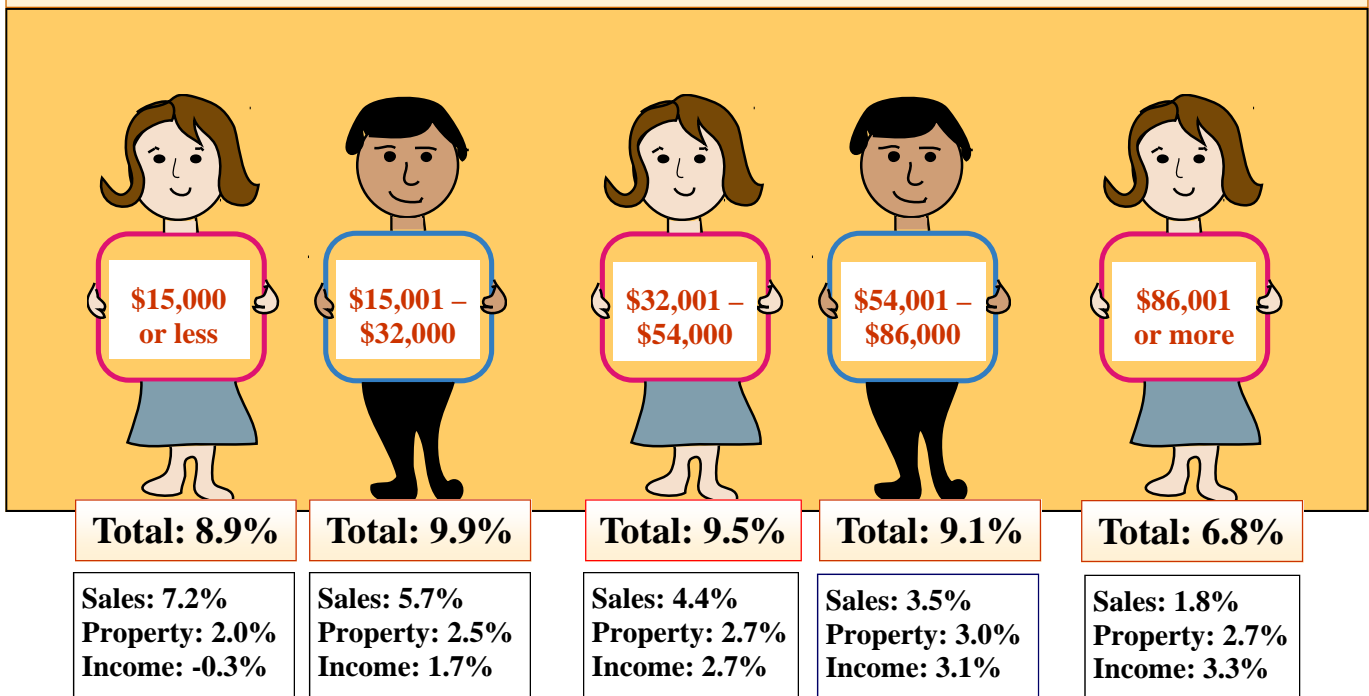
Whether or not a household pays personal income tax, they still pay about the same percentage of their income to taxes.

A look at income distribution can help demonstrate what portion of a household's income is spent on taxes. Income is generally measured in quintiles, or fifths. For example, households that make under \$15,000 a year are considered to be in the lowest quintile which is 20% of all households. The top of the income scale measures the 20% of households that make the most money — \$86,000 or more. The top quintile is also broken down to identify the top 4% and top 1% of households in the country.

Sales and excise taxes make up the largest portion of a household's tax expenditures for all but the top 20% of households. **Households that don't pay income tax still end up paying almost 9% of their income to taxes, approximately the same as households that do pay income tax.**⁴



PERCENT OF STATE AND LOCAL TAXES PAID BY QUINTILE IN MICHIGAN



Source: *Who Pays? A distributional analysis of the tax systems in all 50 states, 3d. edition.* Institute on Taxation and Economic Policy, November 2009.

Every Worker Pays Payroll Taxes

Just because a household does not pay income tax does not mean they don't work. Sixty-one percent of households that do not pay income tax do in fact work; they just don't make enough money to be subject to the federal income tax. And every employed individual has 7.65% in payroll taxes deducted from their paycheck in federal payroll taxes. Federal payroll taxes (FICA on your paycheck) pay for Medicare and Social Security.⁵

In 2007, prior to the economic downturn, approximately 40% of households did not owe federal income taxes, but when payroll taxes are included, only 14% of all households did not pay federal taxes that year. The households that paid no federal taxes were primarily made up of seniors, students or people with disabilities who are more likely to live in poverty or not work at all and so do not make enough money to pay income tax.⁶ Of course, seniors paid taxes during their working years and students will pay taxes when they graduate and start a career.

The wealthiest households in the nation actually pay a smaller percentage of their income to payroll taxes than other households because many high-income households draw their income from capital gains and dividends which are not subject to Social Security payroll taxes. In fact, any income earned over \$110,100 is not subject to the Social Security portion of the payroll tax.

Only
14%

of all households do not pay federal income or payroll taxes

82%

of working households pay more in payroll taxes than income tax

Who didn't pay federal income tax in 2011?

Households that don't earn enough money to be subject to federal income still pay 7.65% of their earnings to payroll taxes



61% were workers who paid payroll taxes

22% were senior citizens

17% were students, disabled, or unemployed

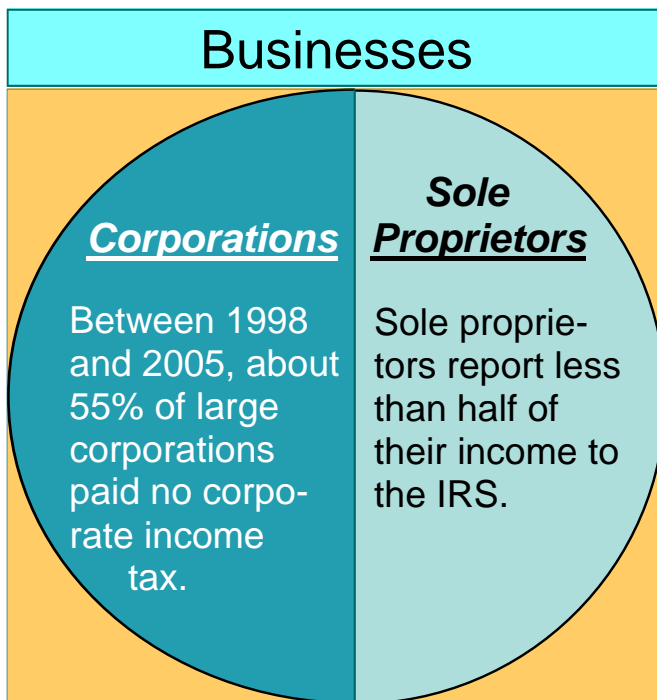
Figure borrowed from Who Doesn't Pay Taxes?, Urban Institute-Brookings Institution Tax Policy Center.

Who Doesn't Pay Taxes?

Low-income households are not the only ones that don't pay income tax in a given year, and those that do owe taxes do not always pay. In 2006, the IRS estimated that taxpayers failed to pay \$450 billion in federal taxes on time, \$385 billion of which was never paid. That is more than Medicare costs in a year.⁷

Businesses

Businesses also pay income tax and, like individuals, may pay no taxes in one year, but pay substantial taxes in subsequent years, depending on their profits. And businesses do not always pay what they owe.⁸



Source: Marr, C., *Congress Should Start Minding the Tax Gap*. Center on Budget and Policy Priorities – Off the Charts Blog. January 11, 2012.

Under-reported
business
income
accounts for
the largest
source of
unpaid taxes:

**\$122
billion
a
year**

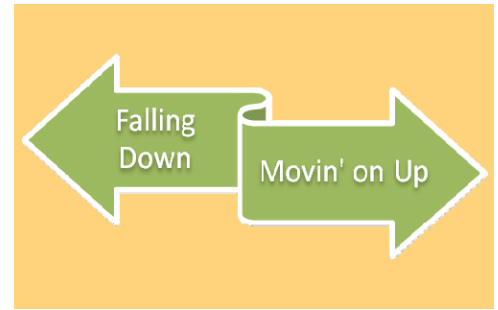
Middle- and High-Income Households

Many households take itemized deductions. Middle-income households get tax credits for children and education. High-income households have reduced tax rates on capital gains and dividends.

People Who Don't Pay Income Taxes One Year Do Pay Income Taxes in Subsequent Years

Just because a household does not owe income tax in a given year doesn't mean that they don't pay income tax over the course of their lifetime. For example, the Earned Income Tax Credit offers a refundable tax credit to low-income working households, negating their federal income tax in a given year. However, most EITC recipients only get the credit for a year or two at a time, but pay substantial federal income taxes in other years.⁹

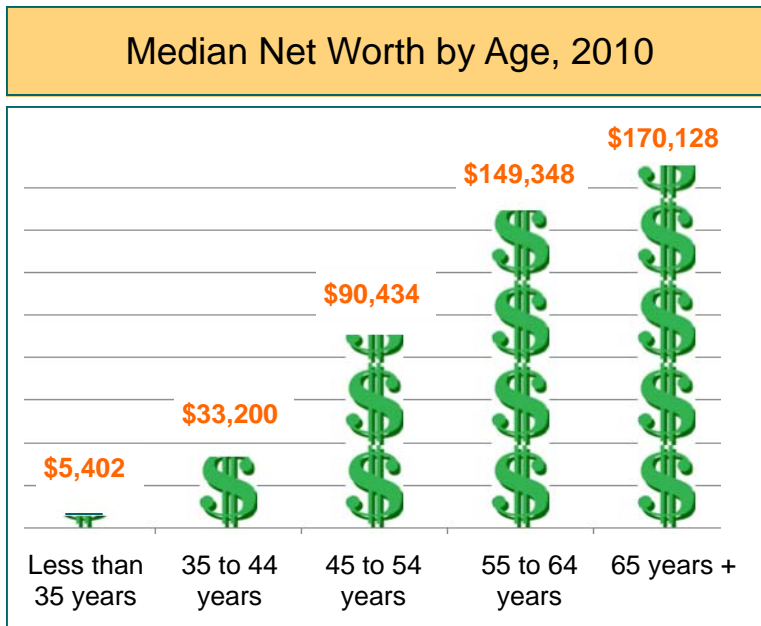
Household wealth varies over time and people experience income changes throughout their life. Net worth generally increases as people get older and then starts to decrease after 65 years of age. The economy also contributes to a household's net worth. In good years, net worth is higher and more taxes are collected. In bad years, net worth and revenue collections drop.¹⁰ Almost half of the households in the middle quintiles will experience enough income fluctuation to move them to a different quintile over time.¹¹



Approximately

1/3rd

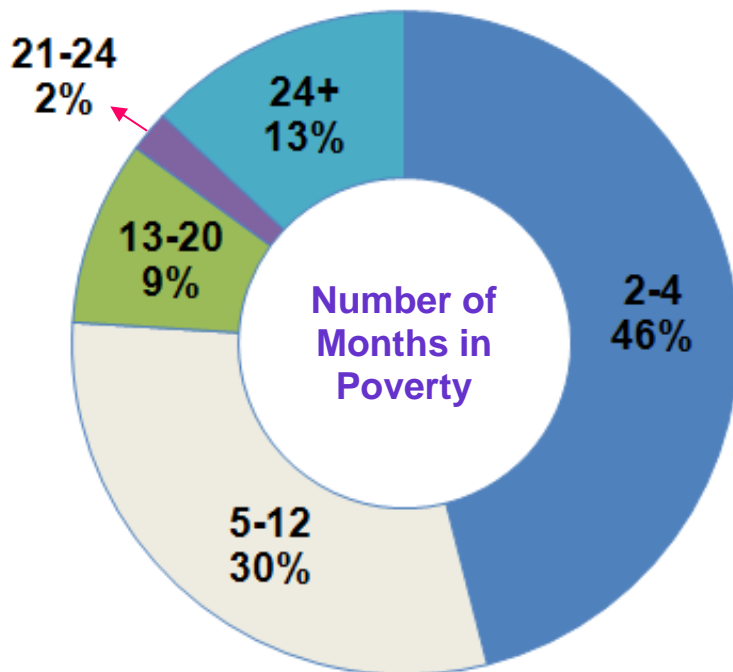
of low-income households will move to a higher income category during their lifetime



Source: Bureau of the Census Statistical Brief, Household Wealth and Asset Ownership: 1991.

People Rarely Live in Poverty Their Entire Lives

While there is a general assumption that most poverty is chronic, in actuality, few people spend their entire life being poor. Rather, they move in and out of poverty over the course of their lifetimes. A study by the U.S. Census Bureau found that almost 20% of households experienced a bout of poverty over a two-year period, but only 4.8% of households were in poverty the entire time. Of the households in poverty, 75% were in poverty for one year or less and only 13% of poor families remained in poverty the entire 24 months.¹²



Source: Eller, T.J., *Dynamics of Economic Well-Being: Poverty, 1992-1993*. Current Population Reports. June 1996. P70-55.

75%

of households in poverty moved out of poverty in a year or less

Less than

5%

of all households experience poverty for multiple years at a time

Just Because You Get It Doesn't Mean You Didn't Pay for It: Receipt of Government Assistance

Most people that use government assistance do so for only a finite period. As would be expected, caseloads for assistance programs grow during an economic recession and subside when the economy improves. In fact, that is precisely why these programs exist – to respond to poor economic conditions. Due to the recession, the number of people receiving some sort of government assistance in Michigan has increased over the last five years.¹³ These increases track with changes in the economy.

The USDA looked at food assistance usage in the mid-2000s and found that about 17% of recipients received food assistance for one year or less and more than 29% had a spell of two years or less. Overall, half of households that received food assistance did so for seven years or less over their lifetime.¹⁴

A similar study that looked at cash assistance participation found that 30% of recipients in Michigan were not on cash assistance for more than a year and more than half did not receive benefits for more than two years.¹⁵ **In fact, the average number of months that a family receives cash assistance in Michigan has dropped significantly over the past 10 years.**¹⁶

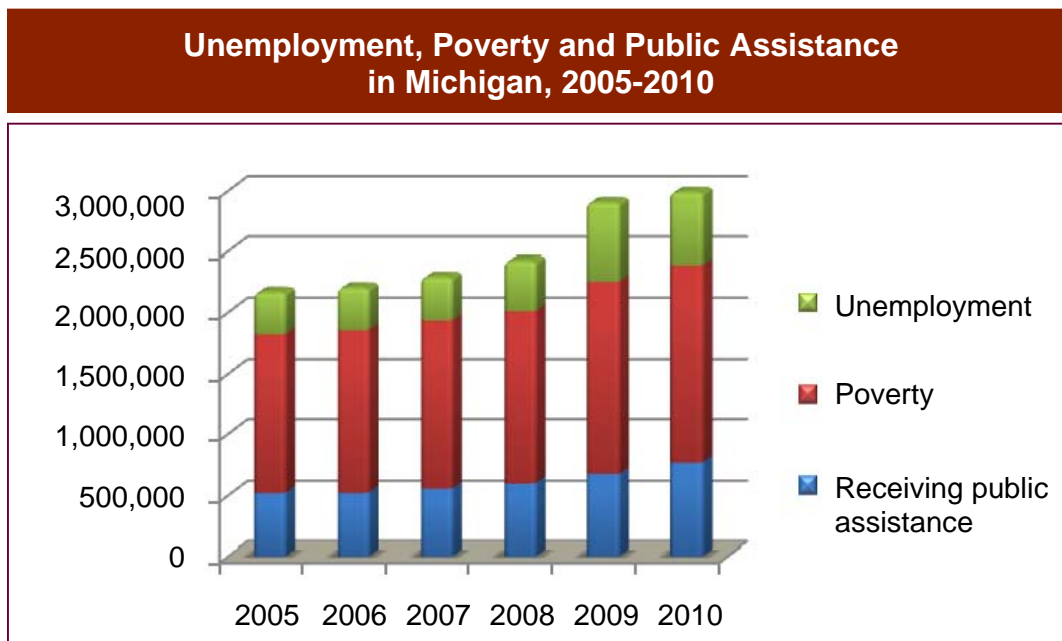
Prior to the recession, the median duration on food assistance was

10 months

There has been a

42%

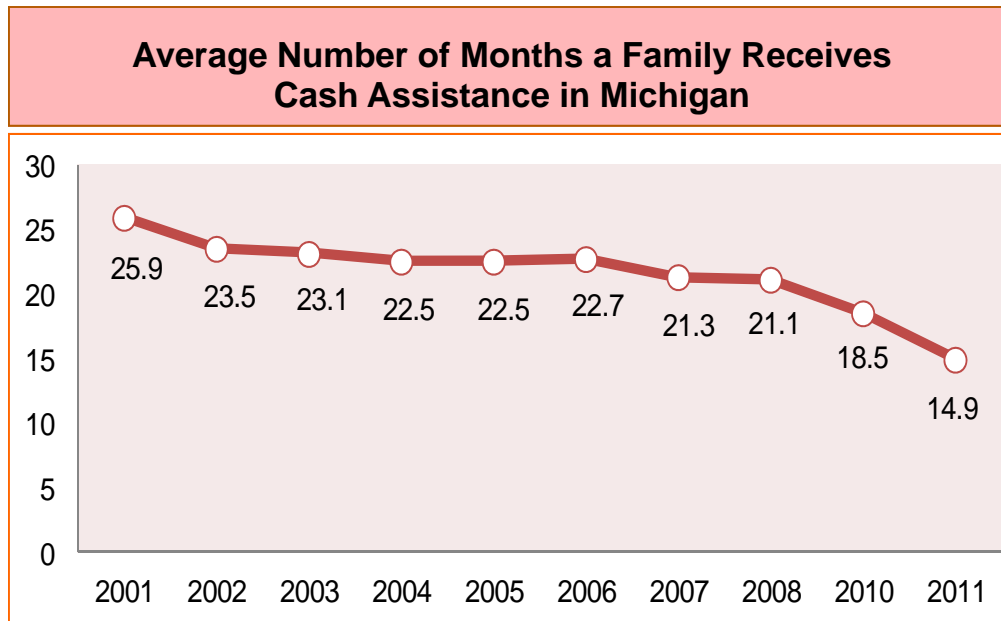
drop in the average amount of time that a household in Michigan receives cash assistance over the past decade



Sources: American Community Survey; Local Area Unemployment Statistics; Michigan Department of Human Services Green Book.

During downturns in a recession, many people lose their jobs and can't find other employment. This doesn't mean that people who don't have jobs don't want to work. **Only about 5% of people who don't work do so because they have no interest in working and many of those who do not work are seniors or have a disability or temporary illness.**¹⁷

Just because a family is receiving government assistance does not mean they are not working and paying taxes. More than one-third of Michigan food assistance recipients had earned income in FY 2010, a trend that has been increasing over the last 20 years.¹⁸ **More than half of households receiving cash assistance in Michigan are either employed or looking for work.**¹⁹



Source: Information Packet, DHS Budget Division, Michigan Department of Human Services, DHS-PUB-0790, August 2011. 2009 data not available.

More than 1/3rd

of food assistance recipients in Michigan had
earned income in 2010

Only 5%

of people who don't work do so because
they have no interest in working

More than half

of households receiving cash assistance in Michigan are
either employed or looking for work

Conclusion

Income taxes make up only a small portion of state revenue. Sales tax and other consumption taxes continue to grow as a share of government revenue and currently make up more than one-third of Michigan's state revenue. Sales tax is a universal tax that everyone pays.

Because of this, households that don't pay income tax end up paying a larger share of their income to sales tax. But they still pay a proportionate amount of their income to taxes as other households.



Whether a household has enough earnings to have to pay income taxes will change over time as wealth is not static.

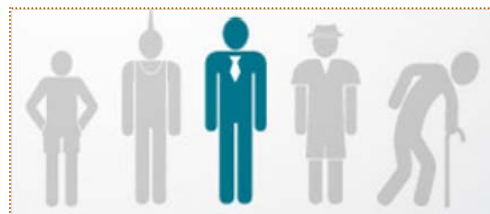
Most people who live in poverty only do so for a few years. As people get older, their net worth increases. Less than 5%

of households actually live in poverty continually. And low-income households are not the only ones not paying income taxes. More than half of large

corporations do not pay corporate income tax in a given year and sole proprietors report less than half of their income to the IRS.

Most of the households that don't pay income taxes are working households that may not make enough money to be subject to the income tax, but still pay payroll taxes. When both income and payroll taxes are considered into the equation, only 14% of all households in the U.S. do not pay either of these taxes, most of which are seniors, students, or

people with disabilities. Even these households, however, pay sales tax.



What all of this means is that everyone pays taxes.

The type of taxes a household pays may vary over time, but everyone contributes money to government revenue. **One way or another, we all have "skin in the game."**

Sources:

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- ³ *Outline of the Michigan Tax System*, Citizens Research Council of Michigan, March 2012; *The ITEP Guide to Fair State and Local Taxes, 2011*. Institute on Taxation and Economic Policy. Analysis based on FY 2007-08 State and Local Census Data.
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- ⁸ Marr, C., *Congress Should Start Minding the Tax Gap*. Center on Budget and Policy Priorities – Off the Charts Blog. *January 11, 2012*.
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- ¹⁶ *Information Packet, August 2011*. Michigan Department of Human Services Budget Division, DHS-PUB-0790.
- ¹⁷ Dalirazar, N., *Reasons People Do Not Work, 2004*. Current Population Reports, Sept. 2007, P70-111.
- ¹⁸ *Fiscal Year 1989 to 2010 Supplemental Nutrition Assistance Program Quality Control Samples*. United States Department of Agriculture, Food and Nutrition Services Office of Research and Analysis.
- ¹⁹ *Characteristics and Financial Circumstances, Temporary Assistance for Needy Families Program, FY 2009*. U.S. Department of Health and Human Services, Administration for Children and Families.