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Who pays what, who doesn't pay, and how do you fit in?

By Robert W. Wood

Paying taxes is on everyone's mind, rarely in a good way. Knowing some pithy facts about our tax system and your role in it won't make you feel any better. Still, as you embark on your own annual tax odyssey, you might be surprised about who pays what, who doesn't pay, and how you fit in according to recent IRS statistics. You might even alter your behavior to improve your tax posture or at least how the IRS sees you.

Let's start with the basics. Our tax code is wordy, about 4 million words. It's always changing, too. Since 2001 alone, there have been more than 4,500 changes.

The IRS receives over 140 million individual tax returns annually. That's staggering, and so are collections. The IRS collects over $950 billion in annual taxes.

But a lot of people file and get money back in the form of a tax refund. The average tax refund is almost $3,000 – $2,953 to be exact. In all, over $325 billion in tax refunds are paid out annually.

Tax refunds are great, and who doesn't like receiving them? However, since it is really your own money, getting a refund really suggests that you were having too much withheld from your pay or that you made estimated tax payments that were too large. Tax refunds are like interest-free loans to the government.

Want to be in the top 1 percent of earners nationally? You'll need $369,509 of annual income to join that group. If you aim to be in the top 10 percent of income earners, you'll only need $116,555. That means 90 percent of taxpayers make less.

Making a million dollars is a nice goal, but roughly 7,000 millionaires didn't pay *any* income tax in 2011. They would be quick to point out that they had losses that more than offset their income. But a large number of returns – over 275,000 – showed adjusted gross incomes of $1 million or more.

California has the largest number of millionaires. More than 40,000 Californians reported over $1 million in income. Vermont has the least – less than 300 millionaires. Want to aim really high and try to crack the $10 million mark? More than 11,000 individual tax returns reported adjusted gross income above $10 million.

I still like paper returns whenever possible, but e-filing is now nearly universal. E-filing makes the IRS's job easier. It allows them to effectively mine our information, and helps them audit more readily. Ouch. Almost 90 percent of individual tax returns are now e-filed, and many taxpayers don't have a choice. There are still some exceptions from required e-filing, but most of us are required to file this way.

As you would expect, the biggest tax deductions are claimed by itemizers. Of all tax deductions on individual returns, the biggest are those for taxes paid to state and local governments. Next biggest are for interest, especially on home mortgages.

You probably know that to deduct medical and dental expenses your expenses have to be quite high. Still, medical expenses count as the fourth most popular individual tax deduction, behind taxes, interest and charitable contributions.

If you don't itemize and claim the standard deduction, you might want to know that the average standard deduction is $7,000 to $8,000 ($7,884, to be exact). Itemizers on average claim $26,084.

Who uses paid tax preparers? More than half of returns – about 57 percent – are done by paid preparers. There's been lots of controversy about the IRS regulation of preparers, but it mostly impacts the lower end of the tax preparation market.

Most of us focus on top marginal tax rates, and that's what you see in the press and on the news. But the *average* income tax rate as a percentage of adjusted gross income might surprise you. It's only 11.8 percent. As a percentage of adjusted gross income, people earning $100K to $200K pay an average federal tax rate of only 12 percent. From $200K to $500K, it's 19.6 percent. Don't confuse marginal tax rates with average tax rates. The marginal rate is what you pay on your very last dollar.

Interest and capital gains are popular types of income – especially interest. Of 142 million individual tax returns filed in a recent year, 55 million of them reported interest income. Twenty-eight million of them reported dividends, and 21 million reported capital gains.

A whopping 4 million tax returns report Alternative Minimum Tax, otherwise known fondly as AMT. It remains hard to handicap. You compute your regular tax and your AMT and pay whichever is more. Since the AMT rate is 28 percent, you might think it doesn't sound too bad. But in computing your AMT it can feel like you're on another planet.

One AMT rule every lawyer should know about involves attorney fees. If a client recovers $1 million in a dispute with a neighbor and pays you a $400K contingent fee, the client has $1 million of income. For regular tax purposes, the client claims a miscellaneous itemized deduction for the $400K. For AMT purposes? The client can't deduct *any* of the attorney fees. That's why clients complain they are paying tax on fees paid to their lawyers.

There are about 8 million partnership and S corporation tax returns filed every year. When you consider that partnership returns include general partnerships, limited partnerships, LLCs and LLPs – and that S corporation returns are thrown into this figure – that's a surprisingly small number.

Business income or loss on a schedule C – the form that proprietors complete – remains popular, with more than 20 million returns reporting this way. Schedule C is how hobby losses get reported, and it remains one of the most likely tax forms to be audited. Why do people still use it? Go figure.

If you have a gambling problem, you're not alone. About 1.8 million tax returns claim earnings from gambling. But it's not all income. Nearly 900,000 tax returns claim gambling loss deductions, writing off a whopping $16 billion in losses. The biggest age group writing off losses from gambling? Those in the 55 to 65 age group. The figures don't lie.

No one likes taxes, but we all face them. And while we're talking federal taxes here, in California we face another set of issues and rules. California rates are high, especially on high earners. Many state rules are less favorable than with the IRS.

What's more, California's tax administrators are tougher than their IRS counterparts. Especially in light of these facts, California taxpayers should be especially careful to plan ahead. With our state's budget woes, it's probably going to get worse before it gets better.

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