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# Montana Department of Revenue



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To: Dan Bucks, Director  
From: Dan Dodds, Senior Economist  
Date: August 29, 2012  
Subject: Demographic Trends and the Income Tax

## *Summary and Conclusions*

This memo looks at what income tax returns show about recent changes in the age structure of Montana's population and the effects of these changes on income tax collections.

Since 1998

- The proportion of returns with at least one taxpayer age 65 or over increased, from 16.2% to 18.8%, and the proportion with retirement income increased from 24.0% to 27.6%.
- The proportion of taxpayers age 65 or over reporting income from wages or active participation in a business increased from 48.5% to 51.6%.
- The average number of dependents per return decreased from 0.607 to 0.541.
- The average number of taxpayers with wage and salary income or income from active participation in a business per return decreased slightly, from 1.12 to 1.10.
- The small decrease in income earners per return and larger decrease in dependents per return resulted in an increase in the proportion of the population actively earning income, from 54.3% to 55.8%.
- Taxpayers age 65 or older or with retirement income have average income that is the same as or higher than other taxpayers' average income.
- Taxpayers age 65 or older or with retirement income pay about the same or higher average income tax than other taxpayers.
- Retirees who move into or out of the state have slightly higher average income than retirees who do not move.

### *Demographic Information on Tax Returns*

Montana income tax returns do not ask for the taxpayer's age or birth date but do collect several age-related pieces of information. Taxpayers who are at least 65 years of age are allowed to claim an extra personal exemption. This makes it possible to count taxpayers who are 65 or older. Taxpayers can claim a personal exemption for each dependent, and most dependents are minor children. The number of dependents claimed on tax returns therefore gives an approximate count of the number of minor children. Taxpayers who are claimed as a dependent on someone else's return are not allowed to claim a personal exemption on their federal return. Montana law allows these taxpayers to claim a personal exemption, but it appears that many do not check the box on their state returns. Returns with zero exemptions are mostly teenagers and young adults who have incomes but are still primarily supported by their parents. The number of zero exemption returns thus may give an estimate of the number of teenagers with jobs. Taxpayers report income in fifteen categories, and three of those categories, pension and annuity income, taxable social security benefits, and IRA distributions, are received mostly by retirees. The number of returns with retirement-related income gives an estimate of the number of people who are partly or fully retired.

Table 1 on the next page shows the number of income tax returns filed for 1998 through 2010, the percent of returns claiming an extra exemption<sup>1</sup>, the percent of returns with retirement related income, and the ratio of dependents to returns. It also shows the percent of returns with no personal exemption for the last three years. This information is not available for earlier years. Figure 1 shows the same information graphically.

Over the last thirteen years, there has been a slow, steady increase in the fraction of returns claiming an extra exemption and a slow, steady decrease in the ratio of dependents to returns. This is consistent with data from the Census and other sources indicating that the proportion of older adults in the population is increasing and the proportion of children is decreasing. The drop in the percent of returns that claimed no personal exemption from 2008 through 2010 is probably due to the recession rather than a long-run trend.

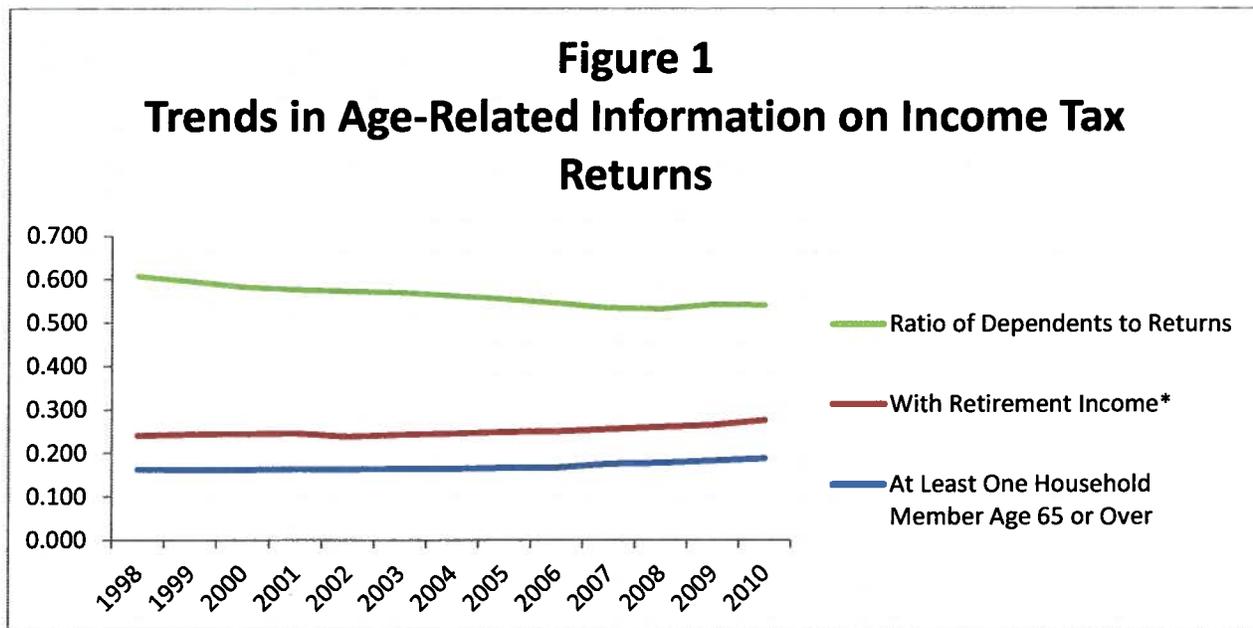
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<sup>1</sup> Taxpayers may claim an extra exemption if they are at least 65 years of age and may claim an extra exemption if they are blind. The return databases for the last two years indicate which extra exemptions taxpayers claimed, but databases for earlier years only indicate the number of extra exemptions each taxpayer claimed. In the last two years, less than half a percent of returns with one or more extra exemptions claimed the exemption for being blind without also claiming the exemption for being 65 or older.

**Table 1**  
**Age-Related Information on Montana Income Tax Returns 1998 - 2010**

Year	At Least One Household Member Age 65 or Over	With Retirement Income*	Ratio of Dependents to Returns	No Personal Exemption Claimed
1998	16.2%	24.0%	0.607	n/a
1999	16.2%	24.3%	0.595	n/a
2000	16.1%	24.4%	0.582	n/a
2001	16.3%	24.5%	0.576	n/a
2002	16.2%	23.8%	0.573	n/a
2003	16.4%	24.2%	0.569	n/a
2004	16.4%	24.5%	0.562	n/a
2005	16.7%	24.8%	0.555	n/a
2006	16.7%	25.0%	0.545	n/a
2007	17.6%	25.5%	0.534	n/a
2008	17.8%	26.0%	0.532	10.2%
2009	18.4%	26.5%	0.542	9.4%
2010	18.8%	27.6%	0.541	8.9%

\*Pension, Social Security, or IRA distribution



*Income Sources – Retirees and Others*

Table 2 shows the percentages of returns that had wage and salary income, income from a small business, or both, for returns with at least one taxpayer 65 or older and for other returns. Figures 2a, 2b, and 2c show the same information graphically.

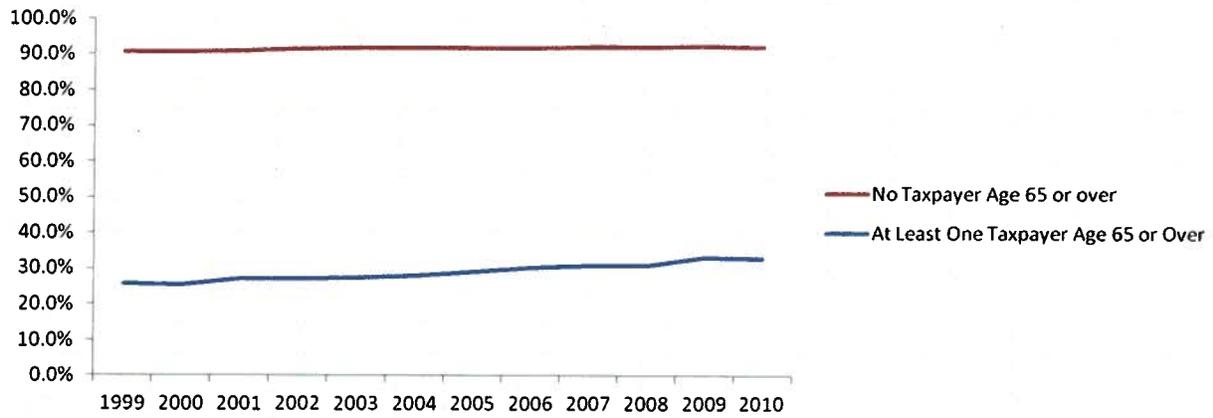
**Table 2**  
**Returns Reporting Wages and Income from Non-Farm Small Business**

Year	At Least One Taxpayer Age 65 or Over			No Taxpayer Age 65 or over		
	Wage and Salary Income	Small Business Income*	Wage or Business Income	Wage and Salary Income	Small Business Income*	Wage or Business Income
1999	25.8%	30.4%	48.5%	90.5%	21.7%	95.8%
2000	25.5%	30.3%	48.2%	90.6%	21.5%	95.8%
2001	27.1%	29.8%	49.0%	91.0%	21.1%	95.9%
2002	27.1%	29.6%	48.8%	91.5%	21.0%	96.4%
2003	27.4%	29.1%	48.7%	91.6%	20.7%	96.5%
2004	28.1%	29.1%	49.2%	91.8%	20.9%	96.6%
2005	29.3%	28.9%	49.9%	91.8%	21.0%	96.7%
2006	30.3%	29.1%	50.9%	91.8%	21.4%	96.7%
2007	30.9%	28.6%	50.6%	92.1%	21.0%	96.7%
2008	30.9%	27.2%	49.6%	92.0%	20.5%	96.5%
2009	33.2%	28.0%	52.0%	92.3%	19.8%	96.7%
2010	33.1%	27.4%	51.6%	92.0%	19.6%	96.5%

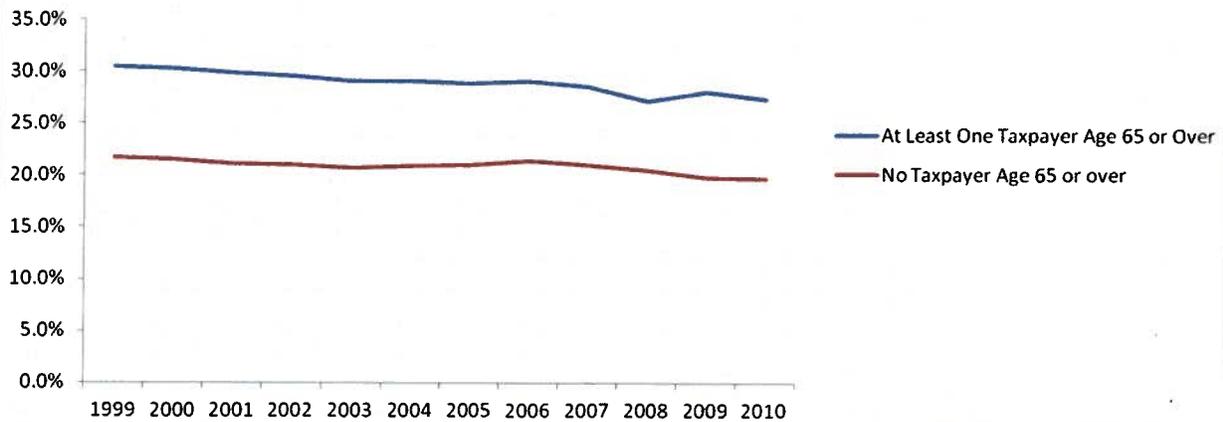
\*Income Reported on Schedule C for sole proprietor business or Schedule E for S-corporation, partnership, rental income, and royalties

About half of returns with a taxpayer 65 or older report wage and salary income, small business income, or both. There has been a large increase in the percent reporting wage and salary income and a smaller decrease in the percent reporting small business income. Changes for other taxpayers were in the same directions, but much smaller. As people are living longer and staying healthy longer, they also appear to be working longer.

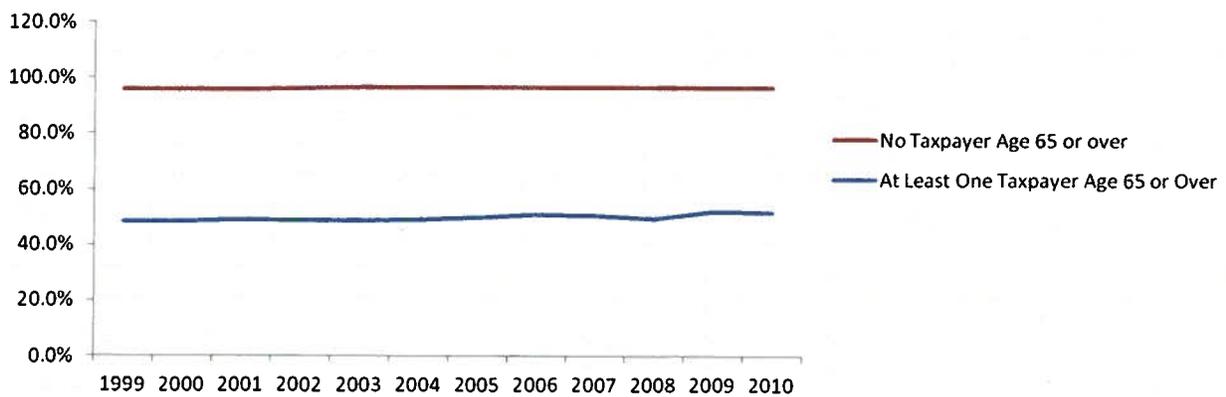
**Figure 2a**  
**Percent of Returns with Wage and Salary Income**



**Figure 2b**  
**Percent of Returns with Small Business Income**



**Figure 2c**  
**Percent of Returns with Wage and Salary or Small Business Income**



### *Proportion of the Population Involved in Income Producing Activities*

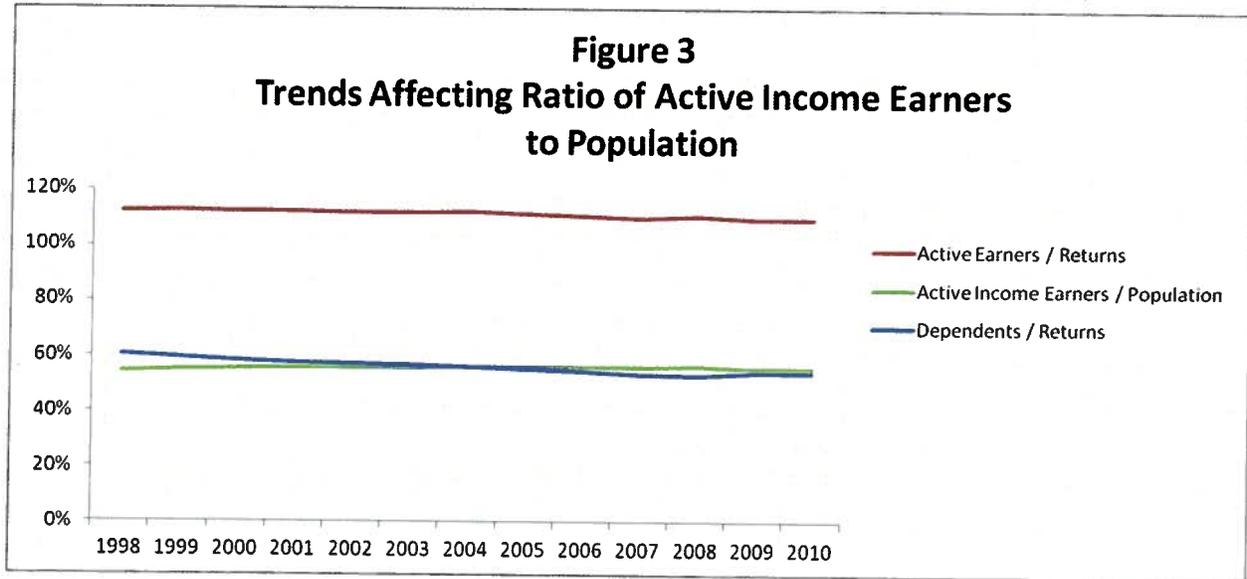
Everyone consumes part of the output of the economy, but not everyone is involved in producing that output. People who are employed or who are actively involved in running a business produce output, while dependent children, retirees, and trust-fund recipients just consume. Income tax returns can be used to construct a rough measure of the fraction of the population that is actively involved in producing goods and services. Taxpayers who are employed report wage and salary income. Taxpayers who are actively involved in running a business will report income as wages and salaries if they are a manager in a C-corporation, on Schedule E if they are running a partnership, an S-corporation, or a real-estate rental business, or on Schedule C if they are running a sole-proprietor business. Passive income such as dividends, interest, and pensions, is reported on other lines. Some passive income is also reported on Schedule E, but as a rough approximation, taxpayers who report income on the wage and salary line or on Schedules C or E are probably involved in producing goods and services, and taxpayers who report income only on other lines probably are not.

Table 3 and Figure 3 show trends since 1998 in the number of taxpayers<sup>2</sup>, the number of dependents claimed on returns and the number of active income earners on returns. The right hand column shows the ratio of active income earners to the population reported on tax returns, consisting of taxpayers and their dependents. This ratio shows a general upward trend since 1998, as the number of dependents per return has fallen faster than the number of active earners per return.

**Table 3**  
**Active Income Earners and Total Population**

Year	Taxpayers	Dependents	Population	Active Income Earners	Active Income Earners / Population
1998	537,965	223,521	761,486	413,162	54.3%
1999	543,032	222,121	765,153	420,300	54.9%
2000	553,819	222,834	776,653	430,030	55.4%
2001	555,122	221,179	776,301	431,731	55.6%
2002	560,356	222,410	782,766	435,067	55.6%
2003	562,728	222,177	784,905	437,300	55.7%
2004	573,057	224,034	797,091	447,326	56.1%
2005	577,946	223,207	801,153	448,729	56.0%
2006	596,349	227,492	823,841	462,876	56.2%
2007	617,394	231,773	849,167	477,768	56.3%
2008	623,736	233,053	856,789	484,941	56.6%
2009	618,919	234,714	853,633	475,402	55.7%
2010	619,687	234,626	854,313	476,280	55.8%

<sup>2</sup> In this table, a married couple counts as two taxpayers whether they file a joint return or separate returns.



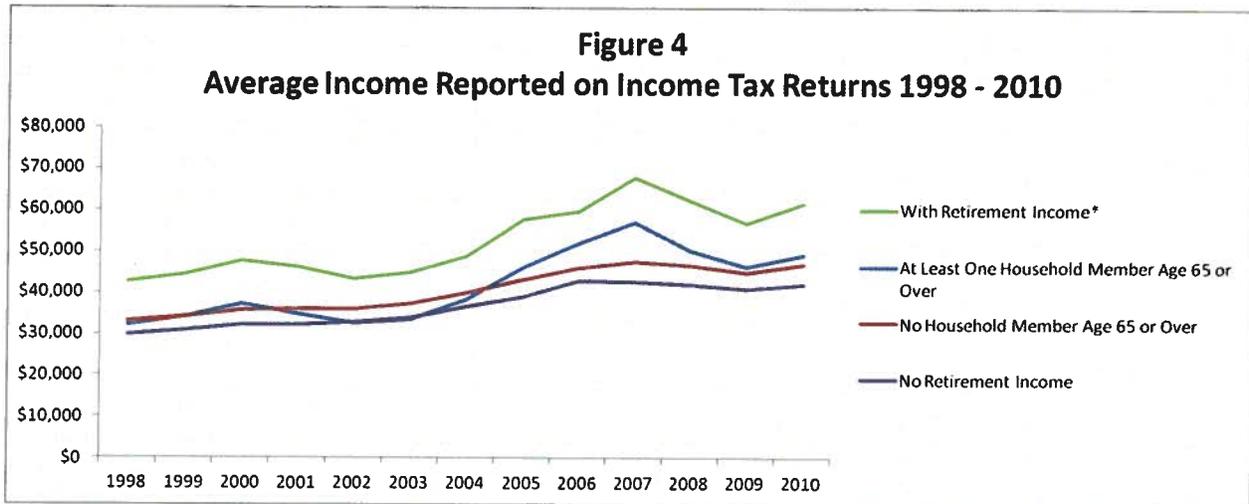
*Retiree's Income and Tax*

Table 4 and Figure 4 compare average total income of returns with and without an extra exemption and with and without retirement income.

**Table 4**  
**Average Total Income Reported on Income Tax Returns**  
**1998 - 2010**

Year	At Least One Household Member Age 65 or Over	No Household Member Age 65 or Over	With Retirement Income*	No Retirement Income
1998	\$32,288	\$33,010	\$42,621	\$29,825
1999	\$34,087	\$34,110	\$44,307	\$30,837
2000	\$37,131	\$35,684	\$47,640	\$32,140
2001	\$34,800	\$35,786	\$46,168	\$32,213
2002	\$32,694	\$35,788	\$43,385	\$32,762
2003	\$33,441	\$37,183	\$44,854	\$33,923
2004	\$38,270	\$39,721	\$48,783	\$36,471
2005	\$46,157	\$43,024	\$57,692	\$38,869
2006	\$52,012	\$45,983	\$59,579	\$42,797
2007	\$57,000	\$47,461	\$67,793	\$42,742
2008	\$50,256	\$46,634	\$62,243	\$42,018
2009	\$46,239	\$44,766	\$56,792	\$40,806
2010	\$49,186	\$46,883	\$61,505	\$41,915

\*Pension, Social Security, or IRA distribution



Returns with retirement income consistently have higher total income than returns with no retirement income, and the difference is large. There is less difference between returns with an extra exemption and other returns, and total income is not consistently higher for one group or the other. Returns with an extra exemption have higher income seven of the thirteen years, and returns with no extra exemption have higher income the other six. In this period, total income was more variable for returns with retirement income than for returns with no retirement income and for returns with an extra exemption than for other returns.

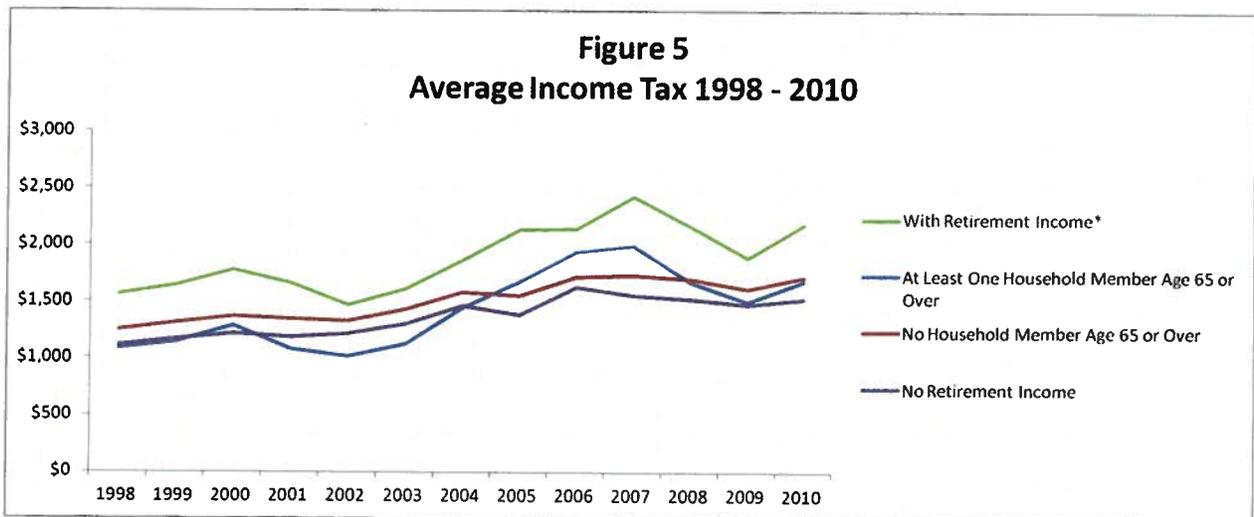
Contrary to what is widely believed, older taxpayers, on average, do not have lower incomes than other taxpayers, and taxpayers who have some retirement income have higher average incomes than taxpayers with no retirement income.

Table 5 and Figure 5 show average tax on the same groups of returns as in Table 4.

**Table 5**  
**Average Income Tax**  
**1998 - 2010**

Year	At Least One Household Member Age 65 or Over	No Household Member Age 65 or Over	With Retirement Income*	No Retirement Income
1998	\$1,086	\$1,247	\$1,561	\$1,114
1999	\$1,140	\$1,309	\$1,641	\$1,166
2000	\$1,287	\$1,366	\$1,779	\$1,216
2001	\$1,078	\$1,340	\$1,657	\$1,180
2002	\$1,014	\$1,322	\$1,464	\$1,212
2003	\$1,126	\$1,428	\$1,609	\$1,305
2004	\$1,446	\$1,580	\$1,862	\$1,460
2005	\$1,676	\$1,548	\$2,137	\$1,382
2006	\$1,934	\$1,717	\$2,140	\$1,624
2007	\$1,990	\$1,733	\$2,423	\$1,557
2008	\$1,676	\$1,695	\$2,169	\$1,524
2009	\$1,500	\$1,608	\$1,891	\$1,479
2010	\$1,680	\$1,711	\$2,182	\$1,524

\*Pension, Social Security, or IRA distribution



Returns with retirement income consistently have higher tax liability as well as higher income, but the relative difference is slightly smaller for tax liability. Tax for returns with

and without an extra exemption is close, but returns with an extra exemption have higher average tax liability in only three of the thirteen years.

This difference between the results for income and tax is due to the fact that Montana law has several favorable provisions for older taxpayers and retirees. Taxpayers age 65 and older can claim an extra personal exemption and exempt up to \$800 of interest income per taxpayer. Taxpayers can exempt part of pension and annuity income regardless of age.

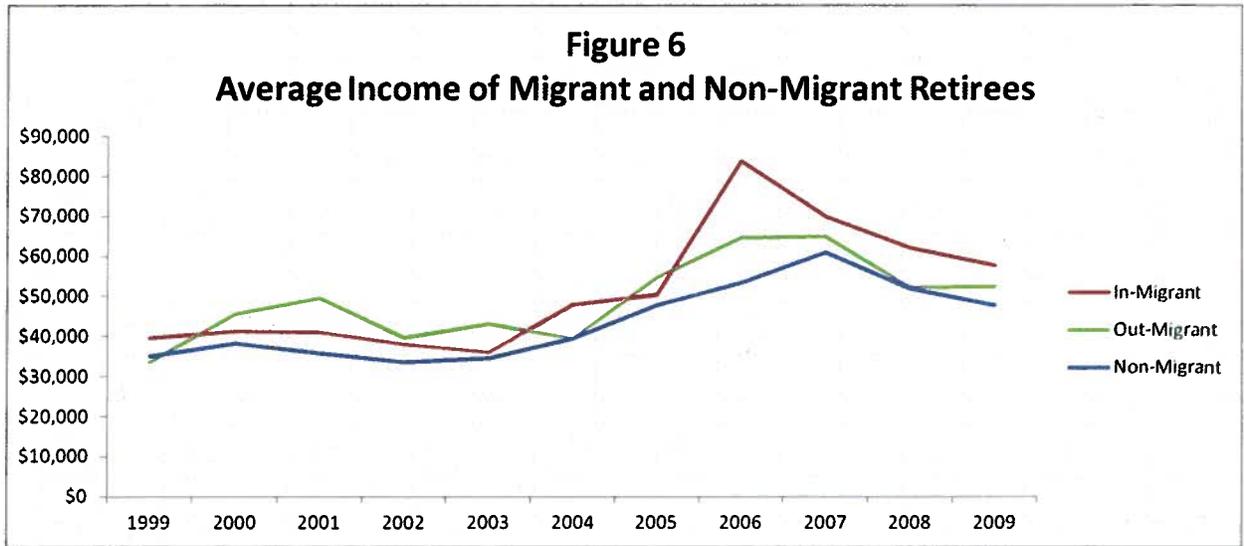
*Income of Retirees Who Move Between States*

It is fairly common for people to move after they retire. They no longer need to live close to a job, and retirees may want different amenities than they did earlier in their lives. People retiring to Montana from out of state may be different from Montana residents who retire to another state. Table 6 and Figure 6 compare the average incomes of three groups of returns with retirement income – returns that can be identified as new residents, returns that can be identified as continuing residents, and returns that can be identified as former residents.<sup>3</sup>

**Table 6**  
**Average Income of Migrant and Non-Migrant Retirees**

	Non-Migrant	In-Migrant	Out-Migrant
1999	\$35,089	\$39,409	\$33,539
2000	\$38,314	\$41,068	\$45,630
2001	\$35,807	\$40,997	\$49,521
2002	\$33,644	\$37,884	\$39,770
2003	\$34,524	\$36,134	\$43,233
2004	\$39,405	\$47,733	\$39,424
2005	\$47,653	\$50,238	\$54,552
2006	\$53,311	\$83,666	\$64,584
2007	\$60,937	\$69,763	\$64,859
2008	\$51,966	\$62,095	\$52,277
2009	\$47,746	\$57,593	\$52,519

<sup>3</sup> Taxpayers who filed a non-resident or part-year resident return one year and a resident return the next year moved to the state. Taxpayers who filed a resident return one year and a non-resident or part-year return the next year moved out of state. Taxpayers who filed resident returns in successive years are continuing residents. Taxpayers who did not file a return one year and filed a resident return the next or filed a resident return one year and did not file the next may have moved but there may be other reasons for the change. They cannot be put in one of these categories with any confidence.



Both in-migrant retirees and out-migrant retirees have somewhat higher average income than continuing resident retirees. This is not surprising. People with higher incomes can better afford to move in retirement. In-migrant retirees had higher average income than out-migrant retirees in six of the eleven years where they can be compared.

In-migrant retirees' income shows a sharp increase at the peak of the national housing boom, while out-migrant retirees' income shows a smaller increase at the same time. People who move between states generally sell a home and possibly other assets. In-migrants selling appreciated real estate in other states would have had much-higher-than-normal capital gains in this period. Montana real estate prices were less affected by the real estate bubble than prices in other states, so out-migrants would not have had as large an increase in capital gains in this period. On the other hand, the greater volatility in the average income of retirees who move both directions, compared to retirees who do not move, could just be due to the fact that there are only a few hundred retirees who move in and out each year, and the average income of a group this size is fairly sensitive to changes in the few highest incomes in the group.