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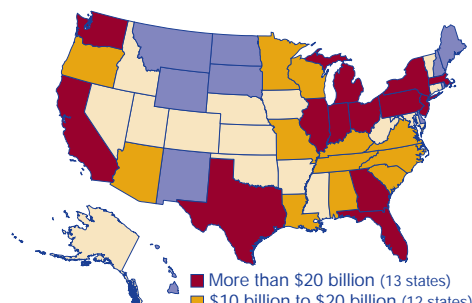
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U.S. Exports, 2005

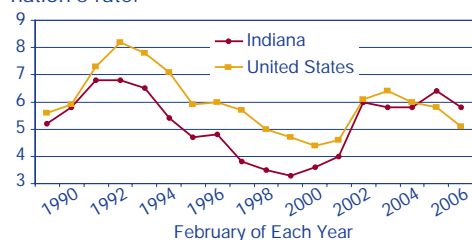
Population size and export volume go hand in hand. Indiana's export growth rate of 12.4 percent between 2004 and 2005 ranked 28th relative to other states. Learn more about Indiana exports on Page 4.



Source: U.S. Census Bureau

February Unemployment

Indiana's February unemployment rate dropped 0.6 percentage points from the same time last year, down to 5.8 percent. This, however, was still 0.7 percentage points higher than the nation's rate.



*Not seasonally adjusted

Taxing Indiana—2004 Returns Reveal Much about Our Relative Wealth

Each year, the dawn of spring coincides with the arrival of one of life's inevitabilities. As the procrastinators among us scurry to complete their 1040As and IT-40s for the 2005 tax year, let us take a look at the data gleaned from the 2004 taxes we filed last year.

Indiana Returns

Over 2.89 million Indiana income tax returns were filed for 2004. This is 56,981 more returns than the prior year, a 2 percent increase, according to the Indiana Department of Revenue.

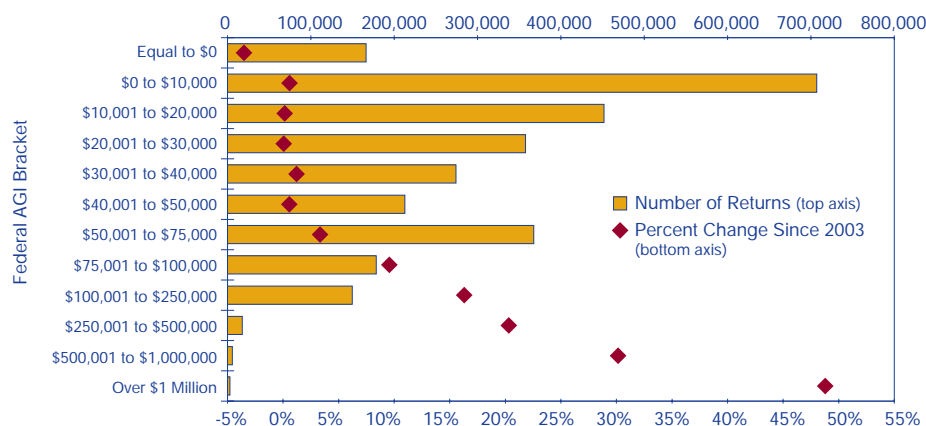
Figure 1 shows the distribution of returns according to their federal adjusted gross income (AGI) bracket. Combined, the AGI for all Hoosiers exceeded \$126.5 billion. With almost a quarter of all returns, the \$10,000 or less bracket was clearly the largest (706,893 returns). That category was the largest in each of the 92 counties, ranging from 17

percent of all Hamilton County returns to nearly 29 percent of all Knox County returns.

The second-largest category in the vast majority of counties was the \$10,001 to \$20,000 bracket. For 17 suburban counties, the second-largest category was the \$50,001 to \$75,000 range. Hamilton County stood alone with its second-largest number of returns being those in the \$100,000 to \$250,000 range.

There were 2,891 returns with an AGI over \$1 million for 2004, a 48.8 percent increase over the previous year. However, these high-dollar returns still account for a mere fraction of the total; Hamilton and Boone counties led the state at just 0.4 percent. Hoosier millionaires were found in all but eight counties, although they were, not surprisingly, concentrated in the state's metro areas.

FIGURE 1: INDIANA TAX RETURNS, 2004



Source: IBRC, using Department of Revenue data

Median Adjusted Gross Income

Indiana's median adjusted gross income was \$23,372 in 2004. This means that half of income tax returns reported AGIs above this number, while the other half were below it. At the county level, the median AGI ranged from \$19,134 in Orange County to \$44,512 in Hamilton County.

Indiana experienced a five-year growth of 9.7 percent (\$2,062) from its median AGI of \$21,310 back in 1999. Local growth rates ranged from 28.2 percent in Gibson County to a measly 0.5 percent in Steuben County.

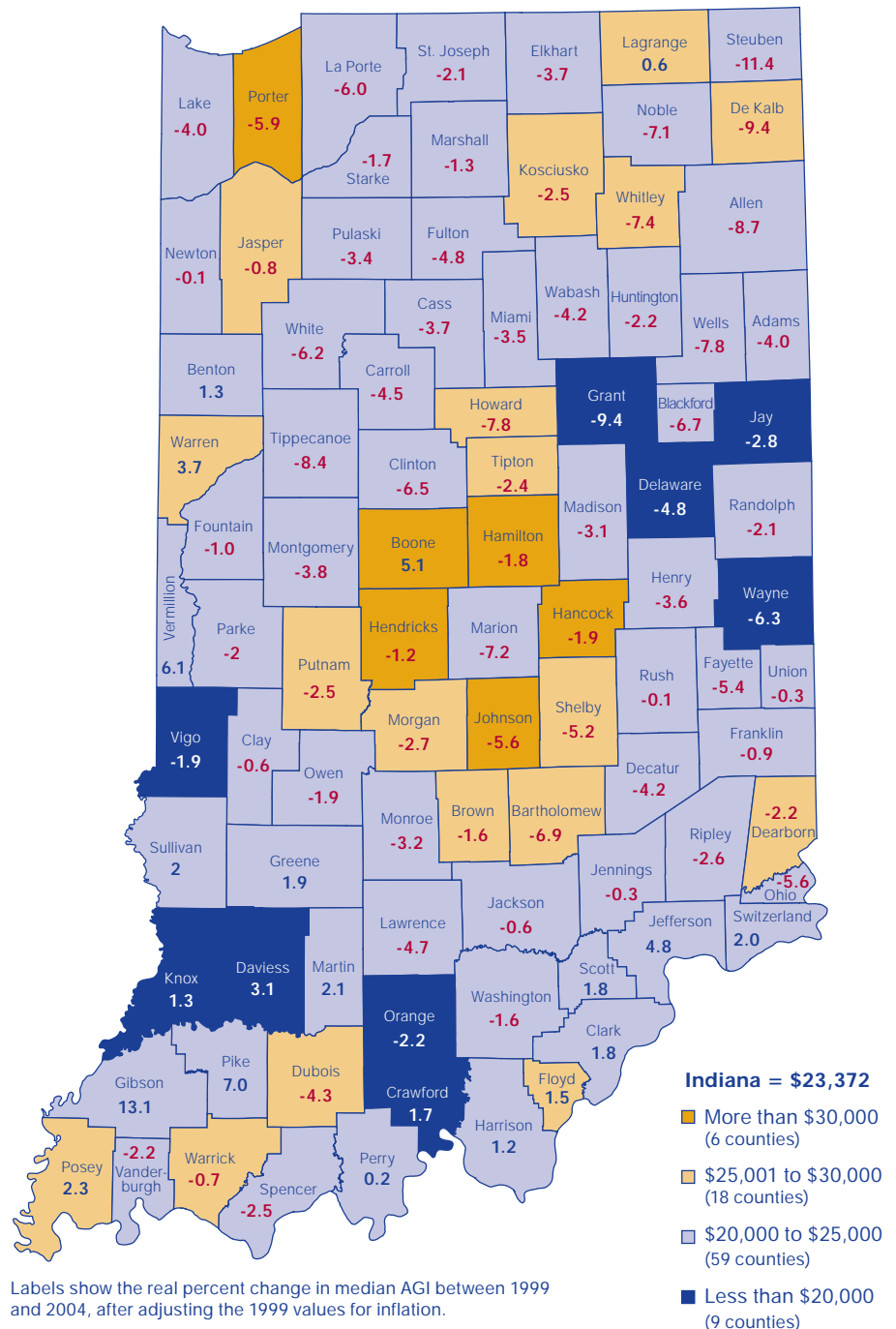
However, if one adjusts the 1999 values for inflation, the picture is not so pleasant. When taking inflation into account, Indiana saw the purchasing power of its median AGI drop 3.3 percent. Only 21 counties, virtually all in southern Indiana, saw median AGI increase in real terms between 1999 and 2004 (see **Figure 2**). Gibson, Pike, Vermillion and Boone counties led the way, with inflation-adjusted AGI growth topping 5 percent. Fifteen of these 21 counties had been below the 1999 Indiana median, so they had lost ground to make up. Yet even with the

gains made between 1999 and 2004, 12 of the 21 were still below the Indiana median. Gibson County, on the other hand, experienced the most dramatic growth in median AGI, jumping a remarkable 44 spots, from a rank of 74th in 1999 to a rank of 30th in 2004.

Major Deductions on Indiana Tax Returns

Over 70 percent of returns claimed one Indiana deduction or another, with total deductions close to \$7.7 billion. That equates to an average total deduction around \$3,750 per return. While a

FIGURE 2: MEDIAN ADJUSTED GROSS INCOME, 2004



Random Tax Fact

Ever get to the end of your Indiana tax return and wonder how many people contribute to the Indiana Nongame Wildlife Fund on Line 32 of the IT-40? On their 2004 returns, nearly 21,000 Hoosiers donated over \$369,000 to the cause, which protects and manages more than 550 species of nongame and endangered wildlife.

plethora of deductions are there for the claiming, the following four deductions, as seen in **Figure 3**, account for over 82 percent of all Indiana deductions in dollar terms.

Homeowner and Renter

Deductions: Since everyone needs a place to live, it is not surprising that the most common were the residential homeowner property tax deduction, claimed on over 1.3 million returns, and the renter deduction, found on over 624,000 returns. Both of these deductions are capped at \$2,500 per return; the average amount deducted for the residential property tax deduction was \$1,197 per return, while that amount increased to \$2,296 for the renter deduction. Together, these two deductions (\$1.6 billion and \$1.4 billion, respectively) account for about 40 percent of the value of all Indiana's deductions.

Social Security: Indiana does not tax social security benefits, so that income gets deducted from federal AGI as well. While a smaller number of returns (not quite 234,000) claim this deduction, the total value of that deduction is nearly \$2.1 billion—making it Indiana's

Federal Income Tax History

Prior to the Civil War, the United States relied on excise taxes to finance the federal government. However, the war's expense caused the northern states to pass an income tax law in 1862 that would sunset after a decade. Those with incomes between \$600 and \$10,000 paid 3 percent, while higher incomes were taxed at 5 percent.

Congress tried to enact an individual income tax again in 1894, but this time, the Supreme Court ruled it unconstitutional. They said that income taxes were direct, not indirect, taxes—making it illegal since the Constitution mandates that direct taxes be apportioned among the states. The 16th Amendment, ratified in 1913, got around the question of direct/indirect taxation by explicitly giving Congress the power to collect taxes on income without apportionment. (According to the U.S. Department of the Treasury, states began implementing state income taxes about this same time—the first being Wisconsin in 1911.)

Just 1 percent of the population was liable for federal income taxes in 1913 and the Internal Revenue Service audited all 357,598 returns. Individuals with incomes over \$3,000 (about \$59,000 when adjusted to 2005 dollars), or married couples with incomes over \$4,000 (about \$79,000 in current dollars), paid a 1 percent tax. Incomes over \$500,000 (roughly \$9.9 million in current dollars) were taxed at 7 percent. Not until World War II did the income tax become a tax paid by the masses.

Source: John L. Mikesell, *Fiscal Administration*, 6th ed. (Belmont, CA: Wadsworth, 2003), 319-320.

single largest, at 27 percent of all deductions. The average deductible amount was \$8,957 per return.

Interest on Government

Obligations: Not many people have interest on government obligations to deduct, but the total value of those deductions exceeds \$1.2 billion, accounting for about 16 percent of all

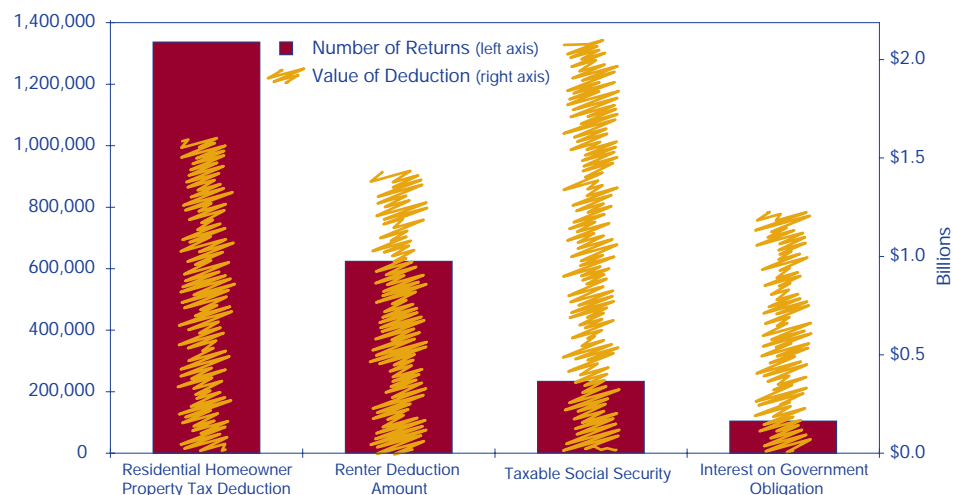
Indiana deductions. For the roughly 104,000 returns deducting the interest on U.S. savings bonds and the like, the average value of the deduction was almost \$12,000.

Withholding Works

The vast majority of taxpayers (more than 70 percent) overpaid their Indiana income taxes in 2004 and received a refund; the average refund was \$230. For those Hoosiers who owed taxes, the average amount owed was \$522. Jennings County had the largest percentage of filers (75 percent) receiving a refund, while Clark County had the largest percentage of filers (35 percent) owing money to the state. All told, the 2004 Indiana individual income tax brought in \$3.81 billion of revenue to finance Indiana government and services.

—Rachel Justis, Managing Editor, Indiana Business Research Center, Kelley School of Business, Indiana University

FIGURE 3: MAJOR INDIANA DEDUCTIONS, 2004



Source: IBRC, using Department of Revenue data