MEASURING INCOME FOR DEVELOPING AND REVIEWING INDIVIDUAL TAX LAW CHANGES: EXPLORATION OF ALTERNATIVE CONCEPTS

Susan Hostetter, Internal Revenue Service

How close to the personal income tax return information is the real profile of a taxpayer's economic circumstances? In many cases it's not very close, and this is particularly true for taxpayers with the greatest resources.

The Tax Reform Act of 1986 was passed by Congress after lengthy negotiations and considerable publicity. During this time millions of taxpayers became far more aware of the tax law and the consequences for themselves as individual taxpayers. Highlighted throughout the controversy was the concept of "economic income." That is, what definition of income should be used to classify the individual and what tax consequence would be affected for each income classifier? The Office of Tax Analysis (OTA), which prepared initial drafts of the law, used a "family economic income" concept to review tax consequence.

The designers of the law made it clear that using economic income was the focus of their plan. The new law shed many of the legal or non-economic characteristics of the tax system in an attempt to come closer to economic income. Therefore, as we move toward a tax law based more closely on economic income, and as public awareness of the concept has been heightened, IRS, too, is changing its methods, to be consistent with these new needs. Beginning with Tax Year 1985, the Statistics of Income Division of the Internal Revenue Service (IRS) will address this issue by reporting the characteristics of individual taxpayers by a measure of income closer to that of economic income.

This paper will give a historical perspective of the IRS income classifier -- adjusted gross income (AGI). The limitations of AGI and its relationship to economic income will be discussed. The major focus of the paper, a description of a new retrospective income concept, is next. This will be followed by a brief analysis of the new income concept, using data from the 1985 Statistics of Income (SOI) sample of income tax returns for individuals and sole proprietors. The paper's emphasis will then turn forward to describe a new prospective income concept, designed to address new changes introduced by the Tax Reform Act for Tax Year 1987. Comparisons to other major income concepts will be provided, as will a brief look at the effects of inflation on total income. Finally, the paper will cover current and future plans for IRS publication of individual income tax data under both new income concepts, using constant dollars as well as the traditional current dollars.

HISTORICAL BACKGROUND

IRS' current income concept is AGI. Before going on to describe some alternative income concepts, a historical perspective of AGI, the basis for developing many income concepts by our users, may be in order.

On February 25, 1913, the Sixteenth Amendment to the Constitution became effective. It provided that "...Congress shall have the power to lay and collect tax on incomes, from whatever sources derived, without apportionment among the several States, and without regard to any census or enumeration." From 1913 on, Federal income tax has been collected each year. This led the way for developing the SOI programs.

With the inception of the Statistics of Income program in 1916, Congress stipulated that IRS had a statutory obligation for "...the preparation and publication of statistics reasonably available with respect to the operation of the income tax law and containing classifications of taxpayers and of income...and any other fact deemed pertinent and valuable..." In accordance with this Congressional mandate, annual reports providing data on individual taxpayers at the National level have been published throughout the more than 70-year history of the SOI program.

By as early as 1930, the SOI data had developed into a leading source of basic economic information. As numerous Congressional, Federal, State and private economic research organizations were created, and as tax administration and projection became important for estimating future tax revenue, increasing demand and importance were attached to IRS statistics. [1]

AGI AS AN IRS INCOME CLASSIFIER

Prior to 1944, IRS individual statistics were based on "net income," which was defined as positive sources of income less negative amounts (as provided for under the tax law for each particular year). Since 1944, the IRS individual statistics have been, and are still today, based on AGI, which was (and is) defined as positive sources of income less negative amounts and statutory adjustments.

Effects of Tax Law Changes on Composition of AGI

Definitional differences in the AGI, caused by tax law changes from one year to the next, make historical comparisons difficult. For example, unemployment compensation and social security income were first potentially subject to tax, and therefore partially included in AGI, in 1979 and 1984, respectively. Salaries and wages, one of the more consistently defined income sources, originally excluded sick pay, but now includes it. Tax laws have treated interest income differently, as well. In 1935, interest income included certain interest on Liberty bonds and tax-free covenant bonds; in 1981 a partial exclusion for interest income was introduced. Dividends exclusions have changed many times over the years, but the sales of capital assets exclusions have changed far more extensively. Adjustments to income, new in 1964, have included such items as employee moving expenses, IRA's, and Keogh's.

AGI is not only composed of income; it also includes adjustments. These adjustments have a similar affect to that of a deduction, except that adjustments are subtracted from income before AGI -- the income classifier -- is determined. Figure 1 is an example of how tax law changes in both income sources and adjustments from 1983 to 1987 would change the AGI for an individual who had the same economic income in both years.

Figure 1.--Illustrative Example for "T.X.Payer"

Income Source	Gross Income	Included in AGI 1983	Included in AGI 1987
Wages			
& Pension.......	$71,000	$71,000	$71,000
Dividends........	4,000	3,800	4,000
Capital Gains....	30,000	12,000	30,000
Social Security..	8,000	0	4,000
Total Income...		$86,800	$109,000
IRA Contribution	2,000	2,000	0
Ded. Married and			
Both Working....	2,000	2,000	0
Tot. Adjustments		$4,000	0
AGI.............		$82,800	$109,000

Consider the fictitious "T.X. Payer," who, with his wife's wages and his pension income reports $71,000. He and his wife also have dividends, capital gains, and social security income. With the same income they look very different under the 1983 tax law and the new 1987 tax law. For Tax Year 1987 they lost the dividend exclusion, the sizable capital gains exclusion, the exclusion of social security income, the adjustment for the Individual Retirement Account (IRA) contribution, and the deduction for a married couple when both work.

The result is that his AGI increases from $82,800 to $109,000. Thus, because of tax law changes he changes income classes dramatically -- instead of being in the income class from $75,000 to $100,000, he is now in the class from $100,000 to $200,000. This "apples vs. oranges" effect in looking at income characteristics from year to year could cause data users to make false assumptions about numbers of individuals in various income classes and their characteristics.

Strengths of the AGI Classifier

The strength of continual use of the AGI concept is that it has always been well defined and documented for any given year; it is understood by much of the population; and it is reliable, because it is so thoroughly built into the tax law that all phases of tax processing calculate and test the accuracy of this figure. Because it is part of the tax system, it has a kind of stability such that it can be successfully used over time.

Most IRS data users -- with the exception of the Treasury Department's Office of Tax Analysis and the Congress' Joint Committee on Taxation -- such as the General Accounting Office, the Bureau of Economic Analysis, the Bureau of the Census, state tax administration offices, economic forecasters, universities, researchers, and many others have relied primarily on our IRS classification by AGI. In fact, the AGI classifier has been the main income variable used in published tables for over 40 years. Of course, for over 25 of those years these users could buy the SOI Individual Tax Model and use these microdata extracted from the SOI Individual/Sole Proprietorship Program file to "roll their own" classifier.

Limitations of the AGI Classifier

On the negative side, the components of income and adjustments have changed many times over the years, especially for the following Tax Years:

- 1982 for the Economic Recovery Tax Act of 1981,
- 1983 for the Tax Equity and Fiscal Responsibility Act of 1982, and
- 1987 for the Tax Reform Act of 1986.

Definitions of the components have altered greatly. Since the definitional base has been modified from year to year, the basic measurement of income in SOI Individual program statistics has changed, as well.

Effects of Tax Law Changes on the Tax Behavior

Another problem affecting the stability of AGI as an income classifier is the increasing change in taxpayers' behavior with regard to tax laws. For example, the end of Tax Year 1986 saw tremendous increases in sales of capital assets, presumably to take advantage of the 60 percent exclusion that would no longer exist for Tax Year 1987. In recent years, not all, but a significant number of, taxpayers changed their emphasis in making business management and investment decisions to decrease their individual tax burden through tax shelters. Instead of making personal financial and business financial decisions independent of tax law and paying taxes accordingly, some taxpayers made financial decisions based primarily or partly on the tax consequence.

AGI as a Tool for SOI Users

Finally, the income concept that SOI has used -- AGI -- was designed to administer collection of taxes and what SOI really needs is a concept that is adaptable for use by our major customers. However, if one considers just SOI individual income data, it is interesting to note that, even there, the two major users have defined it differently.

The Office of Tax Analysis has developed "family economic income," which uses an accrual method to estimate total income for the family unit. The Joint Committee, on the other hand, uses an expanded income concept, which focuses on adding back tax preferences that were excluded in AGI. Understanding the Joint Committee's income concept is particularly important, since the official Congressional estimates of the distributional impact of the Tax Reform Act of 1986 are based on it. [2] Both of these concepts -- discussed more fully in the section on "Other Income Concepts," which appears later in this paper -- draw on the SOI Individual program microdata file, but impute many of the sources of income that are not included on individual income tax returns.

It is for these reasons that IRS has decided to look for a broader income concept. The next section proposes a new definition under consideration to replace AGI as the principal income classifier for IRS data.

A NEW DEFINITION FOR IRS INCOME

What is Economic Income?

In order to develop a better and broader income concept we need to begin by answering the crucial question "What is economic income?" Economic income has an elusive definition. One definition frequently cited is that by Haig (1921) and Simons (1938): income is the amount that a family or individual consumes in a particular time period, plus the net increase or decrease in the value of their assets. [3] In the broadest conceptual definition of personal or individual income, we would include not only gross wages, dividends, interest payments, all business income, etc., but also untaxed employer contributions; transfer payments, such as veterans' benefits and food stamps; increases in net assets (whether or not realized); insurance payments for pain or injury; net rental income for homeowners; and the value of benefits provided by municipalities, such as public schools, fire and police protection, and public libraries. Of course, a definition this broad is beyond the scope of any existing U.S. income measurement program, whether at the Treasury Department, the Census Bureau, or the Federal Reserve Board.

Issues and Assumptions

Let us begin, then, with a concept which is achievable. Recognizing the difficulty in defining economic income; admitting that information on the individual tax form is limited; realizing that the behavior of taxpayers, themselves, plays an important role; and accepting that a constant definition over a base period of substantial years is necessary, IRS staff recently set out to develop a new income classifier. First, we identified three major issues surrounding its development:

- the unit to be classified: return or family;
- the number of classes and the nature of the classifier (e.g., current or constant dollars, fixed dollar intervals, fixed percentile intervals); and
- the income concept to be employed in a new definition of "Total Income."

The last issue is the focus of the discussion in this section. How can IRS improve its measurement of income and, therefore, its statistics? How can it provide comparisons from year to year that adjust for the changes in the definition of the AGI classifier caused by tax law changes?

Statistics of Income data are derived from an administrative tax program and are limited to those sources of income that Congress has decided to tax, either entirely or in part. These sources of income appear on the individual income tax forms -- the Form 1040, Form 1040A, Form 1040EZ, and their supporting schedules and forms. [4] IRS income concepts and statistics should be limited to reported data for these items. The qualifier of "reported data" is important, because of such cases as social security income which is required to be reported if certain conditions are met. So, not all social security income would be reported on tax returns. This leads us to the following three assumptions used to develop the new income definition:

- The new concept must be applicable over several years and should allow comparisons, both pre- and post the major tax legislation of the 1980's.
- The definitions of income chosen should be such that they use available tax return items and do not rely on imputation, at least for the base years.
- The definition should be for a given year's income and not incorporate "carryovers" and "carrybacks," nor should it include deferred compensation. [5]

This means, for example, that items such as welfare payments, which are commonly included in non-IRS income definitions, would not be part of the new IRS classifier, since they are excluded from Federal income tax reporting, and could only be included by imputation. If IRS provides income data that include all income reported on income tax forms without exclusion, deduction, or adjustment, those data will provide the strongest income base for OTA to use in developing family economic income. Many users of IRS data could then choose to include imputed data to develop their own income concept. IRS could, even -- and, in fact, may -- impute data items for years prior to the base period, so that a comparable database could be developed going back to 1960.

A Retrospective Total Income Concept

With these assumptions in mind, IRS has designed a new retrospective income concept, called "1979 total income" to reflect the base period 1979 through 1986. Why did we select this base period? Because it covers the tax law changes of the 1980's and IRS data can be treated consistently with only those sources of income or other characteristics that were inclusive for all of those years. Even though the new concept is "retrospective," it can be continued in future years, to show an income that is conceptually similar to income published for these prior "base" years. The 1979 total income concept is preliminary. It does not adjust for costs in generating income, such as the investment interest expense, and IRS is considering a modification to include such deductions. The "expanded income" concept used in the OTA High Income Nontaxable program, in fact, does reduce income for costs of generating income. Using the expanded income computation, it is possible to have a lower expanded income than AGI. So, you see, AGI doesn't always underestimate income, but it most frequently does. [6] However, the 1979 total income concept described in this paper -- and that which IRS will include in its 1985 annual report on statistics of individual taxpayers -- does <u>not</u> reduce income for income-generating expenses. Figure 2 provides the derivation for the new concept, mostly using the line items on the income tax return.

Figure 2.--Calculation of the 1979 Total Income Concept [7]

1979 TOTAL INCOME =

Salaries and wages*
+ Interest (without any exclusion)*
+ Dividends (without any exclusion)**
+ Alimony received*
+ Capital gains (without exclusion, and allowing for short-term and long-term loss without limitation)**
+ Capital gains not reported on Schedule D (without any exclusion)**
+ Other gains reported on Form 4797*
+ Net Business income, Schedule C*
+ Net farm income*
+ Net rent income*
+ Net royalty income*
+ Net partnership income*
+ Net Subchapter S Corporation income*
+ Net farm rental income*
+ Net estate and trust income*
+ Unemployment insurance income reported**
+ Depreciation in excess of straight-line depreciation
+ Pension income reported**
+ Advance earned income credit
+ Net other income*

LESS
Moving expenses*
+ Employee business expenses*
+ Alimony paid*

* Included in Tax Year 1985 AGI.
** Modified from income included in Tax Year 1985 AGI.
Note: Items without an asterisk were not included in Tax Year 1985 AGI.

By applying this definition, IRS has come up with a concept of income that is broader and more stable than AGI. The largest difference between the 1979 income concept and AGI is the 60 percent capital gains exclusion, which was included in the 1979 concept income. Since most adjustments are really tax items and not income, we added those back, leaving only expense items, such as the employee business expense, as adjustments to income. The State income tax refund was omitted because it is a tax recovery or adjustment -- again, not a measure of income. Social security benefits are obviously income, but they weren't potentially subject to tax or even partially included on the tax return until 1984 and, therefore, could not be used consistently for all years from 1979 through 1986.

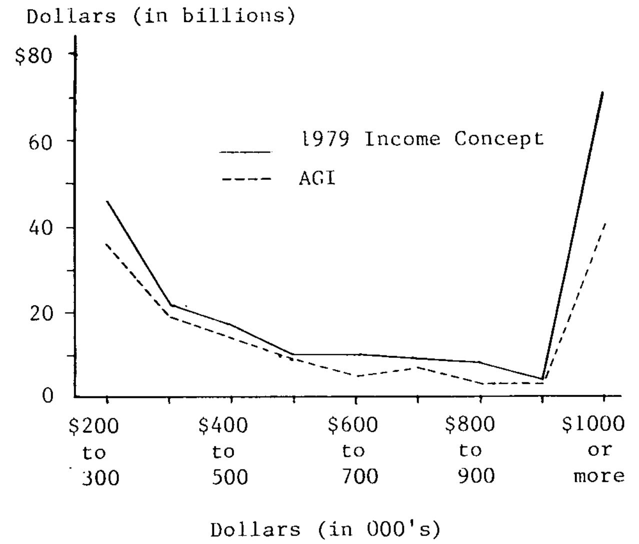
COMPARISON OF INCOME CONCEPTS USING SOI 1985 FINAL INDIVIDUAL PROGRAM DATA

How confident can we be that the 1979 income concept meets our needs (i.e., is a more comprehensive measure of income than AGI)? In order to assess its usefulness, we decided to look at the effect of the new definition on the distributions of the two major variables -- amount of total income and number of returns. Using the SOI final 1985 Individual data file, we can compare the distribution of individuals across income classes for the 1979 income concept and for AGI.

<u>Total Income</u>

What happened with income? There was an increase in total income of 140 billion dollars (or six percent) when computed according to the 1979 income concept. Figure 3 compares total income for the two concepts for classes from $200,000 up. The greatest differences occur above $500,000. This is not surprising, since more taxpayers are now in those classes and they are credited with more income when computed for the 1979 income concept. The amount of income for returns with a million or more increased 78 percent, and it was 46 percent for those from $500,000 to $1,000,000.

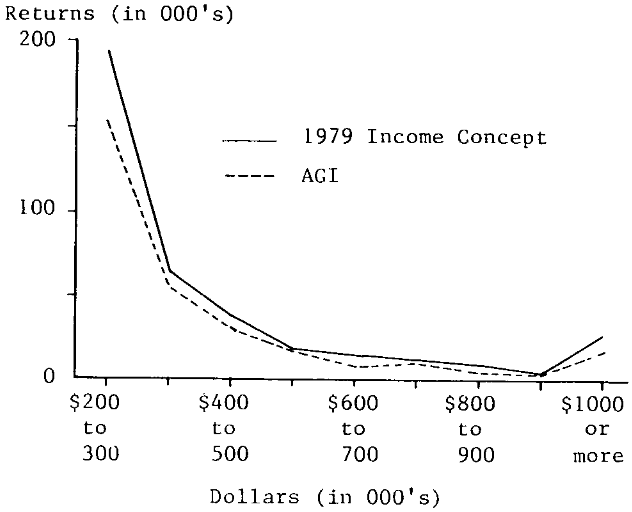
Figure 3.--Total Income for High Income Returns by 1979 Income Concept and AGI



<u>Number of Returns</u>

Figure 4 plots the distributions for high income returns for both AGI and the new retrospective income. As expected, it shows that the number of all returns for the high income classes -- over $200,000 -- was consistently higher when the income was computed according to the 1979 income concept. The shift to income classes over $200,000 using the 1979 income concept was about 86,000 returns or 29 percent of the high income returns. Why? With the increase in income for high income classes

Figure 4.--Distribution of High Income Returns by 1979 Income Concept and AGI



shown if Figure 3, we would expect such increases in the number of returns distributed in the high income classes. Much of this shift to higher income classes was due to the elimination of the capital gains exclusion in the 1979 income concept.

Total income tax was a higher percent of AGI income than it was of the 1979 income concept for all classes. This would be expected, since AGI is a major component of taxable income and income tax under current law. The average tax paid for individuals in the million dollar class was $911,000 for AGI income and dropped to $677,000 for the 1979 concept income. Many of the taxpayers who moved into this income class had considerable capital gains income which was taxed at a lower rate, causing the average tax to drop. These and other sources of income data are shown by income class in the table at the end of this paper.

A FUTURE INCOME CONCEPT

While the new retrospective 1979 income concept will provide some continuity in providing statistics on individual income over time, it still falls short of offering the best income data for users who want to employ it in the development of economic income. This may not be bad, since the concept has been designed to allow each user to impute or change the income according to his or her own needs.

Unfortunately, the 1979 total income concept is suitable for only one of IRS' needs. It was developed to cover the base period from 1979 to 1986 (coinciding with several major tax law changes). However, because of differences introduced in those crucial years, it was not possible to define the new retrospective income concept to reflect the actual changes and still provide the historical consistency we were seeking.

Therefore, for the immediate future, a revised definition is needed to reflect the extensive changes specific to the Tax Reform Act of 1986. In other words, the 1979 income concept will be based on and reflect the law without changes occurring in the 1980's, and a different concept is needed that will incorporate all the new items brought about in the three major new laws of the 1980's. For this purpose, IRS has also developed a prospective income concept -- the 1987 total income concept.

A Prospective Total Income Concept

The 1987 total income is designed to meet current classification needs; that is, it is based on information available for Tax Year 1987 and includes all the income sources added to the tax form in the changes in the law during the 1980's and, particularly, those changes from the Tax Reform Act of 1986. Since the essential purpose of the prospective, and more comprehensive, definition is to include all the items that were not available from data reported on returns in previous years, it is also true that this concept cannot be extended back to previous years. It's purpose is to move forward. Figure 5 describes the 1987 total income concept, mostly

Figure 5.--Calculation of the 1987 Total Income Concept [8]

1987 TOTAL INCOME =

Salaries and wages*#
\+ Interest*#
\+ Dividends**#
\+ Alimony received*#
\+ Capital gains**#
\+ Net business income*#
\+ Net farm income*#
\+ Net rent income*#
\+ Net royalty income*#
\+ Net partnership income*#
\+ Net Subchapter S Corporation income*#
\+ Net farm rental income*#
\+ Net estate and trust income*#
\+ Net real estate mortgage investment conduit income*
\+ Allowable passive loss
\+ Depreciation in excess of straight-line depreciation#
\+ Pension income reported**#
\+ Advance earned income credit#
\+ Net other income*#
\+ Foreign earned income exclusion
\+ Unemployment insurance income reported*#
\+ Social security income reported**
\+ Tax shelter farm loss
\+ Amortization of certified pollution control facilities
\+ Incentive stock options
\+ Intangible drilling costs
\+ Natural resources depletion expenses
\+ Tax exempt interest
\+ Completed contract method
\+ Circulation expenditures
\+ One-time exclusion for sale of principle residence

LESS

Moving expenses*#
\+ Employee business expenses*#
\+ Alimony paid*#

* Included in Tax Year 1987 AGI.
** Modified from income included in Tax Year 1987 AGI.
\# Included in the 1979 income concept.
Note: Items without an asterisk were not included in Tax Year 1987 AGI.

using the line items which will appear on the income tax return for Tax Year 1987.

This definition should provide an even broader and more stable classifier of income for our users -- one that more nearly reflects the legislators' intent when restructuring the income tax system in the Tax Reform Act of 1986. The 1986 Act took care of the capital gains and the dividends exclusion. It also required the reporting of tax exempt interest. New laws and new forms provide a great deal more detail on passive loss, and IRS statistics can, in turn, transcribe and include appropriate amounts in total income. For example, many of the tax preferences will be identifiable on the alternative minimum tax form. Furthermore, the foreign earned income exclusion (up to $80,000) has been on the individual tax return for several years, but, beginning with Tax Year 1987, IRS statistics will include this field on the data file and use it in the concept of total income. These and other additions to total income are also reflected in Figure 5.

OTHER INCOME CONCEPTS

We have shown how AGI is not only income, but rather has adjustments, exclusions, and many of the trappings of tax law included. We have also described a broad concept of economic income and some new income concepts that IRS will develop to provide data that will be more useful and accurate for OTA and the Joint Committee, as they each develop their version of economic income. To evaluate the potential benefit of the new IRS income concepts it would be useful to review some of the major income concepts, two of which depend upon IRS for their major resource. Most comparisons of income concepts, such as Susan Nelson's report on "Family Economic Income and Other Income Concepts Used in Analyzing Tax Reform" [2], use AGI as a basis of comparison. But the following brief descriptions of OTA's family economic income, OTA's expanded income used to assess high income nontaxable returns, the Joint Committee's expanded income, and the Bureau of Economic Analysis' personal income are limited to discussion of characteristics not included in the IRS 1987 Income Concept. A review of these concepts should help the reader to understand the fitness of the 1987 income concept as a basis from which SOI's users can expand to their own broader income concepts.

Family Economic Income

This income concept was developed by OTA and has been used since the release of Tax Reform for Fairness, Simplicity, and Economic Growth in November 1984. [2] The concept is designed "to implement the theoretical concept of income commonly endorsed by economists for use in tax analysis." As such, the concept and its relationship to the new IRS concept is particularly important, since OTA is the primary user for IRS data.

"Family economic income is a comprehensive measure of income, independent of the prevailing tax law. To the extent feasible, it approximates economists' notion of income as consumption plus change in net worth, it includes many forms of income not reported on tax returns, it measures more accurately other forms of income that are subject to tax, it attempts to avoid double counting of income, and it adjusts for inflation." [2]

The family economic income concept starts with the SOI Individual Income Tax File and then adds income from many other sources. It is based on the family unit rather than the tax return, the individual, or the household, as some other concepts are. The assumption is that income and economic well-being are shared by members of a family. A student who files a tax return with $2,000 of AGI primarily to get a refund is economically more similar to his family -- with $75,000 of AGI -- than to a welfare mother with a minimum wage part-time job, who may also file a return with $2,000 of AGI.

The family economic income concept uses an accrual basis and allocates to individuals (the family) all the pre-tax income in the economy from resources owned by individuals. Coverage includes income tax nonfilers, whether legitimate or delinquent. It allocates corporate income to individuals and rejects the "corporate veil," where the corporation is viewed as distinct from the stockholders. It omits including capital gains for corporate stock and dividends, as reported on tax returns; instead it distributes corporate earnings to individuals. It also includes as income the implicit net rental income for owner-occupied homes. However, family income does include capital gains reported on returns other than those for corporate stock and other securities. Untaxed employer contributions -- pensions, profit sharing, health and medical insurance, life insurance, military benefits, fringe benefits, etc. -- are also handled differently. That is, individuals are credited with income when the employer contributes -- such as to the pension fund -- not when the actual pension income is received.

Social security payments are regarded as a tax. (OTA sees the link between present contributions and future benefits as weak and uncertain.) Both the withheld contributions to social security and the social security income reported on returns are included in income. Family economic income includes transfer payments -- workman's compensation, veterans' benefits, food stamps, and welfare payments. Inflation adjustments are generally made for income sources in the OTA family income. It adjusts all business income for the excess of tax depreciation over economic depreciation.

Expanded Income

Because of the limitations of using AGI as an income classifier, the Treasury Department, the Joint Committee, and others have used an "expanded income" concept for several years. In fact, "the Congress has asked for high-income data to be tabulated on the basis of a measure closely approximating economic income but using only data available on tax returns. This measure is called 'expanded income'." [6] Allen Lerman, of the OTA, oversees an annual IRS study of high income returns and writes a report based on the study. The expanded income concept, described there, improved upon AGI, because it added back tax preference items, and it was easy to use, because it could be derived solely from information reported on tax returns. Lerman's expanded income concept also subtracted income-producing items such, as the investment interest expense.

The expanded income used by the Joint Committee to assess the 1986 Tax Reform Act is similar in concept to previous expanded income concepts -- it adds back tax preferences, reported on minimum tax forms, and the exclusions, such as that for capital gains. However, it is different from OTA's version because it adds in nonfilers. Also, it includes estimates of employer contributions for health and life insurance, workman's compensation, and earnings on life insurance funds. The Joint Committee's expanded income concept excludes losses from rental properties, royalties, estates, small business corporations, and from "passive" partnership interests.

Personal Income

Personal income, for which the Bureau of Economic Analysis (BEA) provides monthly estimates, is similar to OTA's family economic income, in that it attempts to estimate all economic income and uses a number of sources to do that. However, it is different in several ways. One notable difference is that it is comprised of aggregate numbers and cannot be allocated back to individuals in the economy. This difference is appropriate, considering the major purpose for each income concept. BEA's income is an important economic indicator and is a major input to the monthly Gross National Product estimates. On the other hand, OTA's purpose -- to review the effect of tax laws -- operates at the individual level, so that effects for different income classes and taxpayers with different characteristics can be estimated.

Like family income and expanded income, personal income also covers nonfilers, whether legitimate, delinquent, or other. It credits untaxed employer contributions such as health insurance, life insurance, military benefits, fringe benefits, but not pension contributions. It includes pension income and social security income, but deducts from income contributions to social security. Treatment of capital income is different from either OTA or the Joint Committee -- neither capital gains income nor the distribution of corporate earnings is included in personal income.

Personal income includes transfer payments more completely than either of the other income concepts. It includes workman's compensation, veterans' benefits, food stamps, welfare payments, Federal hospital and supplementary medical insurance, and other government transfers. The in-kind transfer payments are difficult to value at the individual level, so they are omitted by OTA from family income. Personal income also adds in investment income received by nonprofit institutions, which neither of the others includes. And, finally, unlike the family income concept, personal income doesn't include inflation adjustments.

CONTROLLING INCOME FOR INFLATION

Comparison of income from different years is not only affected by differences in income items composing the definition, but also by inflation. To deal with this effect, economists often choose a base year as a reference point. Begining with Tax Year 1986 IRS will provide data using constant dollars as well as the standard current dollars. It will use the Bureau of Economic Analysis' 1982-based Personal Consumption Expenditure Implicit Price Deflator to make the inflation adjustment. [9] Figure 6 shows total income for selected years from 1922 to 1985 in both current and constant dollars.

Figure 6.--Total Income for Selected Years, 1922-1985

Selected Income Year	Total Income: Current Dollars (millions)	Total Income: Constant (1982) Dollars (millions)
1922	21.3	126.8
1929	26.7	162.8
1930	17.0	106.9
1935	12.2	90.4
1940	40.2	309.2
1945	120.0	594.1
1950	179.1	683.6
1955	249.0	844.1
1960	316.1	960.9
1965	432.3	1214.3
1970	639.4	1522.4
1975	962.9	1626.5
1980	1,642.3	1,896.4
1981	1,804.0	1,907.0
1982	1,917.0	1,917.0
1983	2,024.0	1,944.3
1984	2,229.6	2,062.5
1985	2,401.0	2,145.7

The real growth change (constant dollars) over the 63 years is 17 times the 1922 total income, but this considerable increase is more understandable than the 113 times the 1922 total income measured in current dollars. The 1930 and 1935 lows for both current and constant dollars reflect the decline of the Great Depression, with $90 billion for 1935 as the lowest constant dollar total income. During the Depression, current-dollar total income decreased proportionally more than constant-dollar income. This difference reflects the fact that there were fewer individuals receiving income because of widespread unemployment, but those who had income received more real value for income spent. The dramatic gains in total income during the 1960's reflect increases in real income, as well as a considerable increase in the number of individuals filing returns. Figure 6, overall, shows considerable differences in income levels by constant dollars vs. current dollars. It makes a good case for providing IRS income data by both measures.

FUTURE PLANS FOR IRS

So far we've provided some historical and definitional information on income and on AGI; we've defined our goals, in terms of what the definition of income is and what IRS' role should be in contributing toward that goal; we've defined two new income concepts, retrospective and prospective; we've provided some data based on the retrospective 1979 income concept; we've discussed some of the major characteristics of the most important income concepts; and we've given some perspective to the subject of constant dollars vs current dollars. Similar comparisons for the 1987 income concept will have to wait until the data become available. Where do we go from here? Following is a discussion of IRS plans for developing, publishing, and generally incorporating these ideas in the SOI Individual/Sole Proprietorship Program.

Data using on the 1979 concept are already available. Statistics of Income...1985, Individual Income Tax Returns includes data based on both AGI and the 1979 income concept, as well as a comparison of current and constant dollars. For Tax Year 1986, the 1979 income concept will be introduced more systematically in the data presentation. The value will be included on each individual's record in both the final file for OTA and in the Individual Tax Model. Tables will cover the 1979 income concept and AGI in both current and constant dollars. We will also have a table showing percentile distribution of selected income and tax items.

IRS plans to develop data based on the 1979 income concept for all Tax Years back through 1979. We expect further research to allow us to capture similar data for some years prior to that -- going back as far as 1960. The number of new concepts of income may increase -- there may be other concepts developed to serve other purposes.

For Tax Year 1987, primary emphasis in publishing data will be on the new and more inclusive 1987 income concept. Its value will be included in the data file and in the Tax Model, as will the 1979 income concept value, to provide a common base for comparison to prior years' data. In other words, data will include tables based on AGI, the 1979 concept, and the 1987 concept. As for the Tax Year 1986, publication, current dollars, constant dollars, and percentile intervals will be used to present 1987 data.

With the introduction of taxpayer identification numbers for dependents for Tax Year 1987, IRS is also looking towards developing and producing data using a family income concept. And, beginning with Tax Year 1989, SOI will have a redesigned sample which includes an imbedded panel. Having a panel included in the sample will allow OTA to make valuable comparisons of change at the individual taxpayer level -- a considerable improvement over comparisons at the aggregate level, when studying the effects of tax law change on individual taxpayers.

IRS was the leader in providing income distribution statistics up through the 1940's. Now, with the recent Tax Reform Act, IRS is in a strong position to gain this stature again. The discussion in this paper is simply the introduction to many future chapters representing a variety of expanded income statistics.

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NOTES AND REFERENCES

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[2] Nelson, Susan C., "Family Economic Income and Other Income Concepts Used in Analyzing Tax Reform," Compendium of Tax Research, 1986, The Office of Tax Analysis, Department of Treasury, 1987.

[3] Haig, Robert Murray, "The Concept of Income -- Economic and Legal Aspects," The Federal Income Tax, Columbia University Press, 1921; and Simons, Henry C., Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy, Chicago University Press, 1938.

[4] Statistics of Income...1985, Individual Income Tax Returns, Publication 1304, 1987.

[5] Carryovers are losses incurred in one Tax Year in excess of the allowable deduction and deducted in a later Tax Year. See "Explanation of Terms" in [4].

[6] Lerman, Allen H., "High-Income Returns, 1984," Statistics of Income Bulletin, Internal Revenue Service, Spring 1987, pp. 1-29.

[7] The income items included in the calculation of the 1979 Total Income Concept are defined in the "Explanation of Terms" in [4].

[8] Definitions for the income items included in the calculation of the 1987 Total Income Concept are defined on the 1987 Tax Forms and their instructions. A few, such as allowable passive loss and depreciation in excess of straight-line depreciation, are computed from line items from several forms.

[9] Personal Consumption Expenditure Implicit Price Deflator, Bureau of Economic Analysis, U.S. Department of Commerce.

Table A.—All Returns: Selected Income and Tax Items, By Size of Adjusted Gross Income and 1979 Income Concept, 1985 Statistics of Income Individual File

[All figures are estimates based on samples—number of returns are in thousands and money amounts are in millions of dollars]

Size of Income	Total Income				Salaries and Wages				Interest Received			
	By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept	
	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
All returns, total	**101,660**	**2,305,951**	**101,660**	**2,446,165**	**87,198**	**1,928,201**	**87,198**	**1,928,201**	**64,526**	**182,109**	**64,526**	**182,109**
Under $10,000	33,240	127,334	32,285	118,124	26,457	137,789	25,718	132,600	14,891	24,791	14,260	23,570
$10,000 under $20,000	25,551	375,530	25,367	372,658	21,550	303,425	21,396	295,293	14,538	35,076	14,199	33,334
$20,000 under $30,000	16,434	405,267	16,311	402,101	14,893	353,673	14,580	335,042	11,791	25,729	11,652	27,154
$30,000 under $40,000	11,636	402,943	11,496	397,365	10,850	361,611	10,664	343,394	9,560	20,892	9,392	21,526
$40,000 under $50,000	6,702	297,914	6,916	308,020	6,247	267,749	6,476	267,375	6,062	16,582	6,209	15,847
$50,000 under $60,000	3,359	182,898	3,638	198,353	3,075	161,040	3,398	167,859	3,127	11,600	3,381	10,867
$60,000 under $70,000	1,727	111,453	1,910	123,202	1,560	93,858	1,771	102,726	1,640	8,236	1,811	7,565
$70,000 under $80,000	940	70,052	1,161	86,507	831	55,929	1,046	67,123	906	5,942	1,113	5,846
$80,000 under $90,000	515	43,507	660	55,818	445	33,248	566	38,895	495	3,846	643	4,768
$90,000 under $100,000	352	33,225	439	41,491	299	23,362	372	28,342	342	3,049	425	3,007
$100,000 under $125,000	472	52,473	533	59,243	397	35,895	459	38,415	457	4,835	519	4,603
$125,000 under $150,000	234	31,843	289	39,366	189	21,228	237	24,109	224	3,717	278	3,169
$150,000 under $175,000	123	19,911	167	27,086	103	13,171	136	14,585	121	1,839	164	3,017
$175,000 under $200,000	80	14,974	106	19,625	66	9,780	87	11,011	79	1,513	102	1,717
$200,000 under $300,000	153	36,457	194	46,354	127	21,922	153	23,383	150	3,457	191	3,815
$300,000 under $400,000	55	18,798	65	22,054	39	9,243	49	9,790	54	2,332	64	2,463
$400,000 under $500,000	31	13,731	39	17,274	23	5,261	25	5,832	30	1,506	38	1,610
$500,000 under $1,000,000	41	27,541	59	40,340	31	11,025	46	12,161	41	3,220	58	3,543
$1,000,000 or more	17	40,100	27	71,185	14	8,992	21	10,265	17	3,945	26	4,689

Size of Income	Dividends Received				Business Net Income (Less Loss)				Sales of Capital Assets			
	By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept	
	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount
	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)
All returns, total	**19,717**	**57,004**	**19,717**	**57,004**	**11,900**	**78,773**	**11,900**	**78,773**	**12,659**	**68,278**	**12,659**	**68,278**
Under $10,000	2,972	3,503	2,758	3,213	2,897	-153	2,785	-308	1,728	5,891	1,569	5,579
$10,000 under $20,000	3,671	6,227	3,451	5,720	2,517	11,439	2,414	10,435	2,119	2,030	1,934	1,531
$20,000 under $30,000	3,086	5,193	3,105	5,759	2,167	11,686	2,141	11,197	2,020	2,388	2,008	2,067
$30,000 under $40,000	3,134	5,312	2,994	5,073	1,656	9,990	1,652	9,615	1,846	2,935	1,803	2,552
$40,000 under $50,000	2,323	3,958	2,315	3,909	1,023	8,903	999	7,784	1,445	2,923	1,409	2,190
$50,000 under $60,000	1,517	3,499	1,579	3,089	570	6,658	624	7,070	1,017	2,939	1,040	2,713
$60,000 under $70,000	943	2,982	974	2,449	316	5,951	347	4,622	683	2,660	675	1,837
$70,000 under $80,000	576	2,317	695	2,221	206	4,455	237	4,147	438	1,871	531	2,293
$80,000 under $90,000	323	1,507	418	1,950	125	3,238	152	3,832	270	1,815	359	1,828
$90,000 under $100,000	243	1,754	294	1,542	84	2,610	118	3,235	217	1,547	256	1,681
$100,000 under $125,000	340	2,744	379	2,447	135	4,275	149	4,431	307	3,819	336	2,775
$125,000 under $150,000	178	2,185	216	1,708	67	2,163	88	2,929	164	2,564	205	2,515
$150,000 under $175,000	98	1,490	133	1,743	38	1,467	51	2,354	90	1,703	122	2,034
$175,000 under $200,000	62	875	82	1,189	20	982	34	1,349	59	1,450	79	1,444
$200,000 under $300,000	125	2,573	158	3,196	39	1,879	52	2,444	124	4,526	160	4,607
$300,000 under $400,000	47	2,713	55	1,530	17	755	22	963	47	2,841	56	2,494
$400,000 under $500,000	27	1,613	34	2,282	6	402	9	425	28	2,741	35	2,226
$500,000 under $1,000,000	37	2,596	52	3,471	14	1,146	18	1,312	38	6,067	54	6,586
$1,000,000 or more	16	3,963	24	4,514	6	926	9	936	16	15,564	26	19,326

Table A.—All Returns: Selected Income and Tax Items, By Size of Adjusted Gross Income and 1979 Income Concept, 1985 Statistics of Income Individual File—Continued

[All figures are estimates based on samples—number of returns are in thousands and money amounts are in millions of dollars]

Size of Income	Pensions and Annuities				Rent, Royalty and Farm Rental Net Income (Less Loss)				Partnership and S Corporation Net Income (Less Loss)			
	By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept	
	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount
	(25)	(26)	(27)	(28)	(29)	(30)	(31)	(32)	(33)	(34)	(35)	(36)
All returns, total	**13,953**	**116,588**	**13,953**	**116,588**	**10,590**	**-10,946**	**10,590**	**-10,946**	**5,488**	**-2,527**	**5,488**	**-2,527**
Under $10,000	2,985	13,050	2,746	10,488	1,811	-4,380	1,734	-4,062	794	-16,812	771	-15,324
$10,000 under $20,000	3,916	27,688	3,759	25,377	1,976	-569	1,898	-360	669	185	611	68
$20,000 under $30,000	2,366	21,000	2,454	21,329	1,756	-1,760	1,699	-1,411	713	-107	672	123
$30,000 under $40,000	1,813	16,679	1,785	15,670	1,506	-2,175	1,484	-1,759	626	491	609	365
$40,000 under $50,000	1,163	11,340	1,189	11,270	1,135	-1,635	1,157	-1,801	602	479	571	932
$50,000 under $60,000	680	7,808	736	7,403	698	-1,487	699	-1,665	453	-331	447	-104
$60,000 under $70,000	381	5,019	382	4,129	458	-616	453	-863	335	192	332	76
$70,000 under $80,000	212	4,121	279	3,757	305	-471	342	-400	260	590	277	400
$80,000 under $90,000	119	1,751	167	2,659	177	-311	228	-239	182	732	205	526
$90,000 under $100,000	73	1,204	106	1,746	138	-70	151	-250	140	1,008	153	342
$100,000 under $125,000	95	2,261	130	3,007	202	-185	220	-204	227	1,162	229	1,010
$125,000 under $150,000	48	1,008	61	1,589	120	54	137	-237	133	182	160	802
$150,000 under $175,000	25	845	39	1,000	62	33	88	-52	74	107	108	-121
$175,000 under $200,000	19	440	32	955	43	92	53	52	54	297	66	305
$200,000 under $300,000	31	1,196	44	1,717	89	464	109	424	108	1,609	127	1,444
$300,000 under $400,000	9	313	15	1,148	34	257	42	139	45	275	49	399
$400,000 under $500,000	4	171	7	593	27	-530	27	-577	21	768	27	150
$500,000 under $1,000,000	10	387	16	1,435	39	1,824	52	1,832	36	1,352	50	1,512
$1,000,000 or more	3	307	6	1,316	12	521	18	486	15	5,295	22	4,569

Size of Income	Estate and Trust Net Income (Less Loss)				Total Statutory Adjustments				Total Itemized Deductions			
	By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept	
	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount
	(37)	(38)	(39)	(40)	(41)	(42)	(43)	(44)	(45)	(46)	(47)	(48)
All returns, total	**1,149**	**9,730**	**1,149**	**9,730**	**37,763**	**95,082**	**37,763**	**95,082**	**39,848**	**405,024**	**39,848**	**405,024**
Under $10,000	250	454	228	420	2,244	3,255	1,846	2,535	2,303	11,697	2,131	11,431
$10,000 under $20,000	184	807	191	795	6,568	9,202	6,131	8,025	6,134	37,879	5,834	35,343
$20,000 under $30,000	134	680	134	727	8,581	14,543	8,222	13,078	8,576	59,295	8,249	56,498
$30,000 under $40,000	138	859	139	857	8,131	17,549	7,945	16,163	9,078	75,619	8,707	71,287
$40,000 under $50,000	93	419	91	444	5,438	15,399	5,642	15,113	6,006	62,523	6,080	61,029
$50,000 under $60,000	76	555	64	473	2,850	10,746	3,165	11,412	3,167	40,053	3,412	40,940
$60,000 under $70,000	55	426	53	328	1,481	7,290	1,695	7,469	1,642	24,638	1,817	25,310
$70,000 under $80,000	36	238	37	257	800	4,400	1,015	5,347	912	16,218	1,115	18,390
$80,000 under $90,000	22	226	30	260	436	2,617	561	3,165	500	10,297	635	11,440
$90,000 under $100,000	19	296	21	260	284	1,863	365	2,362	345	7,729	429	8,958
$100,000 under $125,000	36	350	37	431	383	2,776	445	3,090	460	12,387	512	12,453
$125,000 under $150,000	25	218	19	157	184	1,504	238	1,880	230	8,101	283	8,058
$150,000 under $175,000	16	258	21	210	101	898	129	1,483	121	4,651	164	6,279
$175,000 under $200,000	7	83	12	165	64	547	86	804	79	3,366	104	3,880
$200,000 under $300,000	16	261	23	294	118	1,115	145	1,392	151	7,922	189	8,951
$300,000 under $400,000	11	435	12	404	36	394	47	537	54	4,934	63	4,617
$400,000 under $500,000	11	1,930	9	1,960	21	184	22	222	30	3,289	38	3,321
$500,000 under $1,000,000	14	396	20	410	32	586	46	698	41	6,323	58	7,582
$1,000,000 or more	4	838	5	878	12	216	18	308	17	8,103	26	9,256

Table A.—All Returns: Selected Income and Tax Items, By Size of Adjusted Gross Income and 1979 Income Concept, 1985 Statistics of Income Individual File —Continued

[All figures are estimates based on samples—number of returns are in thousands and money amounts are in millions of dollars]

Size of Income	Taxable Income				Total Tax Credits				Total Income Tax			
	By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept		By Size of AGI		By 1979 Income Concept	
	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount	Returns	Amount
	(49)	(50)	(51)	(52)	(53)	(54)	(55)	(56)	(57)	(58)	(59)	(60)
All returns, total	**96,124**	**1,820,741**	**96,124**	**1,820,741**	**20,995**	**10,248**	**20,995**	**10,248**	**82,846**	**325,710**	**82,846**	**325,710**
Under $10,000	27,969	107,980	27,095	104,656	3,552	677	3,322	675	15,879	5,665	15,295	5,883
$10,000 under $20,000	25,358	294,357	25,148	284,774	4,660	1,495	4,693	1,487	24,458	30,257	24,009	29,066
$20,000 under $30,000	16,401	325,795	16,255	313,949	3,747	1,378	3,587	1,298	16,210	43,337	16,025	41,404
$30,000 under $40,000	11,625	320,092	11,474	306,767	3,303	1,314	3,177	1,227	11,544	49,794	11,394	47,064
$40,000 under $50,000	6,693	233,646	6,902	232,432	2,227	979	2,275	974	6,678	41,502	6,877	40,449
$50,000 under $60,000	3,352	142,532	3,629	146,339	1,221	550	1,313	589	3,353	29,294	3,626	29,028
$60,000 under $70,000	1,723	86,728	1,905	90,230	698	485	738	478	1,720	19,517	1,902	19,575
$70,000 under $80,000	937	53,818	1,156	61,564	416	309	501	369	938	13,146	1,153	14,391
$80,000 under $90,000	514	33,190	657	39,657	241	191	301	197	513	8,735	658	10,060
$90,000 under $100,000	351	25,493	437	28,607	175	175	201	193	351	7,168	437	7,645
$100,000 under $125,000	470	40,080	530	40,718	267	450	273	404	470	12,055	529	11,750
$125,000 under $150,000	233	23,867	287	26,462	141	307	170	309	233	7,841	288	8,277
$150,000 under $175,000	123	15,261	166	17,019	74	152	108	173	123	5,414	166	5,750
$175,000 under $200,000	79	11,627	105	13,214	53	151	66	156	80	4,347	105	4,712
$200,000 under $300,000	152	28,564	192	30,483	104	424	126	437	152	11,362	193	11,756
$300,000 under $400,000	55	13,902	63	13,524	42	174	46	190	55	5,986	64	5,650
$400,000 under $500,000	30	10,454	38	10,658	25	135	30	134	30	4,685	39	4,689
$500,000 under $1,000,000	41	21,270	58	23,203	34	325	47	332	41	9,878	59	10,603
$1,000,000 or more	17	32,087	26	36,484	15	577	22	625	17	15,728	27	17,956