

W&I TAXPAYER OF THE FUTURE

Kay Anderson

Strategic Forecasting & Analysis Group

IRS Wage & Investment Division, Office of Research

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Introduction

Since the stock market peaked in spring 2000, the economy has been slowing, entering a recession in March 2001. Current events—corporate scandals, terrorism, and the war against Iraq—have had an immense impact on the nation’s economic recovery. The decline in the stock market caused many workers to rethink their retirement plans and many families to revise education plans. Meanwhile, the long-run implications are the loss of investor trust, possible legislative changes, and modifications in individual retirement planning. Before the war in Iraq began, the prospect of the war softened consumer confidence and stagnated corporate investments. The war in Iraq and our post-war obligations have resulted in increased government spending, putting new pressures on an already fragile economy.

In addition to economic changes, society is undergoing many demographic and technological changes. For example, the population is getting older, and declining birth rates have resulted in fewer young people to enter the labor force—the nation is facing a potential labor shortage. Immigration will help alleviate some of the shortage, bringing about one million people into the country each year.

Time is becoming a precious commodity. People are looking for more ways to balance time at work with their family and leisure time. The Internet is becoming a valuable tool for time-deprived consumers. Internet shopping has grown from 40 million persons in 2000 to 72

million in 2002. More people are also going online to complete bank transactions and pay bills—all in the name of convenience and timesavings.

Major Trends of Past 50 Years

Before looking at the trends emerging in the 21st century, it may be interesting, as well as useful, to look at some of the biggest trends that emerged in the second half of the past century. As described by Cheryl Russell in *Demographics of the U.S.: Trends and Projections* (2000), they were:

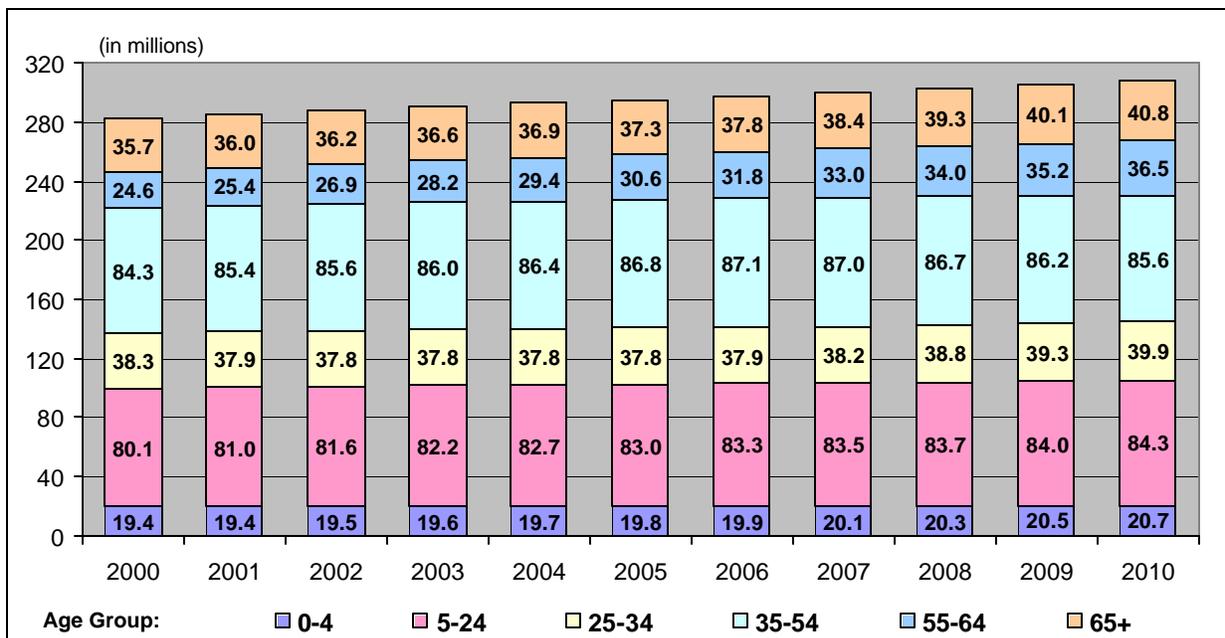
- Expanded role of women—Women’s participation in the labor force has grown dramatically over the past few decades, which has led the way to the dual-income household.
- Emergence of alternative living arrangements—In the 1950s, the normal household was a married couple with children. Today only one in four households fits that description as more people are living alone or with nonrelatives or are single with children.
- Gains in educational attainment—Only a few decades ago, the majority of adults did not have a high school diploma. By 2000, over 90 percent were high school graduates, with over half continuing on to college.
- Improved standard of living—The expanded role of women and the gains in education attainment have fueled the improvement in the nation’s standard of living. At its peak in the 1990s, more than one in 10 households had an income of \$100,000 or more.

The women’s roles, alternative living arrangements, and higher educational levels have become the norm in today’s society. So what are the big trends to emerge in the next 50 years?

Demographic Trends

Over the next decade, the population of the United States will continue to grow. In 2000, the total U.S. population was 281.4 million; by 2010, the population is projected to be more than 308 million. This population growth is a result of births and longer life expectancy. In 2000, a 65-year-old person was expected to live an additional 18 years. Figure 1 shows how the U.S. population will age over the next decade.

Figure 1. Population Projections by Age Group, 2000-2010



Source: U.S. Census Bureau, Economy.com

Four generations dominate IRS’s Wage & Investment (W&I) customer base: the Silent Generation, Baby Boomers, Generation X, and the Millennials. The Silent Generation is already beginning to swell the number of older Americans. With healthier lifestyles and medical advances, today’s seniors are living longer. They have a better chance of reaching age 85 than any previous generation.

Baby Boomers, the largest generation, started many of the trends that are the norm today, such as increased enrollment in higher education, more women in the labor force, and delayed marriage and children. As Baby Boomers reach retirement age, they will begin a new trend in retirement—working longer, with many easing into retirement by moving into part-time work before completely exiting the labor force.

Gen Xers and Millennials are technologically savvy generations. They will demand more advanced telecommunications and Net-based transactions. Both Gen Xers and Millennials will be more willing to move between jobs, whether it be to advance their careers or for more job flexibility. After watching their parents go through downsizing, these workers are not likely to develop strong loyalties to any employer.

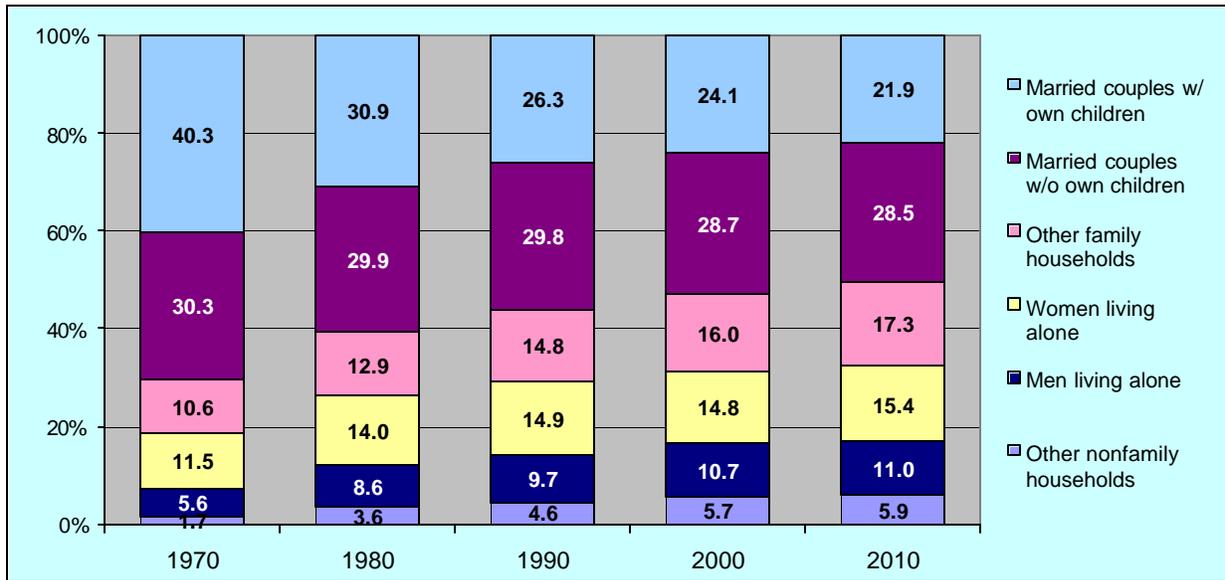
Over the next decade, Millennials will produce the largest high school and college enrollments in U.S. history. According to the U.S. Department of Education's National Center for Education Statistics, college enrollment is projected to increase 20 percent between 1995 and 2010. The graduating class of 2009 is projected to be the biggest in history—3.2 million are expected to graduate that year, up nine percent from 2003.

The U.S. population is also shifting geographically. U.S. Census Bureau projections show that the largest population growth will be in the South and the West, with California, Texas, and Florida each projected to have a net increase of at least six million persons between 1995 and 2025. The projected population growth in southern and western states is a continuation of the trend of the 1990s where interstate migration drained the Northeast and caused the South to grow. That trend is expected to continue. By 2015, 36 percent of the U.S. population is projected to be located in the South and almost 25 percent in the West.

Some of the U.S. population growth will be due to immigration. In 2000, 28.4 million persons were foreign-born, accounting for over 10 percent of the total population. By 2010, the number of foreign-born persons is projected to reach 34 million, about 11 percent of the U.S. population. In 1970, 62 percent of the foreign-born population were from Europe. By 2010, 51 percent will be from Latin America and 26 percent from Asia.

With the growing population of foreign-born persons, there is also a growing portion of the U.S. population that is speaking a language other than English in their home. In 1990, almost 14 percent of the population spoke a language other than English in their home. In 2000, the proportion had reached 18 percent; it is expected to reach 21 percent by 2010. Other than English, the language most commonly spoken in U.S. homes is Spanish. In 1990, 7.5 percent of the population spoke Spanish in their homes. Projections indicate that by 2010, 13 percent of the population will speak Spanish in their homes.

As the population increases, the number of households will also increase. However, the number of traditional households will decline. By 2010, about 22 percent of households will consist of married couples and their children, down from 31 percent in 1980. As Figure 2 illustrates, more households will consist of people living alone, nonrelatives living together, and family households comprised of relatives other than married couples with or without children.

Figure 2. Distribution of Households by Type, 1970-2010

Source: U.S. Census Bureau; SFA staff projection

Among the family households, a rising number of them will consist of single-parent households and grandchildren living with their grandparents. In 2000, 3.8 million grandchildren were living with their grandparents, and that number is projected to rise to 4.8 million by 2010.

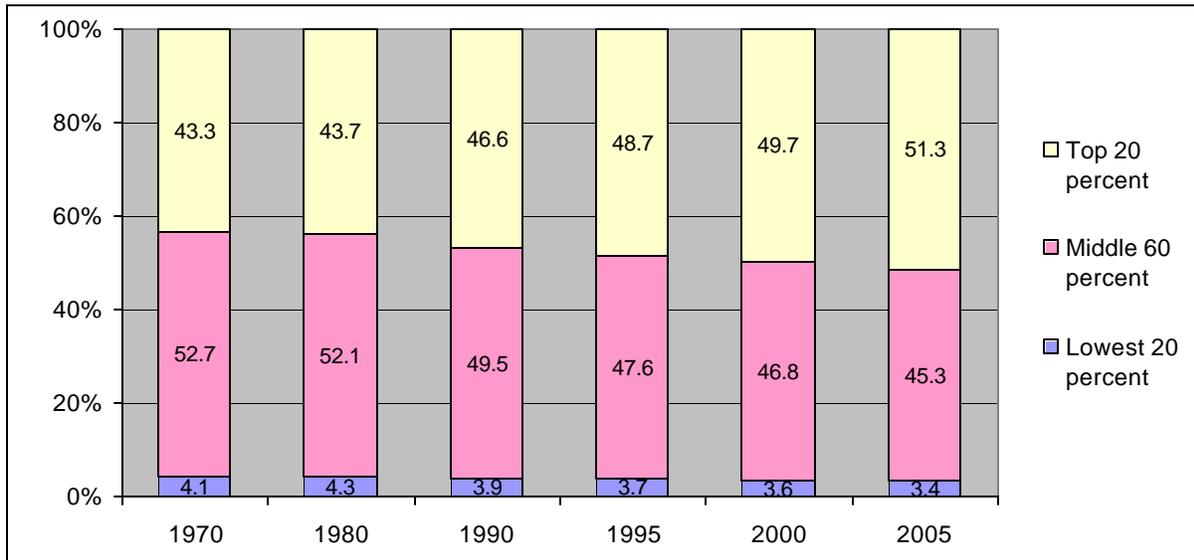
Economic and Financial Trends

One of the major trends over the last 50 years was the rising standard of living among Americans. The standard of living is expected to continue its upward trend, with a projected 17-percent increase in disposable income between 2002 and 2010. A contributing factor to the rising standard of living is the dual-income household. About 60 percent of married-couple households have two earners. This proportion has been relatively steady since 1994.

While the economic boom of the 1990s increased income at almost every level, the increases were not the same for everyone. Data from the Federal Reserve Board's Survey of Consumer Finances showed that before-tax family income grew fastest among families whose income was in the top 10 percent of the income distribution. From 1992 to 2001, the median

income for this group increased over 27 percent, from \$133,200 in 1992 to \$169,600 in 2001. Most of the increase occurred between 1998 and 2001 when the median income grew 19 percent. The median income for the bottom 20 percent of families grew at a slower rate between 1998 and 2001, with an increase of 14 percent. When looking at the longer period of 1992 to 2001, the median income for the lowest income group grew more than 22 percent. Meanwhile, the median income for families in the middle income group (40th through 60th percentiles) experienced the smallest increase for both the 1998-2001 period and the 1992-2001 period, at 9.6 percent and 20.9 percent, respectively. Figure 3 further illustrates how income distribution is changing over time, with the top 20 percent of households accounting for an increasing proportion of aggregate income.

Figure 3. Distribution of Aggregate Household Income, 1970-2005



Source: Current Population Survey, U.S. Census Bureau

The number of taxpayers affected by the Alternative Minimum Tax (AMT) is projected to rise over the next decade, barring any legislative changes. In 2000, an estimated 1.3 million people paid the AMT. Projections produced by The Tax Policy Center show that by 2010, 36

million taxpayers will be affected by the AMT. The cause of this major growth in AMT is that it is not indexed for inflation. While elements of the regular income tax (e.g., standard deductions, exemptions for dependents) are automatically indexed for inflation each year, elements of the AMT are not. For the AMT, Congress periodically raises the exemption amounts. For example, the exemptions in place for tax year 2000 had been in effect since 1993. Estimates show that if the AMT had been indexed (and the 2001 tax cuts not been enacted), only 300,000 households would pay the AMT, both now and in 2010.

Health care costs will continue to rise over the next decade, and in response, health insurance premiums will also continue to rise. In 2003, premiums are forecast to jump an average 15.4 percent for employers who offer health benefits to its workers. Many employers will pass this increase on to their workers through higher premiums, raising deductibles, and higher co-payments while others may discontinue offering health insurance altogether. Per capita out-of-pocket costs will rise from \$694 in 2000 to a projected \$1,603 in 2010.

With the help of the lowest mortgage rates in over 30 years, more householders than ever own their own homes. Homeownership reached an annual average of 68 percent in 2001. The highest rate was in the Midwest, with 73 percent; the lowest was in the West, with 63 percent. The rate of homeownership is expected to continue to rise through the decade, reaching almost 69 percent in 2010.

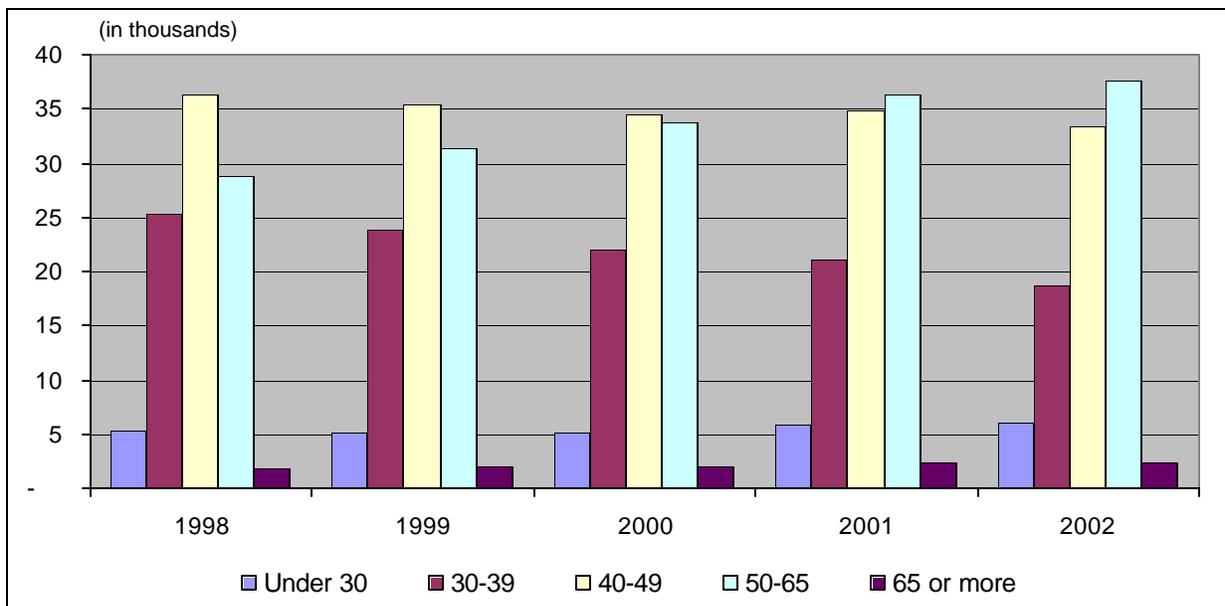
Labor Force Trends

A challenge in the future workforce will be its multigenerational composition. As more workers delay retirement and the Millennials enter the labor force, a wide array of age groups will comprise the workforce. The growing presence of older workers in the workforce is evident

in the median age of the labor force. In 1980, the median age of the labor force was 34.6 years old. By 2008, it will approach 41 years old—a very high level by historical standards.

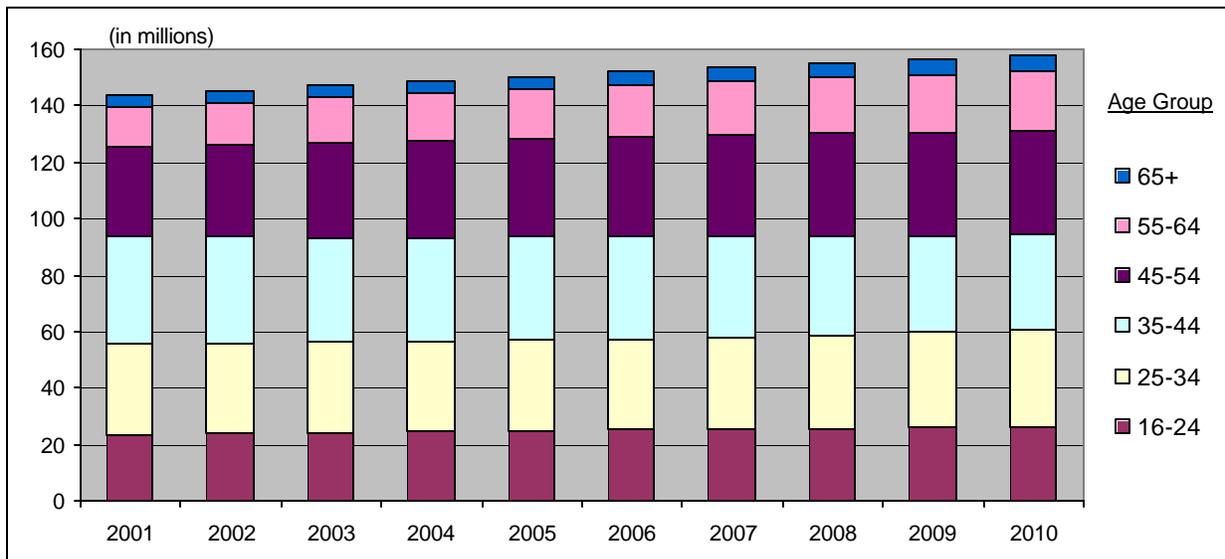
The aging workforce is also present at the IRS. Over the past decade, increasingly more workers comprise the older age groups. In the past two years, 50- to 65-year-olds comprised the largest group of IRS workers, with over 36,000 workers in 2001 and over 37,000 in 2002 (see Figure 4).

Figure 4. IRS Employees by Age Group



Source: FedScope, Office of Personnel and Management; counts include all employees, seasonal and non-seasonal, on payroll in September of given year.

Over the next decade, the number of people in the labor force will continue to increase. The Bureau of Labor Statistics projects that by 2010, over 157 million persons will be in the labor force, up from 141 million in 2000. Baby Boomers will continue to be a part of the labor force—by 2010, persons age 55 and older will comprise about 17 percent of the labor force, compared to 13 percent in 2000. Figure 5 illustrates the expected growth in older workers over the next several years.

Figure 5. Civilian Labor Force by Age, 2001-2010

Source: Bureau of Labor Statistics

One of the major trends over the past 50 years was the rise of women in the labor force. This trend is expected to continue. In 2001, 66 million women comprised almost 47 percent of the civilian labor force. By 2008, over 75 million women are expected to be in the labor force, accounting for 48 percent of the labor force. As immigrants continue to come to this country, they will also play a large role in the workplace. Over the past decade, immigrants (both legal and illegal) accounted for half of the new wage earners entering the labor force.

The total number of jobs is projected to grow 14 percent between 1998 and 2008. The number of jobs requiring a bachelor's degree is expected to grow 24 percent, and those requiring an associate's degree will grow 31 percent. The most new jobs will be created in the professional occupations, which include such occupations as computer systems analysts, teachers, and health practitioners. Service occupations, which include home health aides and nursing aides, are also expected to grow significantly over the next decade—almost 20 percent. The fastest-growing occupations will be high-tech jobs. Most of these fast-growing occupations,

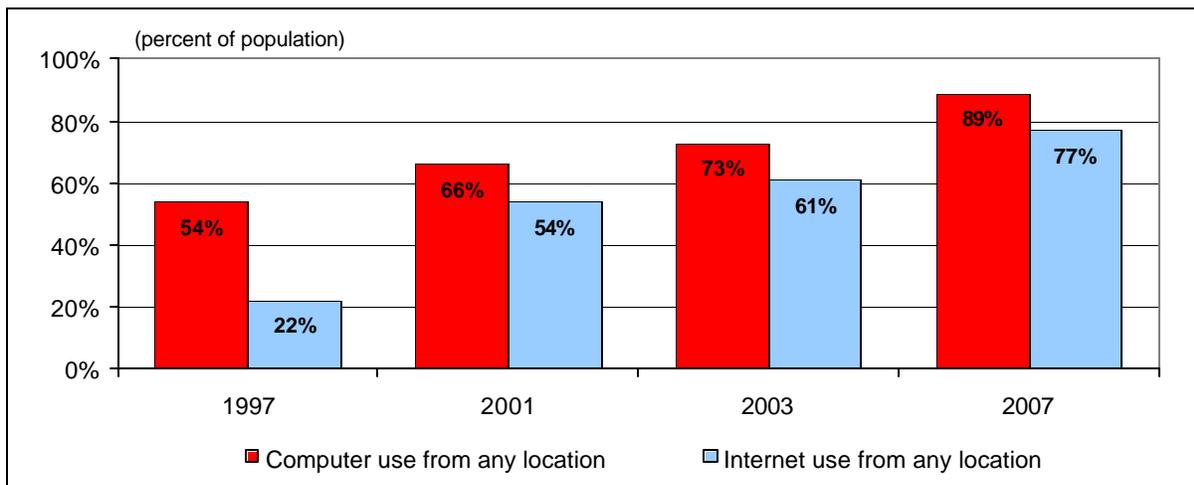
as well as many of the occupations that will experience large job growth over the next decade, will be filled by knowledge workers.

Over the next few years, there is the potential for a labor shortage. As the economy recovers, jobs will be filled and more jobs will be created. But declining birthrates in the 1960s and 1970s have resulted in fewer young people entering the job market today. Between 1996 and 2006, the segment of the labor force aged 25-34 will drop by almost 3 million persons. By 2010, projections indicate that there will be 167,754,000 jobs and only 157,721,000 people in the labor force—a shortage of 10,033,000 workers. However, persons working multiple jobs will ameliorate this shortage.

Technology Trends

Computers are becoming part of today's environment, not just a tool for a specific task. Personal computers and the Internet have transformed both home and school. As illustrated in Figure 6, both computer use and Internet use is expected to continue to climb over the next several years, with Internet use growing at a faster rate.

Figure 6. Computer Use v. Internet Use, 1997-2007



Source: U.S. Department of Commerce, September 2001; projections by SFA staff.

In 2001, 174 million Americans had used a computer and 143 million had accessed the Internet. In 2007, 259 million Americans are forecast to use a computer and up to 225 million are predicted to be Internet users. Internet usage is highest among younger persons while older people have been less likely to go online, and this trend is not expected to change. There will also continue to be an Internet-penetration divide between those with some college education or above (all over 80 percent by 2007) and those with a high school education or below (less than 65 percent by 2007).

Internet usage varies by income, with higher-income households more likely to be online than lower-income households, but all income groups are expected to show increases in usage. The percentage of online households with incomes below \$15,000 is projected to increase from under 20 percent in 2000 to almost 40 percent in 2007. For households in the \$15,000-\$25,000 income range, the percentage will increase from under 20 percent in 2000 to over 50 percent in 2007. For households with incomes in excess of \$35,000, over 80 percent will be online by 2007.

Online shopping has been experiencing a steady increase over the past few years. Between 1997 and 2002, the number of online shoppers grew from five million to 36.5 million, with sales growing from \$2.4 billion to \$72.1 billion. Projections suggest that by 2007, there will be close to 63 million online shoppers, and sales will reach \$217.8 billion.

Another online service that has been showing growth is online banking. Banks are working towards making online services as common as their telephone and ATM services, and it appears that as banks offer more services online, more customers use them. The estimates of online bankers vary, but they all agree that online banking is growing in popularity. A

conservative estimate of online bankers is one in five households was banking online in 2002 and that by the end of 2005, 31.5 million households will be banking online.

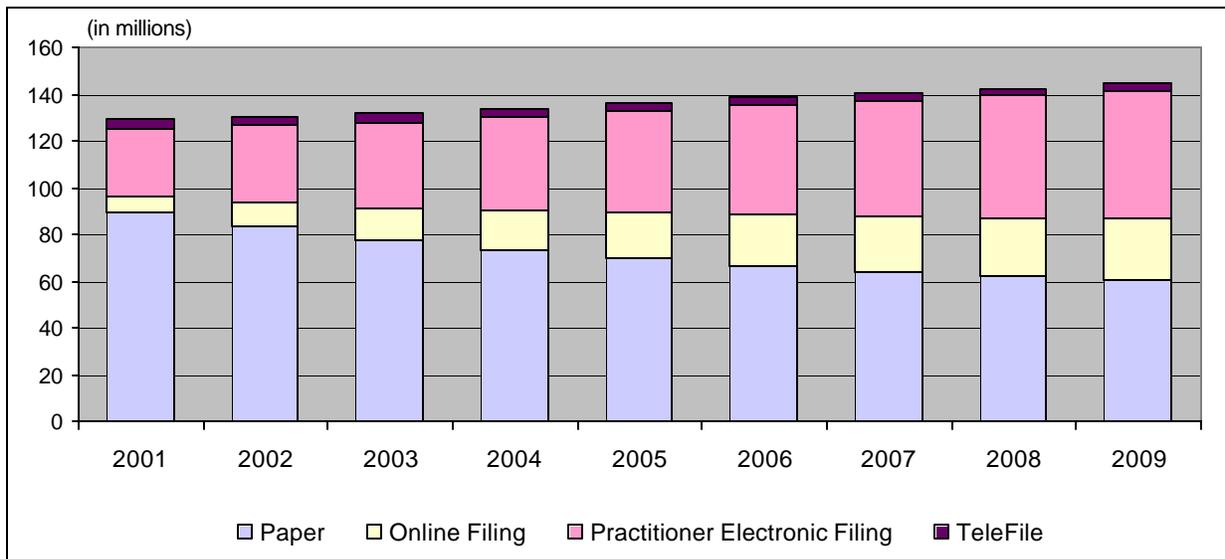
Another growing Internet application is online bill payment. Jupiter Research, a research organization specializing in business and technology market research, projects that 17 million households will be paying bills online in 2003, up from 2.6 million in 1999. They also predict a rise in the popularity of online billing, saying that more than 40 million U.S. households will pay at least some of their bills online by 2005.

IRS Return Processing

The Internal Revenue Service will continue to see an increase in individual returns filed. According the IRS Office of Research's Projections and Forecasting Group, the number of Forms 1040, 1040A, and 1040EZ filed is projected to increase almost 11 percent between 2002 and 2009 when over 144 million returns are projected to be filed.

W&I currently comprises over 73 percent of Forms 1040, 1040A, and 1040EZ filed; by 2009, they will account for about 71 percent. W&I's expected rate of increase in returns filed between 2002 and 2009 is less than 8 percent, from 95.3 million returns in 2002 to 102.4 million in 2009.

By 2009, 58 percent of all Forms 1040, 1040A, and 1040EZ will be filed electronically. As illustrated in Figure 7, among the options available for electronic filing, more taxpayers will use the services of a practitioner to e-file their return.

Figure 7. Total Forms 1040, 1040A, & 1040EZ by Filing Method, 2001-2009

Source: Projections and Forecasting Group, Office of Research (rev. Oct. 2002)

In 2009, 38 percent of Forms 1040, 1040A, and 1040EZ filed will be electronically filed by practitioners, compared to about 25 percent in 2002. Paper returns will account for less than half (42 percent) of all Forms 1040, 1040A, and 1040EZ filed in 2009, a considerable decline from 2002 when 64 percent of individual returns were paper.

For a complete copy of the 2003 W&I Taxpayer of the Future report, please send a request to kay.e.anderson@irs.gov. IRS employees can access the report from the W&I Strategy and Finance home page (<http://win.web.irs.gov/strategy.htm>) under "Hot Docs & Cool Information".

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