

Income Inequality in the United States: Using Tax Data to Measure Long-term Trends

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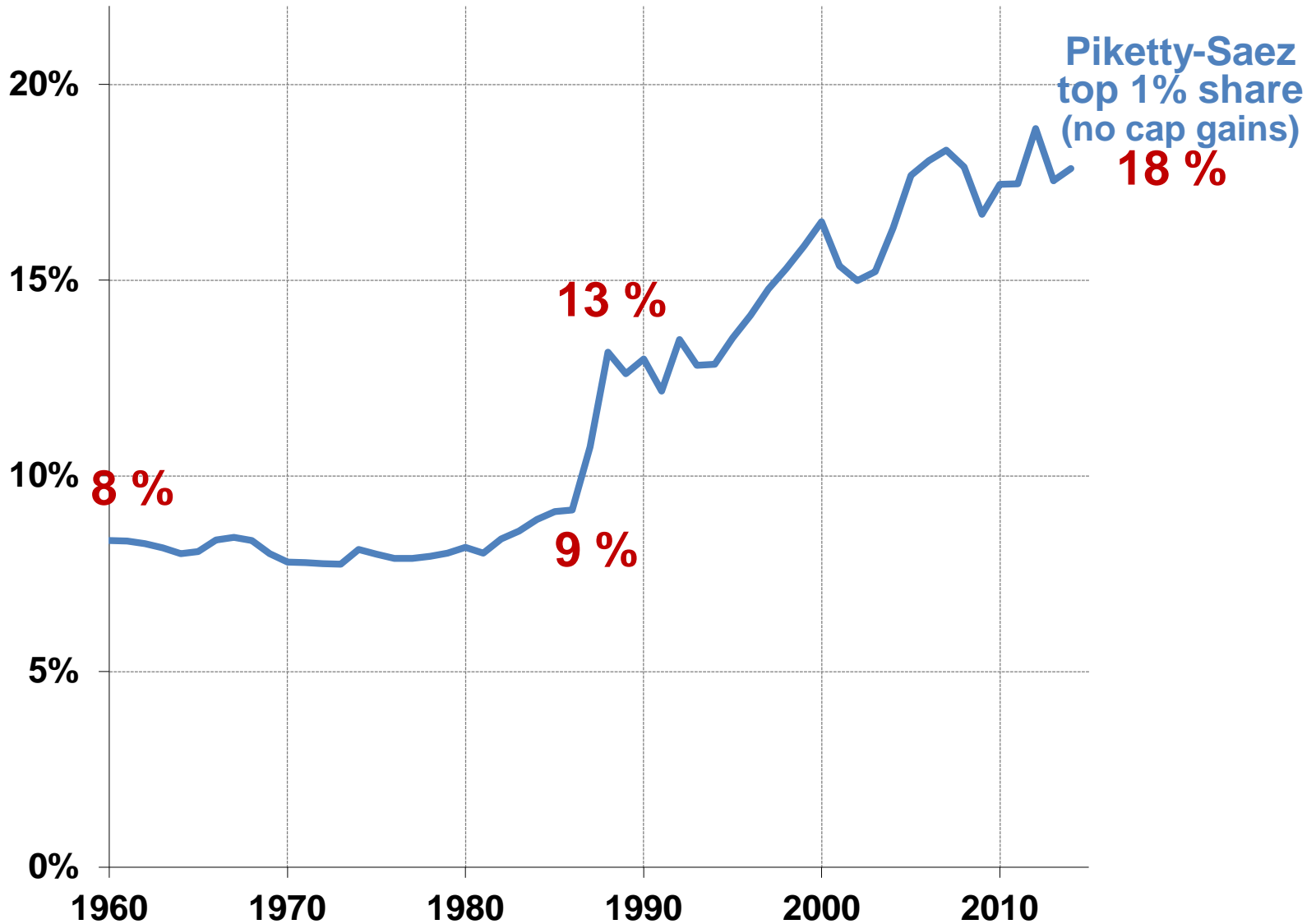
This work embodies work undertaken for the staff of the Joint Committee on Taxation, but as members of both parties and both houses of Congress comprise the Joint Committee on Taxation, this work should not be construed to represent the position of any member of the Committee.

Conventional income inequality story:
Top 1% income shares rose dramatically
especially after 1980

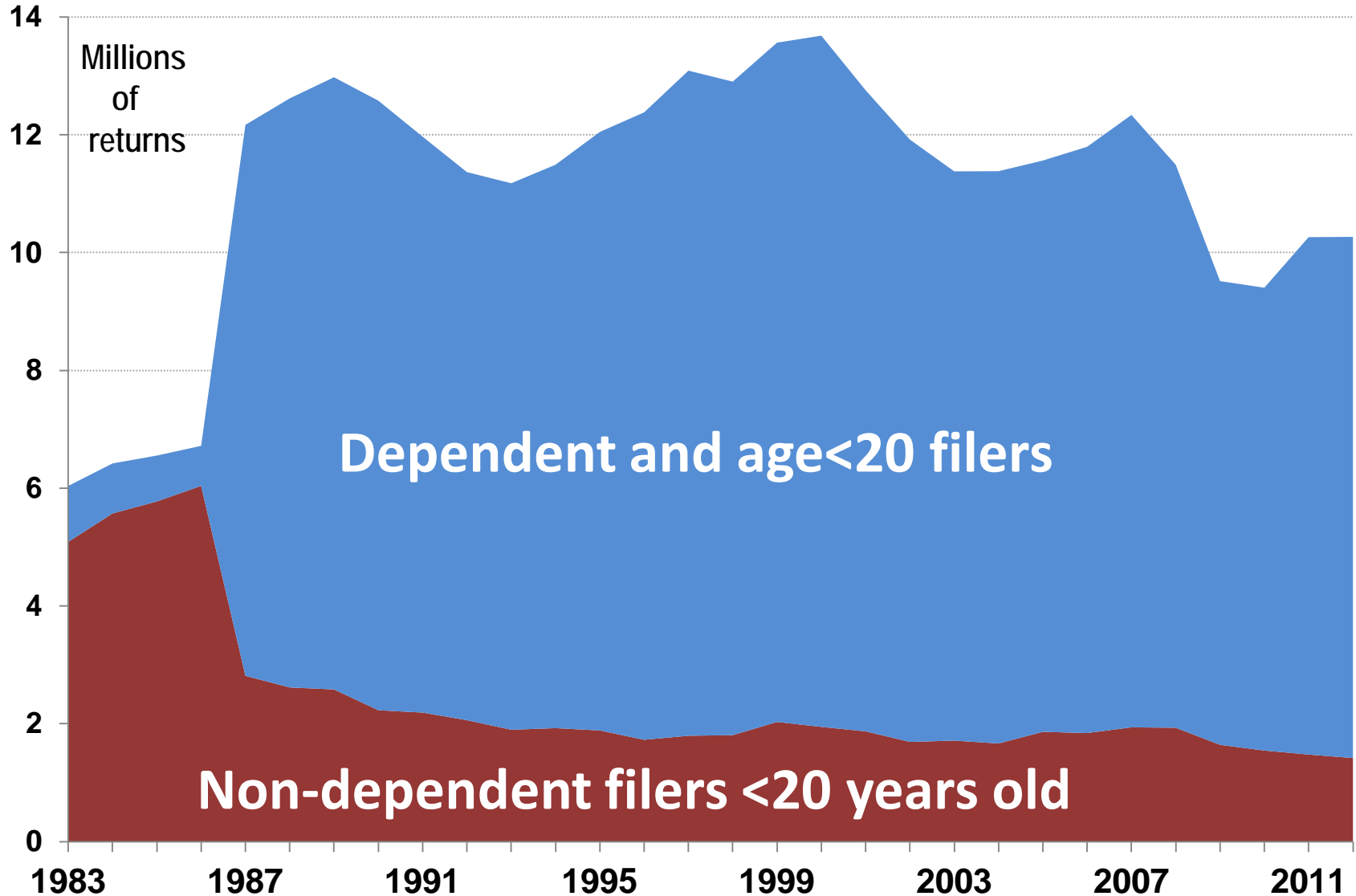
But: Measuring inequality over time isn't easy

- **Base broadening tax reforms (TRA-86)**
- **Government transfers increased**
- **Market income sources not in AGI**
- **Declining marriage rates/family size**
- **More attend college = more dependent filers**
- **Earlier data has less detail**

Conventional Story: Top 1% income share doubled
But: 40% of increase is 1986 to 1988



TRA-86 increased dependent & under <20 filers



Some studies use more comprehensive income:

Tax Data: CBO (2014) since 1979

Piketty, Saez and Zucman (2016)

SCF: Bricker, Henriques, Krimmel and Sabelhaus (2016)

Census: Burkhauser, Feng, Jenkins and Larrimore (2012)

Result: **Generally less inequality & less upward trend**

But: **No adjustment for tax base changes**

Forgotten tax research:

TRA86: Effects on measuring inequality:

Feenberg and Poterba (1993), Gordon and MacKie-Mason (1994)

1960's: Pechman & Okner/ Stanley Surrey

“dipping deeply into the incomes of the wealthy with a sieve”

Goal of this paper:

**Estimate top 1 % income share using
consistent tax based incomes 1960-2013
that adjust for**

Changing tax base & filing rules

Changing marriage rates

And uses comprehensive income

Basic Plan - Estimate Top 1% shares of:

1. Consistent Market Income

- Correct sample to match resident Census
- Adjust for tax law changes: TRA-86
- Adjust for decreasing marriage rate
- Excluded income: ESI, imputed rent, ...
- Retirement Income: when received
- Capital gains: Pre-tax corporate profits

2. Pre-tax Income

- Include transfer payments

3. After-tax Income

Consistent market income adjustments 1

Correct sample and income definition

- Remove <20, dependent, and non-resident filers
- Subtract state income tax refunds and gambling losses
- Add exempt combat pay, dividends and NOLs
- Adjust non-filer income: 30% vs 20% avg. (=CDW)

TRA-86 adjustments

- Apply post-TRA passive loss limits before TRA
- Add tax-exempt interest: use SCF to allocate <1987

Set income groups by # adult filers

- Filer Marriage rates fell from 66% to 40% since 1962
- Marriage rates among top 1% still high: 90% and 86%
- Use # adults to correct for falling marriage rates and increased cohabitation

Consistent market income 2

Add C corporation retained earnings

- **Pre-TRA86: C corporations as tax shelter**
- **Post-TRA86: Pass-through business to avoid double tax and 34% corp. rate > 28% top individual rate**
- **NIPA retained earnings – Individual portion**
 - **Not stock owned by pension/retirement funds or non-profits**
Retirement fund share: 4% to 54% from 1960 to 2013
Non-profit share: 5-7%
- **Allocate $\frac{3}{4}$ by dividends and $\frac{1}{4}$ by capital gains**

Add Corporate income tax:

- **$\frac{1}{4}$ wages and $\frac{3}{4}$ capital (=CBO/JCT assumption)**

Add business property taxes

Consistent market income 3

Add imputed rent

- Distribute by property tax deductions

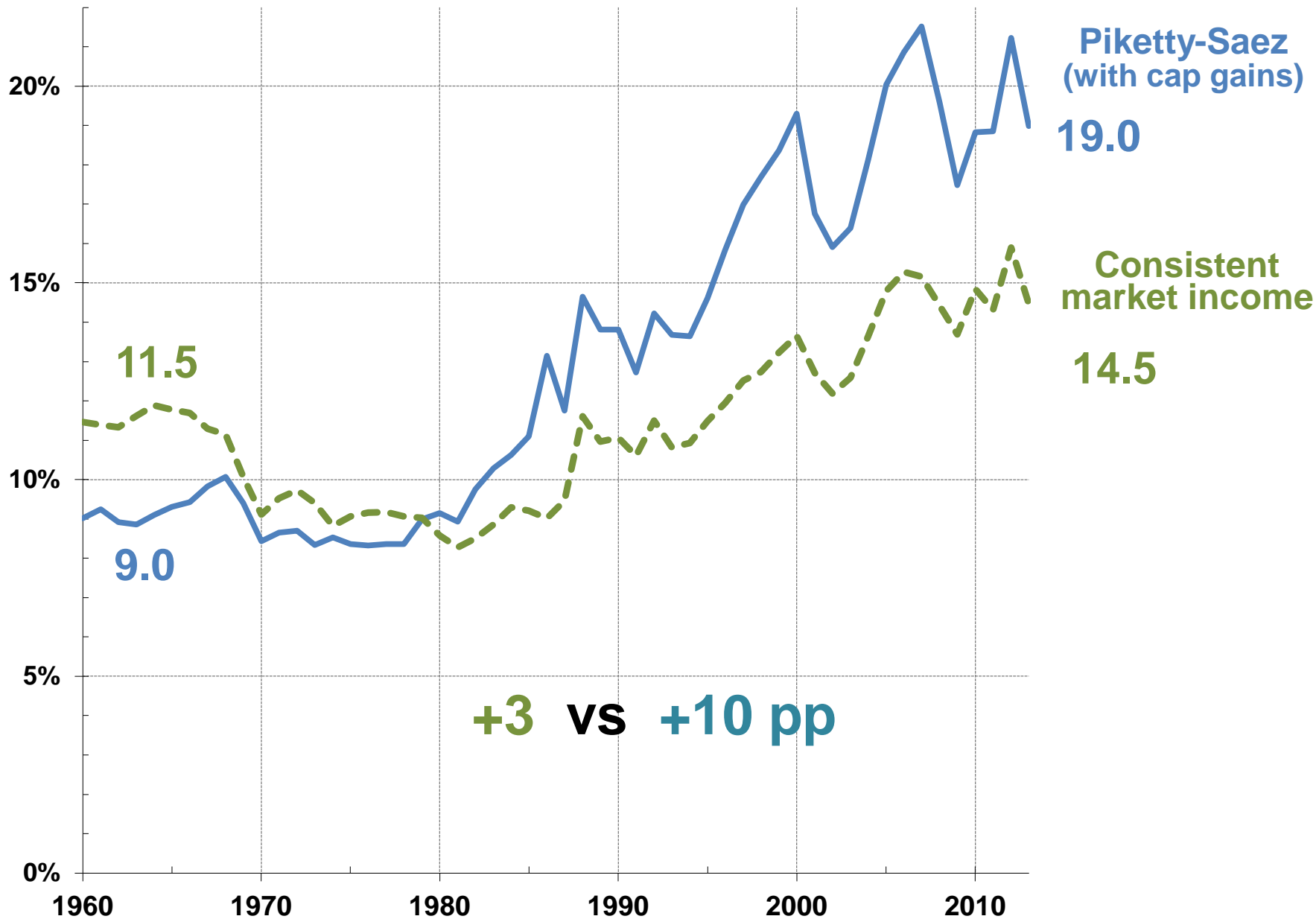
Add employer payroll taxes

- Assume employees bear burden of payroll tax

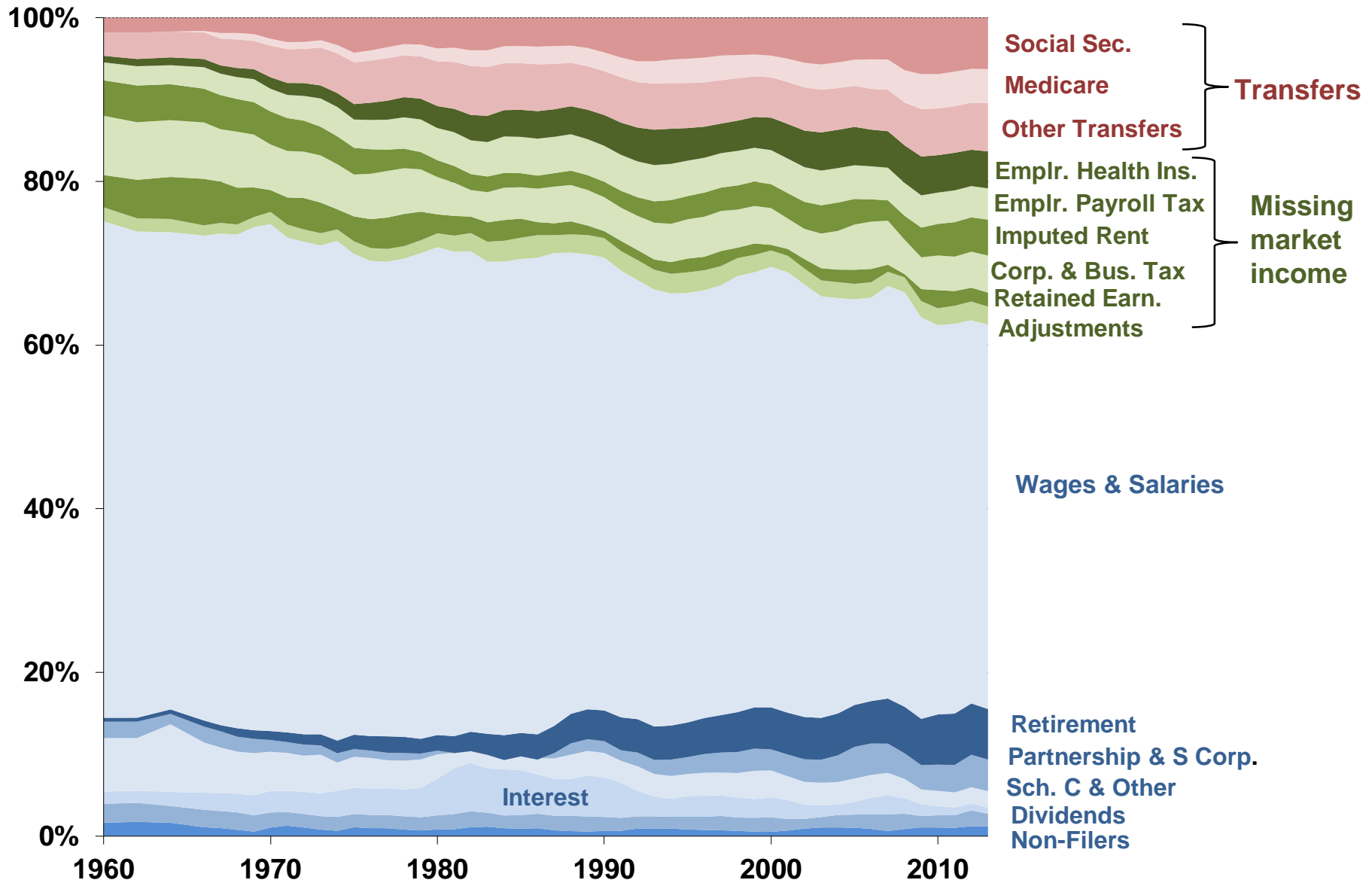
Add employer provided health insurance

- Rose from 1% to 6% of income since 1960
- Distribute NIPA totals using insurance on 2014 W-2

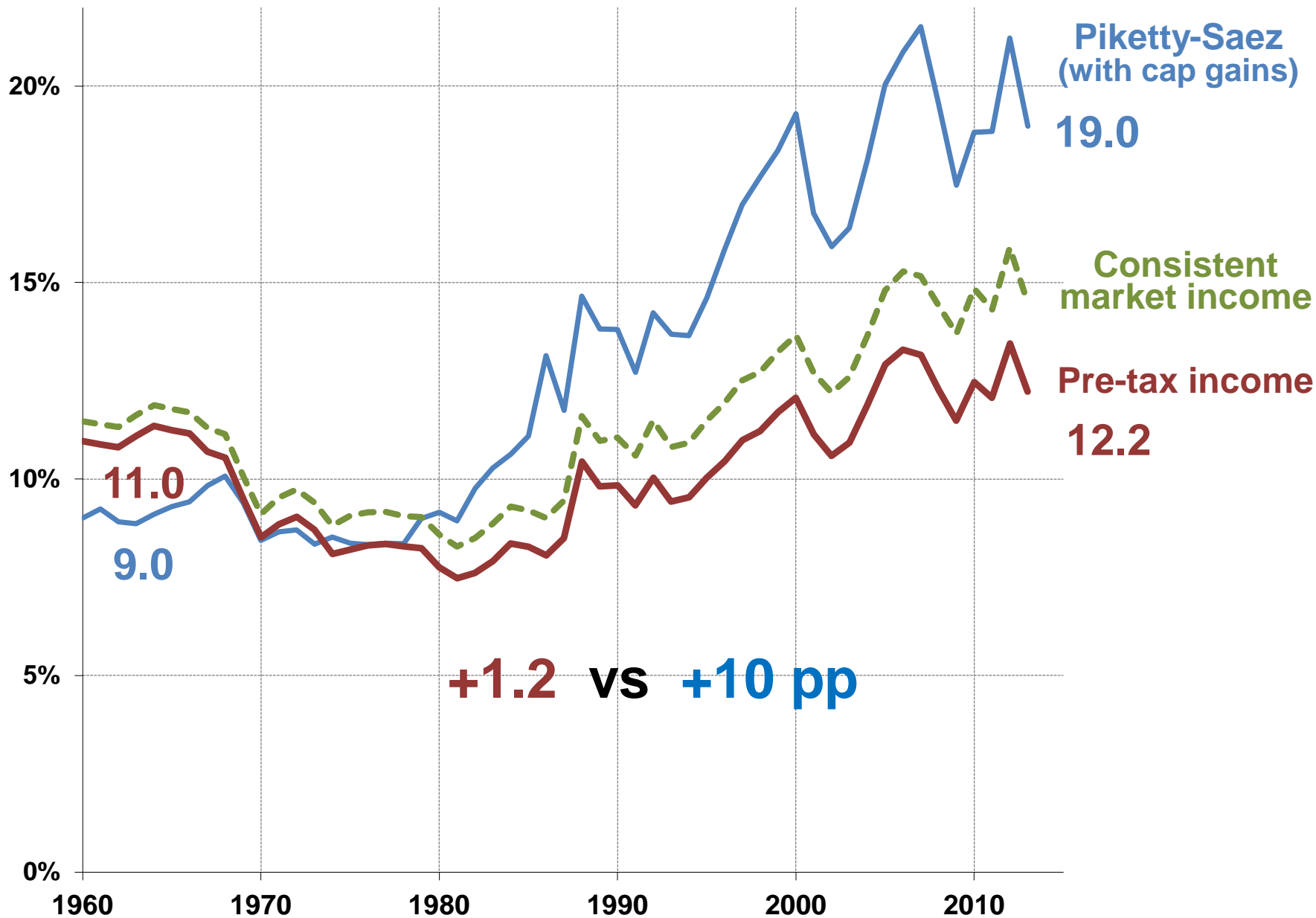
Top 1% shares: Consistent market income



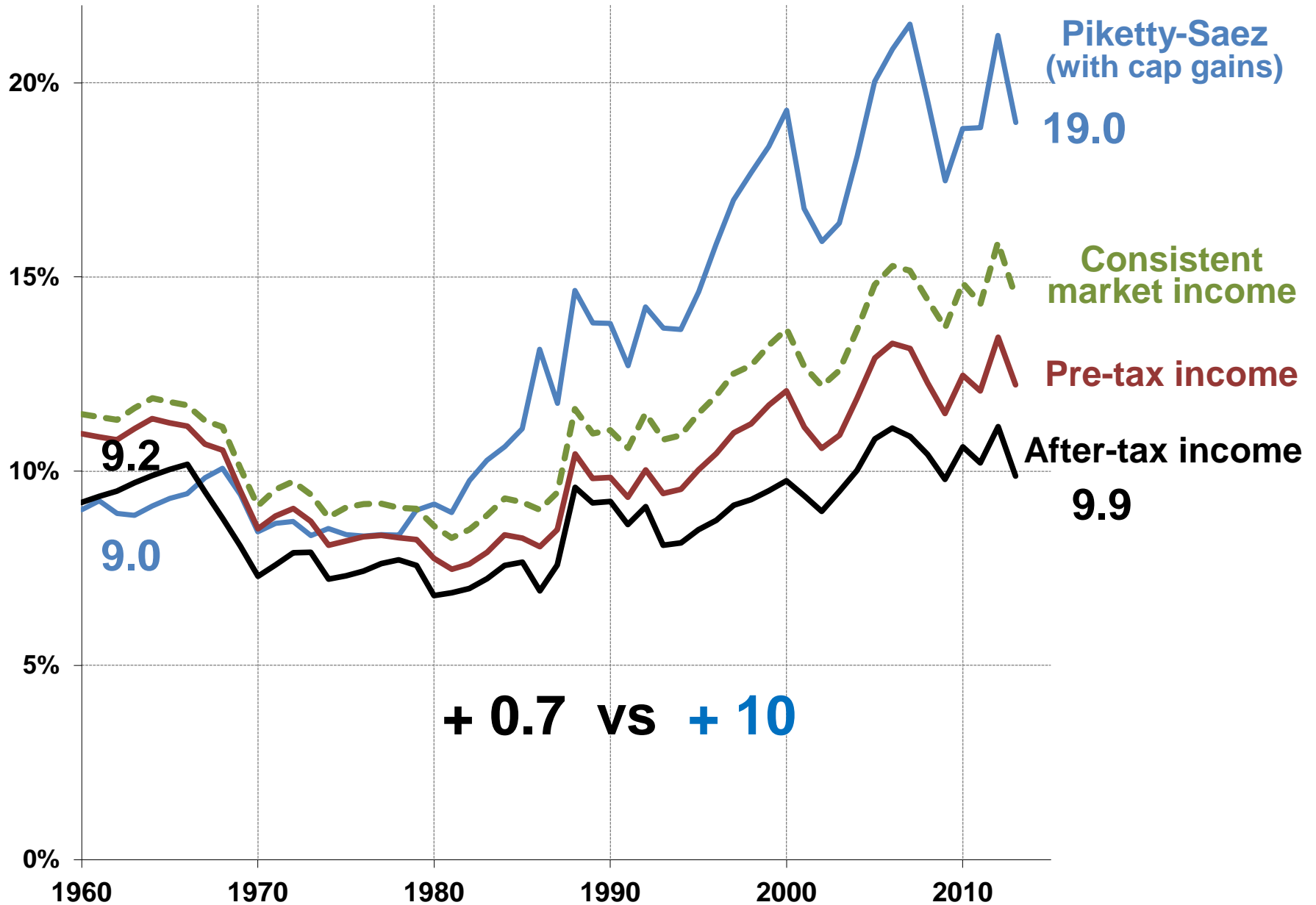
Share of income on tax returns is decreasing:



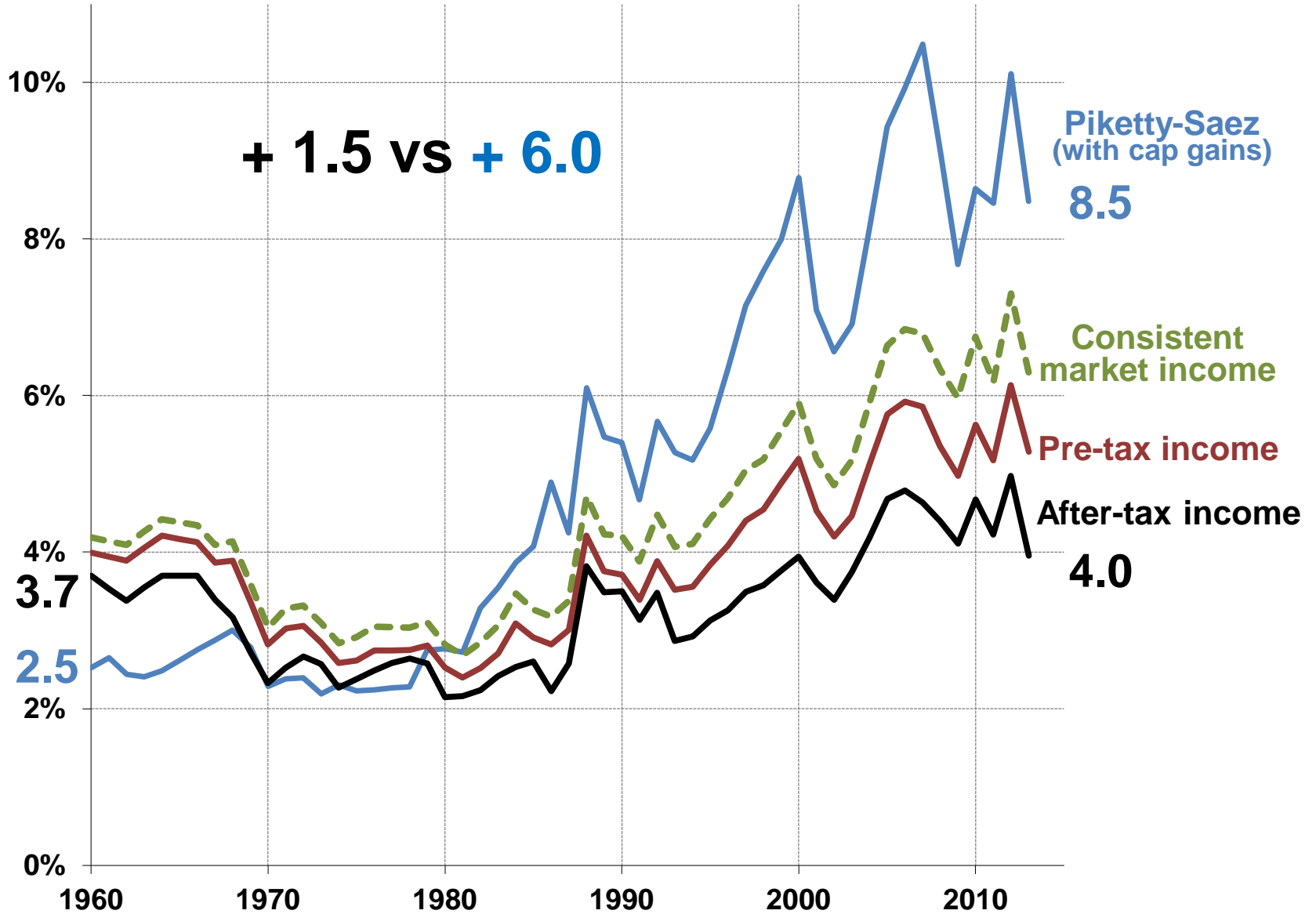
Top 1% shares: Pre-tax income - add transfers



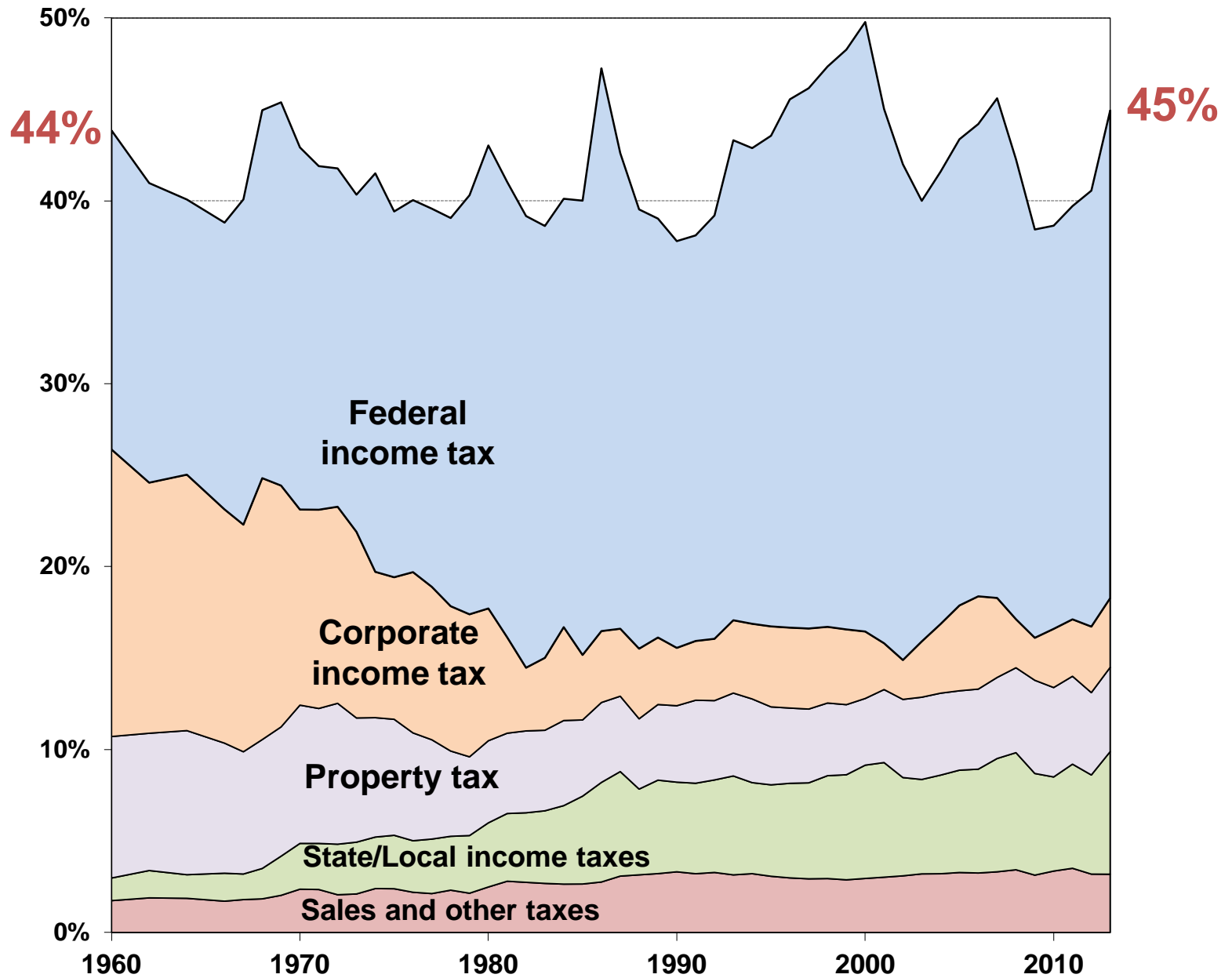
Top 1% shares: After-tax income



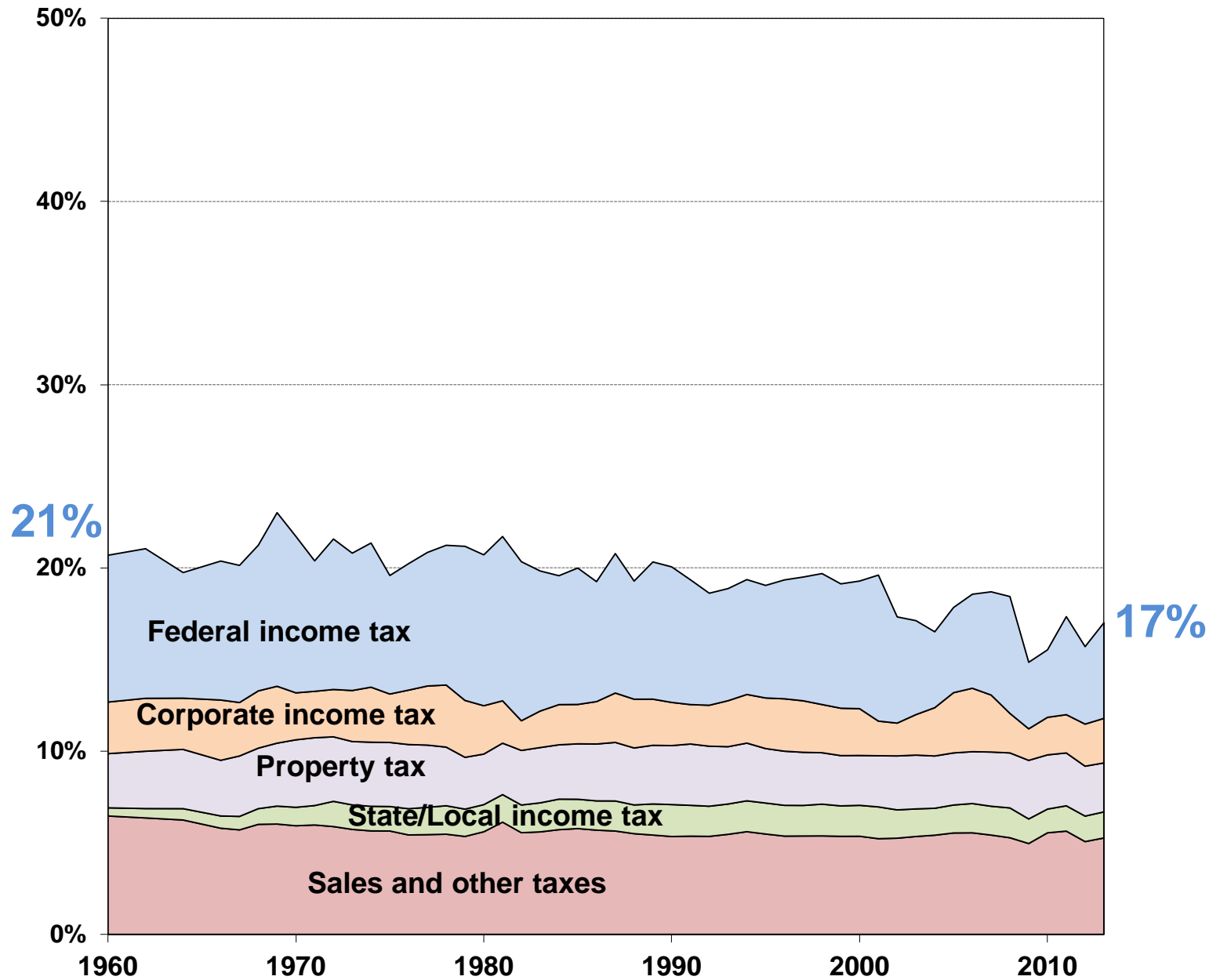
Top 0.1% income shares



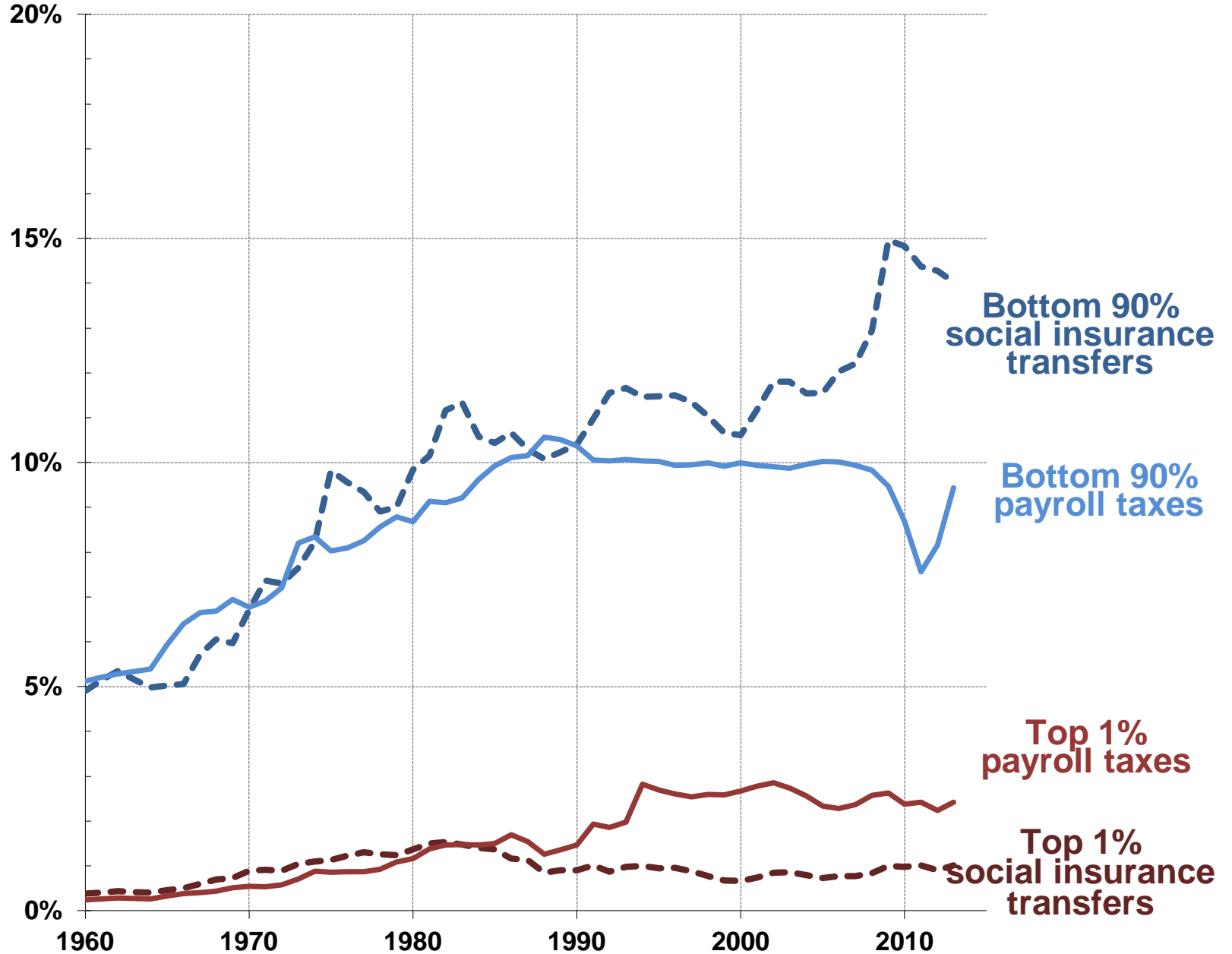
Top 1%: taxes as % of pre-tax income



Bottom 90%: taxes as share of pre-tax income



Payroll taxes & transfers: **Top 1%** & **Bottom 90%**



Sensitivity tests: Top 1% share increases, 1960-2013

Corp. tax incidence

$\frac{1}{4}$ wages and $\frac{3}{4}$ corp. capital	+ 1.3 Base effect
Corporate capital	+ 1.2
All types of capital	+ 1.6

Corp. retained earnings

$\frac{1}{4}$ cap gains and $\frac{3}{4}$ dividends	+ 0.7 Base effect
$\frac{1}{2}$ cap gains and $\frac{1}{2}$ dividends	+ 1.0
Half to retirement share to wages	+ 0.6

Summary: Inconsistent measures give a distorted story

New story: Inequality less high, not much increase

- **TRA86: Tax shelters closed: reduced losses**
Shift from C corps to pass-through business
- **Since 1960 top 1% income shares:**
 - +10 pp: Unadjusted market income**
 - +3 pp: Consistent market income**
 - +1 pp: Pre-tax income (including transfers)**
 - +1 pp: After-tax income (including transfers)**

Summary:

Inconsistent measures give a distorted story

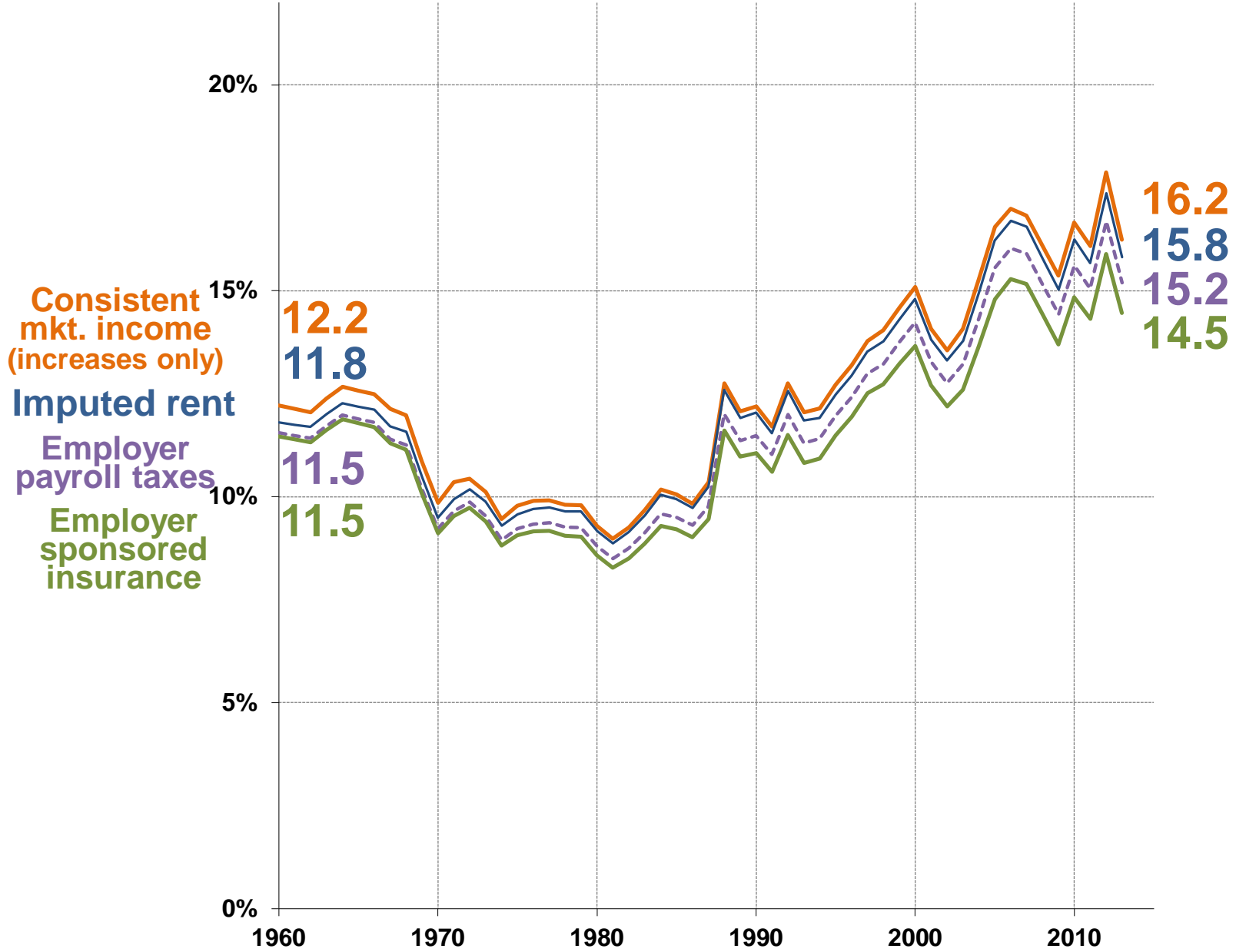
New story: Inequality less high and not much increase

- **Since 1960 top 1% income shares:**
 - +10 pp: Piketty and Saez market income**
 - +3 pp: Consistent market income**
 - +1 pp: Pre-tax income (including transfers)**
 - +1 pp: After-tax income (including transfers)**
- **Main factors:**
 - ~4 pp: C corp retained earnings & taxes**
 - ~2 pp: Transfers**
 - ~1 pp: Employer provided health insurance**
 - ~1 pp: Falling marriage rates**
 - ~1 pp: Filer demographics and non-filer incomes**

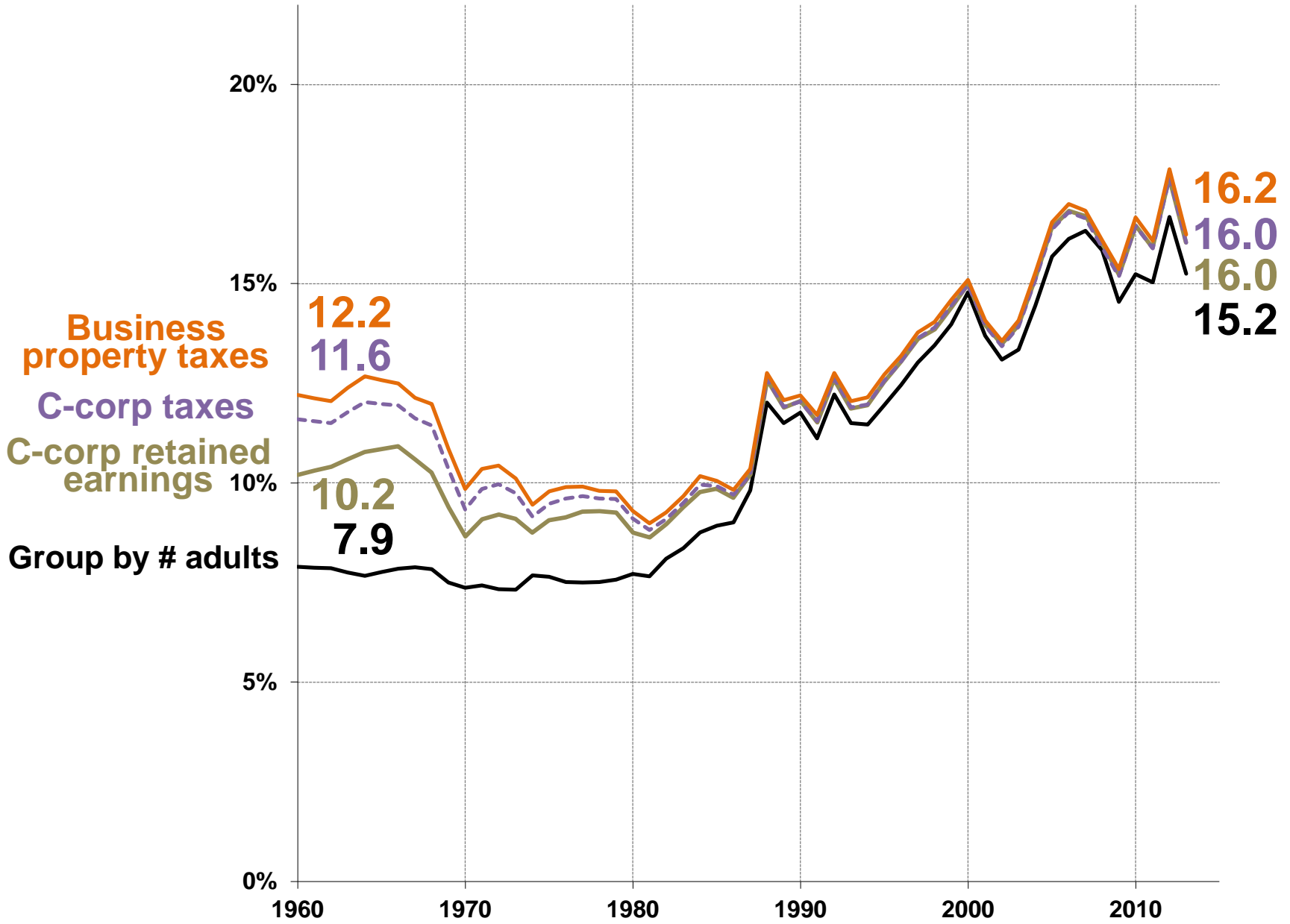
REMINDER: IT'S NOT THE SAME PEOPLE AT THE TOP

The End:

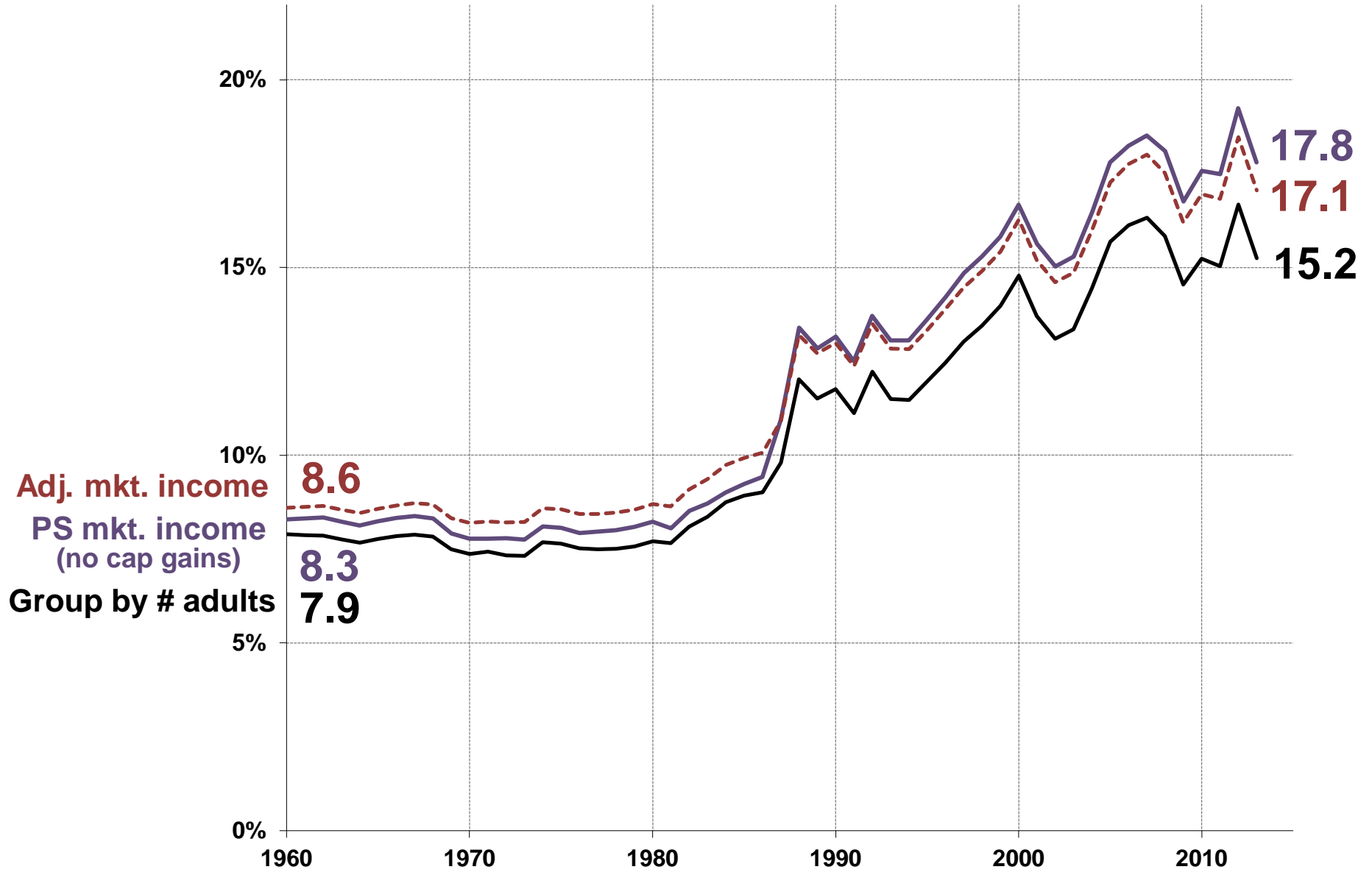
Top 1% shares: Consistent market income adjustments 1



Top 1% shares: Consistent market income adjustments 2



Top 1% shares: Consistent market income adjustments 3



Top 10% income shares

