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THE LATEST IRS DATA ON AFTER-TAX INCOME TRENDS

by Isaac Shapiro

New data from the Internal Revenue Service indicate that the average after-tax income of the one percent of taxpayers with the highest incomes increased by $69,000 in 1998. These data also show that in 1998 income rose at a much faster rate among the top one percent than among the rest of the population.

The growth in income disparities in 1998 continue a long-term trend. These disparities have widened significantly since 1989, the peak year of the economic recovery of the 1980s. After-tax income gaps both between the top and middle of the population and between the top and the bottom were wider in 1998 than in any year on record (data are available back to 1977).

Some assessments based on Census data have suggested income disparities might have remained flat in recent years, but the new IRS data show this is not the case. As many researchers in the field long have noted, Census data alone cannot answer questions related to income trends, because they miss very large amounts of income that people at the top of the income scale receive. Reflecting the incompleteness of its data for those at the top of the income scale, the Census Bureau does not publish income data for the top one percent of the population.

The IRS data reflect adjusted gross income, as reported on income tax returns, as well as the federal income taxes paid on that income. We focus here on adjusted gross income after federal income taxes, which we refer to as "after-tax income." All income figures are adjusted for inflation and expressed in 1998 dollars. The IRS data have been posted on the web site of the Joint Economic Committee of Congress, but the income trends these data depict have not been previously analyzed. (See the Appendix for a more complete discussion of the data used in this report and how these data compare to data from other sources such as the Census Bureau.)

This analysis finds that from 1997 to 1998:

- The average after-tax income of the one percent of tax filers with the highest incomes increased 13 percent, from $526,000 to $595,000.

- The average after-tax income of the bottom 90 percent of tax filers — that is, everyone except those in the top 10 percent — also rose, but by a comparably modest four percent.

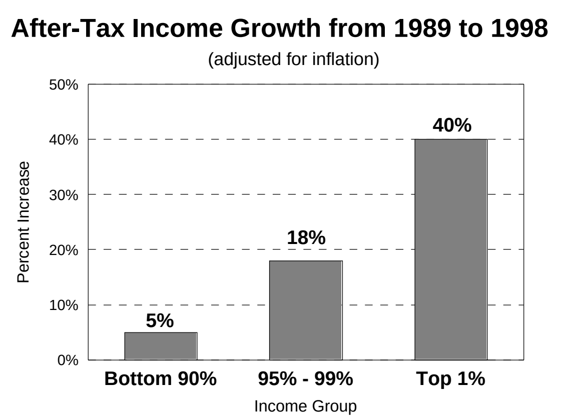
- The average *increase* of $69,000 in the after-tax income of the top one percent of filers between 1997 and 1998 is substantially larger than the incomes of a significant majority of American families.

- The average income tax rate for the top one percent of tax filers *fell* from 27.9 percent to 27.1 percent between 1997 and 1998, primarily because of a large jump in capital gains income (which is taxed at a lower rate than other income) and because a 1997 cut in the capital gains tax rate took full effect. This was the second year in a row that the average income tax rate for high-income taxpayers declined.

The IRS data provide new information about the extent to which the benefits of economic growth in the 1990s were shared across the population. It now is clear that growth in income disparities did not end in the late 1980s, as some have assumed, but continued into the 1990s. The IRS data show that from 1989 to 1998:

- The average after-tax income of the top one percent of tax filers rose by a robust 40 percent, increasing by $171,000 per taxpayer over this period, after adjustment for inflation.

- For those between the 95th and 99th percentiles of the income spectrum (that is, those in the top five percent except for the top one percent), after-tax income climbed a healthy 18 percent. For those between the 90th and 95th percentiles, after-tax income rose 10 percent.



- As one moves further down the income spectrum, the average after-tax income gain continues to diminish. The bottom 90 percent of tax filers experienced a relatively modest after-tax income gain of five percent over this nine-year period.

- In percentage terms, the average income of the top one percent of tax filers rose *eight times faster* than the average income of the bottom 90 percent of filers.

As a result of these sharp differences in income growth, income disparities between the highest-income taxpayers and the rest of the population grew substantially during the 1990s and reached their widest point since the IRS began collecting these data. Data from the Congressional Budget Office, which include actual data only through 1995, but extend back to 1977, show that after-tax income disparities also grew significantly from the late 1970s to 1995. Combining the results of these two sets of data indicates that the share of the national after-tax income that those at the top of the income spectrum receive is now larger than at any other time in at least two decades.

The available indicators for the years from 1998 to 2000 point toward a further jump in incomes at the top. A January 2001 Congressional Budget Office report projects that capital gains income continued to rise sharply from 1998 through 2000. Based on this report and IRS data, we estimate that from 1998 to 2000, the average after-tax income of the top one percent of the population increased by another $57,000 due to capital gains income alone.

One interesting finding that emerges from these data is that gains in after-tax income in recent years have been extremely large among the one part of the population — the top five percent of tax filers —whose marginal tax rates increased in the 1990s. This suggests that the current marginal rates this group faces has not posed major barriers to economic activity and risk-taking among the group. These data also indicate that the principal reason that those at the top of the income spectrum now pay a larger share of federal taxes than in the past is that their incomes have increased sharply and the share of the national income they receive is at record levels.

Changes in Income from 1997 to 1998, and from 1989 to 1998

All income groups experienced gains in after-tax income in 1998, reflecting a year of broad and solid growth across the population. Among most income groups, however, 1997 was the first year in which average after-tax income surpassed the level attained in 1989, the last year before the recession began in 1990. As a result, in 1998, the after-tax income of most income groups was only modestly above its 1989 level.

At the top of the income spectrum, the story was different. Not only did this segment of the population gain far more in 1998 than other groups, but its average after-tax income was far larger in 1998 than in 1989.

- Between 1997 and 1998, average after-tax income rose four percent among the bottom 90 percent of tax filers. In 1998, the average after-tax income of this group was five percent above its level in 1989. (See Table 1.)

- Among the top one percent of the population, average after-tax income climbed 13 percent from 1997 to 1998. In 1998, their average after-tax income was *40 percent* above its 1989 level.

- Those between the 95th and 99th percentiles also fared well. While their average after-tax income rose five percent between 1997 and 1998, it was 18 percent higher in 1998 than it had been in 1989.

- Among those between the 90th and 95th percentiles, average after-tax income increased four percent from 1997 to 1998 and 10 percent from 1989 to 1998.

Table 1: After-tax Income Gains Among Various Groups, Inflation-Adjusted

	Top 1%	95th-99th Percentile	90th-94th Percentile	75th-89th Percentile	50th-74th Percentile	Bottom 50%	Bottom 90%
1997-98	13.1%	4.7%	4.3%	4.0%	3.8%	4.0%	3.9%
1989-98	40.4%	17.8%	9.8%	7.1%	3.9%	4.4%	5.2%

Also of interest, for the second year in a row, the after-tax incomes of the top one percent rose at a faster pace than the before-tax incomes of this group. This occurred because average income tax rates fell for this group in both 1997 and 1998. In 1996, the top one percent paid 28.9 percent of its income in federal income taxes. This tax rate fell to 27.9 percent in 1997 and 27.1 percent in 1998.[1]

Income Disparities

The disparate patterns in after-tax income from 1989 to 1998 between those at the top of the income spectrum and the rest of tax filers resulted in a significant widening of income disparities. The IRS data show that the percentage of the national after-tax income that goes to the top five percent of tax filers — and particularly to the top one percent of filers — increased significantly in these years, while the share going to the bottom 90 percent of tax filers declined.

In 1998, the top five percent of filers received 29 percent of the national after-tax income. In 1989, they received 25 percent of the income.[2] These IRS data go back to 1986. The share of after-tax income that the top one percent of filers received in 1998 is the highest

[1] The percentage of income the top one percent pays in federal taxes was higher in 1998 than in 1989 but lower than it was at the end of the 1970s.

[2] The share of after-income tax income that the top one percent of filers received climbed from 12.5 percent in 1989 to 15.7 percent in 1998, an increase of one-fourth. For those between the 95th and 99th percentiles the share rose from 12.9 percent to 13.6 percent. Among the bottom 90 percent of tax filers, the share of national after-tax income fell from 63.5 percent to 59.8 percent.

recorded over this period. The share of after-tax income the bottom 90 percent of tax filers received is the lowest.

Congressional Budget Office data on after-tax income begin in 1977 and provide actual data through 1995. Although there are some differences in the income and tax measures that CBO and IRS track in their data series, the CBO data similarly indicate that the top five percent of the population received 25 percent of the after-tax income in 1989, the same percent as is found in the IRS data. The CBO data show that after-tax income had become significantly more concentrated by 1989 than during the earlier years of its series; in 1977, the share of national after-tax income the top five percent of the population received was 19 percent.[3]

In combination, the IRS and CBO data demonstrate that between 1977 and 1998, the growth in the concentration of national after-tax income among the top five percent of tax filers has been nothing short of dramatic and that the gaps in after-tax income in 1998 between those at the top and the rest of the population are wider than at any other time on record. (See Table 2.)

Table 2. Share of National After-tax Income

	Top 1%	Top 5%	Bottom 90%
1998, IRS data	15.7%	29.3%	59.8%
1989, IRS data	12.5%	25.4%	63.5%
1989, CBO data	12.3%	25.0%	65.2%
1977, CBO data	7.3%	18.7%	71.4%

CBO Capital Gains Data Suggest Further Large Increases at Top from 1998-2000

The latest actual after-tax income trends among the top five percent of tax filers are the 1998 IRS data analyzed here. Information in a Congressional Budget Office report released in January 2001, however, indicates that income growth from 1998 to 2000 very likely continued to be robust among those with the highest incomes.[4]

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[3] In 1995, the last year of actual CBO data, the CBO data show that the top five percent of the population received 24.3 percent of national after-tax income; the IRS data indicate that their after-tax income was 25.6 percent in that year.

[4] The Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011*, January 2001, pages 54-61.

A major factor behind the most recent growth in incomes among the top one percent of the population has been increased capital gains income. This pattern began before capital gains tax rates were cut in 1997 (these cuts were partly in effect in 1997 and fully in effect in 1998). As CBO noted in its recent report, "Between 1994 and 1998, realizations of capital gains nearly tripled, with most of that increase occurring before the cut in tax rates for them in 1997."

CBO estimates that capital gains income increased by another 36 percent between 1998 and 2000. Capital gains income is heavily concentrated among the top one percent of the income spectrum; IRS data show that in 1998 the top one percent of taxpayers received close to two-thirds of the capital gains income. Based on the CBO estimates of growth in capital gains income and the IRS data on the distribution of capital gains income, this analysis estimates that from 1998 to 2000, the after-tax income of the top one percent of tax filers increased by an average of $57,000 apiece solely due to the increase in capital gains.[5]

Implications

The findings in this analysis provide an important context for assessing how the nation should choose to take advantage of the extraordinary opportunity that the emergence of the budget surplus offers. The Bush Administration has proposed a large tax package which, as other Center reports have shown, is likely to consume most if not all of the surplus that is available independent of the Social Security and Medicare trust funds. This plan would confer about 40 percent of its tax-cut benefits on the top one percent of the population and about half on the top five percent of the population. Since the top one percent receives significantly less than 40 percent of the national after-tax income, the tax package would further increase the share of after-tax income the top one percent of taxpayers receive, thereby further exacerbating income disparities.

Those who argue in favor of these tax cuts for high-income individuals correctly note that their marginal tax rates were raised in the 1990s and that their share of federal taxes has increased. Less often mentioned is the fact that the after-tax income of the top five percent of taxpayers — the only group whose marginal rates increased — has over the same period risen much faster than the after-tax income of any other segment of the population. As noted earlier, the principal reason that the share of taxes the top five percent of the population pay has increased is not that their taxes have increased but that their share of the national income has risen so substantially.

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[5] This calculation subtracts out the tax that would be paid on the capital gains income.

Appendix Table 1.

Average After-tax Income Trends for Various Groups of Tax Filers
IRS Data, 1989-1998
(income figures adjusted for inflation and expressed in 1998 dollars
income is adjusted gross income, minus federal income taxes)

Year	Top 1%	95th-99th%	90th-95th%	Bottom 90%
1989	$423,738	$109,062	$74,835	$23,893
1990	410,042	107,049	73,464	23,506
1991	363,157	106,090	72,361	23,075
1992	404,716	108,335	73,214	23,340
1993	371,854	108,013	72,371	23,111
1994	375,291	109,187	73,712	23,297
1995	402,721	112,498	75,173	23,400
1996	455,693	116,214	76,431	23,529
1997	525,778	122,716	78,848	24,186
1998	594,814	128,439	82,203	25,134
Change 1997-98	13.1%	4.7%	4.3%	3.9%
1989-98	40.4%	17.8%	9.8%	5.2%

The after-tax income of these tax filers (particularly in the bottom 90 percent) is lower than would be expected as 1) families can have more than one tax filer and their income would not be combined into one family; and 2) not all income sources, most notably government cash assistance, are counted in adjusted gross income. Working in the opposite direction, the data subtract only individual income taxes. Other taxes such as payroll taxes or the corporate income taxes are not considered.

Source: CBPP compilation of Internal Revenue Service data

Appendix Table 2.

Share of National After-tax Income Trends for Various Groups of Tax Filers
IRS Data, 1989-1998
(income is adjusted gross income, minus federal income taxes)

Year	Top 1%	95th-99th%	90th-95th%	Bottom 90%
1989	12.5%	12.9%	11.1%	63.5%
1990	12.3%	12.9%	11.1%	63.7%
1991	11.3%	13.2%	11.2%	64.4%
1992	12.2%	13.1%	11.1%	63.6%
1993	11.5%	13.3%	11.2%	64.0%
1994	11.5%	13.3%	11.2%	64.0%
1995	12.1%	13.5%	11.3%	63.2%
1996	13.3%	13.6%	11.2%	61.9%
1997	14.7%	13.7%	11.0%	60.7%
1998	15.7%	13.6%	10.9%	59.8%

Source: CBPP compilation of Internal Revenue Service data

Appendix. The Internal Revenue Service and Other Data

The Internal Revenue Service regularly issues data showing annual trends in adjusted gross income[6] and income taxes for various groups of tax filers. These data are particularly useful in that they include comprehensive income information for people at the top of the income spectrum.

The IRS data are significantly more useful in this respect than the more widely cited data from the Census Bureau. The standard data on income that the Census Bureau publishes do not include capital gains income which, as this report shows, is a large source of income for high-income people. The Census Bureau also places an upper limit on the amount of certain types of income counted for any individual, disregarding income above these amounts; this is done for confidentiality and other reasons.[7] Further, the Census Bureau relies on a survey method that may lead to significant under-reporting of income by those at the top of the income scale. As a combination of these and other factors, the Census data significantly understate the income of those at the top of the income spectrum, as well as their recent gains in income.

A third source of data on income and tax trends is a data series that the Congressional Budget Office maintains. The CBO data series is based heavily on the IRS data for its information about income at the top of the spectrum, while making several improvements in the IRS data. The IRS data do not cover the entire population; they do not cover households that lack any adjusted gross income, have negative income, or have incomes so low they do not file tax returns. CBO supplements the IRS data with Census data so it can cover the entire population. In addition, CBO data take into account the effect of all federal taxes, while the IRS data reflect federal income taxes only.

The latest CBO data on actual income and tax trends cover years through 1995. CBO also has issued income and tax projections for 1999. In 1999, the Center on Budget and Policy Priorities issued an analysis of the CBO data through 1995 and the CBO projections for

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[6] The IRS states, "Adjusted gross income is 'total income,' as defined by the tax code, less 'statutory adjustments' (primarily business, investment, or certain other deductions, such as payments to a Keogh self-employed retirement plan, certain deductible contributions to an Individual Retirement Arrangement (IRA), and self-employed health insurance deductions). Total income includes, for example, salaries and wages, taxable interest, dividends, alimony, and net amounts from such sources as business income, rents and royalties, and sales of capital assets."

[7] For example, the highest salary that can be recorded is $999,999. That is, anyone with a salary above this amount is considered to have a salary of $999,999.

1999.[8] The new IRS data suggest that income disparities have grown much faster than CBO had then projected.[9]

For Parts of the Population, IRS Data Better at Measuring Income Trends than Income Levels

The IRS data are best for measuring income and income trends at the top of the income distribution. They are more limited in measuring incomes at the very bottom of the distribution. They do not include households that have incomes so low that they do not file a tax return. In addition, the adjusted gross income measure does not include sources of income that are especially important to low-income households, such as certain forms of government cash assistance and in-kind benefits.

The IRS measures may not fully depict the actual dollar levels of the bottom part of the population at a particular point in time, but they do provide a reasonable measure of changes over time. Despite the differences in methodology between the Census Bureau and IRS measures, both show similar rates of income growth for most of the population. From 1989 to 1998, Census information on before-tax income shows an average increase in income of 3.5 percent for the bottom 80 percent of the population, close to the 4.6 percent rate of before-tax income growth that the IRS data show for the bottom 90 percent of filers.

The two data sources diverge only for those at the very top of the income spectrum, with the Census data failing to capture the rapid income growth for this group because those data miss capital gains and certain other income these people receive. For example, the Census data show average before-tax income growth for the top five percent of households between 1997 and 1998 of about $3,500 or two percent. In sharp contrast, the IRS data show that the top five percent of filers experienced average before-tax income gains of $23,300 or nine percent.

The IRS data do not break out information in a manner that would permit examination of trends just among those in the middle of the IRS after-tax income spectrum, such as the

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[8] Isaac Shapiro and Robert Greenstein, *The Widening Income Gulf*, Center on Budget and Policy Priorities, September 4, 1999.

[9] The CBO projections for 1999, which were first released in early 1998, indicated that income disparities would continue to widen between 1995 and 1999. The new IRS information indicates the disparities are indeed growing and, in fact, are growing considerably more rapidly than CBO estimated they would. This is occurring because income is growing faster at the top of the income scale than CBO projected it would, due in no small part to the surge in capital gains. In making its projections for 1999 (based on actual data for 1995 and broad economic trends through 1997), CBO assumed that capital gains income would total $331 billion in 1999. The new IRS data show that net capital gains income already had reached $446 billion by 1998. In addition, CBO had projected that the share of national after-tax income received by the top five percent of the population would grow from 24.3 percent in 1995 to 25.3 percent in 1999, or by one percentage point. The IRS data indicate that from 1995 to 1998, the share of national after-tax income received by the top five percent of tax filers grew from 25.6 percent to 29.3 percent, an increase of 3.7 percentage points.

middle fifth or middle three-fifths of tax filers. The closest approximation of this group that can be derived from the IRS data consists of the next-to-the-top quarter of tax filers (i.e., those whose income places them between the 50th and 75th percentiles of income for all tax filers). Among filers in this group, average after-tax income rose 3.8 percent between 1997 and 1998, and by 3.9 percent from 1989 to 1998 (their income fell during the recession of the early 1990s and has now climbed back to above their pre-recession level).