From Personal Income to Taxable Income, 1950-2004

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While much of the tax debate usually swirls around statutory tax rates, those rates must be applied to a base. The tax base can be approximated by the amount of taxable income that is reported on taxable returns — those that pay at least a dollar of tax. The chart below shows the portion of personal income that makes it into that measure of the tax base. (Not captured through that type of calculation is the tax base underlying the swiftly growing alternative minimum tax on the one hand and the relatively small but growing amount of tax reduced — and personal income increased — by an expansion of tax credits, such as the earned income tax credit and the child tax credit, on the other). Still, if we use taxable income as a proxy for the tax base, the fraction of Americans’ personal income subject to tax has grown over the 1950-2004 period from 36.8 percent to 47.8 percent (nearly a 30 percent increase), although it peaked in 2000 at 53.9 percent.

Many factors combine to explain the changes over time. Over the 1950-2004 period, the value of exemptions has declined, partly because they were either not indexed or were indexed to grow only with inflation even while real personal income was also growing. Itemized deductions and standard deductions similarly have gone through periods when they have increased or declined, partly because of legislative activity and inactivity and partly through a growth in expenses (for example, mortgage interest) that could be itemized as deductions. Overall, adjusted gross income as measured by the IRS has fluctuated between 65 percent and 75 percent of personal income. AGI as measured by the national income and product accounts method has fluctuated between 75 percent and 90 percent of personal income, but it includes AGI not reported on returns, including for those taxpayers who might have nontaxable income anyway. Meanwhile, net exclusions have generally — but not always — grown relative to personal income. Those include nontaxable government transfers and private benefit payments, as well as the amount of labor income excluded through healthcare plans and pension plans.

From Personal Income to Taxable Income: Change in Composition, 1950-2004

Notes: AGI is adjusted gross income, NIPA is national income products accounts, and SOI is the Statistics of Income Division of the IRS. Exemptions and itemized and standard deductions are on taxable returns only.
Source: The Urban Institute, 2007. Data from BEA, NIPA, and IRS SOI tables.