



Sources of Personal Income 2016 Update

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Key Findings

- Taxpayers reported \$10.4 trillion of total income on their 2016 tax returns.
- Seventy percent (\$7.2 trillion) of total income reported on the 1040 consists of wages and salaries, and about 83 percent of all tax filers report wage income.
- Pensions and retirement accounts are an important source of capital income for the middle class. Pensions and annuities (\$694 billion), Individual Retirement Arrangement (IRA) distributions (\$258 billion), and Social Security (\$286 billion) combine to create \$1.2 trillion in taxable retirement income.
- Business income is also a large component of reported personal income. Some businesses, like S corporations, sole proprietorships, or partnerships, file their taxes through the individual tax code, accounting for \$1 trillion in personal income.
- Capital gains and dividends accounted for about \$875 billion in income in 2016, less than income from business (\$1 trillion) and retirement accounts (\$913 billion).

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Introduction

The individual income tax is the federal government's largest source of revenue. More than 150 million individual income tax returns were filed for tax year 2016,¹ and in each of these filings a household added up its income to report it to the Internal Revenue Service (IRS). The way the IRS individual income tax form (1040) is structured, all sources of income are listed on the first page of the form, and added up to reach "total income." Then, the tax return moves on to calculating how much each household owes in taxes and determining deductions and credits.

This report will focus on sources of reported total income in 2016,² which totaled \$10.4 trillion.³ It will break down that income into its component parts, reported on lines 7 to 22 of the 2016 Form 1040. Going through the income reported in each category is valuable for understanding both the composition of the government's revenue base and the way Americans earn their taxable income.⁴

This report divides income into four major categories—wages and salaries, business income, investment income, and retirement income—and reviews each of the four categories for tax year 2016.

TABLE 1.

Top Ten Sources of Total Income on U.S. Individual Income Tax Returns, 2016 (Billions of Dollars)

Income Type	Amount
Salaries and wages	\$7,217
Taxable pensions and annuities	\$694
Capital gains less losses	\$621
Partnership and S corporation net income	\$629
Business net income	\$389
Taxable Social Security benefits	\$286
Taxable Individual Retirement Arrangement (IRA) distributions	\$258
Ordinary dividends	\$254
Total rental and royalty net income	\$98
Taxable interest*	\$97

Note: * tax-free interest, such as interest on municipal bonds, adds another \$61 billion.
Source: IRS SOI Table 1.3, 2016.

1 Internal Revenue Service, "SOI Tax Stats - Individual Income Tax Returns Publication 1304 (Complete Report)," Table 1.3, <https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report>.

2 Note that this data is from 2016, prior to the passage of the Tax Cuts and Jobs Act.

3 IRS, SOI Table 1.3.

4 There are limitations on using data from the 1040 to understand the nature of income in the U.S. economy. Not all economic activity finds its way to personal income tax forms—particularly, employer-provided health insurance and returns to owner-occupied housing. Both are substantial components of economic output that do not appear on income tax returns. As broad economic aggregates, though, the categories of income established on the 1040 are still useful and instructive.

Wages and Salaries Make Up 70 Percent of Total Income at \$7.2 Trillion

For most tax filers in the U.S., the largest number on the 1040 comes on line 7, the very first line pertaining to income. On this line, taxpayers mark wages, salaries, tips, and other compensation for their work. Most Americans get that number from their W-2 forms, supplied by their employers. In total, nearly 125 million tax filers in 2016 reported \$7.2 trillion in wage income, or 69.5 percent of all total income.

Most Americans report labor income, and most of their income comes from labor. This should not be a surprise; the U.S. is a nation of workers, and most of its economy is labor compensation. Any meaningful attempt to raise revenue through the income tax will almost necessarily include wages and salaries in the base, simply by virtue of the math: One cannot raise much income tax revenue by excluding 70 percent of income.

The amounts reported on the 1040 reflect most, but not all, labor compensation. Firms also pay for employee health benefits and make contributions to Social Security. Although neither of these is subject to the personal income tax, the IRS has a hand in both. The Patient Protection and Affordable Care Act will levy a “Cadillac Tax” on some health plans beginning in 2022, and the IRS administers the payroll tax through employer withholding.

Business Income Accounts for \$1 Trillion of Personal Income

In the United States, the dominant tax filing structure for firms is as “pass-through” entities, so labeled because their income immediately passes through to individual owners’ tax returns using schedules C, E, and F. The U.S. Census Bureau has not yet released information on the percent of businesses using this structure in 2016, but in 2015, 92 percent of businesses used this structure, and the majority were sole proprietorships, fully owned by a single individual.⁵ Pass-throughs employ most of the private-sector workforce in the U.S., and account for most of all business income.⁶ Partnerships and S corporations accounted for \$628 billion of net income in 2016, and individuals reported an additional \$328 billion of business income, for a total of \$956 billion.⁷

5 U.S. Census Bureau, “County Business Patterns (CBP),” <https://www.census.gov/programs-surveys/cbp.html>, and Census Bureau, “Nonemployer Statistics (NES),” <https://www.census.gov/programs-surveys/nonemployer-statistics.html>. The Census Bureau 2016 County Business Patterns and Nonemployer Statistics Combined Report with the relevant numbers for 2016 will be released this fall.

6 Kyle Pomerleau, “An Overview of Pass-through Businesses in the United States,” Tax Foundation, Jan. 21, 2015, <https://taxfoundation.org/overview-pass-through-businesses-united-states>.

7 IRS, SOI Table 1.3.

Investment Income Accounts for \$913 Billion of Personal Income

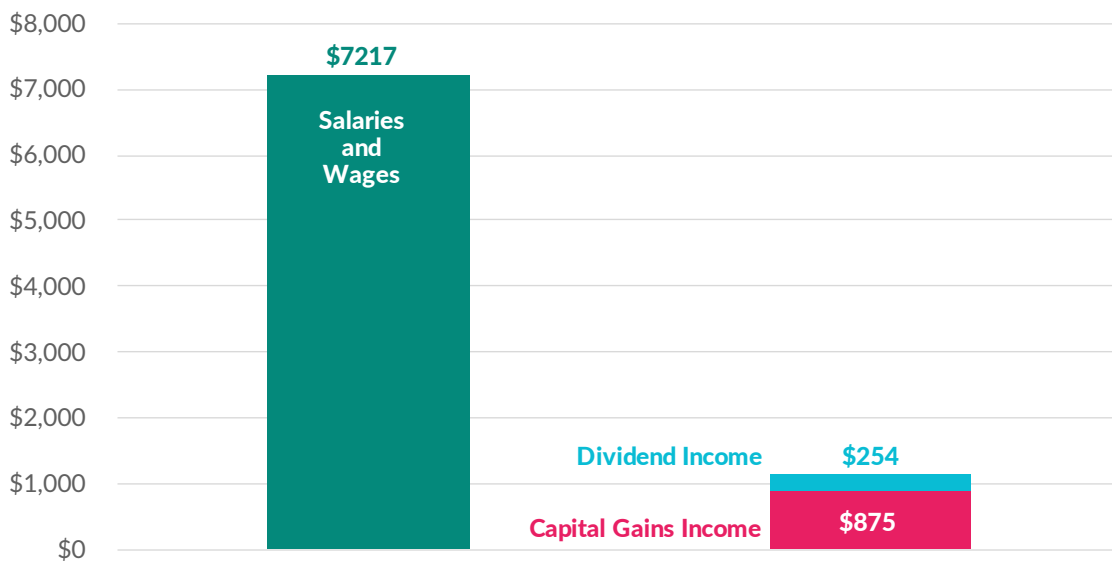
Taxpayers reported \$254 billion of taxable dividends in 2016, and \$620 billion of net capital gains, only some of which come from sale of corporate stock.⁸ Rhetoric about corporate income often exaggerates the impact of shareholder income on personal income and income inequality. Though the returns to corporate equity, as found on individual income tax returns, are substantial, they are much more modest than the rhetoric might suggest. While these amounts certainly matter, they are substantially smaller than the \$7.2 trillion of labor income described above.

Taxable labor compensation greatly exceeds taxable investment income (Figure 1). This contradicts the notion that increasing taxes on investment income would have a substantial effect on the U.S. budget deficit; it is simply too small a portion of the economy.

FIGURE 1.

Labor Income Greatly Exceeds Investment Income

Taxable Labor and Investment Income in the United States, 2016 (Billions of Dollars)



Source: IRS SOI Table 1.3

Retirement Income Accounts for \$1.2 Trillion, Mostly Benefiting the Middle Class

In 2016, taxpayers reported a total of \$694 billion from pensions and annuities, and another \$258 billion in taxable Individual Retirement Arrangement (IRA) distributions.⁹ America's system of retirement accounts, while overly complex, is taxed in a neutral way that removes the bias against saving. Notably, the income from retirement accounts is slightly above the capital gains and dividend income reported outside of retirement accounts.

It's often hard to keep track of capital income in retirement accounts, especially because it doesn't show up on IRS forms until it is distributed. Economists often struggle with categorizing it correctly. For example, the Congressional Budget Office (CBO) released a report in 2011 on trends in the distribution of income.¹⁰ The report accounted for all the sources of income, including some nontaxable sources. It divided income into categories—largely the same kinds discussed in this report. However, it sorted pensions into a separate category from labor income and capital income. Pensions are, of course, in part compensation for labor. But by deferring their income for many years and having the fund invest it, workers also get a lot of capital income out of the deal—many multiples of their original contributions. While it's impossible to allocate pension income precisely between labor and capital, it leans primarily to the capital side for most workers. The CBO report sorted retirement income into a category called “other.”

The CBO's system of categorization was certainly defensible, but it can also leave a misleading impression. The report found that capital income—as defined on its terms—was very unevenly distributed; only the wealthiest Americans relied on it as a substantial source of income. It is important to remember this definition, though, and not conflate two ideas.

The first idea—that middle-class Americans don't report many dividends or capital gains on their 1040s—is true. A second idea that would appear to follow logically—that middle-class Americans don't earn substantial returns to capital—is false. Middle-class Americans wisely put their capital in retirement accounts—where it enjoys proper tax treatment—instead of keeping the money out of retirement accounts and subjecting it to poor tax treatment.

A look at the sources of personal income by income bracket shows the importance of retirement income to the middle class (Figure 2). Retirement income is most important as a source of personal income for taxpayers reporting between \$50,000 and \$100,000 of income, making up about 18 percent. In practice, of course, this means that a minority of middle-class taxpayers—the retirees—rely on this income quite a bit, while the majority, those of working age, do not.

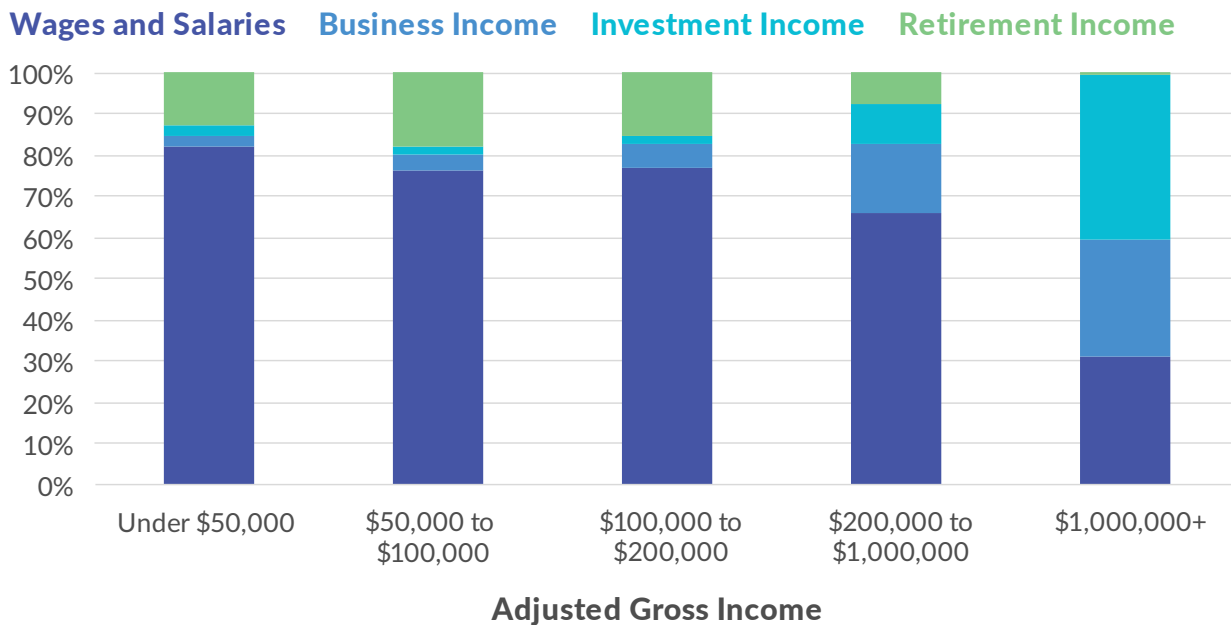
9 IRS, SOI Table 1.3.

10 Congressional Budget Office, “Trends in the Distribution of Household Income between 1979 and 2007,” Oct. 25, 2011, http://www.cbo.gov/sites/default/files/10-25-HouseholdIncome_0.pdf.

FIGURE 2.

Composition of Income Varies with Income Level

Sources of Personal Income by Income Bracket, 2016



Source: IRS SOI Table 1.4

Retirement income is difficult to account for, and the tax rules governing retirement accounts are not readily obvious to people unfamiliar with tax data. While pensions aren't critical to every analysis of personal income, it is worth remembering a few things: pension income is, in economic terms, mostly a kind of capital income; it is about as important as any other kind of capital income; and it is most important to middle-class workers, given its employer-based structure.

Conclusion

Walking through sources of personal income reveals many things about our tax code and our economy in general. Our personal income tax is largely a tax on labor, primarily because our personal income largely comes from labor. However, varied sources of capital income are in the mix as well. While these sources, even when combined, are small compared to labor income, they are still significant and need to be accounted for well, both by policymakers trying to collect revenue efficiently and by economists or journalists attempting to understand the distribution of personal income.

APPENDIX TABLE 1.

Sources of Income by Income Bracket, 2016 (Billions of Dollars)

	Wages and Salaries	Business Income	Investment Income	Retirement Income
Under \$50,000	\$1,610	\$44	\$51	\$251
\$50,000 to \$100,000	\$1,815	\$81	\$59	\$420
\$100,000 to \$200,000	\$1,922	\$142	\$43	\$388
\$200,000 to \$1,000,000	\$1,450	\$369	\$222	\$166
\$1,000,000 and Above	\$420	\$382	\$537	\$11

Source: IRS SOI Table 1.4, 2016.

APPENDIX TABLE 2.

Sources of Income by Year, Billions of Current Dollars

Income Type	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Wages and Salaries	\$3,201	\$4,456	\$4,565	\$4,560	\$4,650	\$4,922	\$5,155	\$5,469	\$5,842	\$5,951	\$5,707	\$5,837	\$6,055	\$6,301	\$6,475	\$6,785	\$7,112	\$7,217
Taxable Interest	\$155	\$199	\$198	\$149	\$127	\$125	\$162	\$223	\$268	\$223	\$168	\$140	\$120	\$112	\$101	\$94	\$96	\$97
Tax-exempt Interest	\$49	\$54	\$56	\$55	\$54	\$52	\$58	\$73	\$79	\$80	\$74	\$75	\$73	\$71	\$68	\$62	\$62	\$61
Ordinary Dividends	\$95	\$147	\$120	\$103	\$115	\$147	\$166	\$199	\$237	\$219	\$163	\$184	\$195	\$260	\$215	\$255	\$260	\$254
Qualified Dividends	N/A	N/A	N/A	N/A	\$81	\$111	\$119	\$137	\$156	\$159	\$124	\$136	\$142	\$204	\$158	\$192	\$203	\$202
State Income Tax Refunds	\$12	\$18	\$21	\$24	\$23	\$23	\$22	\$24	\$27	\$28	\$30	\$27	\$28	\$27	\$28	\$30	\$31	\$33
Alimony	\$4	\$6	\$7	\$7	\$6	\$7	\$8	\$8	\$9	\$9	\$9	\$9	\$9	\$9	\$9	\$10	\$10	\$10
Sole Proprietorship	\$169	\$214	\$217	\$221	\$230	\$247	\$270	\$282	\$280	\$264	\$245	\$267	\$283	\$304	\$302	\$317	\$332	\$328
Capital Gains	\$170	\$626	\$327	\$239	\$294	\$474	\$668	\$779	\$908	\$469	\$232	\$364	\$377	\$623	\$490	\$699	\$707	\$621
Sale of Noncapital Property	(\$3)	(\$1)	(\$2)	(\$2)	\$0	\$3	\$4	\$4	\$4	(\$8)	(\$18)	(\$18)	(\$14)	(\$9)	\$1	\$9	\$12	\$6
Total IRA Distributions	\$60	\$138	\$119	\$120	\$121	\$131	\$147	\$166	\$190	\$216	\$179	\$291	\$263	\$272	\$261	\$279	\$295	\$300
Taxable IRA Distributions	\$37	\$99	\$94	\$88	\$88	\$102	\$112	\$125	\$148	\$162	\$135	\$194	\$217	\$231	\$214	\$235	\$253	\$258
Total Pensions and Annuities	\$311	\$552	\$533	\$561	\$565	\$628	\$685	\$781	\$852	\$845	\$823	\$881	\$911	\$975	\$1,048	\$1,111	\$1,169	\$1,108
Taxable Pensions and Annuities	\$221	\$326	\$339	\$358	\$373	\$394	\$420	\$450	\$491	\$506	\$523	\$559	\$581	\$613	\$639	\$663	\$690	\$694
S corporation, Partnership, Rent, Royalty, Estate, Trust	\$149	\$252	\$268	\$278	\$296	\$357	\$447	\$466	\$453	\$418	\$385	\$446	\$486	\$613	\$614	\$679	\$713	\$706
Farm	(\$8)	(\$9)	(\$11)	(\$14)	(\$12)	(\$13)	(\$12)	(\$15)	(\$15)	(\$15)	(\$14)	(\$12)	(\$10)	(\$6)	(\$8)	(\$8)	(\$14)	(\$18)
Unemployment Compensation	\$19	\$17	\$27	\$43	\$44	\$33	\$28	\$27	\$29	\$44	\$84	\$120	\$92	\$71	\$52	\$33	\$27	\$25
Total Social Security Benefits	\$119	\$187	\$197	\$206	\$214	\$232	\$252	\$340	\$382	\$416	\$457	\$478	\$491	\$527	\$554	\$575	\$605	\$620
Taxable Social Security Benefits	\$46	\$90	\$94	\$93	\$98	\$110	\$125	\$144	\$167	\$168	\$175	\$191	\$202	\$224	\$243	\$261	\$277	\$286
Gambling Earnings	\$8	\$17	\$17	\$19	\$19	\$23	\$25	\$28	\$30	\$27	\$24	\$25	\$27	\$29	\$30	\$29	\$33	\$32
Other	\$16	\$25	\$20	\$19	\$21	\$23	\$27	\$30	\$36	\$34	\$31	\$35	\$34	\$37	\$37	\$39	\$40	\$38
Total Personal Income	\$4,230	\$6,424	\$6,231	\$6,111	\$6,295	\$6,887	\$7,532	\$8,145	\$8,811	\$8,384	\$7,739	\$8,208	\$8,498	\$9,234	\$9,234	\$9,916	\$10,360	10,379

IRS, Table A. Selected Income and Tax Items for Tax Years, 1995-2016, in Current Dollars

Note: Capital Gains includes net capital gain less loss and capital gain distributions reported on Form 1040.