

# Preliminary Evidence on Income Shifting

Matthew Knittel & Karen Maynard  
Independent Fiscal Office  
Commonwealth of Pennsylvania



Andrew Bershadker  
U.S. Department of Treasury



Presentation to: Federation of Tax Administrators  
September 30, 2014

# Income Shifting Due to “Fiscal Cliff”

## ➤ Three Questions:

- Which income sources were affected?
- How much income was shifted?
- Any future implications for tax years after 2013?

## ➤ PIT Revenue Trends – NY, NJ, PA and U.S.

## ➤ Dig Deeper: Tax Return Data: PA and U.S.

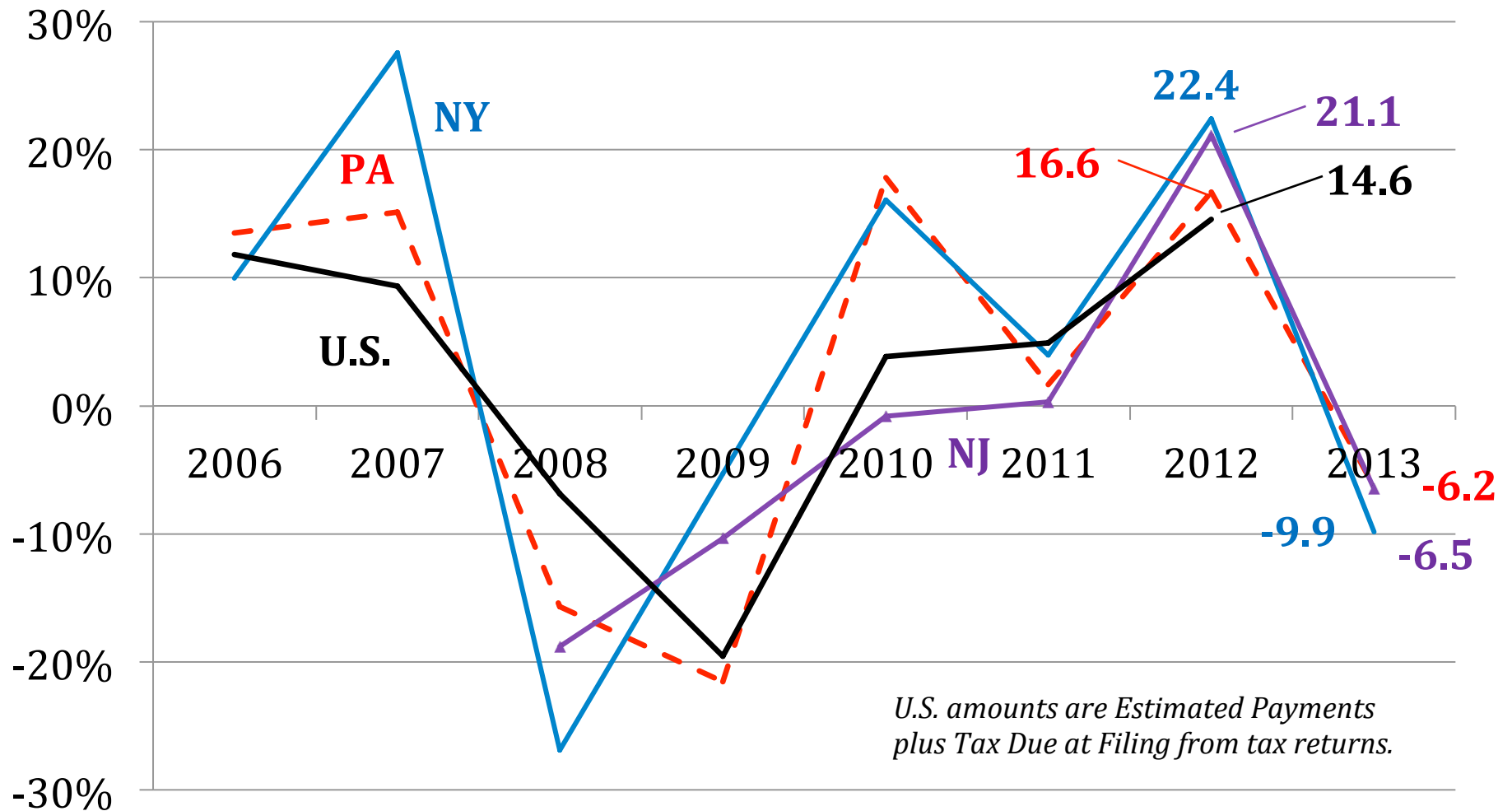
# A Clear Revenue Shift Across States

- Strong PIT Windfall in April 2013.
  - Dec12 - Jan13 **+25.2%** estimated payments (median).
  - 2013 Q2 **+37.4%** final payments (average).
  - Source: Rockefeller Institute.
  
- Reversal in April 2014.
  - Jan - Apr 2014 **-17.6%** final payments and **-17.0%** estimated payments (average).
  
- Current Residual Weakness in Estimated Payments.

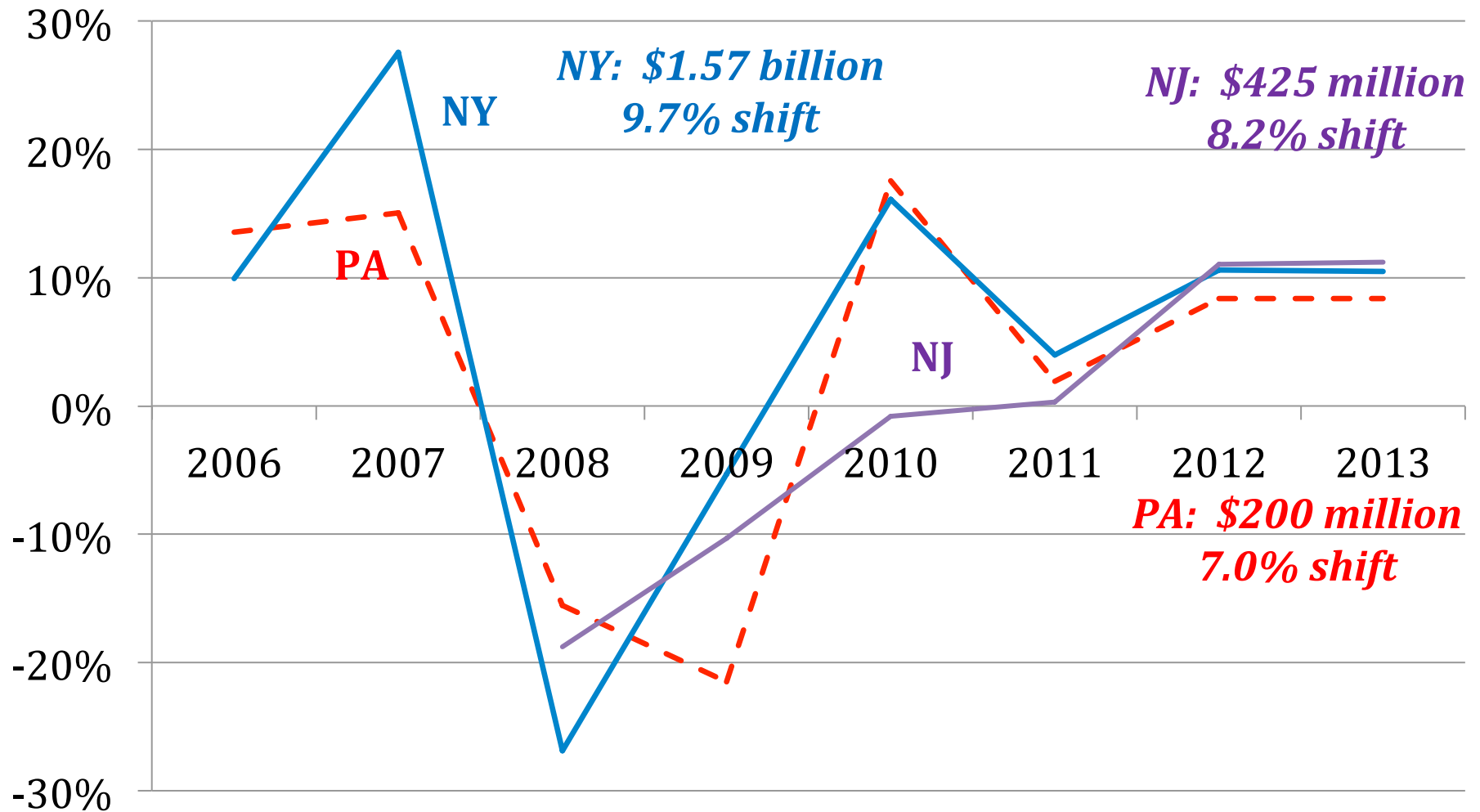
# Cause: The Mini “Fiscal Cliff”

- Top Marginal Rate Increases for Ordinary Income.
  - From **35% to 39.6%** for Taxable Income >\$450,000 (joint).
- Certain Capital Gains and Dividends Rates Increase.
  - From **15% to 20%** for those in highest rate bracket.
- The Affordable Care Act Investment Tax.
  - A **3.8% tax** on capital gains, dividends and interest.
  - Generally, taxpayers with AGI > \$250,000 (joint).

# Growth of Estimated and Final Payments (tax year basis)



# Implied Shift if We Assume Flat Growth (tax year basis)



# What Do Tax Return Data Show?

- Start with a Very Simple Comparison.
  - Compare upper income taxpayers (affected by tax law) to lower income (unaffected).
  - Taxable Income >\$450k for joint and >\$400k for singles.
  - Do we observe different growth rates for income?
  - Is that normal?
- A Gross Oversimplification, but Provides Context.
  - Use publicly available IRS data first.

# Comparison of Growth Rates by AGI Class

(US tax year data)

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>AAGR*</u>	<u>2012</u>
<b>All Net Capital Gains</b>					
< \$500k AGI	-30.4	21.3	6.3	-13.4	21.0
>= \$500k AGI	-52.6	64.1	0.7	-12.3	75.8
<b>Qualified Dividends</b>					
< \$500k AGI	-15.7	-3.4	15.0	2.0	10.5
>= \$500k AGI	-30.0	30.1	-7.5	-0.9	87.9
<b>Net Pass Thru (Schedule E)</b>					
< \$500k AGI	1.9	4.7	8.5	2.5	9.0
>= \$500k AGI	-9.6	6.0	3.5	0.0	26.6
<b>Net Professional (Schedule C)</b>					
< \$500k AGI	-3.0	5.2	4.2	0.3	4.8
>= \$500k AGI	-15.9	5.6	8.9	-1.1	20.7

\*Average annual growth rate from 2006 to 2011. Business income excludes taxpayers with negative AGI.



# Some Obvious Problems

## ➤ Clear **Double Counting**.

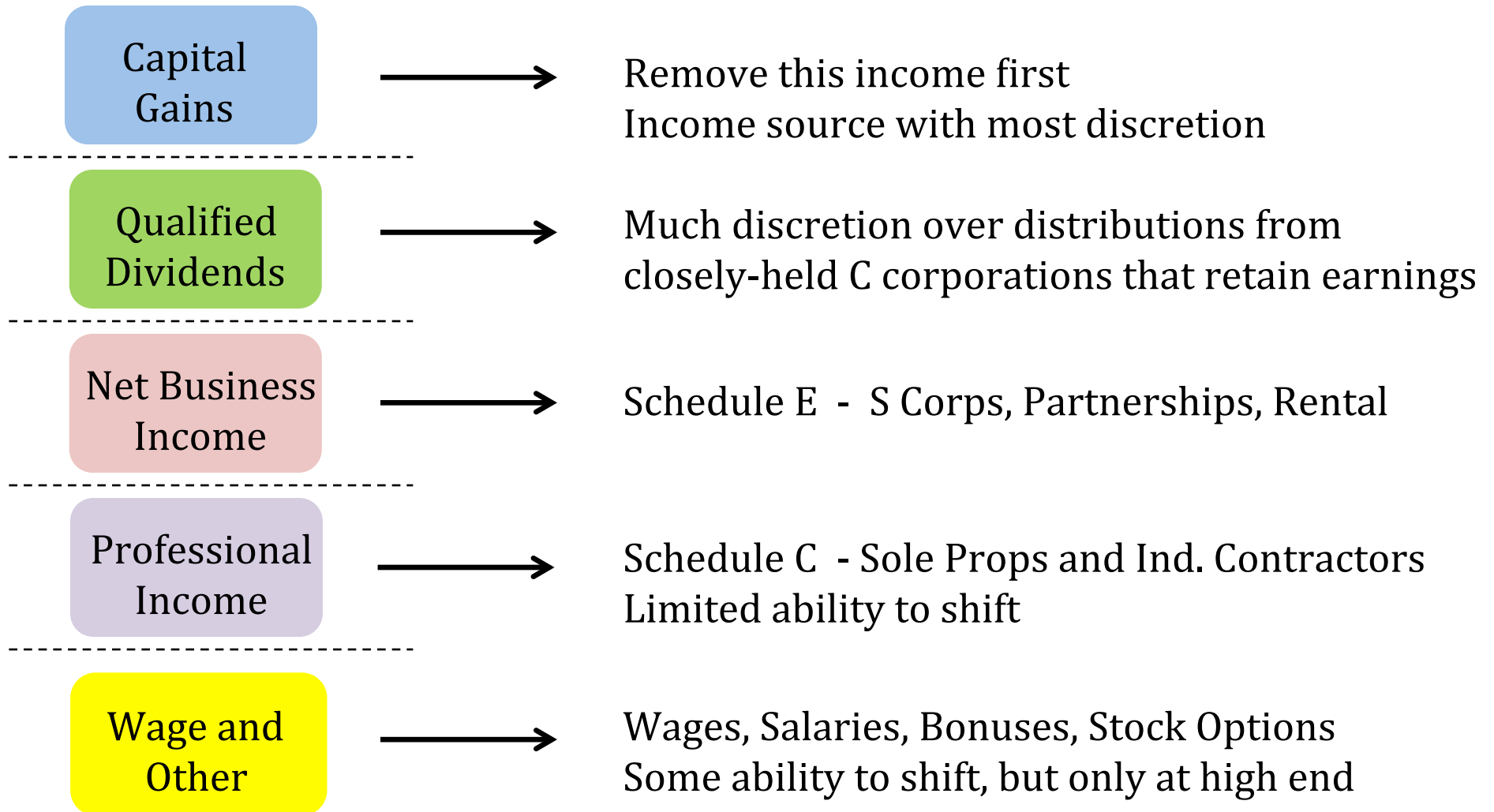
- A large gains realization may push taxpayer into higher AGI group even if ALL other income did not change.

## ➤ Not all income taxed at top rate. Some is inframarginal.

## ➤ A Cleaner Comparison.

- “Stack” the income types and **ONLY** count > \$450k / \$400k.
- Examine each separately, then peel it away.
- Also, gross historical amounts up by inflation.

# The Income Stack



# U.S. Tax Return Growth Rates

	<u>2010</u>	<u>2011</u>	<u>AAGR*</u>	<u>2012</u>
<b>Form 4797 Cap Gains</b>				
All Other	8.7	-3.4	2.5	21.4
Top Bracket	82.2	8.3	40.4	64.7
<b>All Other Net Gains</b>				
All Other	24.7	8.3	16.2	18.2
Top Bracket	58.1	-4.6	22.8	72.6
<b>Qualified Dividends</b>				
All Other	-2.8	13.2	4.9	13.0
Top Bracket	26.1	-13.5	4.4	83.9

Annual average growth rate from 2009 to 2011.

# U.S. Tax Return Growth Rates

	<u>2010</u>	<u>2011</u>	<u>AAGR*</u>	<u>2012</u>
<b>Schedule E Gains</b>				
All Other	3.9	4.6	4.2	6.8
Top Bracket	4.2	-0.5	2.0	21.9
<b>Schedule C Gains</b>				
All Other	2.9	0.6	1.7	2.7
Top Bracket	-2.2	5.4	1.5	12.2
<b>Wages and Salary</b>				
All Other	-0.3	0.3	0.0	1.1
Top Bracket	11.1	3.4	7.2	13.1

*less dramatic,  
but notable*

Annual average growth rate from 2009 to 2011.

# PA Tax Return Growth Rates

	<u>2011</u>	<u>2012</u>
<b>Sale of Property</b>		
All Other	-1.1	19.0
Top Bracket	-15.3	54.3
<b>Dividends</b>		
All Other	10.6	14.1
Top Bracket	-1.8	56.1
<b>Net Business Profits</b>		
All Other	2.6	2.4
Top Bracket	3.6	10.2
<b>Wages (and Other)</b>		
All Other	0.4	0.2
Top Bracket	-3.2	19.2

*similar to U.S.  
smaller spread*

# PA Gains Very Concentrated at Top

	2010		2011		2012	
	<u>Filers</u>	<u>\$ Amt</u>	<u>Filers</u>	<u>\$ Amt</u>	<u>Filers</u>	<u>\$ Amt</u>
All Filers	408,113	\$13,520	440,390	\$12,552	496,512	\$18,046

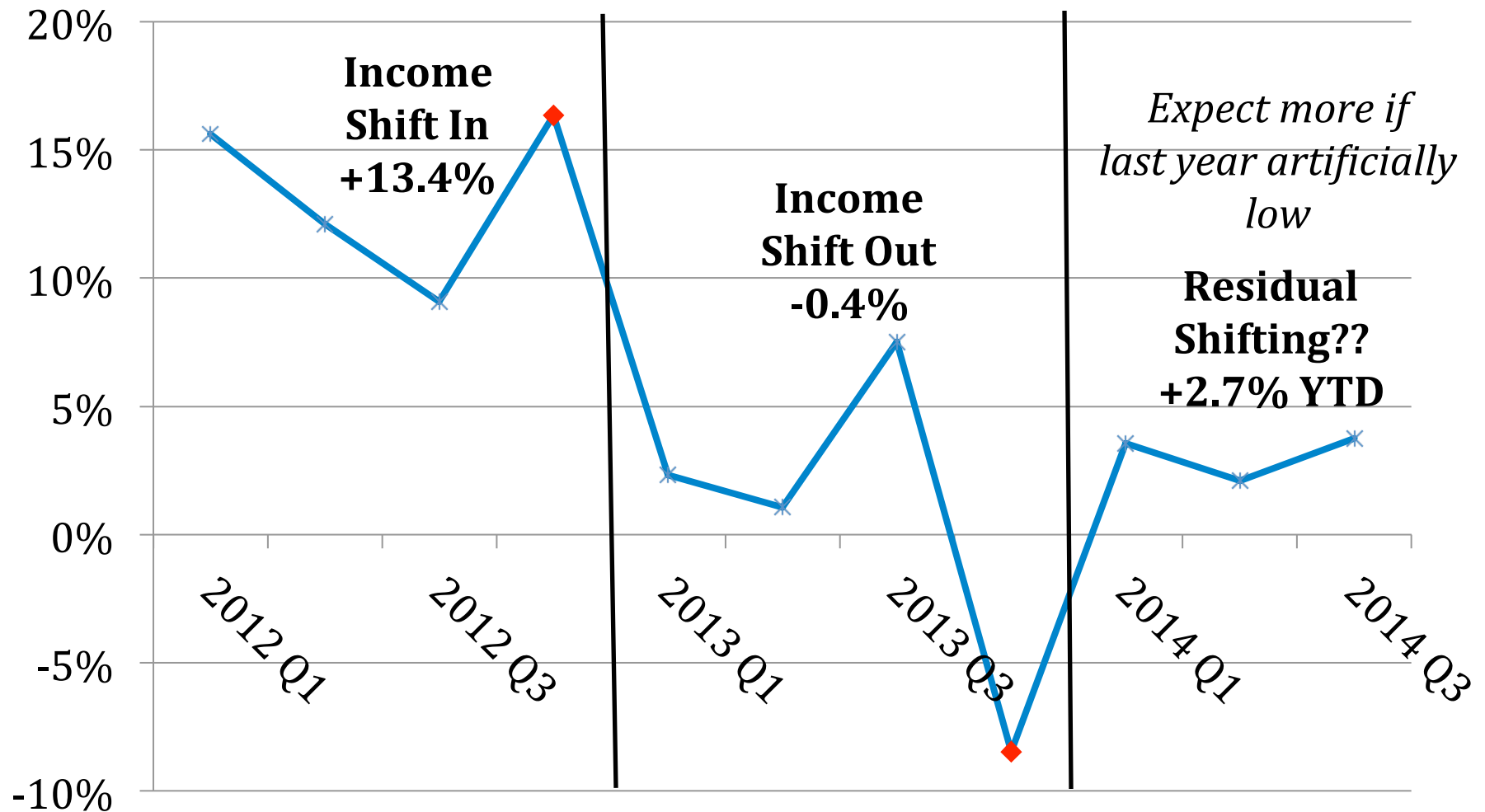
**+\$5.5 billion  
44% growth**

## Filers with >\$1 million gains in 2012, present all three years

No Gains	690	\$0	668	\$0		
\$1k - \$100k	526	\$13	543	\$13		
\$100k - \$500k	276	\$70	264	\$67		
\$500k - \$1,000k	128	\$93	141	\$104		
>\$1,000k	<u>291</u>	<u>\$1,400</u>	<u>295</u>	<u>\$1,595</u>	<u>1,911</u>	<u>\$8,139</u>
Total	1,911	\$1,575	1,911	\$1,779	1,911	\$8,139

**+\$6.4 billion  
358% growth**

# Growth PA Estimated Payments



# Wrap Up

- Capital Gains Shift Expected. Others Less So.
  - Dividends surprising. Closely-held C corps?
  - Business income and wage shifting strong.
- Appears very concentrated at top end.
- Residual shifting impacts current fiscal year?
  - Very large one-time capital gains and dividends.
  - From multiple years, not just 2013?