Household Incomes in Tax Data: Using Addresses to Move From Tax Unit to Household Income Distributions

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Background

- IRS tax return data increasingly common for measuring income distributions
  - Income inequality and income mobility (Piketty and Saez, 2003; Chetty, Hendren, Kline, and Saez, 2014)
  - Tax liabilities (JCT 2012, Tax Policy Center 2017)

- Two major limitations
  - 15% of adults do not file a tax return
  - No links to others in household (Atkinson, Rainwater, Smeeding 1995; CBO 2016)

Goals of this paper

1. Overcome these two limitations of tax data
   - Incorporate non-filers
   - Combine tax records into households

2. Determine how the limitation of not observing households affects income inequality measurement

(Focus on 2010 to match Decennial Census)
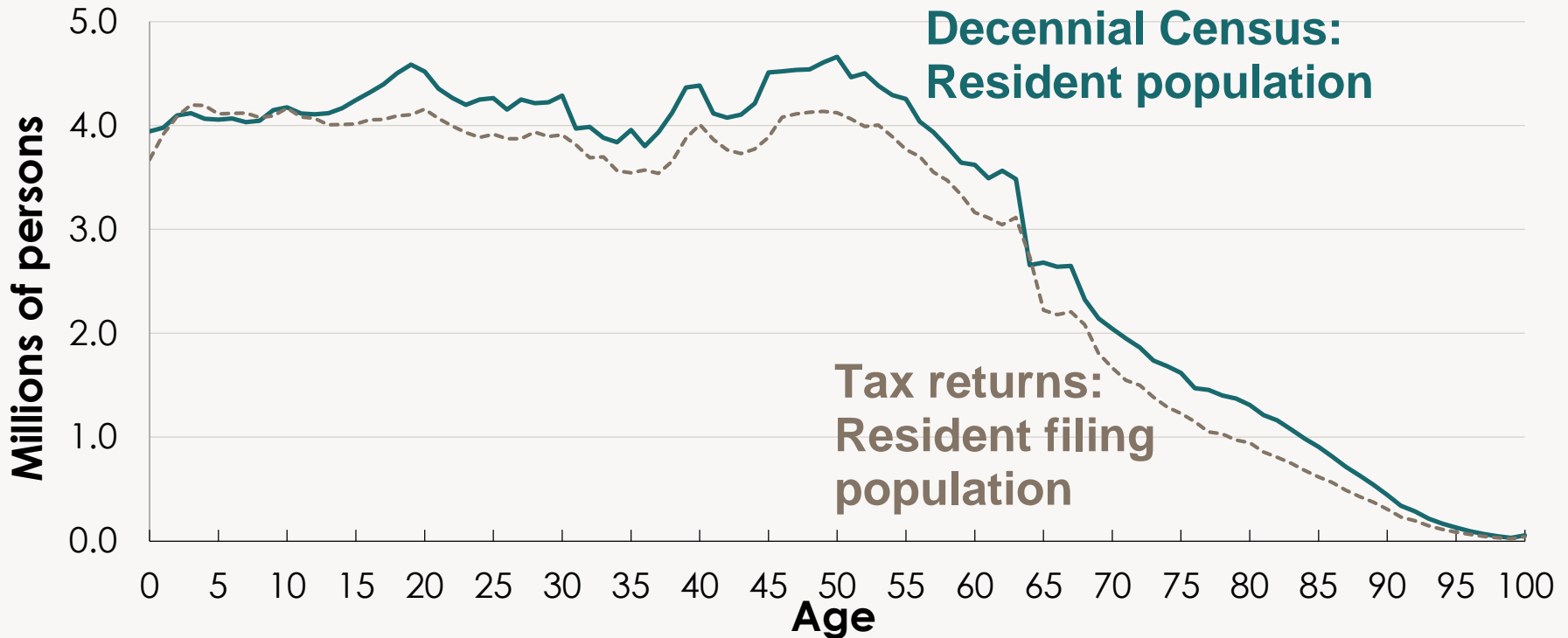
Data: IRS Compliance Data Warehouse

All individual tax forms received by the IRS

- Annual tax returns (e.g. Form 1040)
- Information returns
  - W-2
  - SSA-1099
  - 1099-INT, 1099-DIV, etc
  - 1099-Misc

Population coverage of tax data (2010)

Decennial Census: 308.7 million

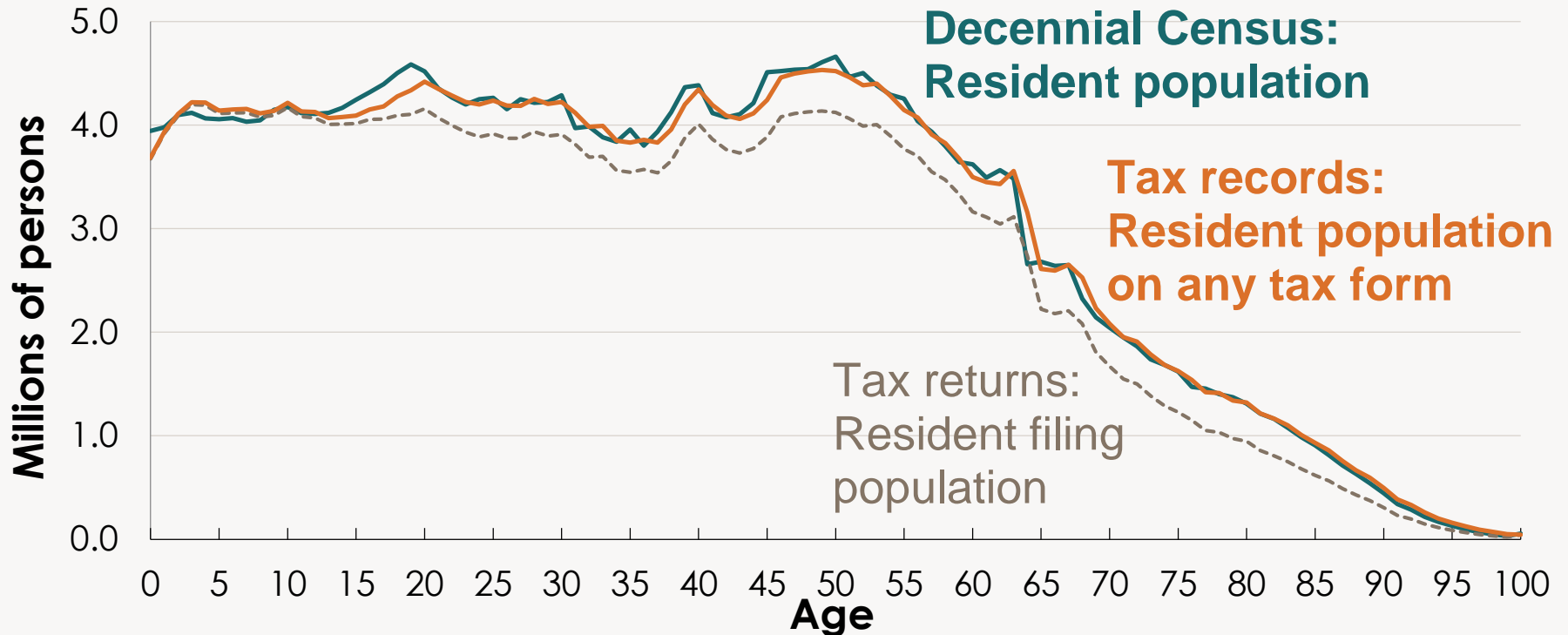IRS (resident filing population only): 281.3 million

Population coverage of tax data (2010)
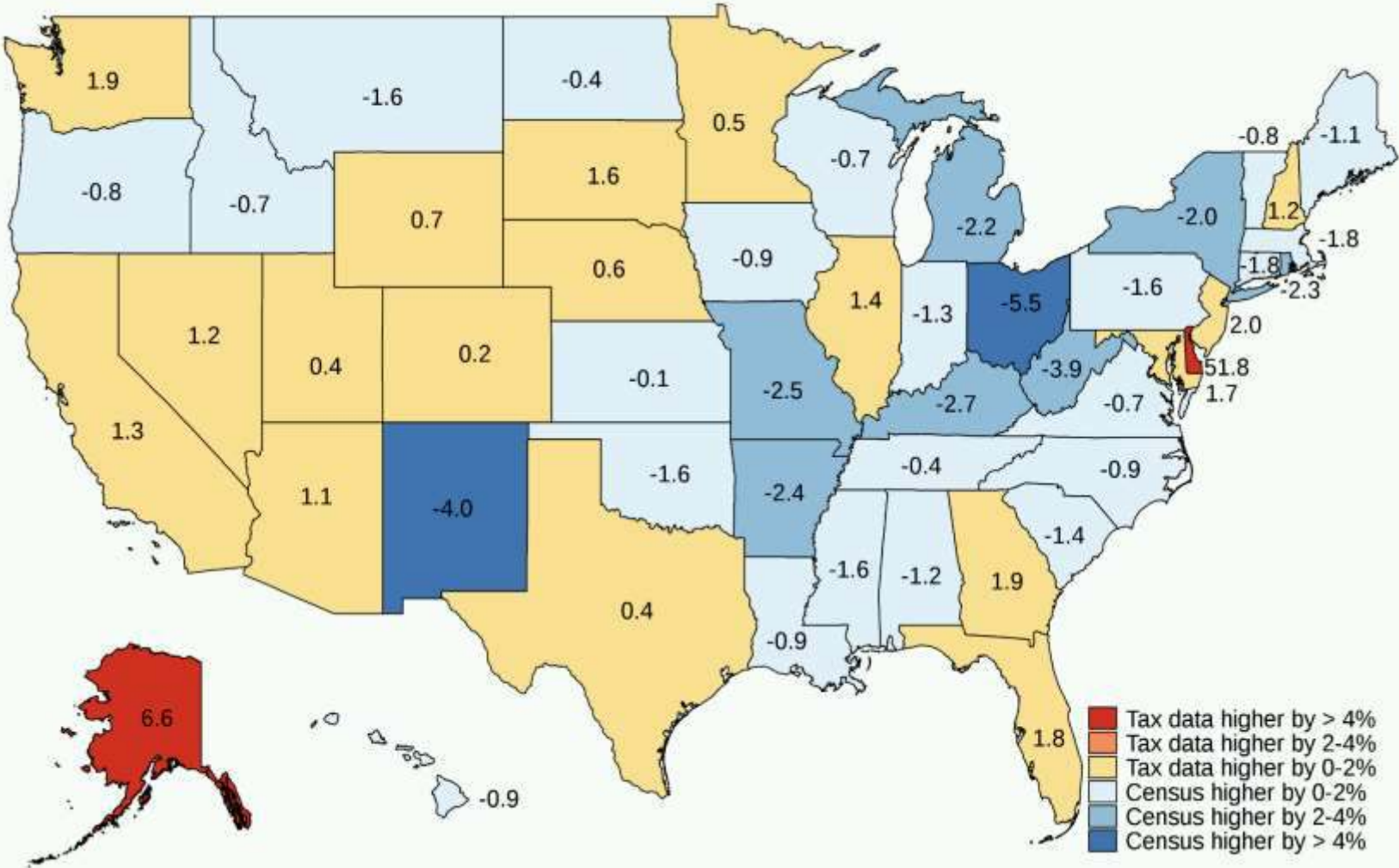
Decennial Census: 308.7 million

IRS (resident filing population only): 281.3 million

IRS (all residents): 307.9 million

Decennial Census: Resident population

Tax records: Resident population on any tax form

Tax returns: Resident filing population

State level population

Creating Households

All tax forms contain a mailing address

- Clean addresses to a uniform style
- Link all returns with the same mailing address and ZIP code

Creating Households (continued)

Check validity of unmatched 1-person addresses with a master list of valid street-ZIP code combinations

- Replace invalid street name with neighboring year if similar and valid
- Replace remaining invalid street names with most similar valid street (if any) in ZIP code

Similarity of text strings defined using Levenshtein distance method

- Count number of replacements, insertions, and deletions between text strings
- Example: [Suoth Street] to [South Street] = 2

Household Counts

March CPS: 117.5 million

Decennial Census: 116.7 million

Tax Data: 113.5 million

About 2 million households would be added if dependents with different addresses were counted independently rather than with claimant
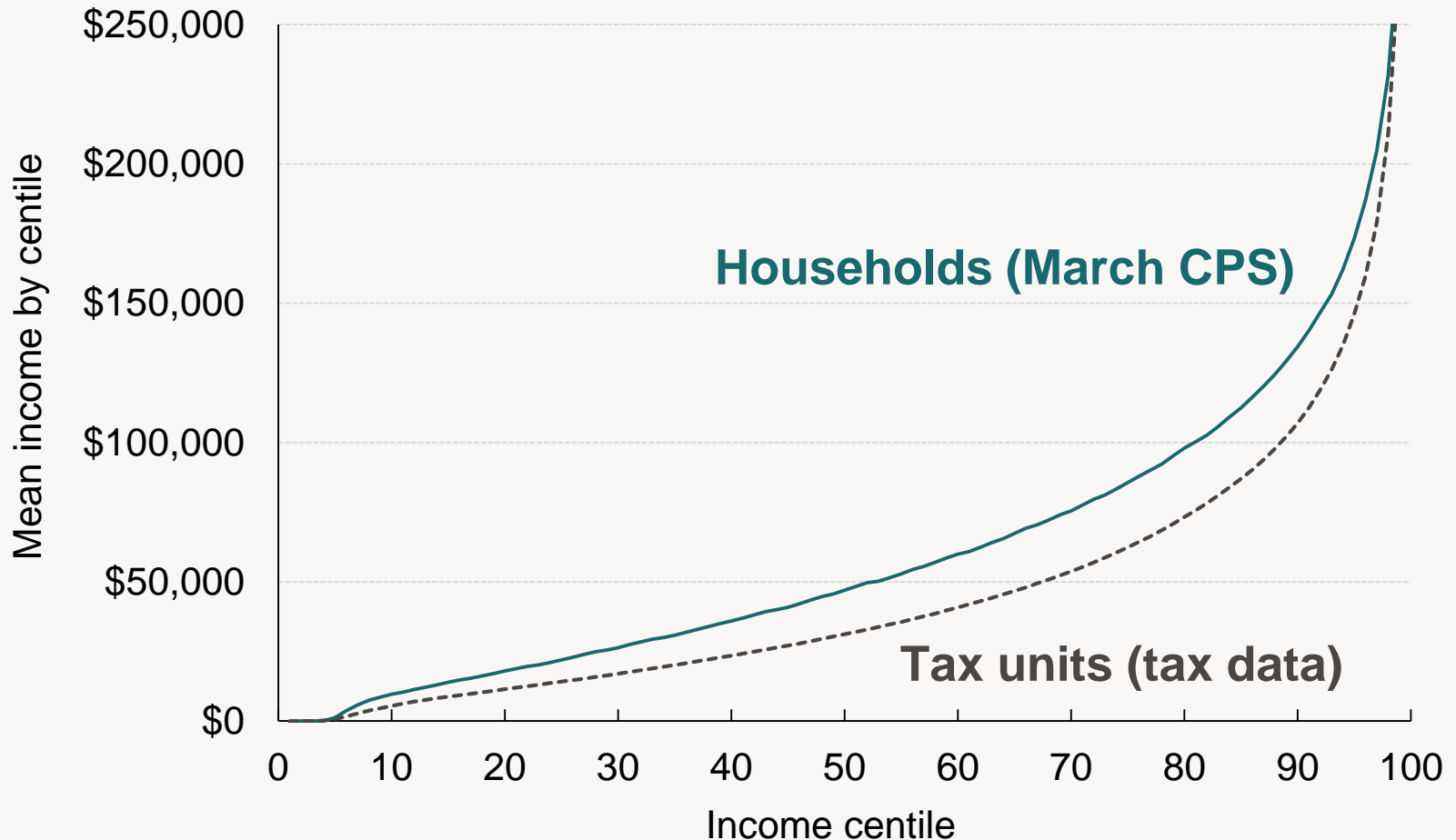
Households vs. Tax Units

Percent of households with each combination of filers and non-filers:

		Non-filing individuals		
		0	1	2+
Filing tax units	0	---	10%	2%
	1	59%	4%	1%
	2+	23%	2%	<1%

Note: dependent non-filers are included as part of the tax-unit who claimed them on their return

Income distributions

Income distributions

Chart: Mean income by centile (y-axis, $0 to $250,000) versus Income centile (x-axis, 0 to 100). Three curves are shown:
- **Households (March CPS)** (teal line)
- **Households (tax data)** (orange line)
- **Tax units (tax data)** (dashed grey line)
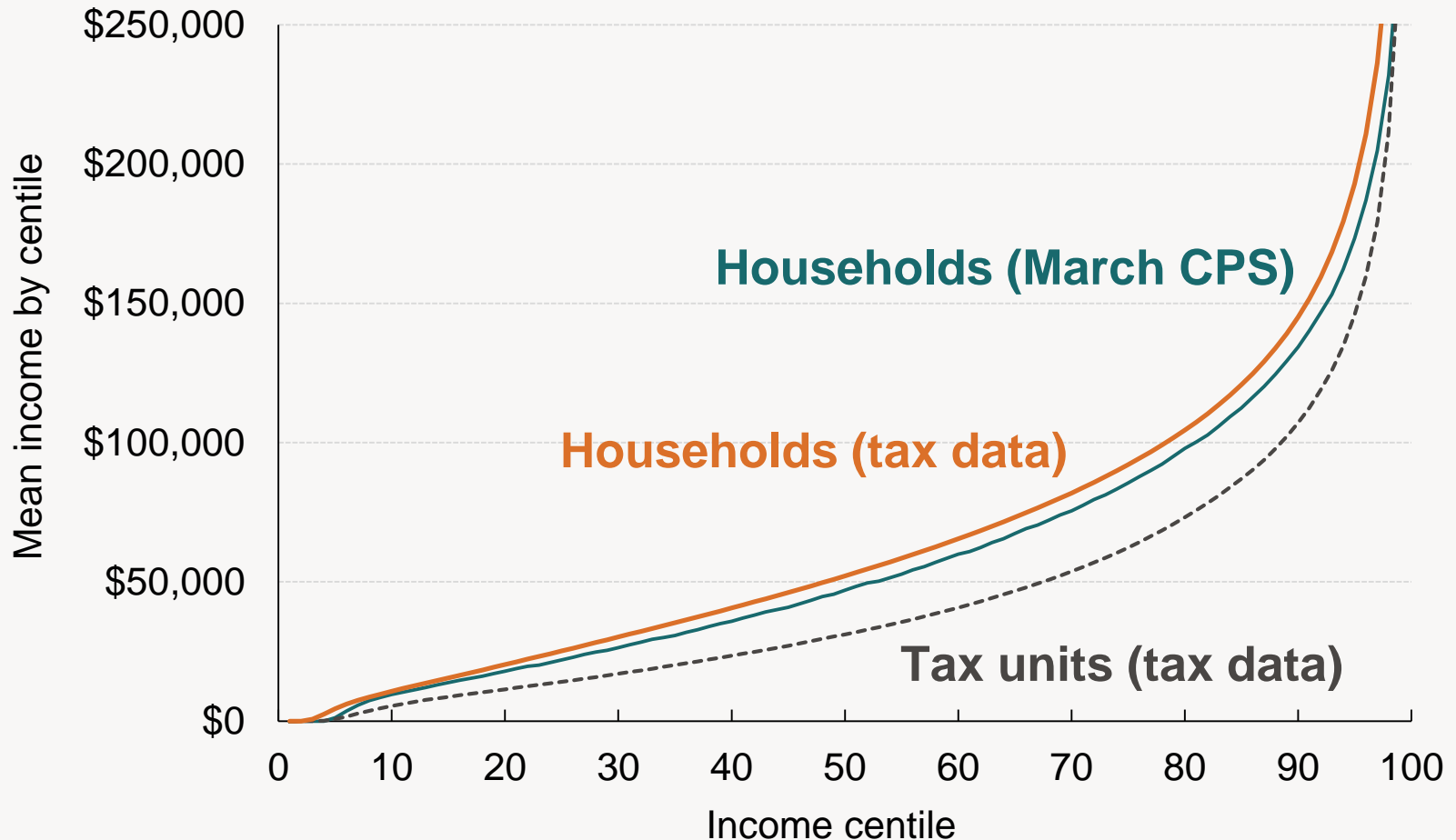
Top 5% distribution
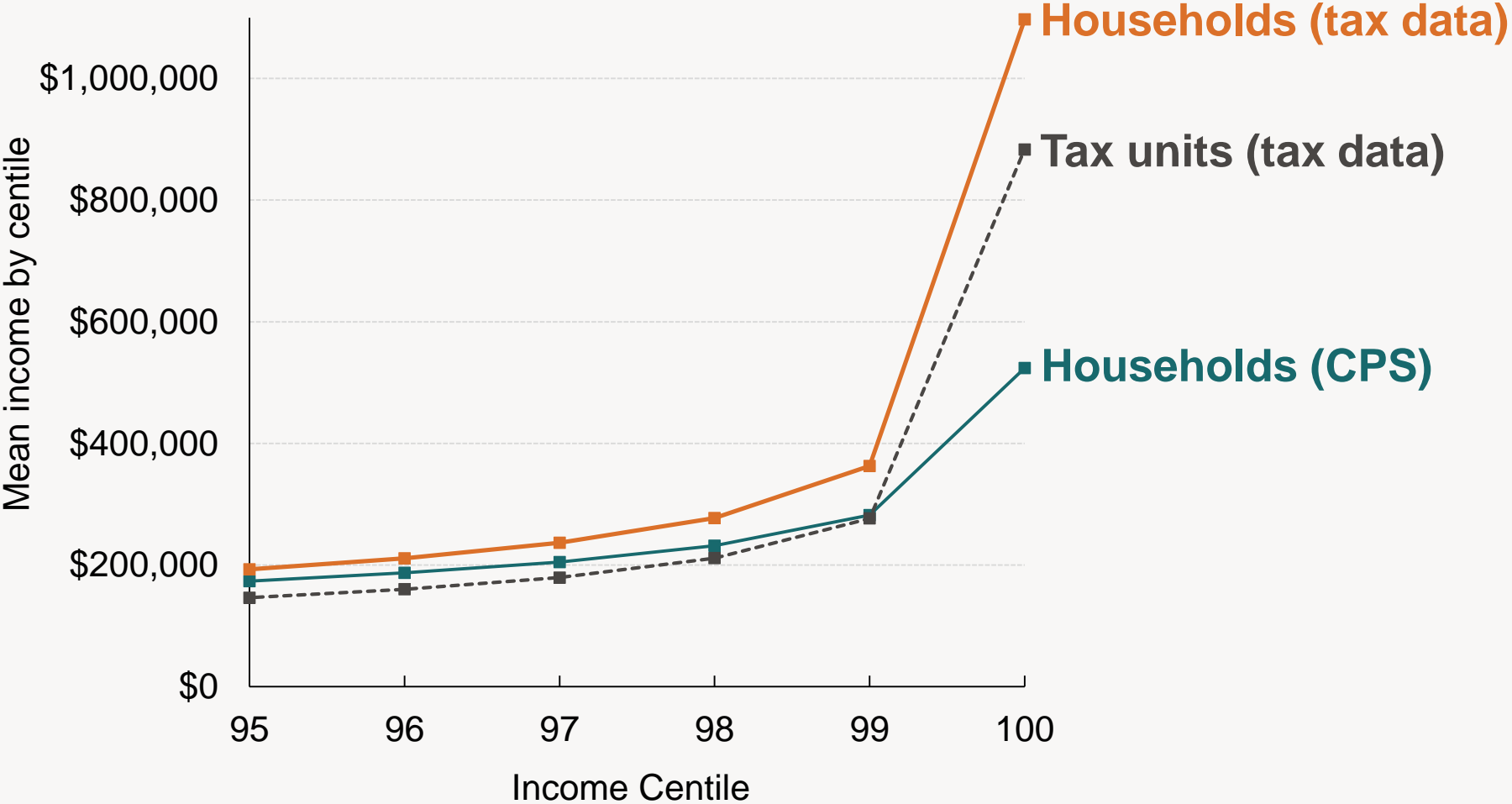
Inequality Statistics

	Tax data (HH)	Tax data (TU)	March CPS (HH)	% difference using tax units	% difference using March CPS
Gini	**0.516**	0.570	0.483	+10%	-6%
P90/P10	**13.2**	18.8	13.7	+42%	+4%
Top 20% share	**54.6**	59.5	51.0	+9%	-7%
Top 5% share	**27.9**	31.4	21.8	+13%	-22%
Top 1% share	**14.0**	16.2	---	+16%	---

Conclusions

- Using universe of tax-record data, possible to:
    - Incorporate non-filers
    - Observe complete households

- CPS understates inequality (greatly understates incomes of the top 2%)

- Tax-units are not a sufficient proxy for households in tax data – assuming equivalence overstates inequality