Federal Personal Income Tax Liabilities and Payments, 1995–96

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THIS ARTICLE presents new BEA estimates for 1996 and revised estimates for 1995 of Federal personal income tax liabilities and revised estimates for 1995–96 of Federal personal income tax payments (table 1).[1] The liabilities estimates for 1996 are derived from newly available tax return data from the Internal Revenue Service; the payments estimates are from the annual revision of the national income and product accounts (NIPA's) that was released last July.[2]

1. The estimates for 1992–94 are in Thae S. Park, "Federal Personal Income Tax Liabilities and Payments, 1992–95," SURVEY OF CURRENT BUSINESS 77 (December 1997): 17–21; and those for 1959–91 are in Thae S. Park, "Federal Personal Income Tax Liabilities and Payments, 1959–94," SURVEY 76 (August 1996): 127–132.

2. For tax return data for 1996, see Internal Revenue Service, *Statistics of Income Bulletin* (Washington, DC: U.S. Government Printing Office, Summer 1998).

Table 1.—Federal Personal Income Tax Liabilities and Payments, 1994–96

[Billions of dollars; quarterly estimates are seasonally adjusted at annual rates]

	Federal personal income taxes			Disposable personal income (DPI)	
	Liabilities basis [1]	Payments basis [2]	Difference	Alternative DPI with NIPA Federal personal income taxes on a liabilities basis	Published DPI with NIPA Federal personal income taxes on a payments basis [3]
1994	540.4	545.3	–4.9	5,023.8	5,018.9
1995	594.0	589.0	5.0	5,272.1	5,277.0
1996	665.8	666.9	–1.1	5,535.8	5,534.7
1995:I	576.6	566.7	9.9	5,202.4	5,212.3
II	586.2	593.3	–7.1	5,241.8	5,234.7
III	598.6	590.5	8.1	5,286.4	5,294.5
IV	614.7	605.5	9.2	5,357.6	5,366.8
1996:I	638.4	633.9	4.5	5,430.2	5,434.6
II	659.5	671.4	–11.9	5,508.7	5,496.7
III	675.6	672.8	2.8	5,574.5	5,577.3
IV	689.8	689.5	.3	5,629.8	5,630.1

1. This series is derived by the Bureau of Economic Analysis and is based on data from *Statistics of Income, Individual Income Tax Returns.*
2. This series appears in NIPA table 3.2 in the section "BEA Current and Historical Data" of the SURVEY OF CURRENT BUSINESS. The components of Federal personal income taxes are published annually in NIPA table 3.4, mostly recently on page 59 of the August 1998 SURVEY.
3. This series appears in NIPA table 2.1 in "BEA Current and Historical Data." Estimates for 1982–94 have been revised as a result of a redefinition of dividend payments in this year's annual revision of the NIPA's. The revised estimates for 1982–94 are in table 2.1 in the section "Annual NIPA Revision: Revised Estimates for 1982–94," on pages 128–131 in the August 1998 SURVEY, and the redefinition is described in Eugene P. Seskin, "Annual Revision of the National Income and Product Accounts," on page 29 of that issue.
NIPA National income and product account

The first section of the article discusses the payments series, the derivation and the use of the estimates of tax liabilities, and the sources of the differences between liabilities and payments. The second section presents the estimates of tax liabilities for 1995–96 and discusses the sources of the differences for these years. The third section discusses the sources of the revisions to the estimates for 1995.

Payments and liabilities

In the NIPA's, Federal personal tax payments is defined as tax payments (net of refunds) to the Federal Government by U.S. residents that are not chargeable to business expense. Federal personal income taxes consist of all Federal taxes except estate and gift taxes, and they are recorded on a payments basis. As shown below, Federal personal income tax payments have three components: Withheld income taxes; declarations and settlements, or "nonwithheld" taxes; and refunds.[3]

Federal Personal Income Tax Payments, 1994–96

[Billions of dollars]

	1994	1995	1996
Federal personal income taxes	545.3	589.0	666.9
Withheld	466.4	501.5	548.9
Declarations and settlements	157.2	174.2	209.2
Less: Refunds	78.3	86.7	91.1

Withhelx income taxes are those withheld at the source of the income, mainly on wage and salary income. Declarations are estimated tax payments, mostly on income that is not subject to withholding, such as capital gains and self-employment income; settlements are additional taxes that are paid when tax returns are filed or

For a detailed discussion of the annual revisions to personal income and Federal personal income tax payments for 1995–97, see Eugene P. Seskin, "Annual Revision of the National Income and Product Accounts," SURVEY 78 (August 1998): 21–22.

3. The estimates of these components are published annually in NIPA table 3.4, most recently on page 59 of the August 1998 SURVEY. Quarterly estimates of Federal personal income taxes are published monthly in NIPA table 3.2 in the section "BEA Current and Historical Data" of the SURVEY.

as the result of audits. Refunds of excess payments, including excess social security taxes, are recorded as negatives in the payments series when the refunds are made.

For certain purposes, payments data may not be the most appropriate basis of measurement. For example, households may base their consumption decisions, especially about major purchases, on their disposable income calculated net of tax liabilities rather than net of tax payments. As a result, liabilities may be the more appropriate basis for analyzing the impact of taxes on consumption and for analyzing fiscal policy.

The BEA estimates of Federal personal income tax liabilities are derived primarily from the estimates of "total income tax" from the Internal Revenue Service's *Statistics of Income: Individual Income Tax Returns* (*SOI*). *SOI* estimates of total income tax are the sum of income tax after credits and the alternative minimum tax and are on a liabilities basis. The *SOI* estimates are adjusted so that the coverage of the liabilities series will be comparable with that of the NIPA payments series.[4]

The following paragraphs identify the sources of differences between liabilities and payments, both for income that is subject to withholding and for income that is not subject to withholding.

Income subject to withholding.—In the Internal Revenue Code, three types of withholding are provided—mandatory, optional, and backup.

Mandatory withholding applies to most wages and salaries, supplemental wages, and certain other incomes, such as gambling winnings. For wages and salaries, differences between liabilities and payments arise for several reasons. The most important reason is that the withholding tables that are issued by the IRS and that are used by employers to calculate the amounts to be withheld on wages and salaries are based on two simplifying assumptions.

The first assumption is that taxpayers use the standard deduction in calculating their income tax liabilities. However, taxpayers who itemize their deductions may have overwithholding if they underestimate the number of additional withholding allowances that are necessary to offset the excess of their estimated itemized deductions over the standard deduction.[5] The second assumption is that wages are constant throughout the year, so overwithholding may result if wages vary widely within the year and are therefore subject to varying withholding rates.

In addition, overwithholding may result from the use of withholding for "forced savings" or from the failure to estimate growth in itemized deductions. Overwithholding may also occur because, for certain payments, withholding is based on flat rates rather than on the withholding-table rates. For example, at the option of an employer, withholding may be based on a flat 28 percent for supplemental wages (such as bonuses, commissions, and overtime pay) and on a flat 20 percent for taxable fringe benefits (such as company cars provided to employees and free or discounted commercial flights). For certain gambling winnings of more than $5,000, withholding must be at a flat 28 percent.

Payments and liabilities may also differ because withholding tables may not always be updated to coincide with the changes in liabilities: Tax law provisions are usually effective on January 1, but the tables are sometimes updated later.[6] The tables are usually updated to reflect changes in the standard deduction, exemptions, and tax rates, but they are not usually updated to reflect changes in the provisions affecting itemized deductions or adjustments to gross income.

Differences may also arise when withholding is at the taxpayer's option, as is the case for pensions and annuities and for sick pay from other than an employer.

Backup withholding applies to all types of nonwage income that are subject to information reporting. For example, backup withholding is required if the recipient fails to furnish an accurate taxpayer identification number to the payor or if the recipient lacks certification that the income is not subject to backup withholding (this withholding was initiated in 1984 as a compliance measure). The backup withholding system

4. The adjustments consist of the following. First, recapture taxes, penalties and other taxes, and exempt organizations excise taxes are added to the *SOI* estimates. Second, fiduciary income taxes are added, because personal income includes fiduciary income. Third, additional assessments from audits, net of refunds on amended returns (Form 1040X), are added because they are excluded from the *SOI* estimates. Fourth, excess social security taxes and the earned income credit that is used to offset nonincome taxes are subtracted. Fifth, income taxes paid by U.S. citizens living abroad for more than a year are subtracted, because, in the NIPA's, these citizens are considered nonresidents of the United States; the *SOI* estimates include these taxes, because these citizens are generally taxed on their worldwide income regardless of how long they have been living abroad.

For more information, see "Appendix: Estimating Methods," in Park, "Liabilities and Payments, 1992–95," 20–21.

5. Employees must fill out "Employee's Withholding Allowance Certificate" (Form W–4) so that their employers can withhold the correct amount of Federal income tax from their pay. Employees determine the number of withholding allowances based on estimated itemized deductions, on estimated adjustments to gross income, on the number of personal and dependency exemptions, and on filing status. Employees may submit new Form W–4's at any time to change the number of withholding allowances. These options provide them with some discretion over the effective rates at which taxes are withheld from their incomes.

6. For example, in August 1993, the Omnibus Budget Reconciliation Act of 1993 created two new tax brackets of 36 percent and 39.6 percent, which applied to all income in the whole year. The withholding tables reflecting these new rates were made available to employers in January 1994.

requires a payor to deduct and withhold income tax from reportable payments—such as interest or dividends—at a 31-percent rate, which may result in overwithholding if the income is actually taxed at a lower rate.

The net result of all of these factors has been persistent overwithholding of taxes on income subject to withholding, despite an attempt to reduce overwithholding through the redesign of the withholding tables in 1992.[7]

Income not subject to withholding.—For income that is not subject to withholding (such as self-employment income, capital gains, taxable social security benefits, and most interest, dividends, and pensions and annuities), differences between liabilities and payments arise for two reasons. First, the proportion of the current year's liabilities that must be paid in estimated taxes in order to avoid a penalty is less than 100 percent. Second, settlements and the last installment of quarterly estimated taxes are for liabilities that are incurred in one year but that are paid to the Treasury Department in the next year; refunds also are made in the year after the liabilities were incurred. (Settlements, quarterly estimated taxes, and refunds are recorded in the payments series in the calendar year in which they are received or paid by the Treasury Department.) As a result, net payments of nonwithheld taxes during a year may not reflect that year's income.

As a result of these factors, nonwithheld tax payments (declarations and settlements) tend to be less than liabilities. However, as noted earlier, overwithholding on wage and salary income tends to offset much of this shortfall, and the net difference between total payments and total liabilities is smaller than the difference that would be expected by an examination of either withheld income taxes or nonwithheld income taxes.

In addition to the timing differences between payments and liabilities, there are measurement errors that cannot be isolated from the timing-basis differences. These errors include sampling and nonsampling errors with the SOI sample data, reporting and processing errors with the financial statements for the Federal Government and with employment tax return tabulations from the Social Security Administration, and estimating errors in the NIPA payments series and in the coverage adjustments made to the SOI data to derive the liabilities series.

Tax liabilities for 1995–96

For 1995, tax liabilities exceeded tax payments by $5.0 billion. The excess of liabilities was partly due to a large increase in nonwage income; in the SOI data, nonwage income increased 11.9 percent in 1995, and wage income increased 5.8 percent. Because most of nonwage income is not subject to withholding, much of the increase in income tax liabilities on this income was paid when tax returns were filed in 1996. Tax payments for 1995 reflected the deferral of additional 1993 taxes that were paid in 1995.[8] In the SOI data, about $4 billion of the 1993 taxes were deferred to 1995 and about $4 billion to 1996. In the payments series, the additional 1993 taxes that were paid in 1995 were largely reflected in the second quarter of 1995 and resulted in an excess of payments over liabilities in that quarter.

For 1996, tax payments exceeded tax liabilities by $1.1 billion. The tax payments included payments of the 1995 nonwage liabilities and of the final portion of the deferred 1993 taxes that were paid in 1996. (The excess of payments over liabilities in the second quarter reflected the payment of the final portion of the deferred 1993 taxes.) In the SOI data, nonwage income continued to

7. However, much of this overwithholding may not represent overwithholding on total income (that is, total payments in excess of total liabilities), because individuals may choose to withhold more from their wages in order to cover for tax liabilities of nonwage income, such as capital gains and other nonwithheld income.

8. The provisions of the Omnibus Budget Reconciliation Act of 1993 increased the marginal tax rates for high-income individuals. These individuals were given an option to defer payments of two-thirds of the additional taxes that resulted from the tax-rate increases; those who elected this deferral option paid half of their deferred taxes by April 17, 1995, and the other half by April 15, 1996.

Table 2.—Revisions to Federal Personal Income Tax Liabilities and Payments for 1995

[Billions of dollars; quarterly estimates are seasonally adjusted at annual rates]

	Liabilities basis			Payments basis			Difference		
	Previously published	Revised	Revision	Previously published	Revised	Revision	Previously published	Revised	Revision
1995	594.2	594.0	–0.2	588.7	589.0	0.3	5.5	5.0	–0.5
1995:I	576.9	576.6	–.3	565.2	566.7	1.5	11.7	9.9	–1.8
II	587.3	586.2	–1.1	592.0	593.3	1.3	–4.7	–7.1	–2.4
III	599.7	598.6	–1.1	590.0	590.5	.5	9.7	8.1	–1.6
IV	613.0	614.7	1.7	607.7	605.5	–2.2	5.3	9.2	3.9

surge in 1996, increasing 16.8 percent, and wage income increased 5.5 percent. As usual, much of the tax liabilities on nonwage income that were incurred in 1996 were paid in 1997.

Sources of revisions for 1995

The revisions to the annual series for liabilities and for payments for 1995 reflected the incorporation of the results of this year's annual revision of the NIPA's.[9] The annual tax liabilities for 1995 were revised down $0.2 billion, and the annual tax payments were revised up $0.3 billion, so the difference between the two series was revised down $0.5 billion (table 2).

The revisions to the quarterly liabilities for 1995 reflected the pattern of the revisions to the quarterly NIPA estimates of personal income.

9. As part of the 1998 annual NIPA revision, personal income was revised back to 1982 to exclude the capital gains distributions of regulated investment companies from personal dividend income. The revisions to personal income for 1982–94 do not affect the annual estimates of the payments or liabilities series for this period. Only the quarterly estimates of the liabilities series are affected because they are derived by the interpolation of the annual estimates using quarterly estimates of selected components of NIPA personal income, but the revisions are small. The revised quarterly estimates of the liabilities series are available on request; for information, write to the Government Division (BE–57), Bureau of Economic Analysis, U.S. Department of Commerce, Washington, DC 20230.