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Volume Title: The Personal Exemptions in the Income Tax

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Volume Publisher: UMI

Volume ISBN: 0-870-14482-0

Volume URL: <http://www.nber.org/books/selt68-1>

Publication Date: 1968

Chapter Title: Quantitative Aspects of the Role of the Exemptions and Associated Factors in Expanding the Coverage and Yield of the Income Tax

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Chapter URL: <http://www.nber.org/chapters/c1149>

Chapter pages in book: (p. 58 - 84)

Quantitative Aspects of the Role of the Exemptions and Associated Factors in Expanding the Coverage and Yield of the Income Tax

1. TRANSFORMED COVERAGE OF THE INCOME TAX

In most years before 1940, taxable returns under the income tax covered less than 5 per cent of the population, including taxpayers and their dependents, and less than 30 per cent of the total of individual incomes (Charts 3 and 4 and Tables 9 and 10). But the coverage of the income tax was transformed by the wartime reductions in exemption levels and the accompanying and subsequent expansion of economic activity and price inflation. As early as 1944 and 1945, when the ordinary exemptions were reduced to \$500 for single persons and \$1,000 for married couples, and *no* exemption was allowed for dependents for the purpose of the normal tax, taxable returns rose to cover about 74 per cent of the population and 83 per cent of total individual income. These proportions fell abruptly immediately thereafter—more markedly for population than for income—when the exemption for dependents, which had been raised in 1944 from \$350 to \$500 for the surtax alone, was also made applicable to the normal tax. After some recovery, a renewed fall occurred in 1948 and 1949, following the increase from \$500 to \$600 in the uniform per capita exemptions. But this fall was short-lived; it was succeeded by an almost uninterrupted annual increase in the proportion of the population and in the country-wide total of individuals' adjusted gross income covered on taxable returns. In recent years, taxable returns have accounted for three-fourths

of the population and about 87 per cent of total adjusted gross income. The coverage of the tax since 1939, including nontaxable returns, has risen from less than 12 per cent of the population and less than 40 per cent of total adjusted gross income to more than 90 per cent of each in recent years (Tables 11 and 12).

More important from the standpoint of revenue capacity has been the increase in coverage as measured by the proportion of the country's total adjusted gross income that became *taxable income*, i.e., that actually became subject to the tax rates (Table 13). The income of many persons filing tax returns is kept outside of the taxable category by the personal exemptions and nonbusiness deductions. But if their incomes become expanded significantly by fuller and more remunerative employment or inflation, or both, much of the additions to their incomes becomes newly taxable. This is so because relatively little of the added adjusted gross income is absorbed by personal exemptions and nonbusiness deductions. Likewise little of such absorption occurs when additions take place to the AGI of persons who previously paid small amounts of income taxes. In consequence a larger fraction of the nation's total AGI becomes taxable income. This type of increase in the coverage of the income tax in the years following 1939 was outstanding (Table 13). Between 1939 and 1946, while the Consumer Price Index was rising 40.5 per cent, and the country's total adjusted gross income in current dollars, 141 per cent, *taxable income* rose 658 per cent. The proportion that taxable income constituted of total adjusted gross income more than tripled, rising from 13.4 per cent in 1939 to 42.2 per cent in 1946; it rose further to about 50 per cent by 1961, and was somewhat in excess of 52 per cent in 1964.

The major factors in the transformed coverage of the income tax are easily summarized:

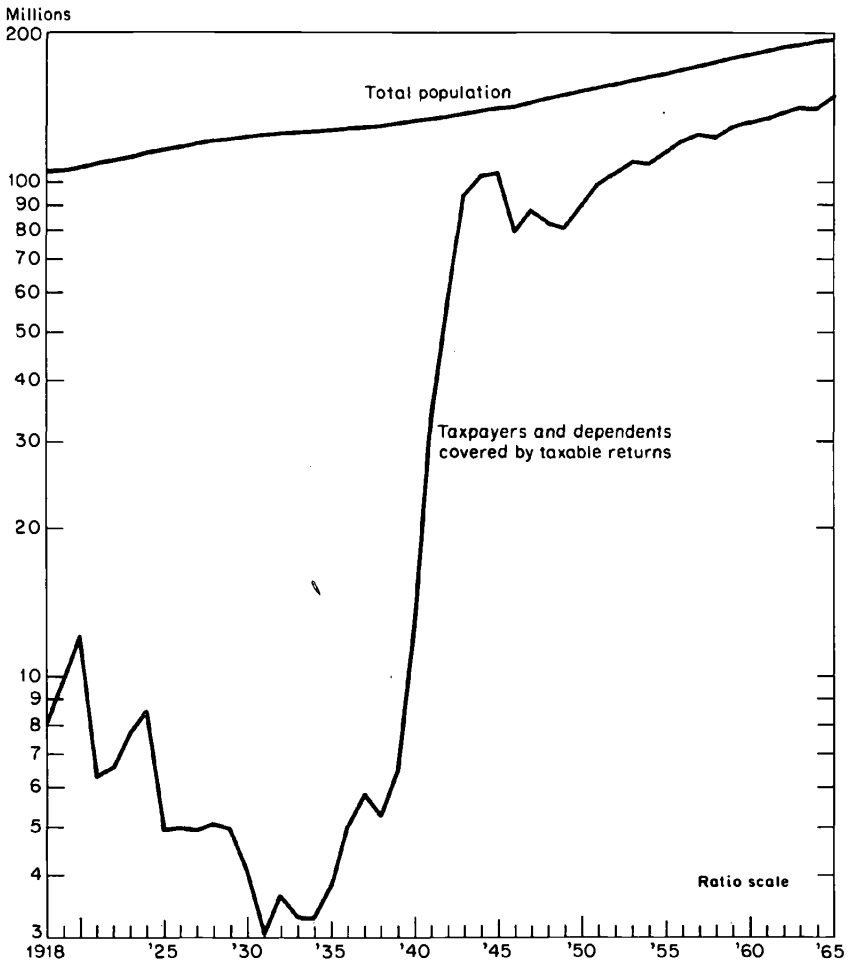
1. The dollar amount of the exemptions was cut by statute from \$1,000 to \$600, or by 40 per cent, for single persons, and from \$2,500 to \$1,200, or by 52 per cent, for married couples, though the exemption for each dependent was raised from \$400 to \$600.¹

2. The proportions of the population and of total personal income

¹ The personal exemptions were allowed only for normal tax, not for surtax, until 1934. But the surtax rates applied only to surtax net incomes of \$10,000 or more in 1924-31, and \$6,000 or more in 1932-33, thus freeing the bulk of taxpayers from liability for surtax in these periods.

CHART 3

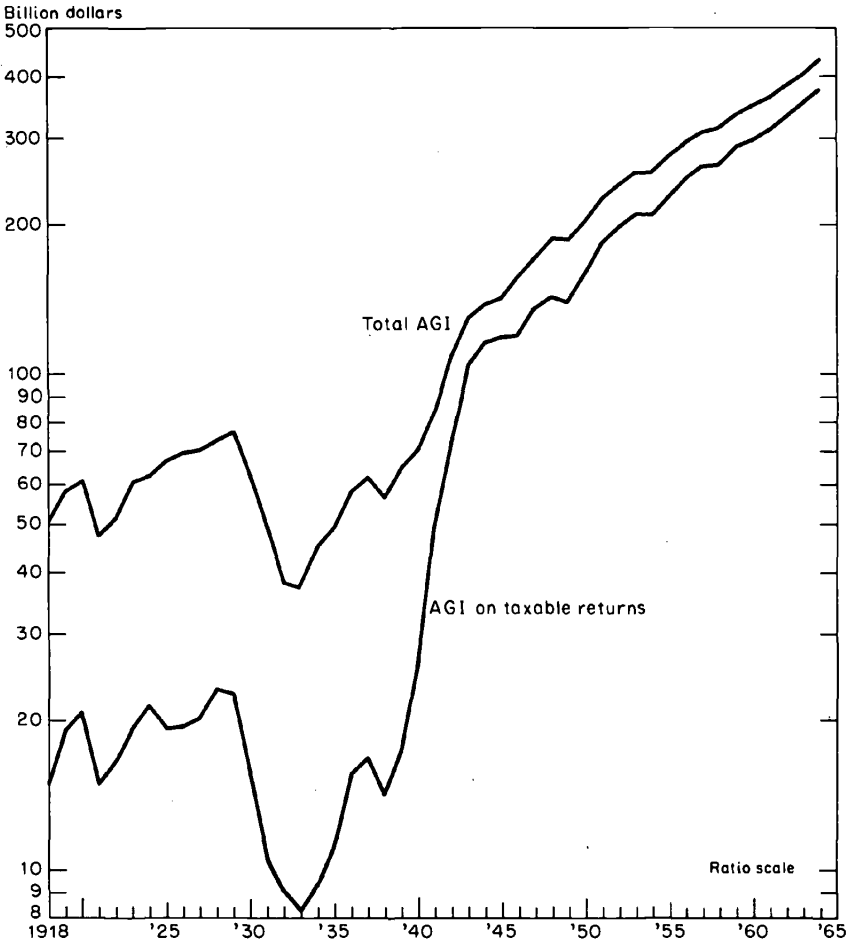
Population Covered by Taxable Returns Compared with Total Population, 1918-65



SOURCE: Table 9.

CHART 4

Adjusted Gross Income Reported on Taxable Returns Compared with Total Adjusted Gross Income, 1918-64



SOURCE: Table 10.

TABLE 9
Population Covered by Taxable Returns, 1918-65
(numbers in thousands)

Year	Number of Taxpayers and Dependents Cov- ered by Taxable Returns (1)	Total Population (2)	Percentage of Total Population Covered by Taxable Returns (3)
1918	8,075	104,550	7.7
1919	9,728	105,063	9.3
1920	12,145	106,466	11.4
1921	6,234	108,541	5.7
1922	6,571	110,055	6.0
1923	7,784	111,950	7.0
1924	8,544	114,113	7.5
1925	4,901	115,832	4.2
1926	4,960	117,399	4.2
1927	4,909	119,038	4.1
1928	5,074	120,501	4.2
1929	4,986	121,770	4.1
1930	4,102	123,188	3.3
1931	3,049	124,149	2.5
1932	3,665	124,949	2.9
1933	3,295	125,690	2.6
1934	3,281	126,485	2.6
1935	3,806	127,362	3.0
1936	5,023	128,181	3.9
1937	5,801	128,961	4.5
1938	5,231	129,969	4.0
1939	6,530	131,028	5.0
1940	12,434	132,594	9.4
1941	33,016	133,894	24.7
1942	56,434	135,361	41.7
1943	94,500	137,250	68.9
1944	103,214	138,916	74.3
1945	104,232	140,468	74.2
1946	79,246	141,936	55.8
1947	88,525	144,698	61.2
1948	82,804	147,208	56.2
1949	81,301	149,767	54.3
1950	89,671	152,271	58.9
1951	99,678	154,878	64.4
1952	104,730	157,553	66.5
1953	110,143	160,184	68.8
1954	108,710	163,026	66.7
1955	115,661	165,931	69.7
1956	121,228	168,903	71.8
1957	124,761	171,984	72.5
1958	123,126	174,882	70.4
1959	129,567	177,830	72.9
1960	132,038	180,684	73.1
1961	134,097	183,756	73.0
1962	138,220	186,656	74.1
1963	141,944	189,417	74.9
1964	143,352	192,120	74.6
1965	149,085	194,572	76.6

SOURCE: Number of taxpayers and dependents estimated from data in *Statistics of Income* for the various years; population figures are the July 1 estimates of the Bureau of the Census, *Statistical Abstract of the United States*, 1966, p. 5.

TABLE 10
Total Adjusted Gross Income Compared with Amounts Reported
on Taxable Returns, 1918-64
(dollars in millions)

Year	Total AGI	AGI on Taxable Returns	Percentage of Total AGI on Taxable Returns
1918	50,434	14,934	29.6
1919	58,660	19,117	32.6
1920	61,020	20,880	34.2
1921	47,141	14,951	31.7
1922	51,965	16,698	32.1
1923	61,035	19,396	31.8
1924	62,209	21,541	34.6
1925	67,295	19,280	28.6
1926	69,602	19,355	27.8
1927	70,347	20,157	28.7
1928	73,783	23,307	31.6
1929	76,547	22,725	29.7
1930	63,149	15,429	24.4
1931	49,879	10,405	20.9
1932	38,037	9,006	23.7
1933	37,297	8,290	22.2
1934	45,012	9,331	20.7
1935	49,228	11,140	22.6
1936	58,395	15,664	26.8
1937	62,289	16,897	27.1
1938	56,281	14,123	25.1
1939	65,475	17,467	26.7
1940	70,693	25,875	36.6
1941	85,973	49,319	57.4
1942	107,886	72,670	67.4
1943	130,240	104,562	80.3
1944	138,443	115,173	83.2
1945	141,288	118,104	83.6
1946	157,863	118,721	75.2
1947	173,159	135,891	78.5
1948	187,029	142,667	76.3
1949	186,153	139,108	74.7
1950	203,260	159,256	78.4
1951	228,260	183,935	80.6
1952	242,324	197,331	81.4
1953	256,862	210,484	81.9
1954	255,571	209,669	82.0
1955	275,673	229,595	83.3
1956	296,578	249,551	84.1
1957	309,441	262,169	84.7
1958	314,035	262,188	83.5
1959	336,738	287,775	85.5
1960	349,373	297,152	85.1
1961	361,693	311,283	86.1
1962	383,067	330,646	86.3
1963	403,390	350,447	86.9
1964	434,617	376,005	86.5

SOURCE: Total adjusted gross income estimates: 1918-28 from C. Harry Kahn, *Business and Professional Income Under the Personal Income Tax*, Princeton for NBER, 1964, Appendix C; 1929-64 from C. Harry Kahn, *Employee Compensation Under the Income Tax*, New York, NBER, 1968; tax return figures from *Statistics of Income*. Both series exclude fiduciaries after 1952.

TABLE 11
Population Covered by Taxable and Nontaxable Returns, for Selected Years
(numbers in thousands)

Year	Number of Taxpayers and Dependents Cov- ered by Taxable and Nontaxable Returns	Total Population	Percentage of Total Population Cov- ered by Taxable and Nontaxable Returns
1918	10,795	104,550	10.3
1926	9,306	117,399	7.9
1933	8,589	125,690	6.8
1939	15,288	131,028	11.7
1946	123,008	141,936	86.7
1951	139,626	154,878	90.2
1953	148,815	160,184	92.9
1955	154,681	165,931	93.2
1957	161,489	171,984	93.9
1959	165,301	177,830	93.0
1960	168,543	180,684	93.3
1961	170,604	183,756	92.8
1962	172,577	186,656	92.5
1963	176,168	189,417	93.0
1964	179,510	192,120	93.4
1965	182,708	194,572	93.9

SOURCE: Number of taxpayers and dependents estimated from data in *Statistics of Income* for the various years; population figures are the July 1 estimates of the Bureau of the Census, *Statistical Abstract of the United States*, 1966, p. 5.

covered by the income tax were further enlarged by the rise in incomes resulting from fuller employment of human and material resources and from other real gains in productivity during and following World War II. The gross national product in constant 1958 dollars, as measured by the Department of Commerce, increased from \$209.4 billion in 1939 to \$324.1 billion in 1949, \$475.9 billion in 1959, and \$652.6 billion in 1966.

3. Large increases in money incomes were brought about by the inflation of prices that partly accompanied and more pronouncedly followed World War II. Even in the period 1939-45, despite heavy un-

TABLE 12

Total Adjusted Gross Income Compared with Amounts Reported on Taxable and Nontaxable Returns, for Selected Years
(dollars in millions)

Year	Total Adjusted Gross Income	Adjusted Gross Income on Taxable and Nontaxable Returns	Percentage of Adjusted Gross Income on Taxable and Nontaxable Returns
1918	50,434	17,081	33.9
1926	69,602	24,606	35.4
1933	37,297	12,964	34.8
1939	65,475	24,920	38.1
1946	157,863	134,754	85.4
1951	228,260	203,028	88.9
1953	256,862	228,708	89.0
1955	275,673	248,530	90.2
1957	309,441	280,321	90.6
1959	336,738	305,095	90.6
1960	349,373	315,466	90.3
1961	361,693	329,861	91.2
1962	383,067	348,701	91.0
1963	403,390	368,778	91.4
1964	434,617	396,660	91.3

SOURCE: Total adjusted gross income estimates: 1918-28 from C. Harry Kahn, *Business and Professional Income Under the Personal Income Tax*, Princeton for NBER, 1964, Appendix C; 1929-64 from C. Harry Kahn, *Employee Compensation Under the Income Tax*, New York, NBER, 1968; tax return figures from *Statistics of Income*. Both series exclude fiduciaries after 1952.

employment during the first eighteen months and price controls thereafter, the Consumer Price Index of the United States Bureau of Labor Statistics, with 1957-59 as a base, rose by 29.5 per cent. Ten years later this index was 92.8 per cent above its 1939 level. In his study, *Inflation in the United States, 1940-1948*, Professor Lester V. Chandler found that by mid-1948 the average hourly wages of American workers had risen to approximately twice their levels in 1939, while output per man-hour worked had risen much less, and that this dis-

TABLE 13
Adjusted Gross Income, Personal Exemptions, Nonbusiness Deductions, and
Taxable Income, Selected Years, 1918-64
(billion dollars)

	1918	1926	1929
1. Total adjusted gross income	50.4	69.6	76.5
2. Minus: amounts not on taxable returns	35.5	50.2	53.0
Amount unreported on any returns	2.6	3.7	4.2
Effective personal exemptions on nontaxable returns	31.3	41.5	40.3
Effective nonbusiness deductions on nontaxable returns	1.6	5.0	8.5
Earned income credit			
3. Equals: adjusted gross income on taxable returns	14.9	19.4	23.5
4. Minus:			
Personal exemptions on taxable returns	5.8	6.2	6.3
Nonbusiness deductions on taxable returns	1.0	1.9	2.2
Earned income credit			
5. Equals: taxable income on taxable returns	8.1	11.2	15.0

SOURCE: Estimate of total AGI: 1929-64 from C. Harry Kahn, *Employee Compensation Under the Income Tax*, New York, NBER, 1968; and 1918-26 from C. Harry Kahn, *Business and Professional Income Under Personal Income Tax*, Princeton for NBER, 1964, Appendix C. The figures relating to tax returns are from *Statistics of Income*, except that the "effective" amounts of personal exemptions and nonbusiness deductions on nontaxable returns—the amounts used by individuals filing nontaxable returns to reduce their taxable incomes to zero—were estimated by dividing the total AGI on these returns between effective exemptions and effective deductions in the same relative pro-

crepancy was a major contributing factor to the height of the inflation.² The increase in real product per man-hour in the private nonagricultural economy was 52.9 per cent in this period, according to the indexes of the Department of Labor.³ Prices continued to advance in subsequent years. In the whole period from 1939 to 1966, the Consumer Price Index rose by 134 per cent, and wholesale prices, by 151 per cent. The gross national product in current dollars increased from \$90.5 billion to \$743.3 billion, a percentage rise more than 3.4 times that of the increase in terms of constant 1958 dollars.

² New York, 1951, p. 325.

³ *Trends in Output per Man-Hour in the Private Economy, 1909-1958*, Bulletin 1249, 1959, p. 17.

1933	1939	1941	1946	1951	1955	1961	1964
37.3	65.5	86.0	157.9	228.3	275.7	361.7	434.6
28.2	47.5	36.2	38.4	44.8	46.0	52.0	58.6
1.9	3.8	9.5	20.2	23.3	24.9	30.8	37.9
22.3	38.4	24.3	16.7	19.6	18.8	18.1	15.2
4.0	2.8	1.4	1.6	1.9	2.3	3.2	5.5
	2.4	1.1					
9.1	18.0	49.8	119.5	183.5	229.7	309.7	376.0
3.1	6.6	22.6	39.6	61.4	71.2	82.5	88.3
0.9	1.7	3.8	13.2	22.5	30.5	47.1	58.4
	0.9	3.6					
5.1	8.8	19.8	66.7	99.6	128.0	180.1	229.3

portions as the total exemptions and deductions on these returns.

In 1964, exemptions and deductions on nontaxable returns totaled \$32.6 billion, as against total AGI of \$20.7 billion, rendering about \$.12 billion of the exemptions and deductions ineffective. AGI unreported on any returns includes amounts received by individuals who did not file returns because their gross incomes were lower than the filing minima, possible underreporting by others, and possible errors in data or estimating procedures.

The combination of these three factors brought about a prodigious expansion in the dollar amount of income actually subjected to the tax rates (Table 13). From \$11.2 billion in 1926 and \$15.0 billion in 1929, this amount had shrunk to a low of \$5.1 billion in 1933. By 1941 it was at a new high of \$19.8 billion, from which it soared rapidly to \$66.7 billion by 1946, \$128.0 billion by 1955, and \$229.3 billion in 1964.

2. SPECTACULAR RISE IN TAX REVENUES

In the same period that taxable income was making its sharpest gains—the years after 1940—steep increases were made in the tax rates, most

notably in the rate applicable to the very first bracket of taxable income after the personal exemptions and deductions. For 1929, the beginning rate had been only three-eighths of 1 per cent, after the tax credit then in force for earned income; and the maximum rate had been slightly less than 24 per cent.⁴ By 1951, the starting rate had been raised to 22.2 per cent and the maximum to 92 per cent (reduced in 1954 to 20 and 91 per cent, respectively). The effects of the increases in tax rates on the revenue yield of the income tax were, of course, compounded by the expansion of actually taxable income that resulted from the lowering of the personal exemptions and the rise in personal incomes.

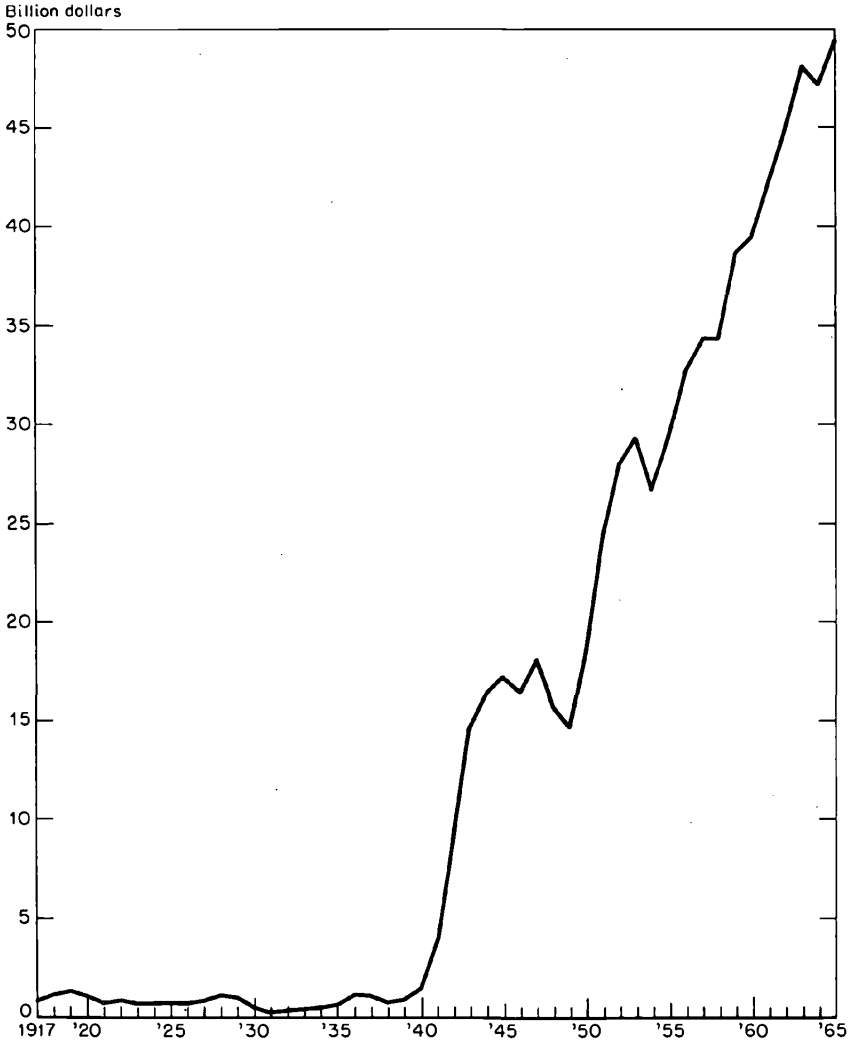
The result was a spectacular rise in tax revenues (Chart 5 and Table 14). Prior to 1940, even under the high tax rates of World War I, the annual yield of the personal income tax had never reached \$1.5 billion. It averaged well under \$1 billion during the prosperous decade of the twenties, and fell to less than one-half that amount in several years of the thirties. Now, under the impact of the forces just noted, the total of individual income tax liabilities rose from less than \$1 billion in 1939 to \$14.6 billion in 1943, \$24.4 billion in 1951, \$34.4 billion in 1957, and \$49.5 billion in 1965. Individual income tax revenues in 1929 had equaled 1.32 per cent of the country's total adjusted gross income of individuals; this proportion was 1.43 per cent in 1939, 10.4 per cent in 1946, and 10.8 per cent in 1964.

While the increases in tax rates and the growth in personal incomes were conspicuous as sources of the growth in revenues, the large role played by the reductions in personal exemptions is not as widely appreciated. To obtain a rough indication of the influence of the latter (a precise measure is impossible because of various other simultaneous changes, and particularly, because of the interaction of these changes), we calculated the reductions in taxable income and tax liability that would have resulted if we applied to the various classes of taxable returns filed in 1959 the dollar scale of personal exemptions that had

⁴ The statutory bracket rate for the first \$4,000 of normal tax net income in 1929-31, after certain credits, was 1½ per cent, that for the second \$4,000, 3 per cent, and that for the balance, 5 per cent, but these rates were each reduced by one percentage point for 1929 by a Joint Resolution of Congress (signed by the President on December 16, 1929) and were further reduced by a tax credit for earned income.

CHART 5

Total Individual Income Tax Liabilities, 1917-65



SOURCE: Table 14.

The Personal Exemptions in the Income Tax

TABLE 14
Total Individual Income Tax Liabilities, 1917-65
(million dollars)

Year	Individual Income Tax Liabilities	Year	Individual Income Tax Liabilities
1917	795	1942	8,925
1918	1,128	1943	14,590
1919	1,270	1944	16,347
1920	1,075	1945	17,226
1921	719	1946	16,281
1922	861	1947	18,179
1923	662	1948	15,618
1924	704	1949	14,682
1925	735	1950	18,584
1926	732	1951	24,439
1927	831	1952	28,038
1928	1,164	1953	29,431
1929	1,002	1954	26,666
1930	477	1955	29,614
1931	246	1956	32,732
1932	330	1957	34,394
1933	374	1958	34,336
1934	511	1959	38,645
1935	657	1960	39,464
1936	1,214	1961	42,225
1937	1,142	1962	44,903
1938	766	1963	48,204
1939	929	1964	47,153
1940	1,496	1965	49,530
1941	3,908		

SOURCE: *Statistics of Income*. Includes fiduciary returns in 1917-52 but not thereafter. Tax liabilities are after tax credits. Figure for 1943 is for Income and Victory Tax liability on 1943 incomes without regard to the amount of tax forgiven (\$1.018 million) under the Current Tax Payment Act of 1943 for individuals liable to income tax on both 1942 and 1943 incomes. Various minor differences in methods of tabulating and estimating in various years are noted in *Statistics of Income* for 1943 for that and prior years, and in the subsequent annual volumes for later years.

been in force in 1929, but retained the 1959 scale of tax rates, tests of dependency, and extra exemptions for the aged and blind.

We found that the amount of income actually subject to any of the bracket rates of tax in 1959 (termed "taxable income" under the Internal Revenue Code of 1954) would have been reduced from \$166.4 billion to \$100.2 billion, or by about 40 per cent, and that the total income tax liability would have been reduced by about \$14 billion, or 37 per cent.⁵ In short, despite the huge rise in aggregate personal income and the sharp increases in tax rates, a substantial part of the increase in revenue yield of the individual income tax since 1929 must be attributed to the reductions in the personal exemptions.

The potent effects of the reductions in personal exemptions in these circumstances are easily explained: (1) they added millions of persons and their incomes to the tax rolls; (2) they added to the taxed income of nearly all other taxpayers; (3) the resulting additions to taxed income forced much income into higher rate brackets, and these additions were taxed, in effect, at each taxpayer's highest bracket rate; and (4) the revenue effects of these additions to taxed income were accentuated by the accompanying increase in bracket tax rates.

3. RADICAL SHIFT IN DISTRIBUTION OF TAX LIABILITIES AMONG INCOME GROUPS

A radical shift in the relative contributions of the different income groups to the revenue yield of income tax was produced by the combination of the reductions in personal exemptions, the rise and altered distribution of personal income,⁶ and the sharp increases in tax rates, particularly in the rate applicable to the first bracket of taxable income. In 1929, taxpayers with net incomes of \$20,000 or more accounted for

⁵ The reductions would have been somewhat smaller, about 38 per cent and 36 per cent, respectively, if the more restrictive definition of a dependent in 1929 and the absence of extra exemptions for the aged and blind were also applied to the 1959 tax returns.

⁶ See Tables 123 and 125 in Simon Kuznets, *Shares of Upper Income Groups in Income and Savings*, New York, NBER, 1953, for figures showing the altered distribution of various sources of personal incomes.

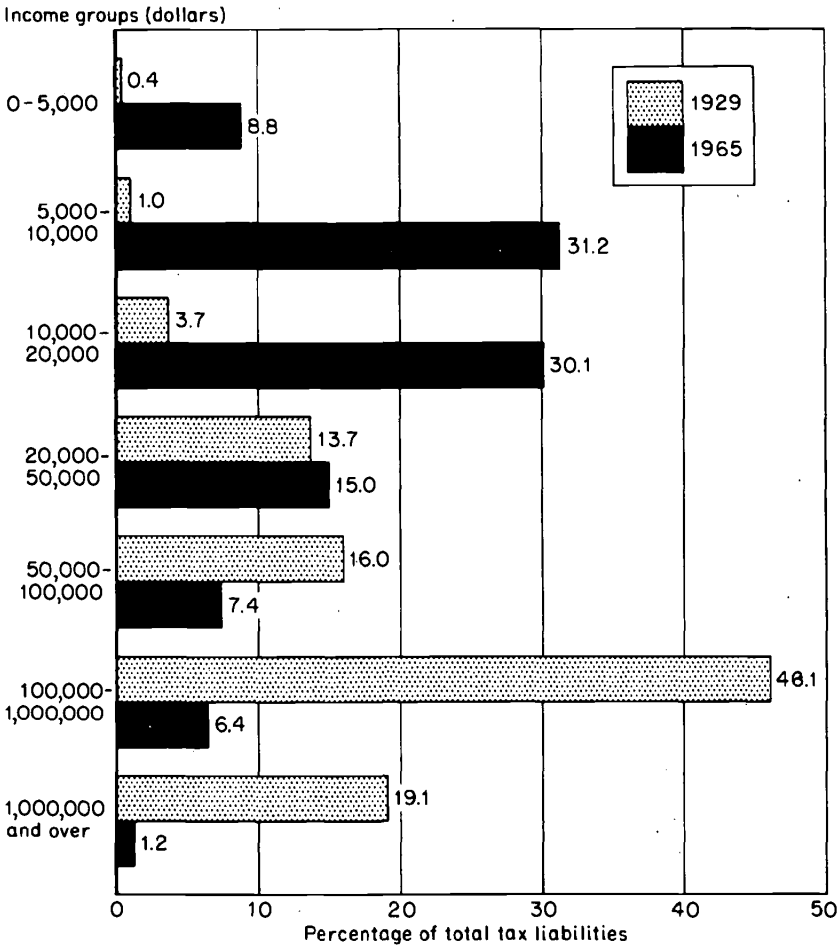
nearly 95 per cent of all revenues from the personal income tax; those with net incomes between \$10,000 and \$20,000 accounted for about 4 per cent, leaving only a little more than 1 per cent to be accounted for by those with incomes under \$10,000 (Chart 6 and Table 15). In 1965, in contrast, taxpayers with adjusted gross incomes of \$20,000 or more accounted for only 30 per cent of total income tax revenue, while those with adjusted gross incomes under \$10,000 accounted for 40 per cent.

It need scarcely be observed that these shifts were not due to a net reduction of taxes on large incomes. Tax rates were in fact raised drastically for all taxpayers. But whereas the income tax revenue needs of 1929 were so small that the vast majority of income recipients could be completely exempted from tax and only small or moderate rates imposed on the others, the revenues sought during and since World War II could be raised only by extending the coverage of the tax to most incomes and by raising the tax rates radically.

That the rise in and wider diffusion of personal incomes have continued since the end of World War II to contribute to the altered distribution of tax liabilities among the different income groups is reflected in Table 16. This table shows the changed distribution between 1948 and 1965 of the number of taxable returns and of total adjusted gross income on taxable returns among the principal income groups, though allowance must be made for the reduced purchasing power of the dollar in interpreting the figures. In 1948, when the law first permitted income-splitting between husbands and wives filing joint returns, 48 per cent of the taxable returns came from adjusted gross incomes of less than \$3,000; 84 per cent from those less than \$5,000. By 1965, when the Consumer Price Index was 31 per cent higher, the proportion of taxable returns with adjusted gross incomes under \$3,000 had shrunk by more than one-half, to 17 per cent, while the proportion with adjusted gross incomes of \$5,000 and more had risen to 64 per cent. The biggest (absolute) rise occurred in the \$5,000 to \$10,000 group, which rose from 12.8 per cent of the total to 42.9 per cent. Whereas total adjusted gross income on taxable returns rose by 188 per cent in 1948-64, the amount reported by those with incomes under \$3,000 fell about 50 per cent; whereas the amount for incomes between \$3,000 and

CHART 6

How the Different Income Groups Shared the Income Tax Burden in 1965 as Compared with 1929



SOURCE: Table 15.

The Personal Exemptions in the Income Tax

TABLE 15
Comparison of Income Tax Liability in 1929, 1955, and 1965,
by Income Groups, Individual Returns

Adjusted Gross Income Group (thousand dollars) ^a	Tax Liability ^b (million dollars)			Percentage of Total Tax Liability		
	1929	1955	1965	1929	1955	1965
0-1	^c	42	5	^d	.1	^d
1-2	^c	569	329	.1	1.9	.7
2-3	1	1,346	769	.1	4.5	1.6
3-5	2	5,511	3,235	.2	18.6	6.5
5-10	10	10,614	15,434	1.0	35.8	31.2
10-20	37	4,001	14,901	3.7	13.5	30.1
20-50	137	3,669	7,440	13.7	12.4	15.0
50-100	161	1,852	3,654	16.0	6.3	7.4
100-150	100	653		9.9	2.2	
150-300	159	622	2,752	15.9	2.1	5.6
300-500	97	233		9.7	.8	
500-1,000	106	210	408	10.6	.7	.8
1,000 and over	191	291	603	19.1	1.0	1.2
Total	1,002	29,614	49,530	100.0	100.0	100.0

SOURCE: *Statistics of Income* for 1929, 1955, and 1965. The figures for the income classes \$150,000-\$300,000 and \$300,000-\$500,000 for 1955 were estimated by interpolation.

NOTE: Individual items do not always add up to totals because of rounding.

^a Tax liabilities are after tax credits.

^b By statutory net income groups in 1929.

^c Less than \$1 million.

^d Less than .05 per cent.

\$5,000 fell by 18.4 per cent, the amount between \$5,000 and \$10,000 rose 462 per cent, the amount between \$10,000 and \$25,000 rose 917 per cent, and that for incomes of \$20,000 or more rose by 295 per cent.

Of the total adjusted gross income on taxable returns, the amount reported by those with incomes under \$3,000 shrank from 24.7 per cent to 4.4 per cent of the total; the proportion for incomes between \$3,000 and \$5,000 shrank from 35.5 per cent to 10 per cent; while the pro-

TABLE 16
Distribution of Number of Returns and Adjusted Gross Income Among
Principal Income Groups, Taxable Returns, 1948 and 1965

Adjusted Gross Income Group (thousand dollars)	Returns		Adjusted Gross Income	
	Number	Per Cent of Total	Amount (thousand dollars)	Per Cent of Total
1948				
Under 3	17,371,900	47.7	35,031,019	24.7
3-5	13,160,857	36.1	50,423,885	35.5
5-10	4,666,206	12.8	29,818,294	21.0
10-20	835,983	2.3	11,254,919	7.9
20 and over	376,302	1.0	15,528,768	10.9
Total	36,411,248	100.0	142,056,885	100.0
1965				
Under 3	9,365,186	17.4	18,024,412	4.4
3-5	10,248,524	19.1	41,126,225	10.0
5-10	23,010,962	42.9	167,440,116	40.9
10-20	9,452,778	17.6	121,399,141	29.7
20 and over	1,623,344	3.0	61,346,861	15.0
Total	53,700,794	100.0	409,336,755	100.0

SOURCE: *Statistics of Income*, 1948 and 1965.

portion for incomes between \$5,000 and \$10,000 rose from 21 per cent to 40.9 per cent, that for incomes between \$10,000 and \$20,000 rose from 7.9 per cent to 29.7 per cent, and that for incomes of \$20,000 or more rose from 10.9 per cent to 15 per cent.

4. TOTAL EXEMPTIONS SHRINK AS PROPORTION OF TOTAL AGI DESPITE SHARP RISE IN EXEMPTIONS FOR DEPENDENTS

Although the total dollar value of the personal exemptions on taxable returns in recent years has risen far above the prewar and wartime levels, the proportion that this amount constitutes of the total adjusted

TABLE 17
 Personal Exemptions as Proportion of Adjusted Gross Income on
 Returns with Income Tax, 1918-65

Year	Personal Exemptions ^a (million dollars)	Per Cent of Adjusted Gross Income	Year	Personal Exemptions ^a (million dollars)	Per Cent of Adjusted Gross Income
1918	5,772	38.6	1943 ^b	48,390	46.3
1919	6,957	36.4	1944	51,631	44.8
1920	8,813	42.2	1945	52,144	44.2
1921	5,766	38.6	1946	39,654	33.4
1922	6,054	36.3	1947	44,292	32.6
1923	7,521	38.8	1948	50,888	35.7
1924	8,170	37.9	1949	50,155	36.1
1925	6,298	32.7	1950	55,243	34.7
1926	6,244	32.3	1951	61,428	33.4
1927	6,152	30.5	1952	64,535	32.7
1928	6,385	27.4	1953	67,896	32.3
1929	6,270	27.6	1954	66,966	31.9
1930	5,164	33.5	1955	71,182	31.0
1931	3,842	36.9	1956	74,648	29.9
1932	3,431	38.1	1957	76,761	29.3
1933	3,094	37.3	1958	75,817	28.9
1934	3,175	34.0	1959	79,719	27.7
1935	3,748	33.6	1960	81,207	27.3
1936	5,001	31.9	1961	82,548	26.5
1937	5,794	34.3	1962	85,097	25.7
1938	5,240	37.1	1963	87,407	24.9
1939	6,564	37.6	1964	88,337	23.5
1940	10,401	40.2	1965	91,922	22.5
1941 ^b	22,594	45.8			
1942	29,540	40.6			

SOURCE: *Statistics of Income*.

^a Personal exemptions were allowed only for normal tax, not for surtax, in 1913-33 and 1944-45; but for both in all other years. Includes fiduciary returns, 1918-52, but not thereafter.

^b Includes taxable returns without net income.

gross income on these returns has shrunk almost continuously since its all-time high of 46.3 per cent in 1943 (Table 17). By 1965, the proportion had fallen to 22.5 per cent, a new low. A pronounced decline in this proportion in recent years should not be surprising. Since taxpayers and their spouses have consistently accounted for the larger part of total exemptions, the drastically reduced levels of their statutory exemptions as compared with the prewar amounts, combined with the great increases in incomes, worked strongly in this direction.

That the decline was not even more pronounced was due to a striking rise in the importance of the exemptions for dependents (Table 18). Between 1939 and 1965, the dollar total of exemptions for dependents on taxable returns rose sixty-seven times, as against increases of fourteenfold and twenty-threefold, respectively, in total exemptions and total adjusted gross income. For all tax returns, taxable and nontaxable, during this period, the dollar total of all personal exemptions rose approximately sevenfold, and total adjusted gross income reported on them, fifteenfold, but the dollar total of exemptions for dependents rose twenty-six times. Whereas the exemptions for dependents had comprised less than 14 per cent of the dollar total of personal exemptions on all tax returns in most years prior to 1940, they almost constituted 40 per cent in 1965.

The most important factors contributing to this result were the substantial increases in the statutory exemption levels for dependents, the great rise in incomes, and the sharp reductions in the statutory exemptions for taxpayers and their spouses. The exemption for each dependent was raised from \$350 to \$500 in 1944, and to \$600 in 1948. The other two major influences, in multiplying the number of taxpayers, added more dependents than taxpayers to the coverage of the income tax. Between 1939 and 1965, the number of taxable returns increased from 4 million to 54 million, but the number of persons covered by them rose from 6.5 to 149 million.

The number of exemptions for dependents was also increased after 1943 by the easing of various statutory restrictions. When the allowance for dependents was first created in 1916, it was limited to dependent children under 18 years of age. In the following year, it was extended to persons incapable of self-support because physically or mentally defective. In 1918, the right to claim the allowance, then termed a credit, was extended to taxpayers who were not heads of families.

T A B L E 1 8
Exemptions for Dependents, the Aged and Blind, and Total Exemptions, 1918-65
(million dollars)

Year	All Returns				Returns with Income Tax			
	Total Exemptions	Exemptions for Aged and Blind	Exemptions for Dependents ^a	Exemptions for Dependents as Per Cent of Total	Total Exemptions	Exemptions for Aged and Blind	Exemptions for Dependents ^a	Exemptions for Dependents as Per Cent of Total
1918	8,097		769	9.5	5,772		421	7.3
1919	9,424		764	8.1	6,957		491	7.1
1920	12,835		1,270	9.9	8,813		609	6.9
1921	14,192		1,832	12.9	5,766		479	8.3
1922	14,702		2,093	14.2	6,054		535	8.8
1923	17,285		2,386	13.8	7,521		519	6.9
1924	16,329		2,319	14.2	8,170		737	9.0
1925	12,228		1,256	10.3	6,298		449	7.1
1926	12,124		1,306	10.8	6,244		500	8.0
1927	12,001		1,165	9.7	6,152		487	7.9
1928	11,859		1,191	10.0	6,385		489	7.7
1929	11,933		1,287	10.8	6,270		483	7.7
1930	11,010		1,128	10.2	5,164		397	7.7
1931	9,682		943	9.7	3,842		294	7.6
1932	8,517		1,216	14.3	3,431		343	10.0
1933	8,305		1,238	14.9	3,094		302	9.8
1934	8,876		1,247	14.0	3,175		331	10.4
1935	9,773		1,288	13.2	3,748		388	10.3
1936	11,372		1,452	12.8	5,001		487	9.7
1937	13,121		1,597	12.2	5,794		538	9.3

1938	12,930	1,528	11.8	5,240	479	9.1
1939	15,554	1,758	11.3	6,564	551	8.4
1940	26,063	3,835	14.7	10,401	916	8.8
1941	38,993	7,343	18.8	22,594	2,536	11.2
1942	44,593	10,196	22.9	29,540	4,916	16.6
1943	51,365	11,539	22.5	48,390	11,134	23.0
1944	55,684	20,025	36.0	51,631	19,045	36.9
1945	58,270	20,926	35.9	52,144	19,489	37.4
1946	61,535	21,862	35.5	39,654	11,708	29.5
1947	63,870	23,196	36.3	44,292	14,058	31.7
1948	80,071	2,577	35.5	50,888	1,175	31.2
1949	80,564	3,003	33.8	50,154	1,344	31.0
1950	83,226	2,949	35.4	55,243	1,407	32.1
1951	87,077	3,269	35.4	61,427	1,588	32.4
1952	89,779	3,310	36.1	64,535	1,661	33.5
1953	92,928	3,638	36.5	67,896	1,810	34.4
1954	93,297	3,591	37.4	66,966	1,739	35.4
1955	96,502	3,694	37.8	71,182	25,755	36.2
1956	98,681	3,789*	38.1*	74,648	1,911*	36.8*
1957	100,792	3,899	38.6	76,761	1,905	37.5
1958	100,926	3,916*	39.1*	75,817	1,941*	38.0*
1959	103,208	4,027	39.4	79,719	1,979	38.8
1960	105,183	4,057	39.9	81,207	1,984	39.3
1961	106,512	4,150	40.8	82,548	2,090	40.0
1962	107,907	4,361	39.9	85,097	2,165	39.7
1963	110,103	4,402	40.0	87,407	2,241	39.9
1964	112,352	4,646	39.9	88,337	2,320*	39.9
1965	114,445	4,820	39.4	91,922	2,471	39.9

NOTE: Individual items may not add to totals due to rounding. ^a Includes what were formerly termed "credits" for dependents and the blind.

Starred figures are estimates.

SOURCE: *Statistics of Income*. Includes fiduciary returns 1918-52, but not thereafter.

In 1944, Congress enlarged the category of dependents by removing the age limit for dependent children and eliminating the requirement that other dependents must be incapable of self-support by reason of physical or mental defect. A dependent was now required (1) to be closely related to the taxpayer, (2) to have less than \$500 gross income for the year (increased to \$600 in 1948), (3) to receive more than one-half of his support from the taxpayer, (4) to be a citizen of the United States or a resident of the United States, Canada, or Mexico, and (5) to be one who does not file a joint return with his spouse. In 1954, in addition to minor relaxations, the first of these requirements was removed and the second was eliminated for children under 19 years of age and for those over 19 who are full-time students.

*5. DRASTIC EROSION IN THE PURCHASING POWER
OF THE PERSONAL EXEMPTIONS
SINCE 1939*

It is a striking fact that the actual movements of the exemption levels in the United States over the whole period since 1913 have been generally opposite in direction to those of the cost of living. This is evident from a comparison of changes in the Consumer Price Index with changes in the exemption levels. Such a comparison is made in Table 19. It will be observed that the personal exemptions were reduced in 1917-20, when consumer prices were rising, and were raised in 1921-31, when prices were generally stationary or declining; that they were cut drastically in 1940-47, when the cost of living rose sharply; and that, following the increase from \$500 to \$600 in the per capita exemptions in 1948, they remained stationary despite a substantial and protracted rise in consumer prices. Compounding the wartime reductions in the dollar amounts of the exemptions, the greater part of which have been retained, consumer prices advanced 73 per cent between 1939 and 1948, when the present \$600 per capita exemption level was established, and they rose an additional 31 per cent between 1948 and 1965.

The resulting sharp erosion in the purchasing power or real value of the personal exemptions, after allowing for the new minimum stand-

TABLE 19
Comparison of Changes in Consumer Prices and the Personal
Exemption Levels, Selected Years, 1913-66
(dollars)

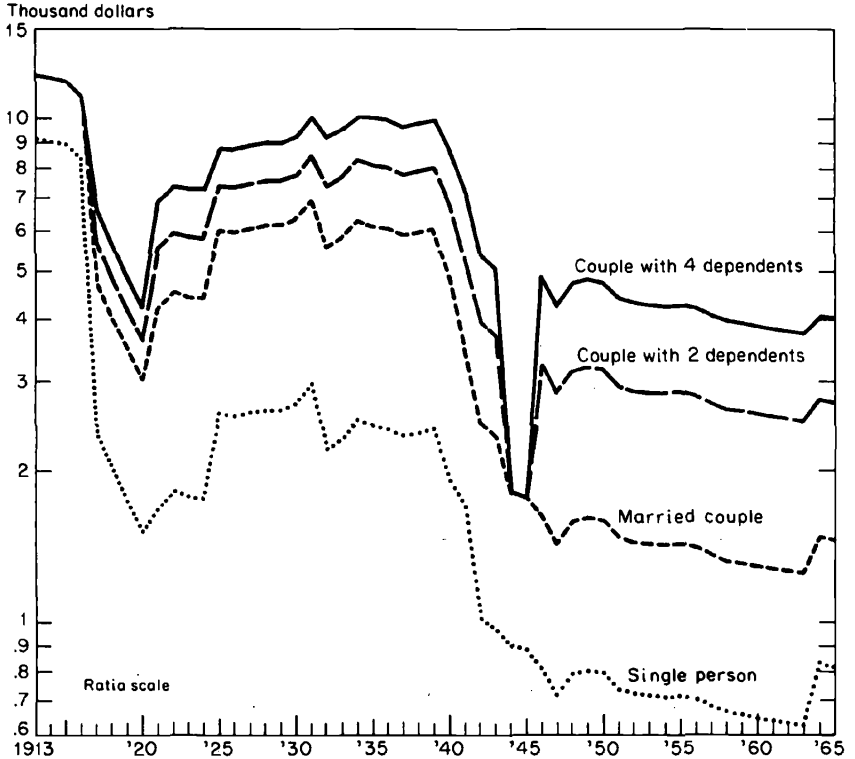
Year	Consumer Price Index (1957-59 = 100)	Personal Exemption for		
		Single Person	Married Couple	Each Dependent
1913	34.5	3,000	4,000	0
1917	44.7	1,000	2,000	200
1921	62.3	1,500	2,500	400
1925	61.1	1,000	3,500	400
1929	59.7	1,000	3,500	400
1932	47.6	1,000	2,500	400
1934	46.6	1,000	2,500	400
1939	48.4	1,000	2,500	400
1940	48.8	800	2,000	400
1941	51.3	750	1,500	400
1942	56.8	500	1,200	350
1944	61.3	500	1,000	500
1946	68.0	500	1,000	500
1948	83.8	600	1,200	600
1955	93.3	600	1,200	600
1959	101.5	600	1,200	600
1963	106.7	600	1,200	600
1964	108.1	600	1,200	600
1965	109.9	600	1,200	600
1966	113.1	600	1,200	600

SOURCE: Consumer Price Index is Bureau of Labor Statistics index for city wage-earners and clerical workers; excludes Alaska and Hawaii prior to 1964.

ard deduction in 1964, may be seen in Chart 7 and Table 20. These illustrate, by years, the equivalent in constant dollars of 1957-59 purchasing power of the maximum amount of adjusted gross income that families of different sizes could receive before incurring liability for income tax. Less than one-half as much real income could be received in 1965 as in 1939 before incurring liability for income tax.

CHART 7

Equivalent in Constant Dollars of Maximum Adjusted Gross Income Receivable Before Incurring Liability for Income Tax, 1913-65, Selected Family Sizes



SOURCE: Table 20.

TABLE 20

Equivalent in Constant Dollars of Maximum Adjusted Gross Income Receivable
Before Incurring Liability for Income Tax, 1913-66, for Selected Family Sizes

Year	AGI Before Liability for Income Tax				Consumer Price Index (1957-59 = 100)
	Single Person	Married Couple	Couple with 2 Dependents	Couple with 4 Dependents	
1913	9,151	12,203	12,203	12,203	34.5
1914	9,020	12,029	12,029	12,029	35.0
1915	8,918	11,864	11,864	11,864	35.4
1916	8,308	11,079	11,079	11,079	38.0
1917	2,353	4,709	5,651	6,593	44.7
1918	2,008	4,017	4,821	5,624	52.4
1919	1,745	3,491	4,189	4,887	60.3
1920	1,507	3,016	3,619	4,222	69.8
1921	1,689	4,223	5,575	6,928	62.3
1922	1,801	4,505	5,947	7,390	58.4
1923	1,771	4,429	5,847	7,266	59.4
1924	1,767	4,414	5,827	7,242	59.6
1925	2,583	6,029	7,408	8,786	61.1
1926	2,562	5,981	7,347	8,714	61.6
1927	2,608	6,089	7,481	8,873	60.5
1928	2,643	6,171	7,581	8,992	59.7
1929	2,643	6,171	7,581	8,992	59.7
1930	2,711	6,330	7,777	9,223	58.2
1931	2,977	6,951	8,540	10,128	53.0
1932	2,238	5,598	7,391	9,183	47.6
1933	2,333	5,834	7,703	9,570	45.1
1934	2,524	6,311	8,330	10,113	46.6
1935	2,460	6,153	8,121	10,092	47.8
1936	2,435	6,089	8,037	9,988	48.3
1937	2,352	5,882	7,764	9,648	50.0
1938	2,395	5,990	7,906	9,825	49.1
1939	2,430	6,076	8,021	9,967	48.4
1940	1,928	4,822	6,750	8,678	48.8
1941	1,719	3,441	5,275	7,109	51.3
1942	1,035	2,486	3,935	5,386	56.8

(continued)

TABLE 20 (concluded)

AGI Before Liability for Income Tax					
Year	Single Person	Married Couple	Couple with 2 Dependents	Couple with 4 Dependents	Consumer Price Index (1957-59 = 100)
1943	975	2,342	3,706	5,073	60.3
1944	907	1,812	1,812	1,812	61.3
1945	887	1,772	1,772	1,772	62.7
1946	818	1,634	3,264	4,902	68.0
1947	715	1,428	2,856	4,274	77.8
1948	796	1,591	3,183	4,773	83.8
1949	804	1,606	3,213	4,819	83.0
1950	796	1,591	3,183	4,773	83.8
1951	737	1,473	2,947	4,420	90.5
1952	721	1,441	2,883	4,324	92.5
1953	716	1,430	2,862	4,292	93.2
1954	713	1,424	2,849	4,274	93.6
1955	715	1,429	2,859	4,287	93.3
1956	704	1,408	2,816	4,224	94.7
1957	681	1,360	2,721	4,082	98.0
1958	662	1,324	2,648	3,972	100.7
1959	657	1,313	2,628	3,941	101.5
1960	647	1,293	2,587	3,880	103.1
1961	640	1,279	2,560	3,839	104.2
1962	633	1,265	2,530	3,795	105.4
1963	625	1,250	2,500	3,749	106.7
1964	833	1,480	2,775	4,070	108.1
1965	819	1,456	2,730	4,004	109.9
1966	796	1,415	2,653	3,890	113.1

SOURCE: The maximum amounts of adjusted gross income in current dollars receivable before incurring liability for income tax were derived by adding the relevant personal exemptions and standard deduction; the figures were then converted into dollars of constant purchasing power by dividing them by the Consumer Price Index of the U.S. Bureau of Labor Statistics, with the average of 1957-59 as 100. For years prior to 1944, adjusted gross income figures were constructed from net income, and 5 per cent of estimated adjusted gross income was allowed for nonbusiness deductions. The figures for 1934-43 were adjusted for the earned net income deduction then allowed. No allowance was made for small differences arising from the use by many taxpayers of the simplified tax tables, nor for the option allowed taxpayers since 1954 to round their tax calculations to the nearest whole dollar, nor for the extra exemptions allowed for age and blindness, nor for the possible effects of tax credits for retirement and dividend income.