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Volume Author/Editor: Daniel Creamer assisted by Martin Bernstein

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Chapter Author: Daniel Creamer, Martin Bernstein

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ESTIMATES OF UNDERREPORTING OF DIVIDENDS AND INTEREST BY INCOME GROUPS, 1939-1948

SINCE the share of the lowest income group (lower 93 per cent in Kuznets' classification) in total dividends and interest payments is the difference between the country-wide total and the amount received by the top 7 per cent, any increase in underreporting by the top 7 per cent would increase the share of the lower 93 per cent, as would any addition to the share of dividends going to nonprofit institutions (which are included in the lower 93 per cent). Both factors, it seems, were operating during the 1940's. That underreporting in general increased during the war years, despite the tremendous broadening of the tax base from 18 to 43 million taxable returns, is clearly established by the figures in Table F-1. It must be more than coincidental that the first large relative decline in reported dividends occurs between 1941 and 1942, when there was a sharp upward revision in tax rates (Table 34).

This deficiency in reported dividends can be traced to three sources: (1) temporary exemption from filing income tax returns given to members of the armed forces serving abroad or on sea duty,¹ (2) underreporting by individuals filing returns, and (3) dividends received by nonprofit institutions not obliged to file tax returns. Any relative increase in nonreporting and underreporting—categories 1 and 2—by individuals in the top 7 per cent would exaggerate the share received by the lower 93 per cent. Some of the dividend recipients among the armed forces, temporarily exempt from filing, probably had incomes that placed them in the top 7 per cent. Their quantitative importance, however, cannot be estimated.

Substantial underreporting by the top 7 per cent, particularly by those toward the bottom of that bracket, is suggested by the Bureau of Internal Revenue's sample audit of 1948 tax returns. Preliminary estimates by Daniel Holland based on unpublished tabulations of the Bureau of Internal Revenue indicate that about 69 per cent of the amount of the dividends detected by the authorities as unreported can be attributed to taxpayers with incomes over \$7,000,

¹ "Beginning 1941, members of the Armed Forces serving abroad or on sea duty may postpone the filing of returns and payment of tax until the 15th day of the sixth month following the month in which they return to the United States (but not beyond June 15, 1948)." *Statistics of Income for 1945*, Bureau of Internal Revenue, Part 1, p. 352.

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TABLE F-1

Number of Taxable Income Tax Returns,
and Dividends and Interest Reported as Percentage
of Dividends and Interest Received, 1939-1948

	Taxable Returns (thousands)	Dividends Reported as % of Total Dividends Received (per cent)	Interest Reported as % of Total Interest Received (per cent)
1939	3,959	79.1	23.0
1940	7,505	85.7	26.6
1941	17,587	88.7	32.3
1942	27,718	82.2	33.8
1943	40,319	78.7	32.5
1944	42,447	n.a.	n.a.
1945	42,764	n.a.	n.a.
1946	38,037	78.5	27.1
1947	41,689	80.7	24.6
1948	36,513	81.7	23.4

n.a. = not available.

Column

Source

- 1 Taxable individual and fiduciary income tax returns: *Statistics of Income for 1945*, Bureau of Internal Revenue, Part I, p. 219, and preliminary releases of *Statistics of Income* after 1945.
- 2 Dividends and interest reported on taxable individual and fiduciary income tax returns as percentages of total dividends and total interest received: unpublished memorandum of Daniel Holland, National Bureau of Economic Research.

who received 77 per cent of all dividends eventually reported on individual tax returns.

If nonprofit institutions had increased their share of dividends, this also would exaggerate the share received by the lower 93 per cent. To judge by the crude estimates now available, private nonprofit organizations did not increase their share of stocks, hence of dividends, during the war but did during the postwar years.²

² Raymond Goldsmith estimates the market value of equities outstanding, excluding intercorporate holdings, at \$82.3, 127.7, and 131.6 billion in 1939, 1945, and 1949, respectively. The book value of equities owned by nonprofit institutions is placed by the same estimator at \$1.7, 2.7, and 3.6 billion for the same selected years. On a percentage basis the institutional holdings represent 2.1, 2.1, and 2.7 per cent of all equities for 1939, 1945, and 1949, respectively. These estimates have been prepared for the Capital Requirements Study of the National Bureau of Economic Research. Estimates of all equities are from Raymond W. Goldsmith, *The Share of Financial Intermediaries in National Wealth and National Assets, 1900-1949*, National Bureau of Economic Research, Occasional Paper 42, 1954, Table 16, p. 69; estimates of equity holdings by private nonprofit institutions are from Raymond W. Goldsmith, "Estimate

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In the case of interest receipts there were no significant shifts in the shares received by the three income-size groups between 1937 and 1943, despite a substantial increase in the proportion of interest reported by taxpayers. However, some time between 1943 and 1946 a shift occurred in favor of the lower 93 per cent, and between 1946 and 1948 their share continued to increase, which was not the case with dividends. This increasing share of interest received by the lowest income group is correlated with the relative decline in the interest reported on individual tax returns. Underreporting increased continuously from 1943 to 1948.

Both phenomena probably can be traced to the same factor: the accrued interest on Series A to F savings bonds issued by the federal government enters the country-wide total of personal interest receipts, but it is a widespread practice for individuals to report this type of interest receipt, if at all, on a cash basis. Accordingly, most of the accrued interest earned by the holders of these savings bonds in the top 7 per cent is counted as interest received by the lower 93 per cent.

The maximum size of this distortion in 1948 can be estimated. The Federal Reserve Board in its postwar Surveys of Consumer Finances has shown that the 10 per cent of the nation's spending units with the highest incomes owned 43 per cent of all personal holdings of liquid assets in 1948. These Surveys also show that the distribution of all liquid assets and that of Series A to F savings bonds are very similar by income-size classes, at least in 1950, when the two distributions can be reliably compared (see Table F-2). We assume, therefore, that the upper 10 per cent owned also 43 per cent of all savings bonds in 1948. On this assumption and on the assumption that the top 10 per cent did not report any interest on savings bonds, we estimate that about \$405 million in federal government interest, or 8 per cent of total monetary interest, actually accrued to the top 10 per cent in 1948 but was counted as having been received by the lower 90 per cent (see Table F-2). Again, we point out that it must be more than accidental that the gain in the interest share received by the lower 93 per cent between 1943 and 1948 was about 6.5 percentage points. Another factor that might help to account for this shift in dividends and interest is that the relative decline in property incomes placed those who received their income mainly from prop-

of the Aggregate Value and the Distribution of the Nonoperating Assets of Private Nonprofit Institutions, Selected Years, 1900-1949," mimeographed, NBER, Work Memorandum 36, 1952, Table 1, p. 2.

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TABLE F-2

Derivation of 1948 Accrued Interest on United States Savings Bonds,
Series A to F, Received by 10 Per Cent of the Population
with Highest Annual Incomes in 1947
(dollars in millions)

1. Value of A to D savings bonds outstanding ^a	\$2,250
2. Value of E savings bonds outstanding ^a	\$32,188
3. Value of A to E savings bonds outstanding ^a (1 + 2)	\$34,438
4. Computed annual interest rate, A to E bonds	2.9%
5. Accrued interest on A to E savings bonds (3 × 4)	\$999
6. Value of F savings bonds outstanding ^a	\$3,505
7. Computed annual interest rate, F bonds	2.53%
8. Accrued interest on F savings bonds (6 × 7)	\$89
9. Total accrued interest on A to F savings bonds (5 + 8)	\$1,088
10. All (A to G) savings bonds outstanding ^b	\$55,197
11. Total savings bonds owned by individuals ^b	\$47,800
12. Per cent of all savings bonds owned by individuals (11 ÷ 10)	86.6%
13. Accrued interest received by individuals (9 × 12)	\$942
14. Per cent of individually owned savings bonds held by upper 10 per cent of population	43%
15. Accrued interest received by upper 10 per cent (13 × 14)	\$405
16. Total monetary interest received by individuals	\$5,092
17. Accrued interest received by upper 10 per cent as percentage of total monetary interest (15 ÷ 16)	8.0%

^a Interest-bearing debt; end-of-year figure.

^b Interest-bearing and matured debt; end-of-year figure.

Line	Source
1	<i>Treasury Bulletin</i> , Dept. of the Treasury, February 1952, Table 3, p. 37.
2	<i>Treasury Bulletin</i> , June 1952, Table 3, p. 28.
4	<i>Ibid.</i> , Table 6, note 4, p. 18.
6	<i>Ibid.</i> , Table 3, p. 29.
7	Same as source for line 4.
10	<i>Ibid.</i> , Table 2, p. 27.
11	<i>Ibid.</i> , Table 3, p. 33.
14	The figure, 43 per cent, is the percentage of all liquid assets owned by the upper 10 per cent of the population ("1951 Survey of Consumer Finances," <i>Federal Reserve Bulletin</i> , June 1951, Table 10, p. 636). The distributions of all liquid assets and of A to F savings bonds by income-size classes seem to be very similar, at least in 1950, the only year the two distributions can be reliably compared:

1950 PERCENTAGE SHARE OF:

INCOME CLASS	All Liquid Assets	A to F Bond Holdings
Under \$1,000	6	5
\$1,000-1,999	9	8
2,000-2,999	15	13
3,000-3,999	15	15
4,000-4,999	11	12
5,000-7,499	18	17
7,500 and over	26	30

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Notes to Table F-2 (continued)

In this table the distribution of liquid assets is from the "1951 Survey of Consumer Finances," as cited, Table 24, p. 643; distribution of A to F bond holdings is from letter from the Survey Research Center, University of Michigan.

- 16 *National Income Supplement, 1951, Survey of Current Business*, Dept. of Commerce, Table 37, p. 202.

erty lower in the income scale. Its quantitative importance, however, cannot be measured.³

These deficiencies in the property-income data⁴ oblige us to be cautious in interpreting any change in the shares of property income received by the highest, middle, and lowest income groups during the war and postwar years.

³ See Simon Kuznets, *Shares of Upper Income Groups in Income and Savings*, National Bureau of Economic Research, 1953, pp. 64-73, and Geoffrey H. Moore, "Secular Changes in the Distribution of Income," *Papers and Proceedings, American Economic Review*, May 1952, p. 536.

⁴ In this context also we consider the changes in the share of rent received by the three income-size groups not worth analyzing because of the weaknesses of the country-wide estimates of rent.