

# SPECIAL REPORT

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## Income Mobility and the Persistence Of Millionaires, 1999 to 2007

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### Summary

Concern over the rising gap between the rich and poor has been the primary rationale for President Obama's redistributive policies. But one important aspect of the American economy that should lessen concerns about snapshots of income inequality is the mobility of people up and down the economic ladder.

If people move quickly up and down through the income spectrum, the position they occupy at any point in time may be less of a concern. Moreover, it is natural that people at different stages in their life cycle of earnings—just entering the work force, just retired, or midlife during their peak earnings years—would occupy different rungs of the economic ladder.

Research has documented that our economy exhibits considerable mobility. Roughly half of

households move up from the bottom income quintile within ten years. Roughly 50 percent also move down from the top quintile within ten years.

This report generally confirms this same basic relationship using recent data covering the nine years from 1999 through 2007:

- Nearly 60 percent of taxpayers move up from the bottom quintile within this nine-year period.
- Nearly 40 percent of taxpayers move down from the top quintile within this nine-year period.
- Nearly 60 percent of taxpayers are in a different quintile in 2007 than they were in 1999.

### Key Findings

- *Concerns over increased income inequality should be tempered by the fact that a substantial number of households move up or down through the income distribution over time.*
- *Nearly 60 percent of households in the bottom income quintile in 1999 were in a higher quintile in 2007, and roughly 40 percent of tax returns in the top quintile in 1999 were in a lower quintile in 2007.*
- *Roughly half of millionaires during the 1999 through 2007 period attained this status just once during those nine years. Only 6 percent of this group were millionaires in all nine years.*
- *The volatile nature of capital gains realizations appears to be a major explanation for the transiency of millionaires.*

This report also focuses more narrowly on the persistence/transience of millionaires and finds that most millionaires are not millionaires for very long.

- Roughly half of millionaires were only millionaires once during the nine-year period.
- Only 6 percent were millionaires in all nine years.
- The volatile and lumpy nature of capital gains realizations appears to be a major explanation for the transiency of millionaires.

### Introduction

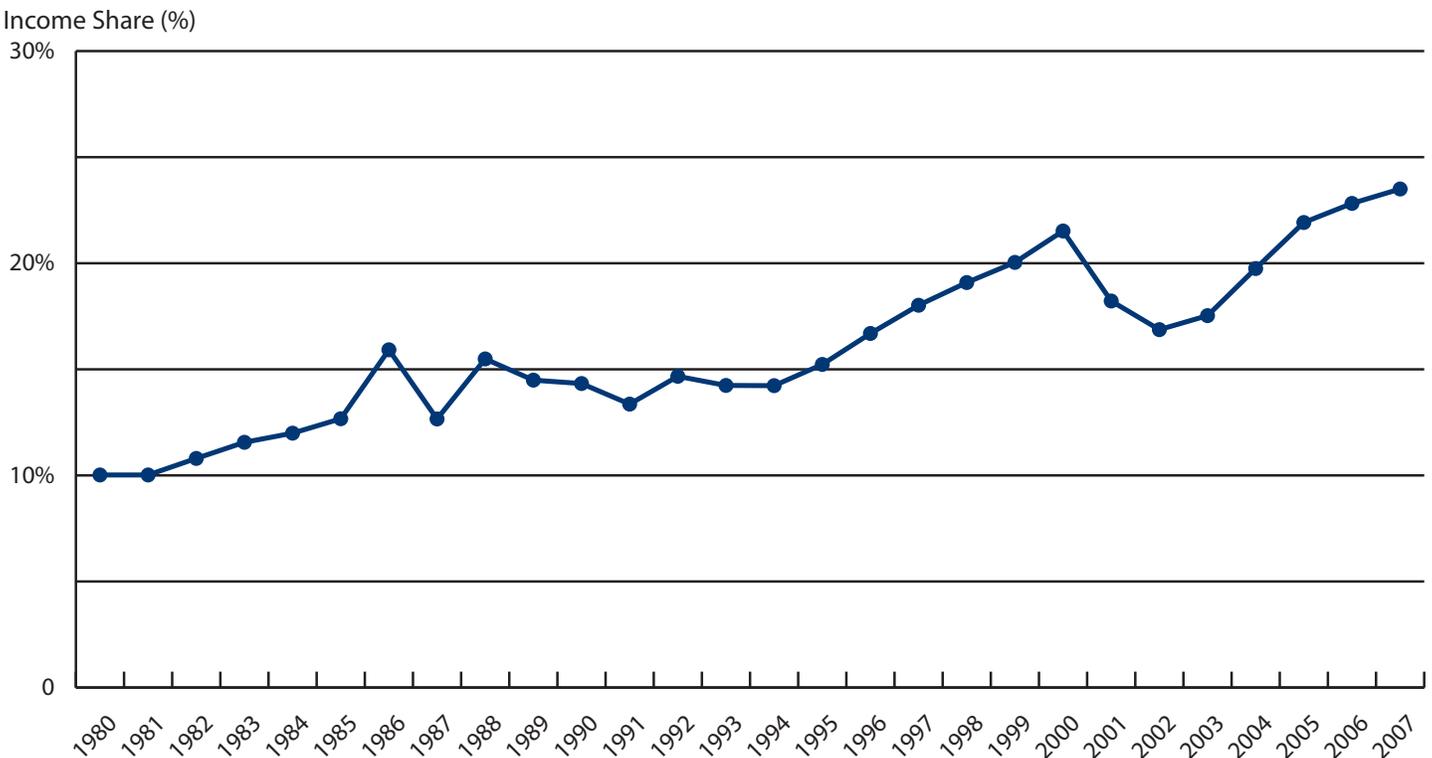
There is little doubt that the gap between rich and poor has grown over the past several decades. For example, the share of household

income received by the top 10 percent of households (i.e., the top decile) increased from 34.6 percent in 1980 to 49.7 percent by 2007.<sup>1</sup>

The trend is even more dramatic as one focuses on yet higher-income taxpayers: The share of income reported by the top 1 percent of taxpayers rose from 10.0 percent in 1980 to 23.5 percent in 2005.<sup>2</sup>

Many explanations have been put forward for these trends. An often cited explanation is the globalization of labor markets, which has caused large pools of relatively unskilled labor to compete more directly with workers from developed economies, such as the United States. Two other causes commonly cited are the changes in the returns to education and skill, which are related to the globalization of labor markets, and the declining role of unions.

*Figure 1*  
*Share of Income Reported by the Top-Earning One Percent, 1980–2007*



Source: Thomas Piketty and Emmanuel Saez. "Income Inequality in the United States, 1913–1998." *Quarterly Journal of Economics*, Vol. 118(1) (February 2003), pp. 1–39.

1 The income share of the top decile was relatively flat between 1960 and 1980, rising from just 33.5 to 34.6 (Piketty and Saez, 2003).

2 The income share for the top 1 percent was 10.0 in 1960, 9.0 in 1970, and 10.0 in 1980. (Piketty and Saez, 2003).

Reductions in tax rates have also been suggested as a contributing factor as the large increases in inequality that Figure 1 suggests began in the early 1980s also coincide with deep reductions in individual income tax rates.<sup>3</sup>

While these and similar statistics have received a lot of attention in the popular press, they are actually somewhat limited in depicting inequality and as a justification for government policy to counteract them. These data do reflect year-by-year movements of income, but they say little about available opportunities or about the distribution of success over longer periods.

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*A major shortcoming of conventional distributional analysis has been that it compares snapshots of the population at different points in time but does not account for the fact that some, and perhaps many, households move up and down the income economic ladder over time.*

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Perhaps the most important limitation of the above statistics is that they fail to capture the idea that people often occupy different places in the income distribution over time. Indeed, a major shortcoming of conventional distributional analysis has been that it compares snapshots of the population at different points in time but does not account for the fact that some, and perhaps many, households move up and down the income economic ladder over time.

If this movement of people through the income distribution is quantitatively important, income inequality in any given year may be less of a concern. As noted by Paul Krugman (1992), “If income mobility were very high, the degree of inequality in any given year would

be unimportant, because the distribution of lifetime income would be very even.”

There has been no dearth of research on income mobility. Most studies find that roughly half of those in the bottom 20 percent of households ranked by income (i.e., the bottom quintile) move up the income distribution within ten years. Similarly, about half of those in the top 20 percent of households ranked by income (i.e., the top quintile) move down the income distribution within ten years.

What is less understood, but perhaps more of a concern, are the income dynamics for those at the top of the income distribution. As Figure 1 above indicates, those at the top of the income distribution have received a larger share of the income gains over the past several decades. But, this group also receives income from more volatile sources, such as from the disposition of financial assets and earnings from small businesses.

This report takes another look at income mobility with an emphasis on those at the top of the income distribution – millionaires – and the role of capital gains and business income in affecting the relative position of these taxpayers in the income distribution.

## The Importance of Income Mobility to Changes in the Income Distribution

A family’s income can go up or down for many different reasons. Death, divorce or marriage usually causes family income to rise or fall significantly. Even more dramatic income changes occur when someone exits the work force due to unemployment or retirement, or enters the work force after graduating or updating skill levels later in life.

Economists have long pointed to the hump-shaped profile of earnings over an individual’s lifetime. First, people enter the workforce. Then they gain additional skill and experience, which allows them to increase their

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<sup>3</sup> See, for example, a series of articles on income inequality in the Spring 1997 issue of the *Journal of Economic Perspectives* (Gottschalk, 1997; Johnson, 1997; Topel, 1997; and Fortin and Lemieux, 1997).

### Prior Research Suggests Considerable Income Mobility

Numerous studies have analyzed the extent to which households' place in the income distribution changes over time. The consensus is that a considerable degree of income mobility occurs in the U.S.. Half the households in the bottom quintile move to a higher quintile within ten years, and roughly one-half of those in the top quintile are found to move to a lower quintile over the same period.

This result – that there is considerable movement of taxpayers through the income distribution over time – holds up surprisingly well for different time periods and different samples.

A study by Sawhill and Condon (1992) examined income mobility using the Panel Study of Income Dynamics (PSID) for 1967 through 1986. The authors focused on the working age population (between the ages of 25 and 54 in 1967 and 1977) and calculated what happened to their incomes over the subsequent decade (1967 through 1976 and 1977 through 1986).

The study found that 44 percent of families in the bottom quintile in 1967 had moved to a higher quintile by 1976. For the decade beginning in 1977, 47 percent of families in the bottom quintile at the start of the decade had moved to a higher quintile by the end of the decade. Slightly greater mobility was found for the top quintile with 48 percent moving down to a lower quintile in the first decade and 50 percent moving to a lower quintile in the second decade. A later study by McMurrer and Sawhill (1996b) concluded that mobility rates had remained largely unchanged during this 20-year period.

Gottschalk (1997) used the PSID data to analyze the 1974-1991 period and reported that for this 17-year period, 42 percent of households remained in the bottom quintile while 53.9 percent remained in the top quintile. Similarly, Bradbury and Katz (2002) used the PSID data to examine mobility for three periods: 1969-1979, 1979-1989, and 1988-1998. For each of the three periods, they found that roughly 50 percent of those in the bottom and top quintiles maintained the quintile positions they held at the beginning of each 10-year period.<sup>1</sup>

In 1992 the U.S. Treasury Department released two income mobility studies using a panel of tax returns for the 1979-1988 period. The first of these studies found a substantial degree of income mobility with 86 percent of taxpayers in the lowest quintile moving to a higher quintile by the end of the 10-year period. Some were quick to point out that the high degree of income mobility was the result of several methodological features.<sup>2</sup>

Krugman (1992) argued that restricting the analysis to individuals who paid taxes in all ten years introduced a bias because only the economically successful tend to pay taxes. Also, Krugman (1992) indicated that by comparing the sample with the population of all taxpayers, rather than only with taxpayers in the panel, the study treated the normal tendency of earnings to rise with age as representing income mobility. That is, according to Krugman, the college student who later gets a real job in his thirties is treated as upward income mobility in the study.

To respond to the criticisms leveled by Krugman (1992) and others, the Treasury released another study (Office of Tax Analysis, 1992b) of income mobility. The Treasury also compared the findings in their revised study to those reported by Sawhill and Condon. Applying a similar age restriction as Sawhill and Condon and using sample-based quintiles, the revised Treasury study reported tabulations based on a methodology similar to the one adopted by Sawhill and Condon. Once these modifications were made, the Treasury results were very similar to those obtained by Sawhill and Condon.

In a new study using a more detailed tax panel developed by the Treasury Department, Auten and Gee (2009) confirm the basic findings of the earlier research: roughly 50 percent of households move out of the bottom quintile and the top quintile within ten years. Importantly, this study also considers whether the degree of mobility has changed over the past two decades, but finds that this basic statistic has remained largely unchanged over this time period.

1 Burkhauser, Holtz-Eakin, and Rhody (1996) also use the PSID but focus on wage and salary incomes from 1970 to 1991.

2 The principal explanation was that the study placed taxpayers on the percentile distribution based on the population for all taxpayers in each year, rather than on the population of tax filers represented by the panel.

earnings. It is commonly thought that earnings peak in their late 40s and into their 50s. Then, earnings decline as an individual approaches their retirement years. In retirement, of course, most people rely on savings (i.e., previously earned income) and Social Security to support themselves.

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Still other factors can affect changes in income levels, particularly among those with higher incomes who are more likely to own small businesses and hold more financial assets. Owners of small businesses often experience a boom-and-bust cycle of earnings and report that volatile business income on their individual tax forms. Similarly, the tax returns of individuals who report substantial capital gains show a roller coaster effect because of holding periods and changes in the valuation of their financial assets.

Some, such as economic historian Joseph Schumpeter, have compared the income distribution to a hotel where some rooms are luxurious, spacious and have a view, but others are small and perhaps on the lower floors. All the rooms are always occupied, but people often switch rooms.<sup>4</sup> An important aspect of fairness is for those in the small rooms to have an opportunity to move up to better ones, and that the luxurious rooms are not always occupied by the same people.

Income mobility means that over time people, in effect, move from room to room. The frequency with which people move and how far they move are both crucial aspects of the changing trend in income inequality in the United States. As discussed in the sidebar, research suggests that the United States economy is sufficiently dynamic to generate rapid, significant changes in the economic fortunes of its people.

Another aspect of discussions of income distribution is the extent to which all income rises over time with an expanding economy and rising living standards. Some have likened this process to an escalator where the opportunity for mobility means that no matter which step a person starts on, he or she can move up. With an escalator, while one can get ahead faster by walking up the steps, much of the movement is due to the escalator itself.<sup>5</sup> That is, the real

**Table 1**

*More than 50 Percent of Taxpayers Moved Out of the Bottom Quintile Between 1999 and 2007*

1999 Income Quintile/Percentile	2007 Income Quintile/Percentile					Total	Top 10%	Top 5%	Top 1%
	Lowest	Second	Third	Fourth	Fifth				
Lowest	42.5%	25.1%	16.3%	10.4%	5.7%	100.0%	2.2%	0.8%	0.1%
Second	32.2%	34.7%	17.3%	10.8%	5.0%	100.0%	1.7%	0.7%	0.1%
Third	14.4%	26.0%	32.8%	17.8%	8.9%	100.0%	3.4%	1.2%	0.1%
Fourth	7.7%	10.7%	25.7%	37.7%	18.3%	100.0%	6.2%	2.2%	0.3%
Fifth	3.1%	3.8%	7.5%	23.3%	62.3%	100.0%	36.5%	20.0%	4.3%
Top 10%	2.7%	2.4%	4.4%	13.3%	77.1%	100.0%	56.7%	34.8%	8.0%
Top 5%	2.4%	1.9%	3.0%	8.2%	84.5%	100.0%	72.7%	54.2%	14.7%
Top 1%	2.3%	1.4%	1.4%	4.5%	90.5%	100.0%	85.5%	78.3%	44.6%

Note: Computations by author from the 1999-2007 SOI Individual Tax Panel.

<sup>4</sup> See Sawhill and Condon (1992) for a more detailed discussion of the hotel analogy.

<sup>5</sup> Litan and Slemrod (1999) use the escalator analogy, while McMurrer and Sawhill (1996b) use a similar analogy of moving up and down the economic ladder. In climbing a ladder, however, all the progress is due to individual effort. Holtz-Eakin, et al., (2000) connect mobility with Horatio Alger success stories.

incomes of households can increase over time with the growth of the overall economy.

### Evidence from a Panel of Tax Returns Filed from 1999 Through 2007

This report analyzes the income dynamics of taxpayers using a recent panel that follows the same tax returns from 1999 through 2007. Unlike most survey data, tax returns provide valuable and reliable detail on income. These data are also stratified by income, meaning the panel data include many high-income tax returns filed by people who often receive a substantial share of their income from capital gains and their businesses.

The tax panel is a subsample of the IRS's Statistics of Income Individual Tax Files from

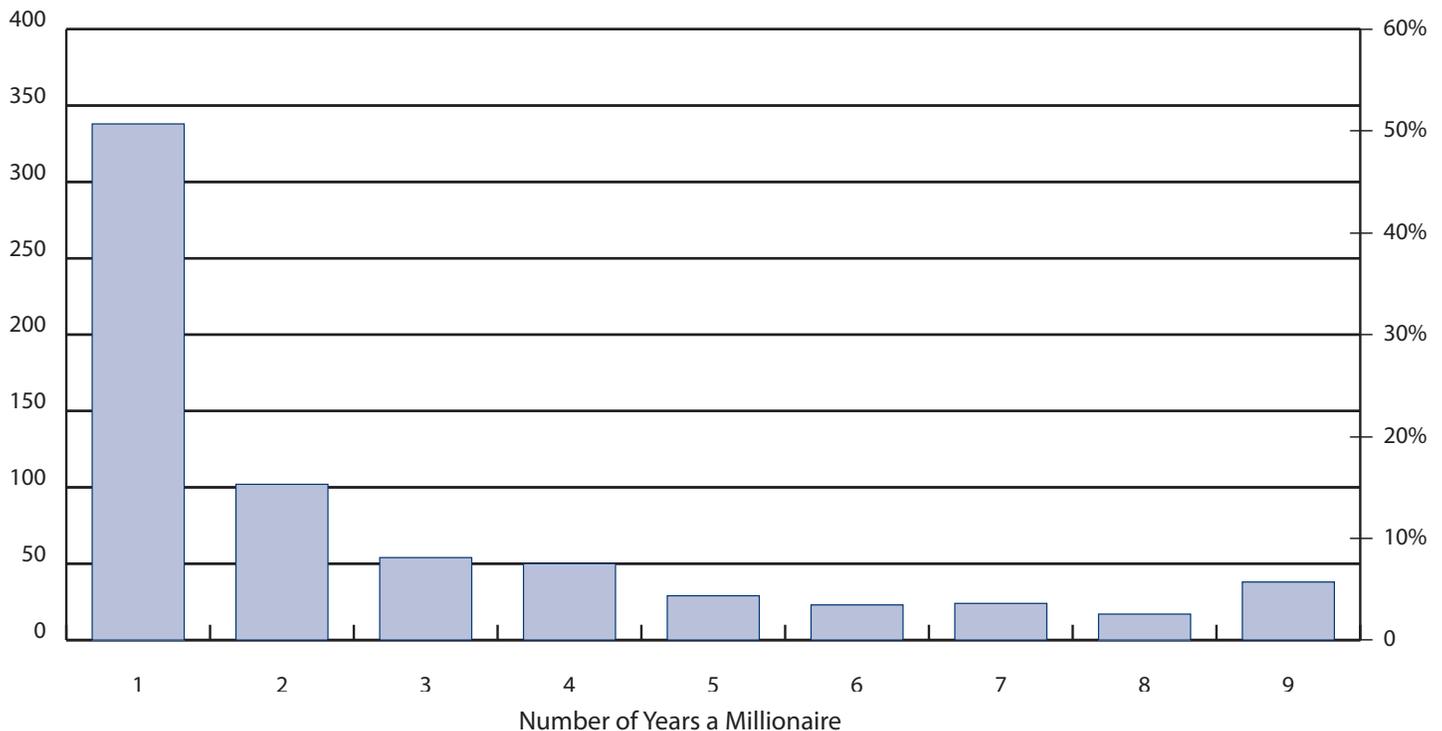
1999 through 2007. Only tax returns present in all nine years of the panel are included in the data used for this report.<sup>6</sup> After these adjustments, the panel data used for this report include a sample of 62,412 tax returns representing 91.4 million returns.<sup>7</sup>

Rather than using a taxpayer's adjusted gross income as the income measure to rank taxpayers, this paper adds tax-exempt interest income, foreign income and net operating losses to AGI to obtain a measure of gross income. The use of tax return data generally requires the construction of an income measure that takes into account statutory changes in the definition of the income over time.<sup>8</sup> Fortunately, during the 1999 through 2007 time period, relatively few changes were made. The

Figure 2

#### How Persistent is Millionaire Status?

Millionaires  
(1,000s)



6 Tax returns that change filing status due to divorce are also excluded from the panel used for this analysis.

7 Note that in 1999, 127.1 million tax returns were filed. The use of a balanced panel together with excluding tax units that split due to divorce explains why the panel data used for this paper is smaller.

8 Using such a consistently defined income concept ensures that measured changes in income reflect just that and not tax law changes.

data are adjusted to 1999 dollars using CPI-U to account for changes in the price level.<sup>9</sup>

This report exploits the tax panel in two ways. First, the now-standard mobility matrix that compares the position of taxpayers in the income distribution over time is replicated for 1999 and 2007.

Second, the panel is used to examine the persistence/transience of millionaires. Millionaires are particularly relevant in the policy area. Focusing on a dollar threshold, rather than the percentile ranking used in the mobility matrix, may well be more policy relevant because the federal and state income tax systems are indexed to inflation, not the real growth in incomes. Also, a number of states have recently enacted millionaire surtaxes, and the recently considered House health care reform included a high-income surtax that, if it had been enacted,

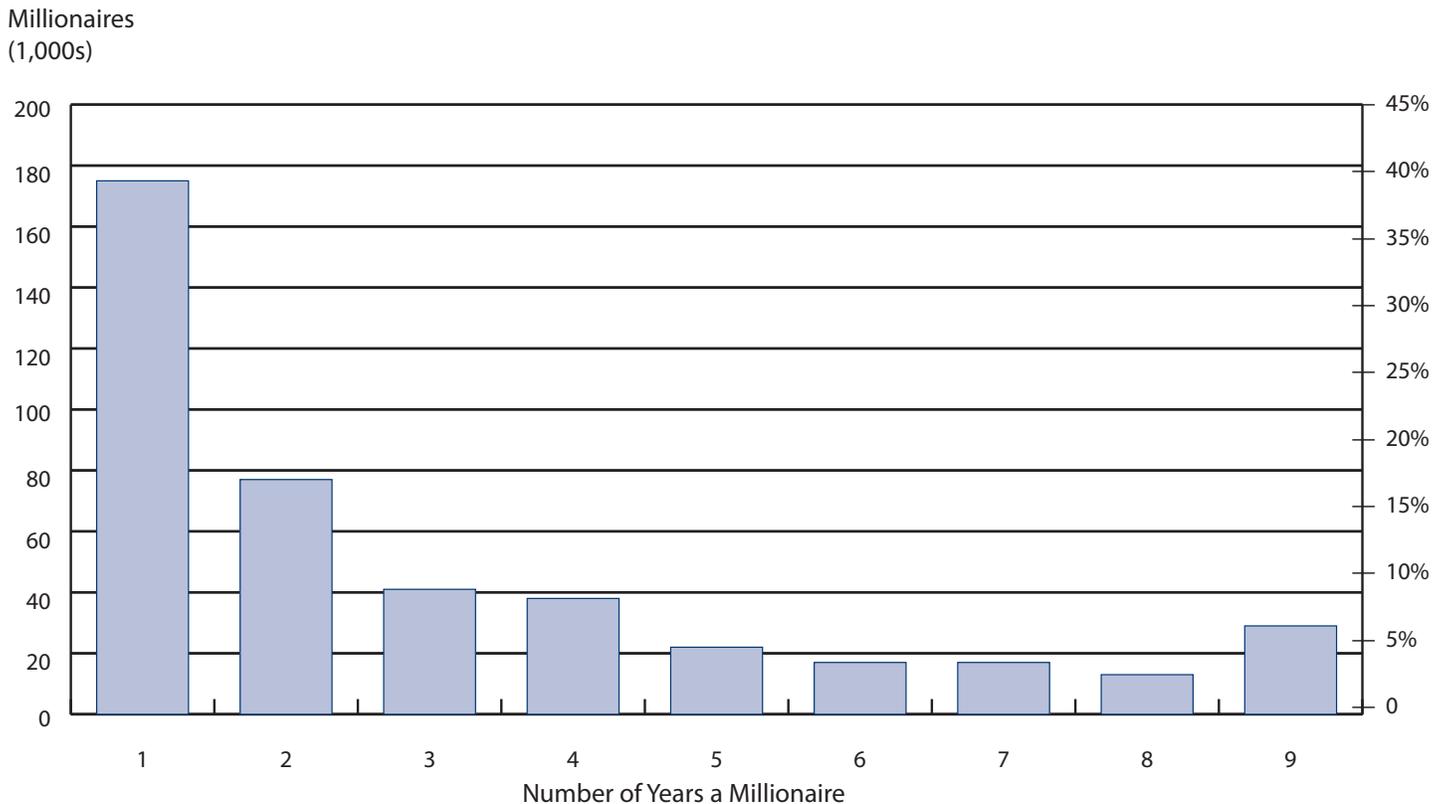
would have increased the marginal tax rates of millionaires by 5.4 percent.

The report calculates the number of times a taxpayer is a millionaire during the 1999 through 2007 period. The tabulations tell us the frequency of one-year, two-year, ..., nine-year millionaires over this period. If a large fraction of taxpayers are millionaires only once, this would suggest that this population is highly transient and not composed of people who are millionaires year after year. The report also considers the role played by both capital gains and business income in pushing taxpayers into millionaire status.

### Basic Income Mobility Results

The basic matrix showing the income mobility of taxpayers in the panel is shown in Table 1 (the income breaks for each of the quintile and percentile groups is provided in Appendix A).

**Figure 3**  
*Persistence of Millionaire Status Excluding Capital Gains*



<sup>9</sup> A taxpayer with \$1 million in income in 1999 would have \$1,244,550 million by 2007 if their income grew by the CPI-U.

This matrix compares the placement of taxpayers in 1999, the first year of the panel, with their placement in 2007, the last year of the panel. Each row and column in Table 1 contains one-fifth of the returns in the panel. This is a reflection of the income quintiles being formed based on the income rankings of taxpayers within the panel.

*Research suggests that the United States economy is sufficiently dynamic to generate rapid, significant changes in the economic fortunes of its people.*

The entries along the diagonal (divided by five so that the total of all entries in the quintile portion of the matrix add to 100 percent) show those taxpayers who remained in the same quintile in both 1999 and 2007, while the

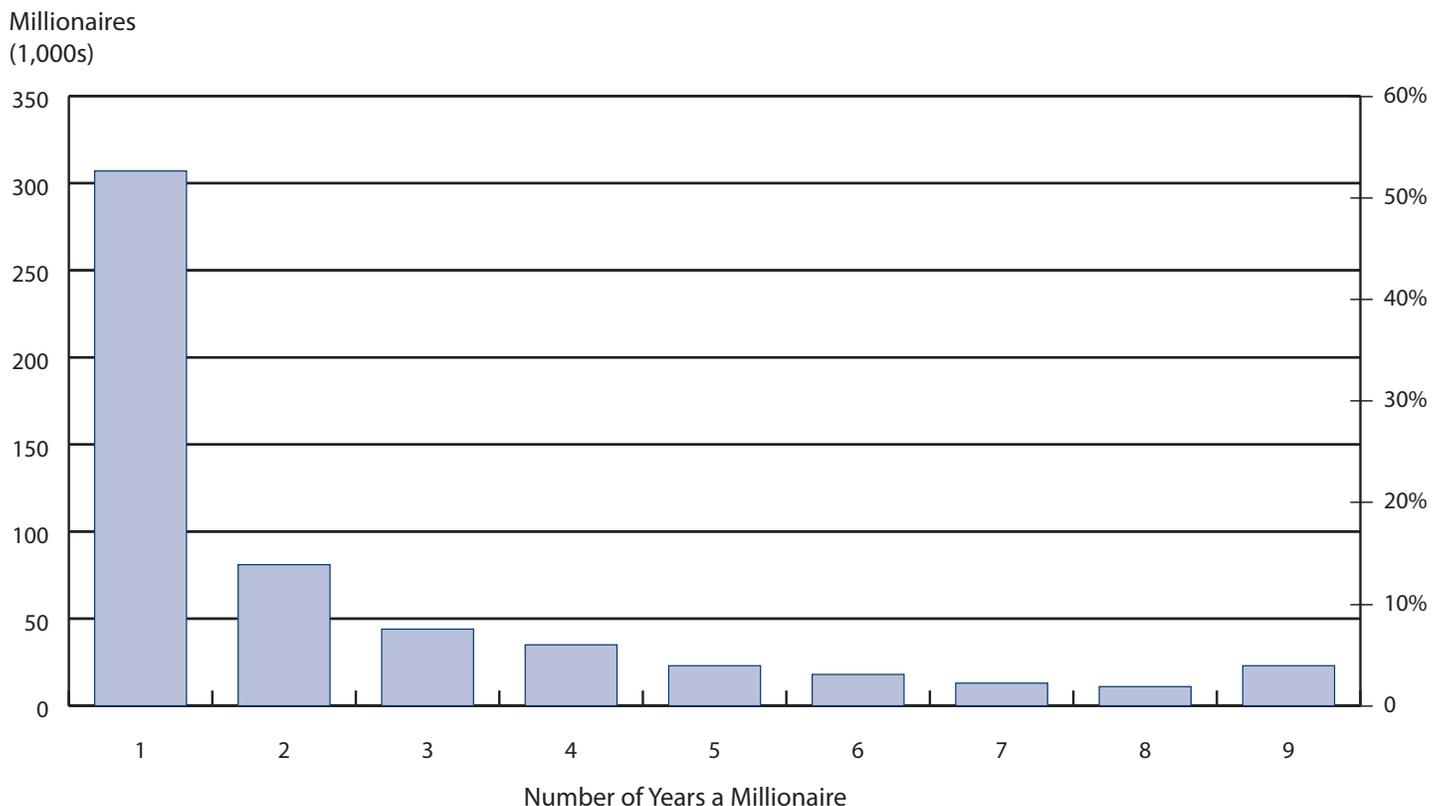
off-diagonal entries show those taxpayers who moved between quintiles.

For example, the entry at the top of the first column indicates that 42.5 percent of taxpayers who were in the bottom quintile in 1999 remained in the bottom quintile in 2007. That is, 57.5 percent of these taxpayers moved to a higher quintile by 2007.

Similarly, the second entry along the diagonal (i.e., second row, second column) shows that 34.7 percent of taxpayers who were in the second quintile in 1999 remained in this quintile in 2007. That is, 65.3 percent of these taxpayers moved to a different quintile.

The sum of all five diagonal entries (divided by five) indicates that 42 percent of taxpayers remained in the same quintile in 1999 and 2007; that is, 58 percent moved to a different quintile.

**Figure 4**  
*Persistence of Millionaire Status Excluding Business Income*



For the top 20 percent of taxpayers in 1999, about 62.3 percent of them remained in 2007 (i.e., the entry along the diagonal for the fifth quintile). That is, 37.7 percent of taxpayers starting in the top quintile were in a lower quintile in 2007.

For the highest-income taxpayers, 44.6 percent of those taxpayers in the top 1 percent remained in the top 1 percent in 2007; that is, 55.4 percent moved to a lower percentile.

All of these results point to one overarching theme: There is substantial mobility of taxpayers up and down the income distribution over time.

Not surprisingly, the results shown in Table 1 are very similar to the results from Auten and Gee (2009) for the 1996 to 2005 period discussed in the sidebar on page 4. Both this report and the earlier Treasury report cover a similar time period and rely on similar data.

### **The Persistence/Transience of Millionaires**

Figure 2 shows the persistence of millionaire status in the panel of tax returns (the data underlying Figures 2, 3 and 4 are provided in Appendix B). In all, over the 1999 through 2007 period, about 675,000 taxpayers earned over a \$1 million for at least one year. Of these taxpayers, about 338,000 (50 percent) were a millionaire in only one year, while just 38,000 (6 percent) remained a millionaire in all nine years. Based on these results, it is clear that taxpayers move in and out of millionaire status with great frequency.

The next step is to consider what types of income push taxpayers into millionaire status. This report considers two types of income: capital gains and business income.

Capital gains can arise from many different sources. Capital gains, of course, are only included in a taxpayer's taxable income when realized. Realizations can arise when a taxpayer disposes of corporate stock, sells shares in a mutual fund, sells a business, receives the proceeds from the sales pass-through to owners from an interest in a partnership or S

corporation, or sells a piece of art or other type of collectible. About half of capital gains realizations arise from the disposition of corporate stock. But some capital gains realizations are related to the disposition of commercial real estate interests, which are often held through partnerships or S corporations and passed through to owners on their individual tax returns.

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*All of these results point to one overarching theme: there is substantial mobility of taxpayers up and down the income distribution over time.*

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The decision to buy or sell an asset may not be a frequent event. Thus, capital gains might be a potential explanation for the apparent transience of millionaires depicted in Figure 2 above. To consider this hypothesis, the persistence of millionaires is considered with the panel data after excluding capital gains from taxpayers' income.

As shown in Figure 3, excluding gains cuts the number of millionaires by more than a third. Instead of 675,000 millionaires, there were 431,000. This should perhaps not be surprising as capital gains tend both to be disproportionately reported by higher-income taxpayers and higher-income taxpayers tend to receive a larger share of their income from capital gains.

What we want to find out is whether the fraction of transitory millionaires fell by more than the total number of millionaires once capital gains is excluded. What Figure 2 and 3 tell us is that while the total number of millionaires fell by about 36 percent, the number of one-year millionaires fell much more, by nearly 50 percent to 175,000. This tells us that realizing capital gains income helps explain why many taxpayers move up to millionaire status for just one year.

Similarly, we can also compare the fraction of one-year millionaires in Figure 3 to the fraction in Figure 2. Again, if this fraction falls, it tells us that once capital gains are removed, the remaining population of millionaires is less transitory (i.e., has fewer one-year millionaires). A comparison of the two charts shows that once capital gains are removed, the fraction of one-year millionaires represents only 40 percent of all taxpayers who are millionaires, rather than the 50 percent shown in Figure 2.

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*Roughly 50 percent of those taxpayers who were millionaires at some point during the 1999 through 2007 period attained this status just once. In contrast, only 6 percent of this group of taxpayers were millionaires in all nine years.*

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It is the change in the fraction of one-year millionaire tax returns that is telling: Once capital gains income is excluded, the remaining millionaires look more persistent.

The business income reported on individual tax returns is also thought to be somewhat volatile, increasing and decreasing with business conditions and the investment and hiring decisions of firms. The net income of partnerships, S corporations and sole/farm proprietorships is passed through to and reported on the owners' individual tax returns. This "flow-through" income comprises about 50 percent of all businesses' receipts and about one-third of all businesses' net income.

In some years, otherwise profitable firms might report a loss due to low business receipts perhaps because the businesses is just getting off the ground or is suffering from poor economic conditions. Alternatively, net income could dip down if the firm decides to make major investments in plant and machinery or expand its work force. These investments might tempo-

rarily reduce a firm's net income until they later pay off and boost business receipts.

The role of business income in explaining the transience of millionaires is considered by examining the persistence of millionaires after excluding their business income.

As shown in Figure 4, excluding business income has a less pronounced effect on the results shown in Figure 2 above. Excluding business income reduces the total number of millionaires at some point during the nine-year period to 555,000. That is 121,000 fewer millionaires than in Figure 2. Similar to capital gains, business income tends to be both disproportionately reported by higher-income taxpayers, and higher-income taxpayers tend to receive a larger share of their income from this source.

The number of one-year millionaires falls by only 31,000, but one-year millionaires now represent 55 percent of all taxpayers who are millionaires excluding their business income. Only 23,000 taxpayers are millionaires in all nine years (4 percent of millionaires excluding capital gains). This suggests that taxpayers who are persistently millionaires may well be more likely to receive business income.

## Conclusion

Standard distributional analyses consider the relative location of households in the income distribution at a particular point in time. This snapshot approach to distributional analysis ignores the idea that many households move up and down the income distribution over time. Concerns over increased income inequality should be tempered to the extent that mobility through the income distribution is substantial.

This report confirms the basic finding of earlier research that a substantial number of households move up or down through the income distribution over time. Using a panel of tax returns from 1999 through 2007, this report finds that nearly 60 percent of households in the bottom quintile in 1999 are in a higher quintile in 2007. Roughly 40 percent of

tax returns in the top quintile in 1999 are in a lower quintile in 2007.

The report also examines the persistence/transience of millionaires and finds that this group of taxpayers, which has been the focus of millionaire surtaxes among some states and some tax policy proposals at the federal level, is highly transient. Roughly 50 percent of those taxpayers who were millionaires at some point during the 1999 through 2007 period attained this status just once. In contrast, only 6 percent of this group of taxpayers were millionaires in all nine years.

Millionaires are a highly transient group of taxpayers, and it appears that the realization of capital gains is at least one explanation. This income source tends to be lumpy and periodic and is a major explanation for why taxpayers reach millionaire status.

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## Appendix A

### Breakpoints for Quintile/Percentile Groups

	1999	2007
<i>Quintile starts at:</i>		
Second	\$13,000	\$22,100
Third	\$24,700	\$40,100
Fourth	\$40,800	\$63,700
Fifth	\$68,000	\$99,900
<i>Percentile Starts at:</i>		
Top 10%	\$96,500	\$143,100
Top 5%	\$135,100	\$200,800
Top 1%	\$339,600	\$549,200

Source: Computations by author from the 1999-2007 SOI Individual Tax Panel. Amounts shown are in nominal dollars.

## Appendix B

### Persistence/Transience of Millionaires: Data Underlying Figures 2, 3 and 4

#### Number of Years a Millionaire

	One	Two	Three	Four	Five	Six	Seven	Eight	Nine	Total
<b>Gross Income</b>										
Returns (1,000s)	338	102	54	50	29	23	24	17	38	675
Percent	50%	15%	8%	7%	4%	3%	3%	3%	6%	100%
<b>Gross Income Excluding Capital Gains</b>										
Returns (1,000s)	175	77	41	38	22	17	17	13	29	431
Percent	41%	18%	10%	9%	5%	4%	4%	3%	7%	100%
<b>Gross Income Excluding Business Income</b>										
Returns (1,000s)	307	81	44	35	23	18	13	11	23	555
Percent	55%	15%	8%	6%	4%	3%	2%	2%	4%	100%

Source: Computations by author from the 1999-2007 SOI Individual Tax Panel.

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