# Partnerships, Partners, and Tax Shelters after Tax Reform, 1987-1989

*by Tom Petska*

The Tax Reform Act (TRA) of 1986 was targeted, in part, at curbing alleged abusive "tax sheltering" activities. The first 3 years of post-TRA data for partnerships and individual partners indicate that its consequences are more evident among partners who were individuals than among the partnerships themselves. The partnership losses claimed by individuals declined from $61.2 billion to $38.4 billion between 1986 and 1989, even though partnership losses for real estate operators and lessors of buildings and for oil and gas extraction, two industries associated with tax sheltering, only declined from $57.9 billion to $56.8 billion over the same period [1,2,3]. However, such a response is not surprising since the limitations on "passive losses," a key provision of TRA, directly affects the tax liabilities of individual partners, giving them incentives to move out of tax shelters, while the partnerships themselves and other types of partners (such as corporations) can still benefit from the tax advantages of tax shelter partnerships.

The partnership form of enterprise has provided an attractive structure for tax shelters because of its "flow-through" nature and its flexibility in allocating income among partners [4,5]. Individuals with large incomes from other sources, such as wages and salaries or self-employment earnings, can invest in partnerships and reduce their taxable income with tax losses passed through to them from these partnership investments. The 1986 Tax Reform Act was a major legislative change toward reducing tax shelter benefits and thereby restoring greater equity to the Federal tax code.

## Partnerships and the Taxation of Partnership Income

A partnership is not a taxable entity. Each partnership annually files an information return (Form 1065) with the Internal Revenue Service (IRS) which shows the partnership's taxable income or loss for the year. Partnerships compute the distributive allocation to each partner and provide a Schedule K-1, *Partner's Share of Income, Credits, Deductions, etc.*, which identifies the partner's share of the total partnership's business activity. This information is used by partners in their own tax computations. As partners calculate their annual tax liabilities, they include their distributive shares of income and deductions from partnerships along with income from other sources. Partners can be individuals, corporations, other partnerships, or virtually any other legal entity, though the focus of this article is on partnerships and individual partners.

### Tax Shelters Defined

Tax shelters are generally defined as investments "in which a significant portion of the investor's return is derived from the realization of tax saving with respect to other income, as well as the receipt of tax-favored (or, potentially, tax-exempt) income from the investment itself" [6]. Tax shelters usually involve one or more of the following advantages [6,7]:

- deferral of tax liability through the use of tax provisions or tax preferences that accelerate deductions;
- conversion of ordinary income into capital gains or other forms of income subject to a lower effective rate of tax; and
- leveraged purchasing which magnifies the other tax advantages [8].

As a flow-through entity with flexibility in allocating income among partners, the partnership form of business provides an attractive structure for tax shelters. Individuals with large incomes from other sources can invest in partnerships and reduce their taxable income with tax losses from partnership investments. If they invested in a "limited" partnership (one for which the liability of one or more partners is confined to the amount of money or property contributed by that partner), they can receive the same limited-liability-of-owners benefit as a corporation, as well as the flow-through benefits of a partnership [9,10].

### Provisions of the 1986 Tax Reform Act

One of the main goals of the 1986 Tax Reform Act was to diminish the ability of individual taxpayers to reduce their tax liabilities through the use of tax shelters [6]. The Act took several steps to accomplish this including:

- lowering overall marginal tax rates;
- eliminating the lower tax rate on long-term capital gains (attributable to the 60 percent exclusion of gains from taxable income);
- reducing the acceleration of depreciation deductions; and
- imposing limitations on "passive losses".

**Individuals invested in partnerships and reduced their taxable income with losses from partnership investments.**

The passive loss limitations, which apply to most forms of flow-through business, particularly affect partnerships. These limitations prevent passive partners — ones who do not "materially participate" in the

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business of the firm — from using any temporary losses generated by the business to offset income from other sources, such as wages and salaries, interest, or dividends [9,10].

**The Taxation of Partnership Income**

The mechanics of the taxation of partnership income at the individual level in the pre- and post-tax reform periods can be illustrated as follows, using categories introduced by TRA; let:

$Y_i$ = "active income (or loss)" which includes wages, salaries, and other types of earned income;

$Y_j$ = "portfolio income" which includes interest, dividends, most capital gains, and other types of taxable investment income;

$Y_k$ = "passive income (or loss)" which includes taxable income or loss generated by a business such as a limited partnership or S Corporation in which the individual does not materially participate [11]; and

$Y_t$ = the sum of active ($Y_i$), portfolio ($Y_j$), and passive ($Y_k$) income, which, absent any other forms of personal income, corresponds to "adjusted gross income" prior to certain statutory adjustments, in both the pre- and post-tax reform periods.

Thus, $Y_t = Y_i + Y_j + Y_k$.

The differences in $Y_t$ before and after the 1986 tax reform are primarily in $Y_j$ and $Y_k$.

- Before tax reform, portfolio income ($Y_j$) excluded 60 percent of most long-term capital gains, whereas after TRA, 100 percent was included in $Y_j$.
- Before tax reform, passive income ($Y_k$) could be positive or negative. After tax reform, it could not be negative. Thus, the passive losses that were previously used to offset active or portfolio income could only be used to offset passive ($Y_k$) gains.

Although some temporary relief was provided through phase-in rules, it appeared that the future of tax shelter partnerships was seriously endangered by these provisions [12].

**Constructing a Partnership Database**

Piecing together partnership and partner financial flows can be a difficult process. Data from the partnership information return (Form 1065) are needed to understand the overall finances of the business, its legal form (as a general or limited partnership), and its principal business activity.

Information from the partnership Schedule K-1 is needed to capture partnership distributions to each partner and other information, such as the legal form of each partner. The Schedule K-1 data are aggregated on the partnership Schedule K, which includes a summary of the income distributed to each type of partner. Data from each partner's tax return (Form 1040 in the case of individual taxpayers) are needed to ascertain the effective tax consequences of the income (or losses) generated by the partnership and distributed (or allocated) to each partner.

Since each return or schedule provides only some of the desired information, an ideal information system for capturing partnership and partner financial flows can be quite complex and costly. The optimal way to examine these issues would be to link, at the individual record level, partnership and partner information sources in both the pre- and post-tax reform periods, and to compare data in the latter with projections based on a model of pre-TRA behavior from the former. Statistics of Income studies involving the linkages of these sources have been carried out with only mixed success [13].

**After tax reform, "passive" partnership losses could only offset "passive" gains.**

In the absence of such a data base, an alternative approach, as reflected in this article, examines tax return data on partnerships and partners from before and after the enactment of TRA for evidence of the anticipated response. If the provisions of TRA were having an impact, it would be expected that the numbers of partnerships and partners and the amounts of losses would decline in those activities where the primary motive was tax sheltering, since partnership losses have a diminished sheltering capability.

## Statistics on Partnerships and Partners

**Partnership Trends, 1981-1989**

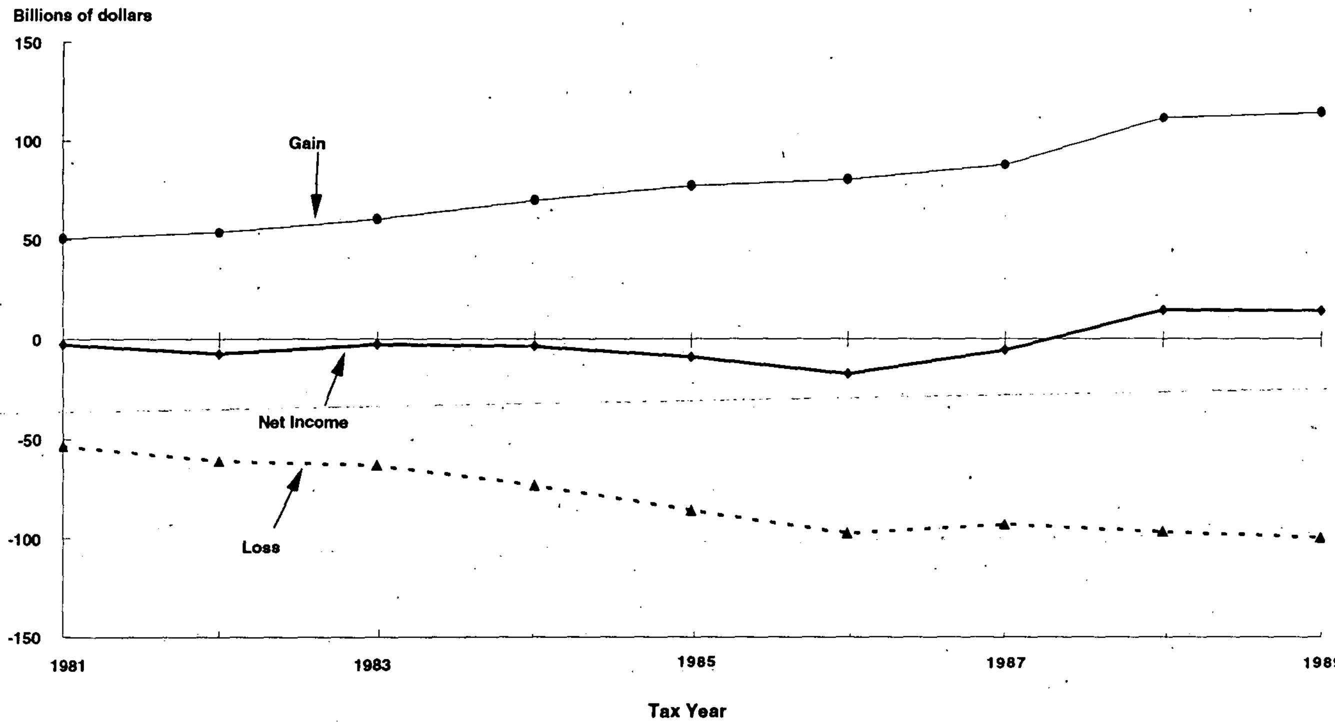
Figure A plots the net income of partnerships for Tax Years 1981-1989 [14]. Overall, partnerships had losses in net income each year, except for 1988 and 1989. These losses peaked in the 1982 recession year, declined slightly for 1983, then began a period of steady and uninterrupted growth culminating in a record overall net loss of $17 billion for 1986. From 1987 to 1989, the first 3 years in which provisions of Tax Reform were in effect, net income moved strongly positive, from a negative net amount of $17 billion for 1987 to approximately $14 billion positive amounts for both 1988 and 1989.

Partnership gains and losses before netting are also plotted for each year in Figure A. Gains (positive net income, or profits) increased annually throughout the 1981-1989 period. Losses, on the other hand, grew annually through 1986, but then dropped by $4.6 billion

# Partnerships, Partners, and Tax Shelters after Tax Reform, 1987-1989

**Figure A**

**Net Income of Partnerships, Tax Years 1981-1989**




for 1987. This was an anticipated response to tax reform; however, increases in losses for 1988 and 1989 were not expected and are in need of further investigation.

In Figure B, partnerships were classified by legal form (i.e., whether they were limited or general partnerships) and by profit status (whether they had positive or negative net income). Because of the limitations on personal liability, limited loss-generating partnerships are most apt to show activities consistent with tax sheltering motives and would thus be expected to more likely show a response to TRA.

Figure B breaks net income into these four types of legal form and profit status. Despite the somewhat erratic trends in total net income, the picture by these four types of partnerships becomes clearer. Net income for profit-generating partnerships (both general and limited) grew for every year, except for a very modest decline among general partnerships for 1989. Losses for both general and limited loss-generating partnerships also increased for every year through 1986, except for the post-recession year of 1983. For 1987, the first post-TRA year, losses of both types of loss-generating partnerships declined. Losses of general partnerships continued to decline for 1988; however, losses increased for limited partnerships for 1988 and 1989 and for general partnerships for 1989.

Figure C shows the number of partnerships. The number grew steadily in the 1981-1985 period. However, amid the widespread public debates and passage of TRA in late 1986, the number of partnerships dropped for that year, the first such decline since 1967. For 1987, the number of partnerships dropped substantially, grew modestly for 1988, but dropped again for 1989 [15].

Data on the number of partnerships by legal form and profit status, which are presented in Figure D, show where these changes occurred. All four types generally registered increases through 1985, with both types of limited partnerships growing more rapidly than general partnerships. The recession of 1982 appears to have contributed to the overall decline in the number of profit-generating partnerships for 1983. After 1985, however, profits appear to have been the determining factor for the increasing or decreasing numbers. While the modest overall decline for 1985-1986 may have appeared to be a response in anticipation of TRA, this decline is actually the result of declines of both limited and general profit-generating partnerships, along with continued growth among both types of loss-generating partnerships. For 1987 and later years, the circumstances reversed, with profit-generating partnerships usually growing in number and loss-generating partnerships declining or leveling off.

**Figure B**

**Partnership Gain or Loss, by Type of Partnership and Profit Status, Tax Years 1981-1989**
[Money amounts are in billions of dollars]

| Tax year | Total gain or loss | Type of partnership: General, Gain | Type of partnership: General, Loss | Type of partnership: Limited, Gain | Type of partnership: Limited, Loss |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| 1981 | $-2.7 | $42.8 | $-29.8 | $7.8 | $-23.5 |
| 1982 | -7.3 | 44.4 | -34.2 | 9.2 | -26.7 |
| 1983 | -2.6 | 48.6 | -32.5 | 11.7 | -30.4 |
| 1984 | -3.5 | 55.7 | -36.6 | 14.0 | -36.6 |
| 1985 | -8.9 | 60.5 | -42.4 | 16.6 | -43.5 |
| 1986 | -17.4 | 63.5 | -45.3 | 16.8 | -52.3 |
| 1987 | -5.4 | 66.2 | -43.4 | 21.5 | -49.6 |
| 1988 | 14.5 | 81.2 | -42.7 | 30.1 | -54.2 |
| 1989 | 14.1 | 80.9 | -45.2 | 33.0 | -54.6 |

NOTES: Detail may not add to totals because of rounding. For data sources, see Figure F.

The increasing number of loss-generating partnerships, despite their growing losses throughout the pre-TRA period, defies conventional economic motives which would have predicted that resources (both in terms of firms and investors) would flow toward profitable activities and away from loss-generating activities. This pattern is, instead, consistent with tax sheltering motives in which investor/partners appear to have been seeking tax losses, not a positive return on their partnership investments.

The number of partners, as shown in Figure E, exhibited substantial and uninterrupted growth throughout the entire 9-year period, even in years for which the number of partnerships dropped. The number of partners in profit-reporting partnerships exhibited consistent growth throughout this period, while the number of partners in loss-generating partnerships grew through 1986, but then leveled off.

In Figure F, the number of partners are classified into the four types of legal form and profit status types. The number of partners in limited partnerships grew much more rapidly and consistently than those in general partnerships, which is consistent with the motives of tax shelters. The number of partners in general profit-generating partnerships declined substantially for 1985, mirroring a similar increase in the number of partners in limited profit-generating partnerships. In the post-TRA period of 1987-1989, the number of partners in limited profit-generating partnerships increased in every year, while the number of partners in general profit-generating partnerships moved erratically. The number of partners in

**Figure C**

**Number of Partnerships, Tax Years 1981-1989**

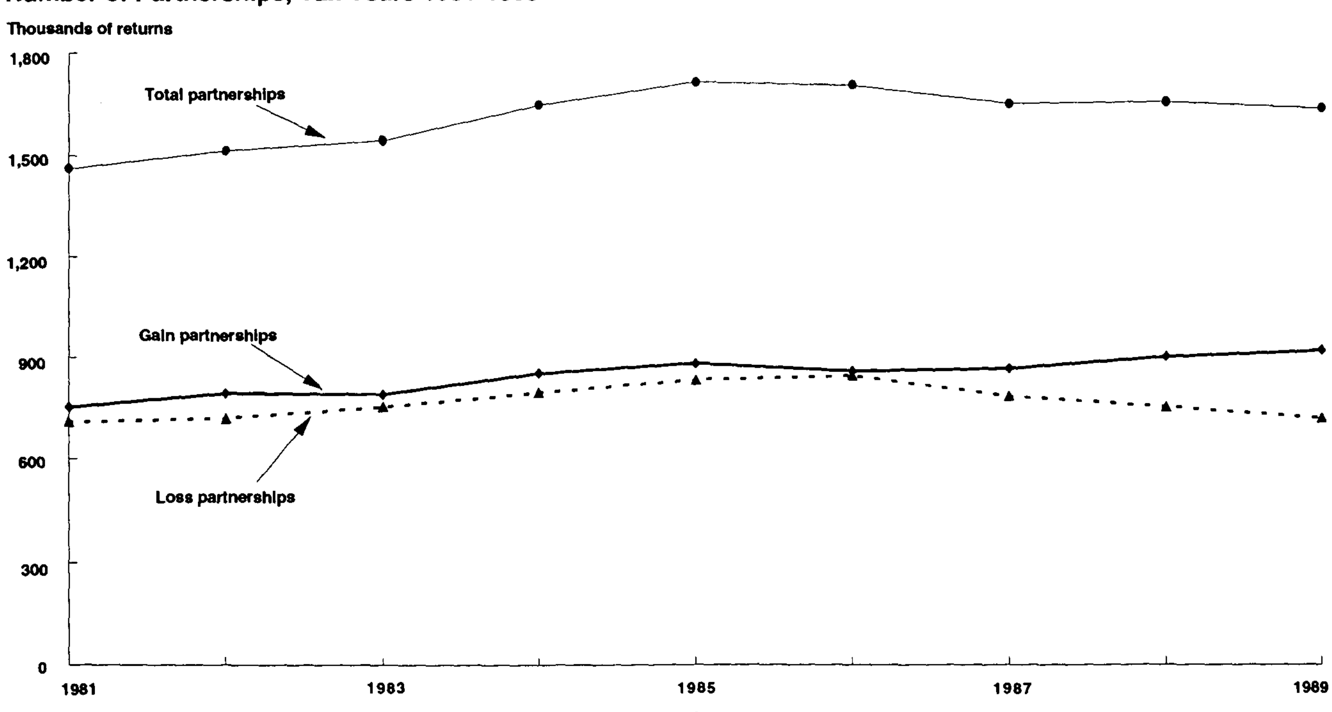


**Figure D**

**Number of Partnerships, by Type of Partnership and Profit Status, Tax Years 1981-1989**
[Numbers are in thousands]

| Tax year | Total partnerships | Type of partnership | | | |
|---|---|---|---|---|---|
| | | General | | Limited | |
| | | Gain | Loss | Gain | Loss |
| | (1) | (2) | (3) | (4) | (5) |
| 1981 | 1,461 | 677 | 576 | 75 | 133 |
| 1982 | 1,514 | 707 | 581 | 87 | 139 |
| 1983 | 1,542 | 707 | 601 | 82 | 152 |
| 1984 | 1,644 | 750 | 636 | 101 | 157 |
| 1985 | 1,714 | 774 | 660 | 107 | 173 |
| 1986 | 1,703 | 766 | 663 | 92 | 181 |
| 1987 | 1,648 | 769 | 617 | 96 | 166 |
| 1988 | 1,654 | 782 | 587 | 119 | 166 |
| 1989 | 1,635 | 770 | 571 | 128 | 166 |

NOTES: Detail may not add to totals because of rounding. For data sources, see Figure F.

loss-generating partnerships declined each year in the post-TRA period, except for a large reversal for 1989 for limited loss-generating partnerships.

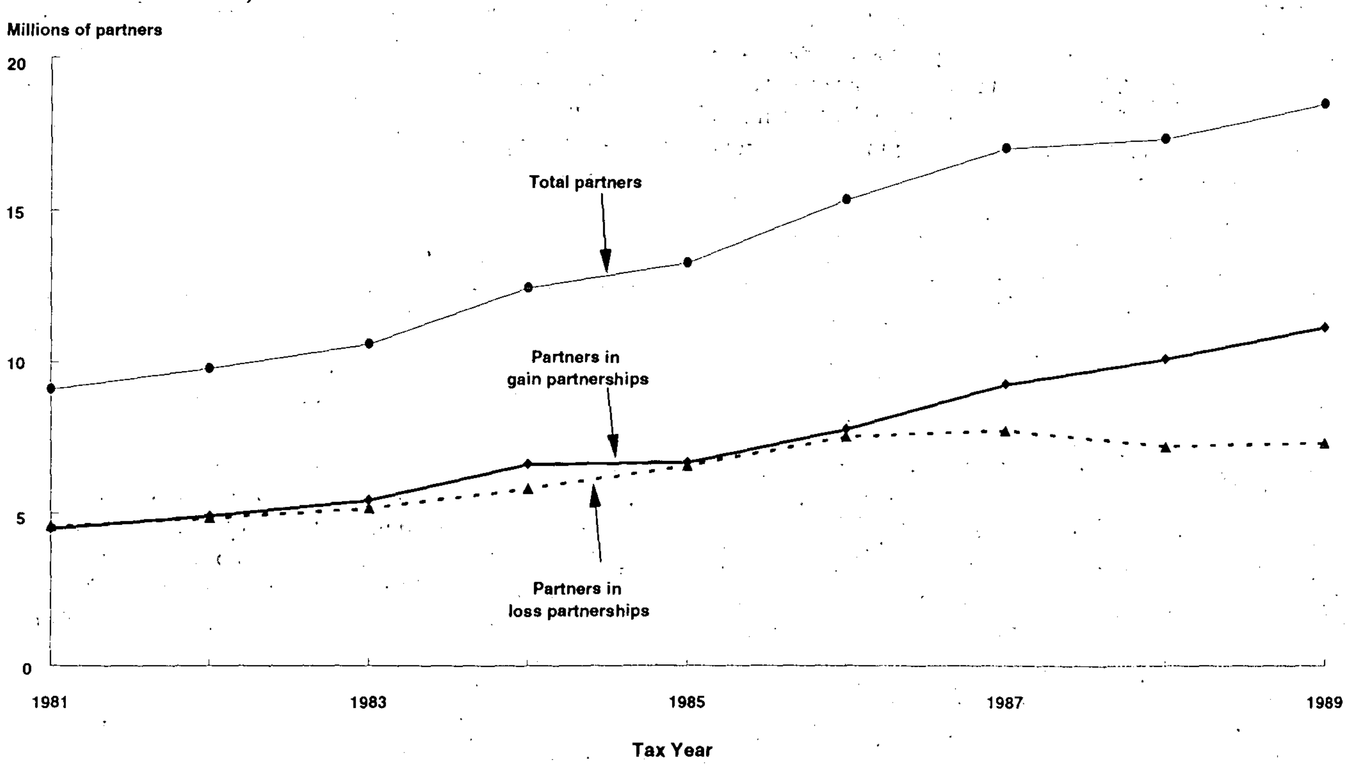
Figures A through F thus indicate a response to TRA, but some indicators have not been consistent. To further investigate, net income (i.e., income less loss), gains (positive net income), and losses of partnerships by selected industry are presented in Table 1 for the period 1985-1989, the period surrounding TRA. The last year unaffected by both the publicity, as well as the provisions of TRA, was 1985. Although 1986 was generally not directly affected by the provisions of TRA, the Act's potential provisions were quite well known from the public debates, especially by individuals and organizations whose pre-TRA benefits were at stake. In addition to a high level of public awareness, TRA's passage in November 1986 allowed time to react prior to its effective date of January 1, 1987, and many persons took advantage of this (apparently) last opportunity to benefit from a reduced tax on long-term capital gains. Thus, 1986 is hardly a pre-reform year in a strict sense. However, the years 1987 through 1989 are all post-tax reform years, although phase-in provisions lessened the Act's immediate impact [12].

**Industrial Activities**

Partnership net income (in Figure A and Table 1) declined by $8.5 billion between 1985 and 1986. This large decline was led by a drop of $4.9 billion in oil and gas extraction

**Figure E**

**Number of Partners, Tax Years 1981-1989**



in the mining division and a decrease of $6.6 billion in real estate operators and lessors of buildings in the finance, insurance and real estate division. These two industries were well known for their tax sheltering activities.

For 1987, the overall partnership loss in net income declined sharply to $5.4 billion. Although oil and gas extraction did show an overall increase in net income of $4.4 billion, the increases in positive net income reported for other industrial groupings played the major role in reducing the overall loss for 1987. In particular, increases were reported for agriculture, forestry and fishing ($3.0 billion), manufacturing ($1.3 billion), and especially holding and investment companies ($4.2 billion) in finance, insurance and real estate. Overall net income improved by $19.9 billion to a positive $14.5 billion for 1988, with gains evident for most industries, including $1.8 billion for both oil and gas extraction and real estate operators and lessors of buildings. For 1989, overall net income was again positive, but declined to $14.1 billion. However, this was only $0.4 billion less than the year before. Since overall net income (or loss) statistics can obscure trends in the underlying gains and losses, these are examined next.

As Table 1 shows, total partnership gains increased annually between 1985 and 1989. The largest increases were for 1987 ($7.4 billion) and 1988 ($23.7 billion). These gains were spread throughout the industries, although manufacturing and service industrial divisions were the only ones to show increases for all years. The largest source of the $23.7 billion increase for 1988 was an $11.8 billion increase for finance, insurance and real estate, consisting of a $4.1 billion increase for holding and investment companies and a $3.1 billion increase for real estate operators and lessors.

On the loss side, partnership losses increased by $11.7 billion for 1986, led by a $2.3 billion increase for oil and gas extraction and $7.4 billion for real estate operators and lessors. Between 1987 and 1989, the rate of increase slowed considerably, however, and losses increased by only another $2.2 billion. Thus, the substantial improvement in net income between 1986 and 1989 is far more attributable to the growth in gains than the reduction in losses.

**Losses of oil and gas extractors and real estate operators and lessors greatly affected partnership profits.**

For 1985, the last pre-TRA year, the losses for oil and gas extraction and real estate operators and lessors of buildings were the largest

**Figure F**

**Number of Partners, by Type of Partnership and Profit Status, Tax Years 1981-1989** [1]

[Numbers are in thousands]

| Tax year | Total partners | Partners by type of partnership: General, Gain | General, Loss | Limited, Gain | Limited, Loss |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| 1981 | 9,095 | 2,883 | 2,036 | 1,628 | 2,548 |
| 1982 | 9,765 | 2,886 | 2,167 | 2,027 | 2,684 |
| 1983 | 10,589 | 2,939 | 2,216 | 2,488 | 2,947 |
| 1984 | 12,427 | 3,527 | 2,215 | 3,082 | 3,603 |
| 1985 | 13,245 | 2,990 | 2,340 | 3,680 | 4,234 |
| 1986 | 15,301 | 3,061 | 2,426 | 4,709 | 5,105 |
| 1987 | 16,963 | 3,185 | 2,255 | 6,054 | 5,469 |
| 1988 | 17,291 | 3,421 | 2,197 | 6,664 | 5,009 |
| 1989 | 18,432 | 3,150 | 2,058 | 7,656 | 5,568 |

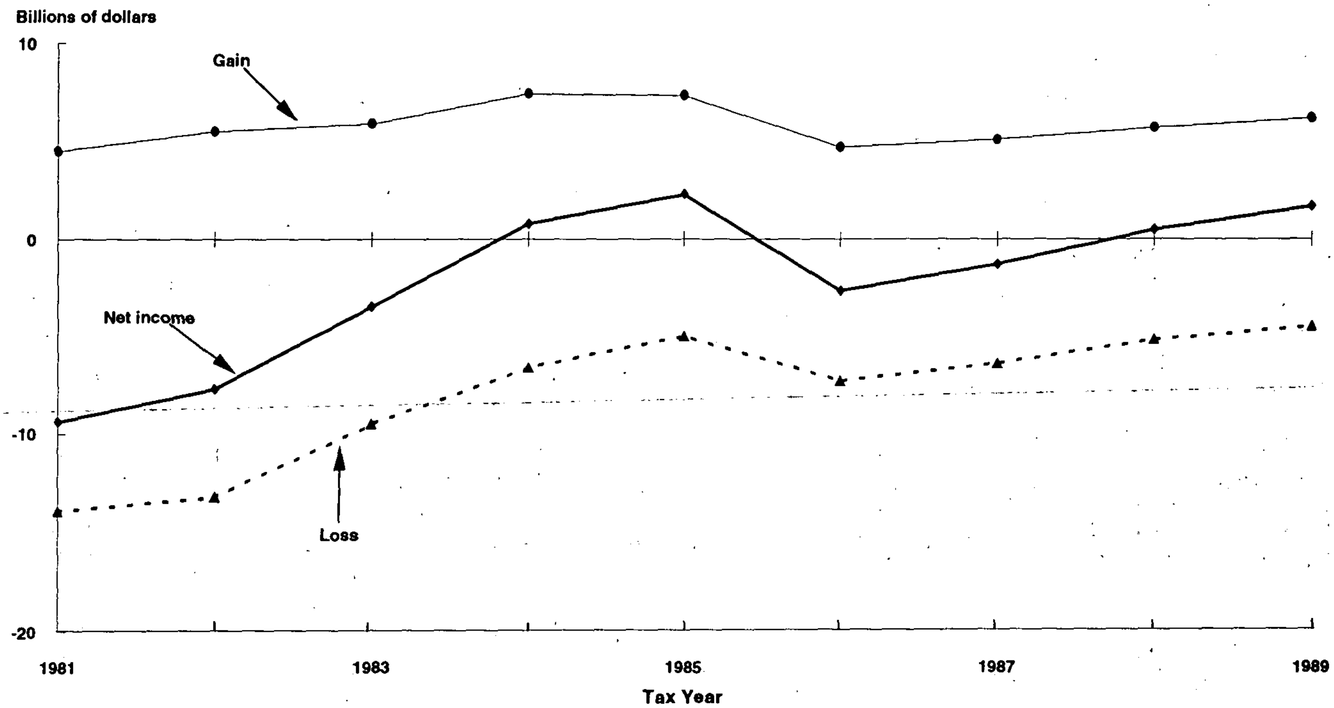
NOTES: Data for Figures A through F are from the *Statistics of Income Bulletin*, selected issues; and *Statistics of Income--1978-1982, Partnership Returns*; unpublished data from Office of Tax Analysis, U.S. Department of the Treasury; and special Statistics of Income tabulations. Profit status is defined as gain or loss in net income; see footnote 14 at the end of this article for a further explanation of how this is defined. Partnerships with a breakeven between gain and loss are included with loss partnerships.

reported. Oil and gas extraction had an overall net income of $2.3 billion, consisting of gains of $7.3 billion and losses of $5.0 billion. Real estate operators and lessors had an overall loss in net income of $26.2 billion, nearly three times the size of the net loss for all other partnerships. The real estate overall loss resulted from gains of $17.0 billion and losses of $43.2 billion; the latter represented half the total loss of all loss partnerships. Clearly, the experience of these two industries, and particularly the latter one, had an enormous impact on partnership profits. If loss partnerships in these two industries are really the largest proponents of tax shelters, a closer look at trends in the net income, numbers of businesses, and numbers of partners before and after TRA is warranted. These data are presented in Figures G through K.

Figures G through I plot net income and the number of partnerships and partners for the oil and gas extraction industry for the period 1981-1989. They also separately plot partnerships with gains or losses. The overall net income of oil and gas partnerships, which is presented in Figure G, climbed steadily from a net loss of nearly $10 billion for 1981 to a positive net income, albeit modest, for 1984 and 1985. However, for 1986, net income dropped by $4.9 billion to an overall net loss of $2.7 billion. Beginning with 1987, net income again climbed modestly, but consistently with each successive year. Oil and gas gains were relatively stable in this period with the

**Figure G**

**Net Income of Oil and Gas Partnerships, Tax Years 1981-1989**




only substantial annual change being a decline of $2.6 billion for 1986. Thus, most of the fluctuation in net income is attributable to changes in losses; in fact, overall net income displays a pattern over time that closely follows the trend for losses.

Figure H shows the number of oil and gas extraction partnerships. Despite year-to-year fluctuations, the number of oil and gas partnerships with gains changed only slightly over the 9-year period, 1981 through 1989, with the most noticeable deviations being a decline for 1986 and an increase for 1988.

Unlike the number of partnerships, the number of partners in oil and gas partnerships show a very pronounced pattern over the 1981-1989 period, as evidenced in Figure I. The number of partners in gain or profit-generating partnerships increased for nearly every year, while the number of partners in loss-generating partnerships shows essentially no growth.

Figures J through L plot similar data for real estate operators and lessors of buildings. Overall net income data presented in Figure J show that losses grew each year from 1981 through 1986. From 1987 forward, the post-TRA period, losses in net income declined very modestly ($2.7 billion) from their level of $32.8 billion for 1986. Gains, on the other hand, were remarkably stable, growing moderately for 8 of the 9 years from 1981 through 1989. However, losses grew every year through 1986 when they totaled $50.6 billion, and then remained in the $50-$52 billion range through 1989.

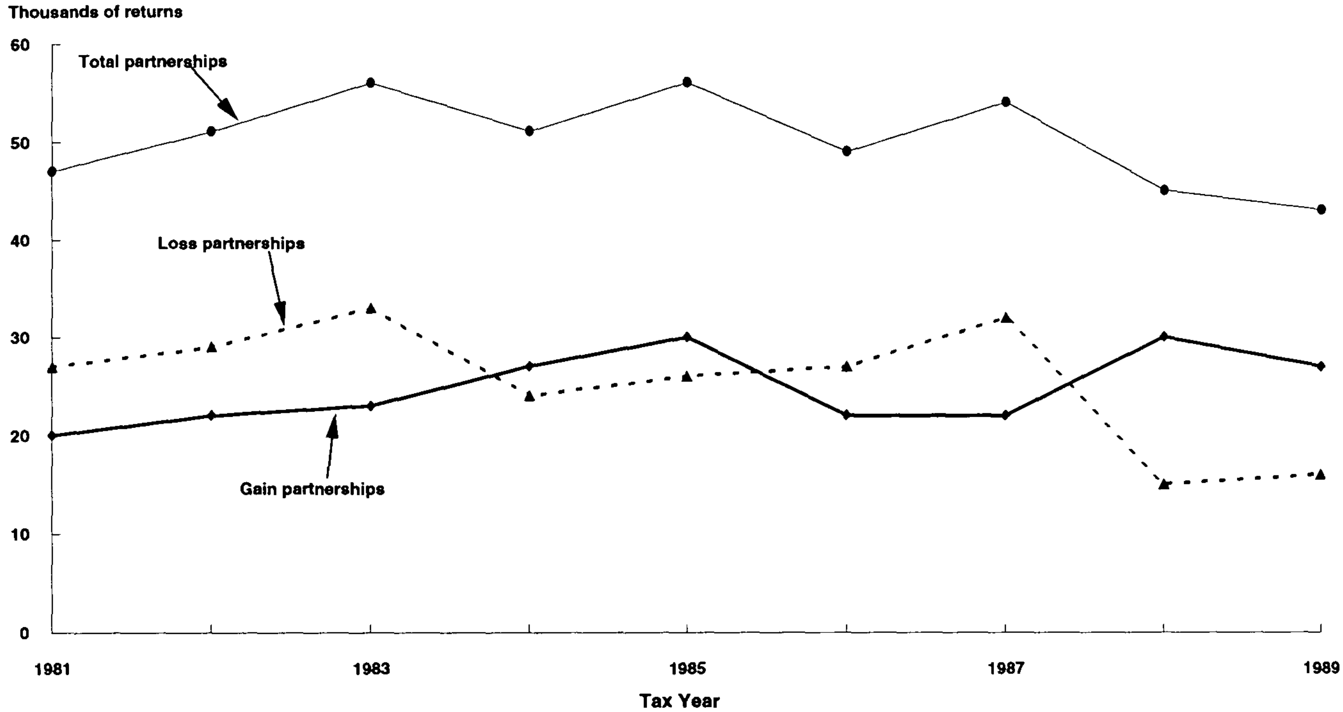
The number of partnerships that were real estate operators or lessors of buildings are presented in Figure K. Through 1986, the number of such partnerships grew annually, with loss-generating firms increasing in number at a somewhat faster rate. Starting with 1987, however, the total number of firms changed very little with the slight increase among gain firms offset by declines among loss-generating firms.

As with the number of partners in oil and gas, the number of partners in real estate operator and lessor ventures grew annually for both gain and loss partnerships through 1986, as presented in Figure L. Growth in the number of partners was very small in the post-TRA years, and attributable solely to gain partnerships.

From these data, several patterns are evident. First, the effects of TRA are more evident in the overall net income and number of partners than in the number of partnerships. This is consistent with tax sheltering behavior since it shows increasing numbers of investor/partners seeking growing losses in the pre-TRA period, with a halt to this in the post-TRA period. Second, as expected, the pattern of losses over time is far more consistent with tax sheltering motives and to a response to TRA than are the

**Figure H**

**Number of Oil and Gas Partnerships, Tax Years 1981-1989**




gain data. This is not surprising in that tax sheltering motives are the underlying reason for the growth in loss-generating businesses, so it would be expected that they show the most responsiveness to the applicable provisions of TRA.

To further examine these issues, annual growth rates for loss-generating oil and gas extraction and real estate operator and lessor partnerships are presented in Figure M, in which the 1981-1989 period is divided into 3 intervals: the pre-tax reform period (1981-1985); the transitional year (1986); and the post-tax reform period (1987-1989).

The number of oil and gas loss-generating partnerships declined modestly in the pre-tax reform period, probably due to market conditions which bottomed out in late 1985. For 1986, the number of loss-generating partnerships increased by nearly 4 percent before declining at an annual rate of over 17 percent in the post-reform period.

The number of partners in oil and gas loss-generating partnerships declined by 4 percent in the pre-tax reform period. For 1986, their partners increased by over 19 percent, which, again, appears to be more of a reaction to market conditions. In the post-tax reform period, the number of partners declined by just over 2 percent per year.

Oil and gas loss-generating partnerships averaged annual losses of nearly $10 billion in the pre-reform period. These losses declined to $7.3 billion for 1986 and continued declining annually to an average loss of $5.4 billion for the post-tax reform period.

Real estate loss-generating partnerships grew in number at annual rates of approximately 6 percent in the pre-reform period, including 1986. In the post-reform period, however, they declined at an annual rate of 4 percent per year. Real estate loss-generating partnerships gained partners at an annual rate of over 13 percent per year in the pre-reform period and nearly 18 percent for 1986, alone. This is further evidence of sheltering behavior, since this growth was attributable to an additional 2 million investors in these loss-generating businesses. In contrast, during the post-reform period, the number of partners showed no growth.

The losses of these real estate loss-generating partnerships averaged $27 billion annually in the pre-reform period. Within this period, they increased steadily from $15 billion to $43 billion. For 1986, the losses increased to nearly $51 billion and then grew slightly in the 3 post-reform years.

What do these figures indicate about the response to TRA? Oil and gas losses did decline from 1986 to 1989.

As previously alluded to, part of this was attributable to the energy sector's recovery from a substantial oil price decline in late 1985. Nevertheless, oil and gas was one of the few industries granted major exceptions to the passive loss limitations. Losses from most general partnerships in oil and gas could continue to offset income from other sources, while losses from limited partnerships in oil and gas could not. Thus, despite some continuation of pre-TRA benefits, losses still declined, which is consistent with the overall intent of TRA--that business losses should reflect economic conditions rather than be generated primarily for tax sheltering purposes.

Real estate contributed heavily to partnership losses, yet the losses leveled off in the post-reform period, rather than declined. Does this suggest that the real estate industry was not affected by tax reform? On the contrary, the fact that real estate losses did not grow is a major reversal of the trend in the pre-reform period in which losses grew substantially. Also, the fact that the number of investor/partners ceased to grow in the post-reform period further reveals the effect of reform. This lack of growth occurred despite the fact that some partners in real estate general partnerships could qualify for a special $25,000 exemption from the passive loss limitations for losses from "active" real estate activities.

The real estate industry also experienced depressed demand in certain geographic areas, probably due in part to overbuilding caused by the pre-TRA tax benefits. Partners in loss-generating real estate partnerships may have found a "buyers market" in their attempts to sell off their partnership interests. The result may be that, at least in the short run, TRA left many such investors with no other recourse than to sell off their investments at a fraction of their original cost or to wait out the soft real estate market by absorbing continued losses even with their diminished capability to offset other income.

Another indication of the impact of tax reform is the birth rate of new firms in these two industries. Figure N presents a percentage distribution of all partnerships, those in oil and gas extraction, or that were real estate operators and lessors, and the total, excluding these two industries. If TRA was having an effect, one would expect growth among new firms to be appreciably less than for other types of partnerships.

Nearly 29 percent of all partnerships were established in the 1987-1989 post-TRA period. Of this group, about 11 percent were formed in 1989, and over 17 percent in 1987-1988. For oil and gas extraction, almost 20 percent were formed in the post-reform period, while for real estate operators and lessors of buildings, 19 percent were

**Figure I**

**Number of Partners in Oil and Gas Partnerships, Tax Years 1981-1989**

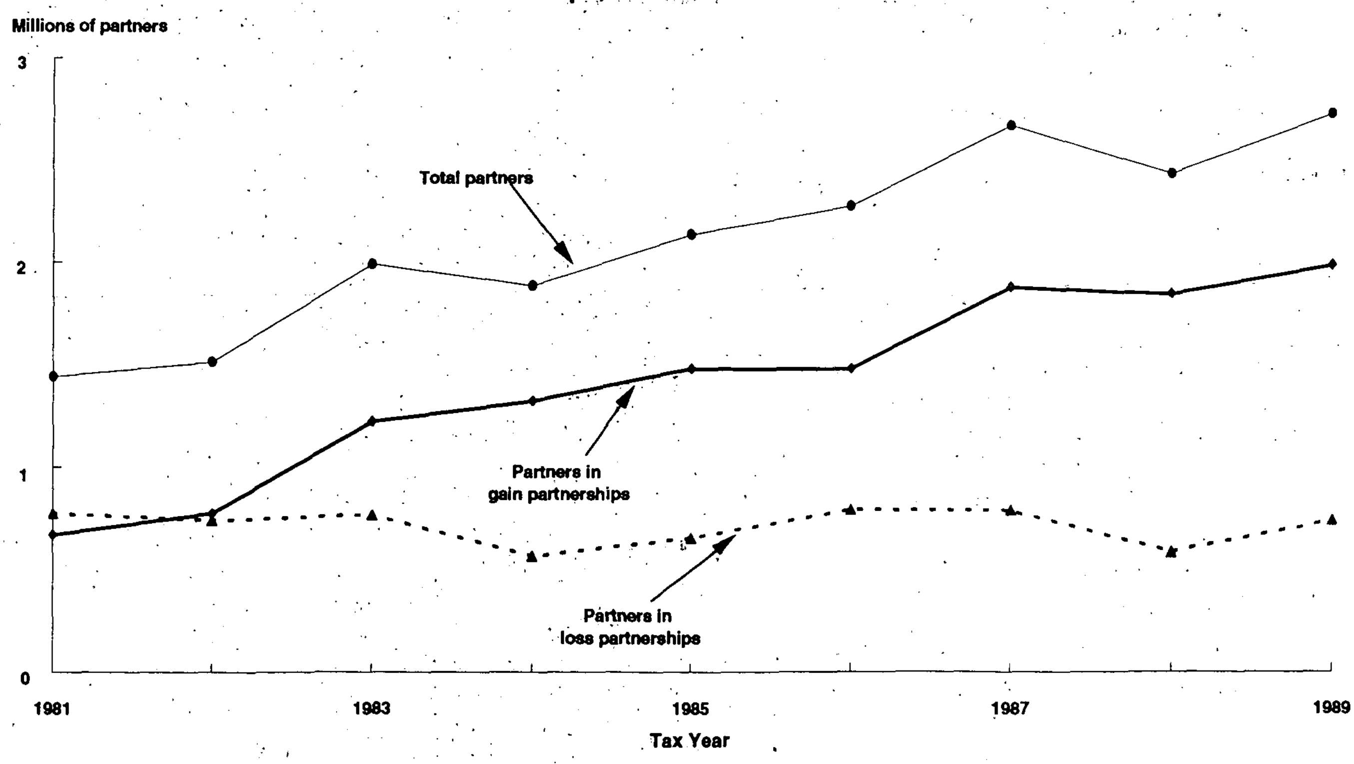
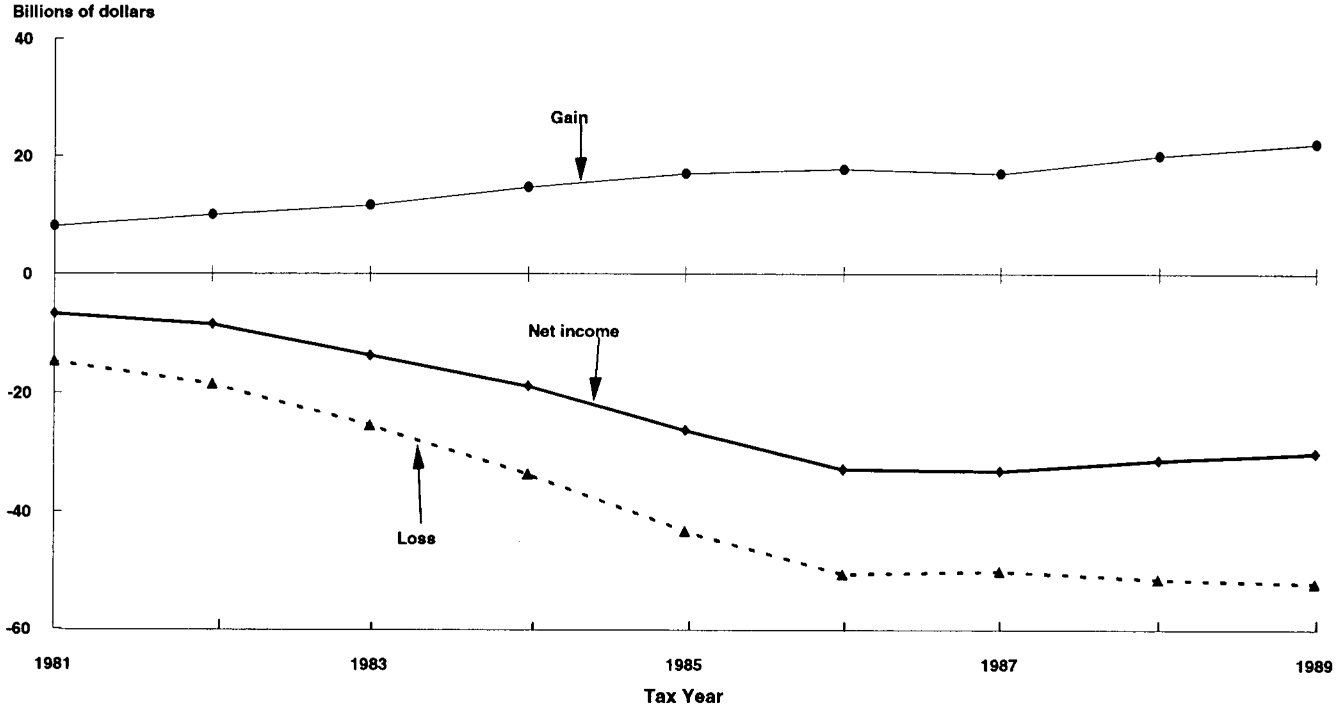


**Figure J**

**Net Income of Real Estate Operator and Lessor Partnerships, Tax Years 1981-1989**




created in this period. If these two industries are excluded from the total, a clearer picture emerges. Nearly 35 percent of partnerships in this "other" group were formed in the post-reform period. Growth in partnerships in these "non-shelter" industries continued at a rate 80 percent higher than that for oil and gas and for real estate. Clearly, the provisions of TRA had an impact.

Of course, economic conditions undoubtedly contributed to these movements as well. For the oil and gas industry, the passage of the Act coincided with the beginning of a period of recovery which appears to have obscured the effect of TRA. For real estate, the passage of TRA more closely coincided with an industry downturn; losses persisted at pre-tax reform levels due to the combined affects of TRA and a slumping market. Separating these effects, however, is beyond the scope of this article.

**Individual Partners**

The intent of the passive loss provisions was to curb the alleged abuses of individual taxpayers' use of partnership losses to offset income from other sources, thereby reducing their "taxable income" and income tax. To help assess the impact of TRA, Figure O provides time series data on "ordinary income and losses" from partnerships as reported on individuals' income tax returns [16]. Such ordinary income is not a total measure of the partnership income reported on tax returns (since it excludes capital gains and losses and most dividends, for example), but the trends it reveals can be used for this purpose, nevertheless.

The most striking results are:

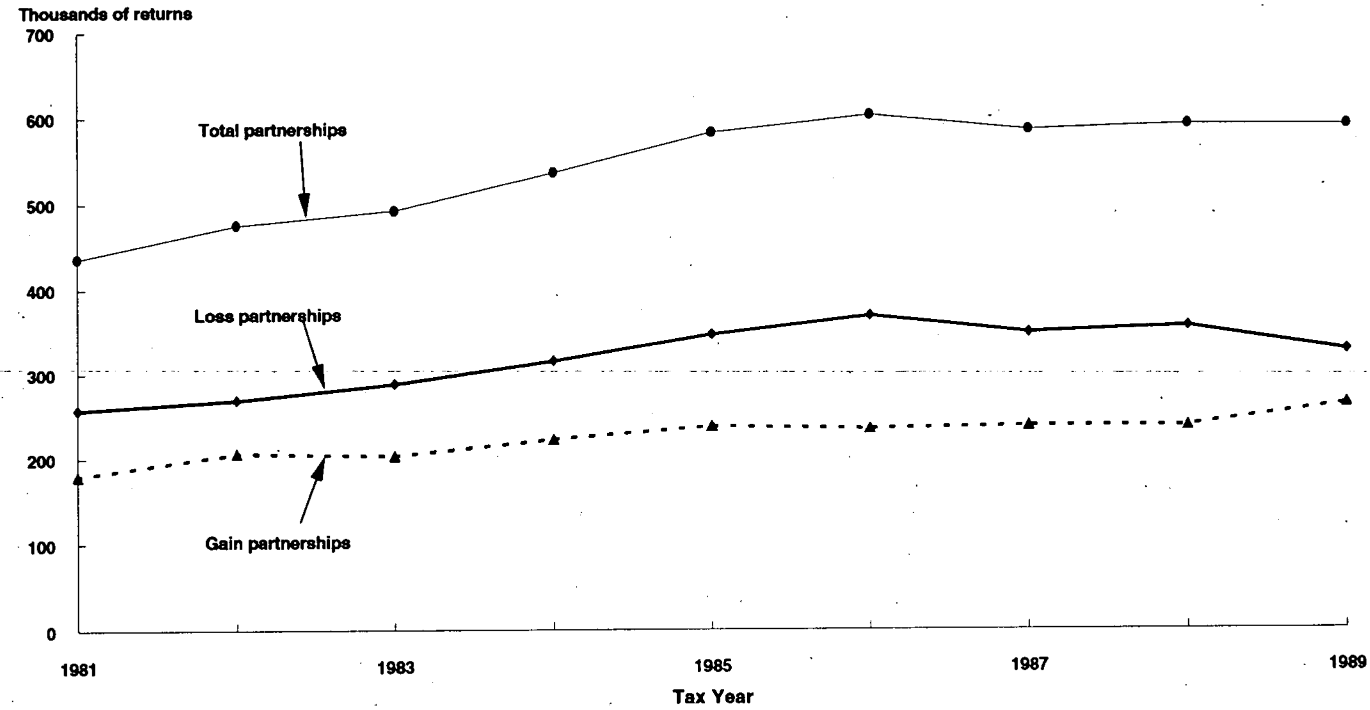
- the fact that individuals claimed overall net losses for each year in the pre-tax reform period, and
- the overall similarity to the plot of partnership income over time as displayed in Figure A.

Partnership total ordinary income reported by individuals increased consistently throughout the entire period; the largest increase was $13 billion for 1987. This may be due to individual partners restructuring their portfolios to obtain additional partnership passive gains against which to apply their passive losses.

Partnership ordinary losses reported by individuals grew throughout the pre-tax reform period, reaching a low of $61 billion for 1986. Losses then declined by $17 billion for 1987 and continued to decline, though much more modestly for 1988 and 1989. Even though these amounts are after deduction of any disallowed passive losses, this movement is still a strong indication of a response to TRA. The passive loss limitations are un-

**Figure K**

**Number of Real Estate Operator and Lessor Partnerships, Tax Years 1981-1989**




doubtedly responsible for much of the reversal in losses, though their precise effect can only be estimated. For 1987, the Treasury Department estimates that approximately $10 billion in passive partnership losses were disallowed [3]. With the phase-in of the passive loss limitations progressing, the amount of disallowed passive losses will likely increase [12]. However, based on what was reported on partnership returns, partnership losses claimed by individual partners would have declined for 1987, even without the disallowance of some of the passive losses. This is further evidence that TRA had sent a clear message to tax shelter investors.

The declines in partnership losses claimed by individuals for 1988 and 1989 were more moderate than for 1987. Since these losses were after deduction of disallowed passive losses, this issue needs further investigation, as well as an estimate of disallowed partnership passive losses for these years [17]. As a result of the decreases in losses in the post-TRA period, overall partnership net income (less loss) claimed by individuals shifted strongly positive over the entire 3-year post-TRA period.

For 1987 through 1989, the data do not include "portfolio income" (interest, dividends and royalties, which were combined with similar income from other sources) earned by partners, as do the figures for earlier years, complicating interpretation. This tends to understate the gains and overstate the losses for 1987 and later years.

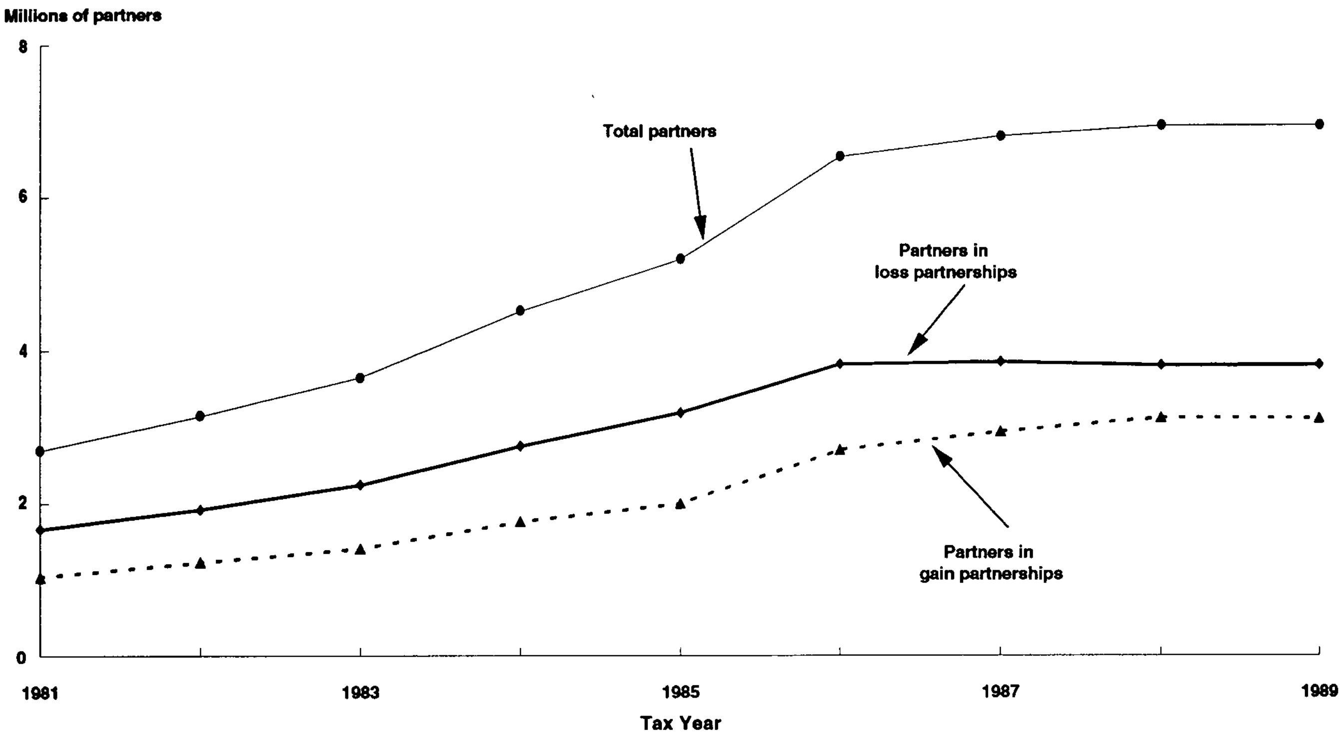
If the partnership losses reported by all individual partners are lower in the post-tax reform period, does this mean that high income individuals are using them less often to reduce their tax liability? How has the use of partnership losses to reduce the tax of high income taxpayers changed with tax reform? Table 2 addresses these questions with data based on the Statistics of Income individual tax return samples for 1985 through 1989.

Table 2 uses a measure of income that ignores taxpayers' losses in determining whether or not they had high incomes. The measure, total positive income, or TPI, looks only at positive amounts of income, viewing individuals as having a high income if they had large amounts of gross income before any netting of losses [18]. Table 2 displays TPI for returns with at least $250,000 and shows, among other information, the portion of TPI offset by partnership losses. In addition, the high TPI returns are classified according to their average tax burdens relative to TPI [19].

The number of high TPI returns grew quite dramatically over this 5-year period, at an annual rate of nearly 15 percent. Most of this growth was quite steady, with

**Figure L**

**Number of Partners in Real Estate Operator and Lessor Partnerships, Tax Years 1981-1989**




one exception — the change from 1985 to 1986 — in which the number grew by 184,700, or by 50 percent. This appears to result from the large number of capital gain realizations, as individuals sold assets near the end of 1986 to take advantage of the lower rate on long-term capital gains that was scheduled to expire at the end of the year. In addition to swelling the ranks of high TPI returns, these large capital gain realizations pushed a greater proportion of the 1986 high TPI returns into a tax rate class other than the 20-percent-and-over class. For each of the other 4 years, a higher portion of returns were in the 20-percent-and-over class and the highest percentages in the 20-percent-and-over class were in post-reform years.

The amounts of TPI clearly show the effect of capital gain realizations for 1986; this year had the highest overall TPI for the 5-year period, though not by much, compared to 1988 and 1989. As for the number of returns, the distribution of TPI among the average tax rate classes was much more skewed away from the 20-percent-and-over rate class for 1986 than it was for the other years.

For partnership losses, 1986 again stands out as different from the other years. Partnership losses for the other years were in the range of $25 to $27 billion; for 1986, however, partnership losses were approximately $10 billion higher.

Average TPI provides some insight into what occurred. TPI averaged between $598,100 and $669,500 for years other than 1986; for 1986, the average was $745,900. As previously noted, capital gain realizations appear to be the

**Figure M**

**Annual Growth Rates and Average Annual Losses for Oil and Gas Extraction and Real Estate Operator and Lessor Loss Partnerships, Tax Years 1981-1989**

[Money amounts are in billions of dollars]

| Tax year | Annual growth rates: Partnerships | Annual growth rates: Partners | Average annual loss |
|---|---|---|---|
| | (1) | (2) | (3) |
| | Oil and gas extraction partnerships | | |
| 1981-85 | -0.9% | -4.2% | $-9.6 |
| 1986 | 3.8 | 19.2 | -7.3 |
| 1987-89 | -17.4 | -2.3 | -5.4 |
| | Real estate operator and lessor partnerships | | |
| 1981-85 | 5.9 | 13.1 | -27.1 |
| 1986 | 6.2 | 18.1 | -50.6 |
| 1987-89 | -4.0 | (1) | -51.3 |

[1] Less than 0.05 percent.

NOTES: This table is based only on data for those partnerships with losses that were engaged in oil and gas extraction or that were real estate operators or lessors. Growth rates reflect annual percentage changes. Losses are annual *averages* for the period stated.

## Figure N

**Number of Partnerships for 1989 and Partnership Birth Rates, Pre- and Post-Tax Reform Act (TRA) Periods**

[Numbers are in thousands]

| Tax year | All industries | Oil and gas extraction | Real estate operators and lessors | All other |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| | Number of partnerships | | | |
| 1989 | 1,635.2 | 42.5 | 589.8 | 1,002.9 |
| | Birth rates | | | |
| Pre-TRA | 71.4% | 80.3% | 80.8% | 65.4% |
| Post-TRA, 1987-89 | 28.6 | 19.7 | 19.2 | 34.6 |
| 1987-88 | 17.4 | 14.8 | 11.3 | 21.1 |
| 1989 | 11.2 | 4.9 | 7.9 | 13.5 |

NOTE: The Tax Reform Act of 1986 was enacted in late 1986 and was effective starting with 1987. Thus, the pre-TRA percentages refer to 1986 and earlier years.

primary reason.

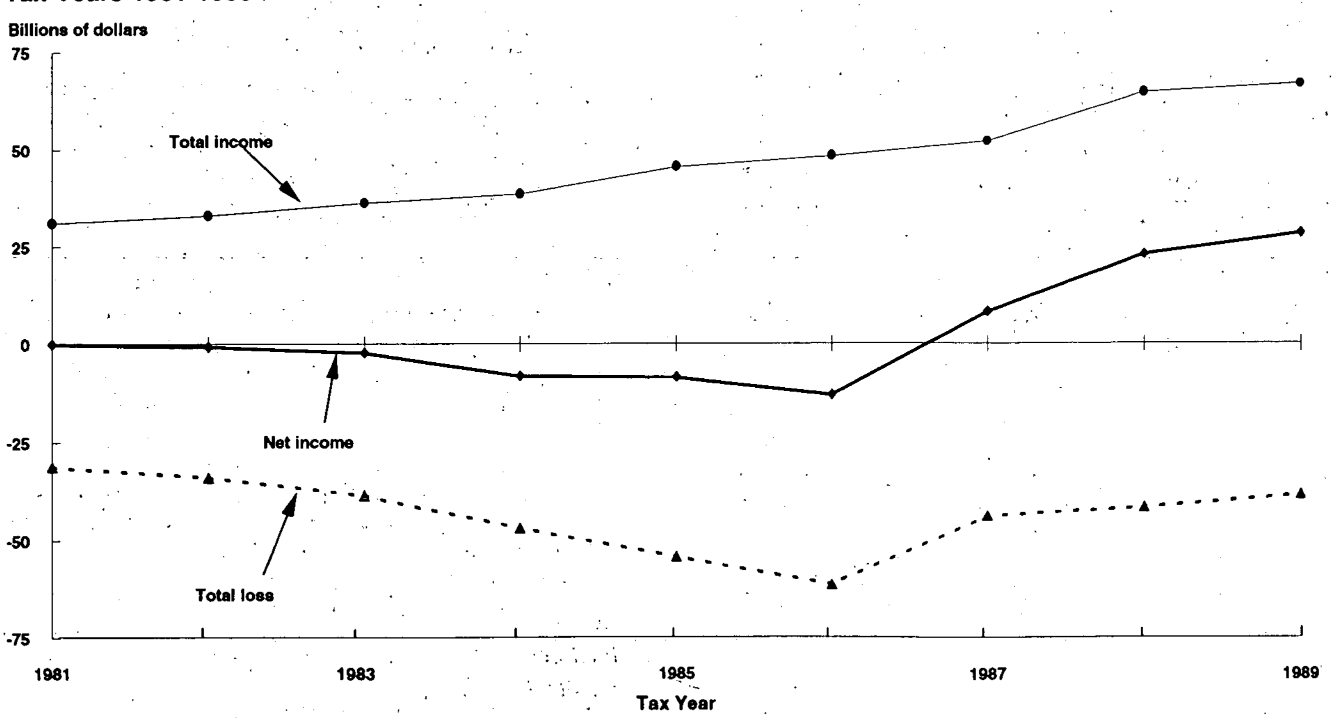
Overall, average partnership losses show a steady decline in this period, from $74,900 for 1985 to $38,700 for 1989. This is consistent with the expected impact of TRA. Within the average tax rate classes, there is considerable variation in the size of these losses. For all years, the lowest average tax rate class shows the largest losses by far, and the size of these losses declines as average tax rates rose.

An important aspect of the impact of TRA is the portion of partnership losses that were used to offset TPI, i.e., losses as a percentage of TPI. Overall, this percentage declined for each successive year in the period, although the drop from 1986 to 1987 was very modest. This percentage is highest by far in the lowest average tax group (particularly in the pre-TRA years), as would be expected if these losses were being effectively used to offset income, thereby pushing such individuals into lower average tax rates. The partnership loss percentage declines as average tax rates increase which is consistent with expectations of a response to TRA.

So what does all this say concerning the impact of TRA on high TPI individuals? The pre-tax reform realizations of long-term capital gains in 1986 cloud the picture, since both the number of high TPI individuals and the amounts of their income increased dramatically for that year. Taxpayers could have indirectly responded to the passive loss limitations by diverting investments into other activities, further reducing partnership losses. Other provisions of TRA, such as the reduction in accelerated

## Figure O

**Partnership Income and Loss Reported on Individual Income Tax Returns, Tax Years 1981-1989**



depreciation, would have reduced the tax losses associated with new investments. Improvements in economic conditions, such as that which apparently occurred in the oil and gas industry after 1986, could have also contributed to the change in partnership and partner income. Separating the response to TRA from the effects of these other factors is, however, beyond the scope of this article.

## Summary and Conclusions

This article presents evidence suggesting that, based on aggregate data for 3 years, the 1986 Tax Reform Act is achieving its intended effect of curbing the abuses of tax shelter partnerships. The consequences of TRA are more evident among individual partners than among the partnerships, themselves. However, such a response was not unexpected, since the passive loss limitations directly affect the tax liabilities of partners, giving them incentives to move out of tax shelters. Because corporate and other types of partners can still benefit from the tax advantages of tax shelter partnerships, many partnerships have less incentive to eliminate tax losses than do their individual partners.

As the phase-in of the passive loss limitations proceed and partnerships are able to restructure their investments, partnership losses, the number of partnerships and the numbers of investor/partners are expected to continue declining in those industries for which pre-TRA provisions contributed largely to their attractiveness. As previously noted, separating the response to TRA from the effects of other economic factors, such as industry-wide business cycles, are useful extensions of this article but are beyond its scope.

## Notes and References

[1] Petska, Tom, "Further Examinations of Tax Shelters in the Post-Reform World," *1991 Proceedings of the American Statistical Association, Section on Survey Research Methods.*

[2] Petska, Tom and Nelson, Susan, "Partnerships and Tax Shelters: An Analysis of the Impact of the 1986 Tax Reform," *1990 Proceedings of the American Statistical Association, Section on Survey Research Methods.*

[3] Nelson, Susan, and Petska, Tom, "Partnerships, Passive Losses, and Tax Reform," *1989 Proceedings of the American Statistical Association, Section on Survey Research Methods* and *Statistics of Income Bulletin*, Winter 1989-90, Volume 9, Number 3.

[4] Dworin, Lowell, "An Analysis of Partnership Activity, 1981-83," *Statistics of Income Bulletin*, Spring 1986, Volume 5, Number 4.

[5] Nelson, Susan, "Taxes Paid by High-Income Taxpayers and the Growth of Partnerships, 1983," *Statistics of Income Bulletin*, Fall 1985, Volume 5, Number 2.

[6] U.S. Congress, Joint Committee on Taxation, *Tax Reform Proposals: Tax Shelters and Minimum Tax* (JCS-34-85), August 7, 1985, page 2.

[7] U.S. Congress, Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (H.R. 3838, 99th Congress; Public Law 99-514), May 4, 1987.

[8] Leveraged purchasing,i.e., by means of "borrowed" funds, increases the benefits of tax-favored status since, not only does it allow for augmenting the magnitude of the investment and the resulting benefits, but such financing creates an additional deduction for interest paid.

[9] Nelson, Susan, "Noncorporate Business Taxation: Before and After the Tax Reform Act of 1986," U.S. Department of the Treasury, *OTA Paper 59*, May 1988.

[10] Shapleigh, Colbert C., and Raley, Terry M., "The Effect of the Passive Loss Rule and Other Related Provisions of the Tax Reform Act," *Journal of Partnership Taxation*, Spring 1987.

[11] S Corporations, like partnerships, are not taxed directly, but are taxed through their shareholders, just as partnerships are taxed through their partners. To qualify as an S corporation, a firm had to be: a domestic corporation which was not a member of an affiliated group and did not have more than 35 shareholders; or a shareholder who was neither an individual (other than an estate or trust) nor a nonresident alien; and which had only one class of stock.

[12] For 1987, under the phase-in rules, 65 percent of passive losses from pre-TRA investments were allowed; for 1988, 40 percent; for 1989, 20 percent; for 1990, 10 percent; and for 1991, none were allowed.

[13] Several Statistics of Income (SOI) studies involving the Schedule K-1 have been attempted with mixed results. One involved sampling from a file based on

the K-1 data and retrieving income tax return information for the first ten individual partners listed. However, weighting problems, particularly in regard to the adequacy of the procedure of weighting the first ten individual partners to population totals, raised serious concerns with the interpretation of these data. A second "piggy-backed" on the SOI partnership program. Fifty partner Schedules K-1 were obtained for all types of partners and selected money amounts were extracted. While this study included a substantially larger protion of the partner population, it still excluded large portions and was considerably more costly as well.

[14] Partnership net income (less deficit) represents ordinary income (loss) on page 1 of the Form 1065 through Tax Year 1986. Beginning with tax year 1987, a comparable net income figure has been computed as the sum of: ordinary income or loss from trade or business, portfolio income distributed directly to partners (excluding capital gains), net income or loss from rental real estate activities, and net income or loss from other rental activities. Profit status is determined as gain or loss on net income. Partnerships with a breakeven between gain and loss are included with loss.

[15] An undetermined number of partnership returns were mistakenly rejected from the 1987 Statistics of Income sample lowering the population estimate. If this downward bias in the population estimate is between 6,000 and 50,000 returns, which appears to be reasonable, the partnership population would have exhibited a steady decline from 1985 forward. See McMahon, Paul, "Statistics of Income Partnership Studies: Sampling Plan Redesign II," *1991 Proceedings of the American Statistical Association, Section on Survey Research Methods.*

[16] Statistics for total net income or loss on individuals' returns (Figure O) frequently differ from the comparable totals reported for partnerships (e.g., Figures A and B, and Table 1) because not all partnership income is distributed or allocated to individual partners and because of income definitional differences.

[17] Total passive activity allowed and disallowed losses are available from the Form 8582, *Passive Activity Loss Limitations*. Although partnership passive losses undoubtedly constitute the majority of these amounts, an estimate of the actual partnership portion requires disaggregation of total passive losses at the individual return level and is beyond the scope of this article.

[18] Total positive income (TPI) is a summation of all line items on an individual tax return that showed positive amounts of income. The only exception to this is for the Schedule E, *Supplemental Income and Loss*. Instead of using the summary total line item amount from the sources of income on this form, positive amounts from each of the following were included: total rental and royalty income (or loss), total partnership and S Corporation income (or loss), total estate and trust income (or loss), and income and loss from Real Estate Mortgage Investment Conduits. For years prior to 1987, the amounts on Schedule D, *Capital Gains and Losses*, were summed before adjusting for the 60-percent exclusion from income of long-term capital gains.

[19] Data in Table 2 differ from those presented in the paper by Nelson and Petska (see footnote 3) because of inconsistencies in the quantification of TPI in the latter.

## General References

U.S. Department of the Treasury, Internal Revenue Service, *Statistics of Income — 1988, Individual Income Tax Returns.*

Zempel, Alan, "Partnership Returns, 1989," *Statistics of Income Bulletin*, Fall 1991, Volume 11, Number 2.

## Table 1.--Partnership Net Income (less Deficit), by Selected Industrial Groups and Profit Status, Tax Years 1985-1989 [1]

[All figures are estimates based on samples--money amounts are in billions of dollars]

| Selected industrial group | 1985 | 1986 | Increase, 1985-86 | | 1987 | Increase, 1986-87 | | 1988 | Increase, 1987-88 | | 1989 | Increase, 1988-89 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Amount | Percentage | | Amount | Percentage | | Amount | Percentage | | Amount | Percentage |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) | (13) |
| **ALL PARTNERSHIPS** | | | | | | | | | | | | | |
| **All industries [2]** | **-8.9** | **-17.4** | **-8.5** | **-95.5** | **-5.4** | **12.0** | **68.8** | **14.5** | **19.9** | **367.4** | **14.1** | **-.3** | **-2.7** |
| Agriculture, forestry and fishing | -1.0 | -.9 | .1 | 10.6 | 2.0 | 3.0 | 314.8 | 1.1 | -.9 | -46.5 | 1.4 | .3 | 27.9 |
| Mining | 1.5 | -3.5 | -4.9 | -333.3 | -.1 | 3.4 | 97.8 | .9 | 1.0 | 1,345.3 | 2.0 | 1.0 | 110.4 |
| Oil and gas extraction | 2.3 | -2.7 | -4.9 | -216.9 | -1.3 | 1.4 | 51.3 | .5 | 1.8 | 136.1 | 1.7 | 1.2 | 263.0 |
| Construction | 2.2 | 2.5 | .3 | 13.2 | 2.8 | .3 | 10.7 | 3.3 | .5 | 18.7 | 2.6 | -.6 | -19.4 |
| Manufacturing | -1.1 | -.5 | .6 | 57.8 | .8 | 1.3 | 276.0 | 1.5 | .7 | 91.1 | 1.4 | -.1 | -9.2 |
| Transportation and public utilities | -3.1 | -3.0 | (3) | 1.2 | -3.8 | -.8 | -24.8 | -2.3 | 1.5 | 39.4 | -2.0 | .3 | 13.7 |
| Communication, electric, gas, and sanitary services | -3.5 | -3.2 | .2 | 7.1 | -3.9 | -.7 | -20.5 | -2.8 | 1.1 | 28.6 | -2.3 | .5 | 18.6 |
| Wholesale and retail trade | 2.0 | 2.3 | .3 | 14.9 | 2.7 | .4 | 18.7 | 3.4 | .7 | 24.2 | 2.5 | -.8 | -24.5 |
| Finance, insurance and real estate | -25.9 | -33.0 | -7.1 | -27.2 | -26.8 | 6.2 | 18.8 | -19.3 | 7.5 | 28.1 | -20.8 | -1.6 | -8.1 |
| Real estate operators and lessors of buildings | -26.2 | -32.8 | -6.6 | -25.2 | -33.1 | -.3 | -1.0 | -31.3 | 1.8 | 5.4 | -30.1 | 1.3 | 4.1 |
| Holding and investment companies [4] | 2.0 | 2.2 | .2 | 9.1 | 6.4 | 4.2 | 193.5 | 9.0 | 2.5 | 39.7 | 8.8 | .1 | 1.5 |
| Services | 16.5 | 18.6 | 2.0 | 12.2 | 18.1 | -.5 | -2.5 | 25.6 | 7.5 | 41.7 | 26.7 | 1.0 | 4.0 |
| **GAIN PARTNERSHIPS** | | | | | | | | | | | | | |
| **All industries [2]** | **77.0** | **80.2** | **3.2** | **4.1** | **87.7** | **7.4** | **9.3** | **111.4** | **23.7** | **27.1** | **113.9** | **2.5** | **2.2** |
| Agriculture, forestry and fishing | 2.8 | 2.7 | -.1 | -1.8 | 4.5 | 1.7 | 63.4 | 3.8 | -.7 | -14.7 | 3.7 | -.1 | -3.9 |
| Mining | 7.9 | 5.2 | -2.7 | -33.9 | .6 | -4.6 | -88.6 | 6.6 | 6.0 | 1,014.3 | 7.0 | .4 | 5.8 |
| Oil and gas extraction | 7.3 | 4.7 | -2.6 | -36.0 | 5.1 | .4 | 9.6 | 5.7 | .6 | 11.8 | 6.2 | .5 | 9.0 |
| Construction | 2.7 | 3.2 | .5 | 16.9 | 3.4 | .1 | 4.5 | 3.9 | .6 | 17.3 | 3.3 | -.6 | -15.7 |
| Manufacturing | 1.2 | 1.5 | .3 | 23.1 | 2.5 | 1.0 | 65.6 | 3.6 | 1.1 | 43.7 | 4.2 | .6 | 15.5 |
| Transportation and public utilities | 1.4 | 1.7 | .3 | 23.8 | 2.0 | .3 | 20.5 | 3.0 | .9 | 45.5 | 3.7 | .7 | 25.2 |
| Communication, electric, gas, and sanitary services | .4 | .8 | .4 | 110.5 | 1.2 | .5 | 63.8 | 2.0 | .7 | 56.6 | 2.5 | .6 | 29.4 |
| Wholesale and retail trade | 3.5 | 3.7 | .3 | 7.2 | 4.2 | .5 | 13.4 | 4.7 | .5 | 12.5 | 4.6 | -.2 | -4.0 |
| Finance, insurance and real estate | 30.4 | 32.5 | 2.1 | 6.9 | 36.1 | 3.6 | 11.0 | 47.8 | 11.8 | 32.7 | 47.8 | -.1 | -0.2 |
| Real estate operators and lessors of buildings | 17.0 | 17.8 | .8 | 4.5 | 17.0 | -.8 | -4.4 | 20.1 | 3.1 | 18.5 | 22.2 | 2.1 | 10.3 |
| Holding and investment companies [4] | 6.6 | 7.4 | .8 | 12.2 | 10.0 | 2.7 | 36.6 | 14.1 | 4.1 | 40.6 | 13.6 | -.6 | -4.0 |
| Services | 27.0 | 29.0 | 2.1 | 7.7 | 29.1 | .1 | 0.3 | 37.5 | 8.4 | 28.9 | 39.3 | 1.8 | 4.7 |
| **LOSS PARTNERSHIPS** | | | | | | | | | | | | | |
| **All industries [2]** | **85.9** | **97.6** | **11.7** | **13.6** | **93.1** | **-4.5** | **-4.6** | **96.9** | **3.8** | **4.1** | **99.8** | **2.9** | **3.0** |
| Agriculture, forestry and fishing | 3.8 | 3.7 | -.2 | -4.2 | 2.5 | -1.2 | -32.9 | 2.7 | .3 | 11.2 | 2.3 | -.4 | -16.3 |
| Mining | 6.4 | 8.7 | 2.3 | 35.5 | .7 | -8.0 | -92.3 | 5.7 | 5.0 | 750.5 | 5.1 | -.6 | -11.3 |
| Oil and gas extraction | 5.0 | 7.3 | 2.3 | 46.1 | 6.4 | -.9 | -12.5 | 5.2 | -1.2 | -18.1 | 4.5 | -.7 | -13.7 |
| Construction | .5 | .7 | .2 | 32.1 | .6 | -.1 | -17.5 | .6 | .1 | 10.4 | .7 | (3) | 3.3 |
| Manufacturing | 2.3 | 2.0 | -.3 | -14.9 | 1.7 | -.3 | -13.8 | 2.1 | .4 | 21.1 | 2.8 | .7 | 34.0 |
| Transportation and public utilities | 4.4 | 4.7 | .3 | 6.4 | 5.8 | 1.1 | 23.3 | 5.2 | -.6 | -9.7 | 5.7 | .4 | 8.1 |
| Communication, electric, gas, and sanitary services | 3.9 | 4.0 | .2 | 3.9 | 5.2 | 1.2 | 28.8 | 4.7 | -.4 | -8.0 | 4.8 | .1 | 1.2 |
| Wholesale and retail trade | 1.5 | 1.4 | (3) | -3.0 | 1.5 | .1 | 5.1 | 1.4 | -.1 | -8.4 | 2.0 | .6 | 45.3 |
| Finance, insurance and real estate | 56.3 | 65.5 | 9.1 | 16.2 | 62.8 | -2.6 | -4.0 | 67.1 | 4.3 | 6.8 | 68.6 | 1.5 | 2.2 |
| Real estate operators and lessors of buildings | 43.2 | 50.6 | 7.4 | 17.0 | 50.1 | -.4 | -0.9 | 51.5 | 1.3 | 2.7 | 52.2 | .8 | 1.5 |
| Holding and investment companies [4] | 4.6 | 5.2 | .6 | 13.5 | 3.6 | -1.5 | -29.8 | 5.2 | 1.5 | 42.0 | 4.7 | -.4 | -8.5 |
| Services | 10.4 | 10.5 | .1 | 0.6 | 11.0 | .6 | 5.4 | 11.9 | .9 | 7.8 | 12.6 | .8 | 6.4 |

[1] Profit status is defined as gain or loss in net income. See footnote 14 at the end of the narrative for this article for a further explanation. Partnerships with a breakeven between gain and loss are included with loss partnerships.

[2] Includes "Nature of business not allocable," not shown separately.

[3] Less than 0.05 billion dollars.

[4] Excludes investment clubs and common trust funds.

NOTES: Data may not add to totals because of rounding. Data are from *Statistics of Income Bulletin,* selected issues; unpublished data from the Office of Tax Analysis, U.S. Department of the Treasury; and special Statistics of Income tabulations.

**Table 2.--Individual Income Tax Returns with Total Positive Income (TPI) $250,000 or More: TPI and Partnership Losses, by Average Tax Rate, Tax Years 1985-1989**

[All figures are estimates based on samples -- number of returns are in thousands; dollar amounts are in billions, except where indicated]

| Average tax rate, year | Number of returns | Percentage | Total positive income (TPI) Amount | Total positive income (TPI) Percentage | Partnership losses Amount | Partnership losses Percentage | Average TPI (thousand dollars) | Average partnership loss (thousand dollars) | Partnership losses as a percentage of TPI |
|---|---|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| **1985** | | | | | | | | | |
| All returns with TPI $250,000 or more | 362.8 | 100.0 | 235.9 | 100.0 | 27.2 | 100.0 | 650.3 | 74.9 | 11.5 |
| Average total income tax as a percentage of TPI: | | | | | | | | | |
| Under 5 percent | 39.1 | 10.8 | 25.0 | 10.6 | 11.5 | 42.3 | 639.6 | 293.9 | 46.0 |
| 5 percent under 10 percent | 35.8 | 9.9 | 19.8 | 8.4 | 4.5 | 16.5 | 552.6 | 124.8 | 22.6 |
| 10 percent under 20 percent | 120.3 | 33.1 | 88.6 | 37.6 | 6.7 | 24.5 | 737.7 | 55.5 | 7.5 |
| 20 percent or more | 167.7 | 46.2 | 102.5 | 43.5 | 4.5 | 16.7 | 611.2 | 27.1 | 4.4 |
| **1986** | | | | | | | | | |
| All returns with TPI $250,000 or more | 547.5 | 100.0 | 408.4 | 100.0 | 35.7 | 100.0 | 745.9 | 65.3 | 8.8 |
| Average total income tax as a percentage of TPI: | | | | | | | | | |
| Under 5 percent | 56.3 | 10.3 | 37.3 | 9.1 | 15.0 | 42.1 | 662.4 | 267.4 | 40.4 |
| 5 percent under 10 percent | 53.9 | 9.8 | 30.9 | 7.6 | 6.1 | 17.0 | 573.4 | 112.7 | 19.6 |
| 10 percent under 20 percent | 233.9 | 42.7 | 211.3 | 51.7 | 10.8 | 30.3 | 903.4 | 46.3 | 5.1 |
| 20 percent or more | 203.5 | 37.2 | 128.9 | 31.6 | 3.8 | 10.6 | 633.5 | 18.6 | 2.9 |
| **1987** | | | | | | | | | |
| All returns with TPI $250,000 or more | 494.4 | 100.0 | 295.7 | 100.0 | 25.9 | 100.0 | 598.1 | 52.1 | 8.7 |
| Average total income tax as a percentage of TPI: | | | | | | | | | |
| Under 5 percent | 58.5 | 11.8 | 37.8 | 12.8 | 10.4 | 40.4 | 645.3 | 177.8 | 27.6 |
| 5 percent under 10 percent | 36.7 | 7.4 | 21.1 | 7.1 | 2.9 | 11.4 | 574.3 | 79.8 | 13.9 |
| 10 percent under 20 percent | 105.2 | 21.3 | 61.0 | 20.6 | 6.5 | 25.2 | 580.1 | 61.7 | 10.6 |
| 20 percent or more | 293.9 | 59.5 | 175.8 | 59.5 | 5.9 | 23.0 | 598.1 | 20.2 | 3.4 |
| **1988** | | | | | | | | | |
| All returns with TPI $250,000 or more | 596.3 | 100.0 | 399.2 | 100.0 | 26.0 | 100.0 | 669.5 | 43.6 | 6.5 |
| Average total income tax as a percentage of TPI: | | | | | | | | | |
| Under 5 percent | 42.7 | 7.2 | 31.3 | 7.8 | 11.0 | 42.3 | 732.3 | 257.7 | 35.2 |
| 5 percent under 10 percent | 28.8 | 4.8 | 19.6 | 4.9 | 2.8 | 10.7 | 679.4 | 96.5 | 14.2 |
| 10 percent under 20 percent | 123.8 | 20.8 | 75.4 | 18.9 | 6.7 | 25.6 | 609.4 | 53.7 | 8.8 |
| 20 percent or more | 400.9 | 67.2 | 272.9 | 68.4 | 5.6 | 21.5 | 680.7 | 13.4 | 2.0 |
| **1989** | | | | | | | | | |
| All returns with TPI $250,000 or more | 653.8 | 100.0 | 406.5 | 100.0 | 25.4 | 100.0 | 621.8 | 38.7 | 6.2 |
| Average total income tax as a percentage of TPI: | | | | | | | | | |
| Under 5 percent | 57.5 | 8.8 | 41.5 | 10.2 | 12.2 | 48.1 | 721.3 | 211.9 | 29.4 |
| 5 percent under 10 percent | 36.8 | 5.6 | 24.9 | 6.1 | 2.9 | 11.5 | 677.5 | 79.0 | 11.7 |
| 10 percent under 20 percent | 157.6 | 24.1 | 89.9 | 22.1 | 6.0 | 23.6 | 570.1 | 37.9 | 6.6 |
| 20 percent or more | 401.8 | 61.5 | 250.2 | 61.6 | 4.3 | 16.9 | 622.7 | 10.7 | 1.7 |

NOTE: Detail may not add to totals because of rounding.