

## CHAPTER 11: NONFARM PROPRIETORS' INCOME

(Updated: May 2019)

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Nonfarm proprietors' income represents the portion of the total income earned from current production that is accounted for by unincorporated nonfarm businesses in the United States. The measure is an integral part of the national income and product accounts (NIPAs), a set of accounts prepared by the Bureau of Economic Analysis (BEA) that provides a logical and consistent framework for presenting statistics on U.S. economic activity (see "Chapter 2: Fundamental Concepts").

BEA's measure of nonfarm proprietors' income provides a comprehensive and consistent economic measure of the income earned by all U.S. unincorporated nonfarm businesses. The featured measure – nonfarm proprietors' income with inventory valuation adjustment and capital consumption adjustment is not directly affected by changes in tax laws, is adjusted for nonreported and misreported income, and excludes dividend income, capital gains and losses, and other financing flows and adjustments, such as deduction for "bad debt." Thus, the measure is a particularly useful analytical indicator of the health of noncorporate businesses and provides both a complement and contrast to the NIPA measure of corporate profits.

Nonfarm proprietors' income is a component of private enterprise income and personal income in the summary NIPA tables.

### Definitions and Concepts

Nonfarm proprietors' income measures the income, before deducting income taxes, of sole proprietorships, partnerships, and other private nonfarm businesses that are organized for profit but that are not classified as corporations. Sole proprietorships are businesses owned by a

single individual. Partnerships include most associations of two or more of: individuals, corporations, noncorporate organizations that are organized for profit, or of other private businesses. Other private businesses are made up of tax-exempt cooperatives, including credit unions, mutual insurance companies, and rural utilities providing utility services and farm marketing and purchasing services.

The NIPA measures of national income and gross domestic income and their components present the incomes that accrue to factors of production as a result of their contribution to production. For corporations, these incomes are separately reported in detailed financial accounts and in tax returns, and they are reflected in the NIPA measures of corporate profits, compensation of employees, and net interest (as well as taxes). Unincorporated businesses, on the other hand, are able to move assets freely between business and personal accounts with little, if any, reporting requirements, and tax liabilities are not separated between unincorporated businesses and their owners. In fact, the income of unincorporated businesses is generally reported on individual income tax returns; while compensation paid to employees is separately reported, the income of the business is not distinguished from the labor of the business owner and therefore reflects the incomes that accrue as a result of the owner's own labor and entrepreneurship. Similarly, dividend and interest incomes are separately reported but do not distinguish between business and personal receipts. The measure of nonfarm proprietors' income is therefore a critical measure for analyses of the shares of income, as it reflects factor incomes that are not separately captured by the other income measures.

Reflecting the concepts of national economic accounting, nonfarm proprietors' income in the NIPAs is defined as that arising from current production. This income is measured as receipts less expenses as defined in federal tax law, but with several important differences. Table 11.1 shows the types of transactions that are included in, and excluded from, nonfarm proprietors' income.<sup>1</sup>

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<sup>1</sup> The NIPA measures of proprietors' income are closely related to the measures for "mixed income" in the System of National Accounts (SNA). However, the SNA definition of mixed income is broader than proprietors' income and includes rental income of persons, noncorporate current transfer payments, and portions of net interest paid and consumption of fixed capital. At the same time, the SNA has a more narrow definition of the entities earning mixed income that excludes limited liability partnerships and any enterprises for which it is possible to separate all assets, including financial assets, into those that belong to the household and those that belong to the business. (See Charles Ian Mead, Karin E. Moses, and Brent R. Moulton, "[The NIPAs and the System of National Accounts](#)," *Survey of Current Business* 84 (December 2004): 17–32.)

Table 11.1—Content of Nonfarm Proprietors’ Income

Category of transaction	Comments
Nonfarm proprietors’ income	<p>Includes all U.S. nonfarm sole proprietorships that are required to file Internal Revenue Service (IRS) Schedule C (Profits or Loss from Business) of IRS Form 1040 (Individual Income Tax Return) or that would be required if they met the filing requirements.</p> <p>Includes all U.S. nonfarm partnerships that are or would be required to file IRS Form 1065 (U.S. Partnership Return of Income).</p> <p>Includes all other U.S. unincorporated private businesses—tax-exempt cooperatives providing utility services and farm marketing and purchasing services</p> <p>Receipts include taxable income from entities otherwise classified as nonprofits.</p> <p>Receipts exclude capital gains and dividends and monetary interest received by nonfinancial business.</p> <p>Receipts exclude rental income received by persons that are not primarily engaged in the real estate business.</p> <p>Expenses exclude deductions for bad debt, depletion, and capital losses.</p> <p>Expenses exclude expensing for, and include depreciation of, intellectual property products (including software) mining exploration, shafts, and wells, and rental clothing and videos.</p>
Inventory valuation adjustment	Inventory withdrawals are valued at current cost.
Capital consumption adjustment	Depreciation is valued at current cost.

BEA uses data collected on a tax-accounting basis as the primary source of information for nonfarm proprietors’ income. These data are based on well-specified, consistent accounting definitions that, in general, parallel NIPA concepts and definitions. In addition, tax-accounting tabulations are comprehensive, covering all unincorporated businesses. However, the data are not entirely suitable for implementing the NIPA concept of income from current production. Consequently, BEA’s procedure for estimating nonfarm proprietors’ income mainly consists of adjusting, incorporating, and supplementing these data.<sup>2</sup>

The featured measure of nonfarm proprietors’ income includes two additional adjustments—the inventory valuation adjustment (IVA) and the capital consumption adjustment (CCAdj)—made to ensure that the measure reflects income from current production. The IVA reflects the fact that as prices change, businesses that value inventory withdrawals at original acquisition (historical) costs may realize inventory profits or losses. In the NIPAs, these gains or losses that result from holding goods in inventory are not considered income from current production and thus are removed from business income. The IVA converts the tax-accounting

<sup>2</sup> See the section “Overview of Source Data and Estimating Procedures.”

value of inventory withdrawals, which is based on a mixture of historical and current costs, to a current-cost basis by removing the capital-gain-like or the capital-loss-like element that results from valuing these withdrawals at prices of earlier periods.<sup>3</sup>

Depreciation measured on a tax-accounting basis must be adjusted to reflect consistent economic-accounting measures that are valued at current-replacement cost. The CCAdj is a two-part adjustment that (1) converts valuations of depreciation that are based on a mixture of service lives and depreciation patterns specified in the tax code to valuations that are based on uniform service lives and empirically based depreciation patterns; and (2) like the IVA, converts the measures of depreciation to a current-cost basis by removing from profits the capital-gain-like or capital-loss-like element that arises from valuing the depreciation of fixed assets at the prices of earlier periods. A reconciliation of the Internal Revenue Service (IRS) measures of depreciation and BEA's measures of consumption of fixed capital for corporations and for proprietors are provided in NIPA "Table 7.13 Relation of Consumption of Fixed Capital in the National Income and Product Accounts to Depreciation and Amortization as Published by the Internal Revenue Service."<sup>4</sup>

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<sup>3</sup> For more information, see "Chapter 7: Change in Private Inventories," 7–4.

<sup>4</sup> Economic stimulus acts sometimes include temporary provisions for accelerated or "bonus" depreciation. Because total depreciation cannot exceed the amount of the investment, the amount of depreciation remaining to be taken in future years will be reduced. As depreciation will be increased during the "bonus" span and lowered thereafter, and because depreciation is an expense in calculating net income, NFPI will be understated during the "bonus" span and overstated thereafter.

BEA's featured measure of nonfarm proprietors' income—that is, NFPI with IVA and CCAdj—are not affected by bonus depreciation because the CCAdj replaces tax-based depreciation with economic depreciation—that is, consumption of fixed capital (CFC). BEA's estimates of bonus depreciation are published and are based on data from the Office of Tax Analysis (OTA) of the U.S. Department of Treasury and on other source data. For more information, see OTA's working paper "[Corporate Response to Accelerated Tax Depreciation: Bonus Depreciation for Tax Years 2002–2004.](#)"

The composition of proprietors' income with IVA and CCAdj is illustrated below.

	2015 estimate (billions of dollars)
Nonfarm proprietors' income with IVA and CCAdj	1,365.5
Nonfarm proprietors income without IVA and CCAdj	1130.3
IVA	9.2
CCAdj	225.9
For consistent accounting at historical cost	268.4
For current-cost valuation	-42.5

### **Recording in the NIPAs**

As described in chapter 2, the NIPAs can be viewed as aggregations of accounts belonging to individual transactors in the economy. In the seven summary accounts of the NIPAs, proprietors' income, which includes both nonfarm and farm proprietors' income, with IVA and CCAdj appears in the Private Enterprise Account (account 2) and the Personal Income and Outlay Account (account 3). Taxes on proprietors' income are included in personal current taxes, which appears in the Personal Income and Outlay Account (account 3) and in the Government Receipts and Expenditures Account (account 4).

The NIPAs present current-dollar annual estimates of gross domestic income by type of income, national income by type of income, and national income by sector and legal form of organization. The sector-specific estimates follow the NIPA sectors—business (including government enterprises), households and institutions, general government, and the rest of the world; within the business sector, the estimates by legal form are classified according to the Internal Revenue Service (IRS) filing requirements for corporate and noncorporate business. Noncorporate business is made up of proprietors—that is, sole proprietorships, partnerships, and “other private business.”<sup>5</sup> Annual estimates of nonfarm proprietors' income are also available by industry; the industry-specific estimates for 1998 forward are classified according to the North American Industry Classification System (NAICS) at the three-digit industry level, and the

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<sup>5</sup> For descriptions of NIPA sectors and of legal forms of organization, see the section “Classification” in chapter 2.

estimates prior to 1998 are classified according to the Standard Industrial Classification (SIC); the estimates for 1998-2000 are also available on an SIC basis.<sup>6</sup>

Estimates of nonfarm proprietors' income with inventory valuation and capital consumption adjustments and its aggregate components are also available quarterly.

The principal NIPA tables that present estimates of nonfarm proprietors' income as a component of GDI and of national income are identified below.<sup>7</sup>

- 1.10 Gross Domestic Income by Type of Income
- 1.11 Percentage Shares of Gross Domestic Income
- 1.12 National Income by Type of Income
- 1.13 National Income by Sector, Legal Form of Organization, and Type of Income
- 1.16 Sources and Uses of Private Enterprise Income
- 6.12 Nonfarm Proprietors' Income by Industry

BEA also prepares nominal, or "current-dollar" estimates of nonfarm proprietors' income that are not seasonally adjusted; these are available in Section 8 of the NIPA Interactive Data Tables.

The Internal Revenue Service (IRS) also prepares measures of nonfarm proprietors' income; specifically, estimates of the net profit (less loss) of nonfarm proprietorships and partnerships. The estimates are derived from tax returns as part of the Statistics of Income (SOI) program and form the basis of BEA's nonfarm statistics; BEA presents the relationship between them in "Table 7.14 Relation of Nonfarm Proprietors' Income in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service." A reproduction of table 7.14 appears in the technical note at the end of this chapter, "Adjustments to IRS Source Data for Nonfarm Proprietors' Income." Additionally, as noted above, NIPA table 7.13 presents the relationship between IRS measures of depreciation and BEA measures of consumption of fixed capital for corporations and for nonfarm sole proprietors and partnerships.

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<sup>6</sup> Time-series breaks caused by the conversion to NAICS and by previous revisions to the SIC are reflected in the separation of estimates into distinct tables for each range of estimates based on a different classification. For instance, table 6.12, Nonfarm Proprietors' Income by Industry, comprises four separate tables: table 6.12A, based on the 1942 SIC; table 6.12B, based on the 1972 SIC; table 6.12C, based on the 1987 SIC; and table 6.12D, based on the 2012 NAICS. For more information on the conversion from the SIC to NAICS, see John R. Kort, "[The North American Industry Classification System in BEA's Economic Accounts](#)," *Survey* 81 (May 2001): 7-13.

<sup>7</sup> The NIPAs also present annual and quarterly estimates of proprietors' income with IVA and CCAdj in NIPA table group 2 as part of personal income. Annual and quarterly estimates of "proprietors' income with IVA and CCAdj" and its major components are available in NIPA table 2.1, and monthly estimates of the same series are available in NIPA table 2.6. Annual estimates of proprietors' income with IVA and CCAdj are available for households in NIPA table 2.9. BEA also prepares state and local area estimates of nonfarm and farm proprietors' income. For more information, see the "[Regional](#)" page at [www.bea.gov](http://www.bea.gov).

## Overview of Source Data and Estimating Methods

As described earlier in the handbook, most of the NIPA estimates are prepared using a wide variety of source data (see “Chapter 3: Principal Source Data”) and using estimating methods that adjust the source data to the required NIPA concepts and that fill in gaps in coverage and timing (see “Chapter 4: Estimating Methods”). Table 11.A at the end of this chapter summarizes the source data and estimating methods that are used to prepare the most recent annual estimates and the current quarterly estimates of nonfarm proprietors’ income for the industry categories shown in NIPA table 6.12; the benchmark and other annual estimates for all industries are derived using the same source data and methods and are described below. The source data and methods for the current quarterly estimates reflect both seasonally adjusted and not seasonally adjusted estimates unless otherwise noted.

### Annual estimates (except most recent year)

Tabulations of income from individual income tax returns are prepared by the IRS and are published in the fall issues of the *Statistics of Income Bulletin*. The tabulations for sole proprietorships are based on a stratified random sample of individual tax returns, and the tabulations for partnerships are based on a stratified random sample of information returns; each provides universe totals by NAICS industry for many of the items on the returns, including receipt and expense items.

The IRS tabulations become available about two years after the year to which they refer, and this timing determines the incorporation of these data into the NIPA estimates. For example, in the July 2017 annual update of the NIPAs, the IRS tabulations for 2015 were the primary source for the estimates for that year; the IRS provides the data prior to its fall publication so that it can be incorporated in the annual update of the NIPAs. The estimates for the most recent year, 2016, were obtained by extrapolating the 2015 estimates (see the section “Most-recent-year estimates”).

The starting point for the NIPA estimates of income for nonfarm sole proprietorships (except for those proprietors that are primarily engaged in real estate) is the measure of “Net profit (less loss) of nonfarm proprietorships and partnerships, plus payments to partners, IRS” (line 1), based on the IRS measure of “net income less deficit.” “Guaranteed payments to partners” reflects the compensation of partners for the use of capital or services that are separate from the distribution of partnership income. For partnership income (except for those primarily engaged in real estate), the starting point is the IRS measure of “ordinary business income (loss); for the income of sole proprietorships or partnerships that are primarily engaged in real estate,

the starting point is the IRS measure of “net rental real estate income (loss)” and “other net rental income (loss)” from Form 1065 schedule K.<sup>8</sup>

*Adjustments to the IRS tax return data*

The by-industry IRS totals are adjusted by BEA as described below; a reconciliation of the IRS and the NIPA measures is presented annually in NIPA table 7.14, which is reproduced for the year 2015 below and discussed in detail in the technical note at the end of this chapter.

Table 11.2—Relation of Nonfarm Proprietors’ Income in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service  
[Billions of dollars]

Line in NIPA table 7.14	NIPA line item	2015
1	<b>Net profit (less loss) of nonfarm proprietorships and partnerships, plus payments to partners, IRS</b>	<b>837.7</b>
2	Plus: Adjustment for misreporting on income tax returns	672.3
3	Posttabulation amendments and revisions <sup>1</sup>	-411.1
4	Depletion on domestic minerals	1.4
5	Adjustment to depreciate expenditures for mining exploration, shafts, and wells	4.5
6	Bad debt expense	17.2
7	Income received by fiduciaries	1.8
8	Income of tax-exempt cooperatives	7.5
9	Adjustment to depreciate expenditures for intellectual property products <sup>2</sup>	5.0
10	Disaster adjustments (net) <sup>3</sup>	0.0

<sup>8</sup> Rental income of persons who are not primarily engaged in real estate is included in the NIPA measure of “rental income of persons.”). The IRS measure of “net income less deficit” is derived from tabulations of “net profit or loss” from IRS Form 1040 Schedule C; “ordinary business income (loss) is from Form 1065; and “net rental real estate income (loss)” and “other net rental income (loss)” are from Form 1065 Schedule K.



11	<b>Equals: Nonfarm proprietors' income, NIPAs</b>	1,130.3
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<sup>1</sup> Consists largely of an adjustment to expense all meals and entertainment, of oilwell bonus payments written off, of adjustments for corporate partners and statutory employees, of interest income, of residential real estate disposal costs and of margins on owner-built housing.

<sup>2</sup> Intellectual property products consists of software, research and development, and entertainment, literary, and artistic originals.

<sup>3</sup> Consists of disaster losses valued at historic-cost less net insurance receipts for disaster-related losses valued at replacement cost.

The major adjustments to this starting measure consist of:

- Adjustments for the misreporting of income (line 2), based on IRS audit data, on information returns, and on Census Bureau studies that match current population surveys with Social Security administrative records and IRS tax returns;
- Posttabulation amendments and revisions (line 3) to account for differences between tax accounting and national income accounting definitions;
- Adjustments to add back in measures that are treated by the IRS as deductions but that are not elements of costs of current production in the NIPAs: IRS depletion on domestic minerals (line 4), IRS expensing of expenditures for mining exploration, shafts, and wells (line 5), IRS bad debt expense (line 6), IRS expensing of expenditures for intellectual property products (line 9); this adjustment also includes net disaster adjustments (line 10);
- Adjustments to add income that is excluded from IRS tabulations: fiduciaries (line 7), and tax exempt cooperatives (line 8).

### **Most-recent-year estimates**

The estimates for the most recent year are prepared by extrapolating the estimates for the preceding year (for a general description of the extrapolation method, see “Interpolation and extrapolation using an indicator series” in chapter 4). The extrapolations are carried out separately for each industry using indicators that are based on a variety of sources, including Bureau of Labor Statistics (BLS) data (primarily on employment, average weekly hours, and average hourly earnings); Census Bureau data (primarily on the value of residential construction put-in-place, on the value of manufacturers’ shipments, and on merchant wholesalers’ total sales); and BEA data (primarily on personal consumption expenditures and on real estate brokers’ commissions).

The BLS data are the source for the indicators for the following industries: agriculture, forestry, fishing, and hunting; mining; utilities; transportation and warehousing; information; administrative and support and waste management services; most of finance and insurance; most

of professional, scientific, and technical services; and other services. BEA estimates of PCE for related goods and services are the source for the indicators for the following industries: retail trade; education services, health care, and social assistance; arts, entertainment, and recreation; accommodation and food services; part of finance and insurance; and part of professional, scientific, and technical services.<sup>9</sup> Census data are the source for the indicators for the following industries: construction; manufacturing; and wholesale trade. BEA data on real estate brokers' commissions are the source for the indicators for real estate and rental and leasing industries.

### **Current quarterly estimates**

Seasonally adjusted current quarterly estimates are published only at aggregate levels and not by industry. They are derived by averaging the most recent monthly estimates that are available for the months of that quarter; monthly estimates are released as part of BEA's monthly personal income estimates.<sup>10</sup> The monthly seasonally adjusted estimates (which are also released only for the total and not by industry) are derived by interpolating and extrapolating the annual estimates by industry, in most cases using the same industry indicators as those used for the most-recent-year estimates (see table 11.A).

Not seasonally adjusted quarterly and monthly estimates are derived using the same methods as the seasonally adjusted estimates, using the not seasonally adjusted versions of the same source data or indicators.

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<sup>9</sup> Information on the sources and estimating methods underlying BEA's measures of PCE for the goods and services noted in table 11.A, as well as other goods and services, is available in chapter 5 of this Handbook.

<sup>10</sup> The monthly estimates of personal income, including nonfarm proprietors' income, are expressed at annual rates; consequently, the current quarterly estimates, also expressed at annual rates, may be derived by averaging the monthly estimates.

Monthly estimates are revised as many as five times, depending on the month. The first month of every quarter (January, April, July, and October) are revised five times. For example, the monthly estimate for January is first released as part of the personal income release in February, revised in that release in March, revised as part of each current quarterly release for the first quarter in April, May, and June, and finally revised as part of the annual update in July. The second month of every quarter is revised four times and the third month of every quarter is revised three times.

<b>Table 11.A—Summary of Methodology Used to Prepare Estimates of Nonfarm Proprietors' Income</b>		
		Most-recent-year and current quarterly estimates (Indicator series used to extrapolate prior annual estimate)
1	<b>Nonfarm proprietors' income</b>	
2	<b>Nonfarm proprietorships and partnerships</b>	
	Forestry, fishing, and related activities	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for forestry and fishing industry.
3	Mining	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for mining industry.
4	Utilities	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for utilities industry.
5	Construction	Value of residential single family construction put-in-place from Census Bureau and private residential improvements (additions and alterations) from Census and BLS.
6	<b>Manufacturing</b>	
7	Durable goods	Manufacturers' shipments of durable goods from Census Bureau.
8	Nondurable goods	Manufacturers' shipments of nondurable goods Census Bureau.
9	Wholesale trade	Sales from total merchant wholesalers except manufacturers' sales branches and offices from Census Bureau.
10	Retail trade	PCE for retail trade excluding food services.
11	Transportation and Warehousing	BEA real wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for transportation and warehousing industry.

<b>Table 11.A—Summary of Methodology Used to Prepare Estimates of Nonfarm Proprietors' Income</b>		
		Most-recent-year and current quarterly estimates (Indicator series used to extrapolate prior annual estimate)
12	Information	BEA real wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for information industry.
13	Finance, insurance, real estate, rental, and leasing	
14	Finance and insurance	For securities, commodity contracts, and other financial investments and related activities, PCE for securities commissions. For credit intermediation and related activities, for insurance carriers and related activities, and for funds, trusts, and other financial vehicles, CES wages for each industry.
15	Real estate and rental and leasing	PCE for residential real estate brokers' commissions and other ownership transfer costs.
16	Professional and business services	
17	Professional Scientific, and Technical Services	
18	Legal Services	PCE for proprietary and public legal services.
19	Computer systems design and related services	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for computer systems designs and related services industry.
20	Miscellaneous professional, scientific, and technical services <sup>11</sup>	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for other professional, scientific, and technical services industry.

<sup>11</sup> Consists of accounting, tax preparation, bookkeeping, and payroll services; architectural, engineering, and related services; specialized design services; management, scientific, and technical consulting services; scientific research and development services; advertising and related services; and other professional, scientific, and technical services.

**Table 11.A—Summary of Methodology Used to Prepare Estimates of Nonfarm Proprietors' Income**

		Most-recent-year and current quarterly estimates (Indicator series used to extrapolate prior annual estimate)
21	Management of companies and enterprises; administrative and waste management services	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for management of companies and enterprises industry and for administrative and waste services industry.
22	Educational services, health care, and social assistance	
23	Educational services	PCE for education services provided by business and government.
24	Health care and Social Assistance	For ambulatory health care services, PCE for proprietary and government physician services. For hospitals, PCE for proprietary hospitals. For social assistance, PCE for proprietary and public child care providers, individual and family services, and vocational rehabilitation services.
25	Arts, entertainment, recreation, accommodation, and food services	
26	Arts, Entertainment, and Recreation	PCE for Arts, entertainment, and recreation.
27	Accommodation and Food Services	PCE for retail sales and balance of payments data.
28	Other services, except government	BEA wages and salaries based on CES data on employment, average weekly hours, and average hourly earnings for other services industry.

## **Technical Note: Adjustments to Data for Nonfarm Proprietors' Income**

This technical note provides detailed descriptions of the adjustments that are made for consistency with NIPA concepts and definitions to the IRS tax return data on nonfarm proprietors' profits. These adjustments are published annually in "Table 7.14. Relation of Nonfarm Proprietors' Income in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service." A reproduction of this table is shown below in table 11.3.

### **Adjustments to IRS Source Data for Nonfarm Proprietors' Income**

The starting point for the derivation of the estimates of nonfarm proprietors' income is "Net profit (less loss) of nonfarm proprietorships and partnerships, plus payments to partners, IRS" shown on line 1 in table 11.2 below. This measure is based on the all-industry total of the IRS item "net income less deficit" obtained from the *Statistics of Income Bulletin*. (This item differs from the IRS measure of total business receipts less total business deductions by the amount of "passive" activity losses that are excluded from the IRS measure of total deductions but that are included in the IRS measure of deficit.) The adjustments to the IRS data are discussed below in the order shown in the table.

Table 11.3—Relation of Nonfarm Proprietors' Income in the National Income and Product Accounts to Corresponding Measures as Published by the Internal Revenue Service  
[Billions of dollars]

Line in NIPA table 7.14	NIPA line item	2015
1	<b>Net profit (less loss) of nonfarm proprietorships and partnerships, plus payments to partners, IRS</b>	<b>831.7</b>
2	Plus: Adjustment for misreporting on income tax returns	672.3
3	Posttabulation amendments and revisions <sup>1</sup>	-411.1
4	Depletion on domestic minerals	1.4
5	Adjustment to depreciate expenditures for mining exploration, shafts, and wells	4.5
6	Bad debt expense	17.2
7	Income received by fiduciaries	1.8
8	Income of tax-exempt cooperatives	7.5
9	Adjustment to depreciate expenditures for intellectual property products <sup>2</sup>	5.0
10	Disaster adjustments (net) <sup>3</sup>	0.0
11	<b>Equals: Nonfarm proprietors' income, NIPAs</b>	<b>1,130.3</b>

<sup>1</sup> Consists largely of an adjustment to expense all meals and entertainment, of oilwell bonus payments written off, of adjustments for corporate partners and statutory employees, of interest income, of residential real estate disposal costs and of margins on owner-built housing.

<sup>2</sup> Intellectual property products consists of software, research and development, and entertainment, literary, and artistic originals.

<sup>3</sup> Consists of disaster losses valued at historic cost less net insurance receipts for disaster-related losses valued at replacement cost.

Adjustment for misreporting on income tax returns (line 2). Adjustments are made to the SOI data to account for income that is underreported on employment tax returns and for income that is not reported at all because the individuals fail to file a tax return; together, these adjustments

have accounted for approximately 50 percent of proprietors' and partnership income in the NIPAs since the 1970s. There is an additional misreporting adjustment offset to remove wages that are incorrectly reported as income. This adjustment is part of the posttabulation amendments and revisions on line 3.

*Underreported income.* The estimates of underreported income are based on audits of individual employment tax returns undertaken as part of the IRS National Research Program (NRP) for 2001, 2006, and 2008-2010 as well as tax gap measures for various years from the previous IRS TCMP studies. Estimates of the underreporting of the income of sole proprietors are taken directly from the IRS studies for the years covered by the studies. The underreporting of income by partnerships is not separately identified in the IRS reports but is combined with the underreported income of S corporations. The partnership share of this measure is derived from the partnership share of reported business receipts of partnerships and S corporations, and when available, the partnership share shown in TCMP studies. The estimates for years not covered by IRS studies are derived by interpolating between TCMP and NRP years and judgmentally extrapolating after 2010.<sup>12</sup>

*Nonreported income.* The estimates of nonreported income are based on “exact-match” studies from the Census Bureau for various years before 2003 and each year from 2003 forward. These studies match records from the Census Bureau’s Current Population Survey with individual IRS tax returns and provide industry-level measures of the total self-employment nonfarm income for those persons with validated social security numbers that did not file tax returns. Prior to 2003, estimates are interpolated for those years for which there are not “exact-match” studies.

Posttabulation Amendments and Revisions (line 3). This adjustment includes a number of items, including those described in table 11.4 below.<sup>13</sup>

Table 11.4 Current Posttabulation Amendments and Revisions to IRS “Net profit (less loss) of Nonfarm Proprietorships and Partnerships, plus payments to partners”

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<sup>12</sup> The IRS Taxpayer Compliance Measurement Program (TCMP) had provided estimates of misreported income for selected years since 1963. In 2001, the IRS launched the NRP to update the research and to reflect a changing economy, revisions to the tax code, and shifts in individual behavior.

<sup>13</sup> Other posttabulation amendments and revisions are very small. They include an adjustment to include the capital gains or losses of real estate developers because their function is trade rather than holding assets for profits and therefore reflects income from production; the exclusion of Section 1231 adjustments – that is, the capital gains or losses on real property because they do not reflect income from current production; and the inclusion of the income earned by newspaper carriers that is excluded from the SOI data.



<b>Adjustment</b>	<b>Estimate (2015)</b>	<b>Type and purpose of adjustment</b>	<b>Sources and Methods</b>
Portfolio interest	\$129	Definitional adjustment: To reflect the interest received by financial partnerships.	Adjustments are based on partnership SOI tabulations of portfolio interest income for selected industries.
Corporate partners net income	\$151.1	Definitional adjustment: to reflect the inclusion of corporate partnership income in corporate profits and its exclusion from nonfarm proprietors' income.	Total NIPA partnership income allocated according to corporate share of income distributed to partners from SOI.
Double counting adjustment	-\$103.3	Statistical adjustment: To avoid the double counting of income received by partnerships from other partnerships.	SOI tabulations of partnership income by type of partner to derive shares applied to total NIPA partnership income.
Meals and entertainment adjustment	\$35.6	Definitional adjustment: To treat all the expenses for business meals and beverages and entertainment as expenses in calculating nonfarm proprietors' income.	SOI tabulations of business meals and entertainment expenses.
Interest passed through to partners	\$93	Definitional adjustment: To exclude from income the interest paid to purchase property held for investment.	SOI tabulations of Schedule K-1.
Foreign distribution adjustment	\$127.1	Definitional adjustment: To remove from partnership income that income that is from sources outside of the United States.	Net income from foreign sources derived by applying the percent of S-corporation gross income that is foreign deductions applied to gross income from SOI.
Misreported wages	\$7.0	Definitional adjustment: To remove from nonfarm proprietors' income employee wages that are misreported as income of sole proprietors; the same	Audits of individual employment tax returns undertaken as part of the IRS National Research Program (NRP)

		amount is added to wages and salaries.	
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Depletion on domestic minerals (line 4). Natural resource discoveries are not considered to be capital formation in the NIPAs; consequently, depletion—the charge for the using up of these resources—is not a charge against current production. In contrast, the IRS permits depletion to be charged as an expense. Through this adjustment, the SOI expense “depletion” is reduced by the domestic depletion claimed on tax returns, thereby increasing net income. The adjustment is based on SOI tabulations of depletion.

Adjustment to depreciate expenditures for mining exploration, shafts, and wells (line 5). Expenditures for mining exploration, shafts, and wells are treated as capital formation in the NIPAs. In contrast, the IRS permits some of these expenditures to be charged as current expense. Therefore, the SOI measures of depreciation, by industry, are adjusted to remove the expensed portion of the current year’s investment and to add a charge for the depreciation of the investments made in the current and in previous years.

The capital formation of drilling and oil well casing is estimated from the American Petroleum Institute’s *Joint Association Survey on Drilling Costs* and BLS producer price indexes (PPIs). For oil well casing, the quantity is valued using the PPI for casing. For drilling, the quantity is valued using data in the *Joint Survey*. Expenditures for exploration are obtained from the *Annual Survey of Oil and Gas*. Expenditures for mine shafts are extrapolated from Census data. The value of the capital formation is depreciated over average service lives of 20 years by geometric depreciation.

Bad debt expense (line 6). Bad debt expenses are not considered to be expenses associated with current production and thus should not be reflected as expenses in calculating NIPA profits. The adjustment removes these expenses, based on the bad-debt expense item in the SOI tabulations.

Income received by fiduciaries (line 7). Sole proprietors that act as fiduciaries (trustees, guardians, executors of trusts or estates) file IRS Form 1041 instead of Form 1040, and they are therefore excluded from SOI tabulations of proprietorships and partnerships. This adjustment adds their income, based on separately available SOI data for 1950, 1974, and 1985. For other years, gross profits, depreciation, and other deductions are extrapolated separately using corresponding items for nonfiduciary sole proprietorships as reported in the SOI tabulations.

Income of tax-exempt cooperatives (line 8). This adjustment is the sum of separate adjustments for each type of “other” private business—specifically, rural electric cooperatives, rural telephone cooperatives, and farmers’ marketing cooperatives that are not included in the SOI tabulations because of their tax-exempt status. The adjustments for rural electric and telephone

cooperatives are based on annual data from the USDA’s Rural Electrification Administration. The adjustment for farmers’ marketing cooperatives estimates the patronage dividends earned by these cooperatives based on sales data and profit margins data provided by USDA’s Farmer Cooperative Service.

Adjustment to depreciate expenditures for intellectual property products (line 9). Expenditures for intellectual property products are treated as capital formation in the NIPAs.<sup>14</sup> In contrast, the IRS permits some of these expenditures to be charged as current expense. Therefore, the IRS data are adjusted to remove the expensed portion of the current year’s investment and to add depreciation charges on investment made in the current and in previous years. This adjustment is described briefly in table 11.5 below.

Table 11.5—Adjustment to Depreciate Expenditures for Intellectual Property Products

Adjustment	Estimates (billions of dollars)	Type and purpose of adjustment	Sources and methods
	2015		
Research and development	3.6	Definitional adjustment: Business and government expenditures for research and development are recognized as fixed investment.	Adjustments are primarily based on BEA investment data, which in turn, are based on National Science Foundation survey data.
Software	1.1	Definitional adjustment: Business and government expenditures for software are recognized as fixed investment.	Adjustments are primarily based on BEA investment data, which in turn, are based on Census Bureau economic census and survey data and on Bureau of Labor Statistics survey data.

<sup>14</sup> As part of the 2013 comprehensive update of the NIPAs, BEA began treating expenditures on research and development and on entertainment, literary, and artistic originals as fixed investment and thus the depreciation of these assets as consumption of fixed capital. For more information on the treatment of these “intellectual property products,” see [“Preview of the 2013 Comprehensive Revision of the National Income and Product Accounts,”](#) *Survey* 93 (March 2013): 14–20; also see the technical note at the end of “Chapter 6: Private Fixed Investment.”

Entertainment, literary, and artistic originals	0.3	Definitional adjustment: Business and government expenditures for entertainment originals are recognized as fixed investment.	Adjustments are primarily based on BEA investment data, which in turn, are based on Census Bureau economic census and survey data.
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Disaster adjustments (net) (line 10). In the NIPAs, the loss of capital as a result of a catastrophic disaster and the insurance payouts that result from them do not affect income associated with current production. The adjustment consists of (1) removing the net of the value of losses from depreciation (a current business expense) and (2) removing from current transfer payments the insurance payouts made by insurance companies.<sup>15</sup>

Depreciation estimates are based on data on insured damages at current cost, broken down by type, from the Insurance Service Office. The amount is adjusted for uninsured damages, distributed by industry according to regional impact using data from the Census Bureau’s *County Business Patterns*, and converted to historic-cost depreciation using various service lives and price indexes. In contrast, the IRS allows all uninsured disaster losses to be charged as current business expenses in “other deductions” on Form 4684.

Insurance payouts and receipts are also based on data from the Insurance Service Office, supplemented by government insurance fund transactions. Income receipts are distributed by industry using the above information on historic-cost depreciation.

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<sup>15</sup> In the 2009 comprehensive update, BEA introduced a new treatment of major disasters (those in which either the associated property losses or the insurance payouts exceed 0.1 percent of GDP) that records them as “changes in the volume of assets” rather than as consumption of fixed capital; see Eugene P. Seskin and Shelly Smith, “[Preview of the 2009 Comprehensive Revision of the NIPAs: Changes in Definitions and Presentations](#),” *Survey* 89 (March 2009): 11–15.