**Income**

Income is the money you receive in exchange for your labor or products. Income may have different definitions depending on the context—for example, taxation, financial accounting, or economic analysis.

For most people, income is their total earnings in the form of wages and salaries, the return on their investments, pension distributions, and other receipts. For businesses, income is the revenue from selling services, products, and any interest and dividends received with respect to their cash accounts and reserves related to the business.

Economists have different definitions of income and different ways of measuring it, from focusing on earnings, savings, consumption, production, public finance, [capital investment](https://www.investopedia.com/terms/c/capital-investment.asp), or other topics.

KEY TAKEAWAYS

* Income generally refers to the amount of money, property, and other transfers of value received over a set period of time in exchange for services or products.
* Taxable income is gross income minus exclusions, exemptions, and deductions allowed under the tax law.
* Financial regulators, businesses, and investors focus on businesses’ annual financial statements, which are prepared in accordance with generally accepted accounting principles (GAAP).

**What Is Income?**

There are different terms for income, depending on the quantity being measured. [Gross income](https://www.investopedia.com/terms/g/grossincome.asp) is the total value of your salary or payments, without accounting for any cash outflows. [Net income](https://www.investopedia.com/terms/n/netincome.asp) refers to the income left over after subtracting taxes or fees.1

You [discretionary income](https://www.investopedia.com/terms/d/discretionaryincome.asp) is the amount you have available after paying for necessary expenses, or money available to budget. Discretionary income may also be calculated for student financial aid using your income and a poverty guideline.2

For taxation purposes, income refers to the types of revenues that are eligible for [income tax](https://www.investopedia.com/terms/i/incometax.asp). These definitions may vary by jurisdiction. Salaries and sales are typically considered [taxable income](https://www.investopedia.com/terms/t/taxableincome.asp), but inheritances and gifts usually are not.

Although tax and accounting rules have similarities, each system has special rules reflecting its distinctive context and purposes.

Generally, taxation, and financial accounting measure income over a 12-month period. While financial accounting income is comprehensive, taxable income is calculated with special statutory exclusions, exemptions, and allowances that vary by tax status, income source, and individual and business decisions.

*If you live and work outside the United States, you are still required to file income taxes, but you do not have to pay taxes on all of it. For the 2023 tax year, the*[*foreign earned income exclusion*](https://www.investopedia.com/terms/f/foreign-earned-income-exclusion.asp)*covers the first $120,000 of your foreign-earned income.*

**Taxable Income**

For income tax purposes, the tax code attempts to define income to reflect taxpayers’ actual economic position. The general tax framework applies to taxpayers’ personal revenue (other than tax-exempt income) from all sources and offsets such revenue with [deductions](https://www.investopedia.com/terms/d/deduction.asp) for expenses and losses to determine taxable income.

In addition, [public policies may offer favorable taxation](https://www.investopedia.com/experts-share-top-tax-savings-tips-8417232) for people at certain income levels or for favored economic activities. Such policies include tax exemptions for government bonds, tax-favored treatment for retirement savings, tax credits for people below a certain income level, and promoting energy efficiency through special tax credits.345

**Types of Income**

Three main categories of income that are part of taxation are: ordinary income, capital gain, and tax-exempt income.

Ordinary Income

In the United States, the tax law distinguishes ordinary income from capital investments. Ordinary income encompasses earnings, interest, regular dividends, rental income, distributions from pensions or retirement accounts, and Social Security benefits. Ordinary income is taxed at rates ranging from 10% to 37% in 2023.6

*Taxpayers whose net investment income exceeds specified thresholds pay an additional 3.8% net investment income tax.7*

Capital Gains

Capital gains are the gains from selling assets that have appreciated in value. In the United States, the [capital gains tax rates](https://www.investopedia.com/terms/c/capital_gains_tax.asp) on assets held for more than one year are 0%, 15%, and 20%. Capital assets include personal residences and investments such as real estate, stock, bonds, and other financial instruments.8

Qualified dividends—that is, dividends distributed with respect to the U.S. and certain foreign corporate stock holdings that meet statutory holding-period requirements—also are taxed at capital gains rates.

To qualify for the [capital gains tax rate](https://www.investopedia.com/terms/c/capital_gains_tax.asp), which is usually no higher than 15%, you must hold an asset for longer than one year before selling it. Otherwise, the gains on that asset will be taxed at the same rate as your ordinary income, which is usually higher.9

Tax-Exempt Income

Interest paid on certain bonds issued by governmental entities is treated as tax-exempt income. Interest paid on federal bonds and [Treasury securities](https://www.investopedia.com/articles/investing/073113/introduction-treasury-securities.asp) is exempt from state and local taxation.10

Interest on bonds issued by state and local governments generally is not subject to federal taxation. Municipal private activity bonds are not subject to the regular federal income tax, but they are subject to the federal alternative minimum tax. Some states and local governments also exempt interest on state and local bonds from taxation.11

**How Is Earned Income Taxed?**

Earned income is the money a person receives due to working or business activities, such as earning a salary, self-employment income, or certain government benefits. This is distinct from [unearned income](https://www.investopedia.com/terms/u/unearnedincome.asp), such as receiving an inheritance, capital gains, or qualified dividends.

Earned income is subject to different taxes than unearned income. In the United States, earned income is subject to payroll taxes, [Medicare tax](https://www.investopedia.com/medicare-tax-definition-5115380), and [Social Security tax](https://www.investopedia.com/terms/s/social-security-tax.asp), although the latter is capped at a certain level.

**Business Income: GAAP Income**

Most businesses, including all public companies, employ standard financial accounting methods and practices—i.e., [generally accepted accounting principles (GAAP)](https://www.investopedia.com/terms/a/accounting-principles.asp)—to determine their income and value. Audited financial statements prepared in accordance with these rules are required for public companies. Investors assess businesses’ financial statements and use them to compare the performance of companies in the same or different industries.

GAAP calculations do not incorporate the type of public policy deviations that are embodied in the tax code. The two systems employ different timing standards for recognizing revenue and expenses. Generally, the snapshot of income and business value determined using GAAP provides a picture of [business income](https://www.investopedia.com/ask/answers/070615/what-difference-between-earnings-and-income.asp) and value that is often closer to economic reality than the results of tax accounting.12

Is There a Standard Definition of Income?

The definition of income depends on the context in which the term is used. For example, the tax law uses the concepts of gross income, which includes all income in all its forms, and taxable income, which is gross income net of expenses and other adjustments. On the other hand, the standard for financial accounting—generally accepted accounting principles (GAAP)—uses the term revenue reduced by expenses to determine net income. In addition, the calculation of income will vary depending on the scope of the context—e.g., an individual, a household, an industry, a nation, etc.

What Is Taxable Income?

Taxable income is the total of all income from all sources and in any form, minus any tax-exempt amounts or allowable deductions. This is the amount that is subject to income taxation.

Which Categories of Income Are Tax-Exempt?

Federal, state, and local tax laws specify certain categories of income that are not subject to income taxation. Generally, interest paid on state and local government bonds is exempt from federal income tax. Federal law also exempts interest paid on some special narrow categories of federal agency debt. State tax laws exempt interest on U.S. Treasury bonds, and some states also exempt interest on state and local bonds. In addition, distributions from Roth 401(k) plans and Roth individual retirement accounts (IRAs) are tax-free. Charities and other tax-exempt organizations do not pay tax on their income, except for income from unrelated trades or businesses.

What Is Not Considered Income?

Certain types of payments are not included in your taxable income by the IRS. They include inheritances and gifts, alimony payments, cash rebates, child support, most healthcare benefits, qualifying adoption reimbursements, and welfare payments. Scholarship payments and life insurance benefits may be taxable, in certain situations.13

Is Net Income the Same As Profit?

[Net income and profit](https://www.investopedia.com/ask/answers/122414/net-income-same-profit.asp) are both business terms that refer to the excess of income over expenses. However, there is a difference: Net income is the difference between a company's total revenues and all expenses, including overhead and operational costs, taxes, depreciation and amortization of assets, and any other expenses. Profit refers to the revenue that remains after some expenses. There are several different calculations for profitability, such as gross profit and operational profit, each of which has a separate importance to analysts.

**The Bottom Line**

Income is one of the most basic measures of economic activity. For individuals and companies, it measures the net gain of their revenues as a result of working or doing business. In public policy, income represents the basis for most forms of taxation.