Types of Income

The income of individuals used to be classified simply as either ordinary or capital gain (or loss). Under the Tax Reform Act of 1986, that's no longer the case. One of the major revisions of the sweeping 1986 tax legislation was the creation of *three basic categories of income*. Devised as a way to curtail the amount of write-offs that could be taken in tax-sheltered investments, they consist of the following:

1. *Active income* consists of everything from wages and salaries to bonuses, tips, pension income, and alimony. It is made up of income earned on the job as well as most other forms of *noninvestment* income.
2. *Portfolio income,* in contrast is comprised of the earnings generated from various types of investment holdings. In fact, this category of income covers *most* (but not all) types of investments, from stocks, bonds, savings accounts, and mutual funds to stock options and commodities. For the most part, portfolio income consists of interest, dividends, and capital gains (i.e., the profit on the sale of an investment).
3. *Passive income,* a special category of income, is comprised chiefly of income derived from real estate, limited partnerships, and other forms of tax shelters.