Introduction

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The five papers in this issue of *Tax Policy and the Economy* are all directly related to important and often long-standing issues involving current taxes and tax policy, often including how transfer programs affect tax rates and behavior as well.

Auerbach, Kotlikoff, Koehler, and Yu take a lifetime perspective on the marginal tax rates facing older individuals and families arising from a comprehensive set of roughly 30 different sources, including the federal income tax and state income taxes, the payroll tax, the federal corporate income tax, and a long list of transfer programs including the Social Security retirement program, Medicare, food stamps, Supplemental Security Income, and Disability Insurance benefits. The transfer programs impose tax rates when their benefits are phased in or out as work and earnings rise. Using a sophisticated calculator that assumes consumption smoothing over the lifetime for any present discounted value of income and that incorporates mortality rates as well as projected lifetime earnings profiles and borrowing constraints, the authors apply it to households in the Survey of Consumer Finances to derive a marginal tax rate equal to change in the net present value of lifetime spending per dollar of lifetime wealth (human capital and financial) resulting from increases in work, retirement ages, earnings, and other measures of labor market activity. Their results show an enormous dispersion of marginal tax rates within the older population—even among those with the same or similar level of resources—but many very high rates as well, higher than in the past literature, which imply a lower net gain in sustainable living standards from working longer. The authors ascribe these high rates primarily to Disability Insurance, Medicaid, and the Social Security earnings test.

In the second paper, Gizem Kosar and I provide new estimates of the
cumulative marginal tax rates facing low-income families over the period 1997–2007, which arise from federal and state income taxes, payroll taxes, and four major means-tested transfer programs: the food stamp program, Medicaid, the Temporary Assistance for Needy Families (TANF) program, and subsidized housing programs. In addition to considering more transfer programs than most past work, they calculate rates for all family types, both those with and without children and for those married and unmarried. They find strong variation in tax rates facing families of different types and participating in different combinations of programs, but especially strong variation by level of earnings. For most families, marginal rates are low or negative at low-earnings levels, particularly at levels below the poverty line, and are somewhat higher for earnings just above the poverty line. But for the minority of families participating in multiple programs, earnings just above the poverty line often result in very high marginal tax rates, often exceeding 100%.

Saez adds to the large literature on the effect of federal income taxes on behavior, focusing on the now-traditional effect of taxes, as measured by the net-of-tax rate, on pre-tax-reported income. He provides new evidence from the increases in the top rates on labor income and capital income that took effect in 2013. Using only published IRS statistics and hence using transparent and easily understood methods, he finds a large difference between the short-term and medium-term elasticity of reported income with respect to the net-of-tax rate. From 2012 to 2013, Saez finds a large elasticity, in excess of one, driven primarily by an uptick in dividends and capital gains realizations in the top 1% of the income distribution. He argues that this was largely a result of timing changes, as the tax rate increases were largely expected sufficiently before they took effect to allow taxpayers to alter the timing of income receipt. But over the period 2011 to 2015, the elasticity was much smaller. Over that period, behavioral responses were modest and only a small reduction in reported income occurred. The incomes of top earners resumed their upward course thereafter.

Clarke and Kopczuk survey the treatment of business income taxation in the United States since the 1950s. Business income is taxed in very different ways depending on the form in which it is generated and received, and its treatment has changed over time with the passage of legislation and administrative rulings. The authors review the history of business income taxation in the United States, drawing on the large body of existing literature on the subject, but go on to provide new data on how business income and its taxation have evolved over time, in
many cases going back to 1958. They find that there have been major changes in whether business income is taxed on an accrual rather than realization basis, the extent to which taxation is deferred, and the share of income that is taxed. They also find that business income is increasingly taxed through personal income taxes instead of a combination of corporate and personal taxes and that income is increasingly taxed on an accrual rather than realization basis. They suggest that research that uses time trends in business income could be affected by the changes over time in the composition of that income arising from these tax-related factors. They also point out that international comparisons are affected by these factors as well, for the share of business income subject to tax, for example, has changed in quite different ways in different countries.

Economists of late have devoted much attention to tax reforms that broaden the base to enable lower tax rates—so-called tax expenditure limitation policies. These policies are often viewed as efficiency enhancing because of the resulting reduction in statutory marginal tax rates. Moreover, by tilting the rate reductions to favor lower-income taxpayers, it is thought possible to enhance progressivity as well, without requiring higher marginal tax rates. The typical approach in the literature is to consider alternative tax structures that improve efficiency and/or distribution while holding revenue constant. In the final paper in the issue, Kaplow provides a complementary, distribution-neutral perspective: in the first pass, policies are examined that hold distribution constant as well. Using this framework, Kaplow shows that the resulting reduction in statutory tax rates from base broadening entails no change whatsoever in effective marginal tax rates, so the efficiency gains from apparently lower rates are illusory. Moreover, deviation from distribution neutrality to enhance progressivity in fact requires higher effective marginal rates. Tax expenditure limitation proposals, therefore, do not escape the familiar distribution-distortion trade-off. Kaplow shows that there are true efficiency gains from tax expenditure limitations, but they arise only from the reduction in distortions that tax preferences create between different forms of expenditures, the traditional microeconomic objection to differential taxation.

Endnote

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