Introduction

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The six papers in this issue of Tax Policy and the Economy are all directly related to important issues concerning U.S. taxation and transfers.

In the first paper, Roger Gordon examines the proposed use of a carbon tax, to be set by international agreement, as a means of limiting global warming. Economists broadly regard such a tax as more efficient than the type of quantity caps on emissions specified in the past Kyoto and Paris international agreements. Gordon argues that there are several drawbacks to such use of a carbon tax. Any tax sufficient to internalize global externalities will far exceed the rate that a country would choose on its own to internalize domestic externalities from extra CO_2 emissions. Even if obliged by treaty to maintain such a high tax rate, Gordon shows that any country has an incentive, given domestic considerations, to undermine the resulting "excess" abatement through a wide variety of other government policies. Many of these policies would be difficult to detect or prevent. Quantity targets, in contrast, directly constrain total emissions. A second problem with use of a carbon tax, given a presumed international objective to put a cap on the extent of global warming, is the high inherent uncertainty in the effects of any given carbon tax rate on global emissions. A quantity cap, in contrast, specifies global emissions, though still leaves the inherent scientific uncertainty concerning the link between emissions and the extent of global warming. Another advantage of setting quantity caps is that the pattern of these caps can be adjusted across countries to assure broad participation in any international agreement, whereas a uniform carbon tax rate can leave some key countries, particularly those with large fossil fuel industries, as net losers from an agreement.

Janet Holtzblatt, Swati Joshi, Nora Cahill, and William Gale conduct an investigation of racial disparities in the treatment of marriage in the federal income tax. The authors note that, while the income tax code does not refer to race, provisions in the code create disparities by race when factors that affect taxes are correlated with race. They study this issue in the context of racial differences in marriage patterns that affect taxes, extending the extensive literature on marriage bonuses and penalties in the income tax to the issue of race. Black and White individuals have different rates of marriage, different income distributions, and different rates of the presence of children, all of which interact to affect tax liability. Using eight waves of the Survey of Consumer Finances from 1988 to 2019, Holtzblatt et al. produce several important findings. They find that Black couples face higher tax costs of marriage than White couples. Controlling for family income, the authors find that penalties are more prevalent for Black couples than for White couples and comprise a higher share of income. In addition, because marriage penalties in general are greater for couples with relatively similar earnings, Black couples tend to face greater penalties than White couples because they have more equal earnings. Hotlzblatt et al. also find that because of the higher marriage rates of White than Black individuals, a greater share of White tax units face penalties than Black tax units, although this also implies that reductions in marriage penalties would benefit White individuals more than Black. Finally, the authors analyze the effect of two marriage penalty reforms, one replacing joint filing with individual filing (which would benefit those with dependents) and the other reinstating the two-earner deduction. While both reforms would benefit all couples, a larger share of White adults than Black adults would benefit.

The third paper, by Niels Johannesen, Daniel Reck, Max Risch, Joel Slemrod, John Guyton, and Patrick Langetieg, analyzes foreign asset holdings as reported under the Foreign Account Tax Compliance Act (FATCA) which newly required foreign banks, investment funds, and other intermediaries to provide to the IRS information on their accounts controlled by U.S. taxpayers. The data cover about 45,000 foreign financial institutions from 190 countries. The authors use these new data, combined with other administrative tax data, to construct new measures of the aggregate foreign financial wealth of U.S. households as well as the distribution of this wealth over income groups. They find that about 1.5 million U.S. taxpayers held foreign financial accounts in tax year 2018 with an aggregate value of about $4 trillion. While only 14 percent of accounts were in countries usually considered to be tax havens, about half of the aggregate assets were in those areas. Their estimates imply a ratio of tax haven assets to GDP of about 10 percent as well. The authors also examine the distribution of foreign assets over the individual income distribution, including assets held directly by individuals and indirectly via partnerships. They find a very steep income gradient. More than 60 percent of individuals in the top 0.01 percent of the income distribution hold foreign accounts, either directly or indirectly, compared to 40 percent for the bottom half of the top 0.1 percent, less than 20 percent for the bottom half of the top 1 percent, and less than 5 percent for the bottom half of the top 10 percent. Likewise, they find assets in foreign accounts, in terms of dollar values, are highly concentrated at the top of the income distribution.

Haichao Fan, Yu Liu, Nancy Qian, and Jaya Wen study the impact of computerizing Value Added Tax (VAT) transactions in China in 2001-2002. In middle-income countries like China, VAT revenues to the government are reduced by considerable misreporting and falsification, which the administrative capacity of the tax authorities is insufficient to address.

This force is particularly important in a large country like China with billions of transactions and where VAT revenues represent nearly half of government revenue. Computerization – the digital recording and electronic linking of transactions – has the potential to address this problem. Using data on firm VAT revenues and deductibles from 1998 to 2007, before and after the 2001-2002 computerization, the authors conduct a differences-in-differences analysis comparing firms that were more intensely affected by the computerization to firms that were less intensely affected (intensity is measured as non-deductible inputs as a share of sales). The analysis shows that computerization increased VAT growth by over 13.7 percent from 1998 to 2007 the authors estimate that the increased VAT constituted 11.7 percent of total 2000 VAT revenue. The effect occurred primarily through a reduction in exaggerated deductions.

In the fifth paper, Louis Kaplow addresses the extensive literature on the charitable deduction in the federal income tax. Much work has been done on that deduction, but most of it has concerned the magnitude of the elasticity of charitable giving with respect to its net-of-tax price. Kaplow instead addresses how to determine the optimal charitable deduction, building on the classic optimal taxation frameworks of Mirrlees and Atkinson-Stiglitz. Consistent with the latter, which showed that uniform commodity taxation is optimal in a basic setting with no externalities, in this framework the optimal subsidy to charitable giving (which subsidizes a particular form of expenditure) equals the Pigovian externality generated by that giving. Kaplow shows that this optimality condition does not involve the elasticity of giving with respect to its net-of-tax price, which is important for tax revenue but tax revenue does not directly enter into the optimality condition. Kaplow's method draws on his previous work to separate the efficiency gains of tax subsidies for charitable giving from their distributional and revenue effects. This methodology involves making an adjustment to the income tax schedule to leave distribution unchanged. With that adjustment, the pure efficiency gains of allowing a deduction for charitable giving can be isolated and used to determine the optimal subsidy rate just on efficiency grounds associated with internalization of the pertinent externality.

The sixth paper, by John Guyton, Kara Leibel, Day Manoli, Ankur Patel, Mark Payne, and Brenda Schafer studies the effects of IRS correspondence audits of filers who claim the Earned Income Tax Credit (EITC). The EITC is the country's largest anti-poverty wage subsidy program, but there are concerns about the noncompliance associated with EITC claims. The IRS attempts to detect and deter erroneous EITC claims through various methods, notably through correspondence audits: a process by which the IRS first identifies tax returns appearing to have a high likelihood of error and then contacts those taxpayers by mail, requiring them to substantiate items in their claim. The authors examine the impact of these audits on future EITC claiming and other outcomes. Using an analysis sample of filers where quasi-random variation in audit selection could be established, Guyton et al. first show that about 53 percent of those audited either do not respond to the audit notice (42 percent) or have a nondeliverable address (11 percent) and that only about 8 percent of those audited are allowed their claim. The authors note that nonresponse could be for a variety of reasons including awareness that the claim was erroneous, confusion about the audit process, or other barriers that might cause a taxpayer to forgo their claim even if it is correct. Examining the impacts on future behavior, the authors show that these EITC correspondence audits result in a 50 percent reduction in EITC claiming one year after the audit, with a gradually declining impact in subsequent years, as well as a negative impact on future rate of tax filing. The analysis also shows that children on audited returns are sometimes claimed by other taxpayers in subsequent years, and that audits are associated with a decline in reported wage income in the future, particularly in the region of earned income where potential EITC benefit amounts are the highest.