Public Policy 290 – Introduction to Tax Policy

Labor and Capital taxation

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Roadmap

1. What are capital taxes?

2. The history of capital taxes

3. Who pays capital taxes?

4. Labor taxes

1 What are capital taxes?

- Taxes on the stock of capital: one-off taxes (inheritance, estates, gifts) vs. annual taxes (property, wealth)

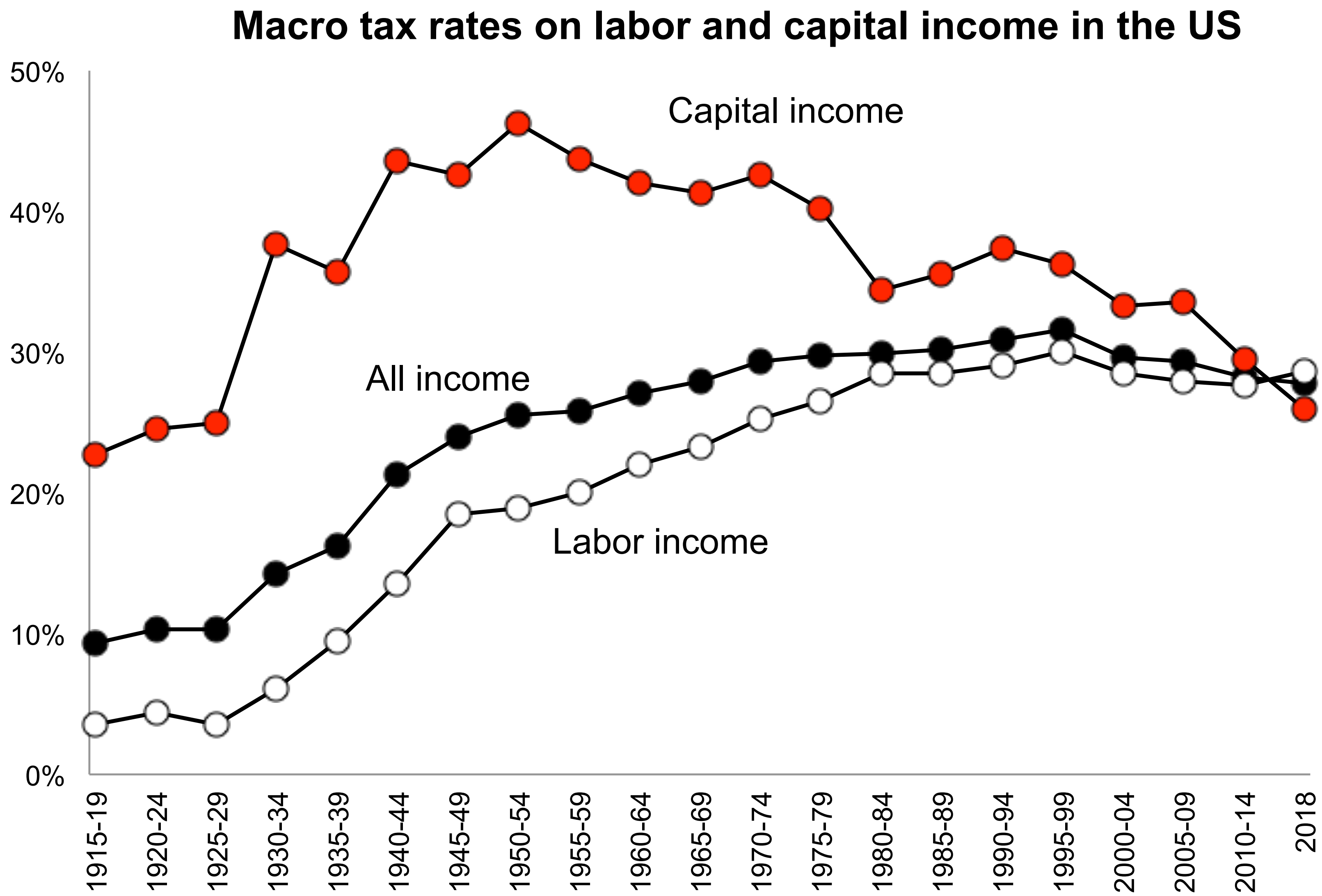
- Taxes on the flow of capital income: corporate level (corporate profits) vs. individual level (dividends, interest, rents, capital gains)

- Capital taxes T_k account for a sizable but falling share of government revenue T

- In the US: T_k about 25% of government revenue T

Macro capital tax rates in the US (2018)

- In the US, capital taxes $T_K = 25\%$ of total tax revenue T
- $T \approx$ 30% of total national income $Y \rightarrow T_K = 7.5\%$ of Y
- Capital income $Y_K = 30\%$ of Y
  (Capital/income ratio $\beta = K/Y \approx 500\%$; $r \approx 6\% \rightarrow$
  $\alpha = r \cdot \beta = 30\%$)
- Macro capital tax rate $\tau_K = T_K/Y_K \approx$ 25%



Source:Saez and Zucman (2019).

The structure of capital taxes in the US (2018)

- Corporate tax $= 1.5\%$ of Y (around 10% of a 15% tax base)

- Annual property taxes $= 3\%$ of Y (around 1% of a 300% tax base)

- Estates $= 0.2\%$ of Y (around 2% of a 10% tax base)

Taxing flows vs. taxing stocks

- If rate of return r is the same for all individuals and assets, then flow and stock capital taxes are equivalent

- Ex: If $r = 5\%$, it is equivalent to tax capital stock at $\tau_K = 1\%$ per year or to tax capital income flow at $t_K = 20\%$ per year

- In practice returns differ; individual i prefers stock taxes if $r_i > r$

- Argument in favor of taxes on stock rather than on flow: they put incentives to get a high return on capital (Allais, 1966, 1977)

- See Guvenen et al. (2017) for recent analysis

2 The history of capital taxes

The property tax: the oldest capital tax

- US: property taxes in Northern states as far back as 17th century (Einhorn, 2004). France: created in 1790.

- On personal real estate and business properties (buildings, land, offices, warehouses, etc.)

- Usually proportional (no wealth declaration required) and low rates

- Still collects sizable revenue (US: about 3% of national income)

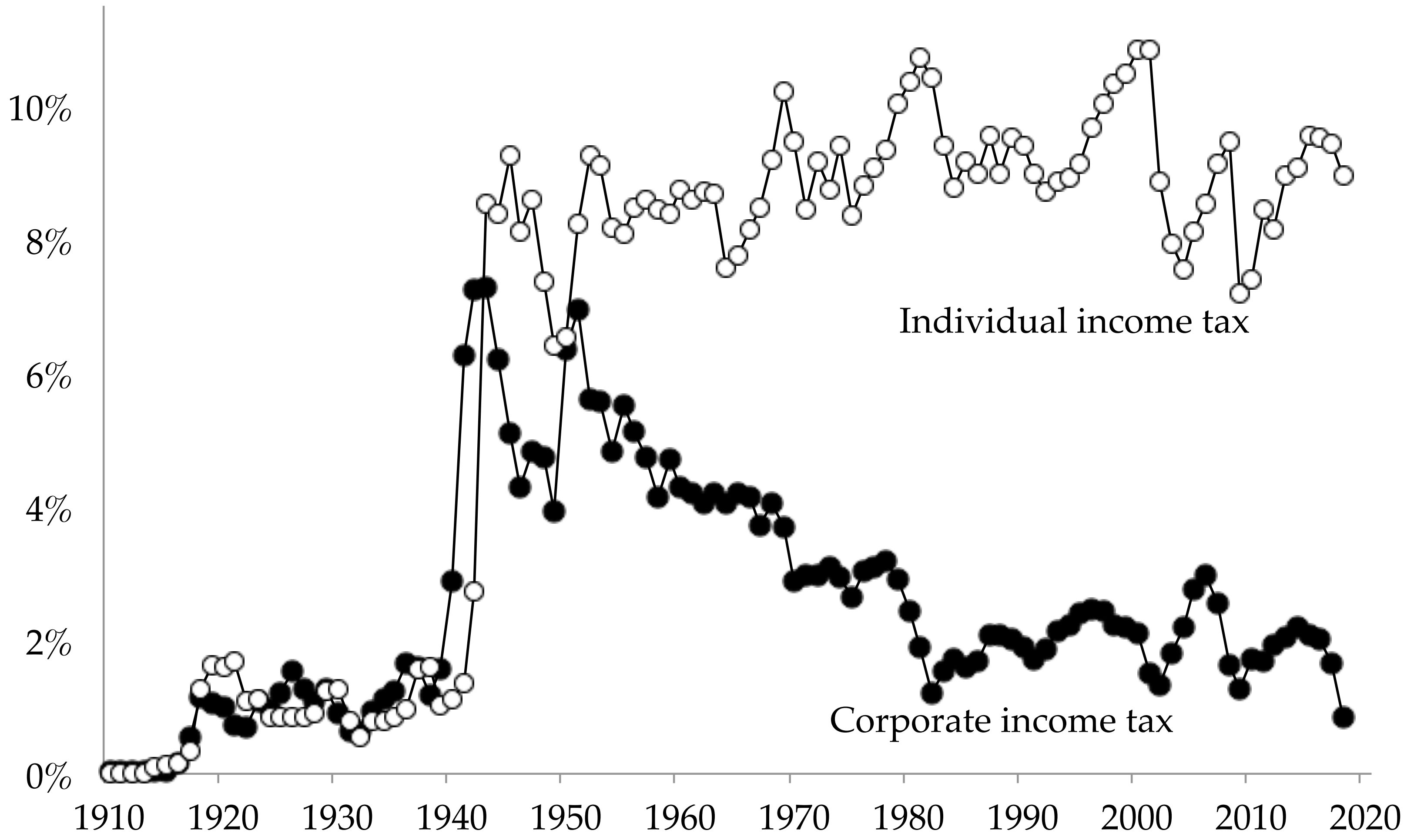
Taxes on capital income

- Individual income tax: initially mostly on capital income (interest, dividends, rents, etc.), because of high exemption threshold

- Corporate tax created at the same time as individual income tax

- Corporate tax is a backstop: without it the rich incorporate $\rightarrow$ progressive income tax fails

Federal tax revenue (% of national income)



Source: Saez and Zucman (2019).

Inheritance and estate tax

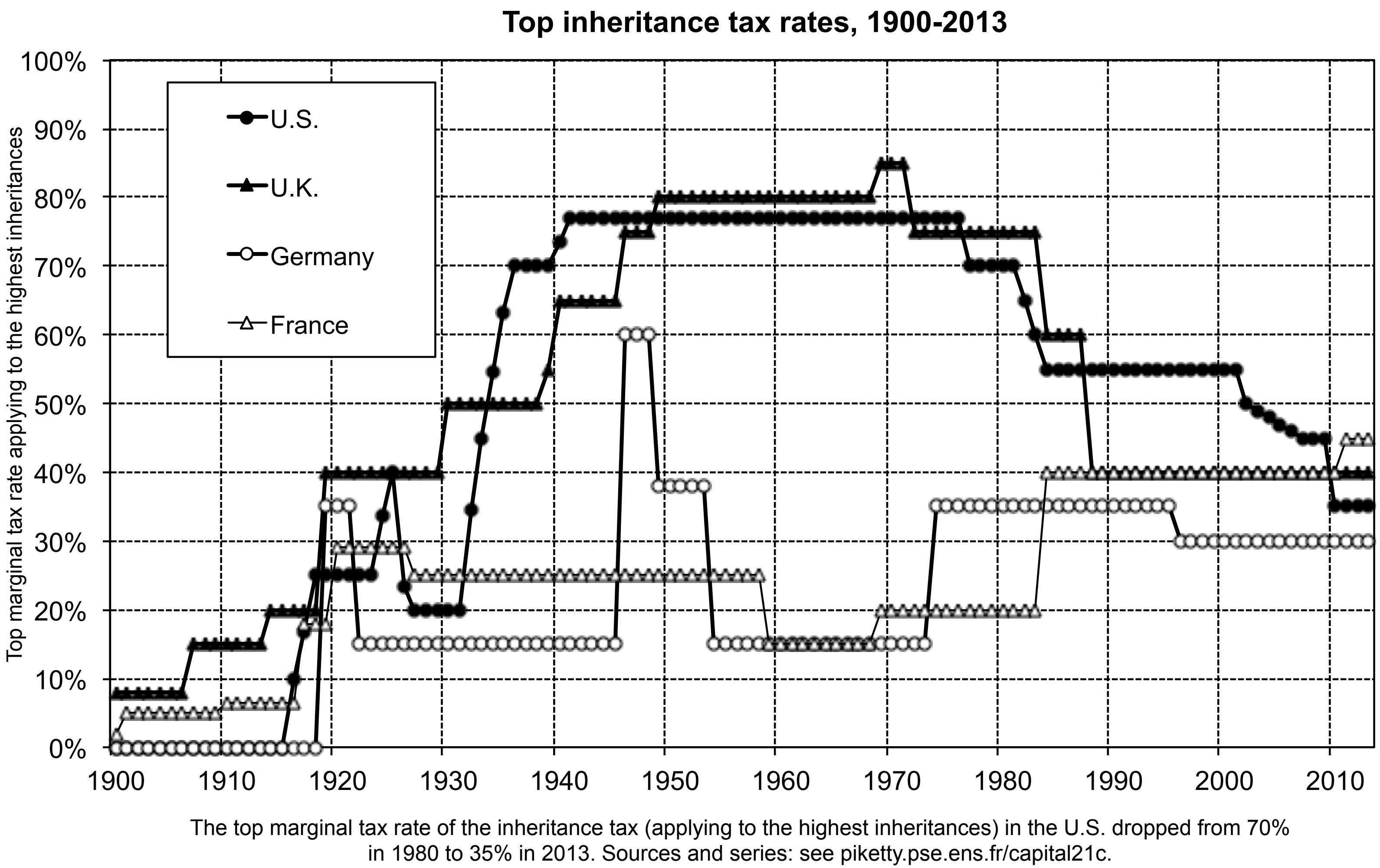
- Estate tax: on wealth of the deceased (US, UK...)

- Inheritance tax: on wealth received by heirs (France, Germany, Japan...)

- Estate / inheritance taxes: smaller (in terms of revenue) than other capital taxes

- But more progressive than other K taxes $\rightarrow$ key role for inequality

- Big increase in inheritance taxation after mass-mobilization wars (Scheve and Stasavage, 2012, 2016)



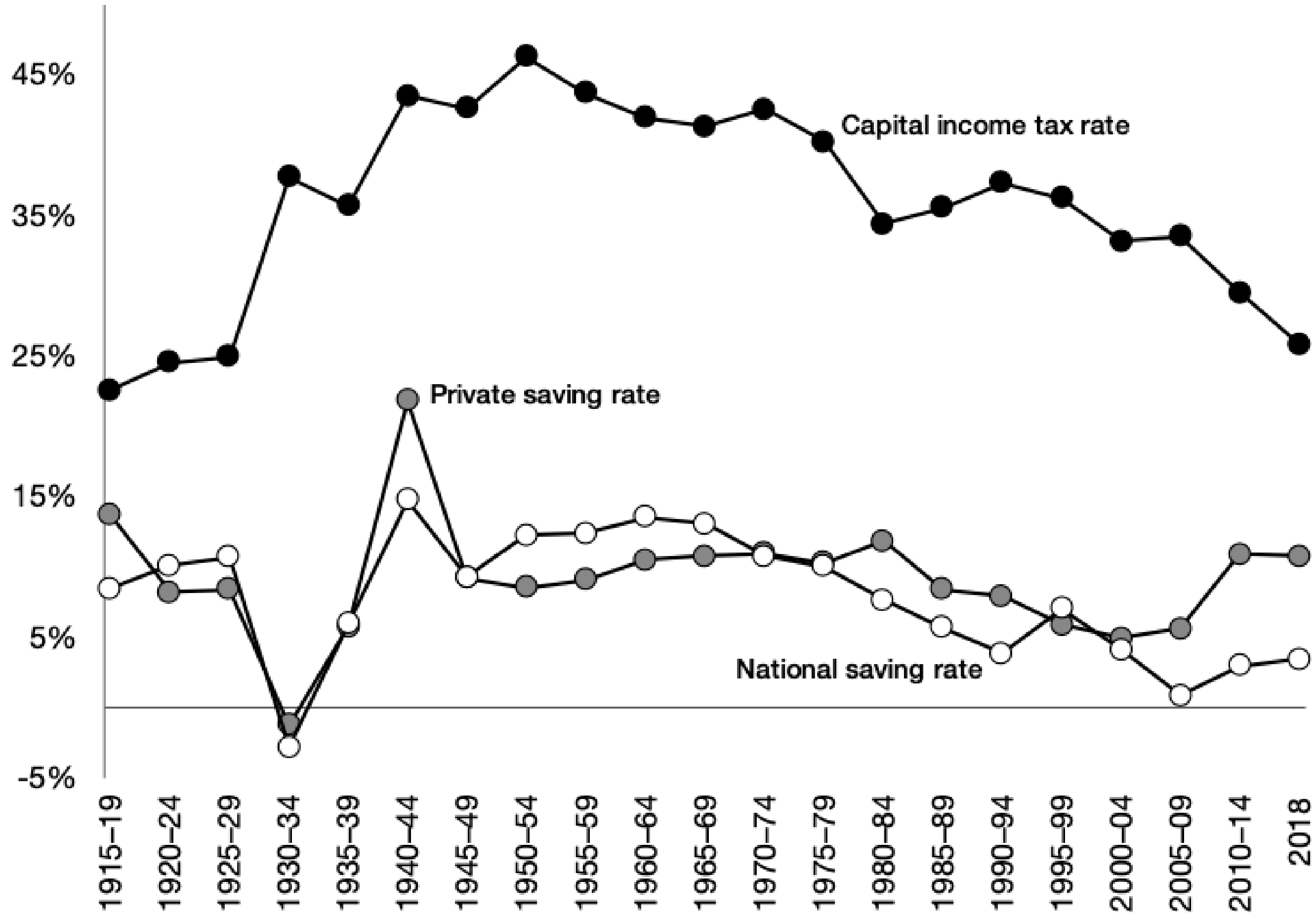
Source: Piketty (2014).

3 Who pays capital taxes?

- Are capital taxes really paid by capital owners or shifted to labor?
- Depends on supply elasticities of labor vs. capital
- Do saving and investment collapse when capital taxes rise?

5.4 CAPITAL TAXATION AND CAPITAL ACCUMULATION

(Macroeconomic capital tax rate versus saving rates
in the United States)



The incidence of the corporate tax

Key distinction: residence vs. source-based capital taxes

- Source: Tax based on location of capital $\rightarrow$ elasticity can be high if unregulated tax competition

- Residence: tax based on residence of the owner

- A policy choice

The incidence of the property tax

View 1: the property tax is mostly a capital tax like the corporate tax

- Property tax in community i is $\tau_i = \bar{\tau} + \epsilon_i$ with $\bar{\tau}$ national average property tax rate and ϵ_i local deviation (Mieszkowski, 1972)

- Harberger model $\rightarrow \bar{\tau}$ tax on all forms of capital

- ϵ_i residual either shifted to prices or immobile factors (labor, land)

- Raising property taxes nationally is progressive, but locally can be regressive

View 2: the property tax is not really a tax ("benefit view")

- Property taxes finance local public goods
- Mobile taxpayers would not live in a jurisdiction that charges a tax higher than value of its local public goods: Tiebout (1956)
- Local property tax is a price paid for those local goods (it's like a fee paid to a gated community for the community's pool)
- Problem: taxpayers probably not as mobile as Tiebout assumes; part of property taxes do not fund local public goods (e.g., part goes to State)

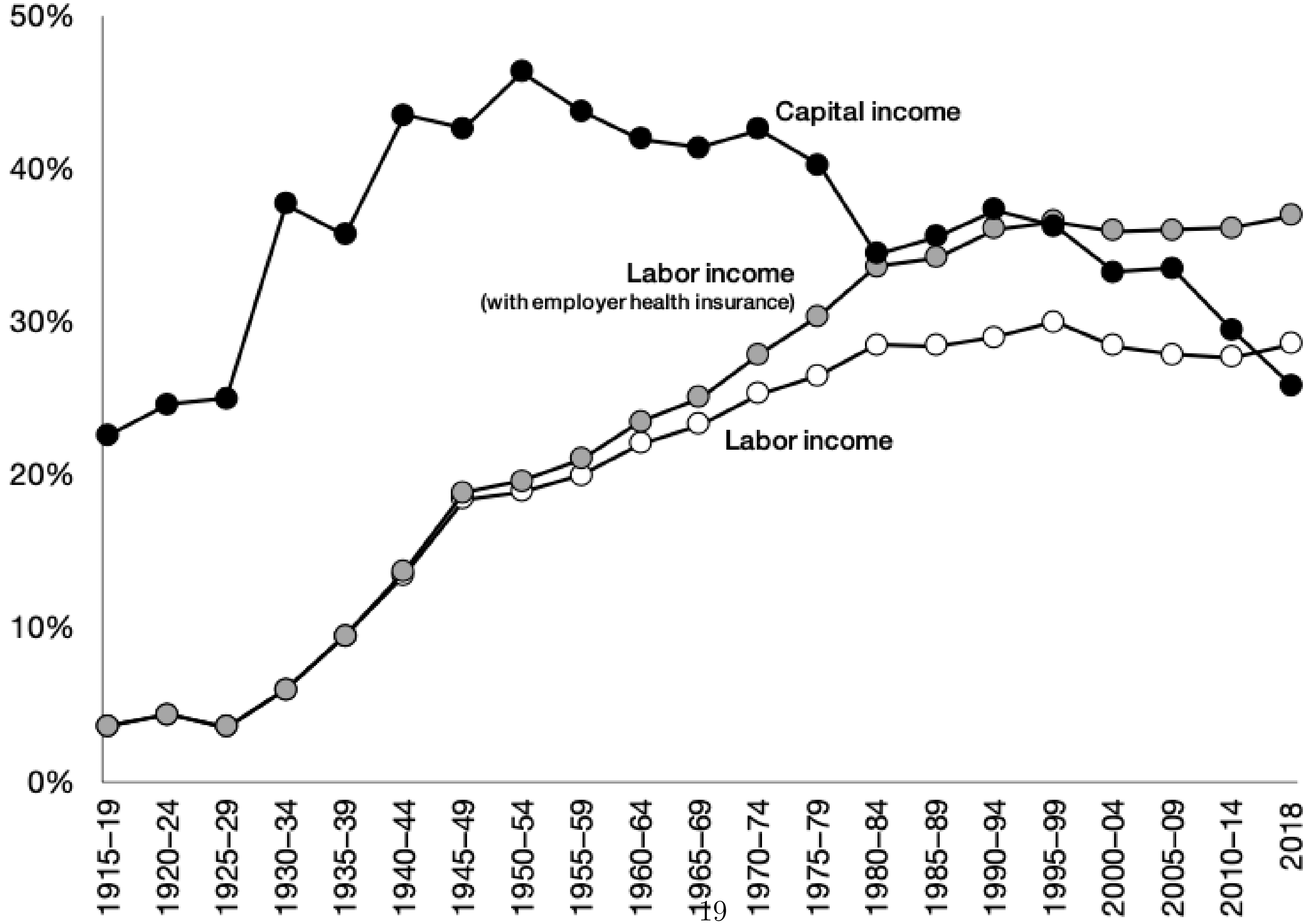
4 Labor taxes

- Large rise in all countries over the course of the 20th century

- Payroll taxes, plus quasi-private taxes (health)

5.2 THE RISE OF LABOR TAXATION

(Macroeconomic tax rates on labor and capital in the United States)



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