

Lecture 1-2 Bridge: From theoretical to real-world (U.S. for now) taxes

references: irs.gov, etc.

Harberger (1962) set of taxes

$$\{\tau_K, \tau_L, \tau_X\}$$

τ_K

Capital income is taxed at the level of the corporation and the level of the household.

Capital income tax enters households' tax liabilities as (i) **capital gains tax** or (ii) **dividend income tax**. Prof. Scholz discussed the taxation of capital last semester in 742, including issues like the legislative history of these two taxes & the responses of investment decisions to gains and dividend taxes.

Capital income is also taxed at the level of corporate profits. A substantial branch of the public finance literature on the taxation of capital looks at corporate debt policy and profit taxes.

What's the current structure of U.S. capital gains taxation?

Presumably many in the class have some background here, but let's start with the following:

The Jobs and Growth Tax Reform Act of 2003 (from here TRA03) cut the tax rates on long-term capital gains, held >1yr, from their previous brackets of 10 and 20% to the current rates of 5 and 15%. Your capital gains tax bracket depends on your total taxable income.

The 5 and 15% rates will be in effect through 2008, barring earlier law changes. In 2009 they revert to 10 and 20% unless the law is changed.

Short-term gains, on assets held ≤ 1 yr, are taxed at personal income tax rates.

How about dividend taxation?

Before TRA03, dividends were taxed as personal income.

TRA03 also legislated that dividends be taxed at their own rates, which were set at 5 and 15% in brackets matching the capital gains brackets above.

Like the capital gains tax change, the dividend tax change holds through 2008. Unlike the capital gains tax, the lower rate on dividend income drops to 0% in 2008.

τ_L

Our previous discussion of mandate incidence falls largely under the heading of τ_L , though the Harberger framework isn't particularly useful for the analysis of taxes tied to benefits that we saw in Summers.

In today's lecture we turn to **Taxation and Labor Supply**, and look at things like estimating the response of labor supply to various types of taxation, and the **income tax reform of 1986**. This will all look somewhat familiar to those of you who studied the **Earned Income Tax Credit** with Prof. Scholz.

For now, the role of the personal income tax in the capital income tax structures above & the transition to the study of taxation & labor supply suggest that we should take a look at the structure of the current U.S. income tax:

2007 U.S. Personal Income Tax, Single	
Income brackets	Tax rate
\$0 - \$7825	10%
7826-31,850	15%
31,851-77,100	25%
77,101-160,850	28%
160,851-349,700	33%
349,701+	35%

source: www.irs.gov

A little background: Rates in 2000 were 15, 28, 31 & 39.6%.

TRA01 instituted the 10% bracket and dropped rates in each of the brackets above 15% by .5 per year. In 2003, the rates in the above table were implemented.

Bracket cutoffs are adjusted each tax year, roughly matching inflation, in order to avoid “bracket creep”.

τ_X Commodity taxation is on the list but we may not get there soon or at all. There is a sizable literature on commodity taxation, encompassing a broad range of subjects from, for example, sales tax burden to environmental concerns.