

Economics 150

Public Finance: Taxation

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Professor Roger Gordon
Department of Economics
Office: Economics 316
Tel: 534-4848
Email: rogordon@ucsd.edu
Web: <http://www.econ.ucsd.edu/~rogordon>
Office hours: Wednesday 12:30 – 3:30 and by appointment

TA: Stephen Lee
Normal office hours: TBA

Course Goals: The overall objective of this course is to provide an overview of the existing national tax structure in the United States, its effects on individual and firm decisions, and the resulting efficiency costs and distributional consequences. We then examine several commonly proposed alternatives to the current income tax.

Prerequisite: Economics 100A, or permission of the instructor

Course requirements: The course requirements consist of a paper and the final exam. The paper will count for 60% of the grade, and the final for 40%. The final will cover all of the material from the course. Past final exams, and past midterm exams from previous years, are posted on WebCT. (Answers are not posted, though so that you can “learn by doing”.)

The paper will be due on March 12 at 5:00 PM. I expect that a paper will end up being roughly eight to ten pages

Each of you should choose a different topic for your paper. Given this, it is fine to discuss and debate ideas with each other. Some suggestions for possible topics are listed below. These possible topics each involve forecasting the economic effects of some plausible tax reform. I’m happy to consider other topics. Please email me a description of your proposed topic for approval. If two of you choose the same topic, then I’ll approve that topic of the person who emailed me first. You should send me a description of your topic at the latest by the end of January.

Part of your work on the paper will involve searching the existing literature for forecasts that others have made about the effects of the tax reform you consider. You should also draw on the material covered in the course to make your own forecasts for how firms and individuals will change behavior in response to the proposed reform, and then the effects of these behavioral changes on economic efficiency.

In order to give you practice presenting ideas to an audience, and to provide you feedback on your paper, I have set aside two classes where each of you can present your findings. Your grade on the paper will be based in part on your presentation. I have scheduled these presentations for the next to last week of classes, to give you the chance to revise your paper in response to any comments you receive. We will need to set up an evening class as well that week, in order to assure that each of you has enough time to present. I will allocate ten minutes per student presentation.

Readings: The basic readings for the course come from:

Gruber: Jonathan Gruber, *Public Finance and Public Policy* and
SB: Joel Slemrod & Jon Bakija, *Taxing Ourselves* (any editions)

Lectures: The lectures are an integral part of the course, and will go well beyond the required readings. They are posted on WebCT.

Course Outline

January 5, 7: Overview of taxation, tax incidence

Gruber, ch. 18.1, 19
SB, ch. 2
Williams, "Where does Federal Tax Revenue Come From?"

January 12: Efficiency costs of taxes

Gruber, ch. 20.1

January 14: Equity considerations

Gruber ch. 18.3, 18.6
SB, ch. 3

January 19: Trade-off

Gruber, ch. 20.2-3

January 21: Other considerations in tax policy

SB, ch. 4-5
Gruber, pp. 726-32. (pp. 691-5 in Edition 1)
Slemrod, "Cheating Ourselves: The Economics of Tax Evasion"

January 26: No class – time to decide on paper topic

January 28: Review session with TA to go through past exam problems

February 2: Personal income tax, overview

Gruber, ch. 18.2, 18.4
Piketty-Saez, "How Progressive is the Federal Tax System?"
Burman et al, "The Expanding Reach of the Individual Alternative Minimum Tax"
Alm et al, "The Marriage Penalty"

February 4, 9: Effects on labor supply (2 classes)

Gruber, ch. 21
Kotlikoff et al, "Does it Pay, at the Margin, to Work and Save?"

February 11: Effects on savings behavior and portfolio choice (2 classes)

Gruber, ch. 22.1-3, 23.1-2
Stiglitz, "The General Theory of Tax Avoidance," *National Tax Journal*, 1985, pp. 325-37.

February 16: Deductible items

Gruber, ch. 18.5
Clotfelter, "The Impact of Tax Reform on Charitable Giving: A 1989 Perspective," NBER Working Paper No. 3273.
Cogan et al, "Healthy, Wealthy, and Wise," *Wall Street Journal*, May 4, 2004.
Gale et al, "Encouraging Home Ownership through the Tax Code"
SB, pp. 185-96
Report of the President's Advisory Panel on Federal Tax Reform, "Policy Recommendations", pp. 70-82.

February 18, 23: Corporate income tax:

Gruber, ch. 24
Toder-Koch, "Fewer Businesses are Organized as Taxable Corporations"
Brill, "Corporate Tax Rates, Receipts, and Distortions"

February 25: Estate tax

Gruber, ch. 23.3
Burman et al., "Options for Reforming the Estate Tax"

March 2, 4: Presentation of papers (ten minutes each)

March 9: Debt finance

Gruber, ch. 4
Auerbach et al, "Generational Accounting"
Shapiro-Slemrod, "Consumer Response to Tax Rebate"
Burman, "Dynamic Analysis and Scoring"

March 11: Fiscal Federalism

Gruber, ch. 10
Oates, "An Essay on Fiscal Federalism"

March 18: Final exam, 8:00 - 11:00

Possible paper topics

Each of the proposed topics below involves analyzing the effects of a plausible tax reform. What behavioral changes and price changes do you expect as a result of these reforms? What are the likely efficiency and distributional implications of the reform? What modifications to these reforms might be preferable? Examples of possible reforms are:

- Introduction of a value-added tax, replacing some or all of the personal income tax. This in fact was done in the U.K. when it joined the E.U.
- Replace the current corporate income tax with a Comprehensive Business Income Tax (CBIT). This tax reform was originally proposed by the U.S. Treasury Department during the first Bush administration.
- Amend the current corporate income tax by providing an allowance for corporate equity (ACE), as proposed by the Gammie Commission and now under serious consideration in the E.U.

- d. Under the personal income tax, shift from taxing couples to taxing individuals, as is done in a number of European countries.
- e. Under the personal income tax, eliminate any limits on pension contributions or withdrawals. This is one variant of the “Fundamental Tax Reform” proposed under the Ford Administration.
- f. Under the personal income tax, expand the amount of money that can be contributed to an IRA, say to \$15,000 per individual, eliminating any restrictions on the AGI of contributors, a proposal discussed during the second Bush administration.
- g. Eliminate all itemized deductions for state and local tax payments, as advocated by the President’s Tax Reform Commission during the second Bush administration.
- h. Replace the current personal income tax with a Dual Income Tax, imposing a flat tax on capital income and a progressive tax on labor income, as is done in each of the Scandinavian countries
- i. Shift to taxing capital gains at ordinary tax rates.
- j. Require all corporate equity to be purchased through a registered account, with purchases tax deductible and sales fully taxable, but with no other tax liabilities on the resulting dividends or capital gains.
- k. Eliminate the corporate income tax on all foreign-source income of U.S. multinationals. This is the policy in many European countries.
- l. Eliminate the deductibility of interest payments and the taxation of interest income under both the corporate and personal taxes, except for mortgage interest payments on owner-occupied housing.
- m. Reduce state personal and corporate income tax rates, replacing the lost revenue with an expanded sales tax, broadening the base to include all currently omitted forms of consumption including food, services, medicine, and housing.
- n. Adopt as a corporate tax base a firm’s accounting profits as reported to shareholders, as is currently done in Sweden.
- o. Commit to raising the corporate tax rate starting in four years, well after the end of the recession, in order to begin repaying the debt.
- p. Eliminate the deductibility of home mortgage interest, cutting the overall tax rate so as to leave tax payments on average unchanged at each level of AGI.
- q. Eliminate the taxation of interest, dividends, and capital gains under the personal income tax.
- r. Eliminate the estate tax, but also eliminate the write-up of basis at death.