NTJ ABSTRACTS
(JUNE 2013 – MARCH 2016)

March 2016

OPTIMAL TAXATION WHEN CHILDREN'S ABILITIES DEPEND ON PARENTS' RESOURCES

Alexander Gelber and Matthew Weinzierl

69 National Tax Journal, 11–40 (March 2016)

Empirical research suggests that parents, and therefore the tax policy that affects them, can have a significant effect on their children's future earnings abilities. We take a first step toward characterizing how this intergenerational link matters for tax policy design. We find that the utilitarian welfare-maximizing policy in this context would be more redistributive toward low-income parents than under current U.S. tax policy. The additional income under such a policy would increase the probability that low-income children move up the economic ladder, and we estimate that it would generate an aggregate welfare gain equivalent to 1.75 percent of lifetime consumption.

DOES THE EARNED INCOME TAX CREDIT REDUCE SAVING BY LOW-INCOME HOUSEHOLDS?

Caroline Weber

69 National Tax Journal, 41–76 (March 2016)

This paper analyzes the effect of the Earned Income Tax Credit (EITC) on investment income. Policy-makers have devoted substantial time and resources toward increasing the saving rate of low-income households, yet the EITC provides a substantial disincentive for individuals to save and realize investment income. I find that a 1 percent increase in the after-tax return to saving causes a 3.05 percent increase in investment income. Nearly 40 percent of the decline over the last two decades in the fraction of EITC recipients with savings in income-bearing accounts can be explained by changing EITC incentives.

THE RESPONSE OF DELINQUENT TAXPAYERS TOMORE AGGRESSIVE COLLECTION

Joshua J. Miller and Silda Nikaj

69 National Tax Journal, 77–102 (March 2016)

To reduce uncollected property tax delinquency, local governments often conduct tax lien sales. Tax lien sales reduce tax delinquency through two effects: the financial effect, or the sale of tax liabilities to private investors, and the behavioral response, or the early payment of delinquency by taxpayers who wish to avoid the sale. Using a policy innovation from Ohio, we estimate that tax lien sales reduce uncollected property tax balances by 5.6 percent through the behavioral response. However, we find evidence that tax lien sales fail to produce a behavioral response under adverse housing market conditions.

STATE EARNED INCOME TAX CREDITS AND THE PRODUCTION OF CHILD HEALTH: INSURANCE COVERAGE, UTILIZATION, AND HEALTH STATUS

Reagan A. Baughman and Noelia Duchovny

69 National Tax Journal, 103–132 (March 2016)

The Earned Income Tax Credit (EITC) has been credited with reductions in poverty and increases in the labor force participation of single mothers. The credit has the potential to affect the health of children in recipient families through three channels: family income, maternal employment, and health insurance coverage patterns. We exploit variation in state-level EITCs to estimate the effects of the credit on health insurance coverage, utilization of medical care, and health status. We find that the EITC is associated with significant changes in health insurance coverage patterns for children age 6–14, increasing rates of private health insurance but producing offsetting decreases in public coverage. State EITCs are also associated with significant improvements in health status for older children, an effect consistent with higher family income.

DOES USE TAX EVASION PROVIDE A COMPETITIVE ADVANTAGE TO E-TAILERS?

Jeffrey L. Hoopes, Jacob R. Thornock, and Braden M. Williams

69 National Tax Journal, 133–168 (March 2016)

Many online retail firms (e-tailers) do not collect sales tax from the majority of their customers. This practice provides these firms with a potential competitive advantage over traditional retailers. We examine stock market returns and analysts' sales forecast revisions surrounding federal legislative proposals, such as the Marketplace Fairness Act, that could erode this alleged competitive advantage for e-tailers. Following events that indicated an increased likelihood of federal sales tax legislation, we find negative abnormal stock returns for e-tail firms relative to traditional retail firms. We also find that analysts forecast a future reduction in sales revenue for e-tailers. These findings imply the existence of a competitive advantage for e-tailers that will potentially diminish with the enactment of federal sales tax legislation.

FINANCIAL TRANSACTIONS TAXES IN THEORY AND PRACTICE

Leonard E. Burman, William G. Gale, Sarah Gault, Bryan Kim, Jim Nunns, and Steve Rosenthal

69 National Tax Journal, 171–216 (March 2016)

We explore issues related to a financial transactions tax (FTT) in the United States. We trace the history and current practice of the tax in the United States and other countries, review evidence of its impact on financial markets, and explore the key design issues any such tax must address. We present new revenue and distributional effects of a hypothetical relatively broad-based FTT in the United States, finding that, at a base rate of 0.34 percent, it could raise a maximum of about 0.4 percent of GDP ($75 billion in 2017) in a highly progressive manner.

FINANCIAL TRANSACTION TAXES IN THE EUROPEAN UNION

Thomas Hemmelgarn, Gaëtan Nicodème, Bogdan Tasnadi, and Pol Vermote

69 National Tax Journal, 217–240 (March 2016)

The merits and demerits of financial transaction taxes have been heavily debated among economists, who remain divided on the effects of the taxes on trading volumes, market liquidity, and quotes volatility. In 2011, the European Commission put forth a legislative proposal for a common system of financial transaction taxes in the European Union. The proposal did not gather unanimity among all Member States and eleven asked to go ahead under the so-called enhanced cooperation procedure. In parallel, countries such as France and Italy have introduced their own taxes, while others of the group of eleven already had an FTT in place (Belgium and Greece). Discussions between Member States on the final design of the financial transaction tax are progressing, but to date no final decision has been made. This paper reviews the most recent economic literature on the effects of financial transaction taxes, with a focus on those recently introduced. It also details the proposals made by the European Commission.

BOOK REVIEW:

VALUE ADDED TAX: A COMPARATIVE APPROACH, SECOND EDITION
by ALAN SCHENK, VICTOR THURONYI, and WEI CUI

Pierre-Pascal Gendron

69 National Tax Journal, 241–250 (March 2016)

A review of *Value Added Tax: A Comparative Approach, Second Edition* by Alan Schenk, Victor Thuronyi, and Wei Cui (Cambridge University Press, 2015, Oxford, New York, NY, 560 pages).

December 2015

THE PERFORMANCE OF STATE TAX PORTFOLIOS DURING AND AFTERTHE GREAT RECESSION

Nathan Seegert

68 National Tax Journal, 901–918 (December 2015)

State tax revenues continue, since the Great Recession, to experience elevated volatility relative to previous decades. The elevated tax revenue volatility is due to both economic uncertainty and the riskiness of the tax portfolios state governments are holding. Since the Great Recession, 18 states have increased the riskiness of their tax portfolio. However, many of these states were constrained to accept additional volatility in exchange for additional tax revenues. The mean-volatility constraint state governments face depends on numerous tax system characteristics. For example, states that tax groceries under the sales tax base and have less progressive income taxes are able to increase revenues and accept less volatility than states that exempt groceries from their sales tax base and have a progressive income tax.

THE RELATIONSHIP BETWEEN TAXES AND GROWTH AT THE STATE LEVEL: NEW EVIDENCE

William G. Gale, Aaron Krupkin, and Kim Rueben

68 National Tax Journal, 919–942 (December 2015)

The effects of state tax policy on economic growth, entrepreneurship, and employment remain controversial. Using a framework that in prior research generated significant, negative, and robust effects of taxes on growth, we find that neither tax revenues nor top income tax rates bear stable relationships to economic growth or employment across states and over time. While the rate of firm formation is negatively affected by top income tax rates, the effects are small in economic terms. Our results are inconsistent with the view that cuts in top state income tax rates will automatically or necessarily generate growth.

THE ROLE OF TAXES IN MITIGATING INCOME INEQUALITY ACROSS THE U.S. STATES

Daniel H. Cooper, Byron F. Lutz, and Michael G. Palumbo

68 National Tax Journal, 943–974 (December 2015)

This paper examines the role that federal and especially state tax policies play in mitigating income inequality. The results show that the tax code reduces income inequality considerably in all states. All of this income compression is attributable to federal taxes, as state taxes, on average, widen the after-tax income distribution slightly. Nevertheless, there is very substantial cross-state variation in the impact of state tax policies. The paper further documents that the mitigating influence of taxes on income inequality has risen since the early 1980s, with the increase at the state level due mostly to changes to the tax code.

WHO BENEFITS FROM THE TAX ADVANTAGES OF ORGANIZATIONAL FORM CHOICE?

Michael P. Donohoe, Petro Lisowsky, and Michael A. Mayberry

68 National Tax Journal, 975–998 (December 2015)

We investigate whether and the extent to which four stakeholders of a firm — customers,suppliers, employees, and owners — benefit from the savings under Subchapter S relative to Subchapter C. Using a balanced sample of U.S. commercial banks from 2001–2005, we find that S corporation banks pay 2 percent more in wages and 38 percent more in dividends than C corporation banks, but pay lower interest rates on deposits and charge similar rates on loans. Further, after the Jobs and Growth Tax Relief and Reconciliation Act of 2003 attenuated the relative tax advantage of Subchapter S, we find that S corporation banks increased wages and dividends to a lesser extent than C corporation banks. These results suggest that employees and owners, but not suppliers or customers, benefit from the tax advantages of the Subchapter S organizational form. Overall, our study provides economic insight into which parties ultimately bear — and do not bear — the incidence of corporate taxation.

RISK CONSEQUENCES OF TAX-MOTIVATED CHOICE OF ORGANIZATIONAL FORM IN THE BANKING INDUSTRY

Michael A. Mayberry, Connie D. Weaver, and Jaron H. Wilde

68 National Tax Journal, 999–1024 (December 2015)

We examine the risk consequences of the S-corporation election, a tax-motivated organizational form, on banks' risk-taking behaviors and extreme adverse outcomes. S-corporations' single level of taxation increases access to after-tax internal capital and likely enhances S-corporation monitoring efforts. However, S-corporations face strict organizational restrictions on the number and type of allowable shareholders. Given banks' rigid capital criteria and active regulatory environment, this differential access to external capital is likely to influence S-corporations' risk-taking behavior. Our evidence suggests that the organizational restrictions necessary to qualify for S-corporation status reduce risk-taking behaviors and limits some extreme adverse outcomes.

MEASURING AGGREGATE BUSINESS INCOME WITH TAX DATA

James Pearce

68 National Tax Journal, 1025–1046 (December 2015)

Tax reform proposals, such as taxing all business entities in a similar manner under an entity level tax or moving to a cash-flow or valued-added consumption tax, require careful accounting so that estimates of the revenue impacts and distributional consequences are consistent across proposals. This paper constructs a broadly consistent measure of tax-based business income and details the correspondence between it and National Income and Product Accounts (NIPA) business income. The paper highlights the importance of addressing the double-counting of partnership income in tax data and the importance of investment income in explaining the differences between tax-based business income and NIPA business income.

CROSS-COUNTRY EVIDENCE ON THE PRELIMINARY EFFECTS OF PATENT BOX REGIMES ON PATENT ACTIVITY AND OWNERSHIP

Sebastien Bradley, Estelle Dauchy, and Leslie Robinson

68 National Tax Journal, 1047–1072 (December 2015)

This paper evaluates the initial impacts of patent box regimes in light of their primary stated objectives: stimulating domestic innovation and retaining mobile patent income to limit base erosion. Despite their lack of nexus requirements, we find that patent box regimes yield a 3 percent increase in new patent applications for every percentage point reduction in the tax rate on patent income. We find no significant impact of these regimes on deterring outward cross-border attribution of patent ownership, or on attracting ownership of foreign inventions. Increased patenting activity hence appears focused on inventions involving co-located (domestic) patent owners and inventors.

CORPORATE INVERSIONS AND ECONOMIC PERFORMANCE

Nirupama S. Rao

68 National Tax Journal, 1073–1098 (December 2015)

This paper assesses the economic factors associated with corporate inversions, including the 48 inversions that have occurred since the analysis of Desai and Hines (2002). The analysis presented here is observational, not causal, as it examines how the business activities of firms that chose to invert changed after expatriation. In addition to statistically assessing the equity market's reaction to inversion announcements, this paper examines how firms alter their patterns of employment and investment after inversion. In particular, the paper follows how the foreign shares of an inverting firm's employment and investment change following inversion, relative to comparable non-inverting firms. The behavior of inverting firms following expatriation is assessed going back to 1980 as well as only after the 2004 policy change, which made expatriation through merger with a foreign firm with substantive foreign business activities more attractive. The results suggest that inverting firms have higher shares of their employees and capital expenditures located abroad after inversion relative to changes experienced by similar non-inverting firms. Further, these increases are not attributable to one-time changes due to the inclusion of a new foreign partner's existing workforce and ongoing investments; foreign shares of employment and investment are higher two or more years after inversion relative to the first year after inversion when any one-time increases would occur.

SUBSTITUTION ACROSS METHODS OF PROFIT SHIFTING

Molly J. Saunders-Scott

68 National Tax Journal, 1099–1120 (December 2015)

Multinational corporations have a variety of profit-shifting methods available. This paper considers the relationship between methods of shifting. Empirical results using panel data on multinational firms indicate that the implementation of an earnings stripping rule is associated with a reduction in earnings before interest and taxes of 3.8 percent. The negative relationship suggests that corporations treat profit shifting through transfer-pricing manipulation and profit shifting through intercompany debt as substitutes.

SEPTEMBER 2015

THE SALIENCE OF COMPLEX TAX CHANGES: EVIDENCE FROM THE CHILD AND DEPENDENT CARE CREDIT EXPANSION

Benjamin M. Miller and Kevin J. Mumford

68 National Tax Journal, 477–510 (September 2015)

The literature on tax salience finds taxpayers are less responsive to the financial implications of a low-salience tax change than to an otherwise equivalent price change. This paper adds to this literature by showing that taxpayers are more responsive to the more salient features of a given complex tax change. Data from the Consumer Expenditure Survey are used to show that taxpayers responded to the direct implications of the 2003 expansion of the Child and Dependent Care Credit, but did not respond to the expansion's less salient interactions with other elements of the tax code.

Winner of the 2015 *National Tax Journal* Musgrave Prize for the Best Article:

NEW EVIDENCE ON THE TAX ELASTICITY OF CAPITAL GAINS

Tim, Dowd, Robert McClelland, and Athiphat Muthitacharoen

68 National Tax Journal, 511–544 (September 2015)

This study updates previous research estimating the persistent effect of tax changes on capital gains realizations by using a large panel of tax returns from 1999 to 2008. Similar to earlier studies in the literature, we use the Type II Tobit model to address the sample selection problem and we address the endogeneity problem in the tax variables, but we improve the identification of the tax elasticity by using an exclusion restriction: the presence of carryover loss. The preferred persistent elasticity estimate is –0.72 and is statistically significant and robust to a number of sensitivity tests. We also compare the results of our model to results from the original model applied to contemporary data, and estimate our model on sub-periods. Unlike prior research, this study estimates the tax elasticity of other types of capital gains. We find that pass-through capital gains are highly sensitive to persistent tax changes, but gains from mutual fund distributions are extremely insensitive.

THE PARCEL TAX AS A SOURCE OF LOCAL REVENUE FOR CALIFORNIA PUBLIC SCHOOLS

Bree J. Lang and Jon Sonstelie

68 National Tax Journal, 545–572 (September 2015)

School finance is highly centralized in California, as the state determines almost all of the revenue school districts receive. The only significant source of local revenue is a tax on parcels of land. We show that the likelihood a district levies this tax is positively related to the income of district residents and negatively related to the tax-price of spending per pupil in the district. It is also negatively related to the revenue a district receives under the state's school finance system. Districts turn to the parcel tax when their residents' demand for spending is not met by the revenue provided by the state.

ASSESSMENT GROWTH LIMITS AND MOBILITY: EVIDENCE FROM HOME SALE DATA IN DETROIT, MICHIGAN

Timothy R. Hodge, Gary Sands, and Mark Skidmore

68 National Tax Journal, 573–600 (September 2015)

In 1994 the State of Michigan imposed a limit on the growth of property values for tax purposes. The assessment growth cap resulted in the emergence of a differential in effective tax rates between new and long-time property owners. This article examines the degree to which this differential creates a lock-in effect. Using parcel-level data from the City of Detroit, we find that homeowners who have lower effective tax rates are less likely to sell their properties; the average duration of property ownership is 7.5 years longer as a result of the assessment growth cap.

THE USE OF NEUTRALITIES IN INTERNATIONAL TAX POLICY

David A. Weisbach

68 National Tax Journal, 635–652 (September 2015)

This paper analyzes the use of neutrality conditions, such as capital export neutrality, capital import neutrality, capital ownership neutrality, and market neutrality, in international tax policy. Neutralities are not appropriate tools for designing tax policy. They each identify a possible margin where taxation may distort business activities. Because these neutralities cannot be all satisfied simultaneously, however, they do not allow analysts to determine the appropriate trade-offs of these distortions, unlike deadweight loss measures used in other areas of tax policy. International tax policy should instead be tied directly to the reasons for taxing capital income, reasons which are derived from optimal tax or similar models.

INTEREST DEDUCTIONS IN A MULTIJURISDICTIONAL WORLD

Mihir A. Desai and Dhammika Dharmapala

68 National Tax Journal, 653–680 (September 2015)

This paper proposes and evaluates alternative methods for addressing the tax treatment of interest expenses in a multijurisdictional setting. The differential deductibility of debt entailed by various current tax law provisions leads to potential distortions in the patterns of asset ownership across MNCs and various proposed solutions have significant limitations. We suggest alternative regimes — a worldwide debt cap (WDC) and a net financing deduction (NFD) — to address the ownership distortions that we highlight along with other well-established problems of income-shifting through debt. These alternative regimes are extensions to a multinational setting of two general approaches to the neutral treatment of interest expenses — the CBIT (comprehensive business income tax) and ACC (allowance for corporate capital). While these regimes provide solutions to ownership distortions and to problems of "base erosion and profit shifting," they have the potential disadvantage of restricting other policy parameters.

BOOK REVIEW:

WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY

Daniel Shaviro

68 National Tax Journal, 681–688 (September 2015)

A review of *We are Better than This: How Government Should Spend our Money* by Edward D. Kleinbard (Oxford University Press, 2014, Oxford, UK, 509 pages).

September 2015 Special Issue

COMPETITION AND SUBNATIONAL GOVERNMENTS: TAX COMPETITION, COMPETITION IN URBAN AREAS, AND EDUCATION COMPETITION

David R. Agrawal, William F. Fox, and Joel Slemrod

68 National Tax Journal, 701–734 (September 2015 Special Issue)

Competition at the subnational level concerns how jurisdictions set tax, spending, or regulatory policies while accounting for the fact that these policies affect the locations of individuals, firms and mobile factors. This paper highlights the importance of studying subnational competition and then places the field of fiscal competition in the context of the broader public economics literature. We argue that studies of competition at the state and local level should extend beyond traditional issues relating to tax competition and must consider how many different agents respond to policies. The paper then summarizes the six papers in this special issue, which were presented at a conference on subnational competition.

E-TAILER SALES TAX NEXUS AND STATE TAX POLICIES

Donald Bruce, William F. Fox, and LeAnn Luna

68 National Tax Journal, 735–766 (September 2015 Special Issue)

The growth in e-commerce has dramatically altered U.S. business practices in ways that erode states' ability to collect sales taxes. States have attempted to reclaim the sales tax base but are constrained by current nexus rules that allow firms to choose whether to establish taxability based on a decision to establish physical presence. We examine how state tax policies affect the propensity of firms to establish nexus in each state. We find that firms are more likely to have nexus in large states, and that the effect of policy on nexus decisions appears to be relatively immediate and a function of current sales tax rates and base breadth. Employment rises with nexus in states where the sales tax is low.

COMPETITION IN BUSINESS TAXES AND PUBLIC SERVICES: ARE PRODUCTION-BASED TAXES SUPERIOR TO CAPITAL TAXES?

Elisabeth Gugl and George R. Zodrow

68 National Tax Journal, 767–802 (September 2015 Special Issue)

Although most of the tax competition literature focuses on the provision of local public services to households, several papers analyze tax competition when capital taxes are used to finance local public services provided to businesses, examining the conditions under which such services are provided efficiently, under-provided, or over-provided. In addition, several prominent observers have noted that "benefit related" business taxation is desirable on both efficiency and equity grounds and argued that such taxation should take the form of a tax based on production, such as an origin-based value-added tax. We evaluate this contention in this paper, comparing the relative efficiency properties of these alternative business taxes. Our simulation results suggest that under many, but not all, circumstances it is more efficient to finance business public services with an origin-based production tax rather than a source-based capital tax.

STATE TAX POLICY AND ENTREPRENEURSHIP

Donald Bruce, Xiaowen Liu, and Matthew N. Murray

68 National Tax Journal, 803–838 (September 2015 Special Issue)

We expand the literature on state taxes and entrepreneurship in several ways. First, we estimate dynamic panel regressions rather than fixed effects models in order to account for the inertia in taxes and small business outcomes. Second, while prior research has focused on extensive-margin indicators of small business activity such as self-employment rates, we consider more policy-relevant intensive-margin measures drawn from nonfarm proprietors' income and employment data. Third, we examine a longer panel (1978–2009) of state data. We conclude that major state tax policies do not have statistically significant impacts on entrepreneurial performance.

DECENTRALIZED ROAD INVESTMENT AND PRICING IN A CONGESTED, MULTI-JURISDICTIONAL CITY: EFFICIENCY WITH SPILLOVERS

Jan K. Brueckner

68 National Tax Journal, 839–854 (September 2015 Special Issue)

This paper shows that the inefficiency of fiscal decentralization in the presence of spillovers, a main tenet of the decentralization literature, is overturned in a particular transportation context. In a monocentric city where road (bridge) capacity is financed by budget-balancing user fees, decentralized capacity choices (made by individual zones within the city) generate the social optimum despite the presence of spillovers. Optimality also requires the correct population distribution across the city's zones, conditional on bridge capacities. This outcome is achieved because the user fees function as optimal congestion tolls, a result that follows from the famous self-financing theorem of transportation economics.

BORDER EFFECTS IN SUBURBAN LAND USE

Benoy Jacob and Daniel McMillen

68 National Tax Journal, 855–874 (September 2015 Special Issue)

Differences in property tax rates and sales tax distribution formulas can give suburban municipalities strong incentives to attract commercial and industrial firms to their jurisdictions. If these land uses generate negative externalities for local residents, suburban governments may form concentrations of non-residential land use at the borders of neighboring suburbs. We test this prediction using land use data for every parcel in the Cook County suburbs of Chicago. After controlling for proximity to major streets and rail lines, both commercial and industrial parcels are significantly more likely to be located near municipal boundaries. Low-priced industrial properties are also significantly more likely to be located near municipal boundaries than in the interior of a suburb.

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SCHOOL ACCOUNTABILITY AND SCHOOL CHOICE: EFFECTS ON STUDENT SELECTION ACROSS SCHOOLS

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Cassandra M. D. Hart and David N. Figlio

68 National Tax Journal, 875–900 (September 2015 Special Issue)

This paper examines the effect of the introduction of school accountability policies in Florida on schools' student body composition. We specifically examine the effects of the state issuing official school "grades" on the composition of incoming kindergarten classes, using novel data on families' socioeconomic characteristics drawn from birth records. High socioeconomic status parents were particularly responsive to the introduction of grades. Schools that received A grades saw significant increases in an index measure of socioeconomic status among their kindergarten students after enactment of the policy. We find some evidence that responses are stronger for A schools that have nearby alternatives, and where nearby alternatives are poorer-performing schools.

JUNE 2015

ARE INCOME TAXES DESTINED TO RISE? FISCAL IMBALANCE AND FUTURE TAX POLICY IN THE UNITED STATES

Jason L. Saving and Alan D. Viard

68 National Tax Journal, 235–250 (June 2015)

We present a model of optimizing government behavior in which a need for increased revenue does not lead to increased income taxes, but instead leads to the introduction of a new revenue source, such as a VAT, accompanied by a reduction in income taxes. We argue that this is a plausible outcome for the United States in view of international experience and recent fiscal reform proposals, and that the prospect of such a tax reform may have important implications for individual investment decisions.

WHITHER THE MARRIAGE TAX?

James Alm and J. Sebastian Leguizamon

68 National Tax Journal, 251–280 (June 2015)

We use household data from the Current Population Survey to calculate how the real value of the so-called "marriage tax" or "marriage subsidy" in the federal individual income tax has changed over the period 1969 to 2009. We examine three issues: the magnitude of the marriage tax/subsidy and its evolution over time, its effects on the distribution of income (including the effects of different demographic characteristics on the magnitudes and trends), and the causal factors in its evolution (e.g., tax changes, demographic changes). We find that the tax treatment of the family has changed significantly over time, from a large average marriage bonus in 1969, to a large marriage tax in much of the 1990s and early 2000s, to a large marriage subsidy since 2003. We also find that the marriage tax varies significantly and systematically by income level, as well as by the number of children in the family, the earnings ratios of the spouses, the race of the family, and the age of the household head. Finally, we find that changes in income and family composition have influenced the magnitudes and trends of marriage taxes and subsidies, but that adjustments in the federal income tax code account for most of the observed changes.

ACCOUNTING FOR INCOME CHANGES OVER THE GREAT RECESSION RELATIVE TO PREVIOUS RECESSIONS: THE IMPACT OF TAXES AND TRANSFERS

Jeff Larrimore, Richard V. Burkhauser, and Philip Armour

68 National Tax Journal, 281–318 (June 2015)

Using decomposition analysis together with March CPS data, we consider the relative importance of factors accounting for changes in post-tax, post-transfer income during each of the last four recessions. Unlike the double dip recession of the 1980s, employment drops rather than falling wage earnings drove income declines during the Great Recession. Furthermore, taxes and transfers played a much greater role in offsetting market income losses — a result largely missed in analyses not accounting for taxes and transfers. This is particularly so among the bottom quintile where lower taxes and increased transfers offset more than one-half of market income declines.

DIFFERENCE-IN-DIFFERENCES METHODS IN PUBLIC FINANCE

Travis St. Clair and Thomas D. Cook

68 National Tax Journal, 319–338 (June 2015)

Recognizing that cross-sectional data are often insufficient to address the identification problems associated with estimating the effect of government taxation or spending, economists engaged in public finance research often utilize longitudinal data that span the period over which a policy change occurred. As economic data have proliferated over the last decade, uses of the difference-in-differences design and its variations have become more numerous. Nevertheless, published research that invokes difference-in-differences commonly fails to present evidence and reasoning that enable the reader to properly evaluate the causal claims under investigation. In this paper, we examine the threats to internal validity that exist when using difference-in-differences for causal inference and review variations of the design that can be used to address these threats. Next, we survey the public finance literature in order to examine the ways that these threats are addressed in practice. We conclude by proposing a number of recommendations for researchers to consider as they implement difference-in-differences as an empirical strategy.

LOCAL GOVERNMENT RESPONSES TO EXOGENOUS SHOCKS IN REVENUE SOURCES: EVIDENCE FROM FLORIDA

Erich Cromwell and Keith Ihlanfeldt

68 National Tax Journal, 339–376 (June 2015)

Little is known about how cities and counties respond to negative shocks in their fiscal resources, such as those that occurred after the Great Recession. We provide evidence from the state of Florida on the millage rate and expenditure adjustments that cities and counties make in response to a loss in their two most important fiscal resources — the property tax base and intergovernmental transfers. These adjustments are hypothesized to vary with the monopoly power possessed by the local government. Our findings support this hypothesis and indicate that fiscal stress results in higher millage rates and cuts in expenditures. The cuts are targeted toward capital expenditures and less essential public services.

REFLECTIONS OF THE 2014 HOLLAND MEDAL RECIPIENT . . .

SAVER HETEROGENEITY AND THE CHALLENGE OF ASSESSING RETIREMENT SAVING ADEQUACY

James M. Poterba

68 National Tax Journal, 377–388 (June 2015)

Determining whether a particular household is saving enough for retirement and estimating the fraction of a population cohort that is on track in retirement planning are complicated by substantial heterogeneity in household spending needs during retirement years. Longevity, health status, capital market returns, and whether family networks will prove a source of support or a drain, all vary significantly across households. It is possible to calibrate each of these sources of uncertainty, but different modeling approaches can yield different answers. Differences in approach explain part of the disagreement about the fraction of U.S. households that are saving adequately for retirement.

MR. PIKETTY AND THE "NEOCLASSICS": A SUGGESTED INTERPRETATION

J. Bradford DeLong

68 National Tax Journal, 393–408 (June 2015)

This essay is an attempt to build a bridge between Thomas Piketty's arguments in *Capital in the Twenty-First Century* and modern neoclassical economics. This is done by deconstructing the variables and mathematical expressions used by Piketty to define specific economic phenomenon, examining the historical periods that Piketty has focused on in *Capital*, and using the results from the previous analyses to critique Piketty's arguments in *Capital in the Twenty-First Century* within a modern neoclassical economics framework.

TAKING CAPITAL'S GAINS:
CAPITAL'S IDEAS AND TAX POLICY IN THE TWENTY-FIRST CENTURY

Glenn Hubbard

68 National Tax Journal, 409–424 (June 2015)

This essay examines Thomas Piketty's proposal in *Capital in the Twenty-First Century* for wealth taxation as a policy tool for addressing rising wealth inequality. In so doing, I also address portions of his other two contributions — a history of inequality and wealth and a forecast for how wealth shares will evolve. While Piketty's scope impresses, his tax policy conclusions miss the mark. Not only does his core analytical apparatus fail to bolster the case for greater taxation of capital, but familiar contemporary policy discussions of social insurance and consumption taxation better address the concerns he raises.

THE ORIGINS OF INEQUALITY AND POLICIES TO CONTAIN IT

Joseph E. Stiglitz

68 National Tax Journal, 425–448 (June 2015)

This paper critiques the notion that unfettered inequality is an inevitable consequence of contemporary capitalism, and provides an alternative, new framework for analyzing changes in income and wealth distribution. By thinking of these distributions as the result of changing centrifugal and centripetal economics and political forces, we can identify changes in our economics and social structure that may have played a central role in the creation of today's high level of inequality, and we can analyze the potential impacts of alternative policies. Specifically, I suggest that much of the increase in inequality is associated with the growth in rents — including land and exploitation rents (e.g., arising from monopoly power and political influence).

CAPITAL AND WEALTH TAXATION IN THE 21st CENTURY

Thomas Piketty

68 National Tax Journal, 449–458 (June 2015)

In this article, I present some of the findings of my book *Capital in the 21st Century*. In particular, I clarify the role played by r > g in my analysis of wealth inequality. I also discuss some of the implications for optimal taxation, and the relation between capital-income ratios and capital shares.

BOOK REVIEW:

DOUBLE DIVIDEND: ENVIRONMENTAL TAXES AND FISCAL REFORM IN THE UNITED STATES

Charles L. Ballard

68 National Tax Journal, 459–466 (June 2015)

A review of *Double Dividend: Environmental Taxes and Fiscal Reform in the United States* by Dale W. Jorgenson, Richard J. Goettle, Mun S. Ho, and Peter J. Wilcoxen (MIT Press, 2013, Cambridge, MA, 640 pages).

MARCH 2015

MYOPIA AND THE EFFECTS OF SOCIAL SECURITY AND CAPITAL TAXATION ON LABOR SUPPLY

Louis Kaplow

68 National Tax Journal, 7–32 (March 2015)

This article analyzes the effect of savings-related policies on labor supply in a model that explicitly incorporates myopic decision-making. Both social security and capital taxation may cause labor supply to rise or fall when individuals are myopic, depending on the curvature of individuals' utility as a function of consumption. Moreover, whatever is the sign of these effects under one assumption about how myopia relates to labor supply decisions, the sign is reversed under the other assumption that is considered. Additionally, some interventions have a first-order effect on labor supply from the outset but others do not, and some labor supply effects rise with the magnitude of the intervention whereas others fall.

DOES FEDERAL DEDUCTIBILITY AFFECT STATE AND LOCAL REVENUE SOURCES?

Bradley T. Heim and Yulianti Abbas

68 National Tax Journal, 33–57 (March 2015)

This paper examines whether the change in federal deductibility of state and local sales taxes initiated by the American Jobs Creation Act of 2004 affected the distribution of state and local level revenue sources. Using data from the 2000–2008 Census Bureau State Government Tax Collections Survey, Annual Surveys of State and Local Government Finances, and Censuses of Governments, we find that federal sales tax deductibility led states to increase sales tax revenue per capita, and decrease individual income and corporate tax revenue per capita and decrease property taxes as a share of total taxes. We do not, however, find any statistically significant impacts on tax sources at the local level.

THE ROLE OF REPRESENTATIVE AGENTS IN THE PROPERTY TAX APPEALS PROCESS

William M. Doerner and Keith R. Ihlanfeldt

68 National Tax Journal, 59–92 (March 2015)

Property tax appeals provide property owners with a mechanism to challenge their assessments and reduce their property tax bill. Appeals are frequently filed not by the homeowner but by a tax representative who often works on their behalf for a contingency fee. Using appeals from Miami-Dade County, Florida, we find that representatives have a greater presence in higher-priced neighborhoods, which makes these homeowners more likely to appeal than those in lower-priced neighborhoods, and representatives increase the percentage reduction in assessed value, but only because they increase the likelihood that appellants show up for the appeal hearings.

RESERVATION PRICES: AN ECONOMIC ANALYSIS OF CIGARETTE PURCHASES ON INDIAN RESERVATIONS

Philip DeCicca, Donald Kenkel, and Feng Liu

68 National Tax Journal, 93–118 (March 2015)

The special legal status of Indian tribes in the United States means that state excise taxes are not necessarily collected on cigarette purchases on Indian reservations. Using novel data from New York surveys that asked directly about cigarette prices and purchases from reservations, we focus on two under-studied but basic empirical economic questions this raises. First, what is the economic incidence of the tax break? In data from New York over a period when the state did not attempt to collect taxes on reservation purchases, our estimates suggest that the tax break is usually fully shifted to the consumer. The notable exception is on one reservation where a tribal monopoly captures almost half of the tax break. Second, has the tax break increased consumer demand for low-quality cigarettes relative to high-quality cigarettes? New York's cigarette tax is a fixed amount per pack, providing an opportunity to test the Alchian and Allen substitution theorem. We find some support for the prediction that the tax break increases consumer demand for lower-quality cigarettes.

CARBON TAXES AND FISCAL REFORM IN THE UNITED STATES

Dale W. Jorgenson, Richard J. Goettle, Mun S. Ho, and Peter J. Wilcoxen

68 National Tax Journal, 121–137 (March 2015)

In this paper we consider the economic and environmental impacts of taxes on emissions of greenhouse gases. Substituting carbon taxes for other sources of revenue or using the proceeds to reduce deficits or finance expenditures are the keys to integration of carbon taxes with fiscal reform. Recycling carbon tax revenues through reductions of capital income tax rates provides the largest margin of economic benefits over the costs of emissions control. Reducing capital tax rates lowers the cost of capital services and increases the rate of capital formation. This mechanism provides a dramatic illustration of the power of intertemporal general equilibrium modeling in the design of new energy and environmental policies for the United States.

CARBON TAXES AND U.S. FISCAL REFORM

Warwick J. McKibbin, Adele C. Morris, Peter J. Wilcoxen, and Yiyong Cai

68 National Tax Journal, 139–156 (March 2015)

This paper examines fiscal reform options in the United States using an intertemporal computable general equilibrium model of the world economy called G-Cubed. Six policy scenarios explore two overarching issues: (1) the effects of a carbon tax under alternative assumptions about the use of the resulting revenue, and (2) the effects of alternative revenue sources to reduce the budget deficit. We examine a simple excise tax on the carbon content of fossil fuels in the U.S. energy sector starting immediately at $15 per ton of carbon dioxide (CO_2) and rising at 4 percent above inflation each year. We investigate policies that allow the revenue from the illustrative carbon tax to reduce the long-run federal budget deficit or the marginal tax rates on labor and capital income. We also compare imposing a carbon tax to increasing rates of other taxes to reduce the deficit by the same amount. We find that within 25 years of adopting the carbon tax, annual CO_2 emissions are 20 percent lower than baseline levels. We find that using the revenue for a capital tax cut is significantly different than other revenue recycling policies. In that case, investment rises, employment and wages rise, and overall GDP is significantly above its baseline through year 25. Thus, adopting a carbon tax and using the revenue to reduce capital taxes would achieve the dual goals of reducing CO_2 emissions significantly and expanding employment and the economy.

CARBON TAXES, DEFICITS, AND ENERGY POLICY INTERACTIONS

Sebastian Rausch and John Reilly

68 National Tax Journal, 157–178 (March 2015)

The United States faces the challenge of bringing its federal budget deficit under control, while also reducing its greenhouse gas emissions. Current energy policy has not been very effective in reducing greenhouse gas emissions, although that has not necessarily been its sole purpose. And rather than raise revenue, much energy policy involves subsidies through the tax system that reduce revenue or regulatory policy that may indirectly reduce revenue through its effects on economic activity. This paper focuses on the role of a carbon tax as one option to raise revenue while also reducing greenhouse gases. We also examine the interaction with other regulatory policies, namely renewable portfolio standards, which have been implemented in many states and the corporate average fuel economy standards.

ENVIRONMENTAL POLICY FOR FISCAL REFORM: CAN A CARBON TAX PLAY A ROLE?

Sugandha D. Tuladhar, W. David Montgomery, and Noah Kaufman

68 National Tax Journal, 179–194 (March 2015)

This paper compares the effects of using revenues from a carbon tax to either reduce the national debt or reduce federal personal or corporate income tax rates. It differs from other analyses by looking at a carbon tax as a purely revenue raising measure, not as an optimal Pigouvian tax or as an instrument to achieve a predetermined reduction in emissions. Thus it addresses the question of whether a carbon tax would be part of an optimal tax policy even if there were no damages to the United States from CO_2 emissions. We use a computable general equilibrium model (NERA's N_{ew}ERA model) that consists of a top-down macro model of the U.S. economy and a detailed bottom-up model of the North American electricity sector. The N_{ew}ERA model is an integrated energy and economic model that includes a detailed plant-level representation of the electricity sector with an aggregate level representation of the rest of the economy. The analysis shows that using revenues for either debt or tax rate reduction can reduce the welfare losses from a carbon tax; however, the savings from reducing either federal debt or the marginal rates of other distorting taxes are still less than the economic costs imposed by the narrowly based tax on CO2 emissions. The higher the carbon tax, the greater the disparity becomes.

THE INITIAL INCIDENCE OF A CARBON TAX ACROSS INCOME GROUPS

Roberton C. Williams III, Hal Gordon, Dallas Burtraw, Jared C. Carbone, and Richard D. Morgenstern

68 National Tax Journal, 195–214 (March 2015)

Carbon taxes efficiently reduce greenhouse gas emissions, but are criticized as regressive. This paper links dynamic overlapping-generation and micro-simulation models of the United States to estimate the initial incidence of carbon taxes. We find that while carbon taxes are regressive, incidence depends much more on how carbon tax revenue is used. Recycling revenues to cut capital taxes is efficient but exacerbates regressivity. Lump-sum rebates are less efficient, but much more progressive, benefitting the three lower income quintiles even when ignoring environmental benefits. A labor tax swap represents an intermediate option, as it is more progressive than a capital tax swap and more efficient than a rebate.

BOOK REVIEW:

CRITICAL ISSUES IN TAXATION AND DEVELOPMENT

Sally Wallace

68 National Tax Journal, 215–224 (March 2015)

A review of *Critical Issues in Taxation and Development* edited by Clemens Fuest and George R. Zodrow (MIT Press, 2013, Cambridge MA, 248 pages).

DECEMBER 2014

WHO PAYS TAXES? A DYNAMIC PERSPECTIVE

Bradley T. Heim, Ithai Z. Lurie, and James Pearce

67 National Tax Journal, 755–778 (December 2014)

This paper examines income and payroll tax payments using a panel of individual income tax returns from 2001–2011. Over that time, the share of families paying positive income taxes decreased from 62 to 53 percent, and the share of individuals fell from 69 to 62 percent. Including payroll taxes increases the share of individuals paying positive taxes in 2011 to 71 percent, but does not alter the trend. Across years, positive tax liability is more persistent than non-payment or negative liability. Finally, across a five-year window, 13 percent of individuals paid positive taxes in no year, while 20 percent had a zero or negative tax liability on average.

USING THE TAX SYSTEM TO ADDRESS COMPETITION ISSUES WITH A CARBON TAX

Gilbert E. Metcalf

67 National Tax Journal, 779–806 (December 2014)

This paper considers how tax reductions financed by a carbon tax could be designed to mitigate the need for specific relief for firms in select energy-intensive, trade-exposed (EITE) sectors at the six-digit North American Industry Classification System level. Providing an output-based tax credit to EITE sectors or a broad based reduction in corporate income tax rates disproportionately benefits EITE sectors, thereby potentially reducing pressure for other transitional relief. Payroll tax reductions, on the other hand, do not disproportionately benefit EITE sectors given their higher than average capital intensity.

THE INITIAL INCIDENCE OF A CARBON TAX ACROSS U.S. STATES

Roberton C. Williams III, Hal Gordon, Dallas Burtraw, Jared C. Carbone, and Richard D. Morgenstern

67 National Tax Journal, 807–830 (December 2014)

Carbon taxes introduce potentially uneven cost burdens across the population. The distribution of these costs is especially important in affecting political outcomes. This paper links dynamic overlapping-generations and microsimulation models of the United States to estimate the initial incidence of a carbon tax across states. Geographic differences in incidence are driven primarily by differences in sources of income. Differing patterns of energy use also matter but are relatively less important. The use of the carbon tax revenue plays an important role, particularly in determining how different income sources are affected, as: (1) using carbon tax revenue to cut capital taxes disproportionately benefits states with large shares of capital income; (2) returning the revenue via lump-sum transfers favors relatively low-income states; and (3) returning the revenue via cuts in labor taxes provides a relatively even distribution of cost across states. In general, geographic differences in incidence are substantially smaller than the differences across income groups.

CORPORATE TAX AGGRESSIVENESS — RECENT HISTORY AND POLICY OPTIONS

J. Richard (Dick) Harvey, Jr.

67 National Tax Journal, 831–850 (December 2014)

This paper examines corporate tax aggressiveness from the 1990s to 2014. The paper also discusses various public indicia of corporate tax aggressiveness and analyzes selected data from 21 public companies. Finally, the paper discusses several policy options for further reducing corporate tax aggressiveness, including: (1) improvements to the IRS whistleblower program, (2) increased transparency, and (3) changes to the penalty structure surrounding aggressive tax positions.

RISKY BUSINESS: THE PROSOPOGRAPHY OF CORPORATE TAX PLANNING

Michael P. Donohoe, Gary A. McGill, and Edmund Outslay

67 National Tax Journal, 851–874 (December 2014)

We trace the history of corporate tax planning from a compliance-focused activity to a profit-enhancing endeavor to a risk management center. Tax directors of U.S. multinational corporations face unprecedented global pressures from taxing jurisdictions seeking to increase their share of the enterprise's worldwide taxes. Increasingly, corporations must consider the risks that a tax strategy will impose on them, not only in terms of potential lost revenue, but also in terms of reputation and market share. We discuss the components of tax risk management in today's global environment and speculate how future corporate tax planning will change in light of the Organisation for Economic Co-Operation and Development Base Erosion and Profit Shifting project.

DEFINING AND MEASURING TAX PLANNING AGGRESSIVENESS

Jennifer Blouin

67 National Tax Journal, 875–900 (December 2014)

In this paper, I discuss the concepts of tax aggressiveness and tax risk from an academic point of view. Although tax aggressiveness is often defined as being in the "eye of the beholder," this is not terribly satisfactory when attempting to measure empirically tax planning aggressiveness and its associations with firm attributes. I explain that tax planning that results in certain tax benefits should not constitute aggressiveness. Although policy makers may argue that these tax planning opportunities are attributable to tax loopholes, this assertion does not imply that the firm has undertaken any significant risk by entering into such tax planning. By documenting that low effective tax rates are not necessarily associated with risky or uncertain tax planning, I hope to convince future researchers to develop better empirical proxies for capturing aggressive tax planning.

MUNICIPAL DEBT: WHAT DOES IT BUY AND WHO BENEFITS?

Harvey Galper, Kim Rueben, Richard Auxier, and Amanda Eng

67 National Tax Journal, 901–924 (December 2014)

This paper examines the incidence of the federal income tax exemption of interest on state and local bonds, applying a fixed-savings, simplified general equilibrium approach to estimate incidence effects on both the sources and uses of income. In contrast to traditional empirical work that allocates the benefit of tax exemption to current holders of tax-exempt bonds based on current interest rates, we incorporate the fact that the existence of tax exemption causes the taxable interest rate to rise and the tax-exempt rate to fall. As a consequence, on the sources side, tax exemption can increase after-tax income for holders of both taxable and tax-exempt bonds. On the uses side, consumers of both private and public goods are affected by the higher cost of funds to private and federal government borrowers, the lower cost of funds to state and local borrowers, and the lower cost of funds to private-sector entities with access to the proceeds of tax-exempt borrowing. Overall, higher income individuals remain the primary beneficiaries of tax exemption on the sources side with this new approach, but less so than under the traditional approach. On the uses side, households who consume a relatively large share of state and local public services, such as those with several school-age children, receive significant net benefits.

THE CHALLENGES OF ACA MARKETPLACE ENROLLMENT: RESULTS FROM BIG DATA AND CAMPAIGN-STYLE TACTICS IN THE KANSAS CITY AREA

Tami Gurley-Calvez, Jessica Hembree, Jane Mosley, Mary K. Zimmerman, and Bridget McCandless

67 National Tax Journal, 925–940 (December 2014)

In the fall of 2013 the Health Care Foundation of Greater Kansas City (HCF) undertook a major effort to increase insurance coverage among the estimated 200,000 uninsured people in their service area. HCF took a multi-tiered approach, providing direct incentive funding for organizations to train Certified Application Counselors (CACs) and conducting outreach activities through multiple modes of contact. Throughout the open enrollment period, HCF efforts involved knocking on nearly 60,000 doors and mailing communication to 68,000 households. HCF was committed to making real-time changes to their outreach strategies in order to increase effectiveness. Short-term evaluation efforts were canceled due to low response rates and it is too soon to assess the longer term impact of HCF outreach efforts. Overall, the experience highlights the role for local entities in providing education on health insurance and federal policy and the limitations of big data campaign-style tactics for identifying the uninsured and evaluating outreach activities, particularly those using phones as the primary contact. Experience also suggests the need for close collaboration between outreach and enrollment activities.

REFORMING PUBLIC PENSIONS SUBJECT TO POLITICAL AND LEGAL CONSTRAINTS: THE ILLINOIS EXPERIENCE

Jeffrey R. Brown

67 National Tax Journal, 941–964 (December 2014)

On December 5, 2013, the Governor of Illinois signed into a law a bill that substantially reduced pensions for public sector workers in Illinois. Designed to partially address the severe under-funding problem created from many decades of inadequate contributions to the state's large pension funds, the new law was negotiated in a highly constrained environment. Strong constitutional benefit protections and political constraints both imposed severe limits on the set of options available to the legislature. This paper discusses these constraints and how they influenced the shape of the final bill. It also analyzes the financial and legal implications of the reform for the state, public universities, and participants.

SEPTEMBER 2014

BUMPY DESIGNS: IMPACT OF PRIVACY AND TECHNOLOGY COSTS ON SUPPORT FOR ROAD MILEAGE USER FEES

Denvil Duncan, Venkata Nadella, Ashley Bowers, Stacey Giroux, and John D. Graham

67 National Tax Journal, 505–530 (September 2014)

The mileage user fee is a promising alternative to the fuel tax but public opposition is a barrier to implementation. We use a nationally representative survey with an embedded experimental design to determine the extent to which technology costs and perceived invasion of privacy influence public opinion regarding the adoption of mileage user fees. We find that the ratio of opponents to supporters is about four to one, and that public opposition can be attenuated by insulating motorists from a new one-time cost for GPS technology to measure mileage, and safeguards that eliminate or minimize perceived invasions of privacy.

INDIVIDUAL INCOME TAX COMPLIANCE AND INFORMATION REPORTING: WHAT DO THE U.S. DATA SHOW?

Mark D. Phillips

67 National Tax Journal, 531–568 (September 2014)

This paper examines 2001 National Research Program data to assess the role of information reporting in explaining individual income tax compliance in the United States. Taxpayers are largely compliant in self-reporting third-party "matched" income; furthermore, many taxpayers underreport 100 percent of "unmatched" income. However a majority of noncompliant taxpayers, particularly those with large amounts of unmatched income, underreport only a portion of it. Taxpayers exhibit significant heterogeneity with regard to the critical amount of unmatched income at which they switch from full to partial noncompliance. The increase in underreported income that arises from a marginal increase in unmatched income also varies across taxpayers.

INDIRECT AND DIRECT SUBSIDIES FOR THE COST OF GOVERNMENT CAPITAL: COMPARING TAX-EXEMPT BONDS AND BUILD AMERICA BONDS

Gao Liu and Dwight V. Denison

67 National Tax Journal, 569–594 (September 2014)

Using data from the California primary market, we find that on average Build America Bonds (BABs) have after-subsidy interest rates approximately 72 basis points lower than tax-exempt bonds, and that the saving increases with bond maturity. The implied tax rate for the marginal municipal bond investor is 25 percent, which is also the neutral subsidy rate at which municipal bond issuers are indifferent between issuing tax-exempt bonds and BABs. Analysis of paired tax-exempt bonds and BABs issued by the same issuers on the same dates suggests a comparable implied tax rate and net after-subsidy savings of about 65 basis points.

DEMAND FOR LOTTERY GAMBLING: EVALUATING PRICE SENSITIVITY WITHIN A PORTFOLIO OF LOTTERY GAMES

Michael A. Trousdale and Richard A. Dunn

67 National Tax Journal, 595–620 (September 2014)

This article introduces a new approach to analyzing whether lottery games are complements or substitutes, and whether a portfolio of lottery games is optimally priced. We estimate Barten's synthetic differential demand system for the on-line lottery games operated by the Texas Lottery Commission. The demand system approach imposes theory-consistent demand restrictions that allow identification of parameters for games without price variation. We use the estimated parameters from the Barten model to construct expenditure and price elasticities. Results indicate that on-line games in Texas are generally substitutes for one another and the portfolio of games is not priced to maximize profit.

CONSUMER RESPONSE TO CIGARETTE EXCISE TAX CHANGES

Lesley Chiou and Erich Muehlegger

67 National Tax Journal, 621–650 (September 2014)

We use a rich dataset of weekly cigarette sales to examine how consumers adapt their behavior before and after excise tax increases — whether by stockpiling or substituting between quality tiers of a product. We find that stockpiling primarily occurs for low-tier cigarettes. In the short-term, consumers shift from high-tier to low-tier cigarettes, presumably to maintain current consumption. However, in the long term, tax increases are associated with substitution toward high-tier cigarettes. In the long term, average levels of tar, nicotine, and carbon monoxide consumed per pack rises, as consumer substitute across tiers and brands, suggesting a long term negative impact on health outcomes.

THE TIFF OVER TIF: A REVIEW OF THE LITERATURE EXAMINING THE EFFECTIVENESS OF TAX INCREMENT FINANCING

Robert T. Greenbaum and Jim Landers

67 National Tax Journal, 655–674 (September 2014)

California's recent decision to discontinue its tax increment financing (TIF) after six decades of use has triggered a re-examination of its broader use. TIF typically allows the borrowing of funds for local economic development in a specified district, to be paid for by taxes collected in the future that are generated by the development. To put the findings of the previous literature into context and to make them more broadly informative, this paper reviews the empirical research, provides some descriptive national analysis of TIF adoption, and provides policy recommendations informed by the empirical findings and literature.

TAX INCREMENT DEBT FINANCE AND THE GREAT RECESSION

Martin J. Luby and Tima Moldogaziev

67 National Tax Journal, 675–696 (September 2014)

This paper explores U.S. local government debt finance activities related to TIF between 2000 and 2013. We gather comprehensive data about debt that is serviced through TIF, document changes in several variables related to the amount, use, and structural features of such debt, and evaluate the impact of the Great Recession on these variables of interest. Our results indicate that the Great Recession limited how local governments could sell and structure TIF debt. We suggest that these limitations were the result of the limited capital available during and immediately after the financial crisis, structural changes in the financial industry caused by the financial crisis, and increased risk aversion by investors.

TAX INCREMENT FINANCING AND THE GREAT RECESSION

Richard F. Dye, David F. Merriman, and Katherine Goulde

67 National Tax Journal, 697–718 (September 2014)

The Great Recession was accompanied by a large decline in real estate values. Tax increment finance (TIF) allocates future property tax growth to promote local real estate development and is thus particularly vulnerable to real estate market shocks. Data on the growth of TIF increments before, during, and after the recession is examined for Illinois and Nebraska. In both states there was rapid growth in TIF increments before the onset of the recession. There was a large decline post-onset that is very apparent in Illinois, but not as sharp or obvious in Nebraska.

REDEVELOPMENT IN CALIFORNIA: THE DEMISE OF TIF-FUNDED REDEVELOPMENT IN CALIFORNIA AND ITS AFTERMATH

George Lefcoe and Charles W. Swenson

67 National Tax Journal, 719–744 (September 2014)

California was the first state to embrace the use of tax increment financing (TIF) for redevelopment, and the first state to abandon it. Both the rise and fall of redevelopment are attributable to the fact that cities and counties sponsoring redevelopment could pledge not just their own share of the property tax increments from redevelopment project areas, but also those of the other taxing entities including schools and special districts. At a time of a projected state deficit of $25 billion, Governor Brown seized the political moment to put an end to redevelopment and the $5 billion a year in property tax revenues he felt would be put to better use for education and other public needs. This paper describes the unique setting and subsequent events leading to the end of TIF in California and its aftermath.

BOOK REVIEW:

FIXING U.S. INTERNATIONAL TAXATION

Harry Grubert

67 National Tax Journal, 745–754 (September 2014)

A review of *Fixing U.S. International Taxation* by *Daniel N. Shaviro* (Oxford University Press, 2014, New York, NY, 223 pages).

JUNE 2014

CALCULATING THE OPTIMAL SMALL BUSINESS EXEMPTION THRESHOLD FOR A U.S. VAT

Edith Brashares, Matthew Knittel, Gerald Silverstein, and Alexander Yuskavage

67 *National Tax Journal*, 283–320 (June 2014)

Most countries with a VAT have a tax exemption for small businesses that have taxable sales below a certain threshold. The exemption reduces both compliance costs for small businesses and administrative costs for the government. We use a static analysis of the U.S. economy to determine the optimal level of taxable sales for this threshold and analyze the potential behavioral response by businesses. For a 10 percent VAT rate, we find that the optimal level for the threshold in the United States is $200,000, and that behavioral responses may be significant close to the threshold.

SWITCHING ON THE LIGHTS: DO HIGHER INCOME TAXES PUSH ECONOMIC ACTIVITY INTO THE SHADE?

Denvil Duncan and Klara Sabirianova Peter

67 *National Tax Journal*, 321–350 (June 2014)

This paper examines the effect of corporate income tax (CIT) rates on shadow economic activity. The paper revives the electricity consumption approach to measuring such activity with a new functional form, a larger sample of countries, a longer time span of 25 years, and the use of instrumental variables. We find that a 1 percentage point increase in the CIT rate increases the size of the shadow economy by 2.3 percent, which implies a tax elasticity of shadow economic activity of 0.78 at the mean CIT rate. This result suggests that efforts to reduce budget deficits with corporate tax rate increases may be offset by an increase in shadow economic activity.

DOES INCREASING AVAILABLE NON-TAX ECONOMIC DEVELOPMENT INCENTIVES RESULT IN MORE JOBS?

Carlianne Patrick

67 *National Tax Journal*, 351–386 (June 2014)

This paper examines the job creation effects of state and local non-tax incentives for capital investment, which are relatively understudied in the literature. The paper's primary contribution is the creation of an Incentive Environment Index (IEI) from state constitutional provisions that limit and structure the ability of state and local governmental entities to aid private enterprises. Comparing estimation results across methods reveals that unobserved heterogeneity results in overstatement of policy effects. The most robust estimates indicate that increasing the ability of governments to aid private enterprise has a significant negative medium-term effect on rural county employment levels but otherwise has no effect on employment levels or growth.

INCOME TAXATION AND BUSINESS INCORPORATION: EVIDENCE FROM THE EARLY TWENTIETH CENTURY

Li Liu

67 *National Tax Journal*, 387–418 (June 2014)

A differential between the corporate income tax rate and the personal income tax rates applied to non-corporate income can play an important role in a firm's choice of organizational form. The impact and interdependency of income tax incentives are crucial factors in the design of efficient tax policies. In this paper I exploit the variation in income taxes across U.S. states in the early twentieth century to estimate these sensitivities. The potential endogeneity of state taxes is addressed using an instrumental variables approach. The results demonstrate that the relative taxation of corporate to personal income has a significant impact on the corporate share of economic activities. On average, a 10 percentage point increase in the corporate tax rate is associated with a 0.2 to 0.3 percent decrease in the corporate share of economic activities, while a ten percentage point increase in the personal income tax rates applied to non-corporate income raises the corporate share of economic activities by 0.5 to 0.6 percent.

REFLECTIONS OF THE HOLLAND MEDAL RECIPIENT . . .

THE TAX REFORM ROAD NOT TAKEN — YET

Michael J. Graetz

67 *National Tax Journal*, 419–440 (June 2014)

The United States has traveled a unique tax policy path, avoiding value added taxes (VATs), which have now been adopted by every OECD country and 160 countries worldwide. Moreover, many U.S. consumption tax advocates have insisted on direct personalized taxes that are unlike taxes used anywhere in the world. This article details a tax reform plan that uses revenues from a VAT to substantially reduce and reform our nation's tax system. The plan would (1) enact a destination-based VAT; (2) use the revenue produced by this VAT to finance an income tax exemption of $100,000 of family income and to lower income tax rates on income above that amount; (3) lower the corporate income tax rate to 15 percent; and (4) protect low- and-moderate-income workers from a tax increase through payroll tax credits and expanded refundable child tax credits. This revenue and distributionally neutral plan would stimulate economic growth, free more than 150 million Americans from having to file income tax returns, solve the difficult problems of international income taxation, and remove the temptation for Congress to use tax benefits as if they are solutions to the nation's pressing social and economic problems.

TAXES AND THE LABOR SUPPLY OF OLDER AMERICANS: RECENT EVIDENCE FROM THE SOCIAL SECURITY EARNINGS TEST

Gary V. Engelhardt and Anil Kumar

67 *National Tax Journal,* 443–458 (June 2014)

This paper summarizes recent work on the impact of taxation on the labor supply of older individuals, with a focus on the Senior Citizens Freedom to Work Act of 2000, which abolished the Social Security earnings test for those ages 65 to 69. For men age 65 to 69, the repeal increased earnings by 8 to 20 percent and hours by 5 to 16 percent. For women claiming Social Security benefits on their own earnings history, the repeal increased earnings by 20 percent. Estimates of the compensated elasticity of earnings with respect to the net-of-tax share range from 0.05 to 0.12. Labor supply is very inelastic, even accounting for adjustment costs.

THE EFFECTS OF THE TAXATION OF SOCIAL SECURITY BENEFITS ON OLDER WORKERS' INCOME AND CLAIMING DECISIONS

Leonard E. Burman, Norma B. Coe, Kevin Pierce, and Liu Tian

67 *National Tax Journal*, 459–486 (June 2014)

Social Security benefits are taxed under a complex regime that raises marginal effective tax rates by up to 85 percent, which could discourage the labor supply of older workers and affect the decision to claim benefits. Using a nonparametric graphical methodology, this paper investigates whether older taxpayers reduce income to avoid the tax. While previous research found that the labor supply of older workers is significantly affected by the Social Security earnings test, we find little evidence of a response to benefit taxation in a large panel of data compiled from individual income tax and information returns. Similarly, while taxation of benefits provides an incentive for many to delay claiming, we find no evidence of such an effect. Overall, the findings suggest that older taxpayers have little understanding of the rules governing Social Security benefit taxation.

BOOK REVIEW:

TAX FAIRNESS AND FOLK JUSTICE

Kirk J. Stark

67 *National Tax Journal*, 487–496 (June 2014)

A review of *Tax Fairness and Folk Justice* by Steven M. Sheffrin (Cambridge University Press, 2013, New York, NY, 246 pages).

MARCH 2014

FISCAL ZONING AND SALES TAXES: DO HIGHER SALES TAXES LEAD TO MORE RETAILING AND LESS MANUFACTURING?

Daria Burnes, David Neumark, and Michelle J. White

67 *National Tax Journal*, 7–50 (March 2014)

Using data from Florida counties, we test the hypothesis that local government officials in jurisdictions that have higher local sales taxes are more likely to use fiscal zoning to attract retailing. We find that total retail employment is not significantly affected by local sales tax rates, but employment in big box and anchor stores rises significantly in jurisdictions where sales tax rates increase. We also find that manufacturing employment falls significantly in these jurisdictions. These results suggest that local officials in jurisdictions with higher sales tax rates concentrate on attracting large stores and shopping centers, and that their efforts crowd out manufacturing. Our results suggest that an increase of 1 percentage point in a county-level local sales tax rate will result in 258 additional retail jobs and the loss of 838 manufacturing jobs.

Winner of the 2014 *National Tax Journal* Musgrave Prize for the Best Article:

RANKING UP BY MOVING OUT: THE EFFECT OF THE TEXAS TOP 10% PLAN ON PROPERTY VALUES

Kalena E. Cortes and Andrew I. Friedson

67 *National Tax Journal*, 51–76 (March 2014)

Texas engaged in a large-scale policy experiment when it instituted the Top 10% Plan. This policy guarantees automatic admission to their state university of choice for all high school seniors who graduate in the top decile of their high school class. We find evidence that households reacted strategically to this policy by moving to neighborhoods with lower-performing schools, increasing property values in those areas. The effect is strongest among schools that were very low-performing before the change in policy. We also find evidence that these strategic reactions were influenced by the number of local schooling options available, as these effects of the Top 10% Plan were weaker in areas that had fewer school choices.

IMPLICIT DEBT CAPITALIZATION IN LOCAL HOUSING PRICES: AN EXAMPLE OF UNFUNDED PENSION LIABILITIES

Robert C. MacKay

67 *National Tax Journal*, 77–112 (March 2014)

I analyze the response of individual housing sales prices to negative information or "news" about local public debt levels and their underlying impact on the provision of public goods and services. In February 2004, it was announced that rising levels of unfunded liabilities for the San Diego City Employees' Retirement System (SDCERS) were higher than previously perceived. Comparing the sales of homes on both sides of the city boundary before and after the shock occurred, I find the "news" led to a 2.5–3.7 percent decrease in housing sales prices in San Diego City over the four years following the announcement. This result implies overcapitalization of the unfunded pension liabilities, where the impact on home values is greater than the residents' financial burden from the unfunded liabilities.

THE ISSUANCE OF STATE AND LOCAL DEBT DURING THE UNITED STATES GREAT RECESSION

Ronald C. Fisher and Robert W. Wassmer

67 *National Tax Journal*, 113–150 (March 2014)

This research explores the borrowing behavior of state and local governments between 2008 and 2010, a period that encompasses the Great Recession. State and local governments continued to borrow markedly during this period of severe fiscal stress. Following an overview of state-local debt and subnational government borrowing, we present a statistical analysis of the demographic, economic, political, and institutional factors that influenced interstate differences in borrowing. This research suggests that both economic and political factors influenced borrowing and that the availability of Build America Bonds contributed to an increase in borrowing during this period.

THE EFFECT OF INSURANCE PREMIUM TAXES ON INTERSTATE DIFFERENCES IN THE SIZE OF THE PROPERTY-CASULATY INSURANCE INDUSTRY

Martin F. Grace, David L. Sjoquist, and Laura Wheeler

67 *National Tax Journal*, 151–182 (March 2014)

States levy insurance premium taxes, which are essentially gross receipt taxes on premiums, with insurers paying the higher of the tax rate in the state in which the company is domiciled and the state in which the policy is written. Using a state-level panel data set from 1996–2010 for the property-casualty insurance industry, the paper explores the effect of insurance premium tax rates on interstate differences in property-casualty insurance industry employment and other measures of industry size. While the estimated elasticities of industry size with respect to the tax rate differ across models, the results indicate that the insurance premium tax has a large, negative, and economically significant effect on the size of the insurance industry in a state.

UNEMPLOYMENT COMPENSATION DURING THE GREAT RECESSION: THEORY AND EVIDENCE

Walter Nicholson, Karen Needels, and Heinrich Hock

67 *National Tax Journal*, 187–218 (March 2014)

The extreme labor market weakness during and after the Great Recession led to the passage of extensive federal legislation related to unemployment compensation. In this paper, we summarize that legislation and some of the research related to it. Although our particular focus is on the very long potential durations of benefits (up to 99 weeks) initially implemented in 2008–2009, we also look at a variety of other initiatives. Most of the research we review comes from the United States. But we also provide a brief look at the vast European literature that addresses many of the same policy issues.

A SHORT REVIEW OF RECENT EVIDENCE ON THE DISINCENTIVE EFFECTS OF UNEMPLOYMENT INSURANCE AND NEW EVIDENCE FROM NEW YORK STATE

Bruce D. Meyer and Wallace K. C. Mok

67 *National Tax Journal*, 219–252 (March 2014)

This paper examines two sets of evidence on the effects of unemployment insurance (UI). First, we discuss two recent lines of research on the effects of UI, one of which argues that UI is more welfare enhancing than previously thought, and a second that suggests that its distortions are often larger than previously argued. We point out limitations in each research program, but conclude that both significantly advance our knowledge. Second, we summarize the evidence on the effect of UI on claim duration from a 36 percent increase in the maximum weekly benefit in New York State. This policy change sharply increased benefits for a large group of claimants, while leaving them unchanged for a large share of claimants who provide a natural comparison group. The New York benefit increase has the special features that it was unexpected and applied to in-progress spells. These features allow the effects on duration to be more convincingly separated from effects on incidence. The results show a fall in the hazard of leaving UI that coincides with the increase in benefits. The estimated unemployment duration elasticities with respect to the UI benefit range from 0.1–0.2, towards the low end of past estimates. We do not find larger effects for those who are more likely to be liquidity constrained. We also examine the extent of bias in standard methods that identify duration effects through nonlinearities in the benefit schedule, finding mixed results.

FINANCING UNEMPLOYMENT INSURANCE

Wayne Vroman and Stephen A. Woodbury

67 *National Tax Journal*, 253–268 (March 2014)

Following the Great Recession, the unemployment insurance (UI) trust funds in most states became insolvent, requiring the states to borrow from the U.S. Department of the Treasury to finance benefit payments. This article describes the basics of UI financing and reviews the origins of the financial crisis facing the federal-state UI system. It then examines the main components of the UI payroll tax — the taxable wage base and the experience-rated payroll tax — and considers how these might be modified to avoid future widespread insolvency. We conclude with some speculative remarks on the future of UI financing.

BOOK REVIEW:

THE DEATH OF THE INCOME TAX: A PROGRESSIVE CONSUMPTION TAX AND THE PATH TO FISCAL REFORM

Laurence Seidman

67 *National Tax Journal*, 269–278 (March 2014)

A review of *The Death of The Income Tax: A Progressive Consumption Tax and The Path to Fiscal Reform* by Daniel Goldberg (Oxford University Press, Oxford, UK, 2013, 318 pages).

DECEMBER 2013

EXPERT AND PUBLIC ATTITUDES TOWARDS TAX POLICY: 2013, 1994, AND 1934

Diane Lim, Joel Slemrod, and Eleanor Wilking

66 *National Tax Journal*, 775–806 (December 2013)

What do tax policy "experts" think about tax policy issues, and why do these views differ so strikingly from those held by the general public? To explore these questions, we examine the results of a recent survey of tax policy experts who are members of the National Tax Association (NTA). We compare those responses to two previous surveys — one conducted in 1994 of NTA members and the other in 1934 of U.S. public finance professors. We also survey the general public on a subset of the questions asked of the NTA members, and discover a large divergence between the answers of the NTA respondents and those of the public. We suspect, but cannot prove, that part of the divergence arises because experts are trained to think of policy changes in a balanced-budget framework, so that supporting a tax cut must also mean raising some other tax or cutting some government expenditures. Absent that connection, lower taxes and narrow bases can indeed look attractive.

EVALUATING BROAD-BASED APPROACHES FOR LIMITING TAX EXPENDITURES

Eric J. Toder, Joseph Rosenberg, and Amanda Eng

66 *National Tax Journal*, 807–832 (December 2013)

This paper evaluates six options to achieve across-the-board reductions to a group of major exclusions and deductions in the income tax: (1) limiting their tax benefit to a maximum percentage of income; (2) imposing a fixed dollar cap; (3) reducing them by a fixed-percentage amount; (4) limiting their tax saving to a maximum percentage of their dollar value; (5) replacing preferences with fixed rate refundable credits; and (6) including them in the base of the existing Alternative Minimum Tax (AMT). We discuss issues of design, implementation, and administration, and simulate the revenue, distributional, and incentive effects of the various options.

INCOME TAXES AND COMPLIANCE COSTS: HOW ARE THEY RELATED?

Rosemary Marcuss, George Contos, John Guyton, Patrick Langetieg, Allen Lerman,

Susan Nelson, Brenda Schafer, and Melissa Vigil

66 *National Tax Journal*, 833–854 (December 2013)

This paper examines the relationship between tax complexity and income tax compliance costs through the development and use of econometric models based on a mix of survey and tax administration data. The models are used to analyze compliance cost differences in taxpayer characteristics and return complexity.

CHANGES IN THE ORGANIZATION OF BUSINESS ACTIVITY AND IMPLICATIONS FOR TAX REFORM

George A. Plesko and Eric J. Toder

66 *National Tax Journal*, 855–870 (December 2013)

We review the changing economic significance of various business entity types since the Tax Reform Act of 1986 (TRA86) and the implications of these changes for the design of tax policy. In particular, we focus on the increased role of pass-through entities and the declining significance of the taxable corporate form. Our analysis suggests that significant reductions in the corporate tax rate, absent changes in the personal tax rate, will likely reverse the organizational form incentives that have existed since TRA86. Further, if the loss in revenue from a rate reduction is offset by a broadening of the tax base, most business entities, comprising most business income, are likely to face an overall increase in their tax burden.

SMALL BUSINESS, INNOVATION, AND TAX POLICY: A REVIEW

William Gale and Samuel Brown

66 *National Tax Journal*, 871–892 (December 2013)

Small businesses occupy a significant role in policy debates. This paper reviews evidence relating to tax policy, small businesses, innovation, and entrepreneurship. We provide background information on the small business sector and alternative business definitions. We examine evidence suggesting that job growth and innovation tends to occur in young firms, which typically start off small, rather than in small firms per se. We review how a wide variety of tax policies influence entrepreneurial activity. The key issue for policy makers going forward appears to be targeting incentives on young firms as opposed to small firms.

NEW PERSPECTIVES ON INCOME MOBILITY AND INEQUALITY

Gerald Auten, Geoffrey Gee, and Nicholas Turner

66 *National Tax Journal*, 893–912 (December 2013)

This study examines several dimensions of income mobility and inequality — mobility of individuals through their peak earnings years, intergenerational mobility, and persistence in the top 1 percent. Its main findings can be summarized as follows. Half of those age 35–40 in the bottom quintile of their cohort moved to higher quintiles 20 years later; over 60 percent moved up relative to the full population. About 70 percent of dependents from low-income households were themselves in higher quintiles 20 years later. Younger generations gradually replaced those that dominated the top percentile in 1987. The results show the importance of life cycle effects and the changing composition of top income groups.

RECENT INCOME TRENDS FOR TOP EXECUTIVES: EVIDENCE FROM TAX RETURN DATA

Seth H. Giertz and Jacob A. Mortenson

66 *National Tax Journal*, 913–938 (December 2013)

We examine income trends for top executives, focusing on the years 2000 to 2010, with special emphasis on the period surrounding the Great Recession. First, we merge Execucomp executive compensation records with IRS tax records. We compare incomes from our Execucomp sample to top incomes reported by Piketty and Saez (2003). We disaggregate executive income trends by industry, showing which industries are driving the divergence in top executive incomes. We compare our results to findings from Bakija, Cole, and Heim (2010) and Kaplan and Rauh (2010), who examine trends in top incomes for broad occupation and industry categories for years prior to the Great Recession. We also decompose these income trends by income source to see which components are driving the observed changes. We find that stock options are by far the most volatile component of executive pay. Options are the key driver of both short-term swings and longer-term trends in top executive pay. However, stock awards are also a large and growing component. We find much greater variation in income across years than across industries. Executive incomes are most volatile at the very top of income distribution. In general, trends for top executives in finance and non-finance industries are quite similar; however; for those above the 99.9th percentile of the income distribution, the decline in income from 2006 to 2009 was much more pronounced for executives in finance.

REVENUE CYCLES AND RISK-SHARING IN LOCAL GOVERNMENTS: AN ANALYSIS OF STATE RAINY DAY FUNDS

Erick M. Elder and Gary A. Wagner

66 *National Tax Journal*, 939–960 (December 2013)

Rainy day funds are one of the primary tools that state and local policymakers employ to dampen the effects of downturns. However, since state business cycles are not perfectly synchronized, theoretically there should be risk-sharing benefits to governments who pool their fiscal resources over the business cycle. In this paper, we explore the issues associated with local government risk sharing and provide estimates of the potential benefits to state governments. Our results suggest that a national rainy day fund would provide considerable fiscal benefits to state governments at a lower price than self-insuring through their own rainy day funds.

SEPTEMBER 2013

Winner of the 2013 *National Tax Journal* Musgrave Prize for the Best Article:

ON FISCAL ILLUSION IN LOCAL PUBLIC FINANCE: RE-EXAMINING RICARDIAN EQUIVALENCE AND THE RENTER EFFECT

H. Spencer Banzhaf and Wallace E. Oates

66 *National Tax Journal*, 511–540 (September 2013)

We reevaluate fiscal illusion in local public finance. The Ricardian Equivalence Theorem suggests that the financing of a public program using either taxation or debt shouldn't affect outcomes, because debt is capitalized into property values. In contrast, we show individuals may rationally prefer public debt if governments can borrow on more favorable terms. We also propose a new test for the renter effect: controlling for differences in demand, the renter effect suggests renters prefer property taxes to sales taxes. Using data from U.S. open space referenda, we find that households do prefer debt financing, but find no evidence of the renter effect.

TAX STRUCTURE AND GOVERNMENT SPENDING: DOES THE VALUE-ADDED TAX INCREASE THE SIZE OF GOVERNMENT?

Dongwon Lee, Dongil Kim, and Thomas E. Borcherding

66 *National Tax Journal*, 541–570 (September 2013)

This paper examines the claim that the adoption of a value-added tax (VAT) increases the size of government. Our analysis suggests that introducing the VAT, despite the fact that it is a relatively efficient tax in comparison to the income tax alternative, has little impact on government growth due to two factors: (1) the substitution of the VAT for other tax sources, and (2) the low price elasticity of demand for public goods. In contrast, demand-side changes may have a more significant impact on government size, thus reversing the direction of causality. Using a panel of 29 OECD countries over a period of 38 years (1970–2007), we confirm these hypotheses. Our findings imply that the demand for government spending markedly influences the tax structure of society. Using a broad concept of tax costs, introduction of a VAT increases social welfare because it reduces compliance costs, rent-seeking, and efficiency costs. Accordingly, increased usage of VATs during the 20th century should be understood as a collective choice to accommodate growing demands for public expenditure.

THE EFFECT OF PUBLIC DISCLOSURE ON REPORTED TAXABLE INCOME: EVIDENCE FROM INDIVIDUALS AND CORPORATIONS IN JAPAN

Makoto Hasegawa, Jeffrey L. Hoopes, Ryo Ishida, and Joel Slemrod

66 *National Tax Journal*, 571–608 (September 2013)

The behavioral response to public disclosure of income tax returns figures prominently in policy debates about its advisability. Although supporters stress that disclosure encourages tax compliance, policy debates proceed in the absence of empirical evidence about this, and any other, claimed behavioral impact. This paper provides the first such evidence by examining the behavioral response to the Japanese tax return public notification system. The analysis suggests that, when there is a threshold for disclosure, a non-trivial number of both individual and corporate taxpayers whose tax liability would otherwise be close to the threshold will under-report so as to avoid disclosure — a response in the opposite direction from that stressed by supporters of disclosure. An analysis of corporations' financial data offers no evidence that these companies' taxable income declined after the end of the disclosure system.

WHEN A NUDGE ISN'T ENOUGH: DEFAULTS AND SAVING AMONG LOW-INCOME TAX FILERS

Erin Todd Bronchetti, Thomas S. Dee, David B. Huffman, and Ellen Magenheim

66 *National Tax Journal*, 609–634 (September 2013)

This study discusses a field experiment on default options and savings decisions by low-income households at the time of federal tax filing. In the treatment, a fraction of the tax refund was automatically directed to U.S. Savings Bonds unless filers actively chose another allocation. We find that this opt-out default had no impact on savings, and our treatment estimate is sufficiently precise to reject effects as small as 20 percent of those found in the literature on defaults and 401(k) plans. Our results have implications for understanding when default interventions will be effective and when their influence will be limited.

USING LITTERED PACK DATA TO ESTIMATE CIGARETTE TAX AVOIDANCE IN NYC

Howard Chernick and David Merriman

66 *National Tax Journal*, 635–668 (June 2013)

Using data on tax stamps obtained from random samples of littered packs of cigarettes, collected once before and three times after a June 2008 New York State tax increase, we find that baseline New York City tax avoidance is high relative to national estimates, and that rates of avoidance are particularly high in neighborhoods with high levels of poverty and in relatively close proximity to a Native American reservation. The share of littered packs with no tax stamp increased from 15 to 24 percent after the tax increase. We find that in addition to the large increase in avoidance, cigarette consumption declined.

FIXING THE SYSTEM: AN ANALYSIS OF ALTERNATIVE PROPOSALS FOR THE REFORM OF INTERNATIONAL TAX

Harry Grubert and Rosanne Altshuler

66 *National Tax Journal*, 671–712 (September 2013)

We evaluate proposals for U.S. international tax reform including dividend exemption, full current inclusion, dividend exemption with an effective tax rate test and active business exception, dividend exemption with a per-country or overall minimum tax, and repeal of check-the-box. As alternatives to active business tests, we consider minimum taxes that allow expensing for real investment abroad. We evaluate reforms along many dimensions including the lockout effect, income shifting, the choice of location, and complexity. We find a per-country minimum tax with expensing has many advantages with respect to these margins. The simpler overall minimum tax is a serious alternative.

BACK TO THE DRAWING BOARD: THE STRUCTURAL AND ACCOUNTING CONSEQUENCES OF A SWITCH TO A TERRITORIAL TAX SYSTEM

Michael P. Donohoe, Gary A. McGill, and Edmund Outslay

66 *National Tax Journal*, 713–744 (September 2013)

We review the basics of international tax planning by U.S. multinational corporations (MNCs) and the organizational structures that facilitate such planning. We then discuss the potential impacts that adopting a participation exemption regime (i.e., a territorial tax system) along the lines proposed by Representative Camp could have on a U.S. MNC's worldwide supply chain structure and financing arrangements. We compare the change in a corporation's global accounting effective tax rate under the current U.S. worldwide tax system and four participation exemption options proposed by Representative Camp. Using a hypothetical set of facts representative of a U.S. multinational with highly mobile intellectual property income, we show that the options produce very different accounting effective tax rates and tax revenues received by the U.S. Treasury. We also point out potential tax planning strategies that could be employed pre- and post-effective date of the implementation of a participation exemption system that would change the expected revenue to be received during the transition to such a system.

WHAT DO WE KNOW ABOUT CORPORATE TAX COMPETITION?

Michael P. Devereux and Simon Loretz

66 *National Tax Journal*, 745–774 (September 2013)

We review the empirical literature on competition in source-based taxes on corporate income. Drawing an analogy to the competition models for the goods market indicates how evidence for the existence of tax competition can be provided, and highlights that tax competition can take many forms. With this in mind we classify the empirical literature, and highlight the importance of the measurement of tax rates and openness. Using measures based on the statutory tax system, there is evidence for tax competition mostly in the European Union. In contrast to the view of Gordon (1992) small countries appear to be the leader of the tax competition game.

JUNE 2013

THE EFFECTS OF GOVERNMENT SUBSIDIES ON BUSINESS R&D EMPLOYMENT: EVIDENCE FROM OECD COUNTRIES

Russell Thomson and Paul Jensen

66 *National Tax Journal*, 281–310 (June 2013)

Existing evidence suggests that government subsidies stimulate business R&D expenditure. However, most studies fail to address the possibility that part of the observed increase in expenditure may be due to higher R&D wages. We consider the impact of different government subsidies on R&D workers in 25 OECD countries and find that the short run tax-price elasticity of R&D employment is marginally higher than existing estimates of the elasticity of expenditure with respect to the tax price of both labor and capital combined. We conclude that there is no evidence to indicate that wage inflation has seriously conflated past estimates of the effectiveness of government R&D subsidies.

CHANGING NEEDS, STICKY BUDGET: EVIDENCE FROM THE GEOGRAPHIC DISTRIBUTION OF U.S. FEDERAL GRANTS

Valentino Larcinese, Leonzio Rizzo, and Cecilia Testa

66 *National Tax Journal*, 281–310 (June 2013)

Most U.S. federal grants are allocated through arguably obsolete formulas, leading fast growing states to contend that they are not receiving their fair share of such grants. We examine this issue by analyzing the allocation of formula and non-formula grants during the period 1978–2008. We find that states with fast growing populations are penalized in the allocation of formula grants, whereas for non-formula grants population dynamics does not play a significant role. The estimated losses are sizable and heavily concentrated among the three fastest growing states — Nevada, Arizona, and Florida. Nevertheless, the majority of the U.S. states benefit from formula allocation, thus providing a plausible explanation for the status quo bias in budgetary formulas.

LOCAL SPENDING, TRANSFERS, AND COSTLY TAX COLLECTION

Fernando M. Aragón

66 *National Tax Journal*, 343–370 (June 2013)

This paper studies the effect of relatively costly local taxation on the fiscal response of local governments to intergovernmental transfers. Using a panel dataset of Peruvian municipalities, I find robust evidence that the central government's grants have a greater stimulatory effect in municipalities facing higher local tax collection costs. The results are consistent with the hypothesis that relatively costly local taxation may partially explain the flypaper effect.

CIGARETTE TAXES AND HOW YOUTHS OBTAIN CIGARETTES

Benjamin Hansen, Daniel I. Rees, and Joseph J. Sabia

66 *National Tax Journal*, 371–394 (June 2013)

Using state Youth Risk Behavior Survey data for the period 1995–2011, we examine the relationship between state cigarette taxes and how high school students obtain their cigarettes. Our estimates suggest that, among respondents under age 18, higher cigarette taxes reduce smoking participation primarily through third- party purchases, an important component of the secondary market. We also find that, among respondents age 18 and older, cigarette taxes are negatively related to purchasing cigarettes directly from a commercial establishment. Finally, we find that cigarette taxes are essentially unrelated to borrowing.

TAX-HAVEN INCORPORATION FOR U.S.-HEADQUARTERED FIRMS: NO EXODUS YET

Eric J. Allen and Susan C. Morse

66 *National Tax Journal*, 395–420 (June 2013)

U.S. income tax rules may encourage a U.S.-headquartered multinational corporation (MNC) to adopt a structure with a tax haven parent. We study data from firms that conducted initial public offerings in the United States between 1997 and 2010 and offer evidence that U.S.-headquartered MNCs rarely incorporate in tax havens. Of the 918 U.S.-headquartered MNCs that we identify, only 27 are incorporated in tax havens. Others have pointed to the recent increase in the proportion of firms conducting U.S. IPOs that incorporate in tax havens as possible evidence that more U.S.-headquartered MNCs make this decision. We show instead that Chinese-headquartered firms drive this increase.

THE ANATOMY OF THE VAT

Michael Keen

66 *National Tax Journal*, 423–446 (June 2013)

This paper sets out some tools for understanding the performance of the value added tax (VAT). Applying a decomposition of VAT revenues (as a share of GDP) to the universe of VATs over the last 20 years shows that developments have been driven much less by changes in standard rates than by changes in "C-efficiency" (an indicator of the departure of the VAT from a perfectly enforced tax levied at a uniform rate on all consumption). Decomposing C-efficiency for EU members into a "policy gap" (in turn divided into effects of rate differentiation and exemption) and a "compliance gap" (reflecting imperfect implementation) suggests that the former are in almost all cases far larger than the latter, with rate differentiation and exemptions playing roles that differ quite widely across countries.

WHAT INTERNATIONAL EXPERIENCE CAN TELL US ABOUT THE POTENTIAL CHALLENGES OF ADMINISTERING A U.S. VAT

Katherine O. Baer

66 *National Tax Journal*, 447–478 (June 2013)

Much has been written about the possible design of a U.S. VAT. There is less literature discussing the types of compliance issues that the U.S. tax authorities might face if a federal VAT were adopted — in other words, the most common pat- terns of VAT noncompliance, strategies that tax authorities are implementing to address noncompliance, and the measurement of noncompliance — in the context of advanced industrialized countries. This paper expands on the existing literature by discussing the recent experience of Australia, Canada, New Zealand, and the United Kingdom with ensuring VAT compliance. It also discusses the context for VAT introduction and recent trends.

POSSIBLE LESSONS FOR THE UNITED STATES FROM NEW ZEALAND'S GST

Matt Benge, Marie Pallot, and Hamish Slack

66 *National Tax Journal*, 479–498 (June 2013)

New Zealand's broad-based GST has often been suggested as a desirable model for a value added tax. This paper explains how New Zealand's GST works and discusses how its broad-based approach came about, why this has been acceptable in New Zealand when it has not been in many other countries, and outlines what we see as problem areas of the tax.

BOOK REVIEW:

THE ELGAR GUIDE TO TAX SYSTEMS

Henry J. Aaron

66 *National Tax Journal*, 479–498 (June 2013)

A review *of The Elgar Guide to Tax Systems*, edited by Emilio Albi and Jorge Martinez-Vazquez (Edward Elgar, 2011, Cheltenham, UK, 462 pages).