

Intertemporal Income Shifting and the Danish 2010 Tax Reform

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Project Description

In practice, decisions to change the tax system will almost always create unintended incentives for, so-called, intertemporal income shifting where tax payers earn some income in one year but report this income to the tax authorities in another year (legally or illegally). This was also the case for the recent Danish tax reform, which created large tax incentives to postpone wage payments from the end of 2009 to the beginning of 2010 and to move pension contributions forward to 2009.

The main purpose of this project is to investigate the extent to which people use their employer to postpone the payment of their earnings to after the implementation of the 2010 tax reform, where the highest marginal tax rate on earned income was reduced from 59,0 to 51,5 percent (skatteløftet).

Whether tax payers do respond to intertemporal incentives through income shifting is an empirical question, and in most cases it is quite hard to provide a convincing answer with the existing data.¹ However, new Danish data provides a unique possibility to provide convincing estimates of the intertemporal income shifting effects of the recent tax reform in Denmark. From SKAT and their data source (IBM), we will obtain *monthly* earnings and pension contributions for the universe of employees in Denmark (e-indkomst) from January 2008 to September 2010. This allows us to measure monthly earnings and to measure the extent to which income is shifted from 2009 to 2010. The high frequency of the data gives the opportunity to investigate exactly the timing of the shift if it appears. For example we are able to detail out if it is the earnings of December 2009 that are shifted to the January 2010 payment.

Empirical evidence on income shifting is interesting for different reasons. First, tax motivated income shifting is in itself distortionary and providing evidence on income shifting is therefore important for assessing the efficacy of the tax system.

Second, intertemporal income shifting may create serious measurement problems when measuring the so-called elasticity of taxable income, which is the most crucial statistics to evaluate the overall distortionary effect of the tax system (Feldstein 1995). For an evaluation of the distortionary effect of the tax system, the elasticity of taxable income is supposed to measure the *permanent* change in behavior/taxable income from a change in the tax wedge. The modern empirical public finance literature uses exogenous variation in incentives to work created by tax reforms to estimate the elasticity of taxable income. If tax payers *temporarily* shift income from a period with a high tax rate to a period with low tax rate then this effect enters into the empirical estimate of the elasticity of taxable income thereby creating a bias. This problem is well-known in the literature (see e.g. the recent survey by Saez, Slemrod and Giertz, 2010), but little is known about its quantitative importance. This project will provide precise estimates of the importance of this phenomenon.

¹ Evidence of tax motivated income shifting has been established for capital income and for the self-employed but little is known about such effects for labor income.

Expected Output and Time Plan

The output of the project is expected to be 1-2 academic papers. Given the unique features of the Danish data, we expect to be able to publish the results in the best field journals or even the best general purpose journals, if we obtain strong empirical results.

Within the next 4-6 months, we plan to transfer the data from IBM and SKAT to Statistics Denmark where it will be combined with demographic variables and wealth data. We will then clean and analyze the data, and expect to have the first results by the end of 2011, and a research paper ready for submission during 2012.

Budget

We apply for funding to buy data from IBM (the data is transferred to SKAT who will link it to their data and afterwards transfer the full data set to Statistics Denmark). SKAT has obtained a cost estimate from IBM of DKR 65 thousand. We also apply for funding to teaching buy-out for CTK and SLP for 1,5 months each (Peer Skov is a Ph.D. student under the supervision of CTK and SLP). The budget is attached.

References

Feldstein (1995): "The effect of marginal tax rates on taxable income: a panel study of the 1986 Tax Reform Act", *Journal of Political Economy*, 103, 551–572.

Saez, Slemrod and Giertz (2010): "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review." *Journal of Economic Literature* (forthcoming).

Budget		
Løn	1 ½ mdr. løn Claus Thustrup Kreiner	105.735,-
	1 ½ mdr. løn Søren Leth-Petersen	101.727,-
Data	Datakøb, IBM/SKAT	65.000,-
Overhead (20%)		54.492,-
I alt		326.954,-