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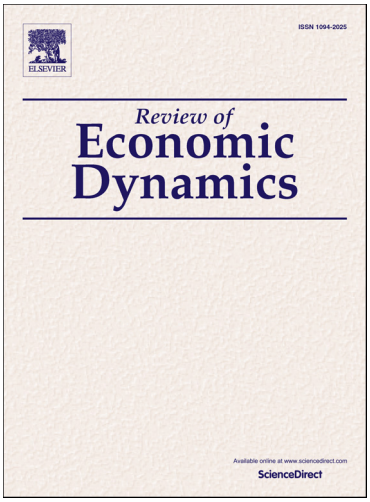

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Laurence Ales, Antonio Andrés Bellofatto, Jessie Jiaxu Wang

PII: S1094-2025(17)30026-1
DOI: http://dx.doi.org/10.1016/j.red.2017.02.007
Reference: YREDY 807

To appear in: *Review of Economic Dynamics*

Received date: 17 July 2016
Revised date: 2 February 2017

Please cite this article in press as: Ales, L., et al. Taxing Atlas: Executive compensation, firm size, and their impact on optimal top income tax rates. *Review of Economic Dynamics* (2017), http://dx.doi.org/10.1016/j.red.2017.02.007

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Taxing Atlas:

Executive Compensation, Firm Size, and Their Impact on Optimal Top Income Tax Rates*

Laurence Ales[1], Antonio Andrés Bellofatto[2], and Jessie Jiaxu Wang[3]

[1] *Tepper School of Business, Carnegie Mellon University*
[2] *School of Economics, University of Queensland - Australia*
[3] *W. P. Carey School of Business, Arizona State University*

This Version: February 10, 2017. First Version: June 10, 2014

Abstract

We study the optimal taxation of top labor incomes. Top income earners are modeled as managers who operate a span of control technology as in Rosen (1982). Managers are heterogeneous across talent, which is both effort-augmenting and total-factor-productivity improving. The latter gives rise to a positive scale-of-operations effect. A tax formula for optimal taxes is derived linking optimal marginal tax rates to preferences and technology parameters. We show how to quantify the model using readily available firm-level data. Our benchmark calibration focuses on the US. Our results suggest that optimal top taxes are roughly in line with the current statutory rates and, thus, are significantly lower than what previous optimal taxation studies that ignore the scale-of-operations effect have shown. Similar quantitative findings hold when we extend the analysis to a panel of developed countries. *(JEL D31, H21, H24, M12, M52)*

*We thank Jeremy Bertomeu and Adriano Rampini for valuable discussions. We also thank Hank Bessembinder, Emilio Bisetti, Chris Edmond, Miguel Ferreira, Brent Glover, Burton Hollifield, Roozbeh Hosseini, Greg Kaplan, Finn Kydland, Christos Makridis, Pricila Maziero, Tomasz Piskorski, B. Ravikumar, Peter Rupert, Florian Scheuer, Ali Shourideh, Chris Sleet, Stephen Spear, Chris Telmer, Gustavo Ventura, Sunil Wahal, Randy Wright, Sevin Yeltekin, Ariel Zetlin-Jones and Marianne Holohan for editorial assistance. We also thank conference and seminar participants at Carnegie Mellon Ph.D. Macro-Finance lunch, Econometric Society summer meetings in Minneapolis, Society for Economic Dynamics annual meeting in Toronto, 5th Tepper-LAEF conference in Pittsburgh, the University of Melbourne, 2015 WAMS/LAEF conference in Sydney, Arizona State University, University of Arizona, 2016 UNC Tax Symposium, and UNSW for feedback. E-mail: ales@cmu.edu (Ales); a.bellofatto@uq.edu.au (Bellofatto); Jessie.Jiaxu.Wang@asu.edu (Wang).

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