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Abstract

Several frictions restrict the government's ability to tax assets. First, it is very costly to monitor trades on international asset markets. Second, agents can resort to nonobservable low-return assets such as cash, gold or foreign currencies if taxes on observable assets become too high. This paper shows that limitations in asset taxation have important consequences for the taxation of labor income. We study a simple dynamic moral hazard model of social insurance with observable and nonobservable saving decisions. We find that optimal labor income taxes become *less progressive* when the ability to tax savings is limited.

Keywords: Optimal Income Taxation, Capital Taxation, Progressivity.

JEL: D82, D86, E21, H21.

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