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"Tax Reforms and Intertemporal Shifting of Wage Income"

Abstract

Differences in tax rates over time induce tax payers to shift income between periods. This behavior, named intertemporal income shifting, is distortionary and generates an upward bias in empirical estimates of the elasticity of taxable income used to measure the (permanent) efficiency loss from taxation. We study intertemporal shifting of wage income using data on monthly earnings that have been reported by employers to the tax authorities for the universe of the Danish population since 2008. The identifying variation is provided by a large tax reform in Denmark, which reduced the marginal tax rate on earnings from 63 percent to 56 percent for the 1/3 of employees with the highest income. The reform was announced in March 2009 and changed the tax scheme for income earned in 2010 and onwards. Therefore, for high-wage earners the reform created strong incentives to shift earnings from the end of 2009 to the beginning of 2010, and it was possible to shift up to five months of earnings from 2009 to 2010 without coming into conflict with the tax law. The shifting of income requires cooperation from the employer, who reports earnings to the tax authorities, and is also expected to depend on knowledge about the potential economic gain and the tax law. Our results reveal clear evidence of tax-motivated shifting of wage income. We provide survey evidence showing that the public in general was not well-informed about the incentive and legal possibilities of income shifting. However, high-wage earners were better informed, and we provide evidence indicating that responses were largest for employees working in a well-informed environment and working for employers that are more likely to cooperate.