Discussion of “Taxing firms facing financial frictions” by Wills and Camilo

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Summary

- What happen if we replace CIT with taxes on business owners?
  - A timely and important topic
- Approach
  - A Dynamic General Equilibrium model with financial friction
  - Main mechanism
    - Efficient firms cannot borrow up to their optimal level; firms finance investment using retained earnings
    - CIT exacerbates distortion while dividend tax does not
- Result
  - Steady-state output increases by about 7% and TFP by 1.7%
  - A revenue neutral tax rate on dividend is lower than a CIT rate

Overall comments

- The DGE framework allows one to examine a revenue-neutral change
  - Not possible in a quasi-experimental analysis – we need an economic model
  - The DGE analysis appears executed with competence
- Results are very thought provoking
  - Related discussions came up in yesterday's tax reform panel as well as the Summers talk
  - I will highlight some of those points

Summers’ reply to a question

- The shareholder-level taxes may not be able to collect as much taxes
- Dividend
  - Those received by pension funds
- Capital gains
  - Step-up of basis upon death
- Suggestion
  - Would it worth building in “leakages” in the model?

Hubbard’s point on income shifting

- CIT as a backstop to PIT
- Behavioral responses
  - The choice of organizational form (Gordon and Mackie-Mason, 1994, JPubE)
  - Income shifting between personal and corporate tax base (e.g. Sivadasan and Slemrod, 2008, JPubE)
- By repealing CIT, will the revenue performance of PIT be lower?
  - On one hand, non-tax facors many dominate incorporation decisions (Onji and Tang, 2017)
  - de Mooij and Nicedeme (2008, ITAX): a reduction in CIT rate that leads to $1 fall in CIT revenue (absent income shifting) only reduces revenue by 76 cents as revenue shifted from personal base)
  - Dividend tax may need to be as high
- Suggestions
  - Explicitly assume no income shifting or build this feature into the model
  - Provide a simulation of intermediate policy change (reduction to 20%)

- Wouldn’t a high tax on dividend increase the incentives to compensate shareholders through retained earnings?

Other points

- Discussion of Zwich et al. (2014) and Yagan (2015)
  - May be calling the results from these papers “contradictory” may be a bit strong
  - The two DID papers look at different interventions
    - Zwich et al. look at depreciation allowance while Yagan looks at dividend tax cut
    - It does not seem apparent to expect the same impacts on investment
- The discussion can be quite useful
  - in systematically synthesizing results from DID studies
  - The strength of the model is in providing a map with which to interpret findings from diverse studies

Minor comments

- Introduction: Perhaps led by the discussion of the double taxation at the outset, I initially misunderstood that the thought experiment involves moving towards a dividend taxation (leaving capital gains tax rate the same) which is not what the model does
  - Some clarification might help. E.g. replace "a tax on shareholders" in p.2, 3rd paragraph to "shareholder-level taxes on dividend and capital gains"
- Section 2: Is the model based on Gourio & Miao (2010) and should that be highlighted more explicitly at the outset?
- p. 14, last paragraph. Some typos around the probability
- Should there be a section looking at sensitivity?