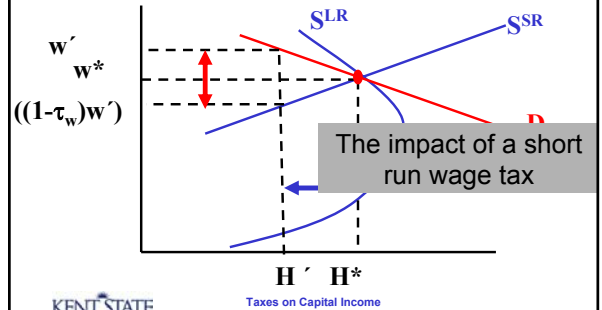


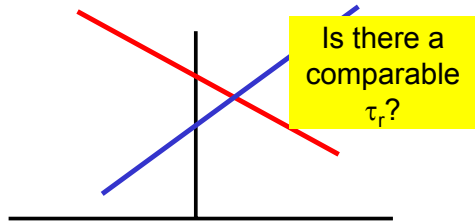
Taxes on Capital Income

τ_r

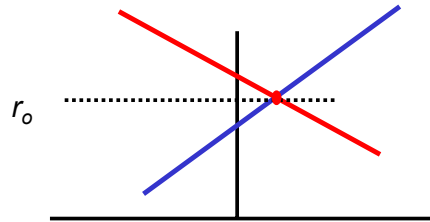
The Tax on Wage Income



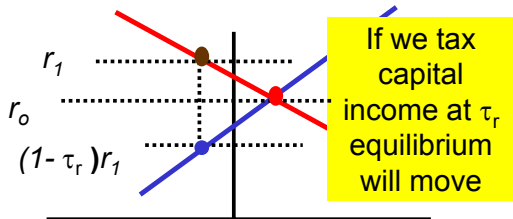
The Demand and Supply of Loans



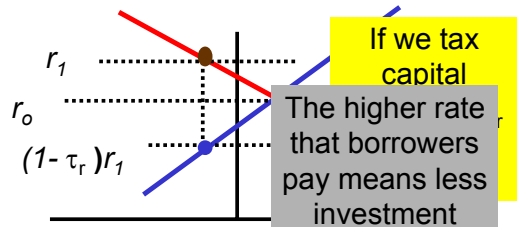
The Demand and Supply of Loans



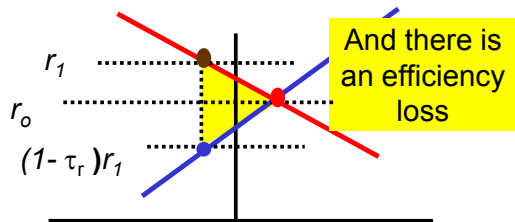
The Demand and Supply of Loans



The Demand and Supply of Loans



The Demand and Supply of Loans



The Problem

$$\tau_w^* = \frac{\tau_w + \tau_s}{1 + \tau_s}$$

The Problem

Is there a comparable formula for τ_r ?

$$\tau_w^* = \frac{\tau_w + \tau_s}{1 + \tau_s}$$

How We Tax Interest Income

- Corporate Profits Tax
- Taxes on Dividends
- Taxes on Capital Gains
- Interest Income

But It Gets Worse

- Sally puts money every year into an IRA. The contributions come from her wage income and are shielded from τ_w
- When she retires, the account is worth \$1,000,000. She begins to make (taxable) withdrawals. What is τ_w ? τ_r ?

The Solution

$$\tau_r = f(\tau_1, \tau_2, \tau_3, \tau_4, \dots)$$

Our Scenario

- Suppose
 - The tax rate on dividends is lowered
 - Capital gains taxes are lowered
 - IRA plans are liberalized

Our Scenario

- Suppose
 - The tax rate on dividends is lowered
 - Capital gains taxes are lowered
 - IRA plans are liberalized
- Each effectively lowers τ_r

There is More

- In fact, there are other effects.
 - Companies sometimes repurchase stock rather than pay dividends; there are tax advantages. These are so-called back-door dividends.
 - A lower tax on dividends, reduces the incentive for back door dividends, and may lead to more dividends and reduced stock repurchases.

There is More

- In fact, there are other effects.
 - Companies sometimes repurchase stock rather than pay dividends; there are tax advantages. **But this is just too much detail for this course.** dividends. reduces the incentive for back door dividends, and may lead to more dividends and reduced stock repurchases.

Our Agenda

- Suppose we want to analyze a reduction in dividend taxes.

Our Agenda

- Suppose we want to analyze a reduction in dividend taxes.
- We will treat it as a reduction in τ_r

Our Agenda

- Suppose we want to analyze a reduction in dividend taxes.
- We will treat it as a reduction in τ_r
- We ignore the impact on stock repurchases

End

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