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Taxing Atlas:

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

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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)

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