

Optimal Taxation with Altruistic Parents

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Abstract

This paper studies the optimal taxes in an OLG economy with parental altruism toward children in schooling and bequests. We find that the estate tax is positive due to private income types, as parents have incentives to work less and to hide income to consume, give inter vivos, or leave bequests more. The positive estate tax is decreased by income types to grown-up children and the positive externality of bequests, but increased by the insurance over time caused by random shocks to parents' and grown-up children's income types. We also find that the labor income tax is positive due to the shirking effect because schooling leads to grown-up children's heterogeneous productivity but may be negative due to private income types. Moreover, we find that the estate tax rates and the labor income tax rates are interconnected by a modified inverse Euler equation due to the insurance effect.