

EXEMPT INCOME, MARGINAL TAX RATES, AND IMPLICIT TAXES

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ABSTRACT

This paper first compares the average investment in exempt interest income by income range and by marginal tax rate. The counter-intuitive result is that taxpayers with a zero marginal tax rate have larger average amounts of exempt interest income than taxpayers with higher marginal tax rates. This observation holds at all income levels. Regressing several explanatory variables on exempt interest income for each income range was only partially successful at explaining this phenomenon. This study has implications for horizontal equity studies and the extent to which we should expect to observe implicit taxes.