

Do People Smooth After-Tax Income? Evidence from Japanese Local Taxes
An Examination of Life-Cycle/Permanent Income Hypothesis

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We investigate the after-tax income/consumption smoothness behavior by using local tax payment information in Japan. The power of our test of smoothing after-tax income/consumption hypothesis relies on the existence of a particular feature in the Japanese local individual income tax payment system, the “pay taxes in advance” (PTA) system. In this system, self-employed people and a fraction of employees can choose the timings of their tax payment and they can either pay the entire amounts of the present year tax liabilities at once or ahead of the due dates of taxes. Japanese local individual tax liabilities are perfectly predetermined, because their tax base is incomes of the previous year, thus tax fluctuations are caused only by tax payers’ intentional taxpaying behavior. In conclusion, we find that people smooth their after-tax incomes/consumptions by choosing the timings of tax payments and paying more taxes when their incomes are high such as in “bonus” periods than other seasons.

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