Tax expenditures & income taxation in France

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Defining tax expenditures

Concept of tax expenditure still very elusive

- For economists:
  - What matters is effective marginal subsidy/tax rate...
  - Tax expenditures or gvt spending via direct subsidies are equivalent.

- France, as most countries, defines tax expenditure in reference to the “tax norm”
  - But how do you define the norm?
  - Equivalent of EITC is a tax expenditure but family income-tax splitting is not
  - Should we not consider the fact of not taxing imputed rents as a tax expenditure?
Great variability in accounting of tax expenditures

- Since SCN-2008, most refundable tax credits are treated as public spending instead of tax revenue losses
- But most other tax expenditures are not (adjustments, non-refundable tax credits, etc.)
- Rhetorical/accounting manipulations are fairly common: “the gvt is not increasing taxes, it is reducing (tax) expenditures”

Most tax expenditures therefore not subject to same controls/requirements in the budget process than direct public spending

- Tax expenditures simply itemized in appendix to the French Budget
Figure 1: Evolution of tax expenditures in France (2000-2011), basis 100=2000

Source: Cour des Comptes, Rapport Public Annuel 2011
Personal income tax is mostly affected

- \( \approx 470 \) tax expenditures itemized in Budget appendix (Voies et Moyens II)

- In 2012, total cost of tax expenditures \( B\€70 \)

- Out of which \( B\€35 \) only for tax expenditures related to personal income tax (IRPP)

- Less than \( B\€9 \) are refundable tax credits counted as direct public spending in public accounts.

- PLF acknowledges that cost of 237 tax expenditures out of 470 can’t be estimated or only a rough order of magnitude can be given
Table 1 : Distribution of tax expenditures ≥ M€100 across tax bases (2010)

<table>
<thead>
<tr>
<th>Impôt</th>
<th>Nombre de mesures</th>
<th>Enjeux financiers (M€)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impôts divers (DIV)</td>
<td>1</td>
<td>487</td>
</tr>
<tr>
<td>Droits d'enregistrement et de timbre (ENR-TIM)</td>
<td>1</td>
<td>470</td>
</tr>
<tr>
<td>Fiscalité directe locale (FDL)</td>
<td>1</td>
<td>1 376</td>
</tr>
<tr>
<td>Impôt sur le revenu (IR)</td>
<td>53</td>
<td>32 485</td>
</tr>
<tr>
<td>Mesures communes à l’impôt sur le revenu et à l’impôt sur les sociétés (IR-IS)</td>
<td>6</td>
<td>4 260</td>
</tr>
<tr>
<td>Impôt sur les sociétés (IS)</td>
<td>5</td>
<td>2 216</td>
</tr>
<tr>
<td>Impôt sur la fortune (ISF)</td>
<td>3</td>
<td>984</td>
</tr>
<tr>
<td>Taxes intérieures de consommation sur les produits énergétiques (TICPE)</td>
<td>6</td>
<td>5 454</td>
</tr>
<tr>
<td>Taxe sur la valeur ajoutée (TVA)</td>
<td>18</td>
<td>13 490</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>94</strong></td>
<td><strong>61 222</strong></td>
</tr>
</tbody>
</table>

Source: RAPPORT DU COMITE D’EVALUATION DES DEPENSES FISCALES ET DES NICHES SOCIALES, 2011
Figure 2 : Income tax revenues in France (IRPP vs CSG)

Certes, ces baisses ont été principalement le fait de gouvernements de droite, qui se sont attelés avec une belle constance à ce démantèlement. Mais le point important est que les gouvernements de gauche n’ont jamais tenté de revenir sur les baisses décidées par la droite, ni en 1988-1993 pendant le second septennat de François Mitterrand, ni en 1997-2002 sous le gouvernement Jospin. Pire, ils ont fini par renforcer eux-mêmes le processus, en 2000. Notre conclusion est sans appel : l’impôt sur le revenu est devenu tellement illisible et impopulaire qu’on ne peut plus le réformer autrement qu’en le baissant toujours davantage. Mieux vaut donc hâter sa fin.

L’ÂNTE AGONIE DE L’IMPÔT PROGRESSIF SUR LE REVENU

Figure 3: Fraction of total earnings included in the income tax base

Figure 4: Fraction of capital income included in the income tax base

Figure 5: Fraction of total gross income included in the income tax base, by gross income groups

Two rationales for tax expenditures:

Social planner may use tax expenditures for:

- **Pigouvian corrections** (externalities)
  - Align private and social marginal returns
  - E.g.: non-refundable tax credit for expenditures on restoration of antique furniture in France

- **Redistribution**
  - Tax expenditures enable tailor-made redistribution
  - Face standard equity/efficiency trade-off
Issues with Pigouvian taxes:

- In practice, complicated to estimate size of external effects
  - Contingent valuations subject to framing, anchoring or gaming
  - Capitalization / revealed preference approaches hard to implement

- Pigouvian subsidies should be limited to cases with well-defined externalities
Welfare effects of tax expenditures

- Administration estimates static cost of tax expenditures
- Irrelevant from a welfare perspective
- Relevant (partial equilibrium) welfare evaluation requires at least:
  - Estimates of social marginal cost / benefit function \(\equiv\) external effect
  - Demand and supply elasticities to compute DWL
Figure 6: Distribution of tax expenditures’ scores from French Tax administration assessment exercise

Source: Comité d’évaluation, Étude effectuée sur le champ des dépenses fiscales (470 dépenses fiscales recensées et non recensées) effectivement étudiées par le Comité.
Tax enforcement matters

Figure 7: Evolution of reported charitable giving, France

- Contributions (fraction of total income)
- Contributions (M of 2006 euros)
- Contributions Received by Fondation de France (right axis)

Source: Fack & Landais (2013)
Figure 8: Distribution of charitable contributions around the 1% deduction threshold, France

Excess mass
1975-79 = 2.54 (.16)
1984-88 = .44 (.05)

Elasticity
1975-79 = -2.4 (.08)
1984-88 = -.62 (.06)

Source: Fack & Landais (2013)
Salience and take-up

- Redistribution relies on strong take-up
- Complexity / lack of salience reduces take-up but also potentially distortions...
- Active vs passive decision and the role of price incentives:
  - Large body of literature on default effects / bounded rationality (Madrian 2001)
  - Chetty & al. 2013: study of retirement savings decision, passive actors are overwhelming majority
  - Limited practical interest of Pigouvian price subsidies...
Moving forward

- Urgent to improve quality of data collection and evaluation (should not be made by tax administration itself)

- General cap on tax expenditures ineffective

- "Clean slate" solution: tax reform deal à la TRA86
  - Trade-off broad tax base reform for redefinition of the tax schedule
  - Only allow tax expenditures after a moratorium of 2 or 3 years
  - Independent evaluation of external effect as a necessary condition