OPINION OF THE COMMITTEE

The committee for the evaluation of capital tax reforms was put in place **in December 2018**, one year after the government had launched the reforms and after they were passed by legislation. The reforms have introduced a single flat-rate tax (PFU) on savings income and replaced the wealth tax (ISF) with a real estate wealth tax (IFI). Futhermore, a corporate income tax (IS) reduction, complementary to these changes, has been scheduled for a five-year period.

In its first report[1] published in October 2019 the committee presented the context of the reforms. It outlined the scope of activity covered by capital taxation in France and the weight of the latter in the overall tax system. It reviewed the tax rules before the reform and gave a precise description of the reform content. It also carried out a review of the state of the art of the theoretical and empirical literature on capital taxation at the French and international level. Moreover, the committee reminded the results of the available *ex ante* evaluations of the 2018 reforms, and presented its first *ex post* analyses of the impact of these reforms on taxpayers and public finances. Due to a lack of data and hindsight necessary for a thorough evaluation, the committee limited its *ex-post* analysis to initial qualitative results, such as hearings of professional associations and a survey on portfolio managers, as well as a description of the quantitative work it would do later.

This year, **the committee has advanced in several directions.** First of all, it has completed its work on the reform context. In particular, it has conducted a thorough analysis on how France stands before and after the reforms compared to other developed economies in terms of wealth and income taxation. In addition, the

[1] France Stratégie (2019), *Comité d'évaluation des réformes de la fiscalité du capital, First report* October.

committee carried out an *ex-post* evaluation of the 2013 tax reform, which was symmetrical to the 2018 PFU reform as it replaced a flat-rate tax with a progressive tax. This 2013 reform happened sufficiently long ago to generate enough data to assess the reform results. The committee also provided additional figures comparing the distribution of dividends received in 2018 to the distribution of dividends received in 2017, and the number of wealthy tax residents moving in and out of the country in 2018. Finally, the committee presented the first evaluation results of the flat tax (PFU) and of the wealth tax transformation into the real estate wealth tax, even as these results remain preliminary, particularly concerning the wealth tax reform.

From this year's work, based on studies by academic[1] and public administration teams, the committee has come to the following conclusions.

How France compares to other countries

- As a percentage of GDP, the capital taxes in France - i.e. all taxes on wealth, income or inheritance borne both by households and companies - remain among the highest by international standards even after the 2018 reforms. This is explained by a more general context where, in order to fund high public spending, particularly on social protection programs, taxes in France are higher than elsewhere overall.

- However, this macroeconomic data is not appropriate for analysing the impact of such a reform: in 2018, household capital income taxes increased in France by almost 0.2 points as a share of GDP, but this is only due to an increase in the tax base (dividends, and to a lesser extent capital gains).

- An international comparison of household capital taxation requires a more detailed microeconomic analysis. The OECD is now carrying out such analyses and has kindly agreed, at the committee's request, to update its results for France, incorporating the impact of the 2018 reform.

- The OECD's work is based on an synthetic indicator, the marginal effective tax rate (METR), which applies to any additional euro invested in a given asset. The METR is modelled on different profiles of taxpayers, applying a case-based

[1] In particular, France Stratégie subsidised the CRED - Centre de recherches en économie et droit, a team from the University of Paris II Panthéon-Assas - for the evaluation of the 2013 scale and the introduction of the UFP, and the IPP for the evaluation of the ISF and its transformation into an IFI. The reports produced by these teams are posted online on the France Stratégie website.

approach depending on whether the taxpayers have "low", "medium" or "high" incomes. The level of this indicator largely depends on strong conventional assumptions (in particular, on the level of the real return on assets which is assumed to be the same for all assets and all countries). Nevertheless, choosing alternative assumptions does not alter the main conclusions on the different tax systems, depending on the savings instrument and the taxpayer’s country of residence.

- Before the 2018 reforms, the marginal effective tax rates in France were not only above the international average but also, for certain assets (bonds, investment funds), the highest among the OECD countries taken into account. The 2018 reforms have brought them down close to the international average levels. This evolution is particularly striking for the wealthiest taxpayers. With the introduction of the flat tax (PFU) and the transformation of the wealth tax (ISF), France met the largest group of countries that apply a flat tax on portfolio capital income and where there is no annual tax on capital assets. France's policy on real estate assets, however, remains unchanged (except for the taxpayers who were previously subject to the wealth tax and whose real estate assets remain below the threshold of the real estate wealth tax, or IFI).

- These results need to be confirmed by a forthcoming OECD report, as today, only the data for France has been updated and is compared to the 2016 data for the other countries[1].

Evaluation of the impact of capital taxation on households prior to the 2018 reforms

- In 2013, capital income, which was previously subject to either a flat tax or a progressive tax according to the choice of the taxpayer, got fully included into the progressive income tax. This reform, that can be considered as symmetrical to the one in 2018 that introduced the « PFU », was accompanied in the same year by a sharp decrease in the level of dividends received by households. The causal effect of the capital income subjection to progressive tax on this downward movement, which the committee described last year as plausible, is now scientifically established. However, its magnitude remains uncertain, as many

[1] The analysis drew on Marginal Effective Tax Rates (METRs) has been developed in consultation with the OECD, however the view expressed remain those of Committee.

reforms which happened at the same time have also affected the capital income taxation (in particular, the taxation of income paid to managers of limited liability companies). While progressive taxation of dividends in 2013 should have automatically increased tax revenues by more than 400 million euros, under the assumption of unchanged taxpayer behaviour, it, in reality, probably led to the opposite effect of a net loss in tax revenues due to behavioural responses that induced a contraction of the tax base. At the same time, while taxes on interest were higher than those on dividends received, the public finances gain from progressive taxation should have been close to the estimate without behavioural effects.

- The fall in dividends induced by the 2013 reform has primarily affected individually owned businesses. However, there has been neither effect on the wages paid by these companies (in particular, no income shifting), nor on their investment. For these companies, lower dividend payments resulted in an increase in equity and cash flow and a fall in net profit due to an increase in their intermediate consumption, which remains to be further explained. Indeed, this increase could be due either to additional personal expenses by company owners or to an increase in intangible investments (advertising, training, etc., which are recorded as expenses in the income statement).

- As to the effects of the wealth tax, an academic study analysed the case of retired business owners who, due to the selling of their businesses, were subject to the wealth tax until 2017. This study confirmed an increase in emigration within this group in the years following the imposition of the wealth tax. However, this increase remains small (around 1% of the people concerned emigrated six years after retirement) and of the same magnitude as that observed for other new retirees with comparable income levels.

- In conclusion, this latest analysis is in line with the main lessons the evaluation committee had drawn from the empirical literature review carried out for its first report. In particular, an increase in dividends tax generally results in lower dividend distribution. At the same time, no empirical study has so far been able to identify any significant short- to medium-term effects on business investment of household wealth tax or dividends tax.

Some figures related to the reforms

- As the committee indicated last year, comparing macroeconomic indicators, such as economic growth, investment, or household financial investments before and after the reforms is not sufficient to assess the tax reforms' impact. In particular, these indicators are insufficient to estimate whether transforming the wealth tax has led the taxpayers to reallocate their portfolio toward businesses. That being said, the following observations can be made for 2019:

– Household financial investments, mainly in cash and deposits, increased sharply in 2019 (from €95 billion to €143 billion);

– For non-financial companies, the proportion of listed shares (2.3%) and unlisted shares (32.7%) in companies' financial resources was lower than the average observed over the last twenty years;

– Equity investment by private investors has levelled off since 2016, after a strong and steady increase from 2010 to 2016. The only notable change since 2018 has been a drop in investment in the Common Fund of Innovation Investment, or «Fonds Commun de Placement dans l'Innovation» (FCPI), and the Local Investment Fund, or «Fonds d'Investissement de Proximité» (FIP). This change might have been due to the closing of the SME wealth tax exemption and has been offset by an increase in private equity via other channels.

- The strong increase in dividends declared by households for 2018 (€23 billion, versus €14 billion in 2017) is comparable to the drop recorded in 2013, when capital income became subject to the progressive income tax. The 2018 dividend level increase was confirmed with 2019 provisional data showing additional increase of around €3 billion. Capital gains, excluding capital gains from small or young companies ,also rose sharply in 2018 by €5 billion. Capital gains from small or young companies were down €3 billion in 2018 after a sharp increase of €2.4 billion in 2017. The dividends received by households were down (€4.7 billion in 2018 from €5.3 billion in 2017) due to the overall falling interest rates and seemingly not because of the reform, despite a sharp reduction in *de facto* household tax rates.

- Every year, dividends – excluding those paid on equity savings plan, or « Plan d'epargne d'action » (PEA), life insurance and those of companies subject to individual income tax (IRPP) - are concentrated in a small number of households. However, in 2018, the dividends were even more concentrated than in 2017: two thirds of the €23 billion were received by 38,000 households, or 0.1% of total households, of which one third by 3,800 households, or 0.01% of the total. By comparison, half of the €14 billion dividends income was received by 38,000 households in 2017, of which less than a quarter was received by only 3,800 households.

- Between 2017 and 2018, 20,000 households have seen their dividends increase by more than €100,000, for a total increase of €8.6 billion. Among them, 1,500 households saw their dividends increase by more than €1 million, for a total increase of €4.4 billion.

- Few households (under 25,000) benefited from strong dividend increase in 2018, and few (over 25,000) recorded high dividend decrease in 2013, each category consisting of a distinct group of households. At the same time, 3,800 households (0.01% of the total) reported both over €100,000 decrease in 2013 and over €100,000 increase in 2018. These 3,800 households account for, respectively, 12.5% of 2013 annual total dividend decrease and for 20% of 2018 total dividend increase. For these households, the effect of dividend taxation on the amount received seems to make no doubt.

- Capital gains on securities, excluding those from small or young companies, are also highly concentrated: 3,800 households (0.01% of all households) received 75% of all these capital gains in 2018, compared to 62% in 2017. This is less true for interest on investment: 38,000 households account for 15% of the total investment interest received in both 2017 and 2018. At the same time, there are no signs of income shifting: other income (excluding dividends, capital gains and interest) is also increasing across the board, including for households which have experienced a sharp increase in dividends.

- One of the goals of transforming the wealth tax into the real estate wealth tax (IFI) was to encourage financial investment. 2018 saw an increase in the number of households subject to the wealth tax and owning over €3 million in real estate assets back in 2015, who reported a substantial decrease in their real estate assets (11% compared to 6% the previous year). Although this in an important indicator, additional data is needed before we can draw conclusions about the effects of the reforms. In particular the real estate wealth tax (IFI) revenues increased in 2019 (€1.56 billion versus €1.25 billion in 2018, excluding the tax audit). This dynamic is partly linked to the new tax collection timing, while it may also stem from a price effect.

- Since the transition from the wealth tax (ISF) to the real estate wealth tax (IFI), there has been a decrease in the number of expatriations and an increase in the number of tax repatriations by wealthy French households. However, this change concerns just a few hundred people, compared to the 130,000 taxpayers subject to the real estate wealth tax (IFI) in 2018.

– In 2017, when presidential candidate and then President announced that he would abolish the wealth tax (ISF) and replace it with the real estate wealth tax (IFI), the number of foreign departures of wealth tax payers fell sharply to less than 400 a year, a rate not seen since 2005. In 2018, the number of registered departures fell further to just over 150, even though the two figures are not directly comparable, as the 2018 number included real estate wealth tax (IFI) taxpayers. This drop in the number of departures could therefore be due to a mechanical effect, simply reflecting the reduction in the number of persons liable to wealth tax with the changeover from wealth tax to the real estate wealth tax (IFI) from 360,000 to 130,000. However, this reduction is not proportionate to the level of wealth: there are more wealthy households which used to be subject to the wealth tax than those subject to the real estate wealth tax (IFI). If the former are also the most likely to move abroad for tax reasons, then the observed decline in the number of departures in 2018 becomes significant in pointing out the effect of the reforms.

At the same time, the repatriation of wealthy French taxpayers has been on the rise for the past two years. Thus, around 100 wealthy taxpayers returned to France in 2017 from among the taxpayers who became subject to the real estate wealth tax (IFI) on January 1st 2018. In 2016, nearly 100 taxpayers subject to the wealth tax on January 1st 2017 returned to France. Although the numbers in both years are approximately the same, they show upward return dynamics, as it is less common to be subject to the real estate wealth tax (IFI) than to the wealth tax (ISF). This upward trend continued in 2018 with almost 250 repatriations from taxpayers who became subject to the real estate wealth tax (IFI) on January 1st 2019.

Empirical assessment of the 2018 reforms

- For its first report, the committee had very little statistical data. It therefore aimed to gather the observations and opinions of professionals on the main impacts of the reforms on wealth management of the wealthy living in France. This year, the questionnaire was updated, with a few additional questions on the effect of the crisis. 42 managers responded, compared to 90 last year, with continued positive feedback about the 2018 reforms. Doubts about the sustainability of the measures had reduced by early 2020, but they have returned to the same level as a year ago after the health crisis. A majority of respondents report the arrival of new clients following the sale of a business.

- Several factors point out that the sharp increase in dividends received by households in 2018 is partly caused by the flat tax reform (PFU), although this causal effect is not yet scientifically and formally established. On the one hand, this causal effect is now proven for the 2013 reform, which is qualitatively the opposite of the 2018 reform. On the other hand, it has been established that, like the decrease in dividends in 2013, the increase in dividends in 2018 was experienced largely by individually owned businesses. Incidentally, there is no significant effect on the investment of these companies (same as in 2013).

- Converging estimates about the budget cost of the flat tax (PFU) last year ranged €1.4 billion and €1.7 billion for income tax *excluding the behavioural effect.* This cost is reduced by €600 million if the accompanying increase in the Generalised Social Contribution («Cotisation Sociale Généralisée» or CSG) is taken into account. A conservative estimate of the additional dividends generated by this reform, published in September 2020 in an INSEE working paper, would reduce this cost by around €500 million. An estimate more in line with the trend observed in 2018 regarding the dividends paid out would reduce the budget cost even further, to the point of cancelling it out. Only a true *ex-post* evaluation will measure the extent of dividends increase generated by the flat tax rate, and thus the effect of the reform, *including the behavioural effect,* on public finances. This has yet to be done.

- Evaluating the effects of the transition from the wealth tax (ISF) to the real estate wealth tax (IFI) remains much more fragmented.

- One point often raised by the wealth tax critics is that it hinders the development of family businesses, which have to pay large sums in dividends to their shareholders so that the latter can pay this tax. A first attempt to shed light on this issue was to compare the change between 2017 and 2018 in dividends received by wealth tax payers in 2017, depending on whether they are majority managers of a company, whether they have signed a family pact of shareholders ("pacte Dutreil") - and can therefore exercise influence over the manager, without direct control over the dividend payment policy - or whether they *a priori* exercise no control, even partial, over the companies in which they are shareholders. In 2018, dividends received increased for all categories of taxpayers, suggesting that the inflationary effect of the flat tax (PFU) on dividends was much greater than the effect exerted by the wealth tax in 2017, if any. The increase in dividends for Dutreil pact taxpayers appears smaller than for managing shareholders, but higher than for non-controlling shareholders. This sends an ambiguous message which does not allow us to draw conclusions.

An attempt has been made to assess the impact of the wealth tax transformation into real estate wealth tax on investment in SME's. However, the study remains inconclusive, as it does not identify all the investment modes based on the available tax data, except the investments which allow to reduce wealth tax or income tax.

Next steps of the committee's work

The 2020 crisis caused by the COVID-19 pandemic will naturally have a major impact on the economy financing and on household investment choices. This will certainly make the medium-term assessment of the 2018 reforms effects more complex. For instance, the amount of dividends received by households will most likely fall sharply in 2020, although there is obviously no link between this fall and the 2018 reforms.

Nevertheless, in its 2021 report, the committee should be able to evaluate the effect the reforms had in 2018 and 2019 fiscal years thanks to the completion of two research projects selected through a public tender in the fall of 2019.

- The first project aims to measure the impact of wealth tax on firms from 2006 to 2018. It will assess the wealth tax financing constraint born by manager-owned companies (i.e. majority owned by individuals) and identify the effect of the wealth tax on their dividend distribution, investment and employment decisions and the frequency of the companies' transmission within or their sale outside of the founding families.

- The second project evaluates the effect of the taxation reform on capital income. It provided input for this commission's report by estimating the response of capital income to the introduction of a systematic progressive rate income tax in 2013. By the end of H1 2021, when the data on income taxation in 2018 and 2019 becomes available, the project will apply the same methodology to estimate the response of capital income to the introduction of the flat tax.

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