The Committee for the Evaluation of Capital Tax Reforms was set up in December 2018--one year after the launch of the major renovation of capital taxation carried out by the government and approved by the legislature. The reform introduced a single flat-rate tax (PFU) on savings income, and replaced the solidarity tax on wealth (ISF) with a tax refocused on real estate wealth (IFI). In addition, the reduction in corporation tax (CIT), designed to complement these transformations, has been programmed over the entire five-year period.

The committee's work, therefore, began at a time when it was not possible to produce a full ex-post evaluation of the reforms simply because these will take years to yield fully the fruits expected of them. When it started work, the Committee had no statistical information on the initial effects of the reform.

This is why the committee sought in this first report to "set the scene" to launch an ex-post evaluation process under the right conditions, conceived as a progressive and cumulative exercise, which will only deliver solid conclusions over several years.

From this first exploration of the subject, the committee learned the following lessons.

**Concerning the context preceding the reforms**

- The taxation of capital in France - all taxes on households and companies concerning wealth, capital income or transmission of assets - was increasingly diverging from international standards. First, by its weight: this tax represented 11% of GDP, two and a half percentage points above the European average. Then by its structure: while many countries have renounced imposing an annual tax on the capital stock, France is among the few countries that apply double taxation on the capital stock and on the income it generates; it used the progressive scale of income tax to tax movable income while many countries have opted for a single tax rate. This high capital tax is part of a more general
context where, to finance the level of our public expenditure, the rate of all taxes is higher than elsewhere in our country (around 45% of GDP, that is, about seven points above the European average).

- To reduce the negative impact of these high tax rates, many amendments have been made to the taxation of capital over time: exemption of the professional tool, the Dutreil pact and a ceiling for the wealth tax; deduction for the holding period applicable to capital gains or deduction on dividends for income from movable property. Hence, the tax environment is highly complex, all the more so because of frequent changes.

- Even though the wealth tax (ISF) was designed as progressive, the tax-rate paid by the wealthiest households decreased with their wealth level. The taxable base is exempt from certain assets that they hold in greater proportion (work tools, works of art, etc.). Yet the cap mechanism - the sum of social security contributions, income tax and wealth tax must not exceed 75% of income - concerned a growing proportion of taxpayers as they rose on the scale of taxable assets: among the wealthiest 1% of taxpayers at wealth tax, more than two out of three were capped. In the end, the wealthiest 0.1%, that is, around 350 households declaring more than €50 million in assets, were taxed under the wealth tax at a median tax rate of only 0.2% of the value of their taxable assets, compared with 1.5% as a marginal rate in the scale. Half of ISF's revenues were generated by households with net taxable assets of less than €3 million.

  - From 2003 to 2016, several hundred households subject to wealth tax moved abroad each year - an average of 750 households each year between 2003 and 2016, or two in a thousand who owe wealth tax. The number of departures from households with taxable assets in excess of €1.3 million more than doubled between 2003 and 2006, then stabilised between 2006 and 2011, and finally increased again sharply to 900 in 2013, when the government was making an exceptional contribution to wealth and taxing financial income and capital gains on the income tax's progressive scale. The number of annual departures then fell back to 630 in 2016. The net taxable assets of ISF taxpayers who leave each year represent an average of €3 billion over the period 2004-2016, or 0.4% of the total net assets declared by ISF taxpayers.

**Concerning the contributions of the economic literature to an ex ante evaluation**

- The ownership of capital confers on taxpayers the ability to contribute which is not limited solely to income from activity. It is, therefore, logical to consider taxation.
• Capital taxation takes various forms which by changing the tax behaviour of taxpayers, have an impact on the economy, with varying effects on investment, activity and employment. From this point of view, not all forms of capital taxation are equivalent.

• According to available studies, the taxation of capital through corporate income tax seems to weigh not only on taxable profits but also on business investment and labour demand (effects on wages or employment).

• Studies on capital taxation at the household level are more limited, with less consensual results. It would seem that the taxation of wealth has a lasting negative impact on its accumulation by the households concerned. Similarly, it would seem that a decrease in dividend taxation increases the dividends distributed. This effect could be partly caused by income shifting, but the extent of the phenomenon remains uncertain.

• As it stands, empirical studies have not been able to show any significant short- to medium-term effects on investment, business activity and employment, or on the taxation of household wealth or dividend taxation.

• These lessons are important, but they remain very general, and studies specific to the particular situation of France remain necessary.

Concerning ex ante impact studies

• At the time of the reform vote, the finance ministries anticipated that the permanent introduction of the PFU would create a loss of tax revenue of €1.9 billion compared with unchanged legislation. The replacement of the ISF by the IFI was expected to cost the State budget $3.2 billion - 850 million of IFI revenues expected in 2018 compared to 4.1 billion net ISF revenues received in 2017. This means a total budgetary cost of 5.1 billion for both measures.

• The few macroeconomic studies available at the time of the vote estimated that tax reform would have a positive impact on growth and employment, even though the extent of this impact remained highly uncertain. The Directorate General of the Treasury anticipated a long-term impact of 0.5 percentage points of GDP and the creation of 50,000 jobs.

Concerning the first quantified elements

• Observation of the main economic variables - growth, investment, household financial investment flows and so forth - before and after the reforms will not be enough to reach any definite conclusions about their effect. In particular, it will not
be possible to estimate with this method alone whether the abolition of the ISF has made it possible to redirect the savings of the taxpayers concerned towards financing companies. Fluctuations in aggregate variables derive from the addition of multiple and diverse factors.

- The only identifiable element at this stage on aggregate data shows the strong increase in dividends received by households in 2018 --comparable in size to the fall in 2013, when securities income was included in the progressive scale of the income tax. The causal effect of the reform of the scale in 2013 and the reforms in 2018 on this dual movement is plausible, but not yet scientifically established, let alone precisely measured.

- The transition from ISF to IFI has reduced the number of taxable persons from 360,000 to 130,000. Therefore, most of the less wealthy ISF taxpayers (four out of five of the lower half of the ISF taxable assets) were exempt from tax on the stock of wealth. Conversely, of the 0.1% very wealthy in 2017, only one in ten is not a taxpayer of the IFI in 2018. However, regardless of the level of wealth reported in 2017, ISF taxpayers have benefited from significant tax cuts, including those now taxable to the IFI: on average, the tax paid has been divided by three and a half. But the maximum reduction in the apparent wealth tax rate is not at the top of the wealth distribution, because the wealthiest people had their wealth tax capped in practice.

- The ex-post budgetary cost would be lower than the ex-ante anticipated budgetary cost.

  - IFI revenues in 2018, significantly higher than expected (€1.3 billion excluding tax audits¹ compared to €850 million), are still €2.9 billion lower than those of ISF in 2017 (€4.2 billion). Considering that ISF revenues would have continued to grow without reform, the budgetary cost of the transition to the IFI would be approximately €3.1 billion.

  - The budgetary cost of the flat-tax on capital revenues (PFU) is the subject of approximate estimates, ranging from €1.4 billion to €1.7 billion excluding behavioural effects. It would, therefore, be slightly lower than the ex ante estimate (1.9 billion). In addition, the additional dividends paid in 2018 (+60% compared to 2017) generated additional tax and social security revenues, although it is not possible at this stage to quantify the portion of the additional gain directly related to the implementation of the PFU.

- The instant redistributive impact of reforms on the income scale is now well documented.

¹ Including tax audit and the activity of the amending returns processing service (STDR), revenues amounted to €1.9 billion in 2018.
For the implementation of the PFU, tax reductions would be concentrated on the 15% of the wealthiest households and, within these 15%, they would be even more important for the top third (top 5%), with average increase of living standards for the latter of nearly €1,000 per year.

- For the transformation of the ISF into the IFI, the study using the most complete statistical information suggests that the top 5% of households profit from 57% of the tax reductions, and that four out of five benefiting households are among the top 15%. The standard of living of such households increases by about 6,500 euros each year.

- Altogether the two reforms initially favour the wealthiest households, but their impact on inequality as a whole remains limited, because the amounts at stake remain small compared with the total amounts of taxes and benefits in the French tax and benefit system: the Gini index, which synthetically measures the importance of income inequality, around 30 points in France, increases by 0.3 points.

In 2017, in a context where the candidate and then President-elect announced that he would abolish the ISF and replace it with the IFI, the number of departures abroad of ISF debtors fell sharply to less than 400, a level that had not been seen since 2005.

There would have been a decrease of €150 million in 2018 in donations to associations eligible to deductions of income tax and ISF/IFI. Since the transformation of the ISF into the IFI has significantly reduced the number of taxable persons, it may be tempting to attribute the decline in donations to this reform. However, this is unclear in practice. For almost all ISF taxpayers who are not liable to the IFI, the abolition of the ISF tax reduction can be offset by an increased use of the IR tax reduction or credit. This decrease in donations could be linked to other factors (particularly high donations in 2017; the "blank year" following the introduction of the withholding tax in 2018...).

Concerning the first elements of ex-post evaluation

- Without any statistical feedback on the initial effects of the reforms, the committee sought out the observations and opinions of professionals about the chief impact on the wealth management of wealthy people living in France. A specific questionnaire was designed and put online in April 2019; ninety responses from asset managers were collected. The main messages are as follows. The reform of capital taxation is considered positive, but many respondents expressed doubts about the sustainability of the measures taken. This reform would not have significantly changed the composition of their clients' investments as early as
2018, but many respondents noted a lower investment in real estate, and an increase in dividend payments, many reinvested in standard unit-linked life insurance products. Structurally, a large proportion of clients' wealth income was saved, but the extra after-tax income brought about by the reform would not have been saved more than usual, or even less. Finally, for tax exile, the reform would not have resulted in a large number of high net worth individuals returning in 2018, but it would have prevented some departures.

**Concerning the continuation of the committee's work**

This first report of the Committee for the Evaluation of Capital Tax Reforms was written only one year after the implementation of the PFU and the transformation of the ISF into the IFI. The monitoring and, more importantly the ex-post evaluation of these reforms are, therefore, very fragmented, because of a lack of available data and the time needed for the effects on the economy to manifest themselves. The 2020 and later reports will focus on ex-post monitoring and evaluation of these reforms.

- In terms of monitoring, the retrospective data made available by the Directorate General of Public Finance (DGFiP) can be analysed in more detail and the data from IFI 2019 will be available: this will make it possible to measure whether subjection to the IFI leads taxpayers to a reallocation of their assets to the detriment of real estate. The 2018 income tax data will also be, but they will not provide a consistent description of the post-reform situation, given the context of the tax free year (“année blanche”) associated with the introduction of the withholding tax. Since 2019 income tax data will only be available in the fourth quarter of 2020, it will be necessary to wait until the 2021 report to conduct a detailed analysis of the evolution of capital income, its composition and taxation after the introduction of the PFU and in a completely stabilised tax system.

- *In terms of ex-post evaluation*, the literature review presented in this report will be updated with new papers published, both on foreign data and on capital tax reforms in France. In addition, to ensure that quality evaluations are produced in a time frame compatible with the publication of future reports, the committee wished to fund specific research projects. Two were selected through a call for tenders.

- The first project aims to assess empirically the impact of wealth tax on firms from 2006 to 2018, by measuring the financing constraint imposed on privately owned companies and identifying the effect of wealth tax on the dividend distribution, investment and employment decisions of these companies, as well as on the frequency of their transfers within and outside the founding families. The full report would be provided in the first half of 2021, with initial results before the summer of 2020.
• The second project will evaluate the reform of taxation on capital income. First (for spring 2020), the capital income scale in force since 2013 will be used to estimate the response of capital income to its taxation and that of business income to capital income taxation (income shifting effect). This will produce an *ex ante* evaluation of the implementation of the PFU in 2018 based on the behavioural responses observed in 2013. Moreover, for the first half of 2021, when data on income tax in 2018 and 2019 are available, the implementation of the PFU can be evaluated *ex post*, using the same methods as those used to evaluate the 2013 scale.

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