

# Assessing the effects of flat tax reforms: micro estimates from rental incomes tax changes in Italy

*PAOLO DI CARO<sup>a</sup>, FRANCESCO FIGARI<sup>b</sup>, CARLO FIORIO<sup>c</sup>,  
MARCO MANZO<sup>a</sup>*

<sup>a</sup> Department of Finance, Italian Ministry of Economy and Finance

<sup>b</sup> University of Insubria, ISER University of Essex, Dondena Bocconi

<sup>c</sup> University of Milan, Irvapp-FBK, Dondena Bocconi

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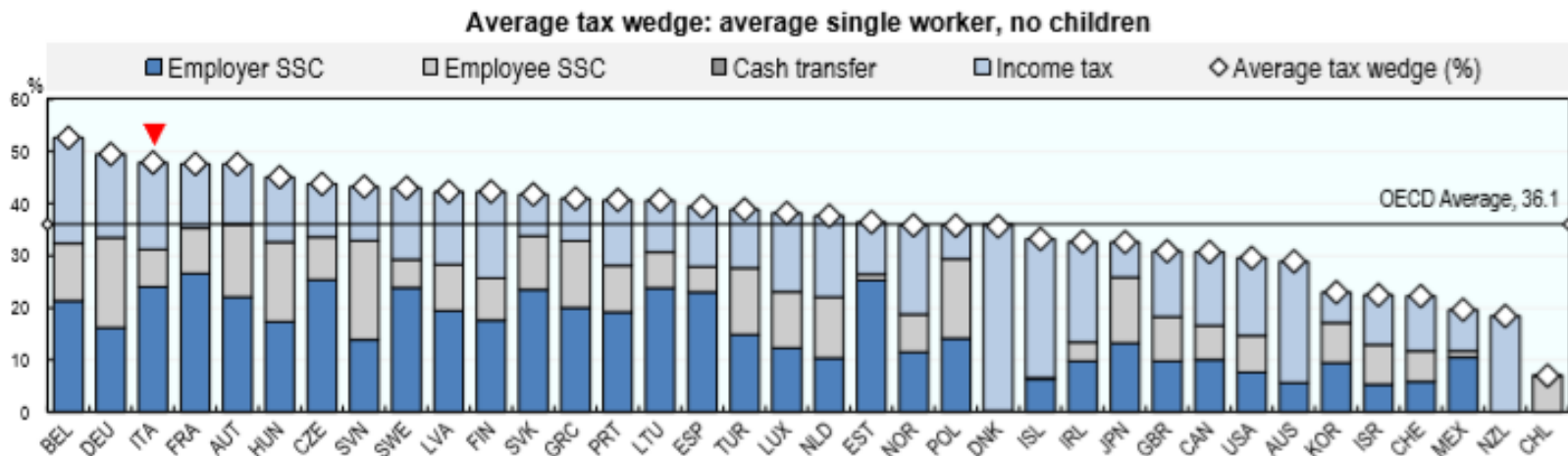
# Starting points for a new research project

- Taxation of property incomes
  - Barrios et al. (2019), Housing taxation: a new database for Europe
  - Figari, Verbist, Zantomio (2019), Homeownership Investment and Tax Neutrality: a joint assessment of income and property taxes in Europe
- Growing use of admin data
  - 2019 EUROMOD workshop on the use of administrative data in microsimulation models
- Flat tax reforms
  - European Semester, Country Report, Italy 2019
  - Barrios et al. (2019) Progressive Tax Reforms in Flat Tax Countries, EEE

# Background

Reforming personal income taxes is leading the agenda of many governments around the world

- particularly in those countries where the tax burden on individuals and households is, or it is conceived to be, relatively high



OECD, 2018

The adoption of flat taxes is presented as a way of enhancing the efficiency of the tax system and encouraging tax compliance (Hall and Rabushka, 2013).



# Flat tax proposals in Italy

Different flat tax options and proposals are (were) at the forefront of the Italian public debate

- Substitution of PIT for (certain) rental incomes since 2011
- Substitution of PIT for (certain) self-employed workers (*Regimi forfettari*) since 2015
  - With income below 65k: proportional rate at 15%
  - Expected to be extended to those with income below 100k but not implemented
- Potential reforms of PIT (different proposals by Lega Nord, Forza Italia, Istituto Bruno Leoni)



# Flat tax proposals in Italy

Reforms and proposals are often not supported by sound empirical evidence

- limited to analysis of changes in tax burden and (perverse) redistributive effects
- incentive and tax compliance effects often ignored

Evidence from Central and Eastern European countries which adopted flat tax in the 1990s and the 2000s provided mixed results (Gorodnichenko et al. 2009)

Barrios et al. (2019) show that the shift to a progressive tax system can lead to a reduction in income inequality and positive, albeit negligible, employment and growth impact.



# Motivations

We aim to assess the incentive, revenue and redistributive effects of the introduction of a flat-tax type reform

- since 2011 possibility to tax the rental income by a proportional tax rate (Cedolare secca) instead of progressive IRPEF

Revenue and incentive effects might be generalized to the case of self-employed

- the level of property and self-employment incomes are, at least in part, decided by the tax payer
- both incomes might be highly evaded (Albarea et al. 2019), due to similar incentives and agreements between the parties

# Fiscal treatment of rental incomes

	<=2010	2011	2012	2013+
Property tax	ICI (0.64%)		IMU (0.76%)	
<b><i>Non rented buildings</i></b>				
Cadastral income in IRPEF	100%		---	50%
<b><i>Rendet buildings</i></b>				
Cadastral income in IRPEF <i>or (if larger)</i>	100%		---	
Rent	85% in IRPEF		"Cedolare secca"	
			<i>or alternatively</i>	
	85% in IRPEF			95% in IRPEF



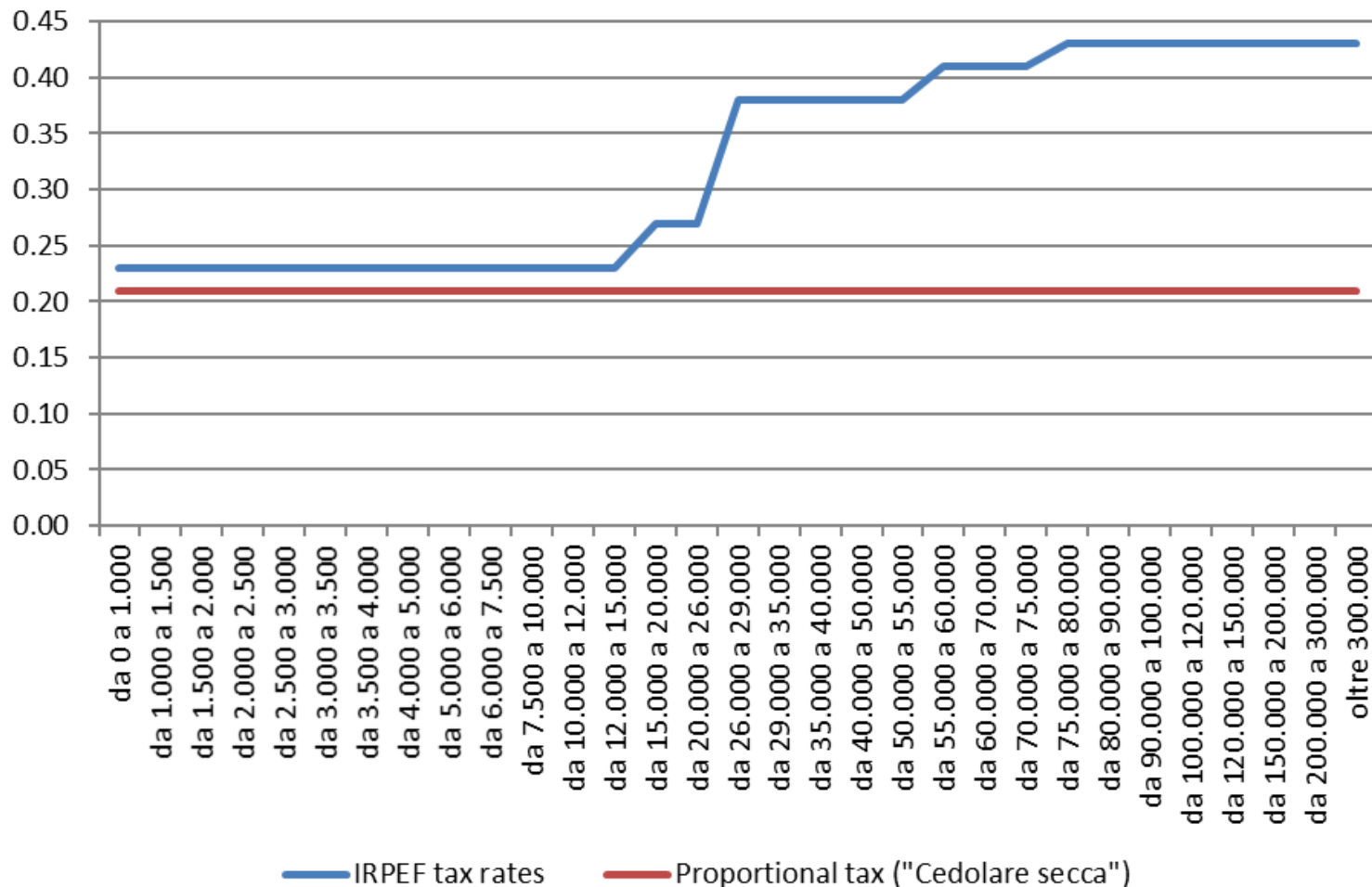
# Fiscal treatment of rental incomes

Flat tax on rented incomes introduced in 2011 (D.Lgs. 23/2011 art. 3)

- Eligibility: on residential properties only (in 2019 on commercial properties as well)
- Tax base: rent
- Standard tax rate: 21%
- Reduced tax rate: (19% → 15% (2013) → 10% (2014) on regulated rent
- Not applicable: IRPEF, Regional and Municipal surcharge, stamp and register duties



# IRPEF marginal tax rates and standard flat tax rate on rental incomes ("Cedolare secca")





# Data I

Panel of individual tax records for the years 2004-2015

- quasi-random sample of 80,000 anonymised individual taxpayers in 2014 (Di Caro, 2017)
- 0.2% of the total Italian taxpayers filling personal income tax return
- 56 variables
  - taxpayers' characteristics (e.g., gender, region, marital status, number of children)
  - income (gross income, taxable income, total income divided by income source)
  - gross and net tax liabilities, tax deductions and tax credits

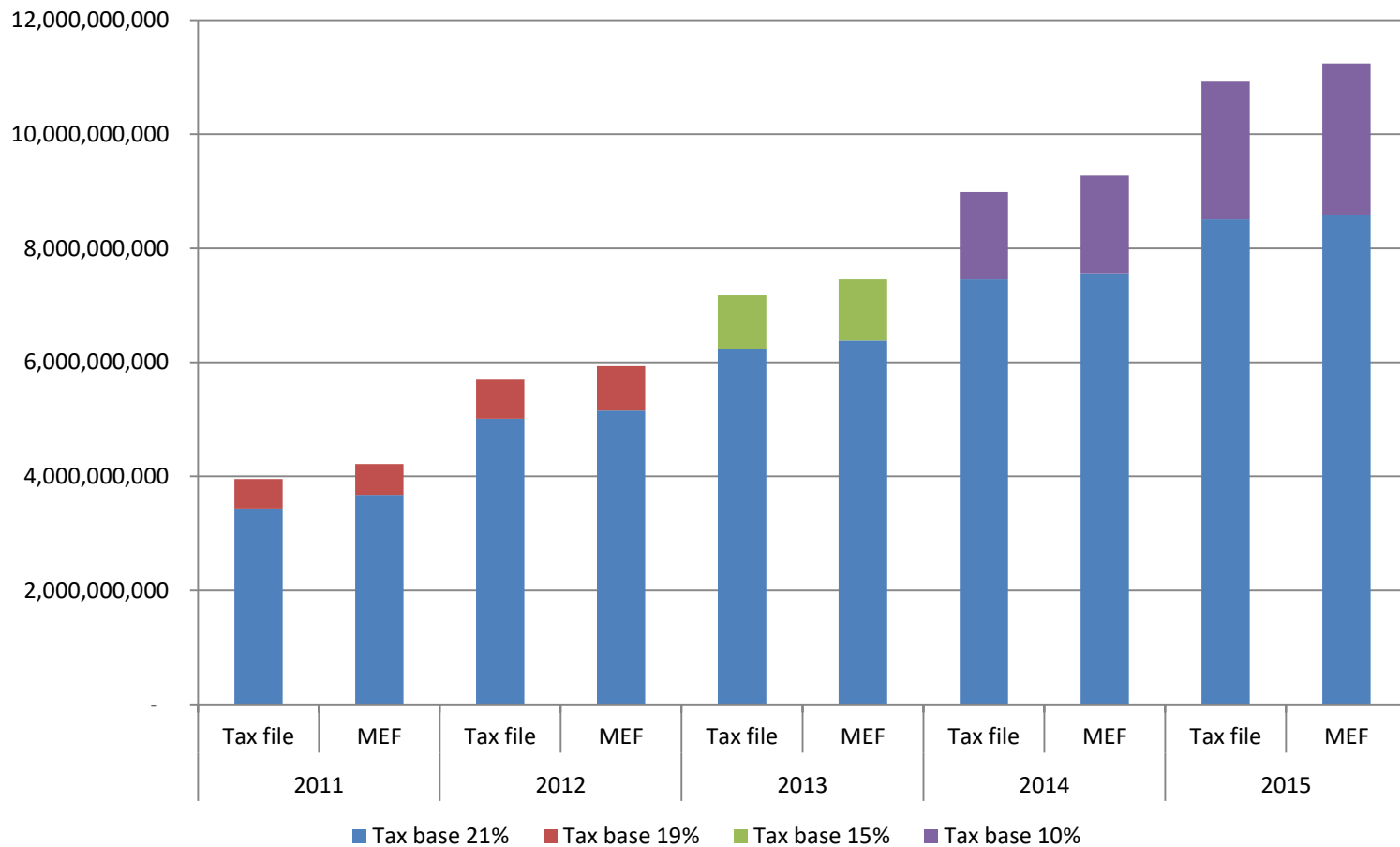


# Data II

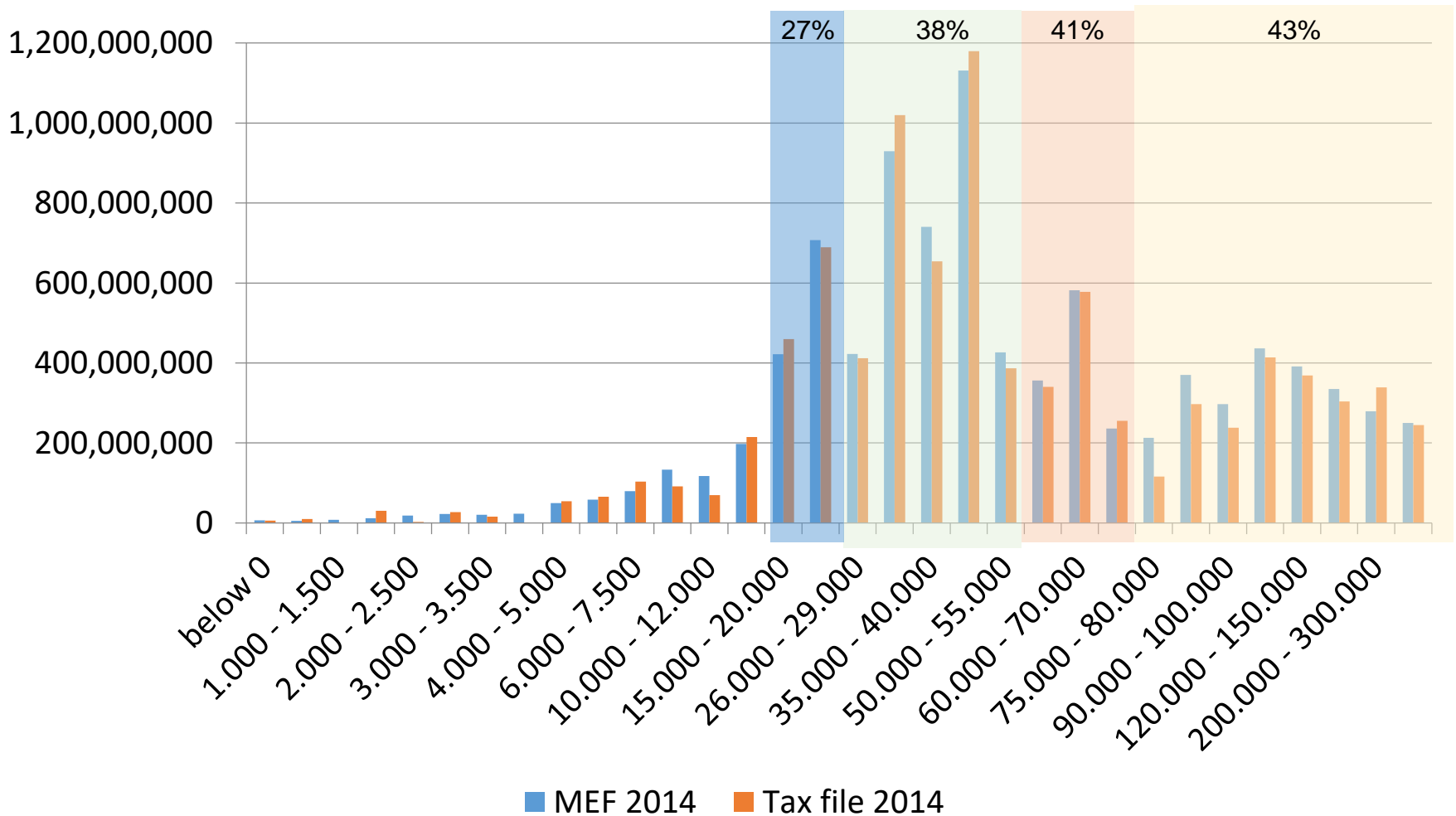
Information on immovable properties from cadastral registry

- Linked to individual tax records through fiscal code
- Variables on:
  - cadastral value
  - cadastral category
  - Use (main residence, rented, at disposal)
  - rental income
  - tax regime adopted

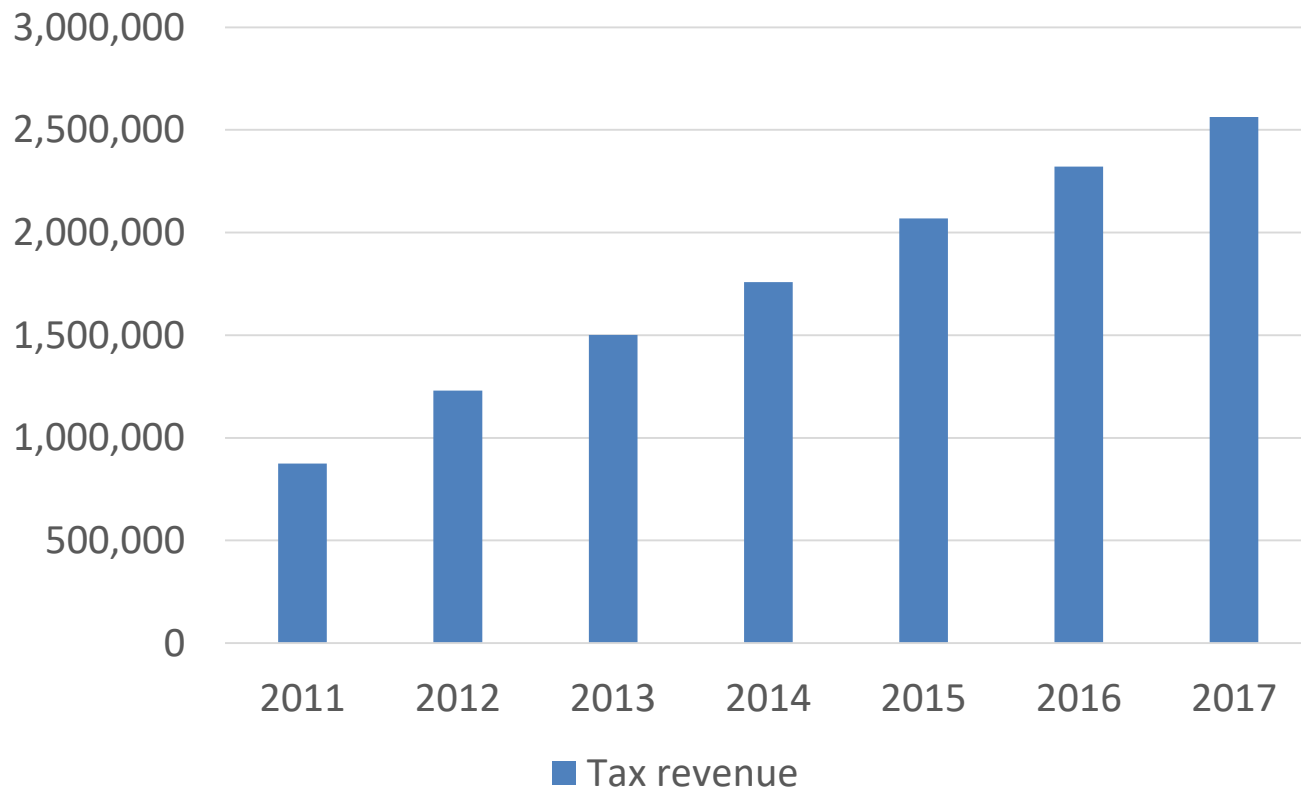
# Tax base of flat tax on rental incomes



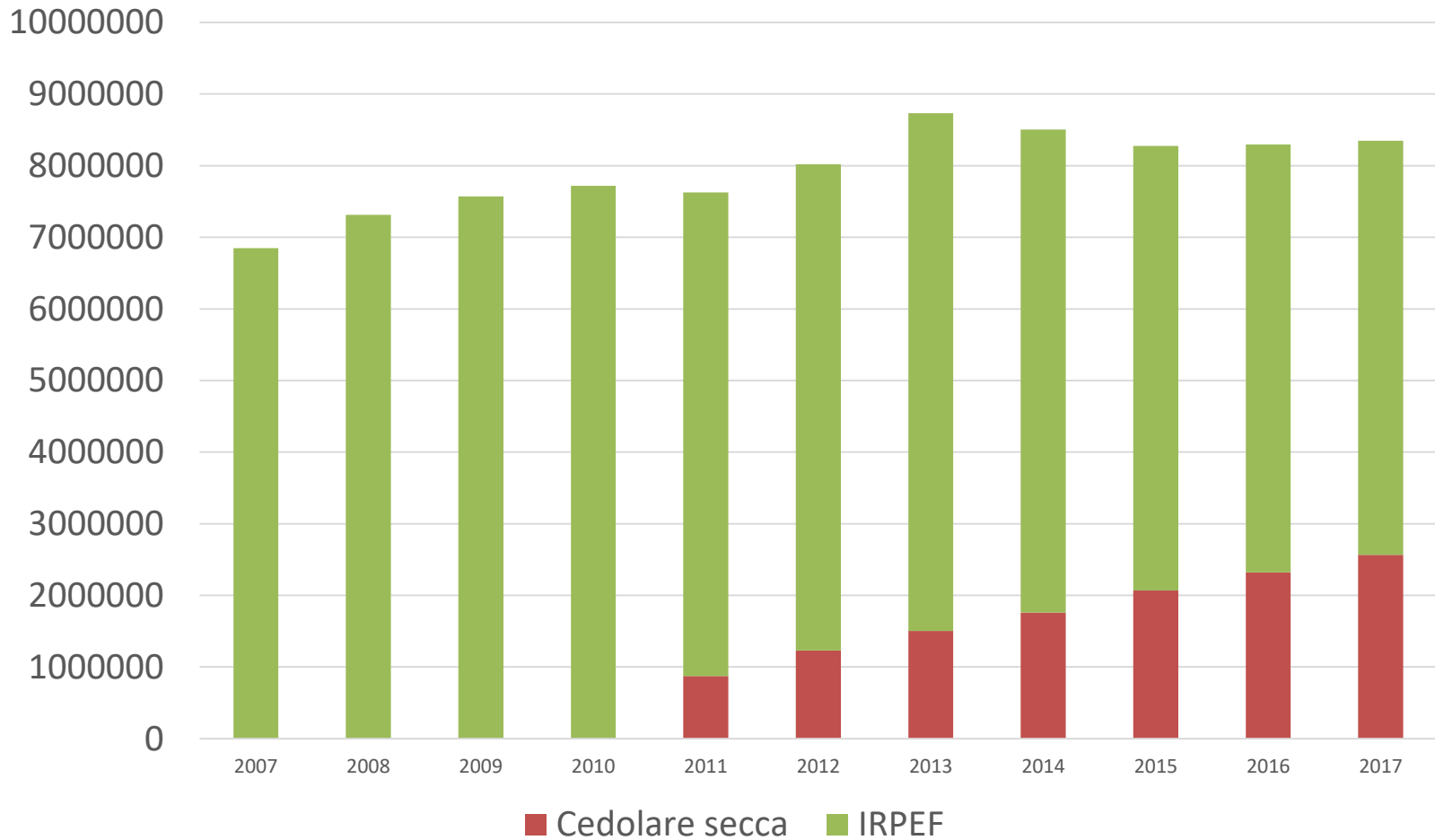
# Distribution of tax base of flat tax on rental incomes



# Tax revenue of flat tax on rental incomes



# Tax revenue on rental incomes





# Research questions - I

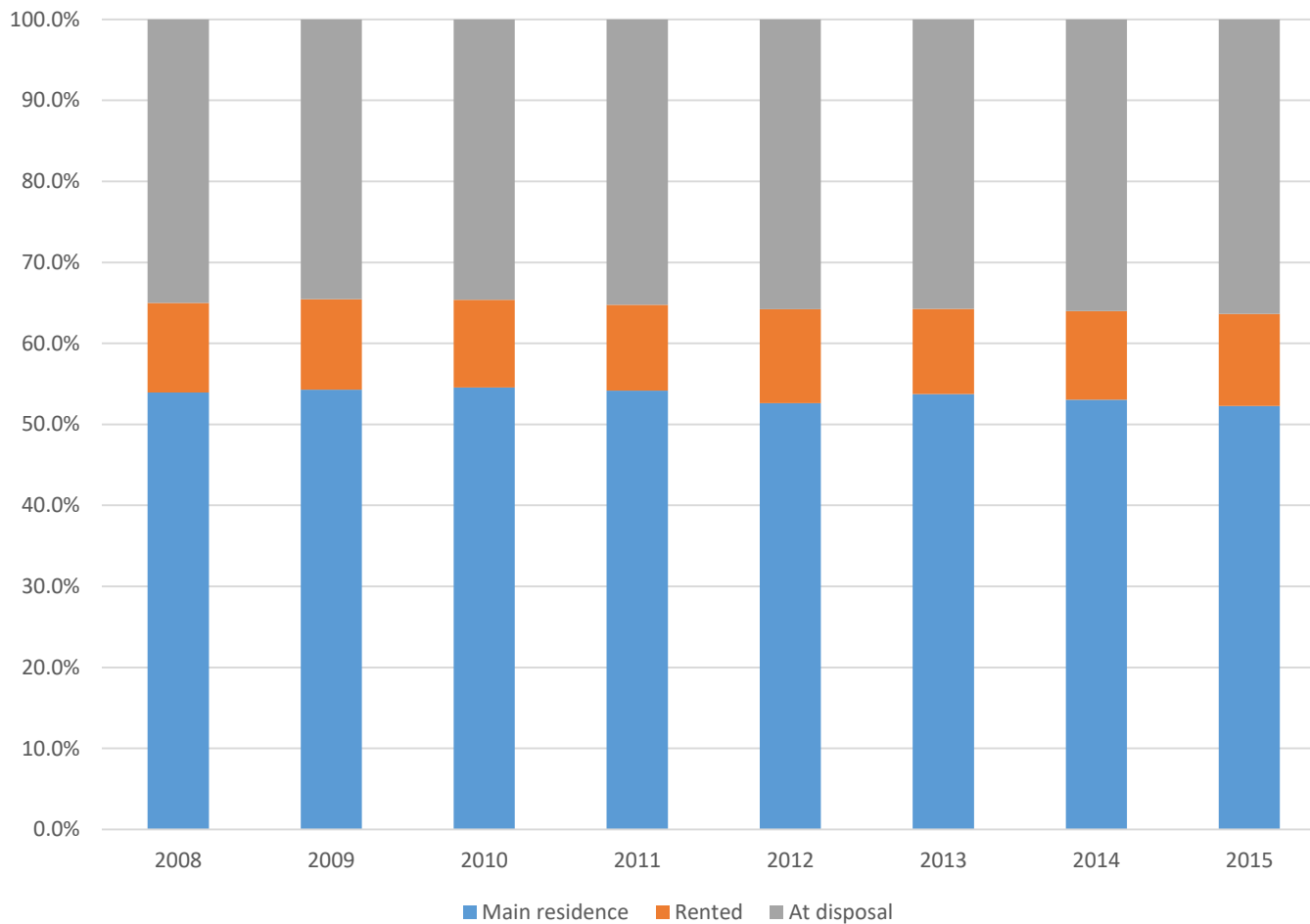
To which extent does the flat tax induce an increase in taxable income and revenues at the **extensive margin**?

- taxpayers can decide to change the use of the building (from keeping at disposal to rent it out)
- taxpayers can decide to declare rental incomes previously evaded

Assumption: the property stock is not hidden but the use of the property can be misdeclared to the tax authority



# Extensive margin



Share of different uses of buildings

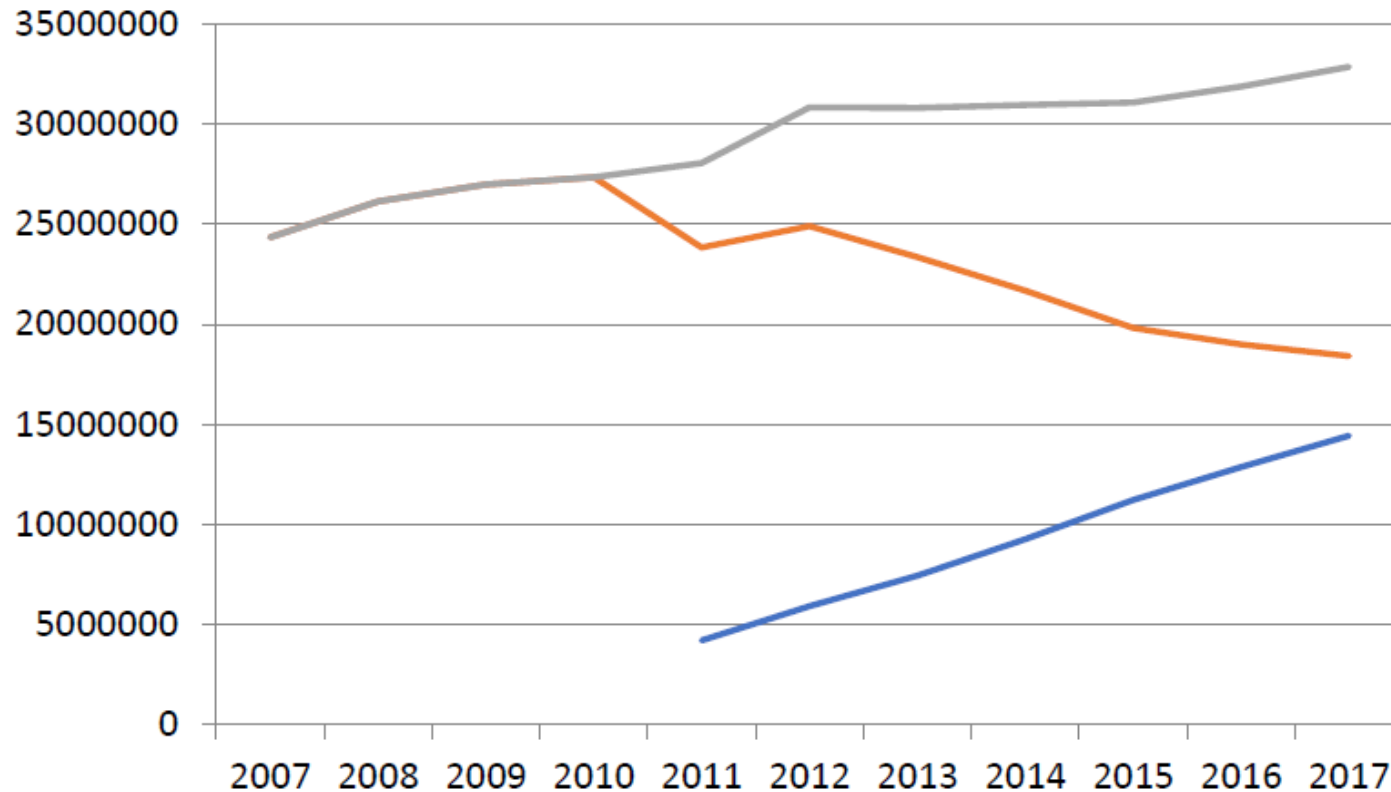


# Research questions - II

To which extent does the flat tax contribute to enhance tax compliance/economic utilization at the **intensive margin**?

- taxpayers might decide to declare higher rental income than previously

# Intensive margin



Rental incomes **subject to IRPEF (orange)** and **Cedolare Secca (blue)**



# Intensive margin

- Annual increase of rental incomes:
  - 2008-2010: 4%
  - 2011-2017: 2.7%
- In order to avoid confounding effects we can exploit a quasi-experimental setting considering
  - Treated: rental incomes subject to Cedolare Secca (i.e. residential buildings)
  - Control: rental incomes not subject to Cedolare Secca (i.e. commercial buildings)



# Research questions - III

Is the change in the tax burden for the landlord passed on the tenant?

- To which extent the difference in tax burden on incomes previously subject to IRPEF and then shifted to the Cedolare secca is reflected in a decrease in rent?
  - Focus on sample of rental incomes shifted from IRPEF to Cedolare Secca



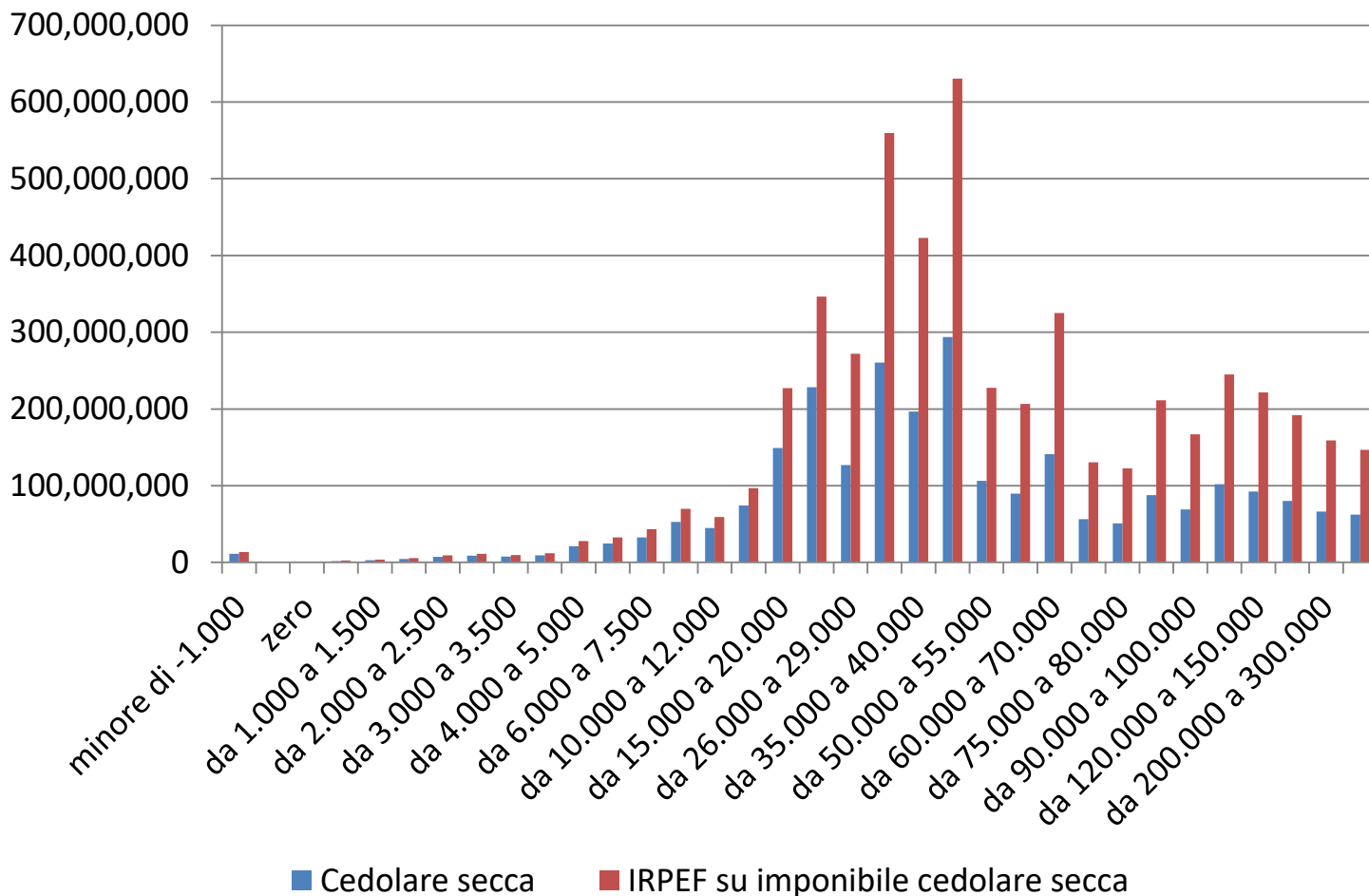
# Research questions - IV

Which are the revenue consequences of the flat tax on rental incomes? Is the flat tax self financing?

- Expected lower revenue for rents correctly declared
- (Higher revenue if new properties or higher rents are declared)

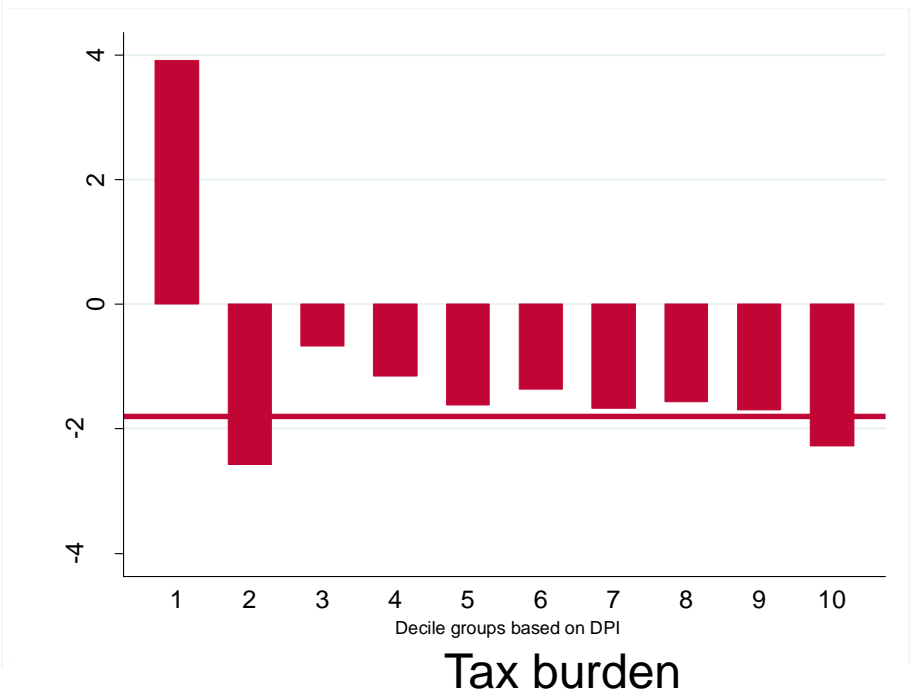
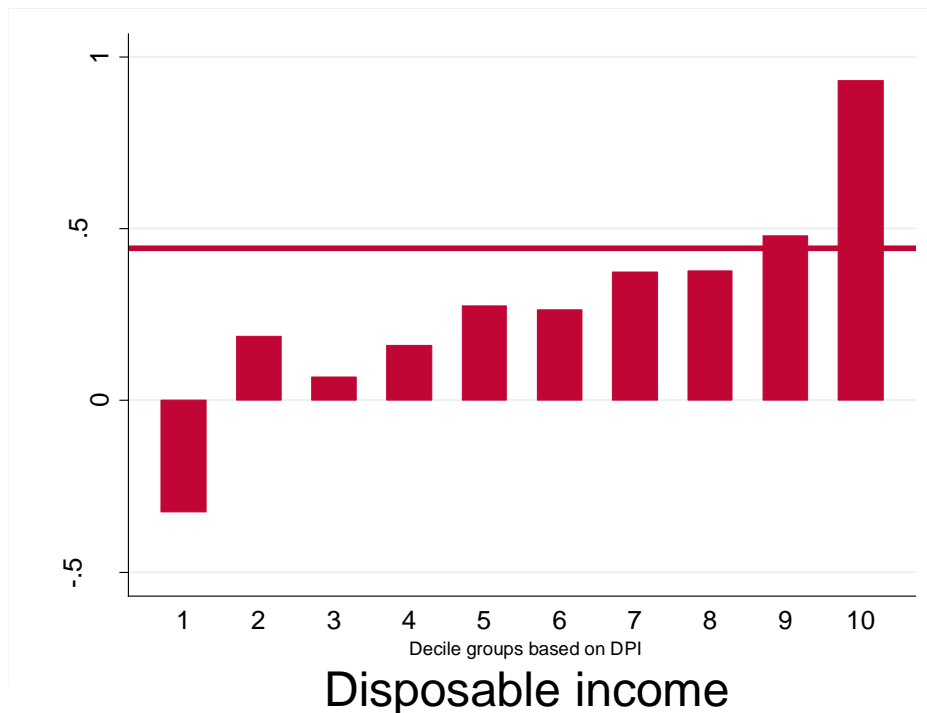
In order to compensate for the revenue losses we would need a tax base 7bil € higher than in the pre-reform.

# Distribution of tax revenue of flat tax on rental incomes (“Cedolare secca” - 2,5€ bil) vs potential IRPEF tax revenue (5,2€ bil)



# Research questions - V

Which are the redistributive effects of the flat tax on rental incomes?



Moving from taxing all rental incomes under IRPEF to proportional tax





# Preliminary findings

The flat tax-type reform of rental property in Italy generates:

- negligible changes in the use of properties
- small (and negligible) changes in tax declared income
- revenues losses, given that the tax reduction was not counterbalanced by enough additional rental income declared
- perverse redistributive effects

# Flat tax

