Assessing the effects of flat tax reforms: micro estimates from property tax changes in Italy*

by

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Abstract

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 in comparison to other countries. In the recent years, a raising number of economists and politicians are sustaining the adoption of flat tax reforms as a way of improving current progressive personal income tax systems, with possible benefits in terms of simplicity, higher compliance and lower distortionary effects on growth and employment (Hall and Rabushka, 2013). In Italy, different flat tax proposals are at the forefront of the public debate and, in particular, changing the progressive personal income tax towards a flat tax regime has been one of the key electoral arguments of the current coalition of government (Rossi, 2018). Despite its relevance in the public debate of different countries including Italy, the supporting evidence on the costs and benefits of flat tax reforms has been mostly limited to the few studies analysing the responses of the adoption of flat tax systems in Central and Eastern European countries in the 1990s and the 2000s. For those countries, however, the existing evidence provided mixed results, by suggesting the lack of most of the desired effects of flat tax regimes (Gorodnichenko *et al.*, 2009; Barrios *et al.*,

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2019). In developed countries, there is an increasing interest in assessing the overall effects of flat tax reform proposals (Spreen, 2018).

In this paper, for the first time, we assess the effects and, in particular, the tax evasion response, of flat tax reform proposals for the case of Italy: a large, developed country where flat tax reform proposals are currently debated and, moreover, where tax evasion is high in comparison to other developed countries (Schneider *et al*., 2015; Albarea *et al*., 2018), and inequality shows persistence across time (Fiorio, 2011). Specifically, we build a novel dataset based on a panel of tax records for the years 2009-2014, for a quasi-random sample of 80,000 anonymised taxpayers (Di Caro, 2017). The dataset contains several pieces of information and allows us to study income changes over the time period. We have data on 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. In the empirical analysis, we study the effects of flat tax-type reforms by analysing the taxpayers' behaviour before and after the year 2011, when the Italian government introduced a proportional tax, i.e. *the Cedolare Secca*, with two rates (21% and 10%) to personal income deriving from rented properties, which was previously taxed at regular PIT rates (Figari *et al.*, 2012). By using difference-in-difference approaches, our preliminary results suggest small, negligible changes in tax declared income and tax compliance, following the flat tax-type reform of rented property in Italy. We also found confirmation for the fact that the *Cedolare Secca* reform generated revenues losses, given that the tax reduction was not counterbalanced by more income declared. Finally, we discuss some potential implications of our results for the current debate on the adoption of a flat tax regime in Italy.

Keywords: Flat tax, tax evasion, property income tax, tax microdata.
JEL classification: D12, H24, H25.

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