

Essays on Public Finance

Research Plan - PhD in Economics

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- Trade-off **Equity** vs. **Efficiency** .
- **Income inequality** ➔ social-political discontent, political instability and populism, missing out on natural talent etc.¹
- **Progressive redistribution** ➔ taxation and public spending.
- **Economic efficiency** and economic growth might suffer from **increasing tax progressivity**.
- What should our societies do?
- **Empirical question** ➔ what are the **behavioral responses** of taxpayers to tax changes? How do vulnerable people respond to public spending policies?
- **Results of this PhD thesis** ➔ recommendations for policy reforms to mitigate **inequalities** while distorting the less the **efficiency** of the economy.

¹See Alesina and Perotti (1996), Stiglitz (2012), and Pástor and Veronesi (2021).



1 Dual Income Taxation and Corporations: Income Shifting

Motivation

- Effectiveness of taxation in reducing inequalities → (i) **degree of progressivity** in the tax code and (ii) **how taxpayers react** to tax incentives.
- **Dual PIT (Personal Income Tax)** and **lowered CIT (Corporate Income Tax) rates** → **eroded progressivity**.
- Incentives for entrepreneurs to become incorporated and declare capital income instead → **income shifting** (i) **between PIT bases** and (ii) **between PIT and CIT**.
- Evidence on it using **data from Spain**. Why Spain?
 - Spanish public finance system follows the outlined global trends.
 - Tax decentralization (many different regional tax schemes changing over years) → interesting **sources of quasi-experimental time and cross-regional variation**.
 - Rich administrative tax micro-dataset.
- Preliminary results → $\approx 3\%$ of taxpayers react to those incentives → responses to taxation are **not completely "real"**, but include **income shifting** → implications for **efficiency** and **inequality**.



1 Dual Income Taxation and Corporations: Income Shifting

Background & Contribution

- **Entrepreneurs** facing a **PIT rate increase** might behave differently.
 1. **Output reduction** as after tax bill fewer net business revenues will remain ("**real response**") → moving downwards in income distribution → paying lower average tax rate → drop in economic efficiency.
 2. Transferring personal income into a firm (**income shifting**) generating **same output** → sheltering income from taxation → real income remains constant → only tax payments reduced.
- **Income shifting** mechanism → entrepreneur files PIT as self-employed → transfer business income into a corporation → CIT taxes are levied on company profits → transfer corporate net-income into personal income as dividends (financial capital income) and convenient salaries (labor income).
- Given dual PIT → dividends enter PIT in the savings taxable income base (lower and less progressive PIT tax schedule than that on labor income) → **combined CIT and PIT burden can be lower than declaring all income as self-employment labor income.**



Background & Contribution

- Literature on **income shifting** ➔ (1) choice of organizational form^a, (2) choice to remunerate business owners^b, (3) moving income between spouses within marriage^c, (4) timing to realize dividend payments or capital gains^d.
- Literature on **elasticity of taxable income (ETI)**, which is not only capturing “real” economic behavior^e ➔ Update Almunia and Lopez-Rodriguez (2019) and depict the ETI part driven by income shifting in Spain.
- Pioneering paper ➔ crucial results for debate on optimal marginal tax rates ➔ **Estimated effects of income shifting on relocation, welfare, economic activity, redistribution, tax revenue, inequality and loss of tax progressivity.**

^a See Gordon and MacKie-Mason (1994), Gordon and Slemrod (1998), and Thoresen and Alstadsæter (2010). In Spain, Domínguez Barrero and Laborda (1999), Domínguez Barrero et al. (2003), Domínguez Barrero and Laborda (1999), Laborda et al. (2014), and López-Laborda et al. (2018).

^b See Alstadsæter and Jacob (2016), and Harju and Matikka (2016).

^c See Stephens and Ward-Batts (2004).

^d See Alstadsæter and Jacob (2016), Chetty and Saez (2005), Kari et al. (2008), le Maire and Schjerner (2013), Auerbach et al. (1998), Jacob (2016), and Jacob (2018).

^e See Pirttilä and Selin (2011), Slemrod (2001), Gruber and Saez (2002), Chetty (2009), Saez et al. (2012), Harju and Matikka (2016), and Bergolo et al. (2022).



1 Dual Income Taxation and Corporations: Income Shifting

Identification, Methodology & Data

- Identify **causal effect of tax changes on income shifting**.
 - Variation → **tax policy changes across regions and over time on PIT and CIT** (and other capital taxes).
 - Data → Administrative tax **panel micro-data** for the period **1998-2019**. [Data](#)
 - Techniques → **new difference-in-difference** and event study methods.
- Treatment → **individual specific threshold** at which each entrepreneur would be **indifferent** between either way of taxation. [Learn more](#)
- Identification of **potential shifters** → firm owners.
 - Those for whom $\frac{SSC}{y_{lab}} > 6.4\%$, where *ssc* are social security contributions and *y_{lab}* is gross labor income.
 - Company owners **can deduct** not only employee social security contributions but also **employer social security contributions**. 6,4% is the normal percentage applied to gross salary to compute the employee social security contributions.



1 Dual Income Taxation and Corporations: Income Shifting

Identification, Methodology & Data

- This **novel identification** overcomes limitations of earlier approaches.
- Estimates on how much of the **response of the taxpayers to tax changes (ETI)** could be attributed to (1) **“real” economic-activity responses** and to (2) **income shifting**.
- **Counterfactual analysis** simulating an economy where actual shifters did not shift. What would be the **tax revenue loss**?
- Quantifying **tax progressivity loss** and effects on **income (and wealth) inequality**.

Preliminary Evidence

[Undisclosed data. No consent to display results.]

- As many as 3% of taxpayers react to those incentives.
- # of identified potential shifters rise and occupy a larger proportion of the total taxpayers during years with higher marginal PIT rates (2012-2014).



Motivation

- Income supplementation ➔ **alleviate poverty and inequality** in many countries.
- Difficult balance between the **emergence of new social needs** and limits to **increasing budgetary resources**.
 - **Evaluation** of minimum income is a crucial need ➔ **how do people receiving it behave in short- / long-term?**
- Spain ➔ multiple and co-existing means-tested and non-means-tested minimum income programs.
 - As of 2007 **regional** governments started to introduce own and differing minimum income schemes ➔ "*Rentas Mínimas Autonómicas*".
 - With COVID-19, central government introduced **national** minimum income program ➔ "*Ingreso Mínimo Vital*".
- Unique **source of rich variation** ➔ **quantitatively evaluate** effects of the Spanish minimum income programs on **poverty, inequality, labor inclusion, and education gap**, among others.

Objective & Expected Contribution

- Descriptive work ➔ **implementation & sufficiency** of minimum income programs to alleviate poverty and inequality, **fitting and overlapping** within the complex system of government benefits, and **non-take-up** analysis.^a
- Quantitative empirical evaluation ➔ address **questions that have not been analyzed in the literature** (or have been studied in a very limited way).^b
 - **Incentives** for those receiving it to get better socio-economic conditions.
 - Insurance against **transitory income shocks**.
 - Potential **undesirable effects** arising.
- Many **policy recommendations** could be drawn from it.

^a My work will contribute to descriptive literature on minimum income: Nelson (2008), Nelson (2010), Marx and Nelson (2013), Wang and van Vliet (2016), Natili (2017), Crepaldi et al. (2017), and Coady et al. (2021). In Spain, Noguera (2019), Natili (2019), Aguilar-Hendrickson and de Durana (2020), and Berjón and Gorjón (2021), among others. It will be also linked with works on non-take-up like Goedemé and Janssens (2020), Reijnders (2020), Lucas et al. (2021), and Sylvia et al. (2022).

^b The paper will be contributing to the non-developed literature on quantitative evaluations of the minimum income schemes, e.g. Saboia and Rocha (2002). It will be entering on top of the specific empirical literature focused on Spain covered so far by Hernández et al. (2020), Gambau-Suelves and Nuria (2020) and Ayala et al. (2021).



Methodology & Data

- Identify **causal effect of minimum income policy changes on several outcomes** (poverty, income and social inequality, labor inclusion, or education gap, among others).
 - Variation → **minimum income policy changes across regions and over time.**
 - Data → Administrative tax **panel micro-data** for the period **1998-2019** → not only on **income**, but also on **wealth** and **other socioeconomic characteristics** → not only for PIT fillers, but for the **whole population.** Data
 - **Quasi-experimental** → *new diff-in-diff or regression discontinuity design.*
- Treatment → individuals **receiving the minimum income quantity.**
- Control → those with **similar characteristics not receiving it** → not small group since many Spanish minimum income programs define some **very strict requirements** on legal issues not based on income or social status.^a

^a It is key here to note that non-compliance of legal issues (those not related with socio-economic status) is equally distributed among those potentially eligible for accessing the minimum income amount when only observable-in-data socio-economic characteristics are taken into account, which prevents individuals in the control group from self-selection bias.



3 PIT Benefits: Rental Housing and Private Pension Plans

Motivation

- **Ageing** at an increasing rate → **sustainability of the public pension system**.
- **Asset inequality**, concentration of housing wealth, depopulation and agglomeration of population around big cities → **rising price of rental housing**.
- Political and economic **solutions in taxation** → Taxable income **deductions in PIT** for (1) those who make **contributions to private pension plans** and for (2) **owners who offer their housing assets in the rental market** for primary residence renting purposes.
- **No proper evaluation so far** of these tax benefit policies in Spain.
- Decentralized tax policy context → **empirical evaluation** with very large and **rich variation** not only over time, but also across different regions.

Objective & Expected Contribution

- Changes in the exemption percentage for residential rental income or the increase in income imputed to non-habitual housing ➔ effects on **rental prices**, extensive margin of **private rental housing supply**, or income concentration in housing landlords.
- Introduction of taxable income deduction of €10,000 or reduction to €1,500 for contributions to private pension plans ➔ effects on **private savings decisions** and on the **form of complementary pension savings**.
- Literature on **tax benefit** evaluations through **micro-simulation** techniques and **causality** analyses^a related to **rental pricing**^b and **fiscal treatment of public pension plans**^c
- First study to **quantitatively and empirically evaluate** these two issues in **Spain**.
- **Relevant to inequality** ➔ holders/savers occupy higher parts of income distribution.

^a See Spadaro (2005) and Roca (2010).

^b See Jappelli and Pistaferri (2007), Cummings and DiPasquale (2010), Williamson (2011), and McClure (2018), among others.

^c See Cymrot (1980), Whitehouse (1999), and Varga (2018), among others.



3 PIT Benefits: Rental Housing and Private Pension Plans

Methodology & Data

- Identify **causal effect of tax benefits on several outcomes** (housing supply, rental prices, income and social inequality, savings decision on pension plans vs. other savings instruments, tax revenue, or social security balance).
 - Variation → **PIT benefit policy changes over time.**
 - Data → Administrative tax **panel micro-data** for the period **1998-2019** → not only on **income**, but also on **wealth** and **other socioeconomic characteristics** → **match landlord-tenant/renter** Data
 - **Quasi-experimental** → *new diff-in-diff or regression discontinuity design.*
- Treatment → individuals **experiencing a marginal tax rate change** due to tax benefit policy changes.
- Control → those with **similar characteristics not facing it.**



4 Work Plan





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[Undisclosed data. Only some main features are provided]²

Base data

- *Panel de declarantes del Impuesto sobre la Renta de las Personas Físicas 1999-2016*, Instituto de Estudios Fiscales (IEF) (2022). ➔ From AEAT & INE.³
- Longitudinal sample of individual PIT returns (4% of total returns) ➔ amount and source of income, personal characteristics (e.g., age and gender), fiscal residence, etc. ➔ 15 of 17 Spanish autonomous communities (+ Ceuta & Melilla).⁴

New Data (Now under construction (AEAT & INE) and not yet disclosed publicly)

- Updated up to 2019 ➔ Richer income information ➔ not only PIT fillers, but whole population ➔ new rich data on wealth and other socioeconomic characteristics.

Back

² Data will be public and accessible to the whole research community once my papers will be close to public circulation. Due to ethical and legal reasons, data cannot be shared with any third person. Datasets used in this PhD research are properly stored following the corresponding security procedures. Data are anonymized by the providing institutions and no results are computed with less than 20 obs.

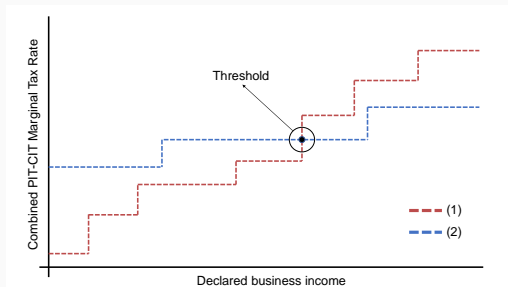
³ A detailed description of the already published and open-access dataset is provided in Pérez López et al. (2019).

⁴ Only data for regions in the Common Fiscal Regime. Regional governments of **Basque Country and Navarre** do not disclose data.

A2 Computation of individual specific threshold

At this point, an entrepreneur would be **indifferent** between:

1. Declaring all income as self-employed in the general PIT base.
2. Transferring income into a company, paying CIT on its profits, and then attributing dividends (entering the savings PIT base) and convenient salaries (entering the general PIT base) from the company to the person.⁵



[Back](#)

⁵ It is also considered that creating a company has certain expenses and requires at the same time greater documentary and formal obligations than self-employment. It also takes into account whether or not the company provides greater legal coverage, mainly for the person's private assets. The threshold provided can also considerably vary depending on the personal characteristics of each individual or company.