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TAXATION IN FRANCE

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Records Deficits and Debts….

Two facts can hardly be missed when studying French public finances. Firstly, the country has one of the highest reported ratios of public spending to GDP (57.1% in 2013, second only to Denmark among OECD countries). It also has a high public nominal deficit (4.1% of GDP in 2013 and probably slightly more in 2014) and, consequently, a rapidly increasing national debt that could reach 100% of GDP in the coming years.

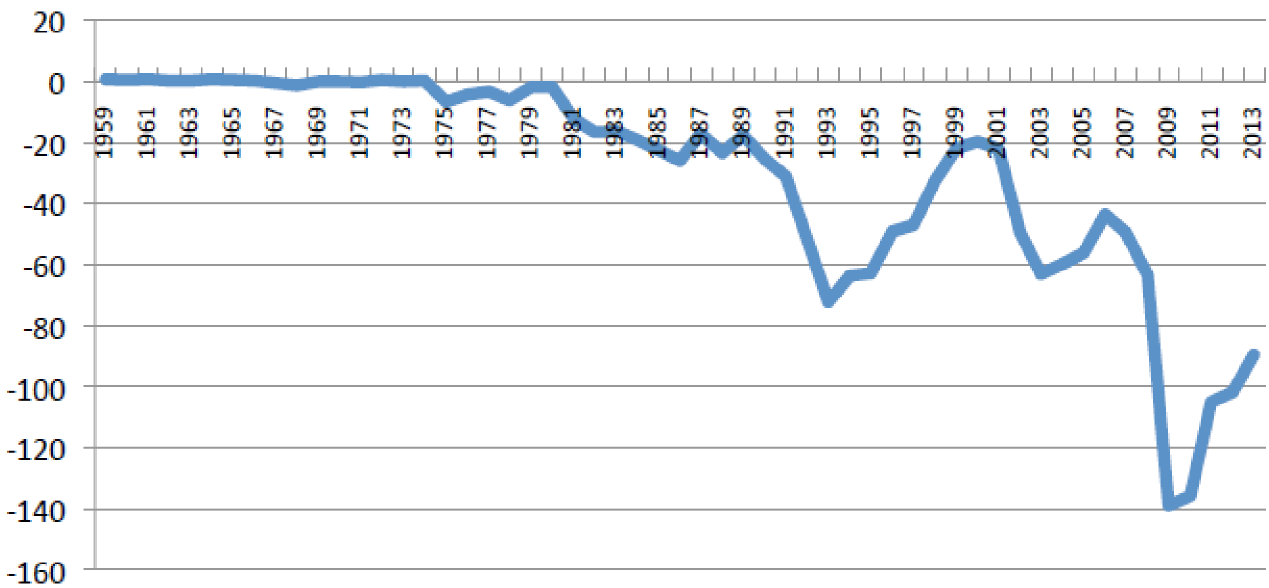
Table 1: Public finances (all levels of government and social security included)				
Year	2012		2013	
	bill. €	% GDP	bill. €	% GDP
Public Debt	1865.8	89.2	1949.4	91.8
Public Deficit	101.6	4.9	87.1	4.1
Consolidated revenue	1083.7	51.8	1120.4	52.99
Consolidated expenses	1185.4	56,67	1207.5	57.11

Source: Comptes nationaux, Base 2010, INSEE

1The author wishes to thank Vesselina Garello for helpful comments on earlier drafts of this work.

Clearly, French public finances are today in dire straits. On 27 April 2009, the European Council has addressed a formal recommendation to the French government on the basis of the deficit observed for 2008. France was given until 2013 to bring the deficit below 3%. In 2013, the government asked and obtained to push this deadline further to 2014. But the deficit is still expected around 4.4% in 2014 and 4.3% in 2015. As Graph 1 shows, this situation is nothing but the last episode of a long series. For each of the last 40 years the consolidated account of all the central branches of the French public administration has been in deficit (1974 was the last time a budget surplus was realized).

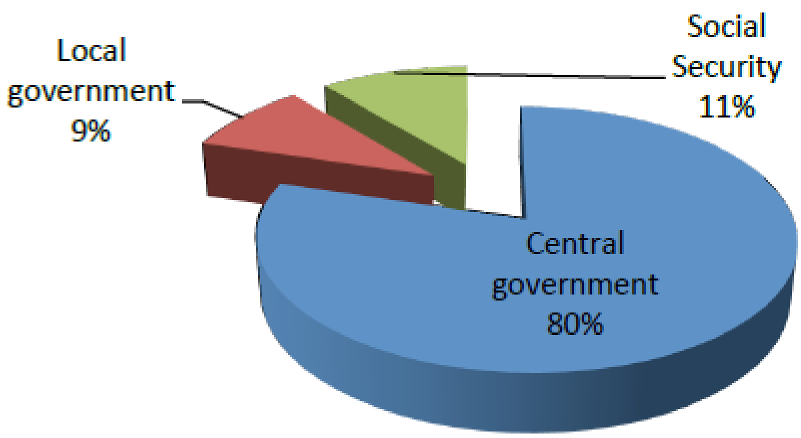
Graph 1: Long run evolution of general government deficit in billion €



Source: from INSEE, table _3201

Looking now at public debt, Graph 2 gives the repartition of gross public debt (in the Maastricht sense). Public debt reached €1949.5 billions representing 91.8% of GDP at the end of 2013. Six months later, mid 2014, it reached € 2,023.7 bill. and amounted to 95.1% of GDP. A large portion of that debt (80%) comes from central government (€ 1,555.5 billions). The second largest contributor to national debt is the social security administration with € 211.7 billions (approximately 11%), closely followed by local governments: € 182.3 billions representing 9% of the total.

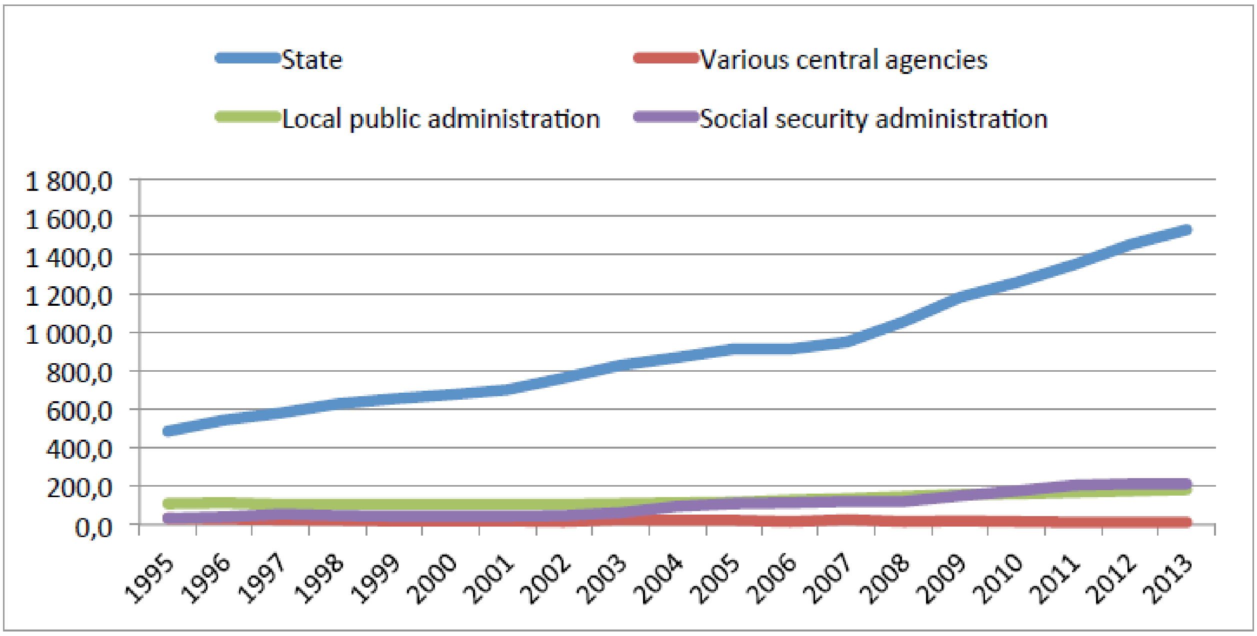
Graph 2: Share of national debt by levels of government (end of 2013)



Source: National account. Base 2010. INSEE

Any concern that this situation may legitimately generate will be reinforced when taking a long-term perspective (Graph 3). Indeed, 2002 was the last time national debt was below the 60% threshold and public debt is growing rapidly, more or less doubling every ten years for the last two decades.[2]

Graph 3: Long term evolution of public debt by level of administration



Source: National account, Base 2010, INSEE

2During that period, the French public treasury was able to borrow at historically low interest rates, a consequence being that, at least in terms of debt financing, things can only go worse for the French Treasury Agency. Exposition to interest risk is high.

…despite having among the highest levels of taxation

Basic economics teaches us that a country, like any household, can arbitrage between taxes and debt. And indeed, to resort to debt in order to finance long run investments that will benefit future generations might sound a reasonable thing to do. So the present situation of France's public finances could be healthier than what it seems if the levels of taxation were low and the money borrowed used to invest. Unfortunately, those impressive deficit and debt levels are reached *despite* one of the highest level of taxation, well above the EU-27 average (Graph 4), and without any compensation in terms of long-run investment.

Graph 4: Total tax including Social Security Contributions as % of GDP

Source: Eurostat

With such a level of compulsory payments, one can hardly find any economic activity or revenue that is not taxed heavily. Table 2 gives the main tax rates and tax basis at the end of 2013.

Table 2: Tax rates and bases					
Personal Income Tax (income from 2013)	< €6011	€6011 to €11991	€11991 to €26 631	€26 420 to €71397	€71 397 to € 151 200
	0%	5.5%	14%	30%	41%
Capital income & capital gains	• Since 2014, dividends and interests are subject to progressive PIT rate (above) and to 15.5% social contribution (SC) The effective tax rate is around 40% • Tax on capital gains also subject to PIT progressive rates with abolition of tax-free threshold and an additional 15.5% for SC • Real estate gains: 19% + 15.5% SC				
VAT	Regular rate: 20% (since 01/01/2014, up from 19.6%), Intermediary rate: 10% (since 01/01/2014, up from 7%) Reduced rates 5.5% and 2.1% (unchanged)				
Corporate income	33.1/3 % + 3.3% SC of taxable benefits + 10.7% of CIT paid (exceptional contribution) 15% reduced rate (turnover below € 7.63 millions)				
Excise duties	• Revenues from excise duties on tobacco (€12.3 bill) and alcohol (€4bill) go directly to the Social security administration. • Excise duties on mineral oil and Energy is raising some €14billion today				
Wealth and death taxes	• In 2014, threshold remains at €1.3 million and rates go progressively through six brackets from 0.5% (wealth between €800,000 and 1.3M) to 1.5% (above €10M). “Fiscal shield” abolished in 2011. • Inheritance and donation rates are progressive. Top bracket (above €1.8M) is at 45% for lineal succession. It is 60% for succession without filiation.				

Besides high rates, French fiscal policy is characterized by:

- *A very progressive income tax*: this is due not only to a top marginal rate set at 45% but also to the fact that, once taking into account the various rules for the calculus of taxable income, only 48.5% of household paid something in 2014. Let us note also that France has been implementing since the end of WWII a rather generous pro-family fiscal policy and that an attempt of the actual government to raise the top marginal rate at 75% was blocked by the constitutional court.

- *A desire "to tax capital at the same level as labor"*. Those were the words of the actual President, François Hollande, during the 2012 Presidential campaign. And, indeed, the effective corporate income tax rate is today usually around 45%. Also, capital gains and capital income are now most often added to personal income and therefore taxed at the top marginal rate of 45%. Without surprise, there exists however many loopholes—such as tax credit for research activities—and it is said that large companies have developed skills to reduce their amount of taxable revenues. An example of one of the most visible actions taken recently is the creation of an employment tax credit for entities with employees whose annual remuneration is less than 2.5 times the minimum salary (that is, a gross salary below 3,613.45€ for 2014).
- *An attachment to the wealth tax.* France is among the last developed country with a wealth tax. The prior government (under the Presidency of Nicolas Sarkozy) had lower the rates at the same time that it abolished the "fiscal shield" designed so that taxpayers will not pay more than 100% of their regular income (something not infrequent with a wealth tax). The actual government has increased the rates and the base without restoring the fiscal shield.
- *Indirect taxation is around European levels*. Because this is one of the most powerful way to increase tax revenues in an already heavily taxed economy, the normal rate has been recently increased at 20% while maintaining a reduced rate at 5.5% to satisfy part of the political majority that favors Keynesian demand-push and sees VAT as a tax hurting low-income household.
- *Steady increase of local taxes*. Although this does not show in the above table, local government (municipalities, *départements* and regions) have been raising tax base and tax rates for the last decade or so. The main sources of fiscal revenues at those levels are to be found in property taxes (residential and non-residential) and business taxes.An economic evaluation of tax burden's allocation: Implicit tax rates

Assessing the fiscal policy of a nation is a complex matter. Of particular importance are the following facts:

1. *Rate and base*: A fiscal policy can play with *the rates* of the various taxes and duties or with the definition of *the bases* to which those rates will be applied. For instance, when, as was the case in France, the definition of the brackets for PIT are left unchanged from one year to the other, this amount to an increase of the fiscal burden, at least to the extent that there is some inflation. One of the consequence is that some households that were not paying PIT the previous year but had their wages indexed on the inflation will now have to pay that tax.

2. *Heterogeneity of a base*. The definitions and computations of the various bases for taxation rely on the use of many parameters often of different natures. Property taxes, to take one example, are computed on the basis of the value of your property, but sometimes also of the owner's income. PIT in France are computed on the basis of your income from labor, from property and of the number of children.
3. *Exemption, incentives, loopholes and the like*. When a government needs more revenues it can decide to enlarge the base instead of raising taxes. Similarly, when a government wishes to promote (to subsidy) some activities it can do it by reducing the corresponding bases or lowering the rates. Tax credits, tax rebates, tax deductions, tax reliefs can substantially affect the tax burden.
4. *What matters to individuals*. Economic agents don't make decisions based directly on fiscal parameters. Instead, they typically reason on such things as: should I work more? Should I invest? Should I accumulate capital (save) or consume? Hence, what matters for economic agents are the global fiscal treatments given to consumption, capital or labor. If it is surely hard (or even impossible) for them to evaluate how much *globally* consumption, labor and capital are taxed, one can reasonably hold that in the long run this has a real impact on their decisions. This has a greater economic meaning than the rates on PIT, CIT or property taxes.

When reporting on taxation trends in the EU, the European Commission is trying to use instruments that would take into account the complexities just mentioned. This is done in two steps: (i) the breakdown of all tax revenues into taxes on consumption, on labor or on capital. (ii) the computation of an implicit tax rates on labor, consumption and capital. Those instruments present, as always, advantages and inconveniencies. On the dark side, the breakdown necessitates that revenues from the same tax be allocated between multiple factors. Hence, revenues from Personal income tax will be partly allocated to tax on labor (since part of your income comes from a paid-job) and partly to tax on capital (for the apartment you rent, or dividends received). On the bright side, the implicit tax rate—that is obtained by the simple division of tax paid (e.g. tax on consumption) over total value (e.g., final consumption expenditures on the territory)—provides an indicator that takes partly care of variations in rates *and in bases*, of loopholes, exemptions, credits and the like and which convey greater economic meaning.

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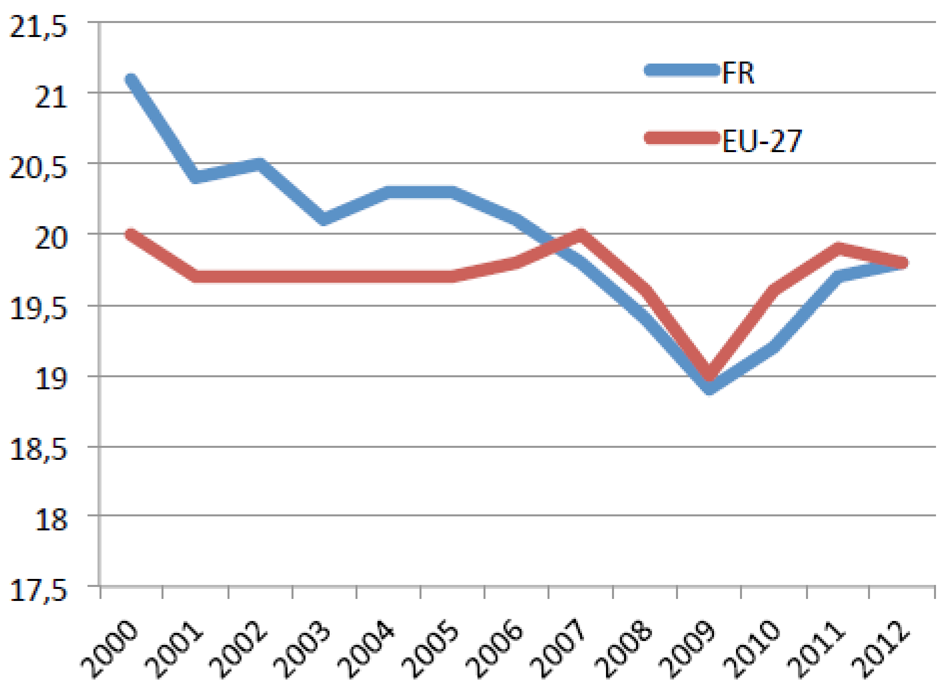
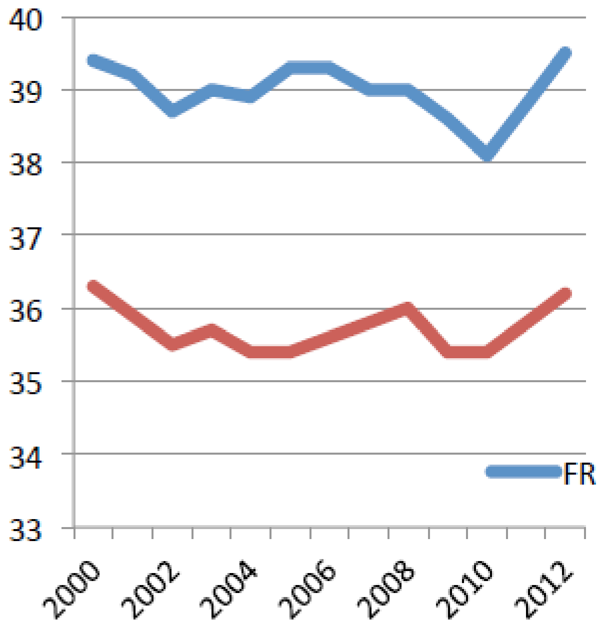
Below are reported and discussed the implicit tax rates for France as computed by the European Commission. Are included in the computation of taxes on consumption: VAT, excise duties (on energy—mineral oil, tobacco, alcohol), import duties. The implicit tax rate on consumption in France is following the EU trend. After a period of decrease, it raised during the crisis time, in large part due to an increase of VAT rates.

Graph 5: France Implicit tax rate on consumption (Eurostat)



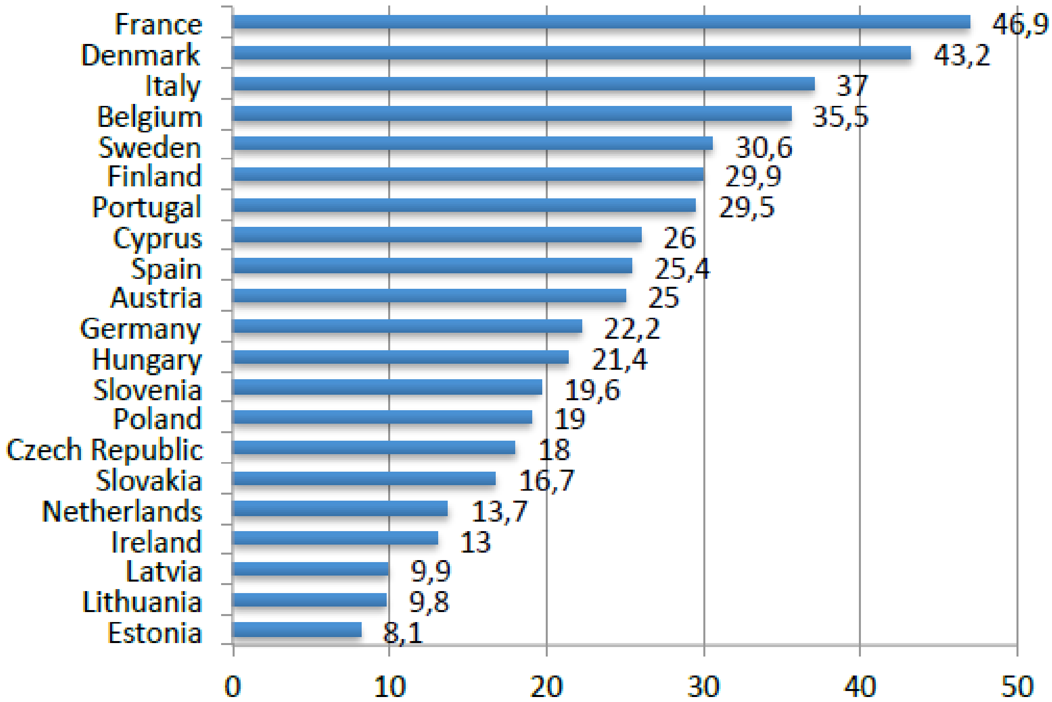
Turning to taxes on labor it must recalled that are included there only the taxes on employed labor income and non-employed labor income (e.g., taxes paid on unemployment benefits, invalidity and health car benefits and benefits from old-age pension schemes. The Commission considers taxes on income from self-employed as taxes on capital. Also, compulsory social contributions *are* included in the taxes on labor whether employees or employers pay them. Altogether, the implicit tax rate on labor in France is well above EU average (39.5% in 2012) putting the country at the 6th rank among EU countries.

Graph 6: Implicit tax rate on labor in France compared with the EU weighted average (Eurostat)

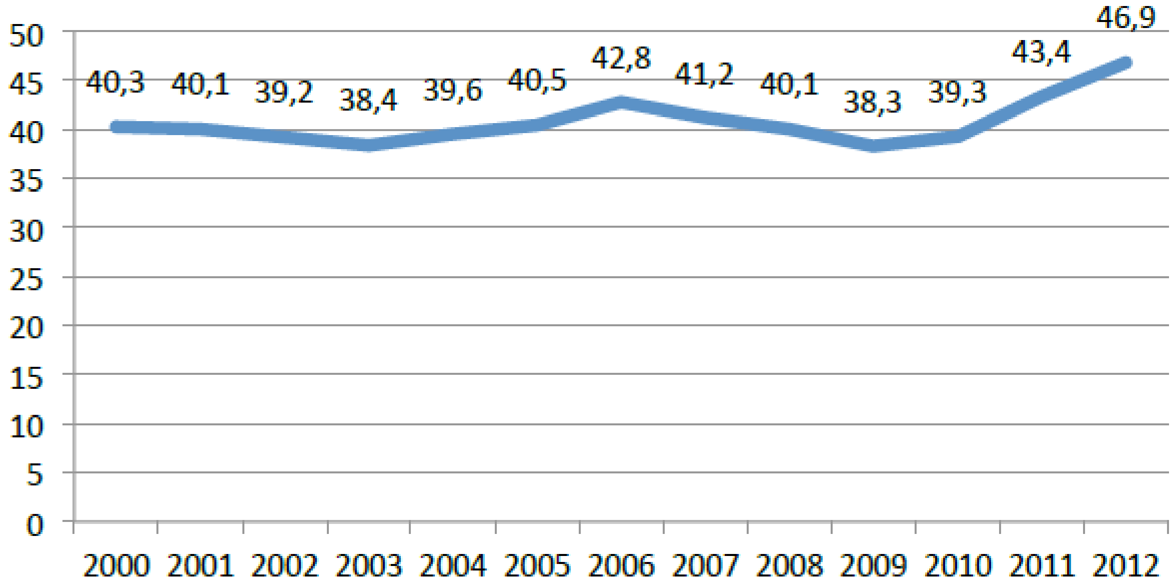


Are included in taxes on capital all the taxes not included in the two previous categories. In particular enter the category of taxes on capital: levies on incomes from self-employment, taxes on business profits, that part of personal income taxes raised on capital income of households, wealth taxes, inheritance tax and real estate taxes. The implicit tax rate on capital in France is extremely high (46.9% in 2012). Indeed, France holds a record in that category.

Graph 7: Implicit tax rate on capital: France by far number one in the European Union (Eurostat for the year 2012)



Graph 8: Implicit tax rate on capital in France: long run trend



Putting things together, France's fiscal policy is characterized by:

- EU-average fiscal burden on consumption
- Above average fiscal burden on labor
- Record high level of taxes on capital.

Let us stress that, contrarily to what politicians often pretend, capital is taxed more than labor in the country, even counting as tax on labor the heavy compulsory social contributions. Also, since the beginning of the crisis the implicit tax rate on capital was increased by 8.6 percentage points (raising from 38.3% to 46.9%) while the implicit tax rate on labor remains more or less stable (39% in 2008, 38.1% in 2010, 39.5% in 2012).

Administrative burden of fiscal procedures

If implicit tax rates are well above average in France, the procedures to be followed by businesses to pay their taxes is rather efficient, at least compared to the situation in other countries. Indeed, if based on 2013 data, France ranks 95th out of 188 countries according to the World bank Group and PWC's 2015 "Paying taxes report", this mediocre result is essentially due to the high level of taxes. As, shown in the table below, the total tax rate borne by a business located in France[3] is 66,44% higher than the average rate paid by businesses located in other EU-EFTA countries! On the other hand, in terms of hours spent and of number of payments necessary to pay your, France is much more efficient than average with only 137 hours and 8 payments. Looking at the previous ten years, France's performance has been stable, while most countries were improving in that field.

Table 3: Paying taxes in France for business

Country	*Ranking*	*Number Payments*	*Time (hours)*	*Total Tax Rate*
France	*95*	*8*	*137*	*66.6%*
EU-EFTA Average	-	*12.3*	*176*	*41*
World average		*25.9*	*264*	*40.9*

Source: Paying Taxes 2015, report from World Bank Group and PWC

As for the ordinary taxpayer, the administrative burden is similarly light. In 2013, out of 36 millions households, 14 millions used electronic means for tax return (income tax as well as various local taxes). The shift to electronic payment has been even faster for businesses. In 2013, 93% of corporate income tax, VAT and payroll taxes were declared electronically and, as of May 2015, electronic reporting will be mandatory for all businesses.[4]

3The methodology to compute this rate is of course different from the methodology developed to compute the implicit rates mentioned earlier. In the « Paying Taxes » report, « the total tax rate measures the amount of taxes and mandatory contributions borne by the business in the second year of operation expressed as a share of commercial profit. » (op. cit., 126).

4http://www.lesechos.fr/economie-france/budget-fiscalite/0203873913884-les-entreprises-devront-bientot-payer-tous-leurs-impots-en-ligne-1055659.php?JIO3g8GYWQois8bQ.99

Taxation at central and sub-national levels of government

The French decentralization process has been and continues to be a very chaotic and sometimes confusing one. The metaphor of a “millefeuille”[5] is often used to describe this territorial organization. Indeed, as of today, the territory inhabited by a people of 65.1 millions is divided between: 36,767 municipalities, 101 départements (including five départements overseas) and 27 regions (22 for the metropolitan state including Corsica and 5 overseas). To this must be added of course the administration of the central government. It is also important to notice that 99.8% of the municipalities cooperate within associations, which, for some of them, have the power to tax and can therefore raise their own revenues (Etablissements publics de cooperation intercommunale, henceforth EPCI). As of 2014 there existed 2,145 such associations. This territorial organization is clearly a complex one.

Looking at actual sources of revenues for local governments one can see that local tax revenues account today for approximately 55% of their total revenues (€ 124.32 billions in 2014), the rest, as we will see, is essentially transfers from the central government (€ 101.2 billions in 2014). The fiscal autonomy of sub-national levels of government is, however, limited and strictly controlled by the central state. As a matter of fact, the power to tax in France remains largely a monopoly of the National Parliament. In a 2009 ruling from the Constitutional Council one can read that: “It does not follow from article 72-2 of the constitution, nor from any constitutional work that local authorities (collectivités territoriales) are granted fiscal autonomy.”[6]

One must also keep in mind that a balanced budget rule is imposed to sub-national levels of government forbidding them to borrow except if for investment purposes. It also required keeping a “critical level” of own-source revenues.

Table 4 gives a precise picture of tax revenues for the various levels of sub-national government in 2012. The following remarks can be made:

1. Often various levels of governments tax the same base. Hence the proceeds from property taxes are shared between municipalities, ECPI and regions while proceeds from local business taxes are distributed across all levels of local governments. This is usually considered to be a source of inefficiency if only for the lack of transparency that it entails.
2. Direct taxes represent close to 60% of tax revenues for sub-national levels of government. This makes local taxes a very sensible issue, especially when the rates increase rapidly as has been the case throughout the past decade.

5 The *millefeuille* is a cake made of many layers of puff pastry alternating with layers of cream. It is also known in some countries as the Napoleon…
6Conseil constitutionnel, Déc. N°2009-599 DC du 20 Décembre 2009.

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Table 4: Local governments' tax revenues in 2012 (Billion euros)

	Municipalities (includes EPCI)	Departments	Regions	Total
Direct contribution	48.11	19.18	4.44	71.73
Revenues from the 3 "household taxes"	36.28	11.58		47.86
Council tax	19.53			19.53
Residential property tax	15.78	11.58		27.36
Non residential property tax	0.98			0.98
Revenues from taxes on business	11.82	7.60	4.44	23.86
Tax on Business Real-estate	6.66			6.66
Tax on Business added-value	4.02	7.36	3.80	15.18
Tax on network companies	0.49	0.24	0.64	1.37
Tax on large retailers	0.65			0.65
Other taxes	18.96	22.34	8.00	49.30
including				
Garbage collection	6.09			6.09
Tax on property transfer	2.22	7.97		10.19
Consumption tax on energy product		6.54	4.36	10.89
Contribution for public transportation	6.85			6.85
Tax on insurance contracts		6.63		6.63
Total	67.07	41.53	12.44	121.03

Source: DGFiP

Conclusion

Despite higher tax rates, the level of local deficits reached unprecedented levels in 2013 (€ 9.2 billions). Local authorities are particularly at an impasse since, as recalled at the beginning of this report, the central government must react to meet the requirements of the EU fiscal compact and will probably do so by reducing transfers to sub-national levels of government. In a way, the true crisis of public finances, at both central and local levels, could well be yet to come, and it could come soon.

To avoid or to mitigate that possibility surely requires a more serious examination of spending budgets since, as shown above, the actual fiscal burden is already quite high. Another road that could be explored would be the introduction of a major simplification of fiscal policy in the spirit of the flat tax revolution. Absent such radical changes, the situation could quickly become unbearable in view of (1) the endemic deficit of the social security system, (2) the thorny problem of pensions' funding (France relying almost entirely on a pas-as-you-go system), (3) the low level of growth and (4) the risk of an increase in borrowing rates for a country with a national debt about to reach 100% of GDP and on the rise.

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