Assessing flat tax reforms in a developed country: evidence from micro administrative data in Italy*

by

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Abstract (extended)

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 benefits in terms of simplicity, higher compliance and lower distortionary effects on growth and employment (Hall and Rabushka, 2013; Spreen, 2018). Despite its relevance in the public debate of different countries including Italy, the supporting evidence on the 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 suggested the lack of most of the desired effects of flat tax regimes (Gorodnichenko *et al.*, 2009; Barrios *et al.*, 2020). There are only few recent studies on developed countries such as Italy that, however, employ simulation analyses and macro models (Albarea *et al.*, 2021; Socci *et al*. 2021).

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We use a large administrative dataset of a cohort of Italian taxpayers followed for nine years to assess the incentive, revenue and distributive effects of the introduction of a flat tax type reform for rental incomes with respect to the former progressive system. Incentives and tax compliance effects are often ignored in public debate and there is limited to analysis of changes in tax burden and redistributive effects. The adoption of flat taxes is presented as a way of enhancing the efficiency of the tax system and encouraging tax compliance, in particular in contexts where tax evasion is large and public policies are implemented to reduce under-reporting. Given the unexpected implementation of a flat tax type reform for rental income and the nature of administrative data, we were able to model the likelihood of reporting personal incomes coming from rents which were previously hidden in tax forms. Under the assumption that dwelling stock is not hidden but instead it is the use of the property that can be mis-declared to the tax authority, we found a negligible increase, around 3%, at the extensive margin on the probability of renting a property. When hypothesising partial tax evasion, taxpayers might however decide to declare higher rental income than previously after flat tax introduction, and also in this case we found small results at the intensive margin of taxable income. In addition, we found that willingness to rent decrease as income increase as a consequence of higher advantages coming from reduced taxation, suggesting that for wealthiest people, both at the extensive and intensive margin, income effects offset substitution effect. Moreover, we were able to estimate an increase in income inequality and an overall reduction in aggregate taxable income after policy implementation.

Keywords: Flat tax, administrative data, tax evasion, inequality.
JEL classification: D12, H24, H25.

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