REFEREE REPORT: TAX DESIGN, INFORMATION, AND ELASTICITIES: EVIDENCE FROM THE FRENCH WEALTH TAX

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1. Summary and contributions

The paper attempts on showing how changes in information reporting requirements in wealth tax law in France affected taxpayers' behavior and reported wealth growth. In the first section the authors show the tax construction. The wealth tax in France (ISF) was applied to the very richest of the society, above around 97th percentile. The tax was progressive and included offshore wealth. The wealth was self-reported but with strict guidelines to follow from the administration - specifying categories of assets to report, their features and proofs of their value. The reform studied in the paper introduced a simplifying threshold, making taxpayers below it report only total taxable wealth, and specific tax credits. What is more, the threshold changed 2 years after introducing the reform with no other policy change taking place around that wealth level in the studied period. That set an environment for studying bunching around the exemption level and its dynamics.

The authors provide charts to show that although there is no missing mass in distribution just above the wealth tax kinks, there is one right above the exemption threshold. Authors further analyse the shift of missing mass when the threshold is increased - the distortion, although not present before, appears right after the change of the threshold. This introduces a reader to the methodology of bunching used later in the paper.

Further, authors move to graphical evidence of simplification threshold showing that although before the reform the distribution of taxpayers around it was smooth, an excess mass appears when the threshold goes into place. When the threshold is decreased, this distribution smooths again while the excess mass is increasing at the new threshold. What is more, the taxpayers quickly adjust to the new threshold and the bunching persists and grows over time.

Then, it is shown that given the new simplification thresholds, the average wealth growth rates below them decrease so that the taxpayers can fill simplified reports for a longer time. This change is overly visible right below the threshold, the rates above the threshold are close to constant.

Following, the authors present the methodology of Dynamic Bunching Approach using the dynamic method to account for a normal growth rate of the

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wealth that occurs every year. However, the authors highlight that these rates cannot be simply normalized as there is strong heterogeneity in growth rates distributions of households below the threshold after the reform.

They proceed with the Dynamic Bunching Approach by selecting a control group (taxpayers far enough from the threshold so that they are not affected by it) and a treated group (taxpayers just below the threshold), creating a placebo threshold for the control group and comparing the differences in distributions. They provide a formula for identifying the share of bunchers (taxpayers who respond to the reform by lowering their wealth growth rates), bunching rate, growth rate reduction in the treated group and specifically among bunchers.

Finally, the results are presented. There are 4 most important results:

(1) Reducing the amount of information that companies and individuals are required to report has significantly distorted how fast wealth has grown for a wide range of people, not just those who are just below the threshold.
(2) Groups further away from the threshold have smaller average responses to it.
(3) Responses of different groups to the threshold are driven by a small subset of taxpayers. Share of bunchers is the highest in the group just below the threshold at 14.7% of taxpayers and decrease in the groups further below the threshold.
(4) For the groups formed a year before the simplification threshold decrease, there was a significantly lower proportion of people who bunched their wealth just above the wealth threshold (3.9%) than those who bunched their wealth just below the threshold (14.7%).

Then, the authors argue that the response to the simplification for the taxpayers just below the threshold grows over time. Moreover, there is a persistent change in the reported lower growth rate for taxpayers below the threshold.

Following, the authors perform a robustness check on the primarily introduced simplification threshold showing the estimates are robust. Then, they perform a classic difference-in-differences strategy simply tracking previously created control and treated groups. The results show significant and persistent reductions in growth rates of the taxpayers just below the threshold. On the contrary to the dynamic bunching, estimates for other groups appear statistically insignificant. The authors don't detect any differences between the treated and control groups in terms of asset composition by plotting the composition of assets of the two groups before the introduction of the first reform, using bins for normalized growth rates from a year of the second reform. Additionally, they explain that the lower growth rates reported are not a result of real effects, as they match the income data and show that there is no corresponding change in the capital or labor income of the treated group, compared to the control group. For the reason why one would cross the simplification threshold, the authors argue that there had to be an inevitable positive shock which made it unable to report a small or negative growth rate.

Summing up, it is explained that the main reason of a will to stay in the simplification regime might be the ease of misreporting, as two other channels - privacy and lower costs of reporting - are proven irrelevant as per already available

banking data to the authorities as well as auditing expenses already covered by the wealthiest. What is more, the simplification reform did not incentivize more taxpayers to enter the wealth tax reporting scheme.

2. Major comments

The paper surely provides strong and evident arguments of bunching of taxpayers in the simplification threshold. The phenomena presented is clear after the section of graphs comparing pre- and after-reform behavior. Nevertheless, the greatest contribution of this paper is quantifying the behavioral responses of taxpayers.

First, motivation behind using the dynamic bunching approach is clear. It provides more information and allows to identify the share of bunchers and their wealth growth rates comparing to simple difference-indifference approach. Moreover, as of focusing only on the bunching range, it provides same estimates as difference-indifference but with less noise.

Nevertheless, defining the control and treatment groups lacks explanation. While the authors use the bins of 70K euros, they do not provide any quantitative explanation on the optimality of these bins. This arbitral choice could strongly impact the results of the analysis. A procedure behind the trade-off between the noise and bin size would be useful.

Later, the authors clearly explain and prove that the control and treated groups have the same distribution of normalized growth rates before the reform.

Identification of the Local Average Treatment Effect relies on 3 assumptions:

(1) Exclusion : the reform affects only the reported growth rate
(2) Independence: distribution of growth rates is identical across all the different groups before the reform
(3) Monotonicity: there is no reason for the taxpayer to report a higher growth rate, i.e. the bunching is done only one way

All these assumptions are proven in the Appendix F, only the independence left proven graphically.

The results are presented in a clear manner, first showing the result itself, followed by a short elaboration on interpretation and reasoning. Again, the dynamic bunching approach is powerful in this case, where the bunchers drive the results. Identyfying them allows us to conclude also on other groups decreasing their growth rates, as the standard errors of the estimates are significantly lower. Moreover, the dynamic analysis highlights the increase in average growth reduction and in share of bunchers over time, which complies with the authors' reasoning of the taxpayers adjusting to the reform.

However, the authors argue that the reason behind the missing mass at small positive normalized growth rates for the group Just above can be justified by reluctance of reporting negative growth rates (even if they are true) not to raise suspicions when falling below the threshold. This is less obvious than the authors try to make it, there is no formal proof of this reasoning, and one may argue that the cost of misreporting is always positive, no matter if the growth rate is positive or negative.

Persistence over reporting lower growth rates is presented with clarity, providing shares of treatment and control groups surpassing the threshold (and the placebo threshold). What is more, there is a substantial reason behind why one would surpass the threshold in the treatment group, which is a positive shock to their wealth, making the growth too difficult to misreport, therefore the pass inevitable.

First robustness check is done on the reform before (simplification to 3M), and constitutes a great check one could do, as the analysis is analogous. It shows its consistency with the dynamic responses by cohorts around the threshold. The information discontinuity disappearing after the second reform also proves the point of the authors. Still, there is only graphical evidence on the analogous situation of misreporting - there is no statement on why the fixed estimates are omitted. Second robustness check is comparing the standard difference-indifference approach which results in the authors' prediction, that is similar estimates but with higher noise, as they correspond to the whole group, not only the compliers. Authors also support their reasoning by matching the income data which shows no real effects drove the change in reported wealth growth rates.

The authors wrote a short paragraph on absence of missing mass at tax kinks. Following the main point of the paper, taxpayers may benefit of staying under the simplification threshold by a possibility of misreporting. However, at 1.3M euros there is a new tax bracket increasing tax from 0.5% to 0.7%. Surprisingly, the taxpayers do not use this possibility to bunch around tax kinks after the reform, below the simplification threshold. Given different marginal tax rates at different wealth levels under the simplification threshold, there is no reasoning behind why the taxpayers would not use this opportunity to lower their reported growth rates and locate below the bracket. The authors refer to the study of Denmark [Jakobsen et al., 2020], in which there are strong third-party reporting rules regarding most assets. If the main reason of bunching around the simplification threshold is a possibility of misreporting, this possibility should be exploited in the tax brackets below the simplification threshold. There is no justification on why this bunching is not present in the data. This is a major issue and threatens the credibility of the main reasoning of the paper.

3. Minor comments

The authors compare the structure of the assets, also done in [Seim, 2017], where rebalancing the portfolio of wealth is a method of paying lower taxes. However, the authors show no difference between asset structure of taxpayers reporting different growth rates, providing a strong argument on misreporting being the main reason behind the lower growth rates in the treated group.

The paper focuses strongly on identification and proving the evasion. However, some of the studies in the field provide the financial consequences of misreporting [Johannesen et al., 2018][Jakurti and Süssmuth, 2023][Brülhart et al., 2021] either in absolute or taxable wealth reduction rates. An interesting follow-up on this study would be to quantify the financial consequences of the introduction of the threshold.

There is a lack of tests performed in the paper. For instance, the authors do not test equality of descriptive statistics of the control and treatment group, but they state their similarity. Often, they do not provide analytical evidence, using only graphical ones, which could be misleading. However, this is often explainable by the unobservability of the characteristics of the treated group.

4. Recommendation

This study provides a great contribution to the field. The innovative method of dynamic bunching is perfectly justifiable, with the robust results strictly indicating the consequences of the reform. With minor corrections, the study is ready to be published. Please

- Justify the absence of missing mass around the tax bracket in the group below the simplification threshold.
- Provide the noise analysis when choosing the bins for the treatment and control groups.
- Elaborate on the reasoning behind the missing mass in the Just above group, as the currently given statement is strong but lacks explanation.

References

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