

THE OPTIMAL TAXATION OF CAPITAL INCOME: COMMENTS

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This presentation reflects only personal views and
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OPTIMAL TAXATION OF CAPITAL INCOME

- Should we tax capital income ?
 - *Obviously* Yes...
- Where do we stand ?
 - *Far away from optimal taxation*
- Reforms: is the RRA the right way to go ?

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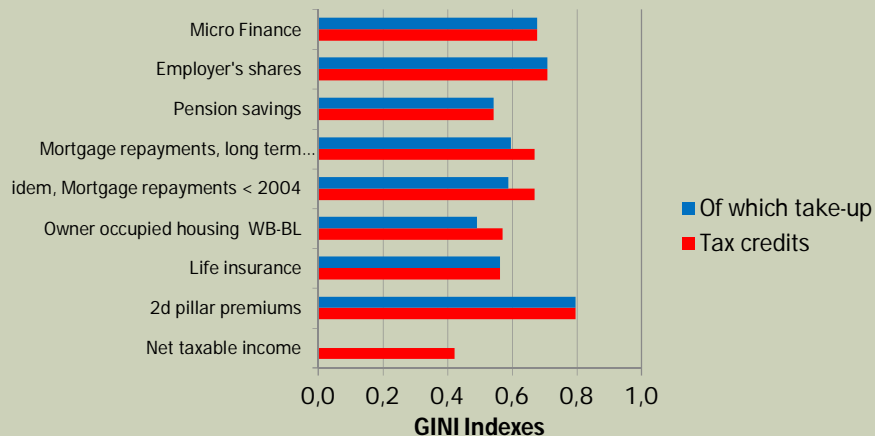
WHERE DO WE STAND ?

- Facts
 - Flat rate taxation of interests and dividends
 - Roughly no taxation of capital gains
 - Exemption of savings accounts
 - Mix of taxes on income and indirect taxes on acquisition and transactions
 - Tax credits for life insurance and pension savings
 - Higher taxation of rented housing , with a preferential treatment for the owner-occupied housing
- Times are changing
 - Increasing policy concerns about increasing inequality in income and wealth
 - From bank secrecy to automatic exchange of information
- Consequences
 - The mix of direct and indirect taxes makes the relation between income and ETR unclear
 - ETR vary across assets, what clearly violates the efficiency-equity tradeoffs
 - Adverse distributive effects of tax expenditures
 - The exemption of savings accounts does not benefit the saver

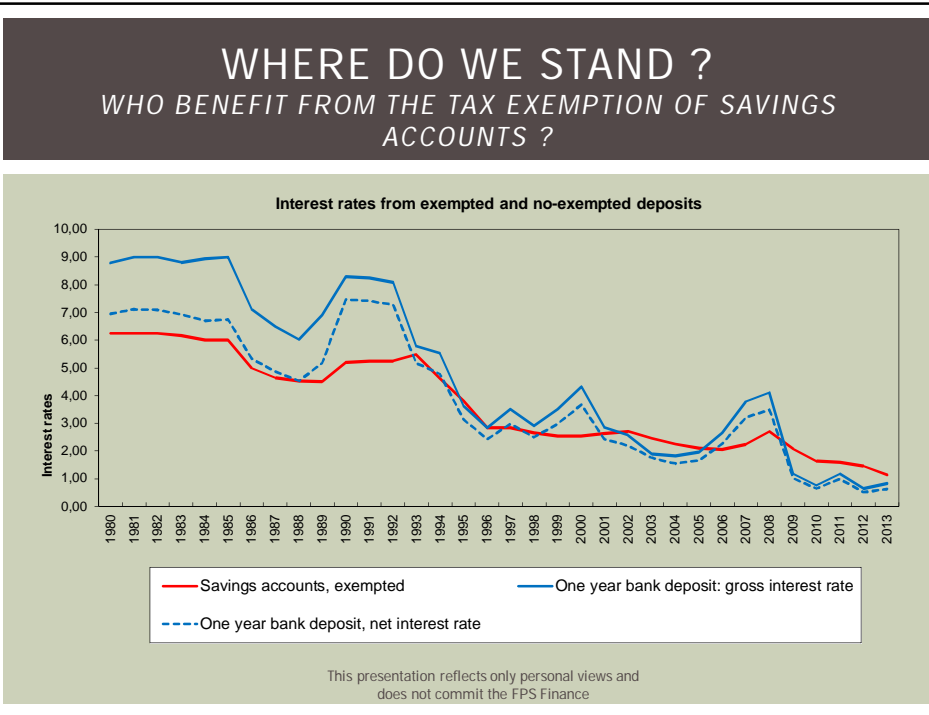
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WHERE DO WE STAND ?

WHO BENEFIT FROM THE PIT TAX EXPENDITURES ?



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WHERE DO WE STAND ? FACTORS EXPLAINING PENSION SAVINGS

	Pension saving		Life insurance
	Take-up	μ Premium	Take-up
C	-4.370	231.852	-3.875
Age	0.080	6.576	0.093
Age ²	-0.001	-0.031	-0.001
Married	0.084	330.520	0.151
Unemployed	-0.214	-40.122	-0.232
Self-employed	0.193	35.194	0.476
Dep_pers	-0.120	-19.934	-0.088
Pre-retirement	0.221	-43.136	0.436
Total Income	0.019	1.544	0.012
Home owner	0.667	24.110	1.005
Part 2nd Pillar	0.066	-0.018	0.012
Part life insurance	0.606	0.048	0.610
Flemish Region	0.611	60.010	0.110
Walloon Region	0.066	-10.023	-0.092

Coefficients in bold = Significant at 5% level
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IS THE RRA THE RIGHT WAY TO GO ?

Tax policy goals	Neutrality across the lifecycle	Neutrality across assets	Inflation adjustment	Vertical Equity
Comprehensive income tax	No	Yes, if taxation of capital gains	No	Yes
Dual income tax (Flat rate)	No	Yes, if taxation of capital gains	No	Less
Dual income tax (Fixed basic allowance+ Flat rate)	?	Yes, if taxation of capital gains	No	A bit more..
Rate of return allowance	Yes	Yes	Yes	Yes if progressive taxation
Expenditure taxation	Yes	Yes	Yes	?

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IS THE RRA THE RIGHT WAY TO GO ?

- The RRA has obvious merits
- But does the distortion over the lifecycle really matter ?
 - Inelasticity of savings
 - Distortions in ETR across assets matter more than the distortion over the lifecycle
- What about inherited wealth ?
 - No case for a RRA
- Remaining issues
 - Savings versus investment in human capital
 - How to design an efficient incentive for pension savings ?
- May be approximated by a zero-rate band ? Or by zero-rating low return assets ?
- At least, an option to be seriously investigated..

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