

## What impact does a freeze on the income tax scale have?

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*It would seem that the idea of total or partial freezing of the income tax scale, debated in recent weeks, has been (for the moment) abandoned by the government... With the help of the micro- simulation, we still propose here an evaluation of the budgetary savings that can be expected from such a measure as well as its redistributive impacts.*

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The freezing of the income tax scale<sup>1</sup> was recently mentioned as a potential avenue for reducing the deficit in a context of public finances that are more degraded than expected. Usually, the income tax scale is indexed to inflation or to changes in household income observed the previous year. This indexation aims to prevent the increase in income from leading to a more than proportional increase in taxpayers' taxes. In fact, in recent years, the income tax scale has most often been indexed not to the evolution of income but to that of prices. This indexation of income tax thresholds to inflation resulted in an increase in the apparent income tax rate in a context where it grew more quickly than prices.

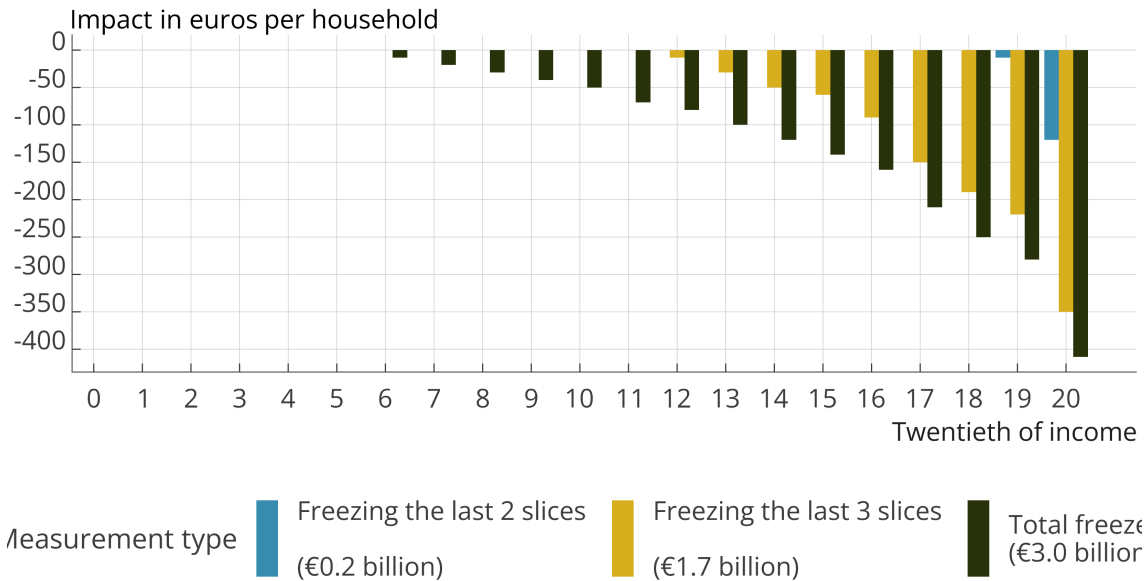
In 2024, we anticipate that income subject to income tax<sup>2</sup> should increase by 4.1% for a consumer price index increasing by 2.2%. Therefore, **indexing the income tax scale to inflation should result in an increase in tax revenue of around 2.6 billion euros**. Using the Ines micro-simulation model, developed jointly by Insee, Drees and Cnaf, and the latest version of which simulates the socio-fiscal legislation of 2022, we simulate different scenarios of freezing, total or partial, of the income tax scale.

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<sup>1</sup>Understood here as the stability of marginal tax rates and the non-indexation of entry thresholds in the different tax brackets.

<sup>2</sup>Since 2017, very dynamic financial income is no longer subject to income tax. They are mostly taxed under the single flat-rate levy (PFU). See: Madec P., "Attention: one PFU can hide another », *OFCE Blog*, September 2018

Figure 1: Comparison of the effects of possible reforms per twentieth of standard of living **en euros par ménage**



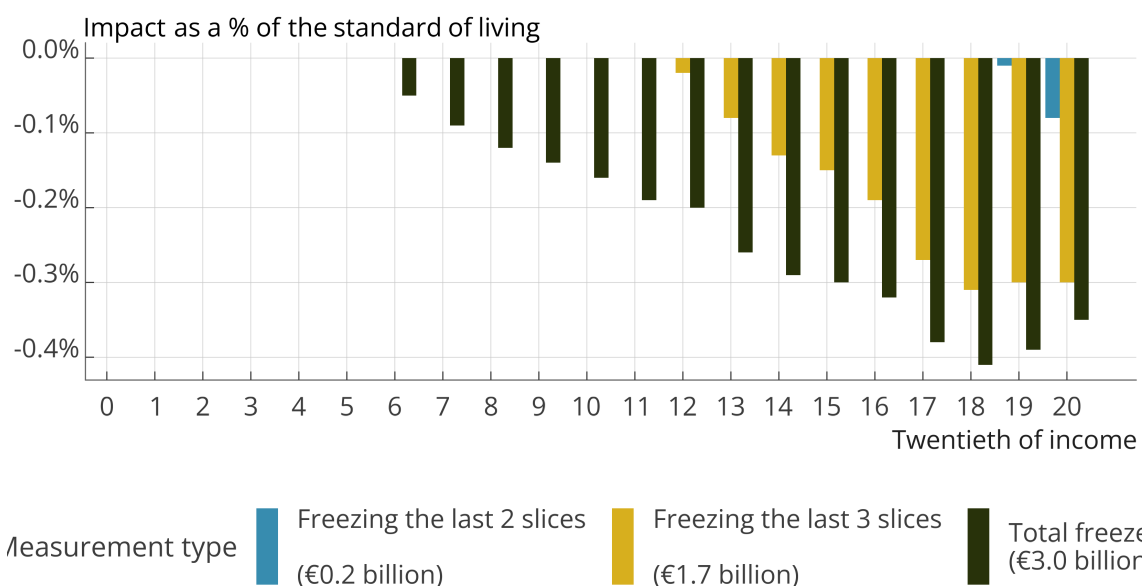
Fields: Metropolitan France, ordinary households, households with positive or zero income

Sources: Insee-DGFIP-Cnaf-Cnav-CCMSA, 2020 tax and social income surveys (updated 2021), Ines 2022 model, OFCE calculations.

Reading: In the event of a total freeze on the scale, the wealthiest 5% of households would lose 410 euros per year per household, or 0.35% of their standard of living.

This loss would be 350 euros in the event of only freezing of the last three installments of

**en % du niveau de vie**



Fields: Metropolitan France, ordinary households, households with positive or zero income

Sources: Insee-DGFIP-Cnaf-Cnav-CCMSA, 2020 tax and social income surveys (updated 2021), Ines 2022 model, OFCE calculations.

Reading: In the event of a total freeze on the scale, the wealthiest 5% of households would lose 350 euros per year per household, or 0.3% of their standard of living.

This loss would be 300 euros in the event of only freezing of the last three installments of

**The budgetary gains** to be expected from a total freeze of the income tax scale are **of the order of 3 billion**. In addition, **nearly 380,000 households would become liable for income tax** although they would be exempt if the scale was indexed to inflation<sup>3</sup>. These households are households belonging to the center of the distribution of living standards, that is to say households belonging neither to the poorest 30% nor to the wealthiest 20%. In the event of a freeze, **households close to the median standard of living would lose between 50 and 100 euros per year** compared to a “usual<sup>4</sup>” indexation situation, i.e. between 0.2% and 0.3 % of their annual standard of living.

These losses would exceed 250 euros for the wealthiest 15% of households (the bottom three twentieths) with a slightly regressive effect as a percentage of the standard of living at the end of distribution. In other words, within the richest households, the wealthiest would be relatively less affected than the others, due to the low progressivity of the tax in the highest brackets. In total, 17.6 million households would see their income tax increase compared to a situation of indexation to inflation.

We simulated a second measure which would consist of indexing the first bracket of income tax to inflation but not changing the last three brackets of the scale, that is to say those of the marginal rates at 30%, 41% and 45%. Under these assumptions, 7.3 million households would see their income tax increase. According to our estimates, this measure would “spare” households in the center of distribution and concentrate the effort on wealthier households. However, the budgetary gains would be smaller, reaching **around 1.7 billion euros**.

Finally, a final scenario was simulated: the sole freezing of the two upper brackets of the income tax scale. The measure would concentrate the effort on the 560,000 wealthiest tax households but the expected tax revenue would be very low, of the order of 200 million euros.

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<sup>3</sup>It should be noted that an equivalent order of magnitude of households become liable to income tax due to the indexation of the scale to inflation and not to changes in income.

<sup>4</sup>Like households newly taxed for income tax, the under-indexation of the brackets on inflation rather than on the evolution of income has the effect of increasing the tax paid by households.