

Do Entrepreneurship and Self-Employment Respond to Simpler Fiscal Incentives? Evidence from France.*

Philippe Aghion

(College de France, LSE, CEPR, and NBER)

Ufuk Akcigit

(University of Chicago, CEPR, and NBER)

Matthieu Lequien
(Banque de France)

Stefanie Stantcheva
(Harvard, CEPR, and NBER)

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Abstract

In this paper we use French income tax returns since 1994 to study the effects of fiscal incentives for self-employment and entrepreneurship. France is a good quasi-laboratory because of its unique variety of fiscal “regimes” for self-employment, which differ according to their financial incentives, their degrees of administrative simplicity, and the scope for misreporting income that they offer. Eligibility for the two simplified fiscal regimes, which have a low administrative burden, requires business revenues to remain below a given threshold. We show that a reform that expanded eligibility for a simplified regime led to an immediate switch of agents from other regimes, but no overall growth in self-employment. On the other hand, a reform which created a regime with more administrative simplicity led progressively to new entry by smaller than average businesses. The eligibility thresholds create a special type of “notches” around which we observe significant bunching. The thresholds have moved a lot over time, and the bunching mass has moved with them, although progressively so, and faster when the threshold change was larger. We use the measured empirical bunching to estimate the value of administrative simplicity, a real income elasticity, and a misreporting elasticity. To do so, we exploit the many variations in policy parameters over time and their heterogeneous impacts on agents in different tax brackets and activity types. We find that there is a significant misreporting elasticity and a value for simplicity, without which the observed bunching is hard to rationalize.

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*Aghion: College de France, London School of Economics and CEPR (e-mail: p.aghion@lse.ac.uk). Akcigit: University of Chicago, NBER, and CEPR (e-mail: uakcigit@uchicago.edu); Lequien: Banque de France (email: Matthieu.LEQUIEN@banque-france.fr), Stantcheva: Harvard University, NBER, and CEPR (e-mail: sstantcheva@fas.harvard.edu). Stantcheva’s work is supported by the National Science Foundation under Grant CAREER No.1654517. Aghion acknowledges support from an Idex grant from Paris-Sciences-et-Lettres (PSL) and by a public grant overseen by the French National Research Agency (ANR) as part of the “Investissements d’Avenir” program (reference: ANR-10-EQPX-17 - Centre d’accès sécurisé aux données- CASD). We thank Simon Bunel, Francois-Xavier Ladant, and Cyril Verluise for outstanding research assistance.

1 Introduction

Many policies and fiscal incentives target self-employed entrepreneurs in an attempt to improve productivity. New developments in the labor market have put self-employment at the forefront of the policy debate again. The development of platforms such as Uber or Air BnB, and services such as Task Rabbit or Handy challenge traditional divides between employment and self-employment. In recent work, [Katz and Krueger \(2016\)](#) cast light on the rise of alternative work arrangements, the fragmentation of the labor market, and their important implications for inequality. In Europe, these developments have been intentionally slowed down by stricter labor regulations, at the same time as many policies to stimulate self-employment and entrepreneurship have been implemented.

Key questions for these policies are, first, what and how strong effects they have on entry into self-employment and on self-employed incomes. Second, are the effects mostly due to real economic reactions, or rather to changes in the reporting of income? Indeed, the self-employed may be a set of agents that is especially able to misreport their incomes. Do financial incentives matter most or are simpler administrative requirements key?

In this paper, we try to answer these questions, making use of individual tax returns data from the French internal revenue service over the period 1994-2012. France is a particularly well-suited quasi laboratory to study self-employment because it has a very unique variety of fiscal “regimes” or modes of taxation of self-employment, which differ according to not only the financial incentives they provide, but also, importantly, according to their degrees of administrative simplicity¹ and the scope for misreporting income that they offer.² These fiscal regimes have changed a lot over time and impact different agents differently, providing valuable policy variation to study their impact on self employment.

In Section 2, we start by describing the landscape of self-employment policies in France. There are three regimes under which a self-employed may choose to operate, which differ along the aforementioned dimensions. To summarize very briefly, the standard regime treats an individuals’ net business income (revenues minus costs) as taxable income and comes with the most involved accounting requirements, which limit the scope for misreporting and also increase administrative complexity.³ The simplified regime, as its name indicates, simplifies administrative requirements, and uses as a taxable income measure the gross revenues times a rebate that depends on the type of activity.⁴ The super simplified regime further simplifies the administrative requirements by replacing the social security contributions and income taxes by a unique payment proportional to the individual’s gross revenue. Both the simplified and super simplified regimes require that revenues remain below a certain eligibility threshold

¹In fact, fostering simplicity was one of the key political motivations for the reforms we will describe.

²More precisely, these differences lie in the taxable income base, their tax rate, administrative and registration requirements, social security contributions and VAT payments.

³In the data, agents in the standard regime are mostly members of so-called Certified Accounting Centers (CACs) which ensure sound fiscal conduct and limit misreporting.

⁴Activity types for tax purposes are Industrial and Commercial Services, Industrial and Commercial Retail, or Non Commercial.

that varies with the type of activity. Thus, broadly speaking, the simplified and super simplified regimes are well suited to agents with small and slow-growing activities, with relatively low production costs and investments (since the latter cannot be deducted), and who care a lot about administrative simplicity.

In Section 3 we provide key summary statistics on the self-employed for the period 1994-2012, based on the tax returns data. The self-employed are on average much older, more likely to be retired, and have more capital income. Women are much more represented in the Non Commercial activities. The fraction of agents with self-employed income has remained stable at around 5% of all tax filers aged 18-65 and the fraction of those who earn only self employed income has remained at around 4% for most of the period. Both shares have experienced a sharp rise since 2009, especially the share of those combining self employed income with additional income.

We then provide event studies of two key reforms to fiscal incentives. The 1999 reform multiplied the eligibility threshold for the Simplified Regime by five for Retail activities and by almost two for Services and Non Commercial activities. This reform thus expanded the financial incentives to a larger group of people, but did not modify the simplicity of the system. The reform led to entry into the simplified regime and a growth in the average size of businesses in that regime. These effects of the reform were immediate: the incentives were sufficiently large to cause a sharp and fast response, which almost entirely took place in the very first year. There was, however, no effect on overall self-employment, as agents simply switched from other regimes. The 2008 reform created the super simplified regime, thus further increasing administrative simplicity and decreasing the costs of entry into self-employment. It led to new entry by smaller than average businesses, who selected into the newly created regime, and thus to an overall increase in self-employment. The effects were progressive, presumably because agents needed time to adjust to or learn about the new regime.

In Section 4, we build a simple model of self-employed behavior, where the various regimes differ – as is the case in the data – in their financial payoffs, hassle costs (i.e., the costs imposed by a lack of administrative simplicity), and the opportunities they offer for misreporting income. In the model, the simplified and super simplified regimes are thus less costly in terms of administrative requirements and allow agents to misreport their income. We show that the choice of regime agents make is roughly in line with what the model’s optimization predicts, given their income, tax bracket, and activity type (which determines the generosity of the simplified and super simplified regimes).

The eligibility thresholds create a special type of discontinuity, so-called tax “notches.” These are studied in a rich empirical literature on the effects of taxation on taxable income using the “bunching” methods, as surveyed in Kleven (2016). Key papers are Saez (2010), Chetty et al. (2011), and Kleven and Waseem (2013). Our setting is well-suited to such a bunching analysis given the strong discontinuities created by the eligibility thresholds and their many movements over time, which eases the identification. Our analysis differs from standard bunching analyses in two key ways: at the threshold, there is not only the average tax rate that changes, but also the administrative simplicity and the ability to misreport income. Second, at the threshold, there is a lot of heterogeneity across agents in terms of their tax brackets (and, hence, the effective payoff from bunching) thanks to the peculiarities

of the French tax system and in their benefit from remaining in the simplified regimes because of different activity types (and the different rebates they entail).

We show that there are discontinuous jumps around the eligibility thresholds in the proportion of agents who are in the simplified and super simplified regimes. Most importantly, in the income distribution of self employed income, there are large and significant excess masses right before the thresholds of eligibility. The thresholds have changed a lot over time and the excess mass follows the thresholds' movement, fostering confidence in the fact that the excess mass is indeed caused by the latter. Agents in higher tax brackets, who have more to gain from optimizing their self-employed regime, exhibit stronger bunching behavior.

We study the dynamic adjustment to the changes in thresholds over time and find that, first, when the threshold changes by a little, there is a smaller bunching at the new threshold, which grows over time, and also a remaining bunching at the old, no longer applicable threshold. When the threshold remains stable over time, there is a progressive increase in bunching. Large changes in the threshold lead to immediate large bunching at the new notch, which keeps growing over time. These findings are consistent with either a model where salience and rational inattention play a role, so that agents do not learn about small changes, but do learn about large changes, or with a model in which there is a fixed cost of adjusting one's activity, which is only worth incurring if the policy change is large enough. In any case, there can be both real and avoidance responses, although the large number of agents who report income exactly at the kink is striking and casts some doubt on the real response hypothesis.

In Section 5, we use the measured empirical bunching magnitudes to estimate the value of administrative simplicity and two elasticities: an elasticity of real income responses and a misreporting elasticity. A key advantage for this estimation is that there is a lot of variation in the policy parameters over time and a lot of heterogeneity across agents in terms of their tax brackets, activity types, and self-employed income that allows for many informative data moments.⁵ We find that there is a significant misreporting elasticity and a value for simplicity, without which it is difficult to rationalize the observed bunching at the threshold.

Our paper is related to several studies on the effects of taxation on entrepreneurship and self-employment. Cullen and Gordon (2007) use U.S. tax returns data and show that different components of the tax system, such as the progressivity and the marginal tax rates, have had distinct and significant impacts on entrepreneurial risk-taking (see also Cullen and Gordon (2006)). Gentry and Hubbard (2000) find that a progressive tax system discourages entry into entrepreneurship. Bruce (2000) finds using the Panel Study of Income Dynamics that reducing marginal tax rates on self-employed income reduces the probability of entry into self-employment, while reducing the average tax rate slightly increases entry. We do not study the effects of general income taxation, but specific fiscal incentives for the self-employed, which modify both the financial returns to and the simplicity of self-employment.⁶

⁵Our strategy is thus related to other papers who use empirical bunching magnitudes to estimate a structural model, such as Einav et al. (2017).

⁶In fact, new entry into self-employment seems to have occurred only when the system was hugely simplified as through the 2008 reform.

More generally, our work is also related to papers on the determinants of entrepreneurship (see, among others, Hamilton (2000), Schoar (2010), Adelino, Schoar and Severino (2015), and Schmalz, Sraer, and Thesmar (2016)), and we focus specifically on the role of fiscal incentives, taxation, and administrative simplicity.

A recent series of papers uses the bunching methodology to study a range of different topics such as intertemporal allocation in response to mortgage contracts changes (Best et al., 2015), transaction taxes in housing markets (Best and Kleven, 2016), corporate taxation (Best et al., 2015), responses to the EITC (Chetty et al., 2013), and the social security earnings test (Gelber et al., 2014). The novel French tax data is also used in two important contemporaneous papers that study income distributions and wealth distributions in France by Garbinti et al. (2017) and Garbinti et al. (2016). Our focus is complementary by studying self-employed individuals.

2 The Landscape of Self-Employment in France 1994-2012

In this Section, we describe the landscape of self-employment in France over the period 1994 to 2012, by providing details on the institutional background in France, the different fiscal incentives in place, and their evolution over time.

2.1 A Primer on the French Personal Income Tax System

We start with a brief note on the French tax system with regards to the features that will be relevant for the self-employed. Taxable income of a household is the sum of all the sources of income minus deductions (itemized and standard) and the taxable income from self-employed activities. Each household has a scaling factor called the number of parts, which is determined by the household composition. For a single adult, that scaling factor is one, for a married couple, it is 2. Each child adds 0.5, up to the third child which adds 1. In addition, a disabled child adds 0.5. For example, a married couple with a child has a number of parts equals to 2.5. A married couple with 3 children has a number of parts equals to 4, and a married couple with one disabled child has a number of parts equals to 3.

The tax bracket is determined by the family coefficient, defined as taxable income divided by the number of parts. Once this tax rate is determined, the household owes the tax rate times the full taxable income.⁷ Appendix A.1 provides the formal details of how tax brackets are determined..

An important feature of the tax system it thus that there is not a unique map from income to tax bracket, which means that at a given taxable income, there are several possible tax brackets based on family structure. In fact, at a given taxable income, there can be a wide range of tax brackets represented, which will be helpful in our analysis and for the estimation.

The national income tax schedule is shown for illustration for the years 1994, 2006, and 2012 in Figure 1. The tax schedule changes almost every year as part of the yearly budget voted by the French

⁷There is a complication due to the fact that the number of parts cannot grant the household more tax reduction in absolute terms than a threshold, but it can be ignored for our purposes.

TABLE 1: Summary of the self-employed regimes

Regime	(1) Standard	(2) Simplified	(3) Super simplified
Taxable base	Net business income	Gross revenues $\times$ (1- rebate)	Gross revenues
Tax rate	Income tax rate	Income tax rate	Flat rate
Registration	Standard	Standard	Simplified
Accounting requirements	Detailed	Only for audit	Only for audit
SS contributions	Standard	Standard rate	Flat rate
Subject to VAT	Yes	but levied on taxable base No	levied on gross revenues No
Timing of payments	Annual	Annual	Monthly or quarterly

Notes: The eligibility thresholds for each of these regimes are (as of 2012): 32,600 euros for the Services and Non Commercial and 81,500 euros for the Retail activities. Certain types of activities are excluded from the simplified regime (those are most notably agricultural activities, leasing of durables and equipment, leasing of professional or non furnished buildings, and real estate businesses) and from the super simplified regime (those are, in addition to the aforementioned ones, liberal professions such as lawyers, doctors, insurance agents, or accounting experts, and formally registered artists rewarded through copyright). Revenues cannot be negative and thus, no deficit can be claimed in the simplified and super simplified regimes. In the super simplified regime, the flat rate is due even if the agent is in the zero personal income tax bracket. However, if gross revenues are zero, no payments are made (either for the income tax or for the social security contributions). In the simplified regime, if gross revenues are zero, no payments are made for the income tax, but a minimal payment is still due for social security contributions.

Parliament.⁸

2.2 Self-employed Regimes and Fiscal Incentives in France

2.2.1 Three main regimes:

An individual who owns a business and is self-employed can select to remain in the personal income tax code or to be subject to the corporate tax code. The latter is the only choice available to large businesses, but typically not used for personal, self-employed activities which are the focus of this paper.

As of 2012, the self employed individuals in France who wanted to remain in the realm of personal income taxation could be in one of three regimes. These regimes can be characterized along seven dimensions summarized in Table 1: i) the taxable income base, ii) the tax rate, iii) the registration and startup requirements, iv) the accounting and reporting requirements, v) the mode of social security contributions, vi) the mode of VAT payments, and vii) the timing of payments. In all regimes, the requirements for professional qualifications and the quality and safety standards of each activity are identical.

⁸Called the *Projet de loi de Finance*.

(1) *The standard regime*:⁹

All self-employed are eligible for the standard regime. The taxable base is the business' net income, i.e., the difference between gross revenues and costs, including depreciation of assets and investments according to standard accounting rules. This taxable income is simply added to an entrepreneur's household income and taxed at the entrepreneur's income tax rate (which, naturally, depends on his tax bracket). The registration procedure for starting an activity is standard. Tax payments occur at the normal tax filing date and social security payments happen separately through the regular social security procedure. Activities are subject to the VAT and can charge VAT on their products sold and claim VAT on their inputs. In addition, self-employed in this regime can benefit from tax credits, such as those for R&D spending.¹⁰ and some government help in special zones, none of which is available when filing under one of the simplified regimes.¹¹ Finally, businesses in this regime can join a certified accounting center (hereafter, CAC), which helps them keep and check their accounts and serves as a guarant of sound fiscal conduct to the tax authority. Joining such a center confers benefits, most notable escaping the 25% augmentation of the taxable income base¹² that faces business that do not join.¹³ We discuss these CAC in detail below. The key advantage of this regime is thus that it allows the individual to subtract its input and running costs from its taxable income. The main cost is that it entails more stringent administrative, accounting, and reporting requirements.

(2) *The simplified regime*:¹⁴

To qualify for the simplified regime, an entrepreneur's income must be below a pre-specified threshold, which varies with the type of activity and has changed a lot over time; the solid lines in Figure 2 show the evolution over time of the thresholds respectively for the Industrial and Commercial activities, the Industrial and Commercial Retail activities, the Industrial and Commercial Services, and for non commercial activities. These thresholds are not very high for the Services and Non commercial activities (equal to 32,600 euros in 2012), but much higher for the Retail activities (81,500 euros). Taxable income is calculated as revenues times a scaling factor $1 - \mu$, where the rebate μ is determined by the tax administration, which depends on the activity type and has changed over time. The dotted lines in Figure 2 show the evolution over time of the rebate rates for the different types of activities. This taxable income is added to the rest of an agent's income and taxed at his regular income tax rate. Social security contributions are also determined on this same income base (revenues times $1 - \mu$), at

⁹ "Régime Réel."

¹⁰ E.g., Crédit d'impôt recherche or the crédit d'impôt compétitivité et emploi.

¹¹ Zones géographiques prioritaires ZRR, AFR, BER, QPV.

¹² I.e., those businesses pay a tax on 125% of their normal taxable income.

¹³ "Centre de Gestion Agrégé"

¹⁴ We lump together under this heading two regimes, which are indistinguishable in the tax data: the (1) *Régime Micro-entreprise* and the (2) *Régime Auto-Entrepreneur sans Option Libératoire*, i.e., the super simplified regime below without the flat rate option. Those two regimes differ in their social security contributions: in (1), a minimal amount of social contributions is due even there are zero revenues, in (2) a flat rate applies to all revenues (rather than revenues minus rebate), but on average the effective rate on revenue is similar. There are also minor differences in the registration and start-up modalities, which streamlined further in the super simplified regime. These two regimes are entirely identical for tax purposes and hence impossible to differentiate in the tax returns. We will henceforth ignore this distinction.

the regular social security rates. If revenues are zero, no income tax is owed, but a minimal social security contribution is nevertheless due. Registration and start-up requirements, the timing of tax and social security payments are similar as for the standard regime.

There is no application of the VAT for this regime: thus entrepreneurs in the simplified regimes can neither charge VAT to their customers, nor claim VAT on their inputs. Thus the main advantage of this regime is the rebate on the taxable income, which may, for some self employed, be more generous than their actual costs. In addition, all procedures are simplified. It does, however, impose revenue threshold restrictions, which are not well-suited to larger scale activities. One thing to note is that, despite the fact that taxable income is determined as a fraction of revenues, self-employed in this regime are nevertheless required to keep accounts for their activity with receipts from purchases and sales linked to the activity in case there is an audit.

(3) The super simplified or “Flat rate” regime:¹⁵ The super simplified regime has similar rules to the simplified regime, but increases administrative simplicity even further. The taxable income base is total gross revenues (i.e., the rebate μ is zero) and the tax rate is a flat rate that, once paid, frees the agents from both income tax and the social security contributions due. The flat rate differs by activity and has also changed over time. Income tax and social security payments are due monthly or quarterly, based on actual realized revenues (cash in hand), and are all taken care of at the same time, thus minimizing filing and administrative hassle (however, potentially deterring agents with credit constraints). The flat rate paid is completely unrelated to an agent’s actual income tax bracket or tax rate.¹⁶ Thus, even a household which is in the zero income tax bracket still owes the flat rate times revenue payment in this regime. An agent owes no income tax or social security payments if his revenues are zero, but can also not claim any deficits he may have. Registration and start-up modalities are further simplified. To be eligible for this regime, the same threshold requirements on revenues as for the simplified regime apply, but, in addition, the family coefficient in fiscal year $t - 2$, has to be below the upper bound of the third tax bracket in year $t - 2$.¹⁷ For instance, that upper bound was 26,420 euros for year 2010, so that for households to be eligible for the super simplified regime in 2012, their family coefficient in 2010 had to be lower than 26,420 euros.

Thresholds, eligibility, and grace period:

In the simplified and super simplified regimes, if the agent’s revenues end up being higher than the threshold, there is a two-year grace period, as long as the revenues are still below a “tolerance threshold” (which is, e.g., 6.1% higher than the actual threshold in 2012 for the Services and Non Commercial Activities and 9.9% higher for the Retail Activities).¹⁸ If the threshold is crossed for more

¹⁵*Régime Auto-Entrepreneur avec Option Libératoire*

¹⁶A subtlety to note is that, to determine the overall tax bracket of the household, it is the revenues times $1 - \mu$ where μ is the same rebate as in the simplified regime above that is added to the rest of a household’s income. It is not the full amount of revenues that is added, which would make the super simplified regime very unattractive.

¹⁷Recall that the family coefficient is, as explained above is equal to taxable income divided by the number of household parts.

¹⁸This grace period and tolerance threshold do not apply in the first year after the business’ creation.

than two years or if the tolerance threshold is crossed, the special regime status is lost, and the agent has to file under the standard regime.

Choosing a regime for each fiscal year:

There are some key considerations when it comes to deciding which regime to be in.

First, agents have to decide by the month of February of fiscal year t which regime they want to be affiliated with for their income during fiscal year t . This means that agents make this choice based on their expected – rather than actual – revenues, costs, and business growth. This may also potentially increase the incentives to misreport income ex post if it turns out that revenues were higher than expected.

Based on these differences, we can imagine that, broadly speaking, agents who should chose the standard regime are those with high business running costs, with larger investments (since no investment can be deducted or depreciated in the other regimes), who want to hire employees, whose activity is expected to grow rapidly during the year, who may expect the need to claim a deficit, and who do not find the extra administrative requirements particularly costly. Conditional on having a given cost, investment, and overall business structure, it is agents in higher tax brackets who would face the strongest incentives to optimize their regime.

It is also worth mentioning that inertia and “default options” could be playing a more behavioral role in the regime choice. As is clear from our description, the regime rules are somewhat intricate, and the thresholds and rates have changed extensively over time, which implies potentially high attention and learning costs from switching regimes. Agents may thus prefer – once the fixed cost of understanding a regime having been incurred – to stay put as long as their financial loss from not switching is small enough. In addition, as regards the super simplified regime, this is an option that agents have to actively pursue when they register their business for the first time, or each fiscal year – it is a box that has to be actively checked on the form. The default is to remain in the simplified regime.

2.2.2 Activity types:

For tax purposes, the self-employed are classified into three types of activities: (i) the “Industrial and Commercial Services” category, referred to as “I&C Services” below,¹⁹ (ii) the “Industrial and Commercial Retail” category, referred to as “I&C Retail,”²⁰ and the (iii) the Non-commercial category.²¹

These activity types, defined for fiscal purpose, do not necessarily align well with the underlying economic characteristics of businesses. For instance, developing and selling software pertains to the Non-commercial type, while purchasing and selling equipment goods pertains to the I&C Retail category. Similarly, bakery, butchery, or restaurant businesses are counted as I&C Retail activities, while construction work, plumbers, carpenters, and auto or other repair shops and dry cleaning count as

¹⁹These are the so-called “*Bénéfices Industriels et Commerciaux Services*”.

²⁰“*Bénéfices Industriels et Commerciaux Vente*”

²¹“*Bénéfices Non Commerciaux*”

I&C services. Moreover, all professional activities, such as those done by consultants, private coaches, translators, or experts belong to the Non Commercial category.

2.2.3 Certified accounting centers

As noted above, agents in the standard regime who are members of a certified accounting center (CAC) do not have to pay taxes on an extra 25% top-up of their taxable income that faces non-members. It would thus seem that all agents in the standard regime should adhere to a CAC. In fact, a large proportion do. Figure 3 shows that at higher income levels, almost 100% of all agents in the standard regime are CAC members. Why is it the case that at lower income levels, there is a gap? First of all, agents in the zero tax brackets in the standard regime face a zero tax rate and, unless the extra 25% tax makes their taxable income cross the first tax bracket threshold, their taxes are not increased from not being members. However, even taking out those agents in the zero tax bracket, the fraction of those who adheres at low income levels is still pretty low. What can explain this discrepancy is that adhering to a CAC makes it harder to misreport income and engage in tax avoidance – one of the key reasons for CACs to exist in the first place. If an agent plans to misreport more than 25% of their taxable income and are not averse to the risk of being audited, it may be beneficial to remain a non CAC member.

The *Cour des Comptes* (2014) reports that conditional on an audit, the size of the penalties among non-CAC members is larger than among CAC members (around 26,000 euros versus 7,000 euros).²² In addition, the *Cour des Comptes* (2014) states that the discrepancies in taxes due and taxes actually paid among CAC members seems mostly due to genuine accounting mistakes and delays in payments, and almost never to tax evasion motivations, as opposed to the discrepancies noticed among non-CAC members.

The large fraction of agents in the standard regime who are members of a CAC, especially around the threshold that we will focus on (where it is essentially 100%) lends support to the modeling hypothesis we will make below, that cheating is much easier in the simplified or super simplified regimes and much more difficult in the standard regime.

2.3 History and Key Reforms

The thresholds and rates applicable to each regime have changed extensively over time as shown in Figure 2. Nevertheless, two major reforms stand out:

The 1999 reform The 1999 reform focused on the simplified regime, for which it greatly extended the threshold from 100,000 French Francs (15,244 euros) to 500,000 French Francs (76,220 euros) before tax for I&C Retail businesses and to 175,000 French Francs (26,678 euros) before tax for the I&C Services or Non Commercial activities. Moreover, rebates on VAT tax payments become applicable

²²Penalties are strongly positively correlated with the amount misreported.

top all individuals under the simplified regime and whose income falls below the new thresholds (500000 Francs and 175000 Francs). In a nutshell, the 1999 reform multiplied the eligibility threshold for the simplified regime by five for I&C Retail and by almost two for I&C Services and Non Commercial activities. Before 1999, the thresholds were so low as to only be applicable for very small activities and the simplified regime was not a relevant option for many self-employed. We will see below that this reform had large extensive margin effects, with many self-employed entering the simplified regime.

The 2008 reform The 2008 reform created the super simplified regime, out of the desire to further streamline the simplified regime. Indeed, the key motivation was to further save on administrative costs by replacing the social security contributions and income taxes by a unique tax transfer proportional to the individual’s revenue.

The administrative procedure for moving from the simplified regime to the super simplified regime following the 2008 reform, is rather light: all that is required is for the individual to fill a form by December 31st of year $t - 1$ to qualify for entry into the super simplified regime in year t .²³

3 Data, Descriptive Statistics, and the Effects of the Key Reforms

In this Section, we provide summary statistics on the demographic characteristics, incomes, and numbers of the self-employed over time, especially as compared to wage earners. We also provide an event study of the effects of the main 1999 and 2008 reforms.

3.1 Data

We use tax returns data from the French Internal Revenue Service²⁴ over the period 1994-2012. For all years, we have the full tax return information on a representative sample of 500,000 households (out of around 33 million on average per year over that period). Each has an associated weight that corresponds to its relative importance in the overall household population in terms of income level and demographic characteristics (marital status, number of children, income, etc.). For the year 2011, we have access to information on the whole population, which comprises about 36 million households.²⁵

The income and demographic information on each household is captured by around 3000 variables. In particular: (i) the demographic data tell us about the age of the tax filer, the number of children in her household, family situation, whether the tax filer is active or unemployed or retired, her fiscal geographic location; (ii) the income data tell us about the household’s income for each activity that household members are involved in, whether the income is a from salaried or non-salaried work, and

²³Exceptionally in 2009 (the year when the super simplified regime was introduced) individuals were granted extra time until March 31st of year t .

²⁴*Direction Générale des Finances Publiques (DGFIP)*

²⁵While this is still work in progress, subsequent versions of this draft will replace the samples for all years between 2002-2014 with full population data.

about all capital income.²⁶

3.2 Descriptive Statistics on Income and Demographics of the Self-Employed

We now turn to summary statistics from the new datasets to document the demographic characteristics, incomes, and evolution of self-employed in France.

Figure 4 shows the evolution over time of the fraction of self-employed among the total population aged 18 to 65. We distinguish people according to whether they have any self-employed income (the red line) and whether they have only self-employed income (the blue line). The fraction of self employed has remained stable over time, at around 5%, while the fraction with only self-employed income has been very slightly decreasing from 4.2% in 1994 to 3.7% in 2009. But self-employment has seen a rise since 2009, especially in the number who have some, but not only, self-employed income. In 2012 the fraction with any self-employed income had risen to 6%. The two vertical red lines represent the 1999 and the 2008 reforms respectively, which we will study in detail below.

Table 7 shows the demographic characteristics (in Panel A), income (in Panel B) and income tax information (in Panel C) of the self-employed and wage earners, as well as their numbers (in Panel D) over the whole period 1994-2012. The sample is split into three subgroups, which are: (i) wage earners only, (ii) self-employed only, (iii) have any self-employed income.

The table shows that the self-employed tend to be older on average 8-9 years older than wage earners and are almost three times as likely to be retired. This goes against the preconceived idea whereby the self-employed – in this vision considered to be “entrepreneurs” – are the young. The “unemployed” variable refers to the fraction who have perceived any unemployment benefits during the year. Agents in this table are, by definition, employed or earning self-employed income for at least part of the year. The self-employed are less likely than the wage earners to have received any unemployment benefits.

Panel B shows that those who receive self-employed income only earn on average around 33,000 euros. Those who earn some, but not exclusively, self-employed income have on average 30,000 euros of self-employed income and very little wage income, around 6,000 euros. Self-employed agents have more than three times more capital income than wage earners: around 6,000 as compared to 1,900.

Panel C shows the distribution across tax brackets of each group. Self-employed individuals are more than three times more represented in the highest tax brackets, and disproportionately less in the second lowest one.

Tables 8, 9 and 10 reproduces Table 7 for different groups of years. There are several noteworthy facts. First, while wage income has on average been consistently rising (adjusted for inflation), average self-employed income experienced a fall post 2008. This is despite and at the same time as the number of agents with self-employed income rose as shown in Figure 4. We will return to this in more detail below when we study the 2008 reform that introduced the super simplified regime. Second, capital income increased strongly for all groups. Third, the proportion of self-employed who perceive unemployment

²⁶Using the year 2011 for which we have both the subsample of 500,000 and the full population data, we can indeed check that all results look very similar when we use either the full sample or the subsample.

benefits at some point during the year doubled from the 1999-2008 to the 2009-2012 period, while the number for wage earners or for the population as a whole only increased by 50%.

3.2.1 Comparing Industrial and Commercial and Non Commercial Activities:

Table 11 shows the demographic and socioeconomic variables for the self-employed split by activity type. There is a strong gender gap, with women being much more represented in the Non Commercial activities. Maybe as a result of this, the average number of children and the likelihood of having children is higher in the Non Commercial activities. Retired people are much more represented in I&C Retail and I&C Services. Earnings are much larger in Non Commercial activities – including wage income, and as a result, the tax bracket distribution is shifted to the right relative to the Industrial and Commercial self-employed. There is an almost double number of individuals with Industrial and Commercial income.

3.2.2 Tax brackets and regimes

Figure 5 shows for each regime the fraction of individuals in each tax bracket. Panel A (resp. Panel B and Panel C) in Figure 5, shows the fraction of individuals in the standard regime (resp. the simplified regime and the Super simplified regime) in each tax bracket. In each of the three Panels, the green curve corresponds to the fraction of individuals in the first income bracket, the orange curve depicts the fraction of individuals in the second income bracket, and the sienna color and blue color curves depict the fraction of individuals in the third and fourth income brackets respectively.

In particular, when comparing between the three panels, we see that individuals in the standard regime are much more likely in the top brackets than the other two groups of individuals (in the simplified and super simplified regimes), and that most of the individuals in the super simplified regime (the French "Auto-Entrepreneurs") lie in the lower income brackets.

3.3 Effects of the Reforms to Self-Employment Statuses

We now turn to studying in more detail the extensive and intensive margin responses that occurred after the two large reforms in 1999 and 2008.

3.3.1 The 1999 reform

In a nutshell, the 1999 reform multiplied the eligibility threshold for the simplified regime by five for I&C Retail activities and by almost two for I&C Services and Non Commercial activities. As could be expected, this reform resulted in mass entry into the simplified regime, whose thresholds were previously too restrictive for any more than tiny self-employed activity.

Figure 6 shows the effects of this 1999 reform. Panel (a) considers the number of agents in the standard and in the simplified regime, as well all self-employed ("All"). The numbers are normalized at

100 in 1994. There is a sharp increase in the number of agents in the simplified regime in 1999. There is a sharp corresponding decline in the number of agents in the standard regime. It thus seems that the threshold limit was very constraining pre 1999 and that there was a very significant 60% increase in the number of agents in the simplified regime after the expansion. There is a very modest increase in the overall number of self-employed (the base is larger, and hence the proportional increase is smaller). Hence, the effect of the reform was to make individuals switch from one regime (the standard one) to another (the simplified) when the latter was made more generous, rather than to simulate new entry into self-employment.

Panel (b) shows the mean revenues earned per business in each of the regimes. While all regimes experienced some growth in mean income, businesses in the simplified regime expanded their incomes most. This in turn may reflect both, an extensive margin effect whereby high-income individuals enter the simplified regime, and an intensive margin effect whereby individuals already in the simplified regime are induced to work harder as performing well reduces less the probability of being subsequently excluded from that regime (i.e., of crossing the eligibility threshold). Given the results from Panel (a), it makes sense that it is on average larger businesses which made the switch from the standard to simplified regime, i.e., those who may previously have found the simplified more attractive but were constrained by the threshold limit.

Thus, the reform led to both entry into the simplified regime and a growth in the size of its average business. These effects of the reform were immediate: the incentives were sufficiently large to cause a sharp and fast response, which almost all took place in the very first year. There was, however, no effect on overall self-employment.

3.3.2 The 2008 reform

We now turn to the 2008 reform that created the super simplified regime. Figure 7 shows the time series around the reform of the number of self-employed and their mean revenues. Panel (a) shows that, after the time of the reform, there was a sharp growth in simplified + super simplified entrepreneurs. The increase seems to come most sharply from non-simplified entrepreneurs since the number of entrepreneurs in the simplified regime grows more marginally.²⁷ Finally, there is actually a reduction in the number of entrepreneurs in the standard regime, indicating a shift from one regime to the other. On net, however, there is new entry into self-employment as can be seen from the fact that the number of all self-employed also gradually increases post 2008, after having been stagnant in the pre-reform period.

Panel (b) shows the mean revenues pre and post reform. The reform seems to have allowed entry of much smaller businesses, and pushed down the average revenues per business for businesses in the super simplified, and overall. In fact, even the simplified regime, excluding the super simplified

²⁷The reason why we merge the simplified and the super simplified regimes in the figure, is simply that the super simplified regime did not exist prior to the 2008 reform.

The adjustment to the reform is very gradual: entry into the new regime did not happen slowly, and the trends continued well into 2012 (and possibly beyond).

Figure 8 shows the income distribution for individuals in the super simplified regime over time. It confirms that entry happened gradually over time. In addition, as agents enter over time, there is also an increase in the number of agents who particularly locate right at the threshold, with a significant “bunching” occurring at the threshold. This will be explored in great detail in Section 4.

3.3.3 Comparison

The effects of the 2008 reform stand in stark contrast to the 1999 reform. It is useful to contrast the two. First, in 1999, the full effect of the reform was quick and almost exclusively concentrated in the first year. The difference to the gradual effects post 2008 may be explained by the fact that in 1999, the expansion of the thresholds affected an existing regime that people may have already had knowledge about. Even those not enrolled in the simplified regime in 1999 must have previously thought about it when choosing their regime and must have thus been more aware of it. On the other hand, in 2008, a new regime was introduced and it may have taken time for individuals to become aware of it, understand it, and decide to make the switch. This is despite the fact that the switch between the super simplified and the simplified regimes in 2009 was made as easy as possible, with a light administrative procedure.

Second, in 1999 there was a switch from the standard regime to the simplified one (that had been made more generous), but barely any increase in overall self-employment. In 2008, there was significant entry into self-employment. The 1999 reform merely expanded the threshold of eligibility. Thus, individuals who previously may have wanted to be in the regime given their cost/benefit trade-offs and who were limited by the low threshold were now able to join in. There was however no change in the costs of either the simplified or standard regime overall. Thus, the trade-off between entering self-employment at all or not was not affected.²⁸ By contrast, in 2008, the administrative costs were further reduced, so that relative payoff from being self-employed or not was affected, mostly for individuals with very small businesses (smaller than the average business in the simplified regime) as seen in Panel (b).

Finally, in 1999 it was mostly businesses larger than the average simplified regime businesses who switched into that regime thanks to the increase in the threshold. In 2008, it was mostly smaller than average businesses which entered from non-self-employment or who switched from one of the other two regimes – those are the ones who mostly seemed to benefit from the additional simplification and reduction in administrative costs.

²⁸This need not always be true: if business size is not flexible, but rather lumpy, it may be that an agent considering whether to enter into self-employment only has the choice between earning 0 self-employed income or earning K euros, where K is above the old pre-1999 threshold. In this case, the entry choice will be affected by the fact that K now falls below the new post-1999 threshold. Given the lack of new entry into self-employment post 1999, this lumpy investment model does not seem to hold.

4 Model and Reduced Form Evidence

In this section, we provide reduced form evidence of behavioral responses around the thresholds, over time, and for different regimes and agents. We first start by outlining a simple model of self-employed behavior that provides the intuition for the reactions of agents to fiscal incentives in each regime. While useful to frame the empirical evidence, the reduced-form results we present here are not reliant on any model.

4.1 Model

To better understand individuals' regime and income choices, we build the following very simple model of self-employed behavior. Each agent has a type θ that captures his productivity and that decreases his cost of earning a given amount of income. We use the words revenues and income interchangeably. The disutility of earning income y for an agent of type θ is denoted by $h(y, \theta)$, increasing in y and decreasing in θ . A given individual can operate in one of the three regimes above: the simplified (regime "m") the super simplified (regime "f") and the standard one (regime "r"). Effective business costs, taking into account inputs, VAT payments, investments and so on are modeled as a fraction c_i of gross output y_i in each of the regimes $i = m, f, r$. An agent can misreport his true income; let $\hat{y}_i$ be reported income. The cost of doing so is $g(y_i - \hat{y}_i)$, increasing and convex in the difference between true and reported income. In addition, each regime entails a hassle cost a_i , reflecting the reporting, registration, and accounting requirement costs.

An agent's utility in regime $i = m, f, r$ is thus:

$$u_i = \tilde{c}_i - h(y_i, \theta) - g(y_i - \hat{y}_i) - a_i$$

where $\tilde{c}_i$ is consumption.

We capture the policy parameters as follows: μ is the rebate on gross revenues in the simplified and super simplified regimes, so that the taxable income for agents in these regimes is $(1 - \mu) \cdot y$, with y being revenues or income. τ^y is an agent's income tax rate and τ^{ss} the social security contributions rate. The effective rates in each regime are denoted by τ_i . In the standard regime, τ_r is equal to the sum of the income tax and social contribution rates, levied on net income $(1 - c_r)y_r$. In the simplified regime, τ_m is levied on $(1 - \mu)y_m$. In the super simplified the rate is the flat rate τ_f that covers both the income tax due and the social security contributions and is levied on gross income.

We make two assumptions. First, we assume that the hassle costs are low enough in the super simplified regime, so that $a_f = 0$. Second, we assume that because of the very large adherence to the certified accounting centers, and the difficulty of misreporting income when a CAC member, there is no willful misreporting of income in the standard regime.

Substituting for the budget constraint under each regime, we obtain the following expressions for

utility as a function of policy parameters and individual choices:

$$u_m = (1 - c_m)y_m - \tau_m(1 - \mu)y_m - h(y_m, \theta) - g(y_m - \hat{y}_m) - a_m$$

$$u_f = (1 - c_f)y_f - \tau_f y_f - h(y_f, \theta) - g(y_f - \hat{y}_f)$$

$$u_r = (1 - c_r)(1 - \tau_r)y_r - h(y_r, \theta) - a_r$$

In the simplified and standard regimes, the tax rate is the same for any given agent, namely equal to $\tau = \tau^y + \tau^{ss}$, i.e., the sum of the personal income tax rate and the social security contribution rate (the tax base on which it is levied is, however, different in these two regimes).

In the super simplified regime, the tax rate is equal to the flat rate $\tau_f \neq \tau^y + \tau^{ss}$ and $\mu = 0$.

4.2 Regime Choice

Let us first discuss a few methodological points. First, note that the I&C Retail activities' threshold is placed much higher – in fact, it seems so high that the income distribution is very thin at that level and there is not enough mass to detect bunching behavior. In this Section, we therefore only focus on the I&C Services and Non Commercial Activities.

Second, when studying all self-employed agents jointly, we need to take into account the fact that the self-employed in the standard regime have to report only their net income (revenues minus costs), while those in the simplified and super simplified regimes only have to report their revenues (and not their costs). We can, however, convert these reports into a common and comparable (reported) “taxable” income measure: for the agents in the standard regime, taxable income is equal to net income, while for agents in the simplified regime it is equal to revenues time the net of rebate rate, and for those in the super simplified it is simply revenues. Similarly, we convert the thresholds for the simplified regime into taxable income equivalent, which yields two thresholds (one for I&C Services and one for Non Commercial activities, due to their different rebates). The thresholds for the super simplified regime remain as such, regardless of the activity type, since there is no rebate. The taxable incomes of agents across all regimes are now directly comparable.

Third, when we consider only agents in any simplified regime (whether simplified or super simplified), we can directly work with the reported revenues, no conversion into taxable income is needed, and, as a result, the threshold is the same for the I&C Services, and Non Commercial activities.

4.2.1 Evidence of behavioral responses in the regime choice

We start by checking whether the proportion of agents who choose the simplified or super simplified regimes exhibits uneven behavior around the thresholds. We use the full population data for 2011, although the results are very similar for the other years.

Figure 9 shows the fraction of agents in any simplified regime among all self-employed, as a function of their taxable income in 2011. The vertical lines represent the thresholds of taxable income for being

in the various regimes. We see that there are consistently sudden jumps in the fraction of agents in a simplified regime at those thresholds. That the response is especially strong at the super simplified threshold is due to the fact that that threshold applies to both I&C Services and Non Commercial activities, and hence attracts a larger mass of people, while the other thresholds apply to one activity type only because of the different rebate rates.

We next consider the fraction of agents who choose the super simplified regime, conditional on choosing *any* simplified regime. In this case, we can directly use the reported gross revenues rather than convert them into reported taxable income. Figure 10 shows the fraction of agents choosing the super simplified regime at each revenue level: It again increases sharply right before the eligibility threshold.

These discontinuities in the fraction choosing the simplified or super simplified regimes around the eligibility thresholds is a first indication for behavioral responses to the thresholds.

4.2.2 Choice between the standard regime and any simplified regime

As explained in Section 2.2, the choice between the standard and the simplified depends on many factors, the importance of which differs for different agents. An entrepreneur’s project, growth projections, and cost structure will affect this choice. In our model of Section 4.1, these different features are captured by the costs c_m , c_f , and c_r , the hassle costs a_m , a_f , and a_r , and the tax bracket of the agent, captured by τ^y . Given this array of factors affecting regime choice, it is hard to assess based on observed choices whether agents are making a rational choice between the standard and the simplified regimes.

Nevertheless, we can document how many agents pick a simplified regime, over time, at different income levels, in different tax brackets, and for different activities. Recall that because of the way tax brackets are determined in the French tax code, there is not a unique map from income to tax bracket, which means that at a given taxable income, there are several possible tax brackets based on family structure. There are two interesting predicted comparative statics to explore here.

First, when an agent’s self-employed income is higher, his tax bracket is on average higher (although the correlation is imperfect), and he may no longer be eligible for the simplified regime; higher income agents are more likely to be constrained by the threshold on revenues and thus unable to choose a simplified regime. This is illustrated in Figure 11. We show here the proportion of self-employed agents (defined as having non-negative self-employed income) who are in the simplified or super simplified regimes, within different tax brackets. There are two findings: (1) The fraction of agents who select a simplified regime is higher in the lower tax brackets, and monotonically declines in the tax bracket. (2) While there is an increasing trend over time, the expansion of the simplified regimes accelerated sharply exactly at the reform times in 1998 and 2008. Particularly, the 1998 had a very sharp jump in the fraction of self-employed agents in a simplified regime and mostly so in the lowest two tax brackets.

Second, for any given business structure and preferences between regimes, agents in higher tax

brackets – holding income fixed– have a larger financial incentives to optimize their regime, since a given difference in payoffs between the two regimes gets amplified by a larger tax saving. We can show this formally. Suppose for simplicity that there is no cheating. The choice of regime for any income level y below the threshold of eligibility for the simplified regimes and the standard regime is driven by the difference in utility:

$$\frac{(u_r - u_m)}{y} = \frac{a_m - a_r}{y} - (c_r - c_m) - \tau(\mu - c_r)$$

For an agent for whom the rebate is more generous than costs (i.e., $\mu \geq c_r$) and for whom the difference in hassle costs and true costs between the standard and simplified regimes are small enough, the loss in utility from not being in the simplified regime grows in the tax bracket.²⁹ Thus, an agent who would chose to be in the simplified regime given his primitives, would be even more inclined to do so if his tax bracket is higher.

Figure 12 shows the fraction of agents in any simplified regime, but split by the different tax brackets. All groups exhibit a strong threshold effect, with the proportion of self-employed agents within each group who choose a simplified regime sharply increasing at the super simplified threshold, and to a lesser extent at the I&C Services and Non Commercial simplified thresholds (this is again due to the fact that the super simplified threshold applies to all these activities, while the other thresholds apply to one activity at a time). We can compute the percent increase in the proportion by taking the ratio of the proportion right at the threshold relative to the proportion at 2,000 euros before the threshold (i.e., around where the excess mass starts forming) for each of the three tax bracket groups. For the low tax bracket, the increase is of 42%, for the medium tax group it is 53%, and for the high tax group it is 73%. Thus, as predicted, it is the high tax group that has the largest incentive to bunch at the notch.

4.2.3 Choice between the simplified and the super simplified regime

The choice between the super simplified and the simplified regimes is more straightforward, and should be based almost exclusively on the comparison of the flat rate and the total tax rate (income tax plus social security contributions) facing the agent. A key additional considerations an agent may have are the timing of payments and the different administrative hassle; recall that social security contributions are paid at the same time under the super simplified regime, but have to be paid monthly or quarterly, and that start-up requirements and registration are simpler. In addition comes the issue of inertia and the fact that the super simplified was introduced after the simplified one (in 2008). It may take some time for people to learn about it and switch. Adjusting may be costly, even if the new regime is financially more favorable, if the initial startup cost has been incurred.

Formally, at a given income y , the difference in payoff for an agent with cost $c_m = c_f$, a_m , and tax

²⁹ Again, and importantly, it is meaningful to vary τ while holding y constant since there is not a one for one map between income and tax bracket in the French tax system.

TABLE 2: Estimated hassle costs

Rate/ Activity	I&C Retail ($\mu = 0.71$) ($\tau_f = 13\%$)	I&C Service ($\mu = 0.5$) ($\tau_f = 23\%$)	Non Commercial ($\mu = 0.34$) ($\tau_f = 20.5\%$)
Bracket 1	2%	3%	3%
Bracket 2	3%	4%	4%
Bracket 3	4%	6%	7%
Bracket 4	6%	10%	12%
Bracket 5	9%	16%	19%

Notes: the table provides the values of $-a_m$ that satisfies: for $a_m = (\tau^y + \tau^{ss})(1 - \mu) - \tau_f$, i.e., the payment that an agent would be willing to pay in the super simplified regime to avoid being in the simplified regime for different values of $\tau^y + \tau^{ss}$ and μ . Note that, here, the displayed τ_f is the overall flat rate (tax + social contributions) paid by individuals in the super simplified regime as of 2011.

bracket τ^y between the super simplified and the simplified regime is:

$$\frac{u_f - u_m}{y} = \frac{a_m}{y} + (\tau^y + \tau^{ss})(1 - \mu) - \tau_f \quad (1)$$

Which shows that the incentives to pick the super simplified regime over the simplified regime increase in the total tax rate $\tau = \tau^y + \tau^{ss}$, i.e., should be higher for agents in higher tax brackets. It also decreases in the rebate μ , so it should be lower for activities with a very generous rebate, such as the I&C Retail activities.

Table 2 shows for the different tax brackets and different rebates (corresponding to the different types of activity) the opposite of the implied hassle cost ($-a_m$), that would make an agent exactly indifferent between choosing the super simplified and simplified regime. This is the payment that an agent would be willing to pay in the super simplified regime to avoid being in the simplified regime. Thus, agents in the lower tax brackets would be willing to pay less to avoid the super simplified regime: in fact, if their social security contributions were also zero, they would prefer for financial reasons to be in the simplified regime. The willingness to pay to be able to be in the super simplified regime increases in the tax bracket for a given μ , and decreases in μ for a given tax rate.

Figure 13 shows the fraction of self-employed who choose the super simplified regime, among those who are eligible for the super simplified regime and who are in either the simplified or the super simplified, split by activity type. Thus, each panel holds the rebate μ and the flat rate constant. It shows that, conditional on being eligible for the super simplified regime, those in higher tax brackets are typically more likely to chose it as of 2012. This fits with the intuition shown in Table 2 that the loss from not being in that regime increases in the tax bracket. What is interesting is that the rise in the high tax bracket agents in the super simplified regime happened progressively over time, and faster than for other groups, presumably as agents learned about the regimes and optimized their choices better. The I&C Services is an exception here. It may be that for this type of activity, lower

tax bracket agents put extra value on the ultra simplicity of the super simplified regime and prefer handling taxes and social contributions at the same time.³⁰

If we look at different tax brackets, we see in Figure 14 that the fraction in the super simplified regime among all eligible ones in a simplified regime that it is especially the proportion of people in higher brackets that increases at the threshold. Those are the agents who, all else equal, and purely based on the tax rate advantage have the highest incentive to want to remain in the super simplified regime and pay the flat rate. We can again compute the percent increase in the proportion by taking the ratio of the proportion right at the threshold relative to the proportion at 2,000 euros before the threshold (i.e., around where the excess mass starts forming) for each of the three tax bracket groups. For the low tax bracket, the increase is of 9%, for the medium tax group it is 27%, and for the high tax group it is 41%. Again, it is the higher tax group that has the largest incentive to remain in the super simplified regime (as exemplified by Table 2).

Figure 15 shows that same fraction but split by activity type: I&C Services and Non Commercial. The bunching is significant for both types of activities, with a proportional increase of, respectively, 33% and 20% in the fraction around the threshold. Note that the I&C services has a lower rebate rate (which would make them more likely to choose the super simplified regime) but a higher total flat rate τ_f (which would make them less likely to choose the super simplified).

Figure 16 shows the fraction in the super simplified regime among all self-employed who are eligible for the super simplified regime, by taxable income level. We can again compute the percent increase in the proportion for each of the three tax bracket groups. For the low tax bracket, the increase is of 47%, for the medium tax group it is 63%, and for the high tax group it is 118%.

4.3 Static Responses to the Notch

We now turn to analyzing the bunching of self-employed income at the notch created by the eligibility thresholds.

4.3.1 Responses to the notch

Note that the choice between the simplified and super simplified is independent of the threshold, since the threshold is the same for both regimes. Hence, let us consider in turn the threshold effect for the simplified regime relative to the standard regime and then the threshold effect for the super simplified regime relative to the standard regime. Not all agents would optimally want to be in the standard regime, depending on their distribution of production costs c and hassle costs a in each regime. Those who are affected by the threshold are those who would like to remain in the simplified regime at higher

³⁰We do not actually know eligibility with full accuracy because we do not see the type of activity at a more granular level than Retail, Services, and Non Commercial and some activities are excluded from the super simplified regime as described in Section 2. Since those professions seem to be mostly higher income ones, and they may be particularly concentrated in the Service sector, it may be that we are overestimating the eligibility of higher bracket households in the Service sector, and thus underestimating the fraction of eligible ones who choose it.

income levels but cannot.

For those who would like to remain in the simplified regime, the threshold conceptually creates a “notch,” i.e., a change in the average tax rate (due to the change in the tax base, i.e., whether it is a proportional rebate or actual production costs that can be deducted), but also a change in the marginal tax rate, and a change in the hassle costs. It also introduces the possibility of hiding income, which makes it different from a standard notch as in Kleven (2016).

After 2008, for those who would like to remain in the super simplified regime, the threshold creates a different notch. Here, the change in the average and marginal tax is due to changes in the tax base (from gross revenues to net income), in the tax rate (from the flat rate to the personal income tax rate facing the agent), hassle costs, and the opportunity of hiding income.

4.3.2 Graphical evidence

We now consider the excess mass at the eligibility threshold for the simplified and super simplified regimes. Figure 17 shows the distribution of self-employed revenues for agents in the simplified and super simplified regimes, pooled over all years 1999-2012, for those in the I&C Services and Non Commercial Activities.³¹ We pool together these years to increase our sample size and precision, but we will show the year-by-year results and different groups of years as well below. The revenues on the horizontal axis are centered around the eligibility threshold, which varies over time and across activities. I.e., in each year, we plot the distribution of the difference between revenues and the eligibility threshold in that year and for that activity. Individuals are grouped into 500 euro bins by recentered revenue and the count of individuals per bin is plotted around the eligibility threshold. The threshold itself is represented by the red vertical line. Recall that only agents in the simplified and super simplified regimes report their revenues; agents in the standard regime instead report net income, not revenues. They have to remain below the threshold (except for those who cross the threshold for less than the grace period of three years and who remain in the tolerance region to the right). Thus, except for revenues that still fall in the tolerance region, we cannot see any revenues for agents above the eligibility threshold. This means that we need to focus exclusively on the range to the left of the threshold, which makes our analysis unusual. We see that, while over a large range before the threshold, the distribution of revenues is smoothly decreasing, there is a sudden spike right before the threshold.

To estimate the counterfactual density to the left of the threshold that would apply absent the notch, we fit a flexible polynomial to the data, excluding a range R_1 of income before the threshold T . We divide individuals into relative income bins of size 500 euros, so that individual incomes in bin B_j are in the interval $]B_j - 500, B_j]$. Bins are always constructed so that $T = B_T$, i.e. such that the threshold T is a bin upper bound. Typically, when income is normalized by the threshold, $B_j = \{..., -5000, -4500, -4000, ..., -500, 0, 500, ...\}$ and $B_T = 0$. C_j stands for the count of individuals

³¹As already explained above, we do not consider the I&C Retail Activities whose threshold is very high up.

in income bin B_j .

To fit a smooth polynomial to proxy for the counterfactual distribution to the left of the threshold, we run the following regression:

$$C_j = \sum_{i \in A} \beta_i (B_j)^i + \varepsilon_j, \forall B_j \leq T - R_1 \quad (2)$$

where A is the set of polynome exponents, which is allowed to be fractional (i.e. A is a finite set, $A \subset \mathbb{Q}$ and $A \cap (\mathbb{Q} \setminus \mathbb{N}) \neq \emptyset$). R_1 is an interval to the left of the threshold which is excluded from the regression. We then use estimates from (2) to obtain the predicted counterfactual

$$\hat{C}_i = \sum_{j \in A} \hat{\beta}_j (B_i)^j \quad (3)$$

in the excluded range. The excess mass B is calculated as:

$$B = \sum_{i \in S} (C_i - \hat{C}_i) \quad (4)$$

where $S = \{i \in \mathbb{N} / B_i \in]T - R_2, T]\}$ and $R_2 \leq R_1$. B is therefore the number of individuals in excess relative to the counterfactual distribution in a “bunching zone” that is smaller than the excluded zone. We take R_2 to be one bin (of size 500 euros). We then define the normalized excess mass b to be the excess mass in the bunching zone, divided by the counterfactual number of individuals in the bin with upper bound $B_T = 0$, which is $\hat{C}_T$.³²

$$b = \frac{B}{\hat{C}_T} \quad (5)$$

The counterfactual distribution is represented by the red curve in the figures. The bunching zone’s area excess mass is colored in yellow. For the graphs, we exclude an interval of 1,500 euros before the eligibility threshold and compute the excess mass over an interval of 500 euros, which is equal one bin size. This is a conservative estimate of the excess mass, since the graphs show that the density starts deviating from the counterfactual typically earlier on.

Figure 17 shows that the excess mass before the notch estimated according to this method is 70% of the average height of the counterfactual distribution within 1,500 euros of the notch. These results are not sensitive to the order of the polynomial or to the excluded region R_1 (within reasonable bounds) because the bunching is sharp enough.

Figure 18 repeats this analysis for three different time periods: 1994-1998 (before the key 1999 reform which expanded the thresholds of the simplified regime), 1999-2008 (before the introduction of the super simplified regime) and 2009-2012 (after the introduction of the super simplified regime). In

³²Both the numerator and the denominator are effectively the counts within a bin, so that their sizes are directly comparable.

TABLE 3: Excess mass by tax bracket

Tax bracket	Excess mass b	Standard error $se(b)$
Zero	0.37	0.11
Low	0.76	0.05
Medium	0.77	0.03
High	1.24	0.05

Notes: the table displays the value of the excess mass b as defined in (5) and as represented graphically in Figure 19. To compute the standard errors, 400 bootstrap iterations are performed.

all cases, there is significant bunching, equal to, respectively 53%, 75%, and 63% of the average height of the counterfactual distribution within 1,500 euros of the notch. It seems quite natural that the earlier period 1994-1999 exhibits less and less sharp bunching because the simplified regime's threshold was very low and thus the regime was not that desirable to start with.

4.4 Heterogeneity in Responses by Tax Rates

Recall from Section 4.2 that any cost or benefit advantage from being in one regime over the other is amplified for agents in higher tax brackets. Figure 19 shows the bunching mass for agents in different tax brackets. Figure 20 repeats this for the two periods 1999-2008 and 2009-2012, with similar results.

Table 3 reports the excess mass and its standard error for each tax bracket. Agents in higher tax brackets exhibit a stronger and more significant bunching mass. The estimates for b and its standard error are summarized in Table 3. This heterogeneity across tax brackets will also influence our estimation strategy in Section 5 since it gives us different behavioral predictions for different groups of agents who face different tax rates.

4.5 Dynamic Adjustment

Recall that the thresholds have changed a lot over time, with sometimes small and sometimes large changes. In addition, the new super simplified regime was introduced in 2008. It is thus interesting to see how the bunching has evolved over time.

Figure 21 reports the excess mass b and its standard error band, estimated for each year separately. The graph shows two interesting and intuitive patterns. First, while the bunching mass is relatively stable since 1999 (it was small in the earlier period as shown above), whenever there have been small threshold changes and/or small rebate changes, there is a fall in the bunching mass. This occurred for instance in 2001 (when there was both a threshold and a rebate change) and in 2011 (when there was a small threshold change only). Second, whenever there is a significant threshold increase, as was the case in 2009,³³ there is an increase in bunching.

³³When the threshold for the I&C Services and Non Commercial increased from 27,000 to 32,000) and the threshold for I&C retail increased from 76,300 to 80,000).

Figures 22, 23, and 24 show the full income distribution with the bunching excess mass for each year of the sample period 1994-2012. The solid vertical red line shows the actual threshold, while the solid black vertical line refers to the threshold for year $t - 1$, and the dotted vertical black line refers to the threshold of year $t - 2$. When the threshold does not change for at least two years, these three lines coincide. There are four key findings here:

1. When the threshold changes but does not move far away from the one in the previous year (as was the case, e.g., in year 2002), there is a decline in the bunching at the notch.
2. When the threshold changes by a little, a lot of excess mass remains at the *no longer applicable* threshold. This is the case even two years later. Consider for instance the years 2011 and 2012. In 2011, the small threshold change led to a remaining significant mass at the old threshold of year $t - 1$ (the solid vertical line). In 2012, there was still significant excess mass at the old threshold (the dotted vertical line).
3. When the threshold remains stable, as was the case between 2001 and 2008, there is a progressive increase in bunching over time, presumably as people are better able to optimize their revenues and are fully aware of it.
4. When there is a large change, as for instance in 2009, there is immediately significant bunching at the new threshold, although it still continues to increase over time.

We can also zoom in particularly on the 2008 reform and its post period. Figure 25 shows the income distribution around the threshold for the super simplified for the years 2009-2012. While the graph shows the extensive margin entry into the super simplified regime throughout the income distribution, it also shows that the bunching at the kink grows significantly over time.

All these facts are consistent with two different models. One in which there is rational inattention to or lack of salience of small changes, but sufficient attention and salience of large changes. The responses could be standard responses or avoidance responses, although the speed of adjustment to larger changes seems to suggest at least some avoidance responses. The other model is one with fixed adjustment costs that make it suboptimal for agents to change the size of their activity in response to small changes, but make it optimal to do so in response to large changes.

4.6 Heterogeneity in Responses

[TO BE COMPLETED]

5 Estimation of Structural Parameters

In this section, we map the excess mass to the structural parameters of the model and propose an estimation strategy that makes use of the bunching at the thresholds, the variation in the policy

parameters over time, and the variation in incentives across different agents at the same self-employed income level.

5.1 Mapping the Excess Mass to Structural Parameters

To estimate our model, we parameterize it as follows:

$$h(y) = \frac{\theta}{1 + \frac{1}{\varepsilon}} \left(\frac{y}{\theta} \right)^{1 + \frac{1}{\varepsilon}}$$

$$g(y - \hat{y}) = \frac{\kappa}{1 + \frac{1}{\eta}} \left(\frac{y - \hat{y}}{\kappa} \right)^{1 + \frac{1}{\eta}}$$

This means that the optimal choice of (actual and reported) income of the agent in the standard regime is:

$$y_r = \theta[(1 - c_r)(1 - \tau_r)]^\varepsilon$$

In the simplified regime, the actual income choice is given by:

$$y_m = \theta[(1 - c_m) - \tau_m(1 - \mu)]^\varepsilon$$

while reported income is given by:

$$y_m - \hat{y}_m = \kappa[\tau_m(1 - \mu)]^\eta \Rightarrow \hat{y}_m = \theta[(1 - c_m) - \tau_m(1 - \mu)]^\varepsilon - \kappa[\tau_m(1 - \mu)]^\eta$$

Notch created by the simplified regime eligibility threshold:

Let's consider the marginal agent who will bunch at the notch, who has type $\theta^* + \Delta\theta^*$. Before the introduction of the notch, this agent was at reported income $\hat{y}^* + \Delta\hat{y}^*$.³⁴ Without the threshold, the agent would have chosen to remain in the simplified regime, with his reported income choice, equal to $y^* + \Delta y^*$ by definition, characterized by the tangency optimality condition:

$$y^* + \Delta y^* = (\theta^* + \Delta\theta^*)[(1 - c_m) - \tau(1 - \mu)]^\varepsilon - \kappa[\tau(1 - \mu)]^\eta \quad (6)$$

His actual income would be given by:

$$y_m = (\theta^* + \Delta\theta^*)[(1 - c_m) - \tau(1 - \mu)]^\varepsilon \quad (7)$$

³⁴As is standard in the literature, we use the terminology of pre and post notch, although the pre-notch refers to a counterfactual where the threshold does not exist.

After the introduction of the threshold, this marginal agent locates his reported income exactly at the kink y^* . His true income given that reported income is at the threshold y^* , denoted by y_m^* , is chosen to maximize:

$$y_m^*(1 - c_m) - \tau(1 - \mu)\hat{y}_m^* - h(y_m^*, \theta^* + \Delta\theta^*) - g(y_m^* - y^*) - a_m$$

The first order condition yields:

$$(1 - c_m) - h'(y_m^*, \theta^* + \Delta\theta^*) - g'(y_m^* - y^*) = 0 \Rightarrow 1 - c_m - \left(\frac{y_m^*}{\theta^* + \Delta\theta^*}\right)^{\frac{1}{\varepsilon}} - \left(\frac{y_m^* - y^*}{\kappa}\right)^{\frac{1}{\eta}} = 0 \quad (8)$$

His utility right at the notch is then:

$$u_m^* = y_m^*(1 - c_m) - \tau(1 - \mu)y^* - h(y_m^*, \theta^* + \Delta\theta^*) - g(y_m^* - y^*) - a_m$$

Let's denote by y_r^I the indifference point in the standard regime, such that the agent is indifferent between reporting income exactly equal to the threshold y^* or to instead earn income y_r^I (truthfully). y_r^I yields utility:

$$u_r^I = y_r^I(1 - c_r)(1 - \tau) - h(y_r^I, \theta^* + \Delta\theta^*) - a_r$$

The indifference income is interior, and hence characterized by the tangency condition in the standard regime:

$$y_r^I = (\theta^* + \Delta\theta^*)[(1 - c_r)(1 - \tau)]^\varepsilon \quad (9)$$

The indifference condition is:

$$y_r^I(1 - c_r)(1 - \tau) - h(y_r^I, \theta^* + \Delta\theta^*) - a_r = y_m^*(1 - c_r) - \tau(1 - \mu)y^* - h(y_m^*, \theta^* + \Delta\theta^*) - g(y_m^* - y^*) - a_m \quad (10)$$

The interval of bunching Δy^* is related to the excess mass B (that can be obtained in the data) through the relation: $B \approx f_0(y^*)\Delta y^*$, where $f_0(y^*)$ is the counterfactual density at the threshold. Thus, the predicted bunch by this model is

$$\hat{B} = f_0(y^*)\Delta y^* \quad (11)$$

which is a function of the full set of primitive parameters to be estimated ($c_m, c_r, a_r, a_m, \kappa, \eta, \varepsilon$) and the policy parameters (μ, τ) for different regimes and activity types.

Notch created by the super simplified regime eligibility threshold:

The notch generated by the threshold of the super simplified regime leads to slightly different

effects. Before the notch, an agent's choice – for a given type $\theta^* + \Delta\theta^*$ is characterized by the following actual and reported incomes:

$$y^* + \Delta y^* = (\theta^* + \Delta\theta^*)[(1 - c_m) - \tau_f]^\varepsilon - \kappa[\tau(1 - \mu)]^\eta \quad (12)$$

$$y_m = (\theta^* + \Delta\theta^*)[(1 - c_m) - \tau_f]^\varepsilon \quad (13)$$

After the introduction of the threshold, this marginal agent locates his reported income exactly at the kink y^* . His true income given that reported income is at the threshold y^* , denoted by y_f^* , is chosen to maximize:

$$y_f^*(1 - c_f) - \tau_f \hat{y}_f^* - h(y_f^*, \theta^* + \Delta\theta^*) - g(y_f^* - y^*) - a_f$$

The first order condition yields:

$$(1 - c_f) - h'(y_f^*, \theta^* + \Delta\theta^*) - g'(y_f^* - y^*) = 0 \Rightarrow 1 - c_f - \left(\frac{y_f^*}{\theta^* + \Delta\theta^*} \right)^{\frac{1}{\varepsilon}} - \left(\frac{y_f^* - y^*}{\kappa} \right)^{\frac{1}{\eta}} = 0 \quad (14)$$

His utility right at the notch is then:

$$u_f^* = y_f^*(1 - c_f) - \tau_f y_f^* - h(y_f^*, \theta^* + \Delta\theta^*) - g(y_f^* - y^*) - a_f$$

The indifference point y_r^I in the standard regime, yields the same utility u_r^I as above, and is characterized by the same tangency condition as in (9). The indifference condition is:

$$y_r^I(1 - c_r)(1 - \tau) - h(y_r^I, \theta^* + \Delta\theta^*) - a_r = y_f^*(1 - c_r) - \tau_f y_f^* - h(y_f^*, \theta^* + \Delta\theta^*) - g(y_f^* - y^*) - a_f \quad (15)$$

We can link the interval of bunching Δy^* to the theoretically predicted excess mass B_f for the super simplified regime in the same way as above for the simplified one.

5.2 Estimation and Methodology: A Method of Moments

Our estimation method make use of the fact that, at any given threshold there is a lot of heterogeneity along three dimensions: i) across tax brackets, as different agents have the same self-employed income but do not land in the same tax bracket due to differences in other non-self-employed income or their family status, ii) across activity types μ because of the different rebates μ implied, and iii) across time because the thresholds, rebates, and tax rates have changed a lot. Thus, we have variation in the policy parameters over time and variation of how those policy parameters affects agents within a time period.

We present here a generalized method of moments to estimate the structural parameters. Additional

details of the computational procedure are in Appendix A.2.

In the data, there are $j = 1, \dots, J$ tax brackets, $t = 1, \dots, T$ years, and $k = 1, \dots, K$ different activity types, which differ with respect to their thresholds and rebates μ . For each tax bracket, j , activity type k and year t , there is a given empirical bunching B_{jkt} and a corresponding Δy_{jkt}^* . Let $\hat{B}_{jkt}$ be the corresponding theoretically predicted bunching mass, and p_{kjt} the proportion of this group in the estimation sample.

We first group agents into G groups indexed by g (to be determined below). Let the parameter set to be estimated (to be specified depending on the case) be denoted by χ . The empirical bunch for that group is B_g . The predicted theoretical bunch is

$$\hat{B}_g(\chi) = \sum_{k,j,t \in g} p_{kjt} \hat{B}_{jkt}(\chi)$$

The “loss function” to be minimized is the weighted average distance between the theoretical bunching and the actual bunching, for each such group, weighted by the share of people who are in that group. Denote the proportion of the group g in the sample by p_g :

$$L(\chi) = \sum_{g=1}^G p_g \left(\hat{B}_g(\chi) - B_g \right)^2$$

We now propose two different ways to estimate the model, one assuming that the parameters $(c_m, c_r, a_r, a_m, \kappa, \eta, \varepsilon)$ are homogeneous for all agents, and one that allows for heterogeneity across agents. In both cases, if we define each group g by a given tax bracket, activity type (hence, μ) and year t , we are over-identified. We make use of this in the Robustness checks by estimating the model based on different groups.

The functional Forms are summarized in Table 4.

TABLE 4: Functional forms

Function	Notation	Functional form
Disutility of labor	$h(y, \theta)$	$\frac{\theta}{1+\frac{1}{\varepsilon}} \left(\frac{y}{\theta} \right)^{1+\frac{1}{\varepsilon}}$
Cost of misreporting	$g(y - \hat{y})$	$\frac{\kappa}{1+\frac{1}{\eta}} \left(\frac{y - \hat{y}}{\kappa} \right)^{1+\frac{1}{\eta}}$

5.3 Elasticity Estimates

Case 1: Homogeneous structural parameters

We start with the case in which the parameters $(c_m, c_r, a_r, a_m, \kappa, \eta, \varepsilon)$ are homogeneous for all agents and all years. Table 5 summarizes the parameters which are externally calibrated and those which are internally estimated. It is important to remember that the excess mass comes from agents who would like to remain in the simplified regimes but are constrained by the threshold. For instance, as explained in Section 2, agent with high production costs or investments would, all else equal, not find it advantageous to be in the simplified regimes to start with and would thus not contribute to the excess mass estimated. The parameters chosen reflect this fact and are targeted to represent agents who should want to choose any of the simplified regimes.

TABLE 5: Parameter values

Parameter	Symbol	Value or range considered
<i>External calibration</i>		
Relative cost of misreporting	κ	10
Hassle costs:		
in standard regime	a_r	$\{0\%, 5\% \cdot y^*, 10\% \cdot y^*\}$
in simplified regime	a_m	0
in super simplified regime	a_f	0
Production cost share		
in standard regime	c_r	$90\% \cdot c_m$
in simplified regime	c_m	$\{70\% \cdot \mu, 95\% \cdot \mu, 120\% \cdot \mu\}$
in super simplified regime	c_f	$\{70\% \cdot \mu, 95\% \cdot \mu, 120\% \cdot \mu\}$
<i>Internal calibration</i>		
Disutility of effort elasticity	ε	
Misreporting elasticity	η	

Notes: y^* denotes the threshold, which varies by activity type. μ denotes the rebate in the simplified regime, which also varies by activity type.

The benchmark case we use is to pool all years t together and split agents into their different tax brackets and activities. In this version of the draft, we fix the parameters $(c_m, c_r, a_r, a_m, \kappa)$ at given values (which we vary for a sensitivity analysis), and estimate only η and ε . A future version will estimate the full vector $(c_m, c_r, a_r, a_m, \kappa)$ making use of more moments. To do so, we compute two moments in the data, namely the bunching masses for two groups: low tax bracket agents and high tax bracket agents, pooled across years and activity types, so that $G = 2$. Low tax bracket agents are, for this purpose, defined as those in the zero, first, and second bracket. The high tax bracket are those in the third and higher tax brackets.

We consider a whole range of estimates for the hassle costs and for the production costs, as summarized in Table 5. The hassle costs are expressed in percent of the threshold (to capture the different sizes of different activities) and the production costs in the simplified regimes are expressed in percent of the rebate (which is, presumably set by policy makers to reflect the costs of production). There

are three cases: one in which the actual costs are in fact, much lower than the rebate (by 30%), one in which they are very similar up to 5%, and one in which the actual costs are in fact higher than the rebate. Recall that the agents who bunch at the notch are those who would like to remain in the simplified regimes, which means they have some financial advantage of doing so or prefer the simplicity. This would most naturally be the case if the production costs are in fact lower than the rebate. Nevertheless, some agents would prefer to remain in the simplified regime purely because it allows them more easily to misreport their income. This would be the case for the simulation with $c_m = 120\% \cdot \mu$, since there is then no financial advantage of being in the simplified regime.

The production cost in the standard regime is every time set at 90% of the costs in the simplified regimes: this reflects the fact that in the standard regime, agents can claim the VAT on their inputs, can make use of tax credits and subsidies or preferential treatments as explained in Section 2.

We obtain, for each of these estimations with different values of the hassle and production costs the elasticities presented in Table 6.

TABLE 6: Estimated elasticities

Value of a_r	Value of c_m	Estimated misreporting elasticity	Estimated income elasticity
0	70%	0.50	0.54
0	95%	0.21	0.01
0	120%	0.01	0.17
5%	70%	0.25	0.50
5%	95%	2.71	0.01
5%	120%	0.01	0.02
10%	70%	0.10	0.19
10%	95%	0.50	0.13
10%	120%	1.13	0.01

Notes: a_r is expressed in proportion of the threshold of eligibility y^* , which varies by activity type. c_m is expressed in proportion of the rebate μ , which also varies by activity type.

The benchmark case is the one in which there is an outright and clear financial advantage of being in the simplified regime, i.e., in which the cost of productions are such that $c_m = 70\% \cdot \mu$ and $c_r = 90\% c_m$. The estimated misreporting and income elasticities are both then decreasing in the hassle cost: the larger the underlying hassle costs and the smaller the elasticities needed to generate the bunching observed in the data. If the hassle costs are equal to zero, the elasticities are almost the same with $\eta \approx \varepsilon \approx 0.5$. Since we allow here for two elasticities, they are not directly comparable to those in [Saez \(2010\)](#), who finds total taxable income elasticities between 0.75 and 1.1 for the self-employed at the first EITC kink in his benchmark estimation. With a large hassle cost equal to 10% of the threshold value, the elasticities are much smaller, equal to $\eta = 0.1$ and $\varepsilon = 0.2$.

When there is almost no financial advantage of being in the simplified regime ($c_m = 95\% \cdot \mu$), it is the misreporting elasticity that needs to be much larger to rationalize the observed bunching behavior.

This makes sense: if there is no financial advantage of being in the simplified regime, agents would like to remain in it mostly because it is then easier to misreport income. Finally, when the costs are higher than the rebate $c_m = 120\% \cdot \mu$, it is very difficult to fit the observed bunching. Although we report the elasticities in the table for completeness, the loss function is very large and it is practically impossible to generate the empirical bunching. This is informative and serves almost as a check on the model, because it tells us that it is highly likely that the rebate rates are more generous than actual costs for those who choose to be in the simplified regime. The only other reasonable possibility is shown in the last row of the table, namely if there are very high hassle costs and misreporting is very elastic. In that case, agents are happy to incur the financial loss that comes from the less-than-generous rebate because they can misreport their income more easily and can save on hassle costs.

Case 2: Heterogeneous structural parameters across agents

Next, we relax the assumption that the vector of parameters $(c_m, c_r, a_r, a_m, \kappa)$ is homogeneous across agents.

[TO BE COMPLETED]

6 Conclusion

In this paper we use French Income Tax data from French Internal Revenue Service over the period 1994-2012 to study the effect of fiscal incentives on self-employment. The French system of fiscal incentives forms a particularly interesting quasi-laboratory because it provides both financial advantages and reduced administrative constraints and requirements through several self-employment “regimes,” which have evolved extensively over time. These regimes, ranging from most complex to least complex are the standard regime, the simplified regime and the super simplified regime.

We start by studying the landscape of self-employment and its evolution and to compare the self-employed to wage earners. We then analyze how the 1999 and 2008 reforms, which provided generous fiscal incentives and significant simplifying features for the self-employed affected entry into and income in self-employment. When eligibility thresholds for being in a more favorable and simpler regime are increased (as was the case in the 1999 reform), there was mostly a switch from other regimes into the more generous one and little entry into self-employment. On the other hand, when the administrative hurdles were reduced further in 2008 through the introduction of the super simplified regime, there was significant new entry into self-employment by mostly much smaller than average entrepreneurs.

We propose a simple model of self-employed regime choice and income. We consider whether agents seem to be making rational choices given their tax brackets and the relative fiscal advantages of different regimes for them. It is indeed the case that agents in higher tax brackets are more prone to optimization, which makes sense because they have more to gain from an appropriate regime choice and more to lose from a suboptimal one.

The core of the analysis is to study the bunching behavior around the notches created by the

eligibility thresholds: there are consistently strong and significant excess masses which indicate behavioral responses to the discontinuities in incentives. Since the eligibility thresholds have changed a lot over time, sometimes by small and sometimes by larger amounts, we can follow the excess mass over time. When the threshold changes by a little, there is a smaller bunching at the new threshold, which grows over time, and also a remaining bunching at the old, no longer applicable threshold. When the threshold remains stable over time, there is a progressive increase in bunching. Large changes in the threshold lead to immediate large bunching at the new notch, which keeps growing over time.

Finally, we make use of the empirical bunching masses and the many dimensions of heterogeneity across agents (in terms of activity type, rebates, thresholds, and tax brackets) and over time to estimate the elasticity of real responses, and the elasticity of misreporting.

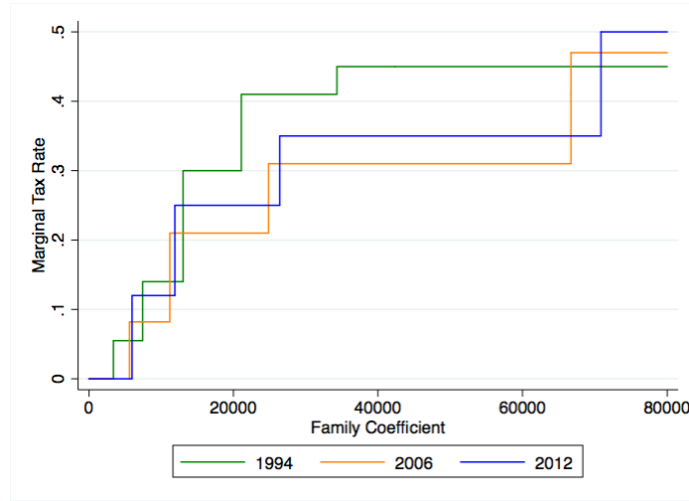
The analysis in this paper can be extended in several direction. A natural next step is to analyze the determinants of entry into self-employment, the factors that influence their growth, and which are the self-employed which end up becoming true “entrepreneurs.” It would also be interesting to know to what extent self-employment is positively or negatively correlated with local unemployment, and whether a transition through self-employment (and through particular regimes within self-employment) helps previously unemployed workers move back into (full-time) employment. There is also scope to study the potential effects of self-employment on the dynamics of human capital accumulation: does it help workers acquire more human capital and limit the depreciation of existing human capital? A final question worth exploring is that of the interplay between self-employment and firm dynamics and whether self-employment is the first step toward the creation and success of new businesses.

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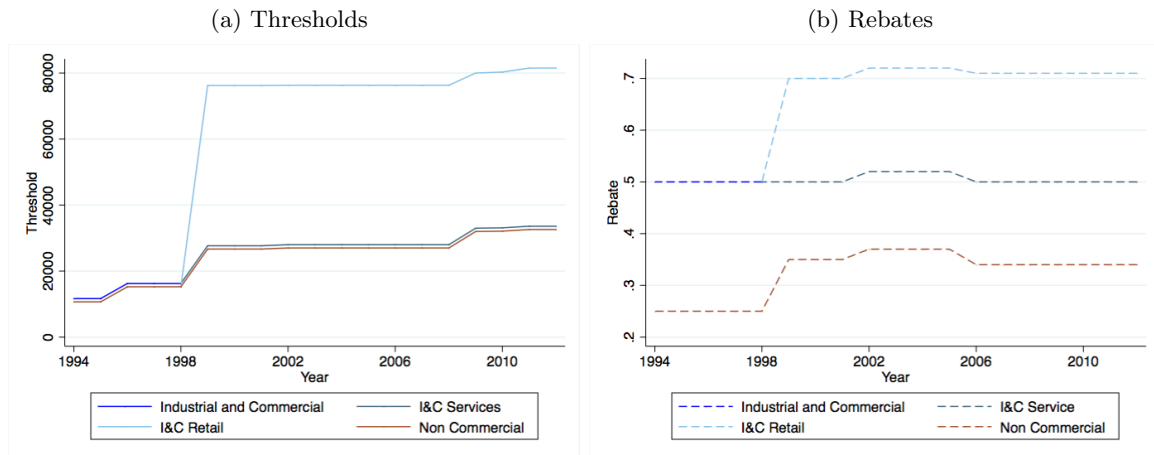
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FIGURE 1: French income tax system 1994-2012



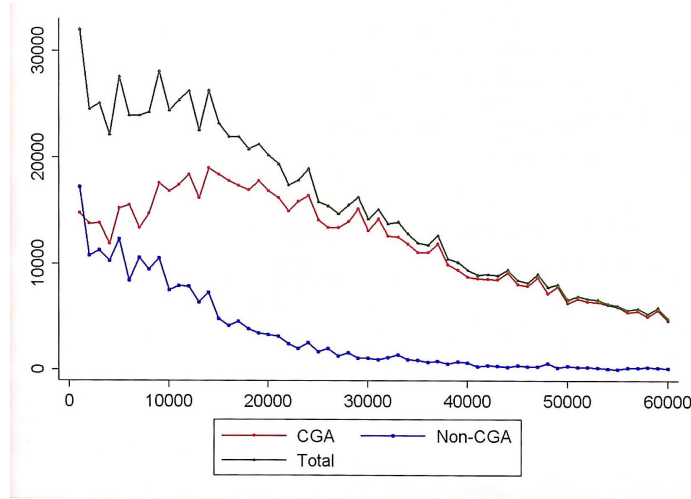
Notes: The Figure shows the marginal tax rates in different tax brackets and for a selected set of years. The x axis shows the family coefficient, i.e., taxable income divided by the number of parts.

FIGURE 2: Rebate and eligibility thresholds for the simplified and super simplified regimes



Notes: The figures show the thresholds (2a) (in panel (a)) and rebates (2b) (in panel (b)) for the different activity types. Before 1999, the I&C Retail and Services cannot be distinguished in the tax data and are thus grouped together into the “Industrial and Commercial” category. Rebates and thresholds have changed a lot over time. The 1999 reform expanded the threshold for the I&C Retail activities and that of the I&C Service activities (which had previously been very low and equal for both types of activities). The 2008 reform introduced the super simplified regime with the same thresholds as the existing simplified regime. The small gap between I&C (Services after 1998) and Non Commercial appears only to make the figure easier to read; in reality the thresholds coincide perfectly.

FIGURE 3: Number of members of a certified accounting center (CAC) in 2011



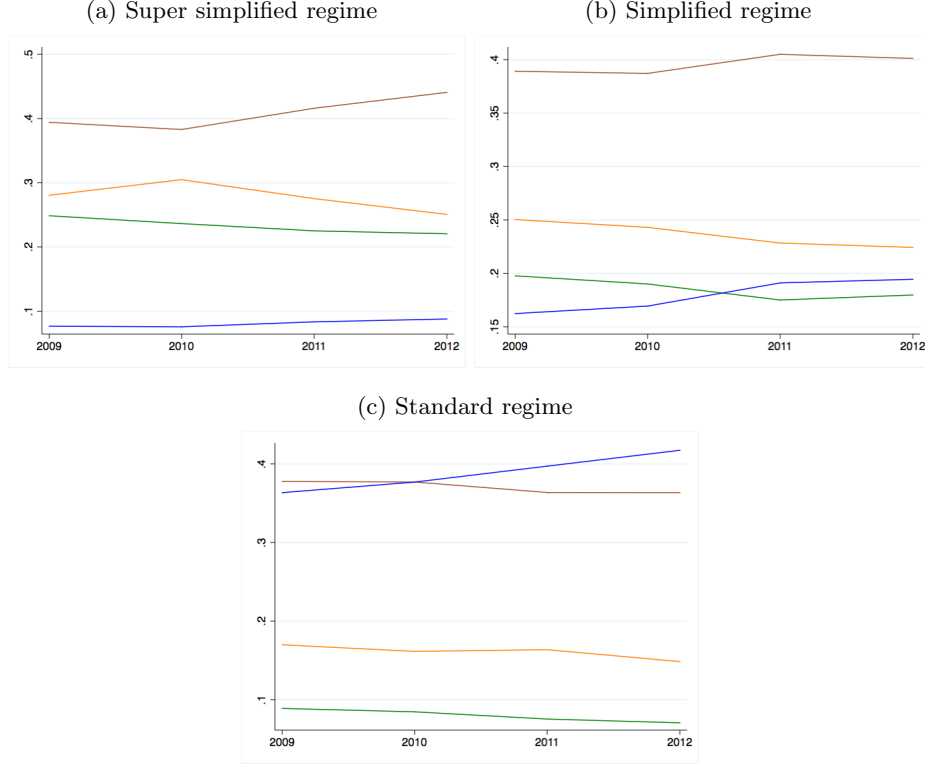
Notes: The figure shows the number of agents in the standard regime who are members of a CAC and the number of those who are not, as well as the total number of agents in the standard regime. The figure is based on the 2011 full population data. The x axis represents taxable income in the standard regime, which is equal to net business income (revenues minus costs). At low income levels, there is a sizable fraction of agents who are not CAC members. That fraction declines rapidly and converges to zero at around 30,000 euros of taxable income.

FIGURE 4: Fraction of self-employed 1994-2012



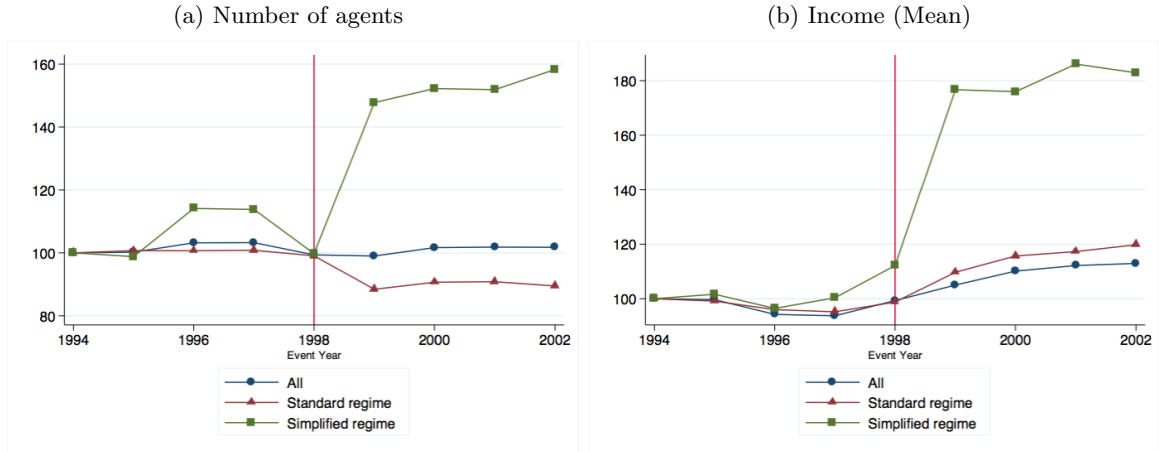
Notes: “Self Employed” denotes individuals who earn any self employment (and may or may not also receive additional wage income). “Self Employed only” denotes individuals who only earn self-employed income. We divide their numbers by the the number of individuals aged between 18 and 65. The two red vertical lines represent the years of, respectively, the 1999 reform and the 2008 reform presented in the text.

FIGURE 5: Distribution of agents across tax brackets by regime



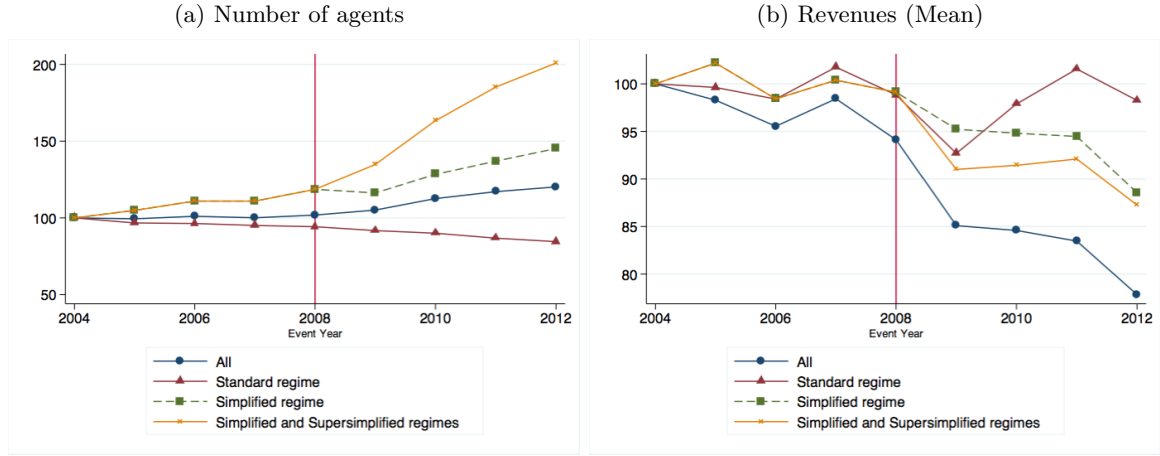
Notes: The figure shows the fraction of agents within different regimes who are in each tax bracket. Zero Tax rate in Green, Low Tax rate in Orange, Medium Tax rate in Sienna and High Tax rates in Blue. Panel (a) shows the super simplified regime, Panel (b) the simplified regime and Panel (c) the standard regime.

FIGURE 6: Event study – The 1999 reform



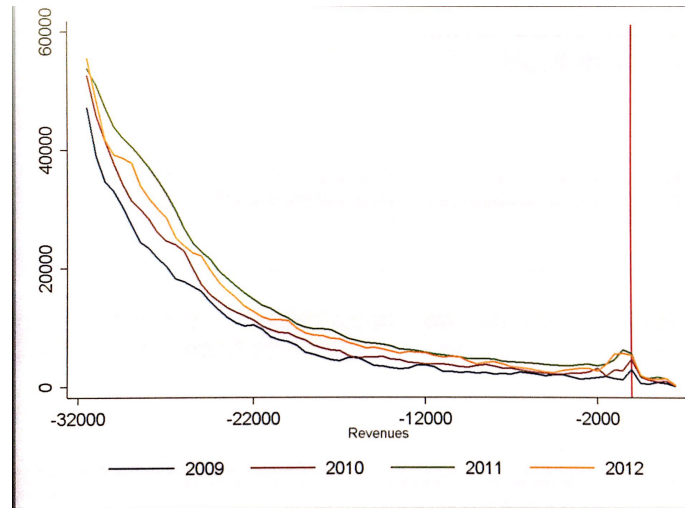
Notes: We normalize all variables so that their value in 1994 is 100. Panel (a) plots the number of agents in each of the standard and simplified regimes, as well as the total number of self-employed. Panel (b) plots the average income per self-employed business for those in the standard regime (reported income is net business income) and those in the simplified regime (reported income is just gross revenues). The 1999 reform greatly increased the number of agents in the simplified regime, increased their average revenues, but did not increase the total number of self-employed.

FIGURE 7: Event study – The 2008 reform



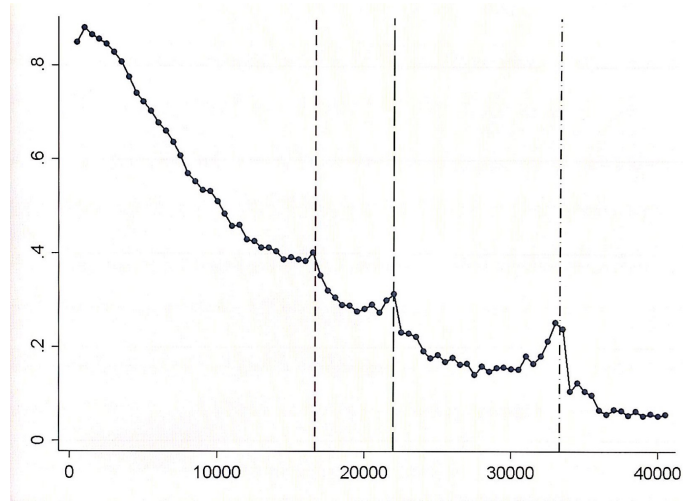
Notes: We normalize all variables so that their value in 2004 is 100. Panel (a) plots the number of agents in each of the standard and simplified regimes, as well as the total number of self-employed. Panel (b) plots the average reported income per self-employed business for those in the standard regime (reported income is net business income) and those in the simplified regime (reported income is just gross revenues). The 2008 reform increased the number of agents in the super simplified regime, and to a lesser extent, overall self-employment. Mean revenues per self-employed businesses fell.

FIGURE 8: Income distribution for the simplified & super simplified regimes 2009-2012



Notes: The horizontal axis shows self-employed gross revenues, centered around the eligibility threshold for the simplified and super simplified regime for each activity, i.e., it plots $y - y^*$ where y is revenues and y^* is the threshold. The figure shows the distribution of centered gross revenues. The red vertical line at zero represents the eligibility threshold.

FIGURE 9: Proportion of agents in the simplified or super simplified regime among all self-employed (2011)



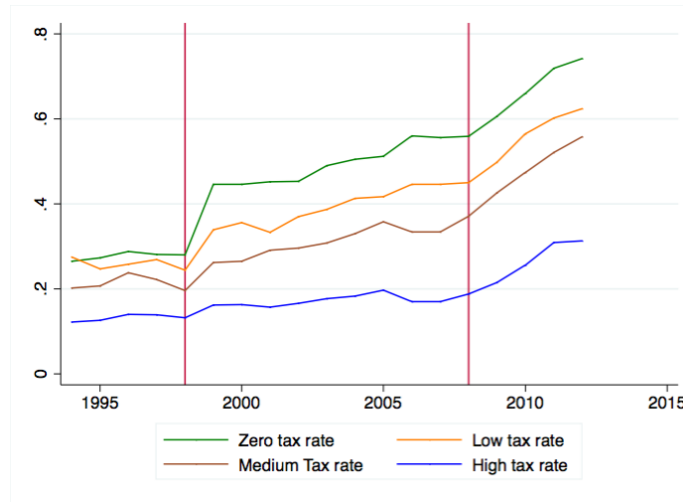
Notes: The horizontal axis represents self-employed taxable income, as defined in the text Section 4.2: it is i) net income for agents in the standard regime, ii) gross revenues times the net of rebate rate for those in the simplified regime, and iii) gross revenues for those in the super simplified regime. The red dashed line represents the threshold (converted into taxable income) for the I&C Services, the green dashed line represents the threshold for the Non Commercial activities, and the blue dash-dot line represents the threshold for the super simplified regime for both I&C Services and Non Commercial Activities.

FIGURE 10: Proportion of agents in the super simplified regime conditional on being in any simplified regime (2011)



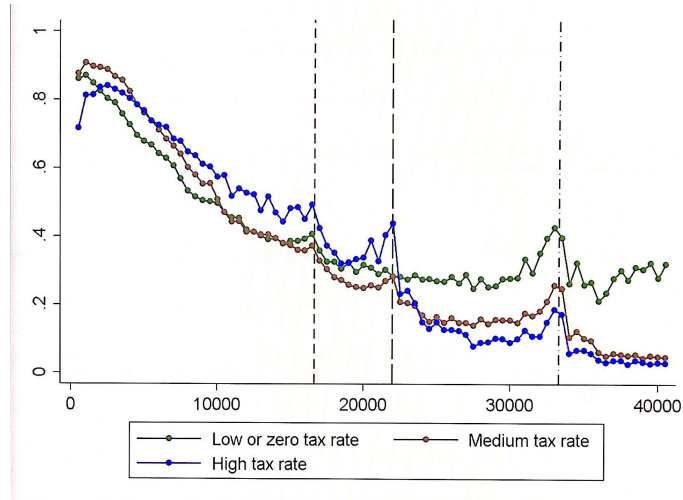
Notes: The horizontal axis shows self-employed gross revenues, centered around the eligibility threshold for the simplified and super simplified regime for each activity, i.e., it plots $y - y^*$ where y is revenues and y^* is the threshold. The figure represents, for each level of self employed revenues, the fraction of agents that choose the super simplified regime among all those eligible and who are in either the super simplified or the simplified regime.

FIGURE 11: Proportion of agents in the simplified or super simplified regime among all self-employed 1994-2012, by tax bracket



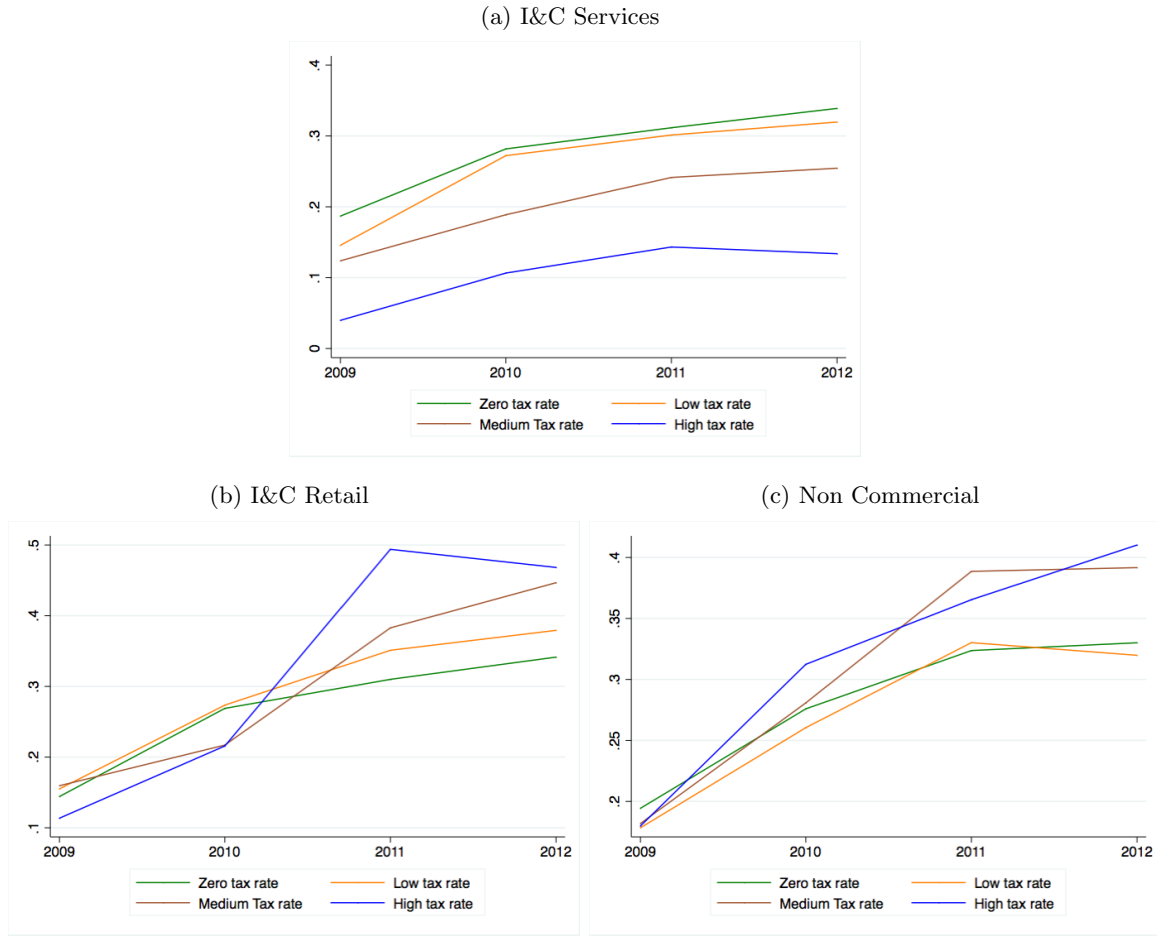
Notes: The figure shows the Fraction of agents who choose the simplified or super simplified regime among all self-employed over the full sample period, and by tax bracket. Tax brackets are as defined in Section 2.

FIGURE 12: Proportion of agents in the simplified or super simplified regime among all self-employed, by tax bracket (2011)



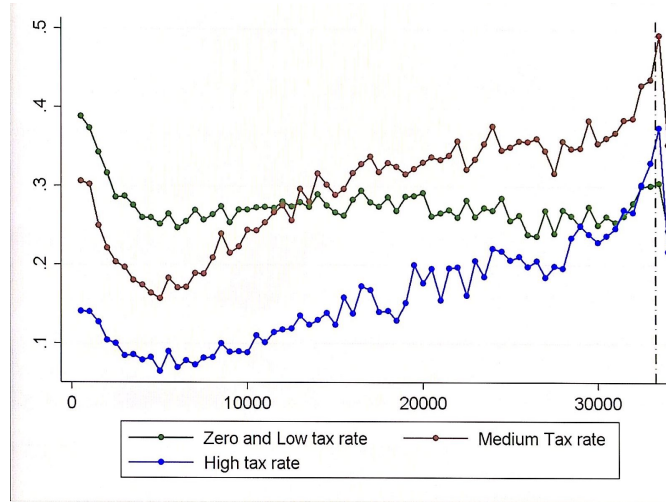
Notes: See the notes to Figure 9 for an explanation of the construction of taxable income on the horizontal axis and the definition of the vertical lines representing eligibility thresholds. The figure shows the proportion of agents who are eligible for the super simplified regime among all self-employed agents and who do pick the super simplified regime. The results are shown for different tax brackets as defined in Section 2.

FIGURE 13: Fraction choosing the super simplified regime over the simplified regime by tax brackets and activities



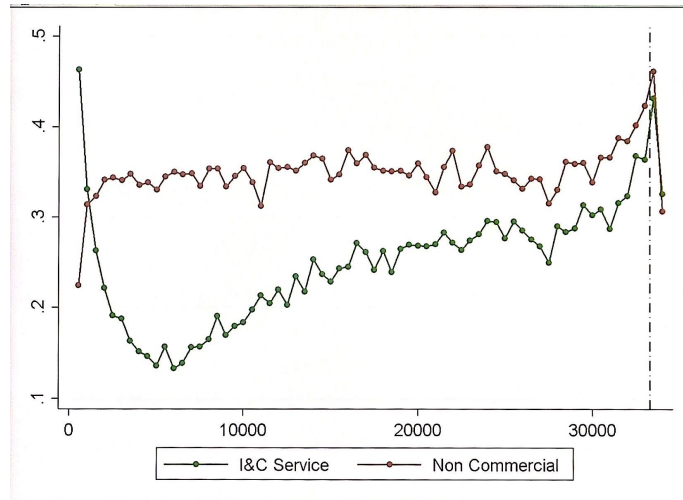
Notes: The figure shows the fraction of agents who chose the super simplified regime among all those who are eligible for the super simplified regime and are in either the simplified or the super simplified regime. The results are shown for different tax brackets as defined in Section 2. Each panel shows a different activity type.

FIGURE 14: Proportion of agents in the super simplified regime conditional on being in any simplified regime (2011) – By tax bracket



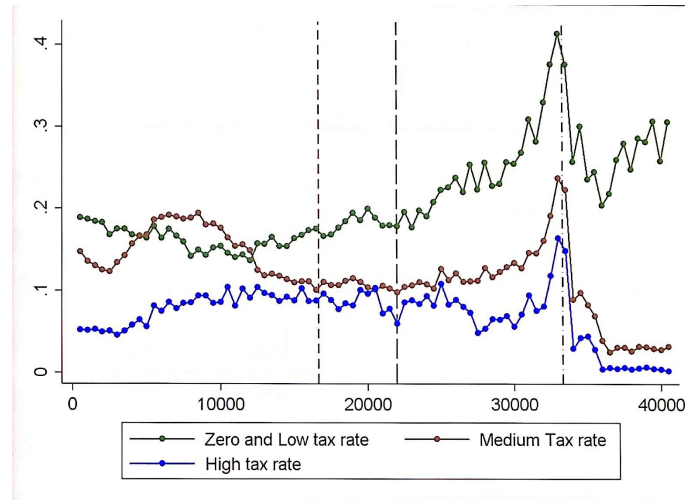
Note: The horizontal axis shows gross revenues. The vertical line is the eligibility threshold for the super simplified regime. The results are shown for different tax brackets as defined in Section 2.

FIGURE 15: Proportion of agents in the super simplified regime conditional on being in any simplified regime (2011) – By activity type



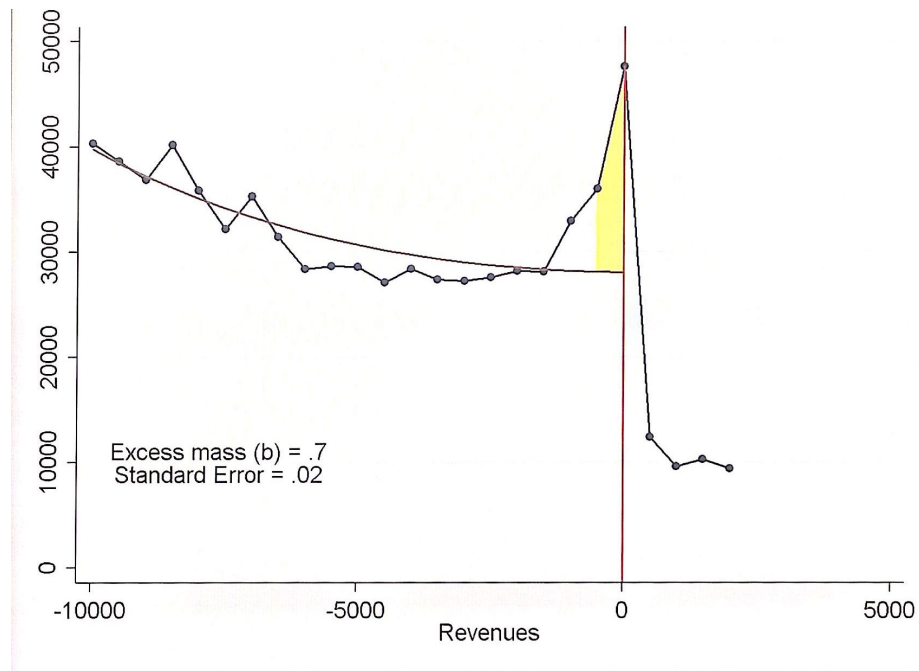
Note: The horizontal axis shows gross revenues. The vertical line is the eligibility threshold for the super simplified regime. The results are shown for the I&C Services and the Non Commercial Activities.

FIGURE 16: Proportion of agents in the super simplified regime among all self-employed (2011)



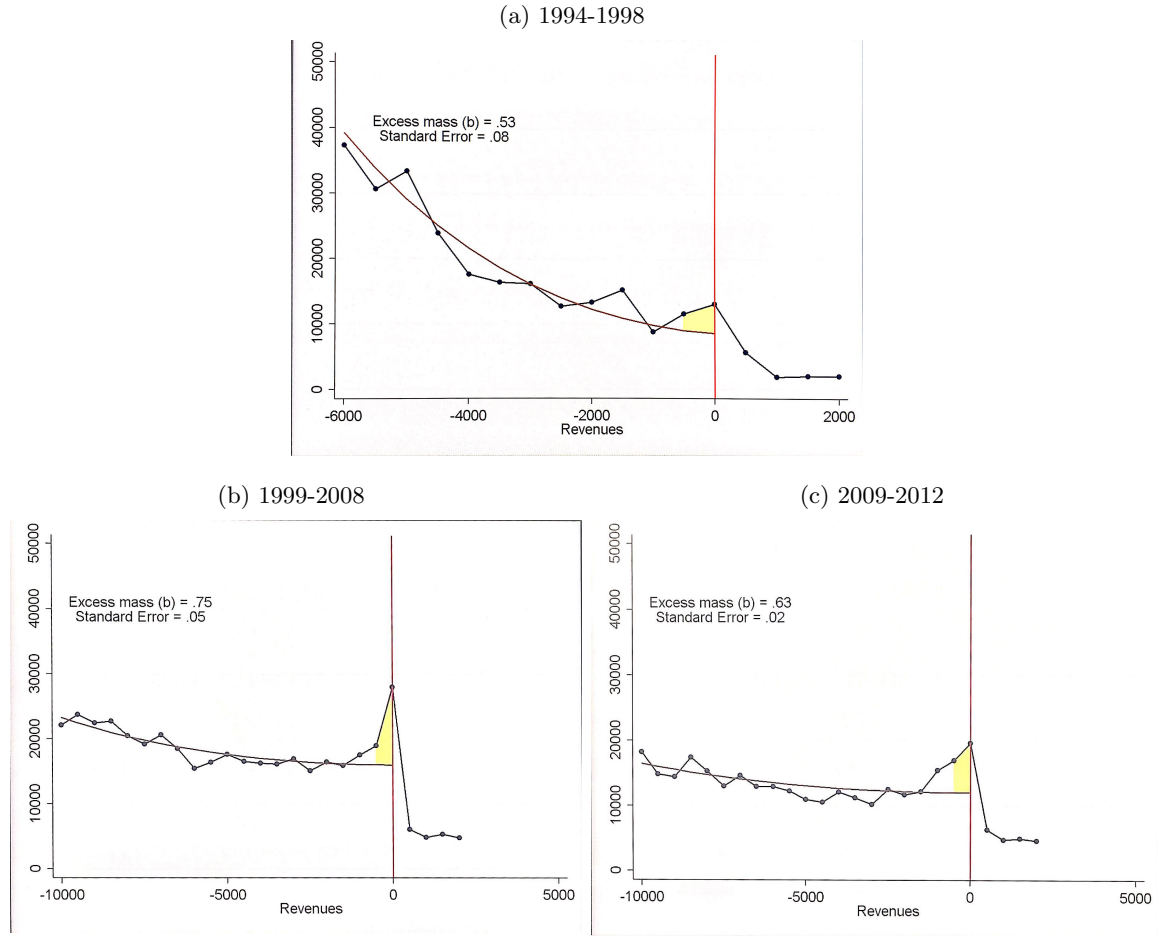
Notes: See the notes to Figure 9 for an explanation of the construction of taxable income on the horizontal axis and the definition of the vertical lines representing eligibility thresholds. The figure shows the proportion of agents in the super simplified regime among all those in any self-employed regime who are eligible for the super simplified one. The results are shown for different tax brackets as defined in Section 2.

FIGURE 17: Bunching at the simplified & super simplified regimes – Eligibility thresholds by period for 1999-2012



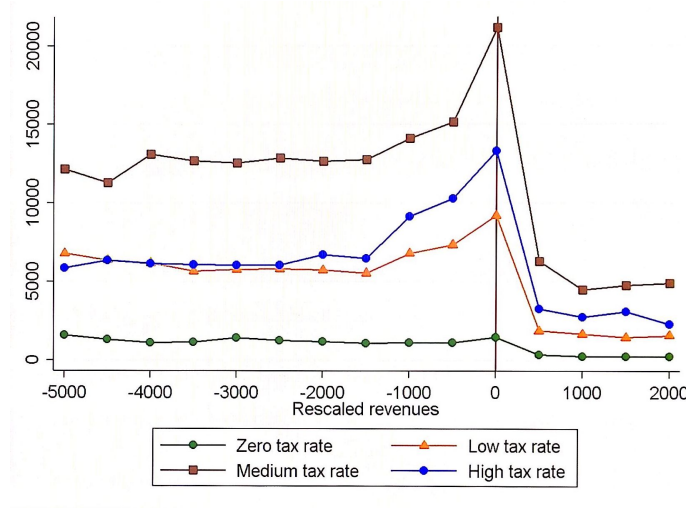
Notes: Frequency of agents by bins of (centered) self-employed revenues, pooled for all years 1999-2012. The vertical red line represents the threshold. The counterfactual distribution (fitted polynomial) is represented by the red curve in the figures. The bunching zone's area excess mass is colored in yellow. There is significant bunching, equal to 70% of the average height of the counterfactual distribution within 1,500 euros of the notch.

FIGURE 18: Bunching at the simplified & super simplified regimes – Eligibility thresholds by periods



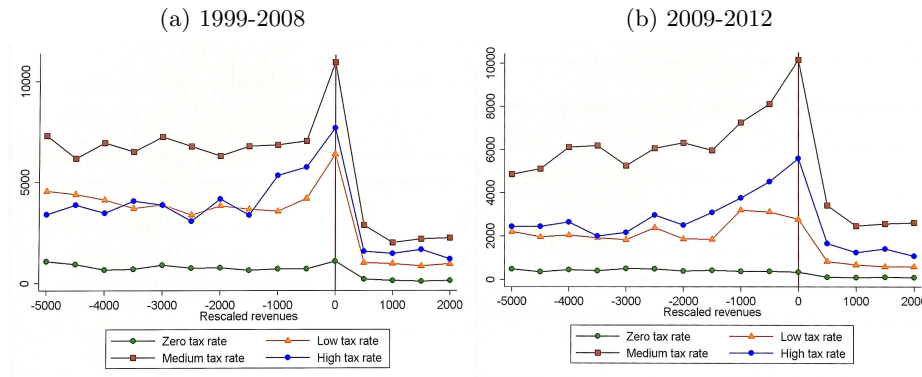
Notes: Frequency of agents by bins of (centered) self-employed revenues centered around their threshold and pooled across 1994-1998 (in 18a), 1999-2008 (in 18b) and 2009-2012 (in 18c). The vertical red line represents the threshold. The counterfactual distribution (fitted polynomial) is represented by the red curve in the figures. The bunching zone's area excess mass is colored in yellow. In all cases, there is significant bunching, equal to, respectively 53%, 75%, and 63% of the average height of the counterfactual distribution within 1,500 euros of the notch. It seems quite natural that the earlier period 1994-1999 exhibits less and less sharp bunching because the simplified regime's threshold was very low and thus the regime was not that desirable to start with.

FIGURE 19: Bunching at the simplified & super simplified regimes – Eligibility thresholds by tax brackets for 1999-2012



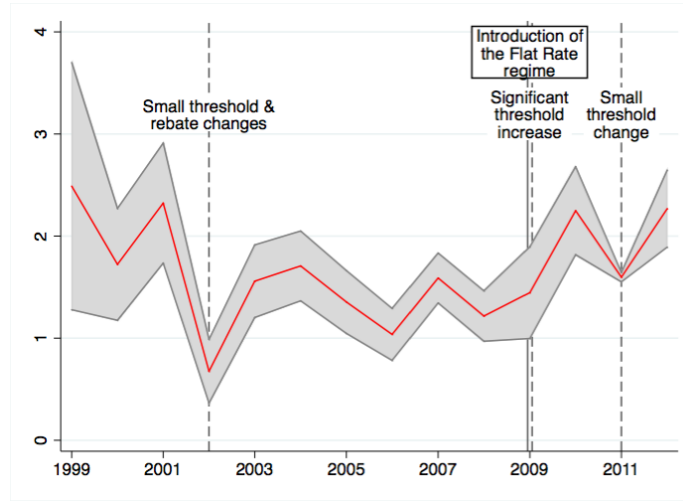
Notes: See the notes to Figure 17. In addition, agents are here split by tax brackets. Bunching is, in proportional terms higher for the high tax rate agents. All results are reported in Table 3.

FIGURE 20: Bunching at the simplified & super simplified regimes – Eligibility thresholds by tax brackets for 1999-2008 and 2009-2012



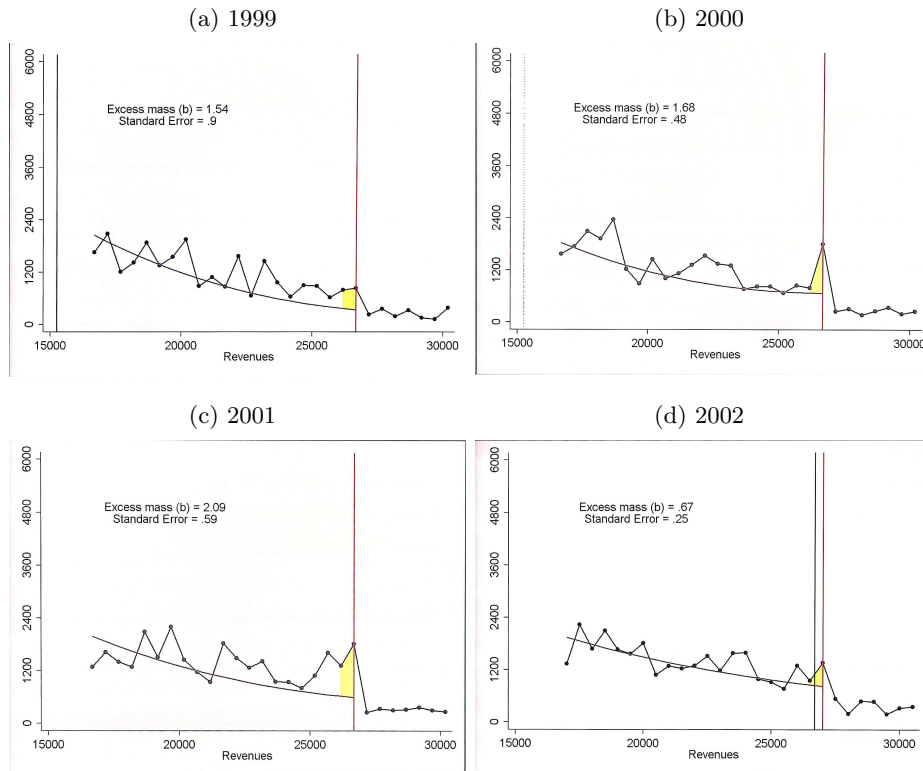
Notes: See the notes to Figure 19.

FIGURE 21: Bunching estimates year by year for 1999-2012



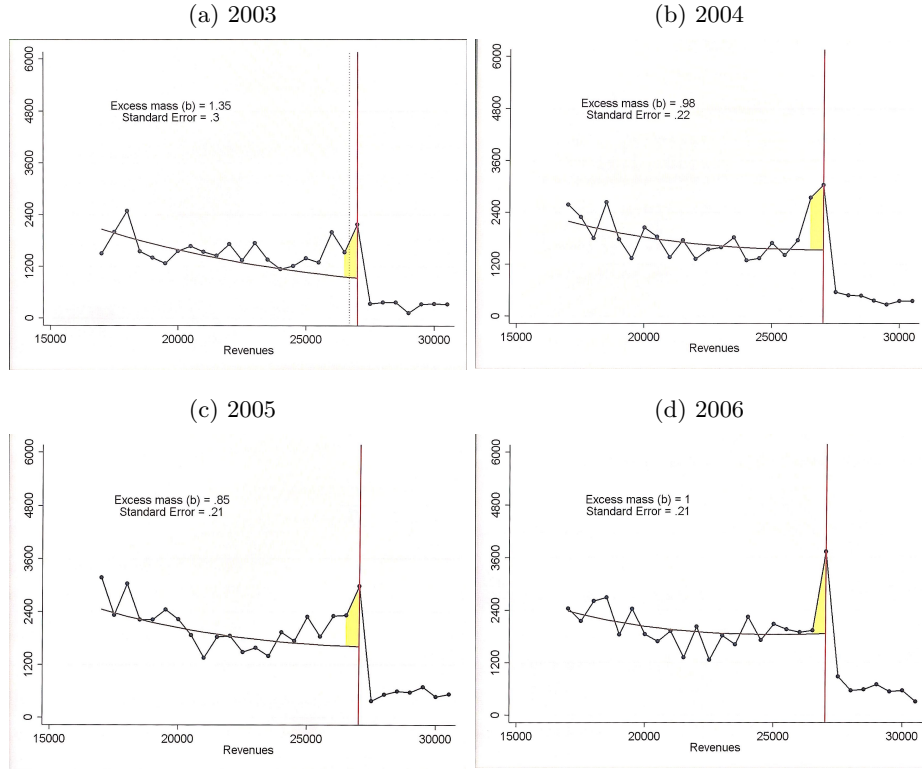
Notes: The figure shows the value of the excess mass with its standard error band (the width of which is two standard errors, centered around the point value), estimated as explained in the text and represented in Figure 22, 23, and 24. The dotted lines represent years with threshold or rebate changes.

FIGURE 22: Bunching estimates by year 1999-2002



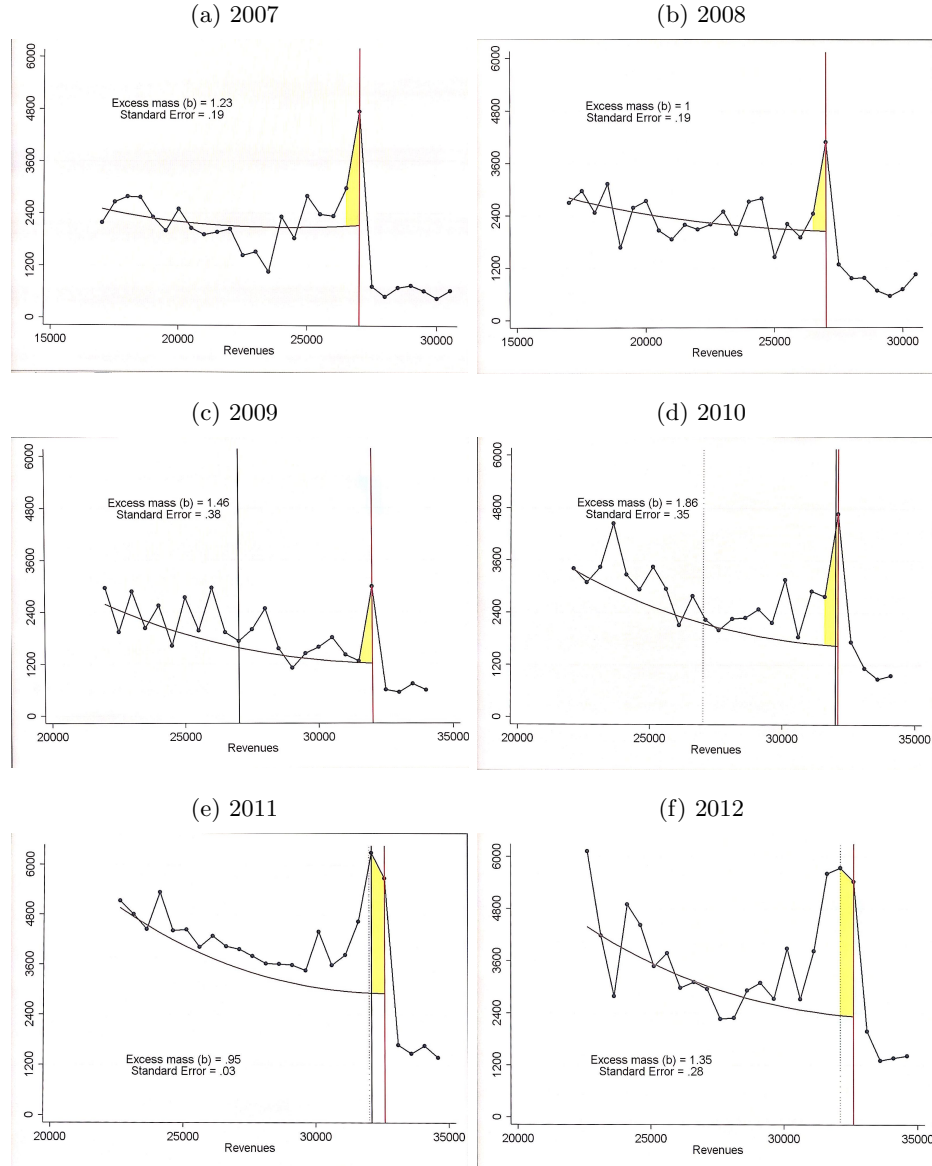
Notes: See the notes to Figure 17. The black solid vertical line represents the threshold in year $t - 1$. The dashed vertical lines represent the threshold for year $t - 2$. If the threshold has not changed for more than two years, it coincides with the year t (current threshold) which is the red vertical line.

FIGURE 23: Bunching estimates by year 2003-2006



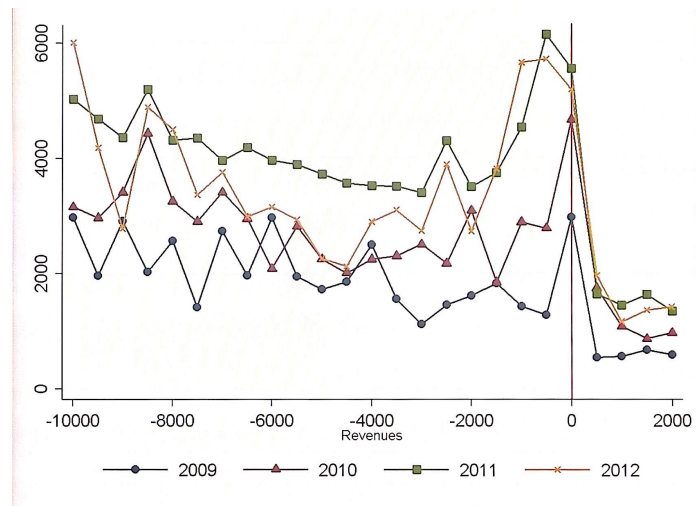
Notes: See the notes to Figure 17. The black solid vertical line represents the threshold in year $t - 1$. The dashed vertical lines represent the threshold for year $t - 2$. If the threshold has not changed for more than two years, it coincides with the year t (current threshold) which is the red vertical line.

FIGURE 24: Bunching estimates by year 2007-2012



Notes: See the notes to Figure 17. The black solid vertical line represents the threshold in year $t - 1$. The dashed vertical lines represent the threshold for year $t - 2$. If the threshold has not changed for more than two years, it coincides with the year t (current threshold) which is the red vertical line.

FIGURE 25: Bunching after the introduction of the super simplified regime



Notes: See figure 19.

TABLE 7: Summary statistics for the French population and samples 1994-2012

Panel A

	All	With wage income only	With self- employed income only	With any self-employed income
Age	40.00	40.00	49.00	48.00
Female	0.47	0.48	0.32	0.33
Married and Civil Union	0.50	0.49	0.63	0.62
Children	0.41	0.41	0.39	0.41
Number of Children	0.71	0.71	0.70	0.72
Retired	0.06	0.06	0.17	0.14
Unemployed	0.11	0.11	0.03	0.05

Panel B

Wage Income	19576	20549	0	6005
SE Income	2004	0	32982	29934
Total NS Income	2056	39	33238	30163
Capital Income	2154	1875	5148	6047

Panel C

Zero Tax rate	0.16	0.16	0.15	0.14
Low Tax rate	0.32	0.33	0.23	0.22
Medium Tax rate	0.38	0.39	0.31	0.32
High Tax rates	0.14	0.13	0.31	0.32

Panel D

Population (in mill.)	532.7	497	26.3	35.6
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Notes: “With wage income only” refers to individuals with only wage income. “With self-employed income only” refers to individuals with self-employed income only. “With any self-employed income” refers to people with any self-employment (who may also have wage income). “All” refers to any individual who earns either some wage income or some self-employed income (or both). All variables in panels A and C are expressed in percent of the full group represented in each column. “Age” is expressed in years. Panel B provides average income in each category in constant 2012 euros. Panel D gives the total population in each column for the whole period. “Unemployed” refers to the fraction who have perceived any unemployment benefits during the year (they must have also received some self-employed or wage income to be in this table).

TABLE 8: Summary statistics for the French population and samples 1994-1998

Panel A

	All	With wage income only	With self- employed income only	With any self-employed income
Age	40.00	39.00	48.00	47.00
Married and Civil Union	0.56	0.55	0.68	0.68
Children	0.43	0.43	0.42	0.44
Number of children	0.77	0.77	0.76	0.79
Retired	0.08	0.07	0.16	0.14

Panel B

Wage Income	18377	19329	0.00	5275
SE Income	1927	0	30254	28438
Total NS Income	1963	26	30435	28601
Capital Income	1457	1250	3642	4306

Panel C

Zero Tax rate	0.19	0.20	0.16	0.14
Low Tax rate	0.36	0.37	0.26	0.25
Medium Tax rate	0.31	0.31	0.28	0.28
High Tax rates	0.14	0.12	0.30	0.32

Panel D

Population (in mill.)	130	121.2	6.8	8.8
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Notes: See Table 7.

TABLE 9: Summary statistics for the French population and samples 1999-2008

Panel A

	All	With wage income only	With self- employed income only	With any self-employed income
Age	40.00	40.00	49.00	48.00
Female	0.46	0.47	0.31	0.31
Married and Civil Union	0.50	0.49	0.64	0.63
Children	0.40	0.40	0.39	0.40
Number of children	0.70	0.70	0.70	0.72
Retired	0.05	0.04	0.16	0.14
Unemployed	0.09	0.10	0.02	0.03

Panel B

Wage Income	19750	20711	0	5824
SE Income	2066	0	34963	32032
Total NS Income	2123	42	35249	32291
Capital Income	2203	1904	5531	6533

Panel C

Zero Tax rate bracket	0.15	0.15	0.14	0.13
Low Tax rate bracket	0.32	0.32	0.22	0.21
Medium Tax rate bracket	0.38	0.38	0.30	0.31
High Tax rates bracket	0.15	0.14	0.33	0.35

Panel D

Population (in mill.)	283.8	265.5	13.7	18.3
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Notes: See Table 7.

TABLE 10: Summary statistics for the French population and samples 2009-2012

Panel A

	All	With wage income only	With self- employed income only	With any self-employed income
Age	41.00	41.00	50.00	48.00
Female	0.48	0.49	0.35	0.36
Married and Civil Union	0.45	0.44	0.57	0.55
Children	0.39	0.39	0.36	0.37
Number of children	0.67	0.67	0.63	0.66
Retired	0.07	0.06	0.21	0.17
Unemployed	0.13	0.14	0.04	0.07

Panel B

Wage Income	20470	21503	0	7145
SE Income	1939	0	31506	26980
NS Income	1999	46	31776	27213
Capital Income	2803	2493	6008	6801

Panel C

Zero Tax rate	0.13	0.13	0.18	0.16
Low Tax rate	0.29	0.30	0.20	0.20
Medium Tax rate	0.46	0.47	0.36	0.38
high Tax rates	0.11	0.10	0.26	0.26

Panel D

Population (in mill.)	118.8	110.3	5.8	8.5
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Notes: See Table 7.

TABLE 11: Summary statistics by type of activity 1994-2012

Panel A

	All	Industrial and Commercial (Retail and Service)	Non Commercial
Age	48.00	49.00	46.00
Female	0.33	0.28	0.41
Married and Civil Union	0.63	0.65	0.59
Children	0.41	0.39	0.44
Number of Children	0.73	0.68	0.80
Retired	0.14	0.16	0.11
Unemployed	0.05	0.05	0.05

Panel B

Wage Income	6049	5265	7538
SE Income	30505	22718	45376
Total NS Income	30733	23029	45454
Capital Income	6133	6040	6552

Panel C

Zero Tax rate	0.13	0.16	0.08
Low Tax rate	0.22	0.26	0.14
Medium Tax rate	0.32	0.34	0.29
High Tax rates	0.33	0.24	0.49

Panel D

Population (in mill.)	34,7	22.5	12.6
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Notes: See Table 7.

Appendix

A.1 Institutional Details

A.1 French Tax System Primer

The French tax schedule typically looks as follows:

Bracket	Lower Bond	Upper bond	Marginal rate
1	$\underline{y_0} = 0$	$\underline{y_1}$	τ_1
2	$\underline{y_1}$	$\underline{y_2}$	τ_2
3	$\underline{y_2}$	$\underline{y_3}$	τ_3
4	$\underline{y_3}$	$\underline{y_4}$	τ_4
5	$\underline{y_4}$	∞	τ_5

In order to determine the tax amount to be paid by a household, the first thing to compute is the Family coefficient y which is defined as the ratio between taxable income Y and the number of parts N of the household :

$$y = \frac{Y}{N} \quad (\text{A1})$$

The household that has a family coefficient $y \in [\underline{y_{M-1}}; \underline{y_M}]$ belongs to the bracket M . Then, the amount of tax the household has to pay is :

$$T(y, N) = N \times \left[\sum_{m=1}^{M-1} \tau_m \times (\underline{y_m} - \underline{y_{m-1}}) + \tau_M \times (y - \underline{y_{M-1}}) \right] \quad (\text{A2})$$

For instance, for a household with a family coefficient $y \in [\underline{y_2}; \underline{y_3}]$, we have :

$$T(y, N) = N \times (\tau_1 \times \underline{y_1} + \tau_2 \times (\underline{y_2} - \underline{y_1}) + \tau_3 \times (y - \underline{y_2})) \quad (\text{A3})$$

Cap of the Family Coefficient

Let's assume that the number of parts is $N_b + N_a$ where N_b is the base number of parts, and N_a is the additional number of parts. To calculate the cap, one first calculates the tax that would apply without the additional parts: $y^b = Y/N_b$. We must then consider two possible situations : if the additional number of parts N_a (i) does place the household in a higher tax bracket, or (ii) does not place the household in a higher tax bracket.

Situation 1

If the additional number of parts N_a does not place the household in a higher tax bracket, then :

$$T(y^b, N_b) = N_b \times \left[\sum_{m=1}^{M-1} \tau_m \times (\underline{y}_m - \underline{y}_{m-1}) + \tau_M \times (y^b - \underline{y}_{M-1}) \right] \quad (\text{A4})$$

The difference in taxes is :

$$T(y^b, N_b) - T(y, N) = (N_b - N) \times \sum_{m=1}^{M-1} \tau_m \times (\underline{y}_m - \underline{y}_{m-1}) + \tau_M \times (N_b y^b - N_b \underline{y}_{M-1} - N y + N \underline{y}_{M-1}) \quad (\text{A5})$$

By definition, we have $Y = N_b y^b = N y$, then :

$$T(y^b, N_b) - T(y, N) = (N_b - N) \times \sum_{m=1}^{M-1} \tau_m \times (\underline{y}_m - \underline{y}_{m-1}) + \tau_M \times \underline{y}_{M-1} (N - N_b) \quad (\text{A6})$$

We can re-arrange the expression to obtain :

$$T(y^b, N_b) - T(y, N) = (N_b - N) \times \left[\sum_{m=1}^{M-1} \tau_m \times (\underline{y}_m - \underline{y}_{m-1}) - \tau_M \times \underline{y}_{M-1} \right] \quad (\text{A7})$$

Situation 2

If the additional number of parts N_a places the household in a higher tax bracket, then :

$$T(y^b, N_b) = N_b \times \left[\sum_{m=1}^M \tau_m \times (\underline{y}_m - \underline{y}_{m-1}) + \tau_{M+1} \times (y^b - \underline{y}_M) \right] \quad (\text{A8})$$

The difference in taxes is :

$$T(y^b, N_b) - T(y, N) = (N_b - N) \times \sum_{m=1}^{M-1} \tau_m \times (\underline{y}_m - \underline{y}_{m-1}) + \tau_M \times (N_b \underline{y}_M - N_b \underline{y}_{M-1} - N y + N \underline{y}_{M-1}) + \tau_{M+1} N_b \times (y^b - \underline{y}_M) \quad (\text{A9})$$

A.2 Computational Appendix