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The Effect of Regional Taxes on the Mobility of Top Income Taxpayers

Taxation and Mobility

Within decentralized countries, the tax burden of high-income individuals varies substantially across sub-national jurisdictions due to regional income taxes. Variation of tax rates within countries, where mobility costs might be low, means that taxes may matter when individuals determine where to legally declare their residence. Recent cases reported in the popular press document that "superstar" individuals move across countries to receive a reduced tax treatment. For example, actor Gérard Depardieu left France to avoid the so-called millionaire tax. In some cases, declaring a different residential location is done as a means of tax evasion: German tennis star Boris Becker was sentenced to two years of prison after the authorities found out that his main residence was still Munich, even though he claimed to live in low-tax Monte Carlo.

We focus on Spain, which decentralized autonomy concerning personal income taxes to the regional authorities. The regional variation provides tax-motivated reasons for individuals to relocate to low-tax regions or to falsely declare their region of residence.

Kleven et al. (2019) survey the existing literature on tax-induced mobility. Studies finding significant responses often focus on specific groups such as star scientists (Moretti & Wilson 2017; Akcigit et al. 2016), athletes (Kleven et al. 2013), or foreigners subject to preferential taxation (Kleven et al. 2014; Schmidheiny and Slotwinski 2018). Other studies looking at high-income taxpayers find smaller effects (Young and Varner 2011; Young et al. 2016).

The Spanish case

Through its process of fiscal decentralization, Spain has granted substantial autonomy to the Autonomous Communities (regions). From 2011 onwards, the regions have the ability to change tax brackets and the respective marginal tax rates on the regional portion of the personal income tax base. The central government taxes half of the personal income tax base and the regions tax the remaining half. Figure 1 shows the range of tax schedules across Autonomous Communities which emerged by 2014. The graph shows the marginal tax rates of each Autonomous Community relative to the tax rates set by the central government on the other half of the tax base. Relative to this standard, some

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regions increased their taxes while others decreased their taxes. Most important, is the fact that the differential is particularly pronounced at the top of the income distribution. An individual in Catalonia with income of more than €175,000 has a marginal tax rate that is 2 percentage points more relative to if Catalonia had simply mimicked the central government tax rate. Madrid, on the other hand, set a tax rate 2.5 percentage points less than the central government rate. Thus, the differential between these two marginal tax rates is 4.5 percentage points. This tax differential may provide incentive for individuals to change residence.

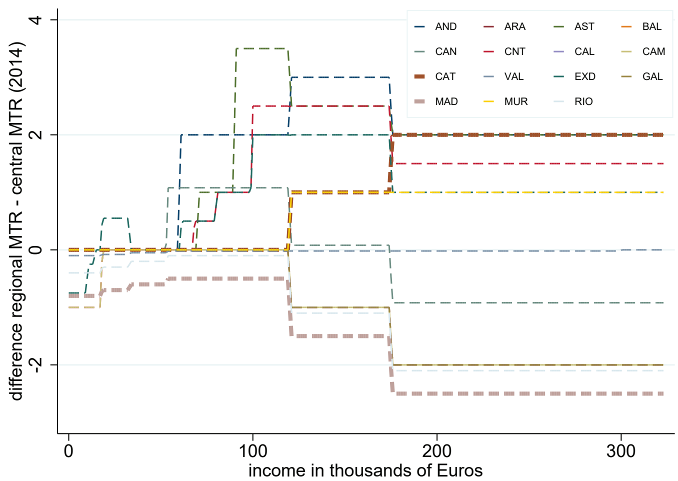

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Figure 1. Regional Tax Rates

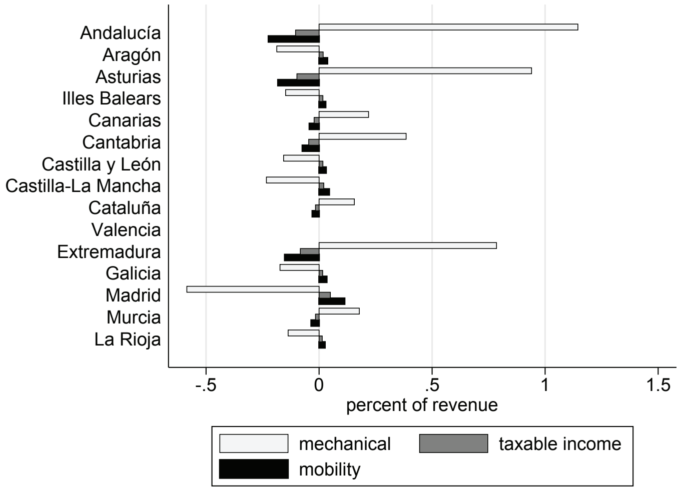

Figure 2. Revenue Responses

Do High-Income Individuals Change Residence?

The short answer is yes. In our paper, Agrawal and Foremny (2019), we use social security records combined with region-specific tax rates to answer this question. We study individuals' location choices and determine the relationship between changes of residence and the regional tax differentials. We focus our analysis on individuals in the top 1% of the labor income distribution where differences in tax rates are salient. Our analysis suggests that, for example, a 0.75 percentage point differential in the average tax rate between Madrid and Catalonia increases the likelihood that a high-income person resides in Madrid by 2.25 percentage points. Self-employed individuals react more intensely. Furthermore, heterogeneous effects by industry suggest the largest effects are in the health, real estate, information, financial, and professional/scientific industries.

Implications for Tax Revenues

We use our mobility estimates to investigate how regional tax differentials change tax revenues. Any change in taxes can have multiple effects. Consider a tax increase. First, ignoring changes in labor supply or migration, tax revenue mechanically increases due to a higher tax rate. Second, tax revenue also falls because of declines in the amount of taxable income that individuals declare. Third, tax revenue also declines due to net migration out of the region. Figure 2 shows a simulation from Agrawal and Foremny (2019) that decomposes these three effects for the average tax changes for individuals in top one percent. We find that the mechanical effect always substantially outweighs the sum of the two other effects. Thus, regions that lowered tax rates saw revenue decline on personal income taxes, while regions increasing tax rates realized revenue gains even in the presence of tax-induced mobility.

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