Treatment of the reduction of local residence tax in the quarterly national accounts

Local residence tax was reduced in Q4 2018 for around 80% of households

The Finance Law for 2018 included a 30% reduction in local residence tax for around 80% of French households (eligibility is determined with reference to taxable income, taking family size into account). This reduction, also known as an abatement, is scheduled to continue over the coming years, leading to the total disappearance of the local residence tax.

The total due for local residence tax is set for each fiscal household on an annual basis. Variations in this total nonetheless need to be taken into account in the quarterly national accounts, which aim to provide a macro-economic description of the recent past, providing a snapshot not yet available from the annual accounts. The Conjoncture in France reports exist within the same conceptual framework as the quarterly accounts, attempting to predict the principal aggregates for the next quarters.

Seasonal adjustment of the tax series requires specific processes

Most of the economic aggregates featured in the quarterly accounts are sensitive to the effects of periodic phenomena of a seasonal nature. In order to calculate the quarterly progression of these aggregates without such fluctuations, they are corrected for seasonal variation. The series for household income and taxes and social contributions are no exception to this rule, and are thus corrected for seasonal variation. Taxes, and income tax in particular, nonetheless receive special treatment when it comes to seasonal adjustment.

As explained in *Insee Méthodes* No.126 (2012), these series "present a unique statistical challenge because their trends change every year, in response to changes in the tax rate and the tax base. But the seasonal adjustment mechanism cannot anticipate these changes, particularly those due to changes in tax rates. To avoid the need for dramatic revisions, seasonal adjustment is performed by forecasting the overall annual variation and the quarterly variations in each tax at the start of each year. Thereafter, the predicted quarterly values are revised after each quarter, taking into account the actual values recorded instead of the estimate, and adjusting the annual forecast accordingly."

New measures (such as tax cuts) are also subject to specific seasonal adjustment measures: they are "taken into account in the quarter in which they take effect for households. When reforms become permanent, or at least when economic agents can plan ahead for them with some certainty, their values are integrated into the seasonal variation for the series."

For the year in which it is introduced, a permanent tax reduction will be entered into the accounts in the season in which it takes effect; for the ensuing years, it will be directly integrated into the seasonal profile of the corresponding series, i.e. smoothed over all four quarters.

Usually, in the absence of measurements, seasonal adjustment requires the total amount of local residence tax paid by households to be spread evenly over the four quarters of the year, for the purposes of the quarterly accounts. In 2018, the actual payments levied for this tax were reduced in Q4 and this reduction should thus also be recorded in Q4 in the seasonally-adjusted national accounts.

A tax cut such as the reduction in local residence tax should, in the first year of implementation, be entered into the accounts in the quarter in which it takes effect (in this case Q4 2018), corresponding to the moment the change becomes effective[1]. Since the reduction introduced in 2018 is permanent, in subsequent years it should be incorporated into the seasonally-adjusted series, i.e. spread evenly over the four quarters of 2019.

To put it another way, for the year 2019 the annual total of local residence tax (less the permanent reduction of 30% introduced in 2018, but before the application of the further reductions scheduled to take effect thereafter) should be spread across the four quarters of the year. As such, in the seasonally-adjusted national accounts the total sum that households are held to have paid in local residence tax should increase between Q4 2018 (where the 30% reduction introduced in 2018 is taken into account) and Q1 2019 (which will only take this reduction into account as a smoothed average over four quarters, i.e. only a quarter of the total). The total paid in Q1 2019 should nonetheless be smaller than the sum paid in Q1 2018.

Given that local residence tax is calculated annually, interpreting year-on-year variations is probably easier than attempting to keep track of quarterly fluctuations.

The abolition of local residence tax for eligible households is scheduled to come into force progressively over several years. As such, a similar phenomenon should be observed in late 2019 and early 2020, when the second phase of the local residence tax abatement will be implemented. In Q4 2019, there should be a clear decrease in the sums paid by households, followed by a less substantial rebound in Q1 2020, corresponding to the smoothing of this new reduction over the four quarters of 2020.

1. That is to say at the time when the debt obligation arises, more precisely at the time when the amounts due are represented by a document; indeed, the notice of taxes due simply forces the taxpayer to pay for the tax.

Given that local residence tax is calculated annually, these infra-annual movements do not necessarily have a direct impact on household consumption behaviour. In general, households smooth their consumption based on their anticipated income status, including any reduction in local residence tax. Hence an annual interpretation remains more pertinent than tracking the quarterly fluctuations. ■

Bibliography

INSEE (2012) "Methodology of the quarterly national accounts" Insee Méthodes No. 126 - May ■