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# TAX PROFESSIONALS' VIEW OF THE SPANISH TAX SYSTEM: EFFICIENCY, EQUITY AND TAX PLANNING

José Mª Durán-Cabré, Alejandro Esteller-Moré

Tax Systems' Analysis

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Postal Address:
Institut d'Economia de Barcelona
Facultat d'Economia i Empresa
Universitat de Barcelona
C/ Tinent Coronel Valenzuela, 1-11
(08034) Barcelona, Spain
Tel.: + 34 93 403 46 46
Fax: + 34 93 403 98 32
ieb@ub.edu
http://www.ieb.ub.edu

# TAX PROFESSIONALS' VIEW OF THE SPANISH TAX SYSTEM: EFFICIENCY, EQUITY AND TAX PLANNING [*]

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ABSTRACT: The design of a tax system is a daunting task. Economies have become increasingly complex, which makes the design of taxes has to take into account behavioral taxpayers' responses - including mobility -, but also tax planning issues. Additionally, increasing inequality trends put more pressure on design. This complex framework increases the need of complete and constantly updated information about the functioning of the system to carry out welfare-enhancing reforms and having stable sources of public funding. It seems now the moment the Spanish tax system takes advantage of all sources of information to undertake a necessary reform. For this ambitious purpose, we aim at providing a novel source of information: the (objective) opinion of tax professionals. From a survey all over Spain, tax professionals unanimously conclude the current tax system is unfair, while the main inefficiencies, rather than due to traditional responses, come out as a consequence of tax planning and tax mobility. We hope the complete results of the survey are a useful source of information.

*MAIN RESULT: From their daily-practice, tax professionals might provide lots of insights into the functioning of a tax system. We have conducted a survey among them regarding the Spanish Tax System (2012); they unanimously conclude the current one is unfair, while the main inefficiencies, rather than due to traditional responses, come out as a consequence of tax planning and tax mobility.*

José Mª Durán-Cabré
Facultat d'Economia i Empresa
Universitat de Barcelona & IEB
Av Diagonal 690, Torre 6 Planta 2
08034 Barcelona (Spain)
E-mail: jmduran@ub.edu

Alejandro Esteller-Moré
Facultat d'Economia i Empresa
Universitat de Barcelona & IEB
Av Diagonal 690, Torre 6 Planta 2
08034 Barcelona (Spain)
E-mail: aesteller@ub.edu

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## 1. Introduction

The Spanish tax system, as any tax system, is far from being a perfect one made of fair, efficient and simple taxes, perfectly coordinated, and that yield enough revenue to finance public expenditure. In practice, there is not a perfect tax system such that economic analysis mainly concentrates on how taxes should be levied to enhance economic efficiency and to promote a fair distribution of income. Because, despite there are not perfect systems, "the way in which these systems are designed matters enormously to economic welfare" (Mirrlees *et al.*, 2011, p. 1).

Economic theory and empirical research are useful tools for assessing the impact of taxes on economic agent's behavior and on the economy as a whole. For instance, public finance has traditionally shown that the corporate tax (CT) and the personal income tax (PIT) should equally levy economic activities so the tax system makes no difference with respect to their legal structure (*e.g.,* Crawford and Freedman, 2010). Regardless the firm is incorporated or not, the tax treatment should be the same. A similar situation happens as far as businesses' financial decisions are concerned. Payments of interests are deductible for the taxable base of the CT, but the opportunity cost of equity finance is not, which provokes a bias towards debt financing that might have deepened the recent financial crisis (*e.g.* Slemrod, 2009; and Keen *et al.*, 2010). Another interesting example is the Value Added Tax (VAT). It has widely been adopted as a general sales tax mainly because has better compliance properties than a retail sales tax and it is clearly superior compared to consumption taxes on producers or wholesalers (Cnossen, 1998). However, in the European Union, the cradle of the tax, VAT is heavily criticized by academics due to numerous exemptions, reduced rates and special schemes that much complicate the tax and cause distortions. In fact, the very European Union in 2010 issued a *Green Paper* on the future of VAT under the title "Towards a simpler, more robust and efficient VAT".

These three examples, pointed out by the academic literature among others, show that better designed taxes can improve tax systems and so that there is scope for more equitable, efficient and simple tax systems. But, what is the opinion of tax professionals, that is, of those working in the private sector and that advice people and businesses in their tax obligations[1]? They play an important role in the application of tax systems, particularly in the Spanish tax system where almost all taxes work under self-assessment schemes, that is, taxpayers assess the rule and calculate tax liabilities[2]. Do they think the system is *really* fair? Is it *really* efficient? Is it *really* simple or rather complex, which in turn is a source of inequity and distortions? All in all, according to their *real* practice, is there an *objective* need to reform the whole tax system or any particular tax? These are some of the many questions that we raise in a survey among tax professionals working all over Spain in collaboration with the two most important professional associations in the field of taxation. From the academia, researchers can easily identify distortions (for example, marginal tax rates on labor income, differential

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[1] In the literature we find examples of surveys sent to tax professionals to know their opinions about tax policy. For instance, the American National Tax Association sent a survey in 1994 to their members, including a subset of a survey questions already given to senior public finance professors in 1934 (see Slemrod, 1994). More recently, in 2013, another tax policy survey was distributed to their member, although their results have not been published yet.

[2] This is probably the main reason why Spain has the lowest ratio citizens / tax administration employees within the European Union (27). According to Onrubia (2013), in 2009 there were in Spain 1,928 citizens per tax administration employee. The average value for the EU (15) was 966 and for the EU (27) 896.

fiscal treatment of financial costs in the CT or differential tax rates on consumption depending on the good or service), but do they cause a change in the behavior of agents? Only if this is so, there will be efficiency losses. That can be empirically tested by means of econometric analyses, which usually, though, require strong identification assumptions. In this paper, we adopt another approach, complementary to the empirical one, which bases on asking tax professionals, among others, whether taxes cause changes of behavior or whether there is tax planning that would tend to lower the tax revenue potential and also cause inequity as long as planning is concentrated on rich taxpayers. This approach allows to obtain relevant information not only for a single tax, but will allow us to get a complete picture of the Spanish current tax system, and about different dimensions (efficiency, equity or tax planning).

Tax advisers have a practical knowledge of taxation, for instance, of complicated tax avoidance schemes or simpler tax planning practices designed to reduce the final tax invoice. Application issues are often very important as legal loopholes or different legal options can significantly alter the final amount to pay and, therefore, the real effect of taxes. Nowadays, tax legislation runs to over thousands of pages becoming only comprehensible to specialists, whereas average citizens and even economists might get tangled. For that reason, it is important to know their opinions about equity, efficiency and tax planning when assessing a tax system. As we will latter comment, the results show that the Spanish tax system is considered to be regressive, as the greatest burden does not fall on rich individuals, but on medium and working-class individuals; inefficient, mainly due to tax planning and tax avoidance schemes, as well as mobility of tax bases; and increasing complex, mostly due to endogenous factors of the system. On the whole, the conclusion is that there is a need for a global reform of the tax system. We share Slemrod's hope when summarizing the results of a similar survey conducted in 1994 by the National Tax Association[3] among American tax professionals: They "will be of interest to both tax professionals and policymakers, and will stimulate a discussion of the policies themselves" (Slemrod, 1994, p. 145), and we add with the aim of improving the system.

The rest of the paper is organized as follows. In the next section, we analyze some issues of the Spanish tax system, albeit common in other countries, which are particularly relevant as far as efficiency, equity and taxing planning are concerned. In section 3, we explain the survey and the main results and we end with some conclusions.


## 2. Efficiency, equity and tax planning issues

Tax systems are usually the result of often conflicting objectives and compromises, as it is not possible to meet all of them at the same time. For instance, a lump sum tax is efficient, but it is not fair as everyone would pay the same regardless his ability to pay. A comprehensive income tax with a very progressive tax schedule can be fair, but high marginal tax rates can be very inefficient as they create economic distortions due to changes in people's behavior. There is a trade-off between equity and efficiency, which can totally alter the final effect of a measure. For instance, higher marginal rates in the PIT, as Spain introduced in 2011 "in order to provide greater fairness to the tax"[4], could

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[3] See fn. 1.
[4] Preamble of Act 39/2010 that increased rates.

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foster the progressivity of the tax, but if well-advised richest taxpayers can avoid higher marginal rates through tax avoidance schemes or tax planning activities, the final result as far as equity is concerned can be very different. Therefore, the final outcome depends very much on the rule of the whole tax system, not only of a particular tax, and also on tax enforcement[5].

But there are not only trade-offs between equity and efficiency in the PIT, because often one can observe conflicts among other objectives and with respect to other taxes. Exemptions and reduced tax rates in the VAT are clear examples. Generally based on social grounds, they complicate the tax, making more difficult both compliance for taxpayers and enforcement for tax administration, and what is worse it seems that they are a weak instrument to help the less well-off (Crawford, *et al.*, 2010). In addition, they go against neutrality of VAT, which then can distort businesses' decisions.

We next analyze some of these conflicting situations in the current Spanish tax system, also common in other countries, particularly taking into account issues related to efficiency, equity and taxing planning.

## 2.1 *Tax schedules and tax bases in the personal income tax and corporate tax*

It is important to jointly assess PIT and CT as both levy income, which may allow to transfer income from one tax to another. Statutory tax rates are a key issue of any tax and usually concentrate much attention in public opinion, particularly top marginal tax rates of the PIT even though they usually levy a small proportion of taxpayers. In the 2011 Spanish tax, only 3.52 % of taxpayers reported a general tax income greater than 60,000 euros, which means that the overall majority of individuals are in the first four brackets of the tax schedule. In other words, only a very small proportion pays the four top marginal tax rates (from 46.9% to 56%, depending on the region)[6]. On the other side, the statutory tax rate in CT is 30%, although most incorporated firms enjoy 25% tax rate for the first 300,000 euros of profits. Therefore, a difference of up to 30 perceptual points, that already reaches 20 points from income slightly greater than 53.000 euros. Thus, in Spain, but also in many other countries, an owner of an unincorporated firm has the opportunity to incorporate his activity with the aim of reducing his tax liability. Indeed, De Mooij and Nicodème (2008) explore income shifting from the personal toward the corporate tax base for 17 European countries between 1997 and 2003. And their results suggest that the tax gap between personal and corporate tax rates exerts a significant positive effect on the degree of incorporation as between 10% and 17% of corporate tax revenue can be attributed to income shifting[7]. The literature reminds us the ideal would be that the legal form of a business should make no difference to its tax treatment *(e.g.* Crawford and Freedman, 2010).

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[5] Diamond and Saez (2011) defend that optimal top rate in the PIT should be modified when: tax avoidance channels produce changes in tax revenue in other periods or other tax bases; and also when tax avoidance or evasion can be reduced through base broadening and tax enforcement. Hence, they obtain that very high earners should be subject to rising marginal rates (and higher than current U.S. rates) as a policy recommendation.

[6] Although their tax liabilities account for approximately 33% of all revenue yielded.

[7] In an empirical study for Spain, Domínguez Barrero *et al.* (2005) suggest that differences between personal and corporate taxes are not significant as far as the incorporating decision is concerned, although the same authors are cautious about the results due to the reduced number of observations.

In fact, this is one of the aims of the dual tax that Nordic countries apply since the early nineties, where all capital income, regardless the specific kind of income and if it is obtained by an individual or by a corporation, is taxed at the same reduced flat rate (Cnossen, 1999). This enhances neutrality as all capital income is levied homogenously, but at the same time improves vertical equity, as tax planning through incorporating business is mainly concentrated on richest individuals (Sorensen, 1994). However, Spain and most EU countries do not have a pure dual income tax, whereby smaller tax rates in CT may increase tax distortions. The average statutory tax rate of the CT in the EU (27) has fallen since the beginning of the XXI century (from an average of 31.9 in 2000 to 23.9 in 2009), although the top marginal rate of the PIT also fell (from an average of 44.8 in 2000 to 37.2 in 2009[8]). Both trends end with the economic crisis once countries introduce consolidation measures. Nevertheless, the change is not the same. While the CT statutory rate remains stable since 2010 (around 23.2%), the top marginal PIT rate has been increased in 13 out of 27 EU states (the average top marginal rate has risen to 38.9 in 2013). This is very true in Spain, where top marginal PIT rates have moved from 43% in 2010 to 56% since 2012. The wider the gap between CT and PIT rates, the more attractive is incorporating activities. Professional opinions, or should rather say, the knowledge of professional of daily tax practices can cast light on the incorporation of activities.

In addition to similar tax schedules, a neutral treatment of economic activities requires taxable income is assessed in a similar way in both PIT and in CT. However, the Spanish PIT foresees the objective estimation for small businesses according to the so-called "signs, indexes and modules". Under this system, taxpayers can assess their taxable income taking into account different variables that the rule sets and which vary depending on the specific economic activity; for instance, number of employees, number of self-employed, surface or electric energy. Hence, taxpayers pay the tax regardless their real profits. The opinion among scholars is almost unanimous: the system is inefficient, as similar businesses may pay very different taxes depending on its legal structure (incorporated or not). But in addition the system is considered to be unfair, rather complex and even becomes a source of tax fraud. Consequently, it requires a complete overhaul (e.g., Paredes (2010), Rubio and Romero (2013), Esteller-Moré and Durán-Cabré (2013))[9]. Tax advisers seem to share the same opinion[10].

## 2.2 *Corporate tax and efficiency on businesses' financial decisions*

Under most countries' CT, firms have traditionally deducted payments of interest from taxable base, although are not allowed to deduct the opportunity cost of equity finance. The rule therefore builds a bias towards debt financing. With the arrival of the crisis, more attention has been paid on the effect of CT on the financial decisions of businesses. Empirical studies (*e.g.* Slemrod, 2009; Keen *et al.*, 2010) show that this distortion was not a major cause of the financial crisis, but by contributing to the excessive level of leverage might have deepened it.

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[8] Source *Taxation Trends in the European Union*, 2013 ed., Eurostat.
[9] More than 50 leading academics, researchers and specialists in taxation identify the complete overhaul of the objective estimation as one of the ten key points for a real tax reform in Spain (Esteller-Moré and Durán Cabré, 2013).
[10] As far as tax fraud is concerned, a particularly interesting result of the survey is that from their experience 64% of professionals fully agree and 24% rather agree with the following statement: "The objective estimation by modules makes tax fraud easier in the PIT and other taxes of the tax system".

There are two main proposals in the literature to eliminate this distortion[11]. On the one hand, the Comprehensive Business Income Tax (CBIT), which does not allow to deduct payments of interest. Under this system, tax revenues rise, since then tax profits become bigger; and the level of investment might go down as the user cost of capital increases. On the other hand, the Allowance for Corporate Equity (ACE), which introduces an allowance for the cost of equity finance. Various forms of the ACE tax have been used, for instance, in Belgium and Italy, but other countries, such as Germany, France or United Kingdom, have limited the deductibility of interest from taxable income. Spain joined this latter group in 2012, as interest payments are deductible up to one million of euros, or 30% of profits when this latter amount is larger than the former. Rather than improving efficiency in the treatment of debt and equity, the aim of the new limitation is to raise more revenue fighting against international debt shifting that multinationals develop to take profit of different tax rates among countries[12].

Consequently, there is still a bias towards debt financing in the Spanish CT, although smaller due to the limitation on the deduction of interest. Nonetheless, the limit is probably binding only for big companies, as it is unlikely that small and medium size companies pay interests above one million of euros. On the other hand, small and medium size companies face more financing constraints, because financial institutions requires them more guarantees and generally have less financial information (Albi, 2013). Therefore, the bias towards debt may also depend on the size of firms. Again, tax advisers' experience can cast light on it.

### 2.3. *Inheritance and gift tax, the role of regions and equity*

Most economies raise relatively little revenue from inheritance and gift taxes. Furthermore, most individuals would never pay the tax[13]. Nonetheless, the inheritance and gift tax (IGT) generates big attention from the public opinion and the mass media, and often becomes the subject of intense political debate.

IGT is frequently justified on the grounds of fairness. The distribution of wealth is more unequal than the distribution of income and has become even more unequal in recent years (Piketty and Zucman, 2013). Supporters of the tax defense that redistribution of wealth should be an objective of the tax system, and therefore levying inheritances is an efficient means to improve wealth distribution. If that is true, the structure of the tax should be consistent with that aim. Nonetheless, this is not always the case, as the tax law often creates loopholes that are used by people to avoid or significantly reduce the tax bill. If wealthy well-advised taxpayers are those that take most advantage of them, it produces doubts about the fairness of the IGT as equivalent wealth transfers pay very different amounts of tax depending on its composition (Durán-Cabré and Esteller-Moré, 2014).

In Spain, for instance, business assets can obtain at least 95% deduction when assessing taxable wealth. Furthermore, once regions (so-called Autonomous Communities (ACs))

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[11] Jérez and Picos (2012) estimate the effects that the application of this type of reforms would have in Spain.

[12] Huizinga *et al*. (2008) find that a firm's leverage depends on national tax rates as well as international tax rate differences. Moreover, international debt shifting is shown to reflect a subsidiary's tax rates, differences vis-à-vis the parent firm as well as vis-à-vis other foreign subsidiaries.

[13] For instance, only 2% of Americans pay the tax (Boadway *et al.*, 2009).

had legal power, many introduced almost full exemption of transfers to spouse and children. In 2012, 11 out of the 17 communities almost do not levy theses inheritances, which generates big pressures to do the same on those still taxing them[14]. The inheritance tax is due according to the residence principle of the deceased, regardless where the heirs live. Having second houses in other regions is not unusual for those who expect to transfer their wealth to their heirs, which makes easier to change the official place of residence. Although the tax law tries to avoid these changes by requiring a five-year gap before the new region's rule becomes applicable, fighting against tax avoidance practices is not easy. Savings from changing the residence can be substantial, as the tax due goes from a big amount to almost nothing[15]. In addition, the gift tax of estates is due to the region where the estate is located, which also makes easier tax planning activities to avoid in the future the inheritance tax without any official change in the place of residence. In 2012, 6 regions did not levy gifts made by the donors to their spouses or children.

Table 1 shows some illustrative examples for two regions, Andalusia, the most populated AC of Spain, and Madrid. Same value transfers in the same AC are taxed in a very different way, depending both on the type of property (eligible for permanent residence or business assets deductions) and on the relationship with the deceased (columns 1 and 2). But in addition, tax liabilities are very different depending on which region levies the transmission (column 3). These important differences make (relatively) smart tax planning very profitable, and so tax advisers play an important role.

[TABLE 1]


2.4 *VAT: neutral for business and equitable for citizens?*

VAT represents one of the pillars of present-day tax systems and despite being a relatively new tax it has been rapidly adopted thanks to its supposed advantages. While the tax was only first levied in France in 1954, during the final third of the last century it was rapidly adopted, so that today it is charged in more than 150 countries[16]. Three main reasons can explain its rapid generalization: globalization makes easier to disseminate ideas, which also holds for taxation; VAT is neutral in its impact on international trade, since the tax due remains clearly separate from the tax base, and so applying the destination principle VAT does not affect the relative prices of products; and it can raise a significant amount of revenue in a rather efficient way (OECD; 2011). However, the Spanish and the EU's VAT systems are heavily criticized by academics and, as we shall see, by professional tax consultants on the grounds of their complex and distorting regulations.

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[14] The Spanish press headlines on these issues are symptomatic of the situation. For instance, "La competencia fiscal autonómica", *El Periódico* 24/10/2007; "La guerra fiscal entre comunidades amenaza el tributo sobre las herencias", *El País* 06/05/2007; "Imposición autonómica y voto con los pies", *Expansión* 22/03/2011; and "Grandes bufetes eligen sitios fuera de Cataluña y Andalucía para sus clientes", *Expansión* 05/07/2007.

[15] Generally, 34% marginal rate is applied from 800,000 euros of taxable wealth, but tax liability can be increased between 20% and 240% depending on the relationship with the deceased and the previous wealth of the heir.

[16] Although the tax had been first proposed in the 1920s by a German businessman, Wilhelm von Siemens, the tax was first introduced in France 1954 thanks to the tax inspector, Maurice Lauré, typically considered to be the father of VAT (Owen *et al.*, 2011).

Indeed, VAT is a harmonized tax within the European Union, being its basic framework outlined in regulations that date back to 1977 (referred to as the Sixth Directive), when the European Economic Community comprised just nine Member States and the economic and social reality was very different from that which prevails today. Moreover, the philosophy guiding these first regulations was the desire to uphold the status quo, which has given rise to numerous exemptions, reduced rates and special schemes that greatly complicate the tax (Cnossen, 2003). Clearly, the economic situation has changed significantly in the intervening years, but VAT has remained unchanged, owing to a situation of inertia, and the inherent difficulties in changing the regulations governing any tax, which in this case would require the unanimous agreement of all Member States. And, now, we are dealing with 28 versions of the status quo! (Durán-Cabré and Esteller-Moré, 2013).

For socio-economic reasons, certain activities of general interest (such as hospital and medical care, goods and services linked to welfare and social security work, school and university education and certain cultural services) are exempted. However, when the supply of goods or services is exempt, the supplier cannot deduct the VAT on purchases, which means that 'hidden' VAT remains included in the price paid by the purchaser. This has important implications as VAT becomes no neutral for businesses leading to distortions of production patterns[17], to distortions on international trade and to more expensive prices to businesses while final consumers pay cheaper prices[18]. Furthermore, exemptions have a revenue cost, increase both compliance costs to businesses and administrative costs to governments as well as litigation[19] (Durán-Cabré, 2013).

Another source of distortion and complexity is the existence of reduced and super-reduced rates, based on redistribute grounds[20]. These rates may be applied, when a country so decides, solely to a closed list of goods and services previously identified by the EU directive. In proportion, reduced rates of VAT benefit more poor households according to an empirical study for nine European countries[21]. Nonetheless, on average, richer households gain more in absolute cash terms, which points to the limitation of using VAT to redistribute. Indeed, if the savings of a Spanish family in the lowest decile (based on family spending, the variable that best represents their welfare) amount on average to 444 euros, the savings of families in the highest decile reach 1,831 euros (Institute for Fiscal Studies, 2011b). The answer to the question if reduced rates ensure that the tax is more equitable by being applied to staple goods is not clear.

Since 2008, and the onset of the crisis, 16 of the 27 EU countries have increased their standard VAT rate, so that overall it has been increased a total of 32 times. Spain

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[17] The effective tax rate entailed by exemption depends on the share of total value that is added before the exempt link in the supply chain. This share is not fixed and a firm can minimize it by supply, for instance, their own technical support and cleaning services, rather than contract them out.

[18] For instance, this happens with financial services, which are VAT-exempt and consequently under-taxed to households and over-taxed to businesses. Two common complaints are that it has been too cheap and easy for households to borrow, but too expensive and difficult for businesses to obtain finance. VAT exemption contributes to both of these (Institute for Fiscal Studies, 2011a).

[19] The lack of clear rules leads to litigation, as the final scope of exemptions is often set by the Court of Justice of the European Union (European Commission, 2010).

[20] From the optimal taxation theory, Mankiw e*t al.* (2009) recommends that taxes on goods and services should avoid intermediate goods and be uniform across final goods. However, Diamond and Saez (2011) defend that some variation is well justified, although limiting variation is appropriate.

[21] These are Belgium, France, Germany, Greece, Hungary, Italy, Poland, Spain and the United Kingdom.

provides a clear example of this situation, having increased the overall rate by more than 30% during this time. Consequently, it seems reasonable to think that VAT revenues are set to rise considerably in the future, especially once the level of consumption recovers from the sharp drop it has suffered. Accordingly, the aforementioned problems derived from a defective design of the tax can only be worsened in the future.

## 3. A Survey among the Tax Professionals regarding the Spanish Tax System

In 2012, we conducted a survey among tax professionals working all over Spain. The aim of the survey was contrasting to what extent the academic assessment of the tax system is in accordance with the *opinion* of the professionals. What do we mean by opinion? We are not interested in inferring their individual preferences about the distribution of taxes or the level of taxation, but about the functioning of the tax system given their daily professional practice. Even so, this opinion might be biased, for example, according to the territory where they mostly work (as there might be differences in the legal definition of taxes and in their very administration across Spanish regions) or according to the "size" of the firm they work for (as, for example, the type of customers, and so the type of cases, might differ between small and big consultancy firms). We will try to control for this potential biases, as we will next show.

We distributed the survey among tax professionals through the two most important Spanish professional associations in the field of taxation, "Asociación Española de Asesores Fiscales" and "Registro de Economistas Asesores Fiscales"; in any case, in the survey it was clearly stated that our research institute – Institut d'Economia de Barcelona (IEB) – was in charge of its design and exploitation. The responses were anonymous and were submitted *on-line* ([www.EncuestaFacil.com](www.EncuestaFacil.com)); the IP address served as a filter to avoid duplication of responses through a given computer. We got 272 responses[22]. Apart from those concerning the tax system, we also included questions about the personal characteristics of the respondent (sex, age, level of studies and years of experience) and those directly related to the firm in which she works (geographical location, number of workers and labor status). These responses should be useful as to (try to) control for potential biases in the responses.

The content of the survey was designed in such a way we could get information about the relevance of distortions – identified from the academic literature – caused by taxes, and most important, whether they provoke changes of behavior (including mobility) and practices of avoidance[23], that is, an assessment of the **efficiency** of the system. In theory, the more equitable (progressive), the less efficiency is a tax system, although distortions are not only provoked by progressive rates. We will check whether this is so.

### 3.1. *Equity of the Spanish Tax System*

Regarding the equity dimension, we posited the following simple question: *Do you*

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[22] The whole set of results of the survey is available at
https://www.dropbox.com/s/p65ghdozhvmtjz2/Survey_tax_professionals.xlsx

[23] In any case, as Saez, Slemrod and Grietz (2012) argue all of them embody efficiency costs.

*think rich people are those who pay the greatest share of taxes, or instead, medium and working-class people do so?*[24] The response was overwhelmingly: 93.4% consider the greatest burden of taxes falls on medium and working-class individuals, 4.4% consider it falls on rich individuals, while 2.2% do not know how to answer. Hence, only 4.4% of the respondents think richest taxpayers bear the greatest share of the Spanish (see fn. 22).

Therefore, according to the experience of the professionals, **the Spanish tax system as a whole is regressive**. There is so little variation that a regression analysis of the responses does not allow us to infer any particular bias.


3.2. *Efficiency of the Spanish Tax System*

While not all taxes aim for equity, certainly it is socially desirable that each tax is efficient. That is why, in order to infer the opinion of tax professionals regarding efficiency, we identify several potential distortions by tax; in particular, we do so for the CT, the PIT and the VAT.

With respect to the **CT**, we ask whether this tax has an impact on the following decisions:

- Source of *financing* (own resources vs. external resources)
- Type of physical *investment* (according to the pattern of depreciation fiscally deductible)
- *Country* where to invest (according to the differences in the level of tax rates)
- *Legal structure* of a business (incorporated vs. unincorporated)
- *Planning* to reduce the tax burden (avoidance)

Hence, questions include classical changes of behavior (*financing*, *investment* or *legal structure*), or even considering mobility (*country*), but also we ask about the possibility of tax avoidance (*planning*). Business decisions are considered separately. In all cases, and this applies to other taxes as well, the responses can be: "fully disagree" (being the response coded as 1), "partially agree" (coded=2), "rather agree" (coded=3), or "fully agree" (coded=4).

For the **PIT**, we ask about the following possible distortions:

- Spanish region of *residence* (mobility)
- Purchasing of *housing* vs. renting (due to the tax credit for first dwellings)
- Type of *assets* in which to invest personal savings
- *Legal structure* of a business (incorporated vs. unincorporated)


And regarding the **VAT**, in general, we ask whether this is a *neutral* tax with respect to firm decisions.

We present the results in Table 2 ordered from more agreement about the distortion (i.e., close to 4) to less agreement (close to 1). First, with the exception of the VAT, all means are above 2, which at least implies partial agreement. Second, with the exception

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[24] In Spanish, the survey question reads as follows: "¿Cree que los más ricos son los que más contribuyen, o son las clases medias y trabajadoras?".

of PIT_*Housing*, the most important distortions are related either to avoidance (PIT_*Legal Structure*, CT_*Planning*, CT_*Legal Structure*) or to mobility (CT_*Country* and PIT_*Residence*). The former distortions are probably due to the complexity of the tax system that creates loopholes, while the second are related to the particular tax decentralization process occurred in Spain but also to the general phenomena of globalization, as both facilitate the mobility of taxable factors.

[TABLE 2]

All in all, it is difficult to conclude how (in)efficient the Spanish tax system is. But, just like the abolition of the PIT tax credit for first-dwellings in 2013, the survey points to the need of reforming the tax system. First, impeding or making it difficult **tax avoidance** schemes (probably, most importantly, aligning as we already said in section 2 the tax levels in PIT and CT). Second, reducing the potential negative consequences of **tax decentralization** within Spain (potentially addressable), but also far away from our frontiers (much less addressable without international cooperation).

Interestingly, in contrast with the assessment obtained for equity, as far as efficiency is concerned we have some variation to exploit the responses trying to infer any potential bias, that is, any particular pattern behind the opinions given by the professionals. In order to exploit it, in Table 3, we show the OLS[25] results for each distortion, where the independent variables are those previously identified (personal characteristics of the respondent and those directly related to the firm where she works) and remain the same for each regression.

[TABLE 3]

From the estimates shown in Table 3, there is nothing remarkable. As a general result, though, it is curious – though we lack a proper economic interpretation – that the older the respondent, the more likely she is, let's say, skeptical about the relevance of the distortions. And as a particular result, it is worth to stress the fact that the mean of CT_*Financing* – being, recall, according to the economic literature, a factor contributing to the problems of leverage of the firms – hides an interesting heterogeneity. For example, the average response of a professional located in a rich AC and working for a big consultancy (size of firm is coded=4, such that there work more than 100 professionals), is 3.3 (i.e., 2.02+0.24+0.26×4), and if she works for a small one (less than 15 professionals, and coded=1), is 2.5 (i.e., 2.02+0.24+0.26×1). For those firm sizes, the average response is 3.06 and 2.28, respectively. If we assume that big firms are advised by big consultancies (more so in rich regions), this would imply that only those firms have the opportunity to choose the financing source, and then in the margin taxes have an impact on the decisions of big firms. In contrast, small firms might not even have the opportunity to choose the financing method, and then taxes do not play any role.

3.3. *Complexity of the Spanish Tax System (as a Potential Source of Inefficiencies)*

In the previous section, we hypothesized that the opportunities of tax planning might be caused by the complexity of the tax system (i.e., loopholes). Thus, complexity indirectly

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[25] For easiness of interpretation we show the OLS results. However, these do not vary qualitatively if we run an ordered probit regression; they are available upon request to the authors.

generates efficiency losses associated with activities related to tax planning. However, complexity might also have a negative direct effect on efficiency as long as it generates uncertainty (Giertz, 2012), or should rather say, adds to the intrinsic uncertainty of the globalized market economies. That is why we added a set of questions related to the complexity of the tax system.

The question reads as follows: *Do you think the Spanish Tax System is more Complex than 5/10/15/20 Years Ago?*[26] The possible reply is Yes (=1) or Not (=0). Independently of the benchmark (5, 10, 15 and 20 years ago), the answers are again overwhelmingly: they range from 0.87 (in comparison to 5 years ago) to 0.91 (in comparison to 15 years ago). That is, it is almost unanimous the opinion that the **complexity has risen during the last years**. Given the existence of an almost unanimous opinion, we are left without variation to exploit it econometrically.

However, is this complexity unavoidable, that is, is it due to exogenous factors to the legislators? If so, this characteristic of the tax system is a restriction we have to cope with. Alternatively, it might be caused by an endogenous action of the legislator within the country. We ask then about the causes of this complexity. On the one hand, for each potential cause, the individual has to answer again Yes (=1) or Not (=0). On the other hand, the causes of complexity are not mutually exclusive. Thus, for a given individual the origin of complexity can be due to a mix of several factors. The results are shown in Table 4.

[TABLE 4]

With great difference, tax professionals think **the origin of complexity is due to endogenous factors**, and within them, almost 100% of the respondents think the continuous changes of the legislation are key as a source of legal uncertainty. In contrast, only slightly above 19% of the respondents think the two exogenous factors are the cause of the increasing complexity. We have tried to infer whether there are some biases in the responses through OLS[27] regressions for each cause of complexity, being the results shown in Table 5. Nothing interesting emerges, but the response of those professionals located in the foral ACs (Basque Country and Navarre). On the one hand, albeit only statistically significant at 90% confidence level, they tend to attach a lower weight to the continuous modification of the legislative as a cause of complexity. This makes sense as foral ACs have their own laws as far as most taxes are concerned. On the other hand, being now the estimate much more precisely assessed, the assignment of tax power to the rest of ACs has increased the complexity of their professional activity. This would merit further research.

[TABLE 5]

3.4. *And as a Conclusion: Do (You Think) We Need a Global Reform?*

According to tax professionals, our tax system is inequitable. We cannot know whether it is very (in)efficient – as this has many dimensions – but according to them, planning

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[26] In Spanish, "Considera que el sistema fiscal español es más complejo de lo que era hace 5/10/15 0 20 años?".

[27] The results – which are available upon request to the authors – are qualitatively identical if we perform binary regressions (*logit* or *probit*).

is the main reaction of taxpayers in front of taxes. Probably, this is due to the complexity, which is confirmed by the survey, being its cause endogenous factors, and so addressable as long as there is a political will to change the current *status quo*. These are our main results.

From them, the natural conclusion is that **the Spanish Tax System needs a Global Reform**, and should rather say a Urgent Reform given the state of our economy, and in particular, of our Public Finances. Tax professionals share this opinion; in particular, 87.87% of those surveyed, which is very high as note that probably some of them representing the *status quo*!, as less complexity might mean less billing. The econometric exploitation of this response (1=in favor of a reform; 0=otherwise) is curious. The OLS[28] estimation is shown in Table 6. Although there is unanimity on average, there is a big discrepancy between those professionals located in the Foral ACs (estimate=0.49, statistically significant) versus those located in the rest of Spain (*ceteris paribus*, the estimate would coincide with the constant). Hence, those professionals might fear that a reform could have an impact on the foral regime, and if altruistic they may consider that would not be good for the economy of those communities, or if selfish they may fear they could lose their professional rents related to the specificity of the foral system.

[TABLE 6]

## 4. Conclusions

Economic theory argues that real tax systems suffer important deficiencies that might reduce the economic welfare of countries. This view is often supported by empirical analyses. Therefore, the conclusion is that there is scope for more equitable, efficient and simple tax systems. But, what do tax professionals working in the private sector believe according to their professional experience? Given their precise knowledge of the fiscal system due to their daily practice, their opinion should be a complementary source of information to the theoretical and empirical analyses.

The results from a survey among tax professionals working all over Spain are quite conclusive and we can draw three main conclusions. First, the Spanish tax system as a whole is considered to be regressive. Second, as far as efficiency is concerned, most distortions are related to tax avoidance and tax planning or to mobility. Third, complexity has risen during the last years, being the main cause the continuous change of the rule. Consequently, and as a final conclusion, the Spanish tax system requires a global reform.

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[28] The results – which are available upon request to the authors – are qualitatively identical if we perform binary regressions (*logit* or *probit*).

**Table 1: Inheritance tax in Andalusia and Madrid: possible situations**

| Heir | Wealth transferred value | Deductions | Andalusia: tax liability (1) | Madrid: tax liability (2) | Difference: Andalusia – Madrid (3) = (1) – (2) | |
|---|---|---|---|---|---|---|
| | | | € | € | € | Effective rate (%) |
| **Child** | 500,000 €, of which 75% is a dwelling | Eligible for permanent residence and relationship | 74,958 | 748 | 74,210 | 14.41 |
| **Nephew** | | Only relationship. Not eligible for permanent residence | 182,671 | 179,131 | 3,540 | 0.69 |
| **Child** | 500,000 € in bank accounts and securities | Only relationship | 122,489 | 1,104 | 121,385 | 23.57 |
| **Nephew** | | | 182,671 | 179,131 | 3,540 | 0.69 |
| **Child** | 1,000,000 € in business assets | Eligible for business and relationship | 2,045 | 68 | 1,977 | 0.19 |
| **Nephew** | | | 4,538 | 12,631 | -8,093 | -0.79 |
| **Child** | 1,000,000 € in bank accounts and securities | Only relationship | 286,285 | 2,728 | 283,557 | 27.53 |
| **Nephew** | | | 459,294 | 437,527 | 21,767 | 2.11 |

Note: Tax liability is assessed considering all deceased's wealth is transferred to a single heir, which according to law has to add 3% of total wealth as household furnishings.
The coefficient reflecting the heir's previous wealth is considered to be 1 in all cases.
Madrid foresees 99% tax credit for spouses, descendants and ascendants.

**Table 2**: Importance of distortions in the Spanish Tax System

| Variable | Observations | Mean | Std. Dev. | Min | Max | General assessment |
|---|---|---|---|---|---|---|
| PIT_Legal Structure | 272 | 3.379 | 0.778 | 1 | 4 | GREAT AGREEMENT |
| CT_Planning | 272 | 3.316 | 0.756 | 1 | 4 | |
| PIT_Housing | 272 | 3.051 | 1.000 | 1 | 4 | |
| CT_Legal Structure | 272 | 2.923 | 0.928 | 1 | 4 | PARTIAL AGREEMENT |
| CT_Country | 272 | 2.710 | 0.976 | 1 | 4 | |
| PIT_Residence | 272 | 2.632 | 0.963 | 1 | 4 | |
| CT_Financing | 272 | 2.426 | 0.934 | 1 | 4 | |
| CT_Investment | 272 | 2.404 | 0.858 | 1 | 4 | |
| PIT_Assets (*) | 272 | 2.312 | 0.858 | 1 | 4 | |
| VAT_Non-Neutral(*) | 272 | 1.423 | 0.934 | 1 | 4 | FULL DISAGREEMENT |

(*): in these cases, we ask about the neutrality; so a high value of it implies a high level of neutrality. We then recode the answer as "4-original answer" in order to be comparable with the rest of items shown in the Table.

**Table 3**: Analysis of Biases in the Responses Related to Distortions

| VARIABLES | PIT_*Legal Structure* | PIT_*Residence* | PIT_*Housing* | PIT_*Assets* | VAT_*Neutral* | CIT_*Financing* | CIT_*Investment* | CIT_*Country* | CIT_*Legal Structure* | CIT_*Planning* |
|---|---|---|---|---|---|---|---|---|---|---|
| Years of experience | 0.1151 | 0.0775 | -0.1410 | 0.1139 | 0.0840 | -0.0636 | -0.0637 | 0.0582 | 0.0177 | -0.0024 |
| | (0.100) | (0.125) | (0.128) | (0.111) | (0.117) | (0.118) | (0.110) | (0.123) | (0.119) | (0.098) |
| Age | -0.0177** | -0.0010 | -0.0015 | -0.0151* | -0.028*** | 0.0010 | -0.0080 | -0.0167* | -0.0123 | 0.0008 |
| | (0.008) | (0.010) | (0.010) | (0.009) | (0.009) | (0.009) | (0.009) | (0.010) | (0.009) | (0.008) |
| Sex | -0.1001 | 0.0007 | 0.0528 | 0.0117 | -0.2227 | 0.0125 | -0.1044 | 0.0193 | -0.1160 | -0.1680 |
| | (0.149) | (0.186) | (0.190) | (0.165) | (0.175) | (0.175) | (0.164) | (0.184) | (0.178) | (0.146) |
| Level of studies | -0.0054 | -0.1704 | 0.0471 | -0.1789* | -0.1350 | 0.1539 | -0.0265 | 0.3251*** | 0.1058 | 0.0876 |
| | (0.087) | (0.110) | (0.112) | (0.097) | (0.103) | (0.103) | (0.097) | (0.108) | (0.105) | (0.086) |
| Professional status | 0.0432 | -0.0054 | 0.0034 | -0.0295 | 0.1711* | -0.0571 | 0.0247 | 0.0446 | -0.1135 | -0.0944 |
| | (0.075) | (0.094) | (0.096) | (0.083) | (0.088) | (0.088) | (0.083) | (0.093) | (0.090) | (0.074) |
| Size of the firm | -0.0703 | 0.0659 | -0.325*** | -0.0037 | -0.0952 | 0.2603*** | 0.1312 | -0.1317 | -0.0971 | 0.0580 |
| | (0.083) | (0.104) | (0.106) | (0.092) | (0.098) | (0.098) | (0.092) | (0.103) | (0.100) | (0.082) |
| AC_average_income | -0.0589 | -0.0092 | -0.0893 | 0.0799 | 0.1695 | 0.3167** | 0.2129 | -0.0142 | -0.1095 | -0.0248 |
| | (0.136) | (0.171) | (0.174) | (0.151) | (0.160) | (0.160) | (0.151) | (0.168) | (0.163) | (0.134) |
| AC_high_income | -0.1912* | 0.0279 | -0.0111 | 0.0254 | 0.0305 | 0.2378* | 0.0231 | 0.0309 | -0.1018 | -0.0475 |
| | (0.111) | (0.139) | (0.141) | (0.123) | (0.130) | (0.130) | (0.122) | (0.137) | (0.132) | (0.109) |
| Foral AC | 0.0244 | -0.1569 | -0.2523 | 0.0831 | -0.0326 | -0.1503 | 0.1115 | -0.2068 | 0.0870 | 0.0993 |
| | (0.229) | (0.287) | (0.292) | (0.254) | (0.269) | (0.269) | (0.253) | (0.283) | (0.273) | (0.225) |
| Constant | 3.9326*** | 2.7385*** | 3.8818*** | 2.5407*** | 2.2957*** | 2.0182*** | 2.8398*** | 2.5231*** | 4.0316*** | 3.6198*** |
| | (0.492) | (0.617) | (0.628) | (0.546) | (0.577) | (0.579) | (0.544) | (0.607) | (0.587) | (0.483) |
| Observations | 272 | 272 | 272 | 272 | 272 | 272 | 272 | 272 | 272 | 272 |
| R-squared | 0.042 | 0.016 | 0.054 | 0.024 | 0.083 | 0.079 | 0.036 | 0.070 | 0.039 | 0.020 |

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

**Table 4**: Origin of Complexity: Exogenous & Endogenous Factors

| Variable | Observations | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|---|
| ENDOGENOUS FACTORS | | | | | |
| | | | | | |
| Continuous Change of the Tax Law | 272 | 0.982 | 0.135 | 0 | 1 |
| Interpretation of the Law by the Administration | 272 | 0.684 | 0.466 | 0 | 1 |
| Deficient Writing of the Tax Law | 272 | 0.614 | 0.488 | 0 | 1 |
| Tax Assignment to the ACs | 272 | 0.408 | 0.492 | 0 | 1 |
| EXOGENOUS FACTORS | | | | | |
| Internationalization of the Economy and Mobility of Tax Bases | 272 | 0.191 | 0.394 | 0 | 1 |
| Increasing Complexity of the Functioning of the Markets | 272 | 0.191 | 0.394 | 0 | 1 |

**Table 5**: Analysis of Biases in the Responses Related to the Causes of Complexity

| VARIABLES | Deficient Writing of the Tax Law | Continuous Change of the Tax Law | Interpretation of the Law by the Administration | Tax Assignment to the ACs | Internationalization of the Economy | Increasing Complexity of the Markets |
|---|---|---|---|---|---|---|
| Years of experience | -0.0669 | 0.0268 | 0.0389 | 0.0465 | -0.0598 | -0.0309 |
| | (0.062) | (0.017) | (0.060) | (0.063) | (0.051) | (0.051) |
| Age | 0.0067 | -0.0020 | -0.0039 | -0.0030 | -0.0004 | 0.0058 |
| | (0.005) | (0.001) | (0.005) | (0.005) | (0.004) | (0.004) |
| Sex | -0.0228 | 0.0506* | -0.0455 | 0.0785 | 0.0311 | -0.0252 |
| | (0.092) | (0.026) | (0.090) | (0.094) | (0.076) | (0.076) |
| Level of studies | -0.0347 | 0.0008 | 0.0128 | 0.0695 | 0.0176 | 0.0426 |
| | (0.054) | (0.015) | (0.053) | (0.056) | (0.045) | (0.045) |
| Professional status | 0.0830* | -0.0019 | 0.0592 | 0.0597 | -0.0198 | -0.0214 |
| | (0.047) | (0.013) | (0.045) | (0.048) | (0.038) | (0.038) |
| Size of the firm | 0.1153** | 0.0073 | 0.0732 | 0.0243 | 0.0189 | 0.0027 |
| | (0.052) | (0.014) | (0.050) | (0.053) | (0.042) | (0.043) |
| AC_average_income | -0.0678 | -0.0128 | -0.0409 | 0.0263 | -0.0194 | -0.1075 |
| | (0.084) | (0.024) | (0.082) | (0.086) | (0.069) | (0.070) |
| AC_high_income | 0.0862 | 0.0100 | -0.1012 | -0.0390 | 0.0399 | -0.0292 |
| | (0.069) | (0.019) | (0.067) | (0.070) | (0.056) | (0.057) |
| Foral AC | -0.2437* | 0.0161 | -0.0346 | 0.3308** | 0.1229 | 0.0341 |
| | (0.142) | (0.040) | (0.138) | (0.145) | (0.117) | (0.117) |
| Constant | 0.0793 | 0.9386*** | 0.4406 | -0.1458 | 0.3995 | 0.0677 |
| | (0.305) | (0.085) | (0.297) | (0.312) | (0.251) | (0.252) |
| Observations | 272 | 272 | 272 | 272 | 272 | 272 |
| R-squared | 0.063 | 0.032 | 0.026 | 0.036 | 0.028 | 0.021 |

Standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$

**Table 6**: Analysis of Biases in the Responses Related to the Need of a Global Tax Reform

| VARIABLES | Need of a Tax Reform |
|---|---|
| Years of experience | 0.0066 |
| | (0.041) |
| Age | 0.0011 |
| | (0.003) |
| Sex | -0.0020 |
| | (0.061) |
| Level of studies | -0.0283 |
| | (0.036) |
| Professional status | -0.0049 |
| | (0.031) |
| Size of the firm | 0.0081 |
| | (0.034) |
| AC_average_income | -0.0411 |
| | (0.056) |
| AC_high_income | -0.0387 |
| | (0.045) |
| Foral AC | -0.4329*** |
| | (0.094) |
| Constant | 0.9260*** |
| | (0.201) |
| Observations | 272 |
| R-squared | 0.091 |

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

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