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The one thing the self-employed want more than a tax cut

By **Andrew Van Dam** December 18 at 7:30 AM

Republicans say their tax cut benefits small businesses.

They're right, up to a point. Any business would be happy to see lower tax bills. But new research shows that in the real world, the self-employed are willing to pay hundreds of dollars more in exchange for simpler taxes, and that a less complicated tax code would spread the benefits around more equally.

That's because when the tax code gets complicated, researchers found, two things happen.

First, it becomes more regressive — tax changes hit low-income, less-educated and older filers harder, because they don't have the resources and knowledge needed to take advantage of the new system.

Second, you increase the burden on the self-employed. Those small businesses have shown they're willing to pay an average of as much as \$830 for a user-friendly tax code.

How do we know this? France was nice enough to turn their entire economy into an experiment. That experiment produced millions and millions of datapoints which the French government has, for the first time, turned over to researchers.

It all came about because, as you'll recall from romantic comedy and period pieces, France has millions of tiny businesses. Think mom-and-pop patisseries, chocolatiers and butchers. But also, plumbers, carpenters and gig-economy workers.

In 1999, French officials decided that the standard tax code, which often applied as much to huge privately owned businesses as it did to the fromagerie around the corner, was too onerous for small artisans and retailers.

So, they greatly expanded a simplified tax regime for businesses with revenues below about \$42,000 for service and professional operations and about \$105,000 for retail operations (all currency values are circa 2012 and converted from euros at 2012 rates). Almost half a million of them took advantage of it.

In 2008, the Sarkozy administration decided that what researchers call the “simplified regime” wasn’t. It could still be tricky to calculate tax liability, and businesses still had to file their income taxes and social-insurance contributions separately.

So, they resolved to really simplify things... by tossing another variable into the tax-filing mix. The new “super simplified” category further reduced the administrative hoops for small businesses and taxed everything, including social insurance, at a flat rate. Of the many businesses that qualified, only about 225,000 participated in the super-simplified regime between 2009 and 2012. All of them should have.

Together, the reforms created a weird three-track system in which each business, before filing anything, had to decide whether they were “standard,” “simplified” or “super-simplified.”

Each decision added friction to the typical tax-filing process. The French government compounded it by tweaking rules over time. A team of four researchers, Philippe Aghion, Ufuk Akcigit, Matthieu Lequien and Stefanie Stantcheva, exploited that friction to learn which socioeconomic groups and businesses were hit hardest when the tax code got more complex.

How? It began, as most great things do, with a herculean feat of data processing. They combined millions of French tax records from between 1994 and 2012 with employment-survey records and benefits data.

That gave them enough to suss out the right tax decision for each chocolatier and plumber in the sample, and compared them with their actual tax decisions. The comparison is key.

The difference between the right decision and the actual decision can be explained by some mix of willingness to pay extra for simplicity, and ignorance of the best option.

It turns out folks who run their own small business put a high value on simplicity. Repair shops and contractors opted for the simplified version even when a more complex tax filing would have saved them \$405 a year. Professionals such as doctors and lawyers valued their time (and/or hated the accounting hassle) even more highly: if they had to pay up to an average of \$830 a year to use the super-simplified regime instead of the complicated one, they’d happily do so.

“For small businesses, complicated stuff is really costly,” Stantcheva, a Harvard economics professor, said. “Having to deal with a lot of accounting and tax systems is a burden.”

Stantcheva explained that the very groups that the government is likely seeking to help with new tax schemes, such as less-skilled, less-educated and lower-income workers, also happen to be the most likely to make the wrong decisions when filing and therefore get hit the hardest when the tax code gets more complex.

“They very slowly learn over time,” Stantcheva said, but “because it’s so complex to decide, people leave a lot of money on the table.”

They know this because the French government changed and tweaked the code several times, and each time it took filers a while to start making the right choice for them. The majority of them never did, especially those who belonged to the vulnerable

groups which probably needed the tax relief most.

Switching to the super-simplified tax code would have been easier and cheaper, but most still didn't. They gave up free money simply because they didn't understand the changes.

The French government has since set out to simplify the tax code once again, this time by combining the two "simplified" tax schemes into one. They probably couldn't ignore the data: Hundreds of thousands of self-employed French taxpayers have shown, over a decade and a half, that the smallest businesses value easier taxes over less taxes.

It's an empirical analysis of how businesses actually behaved in the real world, not a distillation of industry-group requests and memoranda, and as such has a clear message for U.S. tax reformers: if you really want to help small businesses, especially those run by the middle class, the elderly and the less educated, then keep it simple.

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Andrew Van Dam covers data and economics. He previously did similar work for The Wall Street Journal, and dissimilar work for The Boston Globe and The Idaho Press-Tribune.

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