

## 1914 - 2014: ONE HUNDRED YEARS OF INCOME TAX IN FRANCE

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### Summary

Since its establishment in law in July 1914, the French income tax system (impôt sur le revenu) has been through many changes and sparked much debate. The system rests on two funding principles: the declaratory dimension for all categories of income at the tax unit level and the progressivity of the tax schedule. In 1949, the end of "flat tax" schedules differentiated by income types (impôt cédulaire) and the creation of the "family quotient" gave the system its contemporary form. From then until 1980, income tax receipts rose, to 5.6 per cent of GDP. Between 1914 and 1986, the top marginal rate generally exceeded 60 per cent. After this period, the decreasing number of tax brackets, the fall in marginal rates and the introduction of "tax reductions" led to a decrease in income tax receipts as a share of GDP. This decline did not go in hand with a decrease in the overall tax burden in France but was rather compensated for by increases in other taxes including the "generalized social contribution", introduced in 1991, with a larger tax base and flat rates. ■

- The share of income tax receipts in total public revenues fell from 12 per cent in 1981 to 6 per cent in 2014.
- The share of taxable households increased from less than 2 per cent in 1916 to 20 per cent in 1955. It reached a peak of 65 per cent in 1985 and has remained stable at around 50 per cent ever since.
- The effective tax burden of the wealthiest one per cent increased until 1982 (average rate of 34.2 per cent) and has decreased since then (25 per cent in 1986).
- The contribution of the bottom 90 per cent of the income pyramid increased from 15 per cent in the 1950s to 35 per cent in the 1970s.



Poster of Georges Villa for the Central Committee of studies and tax defense, parliamentary elections of 1914

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The year 2014 is rich in historic commemorations, including the beginning of the Great War and the battle of Bouvines (July 1214), but also the centenary of the introduction of a progressive tax on income (15 July 1914). While this event is not likely to inspire any theatrical re-enactments, it is nevertheless an important element in national history and in the democratic debate about consent to taxation.

The aim of this IPP Note #12 is to review the debates and the changes that have affected a tax that is often decried but which has, until now, survived all demands for its abolition.

## A tax in perpetual debate

The name *impôt sur le revenu* (IR) only dates from 1971. Sometimes, it is still spoken of as an *impôt sur le revenu des personnes physiques* (IRPP, tax on the income of individuals), the name used between 1949 and 1971, while in 1914, at its creation, it was called an *impôt général sur le revenu* (IGR, general tax on income).

### An eventful birth (1880-1914)

In 1914 a progressive system of taxation on income was introduced in France, later than elsewhere in Europe : Great Britain introduced an income tax in 1842; progressive taxes on income began in Sweden in 1861, in Italy in 1864, in Prussia from 1891 to 1903, and in the Netherlands in 1893 (Ardant, 1972).

In France, while estate taxes were made progressive starting in 1901, **the imposition of a progressive tax on income has been highly controversial** (Piketty, 2001). The IGR was established after decades of passionate political debate and spirited protest from the public and politicians. Between 1880 and 1907, more than 200 pieces of legislation were abandoned or rejected, examples of numerous "tax battles" that have been waged since the very beginning of income tax in France (Delalande, 2011). The conflict has turned on a two-fold opposition, to the creation of "personal files" and to the progressive aspect, which has been denounced as "unjust" and "arbitrary".

**The budget drawn up by the finance minister, Joseph Caillaux, in February 1907 led to the 15 July 1914 law.** The initial "Caillaux project" proposed a two-step income tax system: distinct flat rates for different income categories and the additional imposition of a general tax according to a progressive scale.

Joseph Caillaux, a leading figure in the Parti Radical, received the support of Jean Jaurès, but faced opposition from Adolphe Thiers, who denounced it as "immorality written in law". In the face of considerable initial reluctance, symbolised in the creation of "tax payers' leagues", the first version of the Caillaux Project was voted up by the National Assembly in March 1909 on the basis of patriotic arguments in a context of international tensions. Promoters of the project also argued for the necessity of collecting statistics about the situation of individuals.

However, final adoption of the bill was delayed for three years in the Senate by the editing of a report by Émile Amond. The elections of April and May 1914 reinforced the "partisans of individual income tax" and allowed the adoption of the law, more moderate than the initial proposal, on 15 July 1914 (gazetted in the Journal Officiel 18 July).

### A fragile infancy (1916-1949)

The Act of 15 July 1914 was applied for the first time in 1916, on 1915 incomes, following a delay because of the global conflict. In 1917, the IGR took the form of a two-step system, in line with the Caillaux bill. There were also six *cédulaires* taxes (so called because of the separate declaration forms called *cédules*): these were independent of each other and applied to different types of income.<sup>1</sup> They were applied at proportional rates (between three and six per cent), in addition to the general income tax.

This initial period was the most unstable for the new tax system: **the different kinds of schedules alternated mainly between formulations at marginal rates and average rates, that is, the total amount of tax paid as a proportion of income**, and therefore directly applicable to the total income (see Box 1).

Following the Act of 25 June 1920, income for the years 1919-1935 was divided into 25 tranches, contributing progressively to taxable income by steps of 1/25th and expressing a single global rate (that matched the top marginal rate). **The tax system took its "definitive" form in 1949**, with the abolition of the *cédulaire* taxes and the introduction of the IRPP. Initially, the IRPP schedule comprised a "flat tax" (TP), similar to the *cédulaire* taxes, and a "progressive super-tax" (SP) similar to the IGR ; which formed the basis of the progressive income tax system.

1. In 1914, there were two of them (land and securities) and four were created in 1917 (wages and salaries, farm profits, industrial and commercial profits, and non-commercial profits); for the values, see « Barèmes IPP: Impôt sur le revenu », Institut des politiques publiques, April 2014 ", available at: <http://www.ipp.eu/fr/outils/baremes-ipp/impot-sur-le-revenu/>

#### Box 1: A schedule based on an average rate or marginal rates?

A tax on income can be expressed as an average rate, that is, as the ratio of tax  $I$  to be applied to revenue  $R$  ( $I/R$ ), or as a marginal rate, that is, as the sum of supplementary tax to be paid on each supplementary euro of income (mathematically, as the differential  $dI/dR$ ).

The existing income tax scale is expressed as a marginal tax applied to each income bracket. For example, the IR bracket 4 for 2014 of 30 per cent implies that the taxable income of that bracket (between 26,631 and 71,397 euros) is taxed at 30 per cent. That does not mean, however, an average rate of 30 per cent, because incomes of less than 26,631 euros are taxed at lower rates. For example, on a taxable income of 36,000 euros (3,000 euros per month), the marginal rate is 30 per cent, while the average rate is 23.3 per cent.

In France, a schedule expressed in average rates was applied in 1917 and 1918, and reinstated by the Popular Front in 1936, before being abolished in 1941 by the Vichy regime.

The debate principally concerns the readability or transparency of the schedule. Tax payers tend to confuse marginal and average rates (hence the fear of being pushed into the next tax bracket) and generally have trouble evaluating their effective average rate of taxation. Recently, economists Camille Landais, Thomas Piketty and Emmanuel Saez relaunched this debate by proposing, in their book *Pour une révolution fiscale* (2011), a new income tax expressed in effective average rates.

Without actually modifying the schedule as it applied, these taxes were rolled into one in 1959, making the IRPP the "sole tax" on income.

While wages were taxed at source between 1940 and 1948, this technique was abandoned when the system was overhauled in 1949, and replaced by the one that has been in place since, in which a tax return is filed one year and the tax is collected the following year.

Since its creation, the amounts due under the IGR for a given year were payable the following year, thus giving very significant reductions to the most comfortably off. This mode was abolished and replaced by the progressive scheme in 1947.

Throughout the period of Third Republic (1870-1940) French income tax was essentially a personal tax with a system of standard deductions for dependants. The family quotient, today a distinctive characteristic of the French system, was introduced in the Act of 31 December 1945.

### The age of stability (1950-1986)

After a ramping up of the schedule between 1946 and 1949 from five tranches to nine, **the highest marginal rate remained at 60 per cent until 1982** (with the exception of the years 1964 and 1967, and not counting exceptional increases).

The number of tranches and the rates rested virtually identical for 25 years, between 1949 and 1974. The typical schedule in this period comprised eight or nine tranches with a simple and quasi-arithmetic progression in rates: 10, 15, 20, 30, 40, 50 and 60 per cent. Then, between 1975 and 1986, the income tax schedule went through a boom period, extending the logic of the '50s, '60s and '70s: the progressivity was spread over 13 to 14 tranches and the rates staggered in five-point steps between 0 and 65 per cent (see column 2, table 1).

This stability in the taxation schedule also translated into a policy of tax increases through the freezing of the tax brackets (fiscal drag). Between 1949 and 1974, the tax thresholds remained relatively stable in nominal value, with the exception of minor rises in 1950, 1951, 1965 and 1966. This led automatically to an increase in the number of those eligible to pay tax and in the average amount of tax paid. From 1970, the tax thresholds went through no major changes, while being adjusted each year in line with inflation. **Between 1975 and 1986, the income tax schedule was as its most progressive of all the post-war years.** In 1986, the 14th and last tranche represented a top marginal rate of 65 per cent on incomes greater than 241,740 francs (ca. 48,000 in 2014 euros).

### The decline (1987 - 2011)

The income tax system has been through several "reforms" over the past few decades: **since 1987, the tax schedule has undergone continuous change characterised by a reduction in the number of tranches and a decrease in the applied marginal rates.**

Thus, there were 14 income tax thresholds until 1986, then seven between 1994 and 2006 (with a top marginal rate of 56.8 per cent) and just five since 2007 (with a top marginal rate of 40 per cent). The creation in 2013 of a sixth tranche (with the top marginal rate of 45 per cent) goes against this long-term trend towards flat tax, without, however, returning to the taxation levels of the 1990s and the years immediately preceding.<sup>2</sup> In 1994 and 2007, the dramatic reductions in the number of tranches were accompanied by an overhaul of the thresholds that define income brackets (through a melding of intermediate tranches). In the other cases, tax brackets were generally revalued in line with inflation, except when they were frozen, as they were in 2011 and 2013.

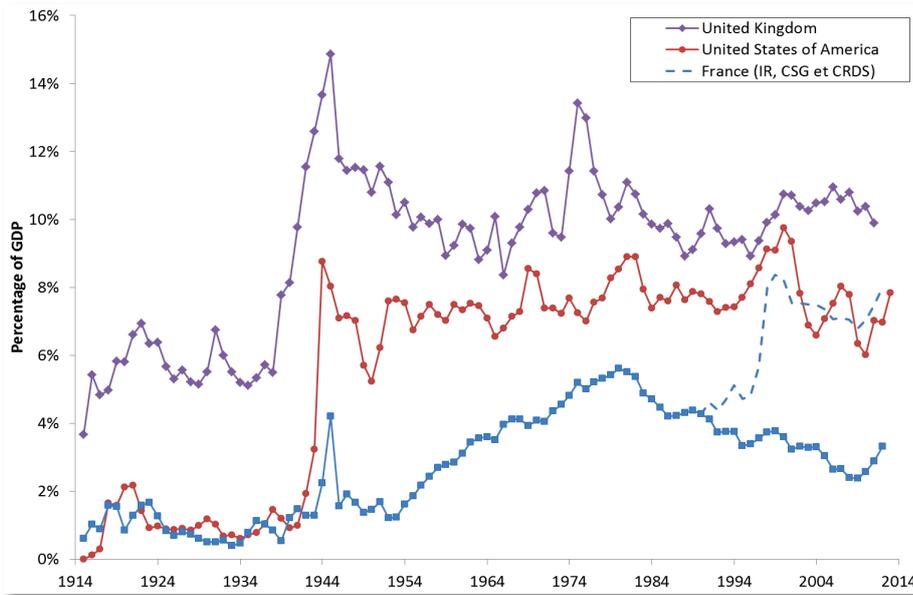
2. An exceptional contribution was created for 2011 incomes, adding an additional marginal rate of three and four per cent for incomes above 250,000 € and 500,000 € respectively.

Table 1 : The decrease in the number of tranches and marginal rates of the income tax schedule

Income tax schedule tranches	Rate in 1983 (%)	Rate in 1988 (%)	Rate in 1994 (%)	Rate in 2006 (%)	Rate in 2007 (%)	Rate in 2014 (%)
Tranche 1	0	0	0	0	0	0
Tranche 2	5	5	12	6,83	5,5	5,5
Tranche 3	10	9,6	25	19,14	14	14
Tranche 4	15	14,4	35	28,26	30	30
Tranche 5	20	19,2	45	37,38	40	41
Tranche 6	25	24	50	42,62		45
Tranche 7	30	28,8	56,8	48,09		
Tranche 8	35	33,6				
Tranche 9	40	38,4				
Tranche 10	45	43,2				
Tranche 11	50	49				
Tranche 12	55	53,9				
Tranche 13	60	56,8				
Tranche 14	65					

Sources : Barèmes IPP: Impôt sur le revenu, Institut des politiques publiques, avril 2014.

Figure 1: Share of income tax receipts in GDP (France, USA, UK)



Sources :

GDP 1900-1948 from the series Production intérieure brute calculée par la production de Villa (1994, p.466), cited in Piketty (2001), Annexe G; 1949- 1950: Insee (comptabilité nationale base 2010).

IR 1915-1998 recalculated on the basis of Piketty (2001); 1999-2013: net income tax received taken from «évaluation voies et moyens». American data from: www.usgovernmentrevenue.com; Institute for Fiscal Studies data and Inland revenue reports for the United Kingdom.

Note: Between 1954 and 1984, revenue collected as income tax in France grew from less than 1.2% of GDP to 4.5% of GDP.

### What weighting does income tax have in France?

French income tax is decried as excessively high and cumbersome and at the same time, denounced as out-of-date, weak and in need of an overhaul. Some of these differences lie in the contrasting opinions about what makes good fiscal policy. But one aspect of the debate arises from confusion between the global weighting of total compulsory deductions – which in France are relatively high in international terms – and the part that represents personal income tax (IR) in those deductions – which are in fact at a relatively low level.

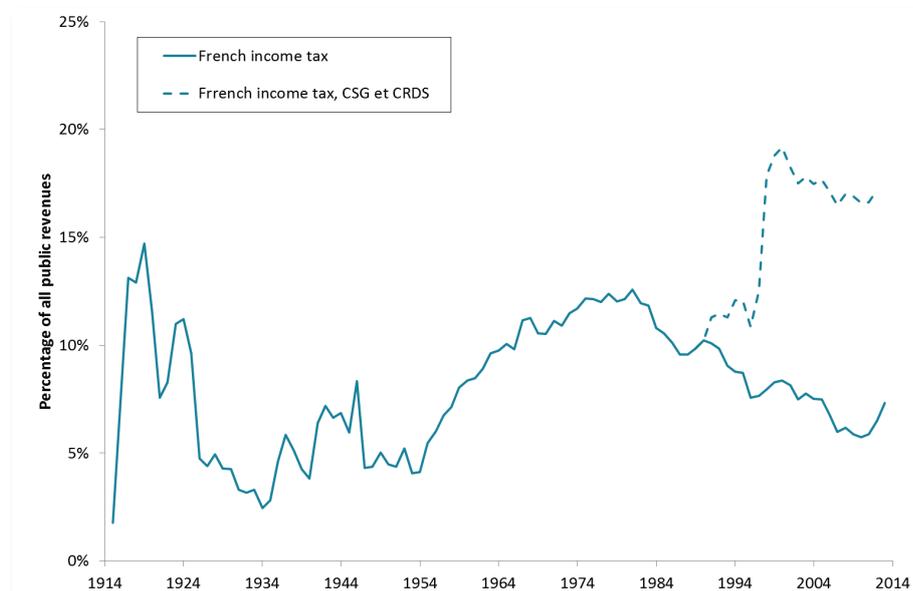
Figure 1 shows the part of French taxation receipts that come from tax on personal income, and income tax in the United States and in Great Britain, over the long-term. In the US and the UK, where compulsory deductions clearly constitute a lower proportion of national revenue than in France, taxes on income clearly are clearly higher: around 8 per cent of GDP in the US and around 10 per cent of GDP in the UK, compared with around 3.3 per cent in France after the massive increases in

2012. In France, in order to reach the same level as in the UK and the US, we have to add the flat taxes, the CSG and the CRDS (for a total of 8 per cent of GDP).

In 2013, at 68.5 billion euros, IR receipts represented only seven per cent of all compulsory deductions (prélèvements obligatoires, PO). In comparison, the general social contribution (contribution sociale généralisée, CSG) represented 91.7 billion euros (4.3 per cent of GDP), VAT was 144.4 billion euros (6.8 per cent of GDP) and 44.3 billion euros came from business taxes (l'impôt sur les sociétés, IS) (2.1 per cent of GDP).

Figure 2 shows the IR proportion of total compulsory payments since 1914: **in the post-war period, the IR part of PO grew until 1981, surpassing 12 per cent of total payments, and then decreased until the beginning of the 2000s, to around six per cent.** The recent increase occurs, then, in a context of decline in the significance of tax on personal income in the totality of the French taxation system.

Figure 2: Share of income tax receipts in total public revenues



Sources :

PO: 1915-1958: series established by Pierre Villa, adjusted by Piketty (2010); 1959- 2013: Insee (comptabilité nationale, base 2010). IR: see Figure 1

Note: Income tax represents 12.6% of the total compulsory payments in 1981.

Box 2: The tax base and real rates: The “return of la cédulaire”?

Since the 1991 Budget and the introduction of the general social contribution (CSG), France has had two taxes on income: a progressive tax and a flat tax. With a tax base broader than that of the IR and the flat taxes, the CSG resembles a return to the *cédulaire* tax. Insofar as it is deducted at the source, the CSG is often ignored to the point that some say that those households not eligible to pay “income tax” pay no taxes at all, whereas in reality, the average rate of imposition (of IR and CSG) of the most modest households (the poorest 20 per cent) has been around five per cent since 2000. The same is true for the introduction of the contribution to pay off the social debt (CRDS), whose very wide base is associated with a low rate (0.5 per cent). In addition, tax reductions linked to specific expenditures, “tax loopholes”, which appeared in legislation in the 1980s and multiplied in the 1990s, have led to an effective lowering of the income tax base: in the redefinition of taxable income, real income tax bills have been reduced. However, the reduction of taxation on income since the 1990s has not led to a reduction in overall taxation in France. With the level of compulsory prepaid contributions either stable or growing, the “tax reductions” have mostly been in the form of shift from tax on income to other deductions, chiefly social contributions and CSG.

Who pays income tax?

Figure 3 shows quite dramatically the development of progressive tax on income. At first characterised by low rates and only paid by those with very high incomes (the richest one per cent), the IR expanded after WWII to the upper middle class: by 1962, the proportion paid by the most comfortably-off 10 per cent had passed 75 per cent. The middle and lower classes, the bottom 90 per cent of income distribution saw their contribution go from less than 15 per cent in the 1950s to 35 per cent since the 1970s (in line with the change in the number of taxable households show in Figure 4 below).

Taxable households

The number of households earning taxable income levels gives us the size of the population affected by income tax.

This proportion has changed a great deal over a long period, as Figure 4 shows.

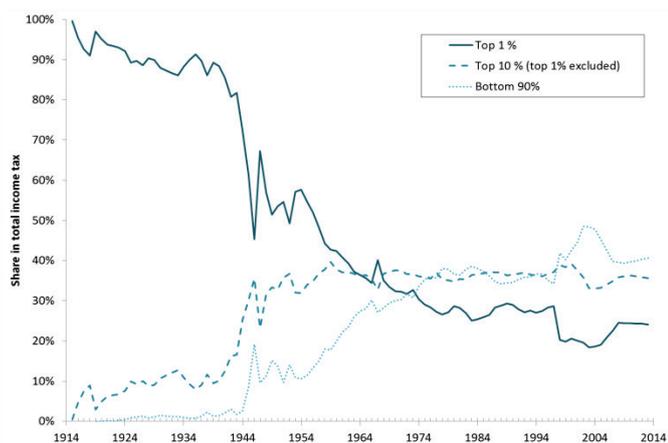
After a phase of progressive extension, particularly thanks to improved recovery rates by the tax office, the proportion of taxable households went from just two per cent in 1916 to 12 per cent in 1925 (around 2 million households), then oscillated between 10 and 25 per cent until 1955.

That share increased constantly each year thereafter because of an increase in wages and inflation, despite the nominal stability of the tax base: it passed 50 per cent in 1967 (more than 10 million households), then steadied between 60 and 65 per cent from 1975 to 1985, after which it declined dramatically and remained stable at around 50 per cent between 1986 and 2012, with a temporary drop to 43.3 per cent in the 2008 tax year.

In 2013, 19.2 million households were obliged to pay income tax.

3. With the tax base nominally stable, inflation automatically rendered some households taxable. In 1986, the creation of the additional half-part (for dependants) for all children in families of three or more children rendered some households non-taxable.

Figure 3: Paid income tax by income category

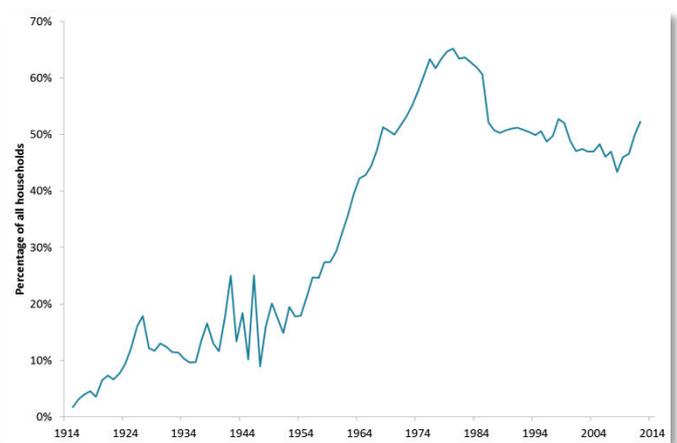


Source: Data for between 1915 and 1998 taken from Piketty (2001) and from the TAXIPP model for the period 1998-2014.

Note: In 1985, the IR paid by the richest one per cent constituted 26% of the total income tax paid.

Note: The total of the three curves is always 100 %.

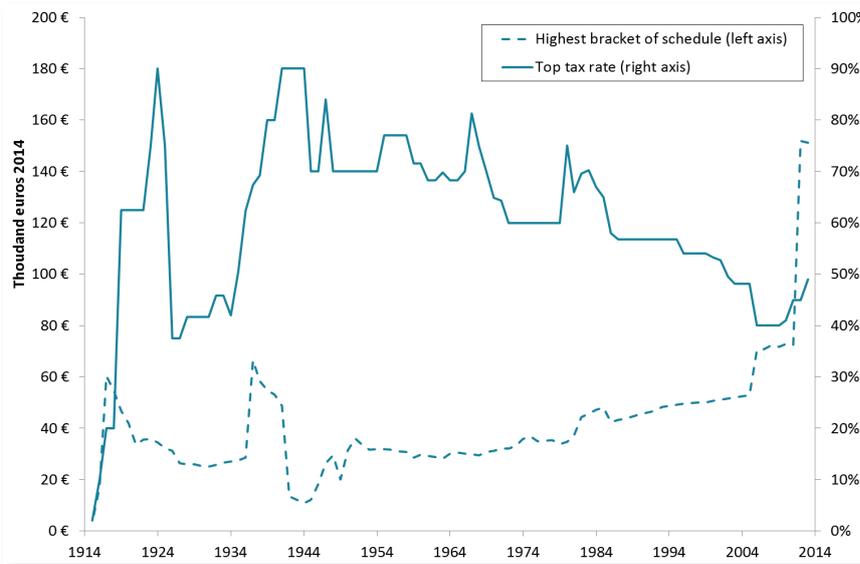
Figure 4: Share of taxable households



Source: Data for between 1915 and 1998 taken from Piketty (2001, p. 347). For the period 1999 to 2012, figures come from the French tax office.

Note: Number of households subject to income tax as a proportion of the adult population.

Figure 5: Top bracket and top incomes



Source : Barèmes IPP: Impôt sur le revenu, Institut des politiques publiques, April 2014.

Note: In 1985, the upper bracket increased to 48,119 euros, and the top marginal rate to 65%.

Note: The amounts are in millions of 2014 euros, that is, they take into account cumulative inflation (from Insee, since 1949; the indicators of historical prices of consumption are taken from Piketty (2001), annexe F).

The highest marginal rates are taken from "worst-case" scenarios and include "increases" and exceptional "contributions".

### What weighting does income tax have in France?

We define the "top one per cent", or the 99th percentile of income distribution, as the richest one per cent of individuals in a given population. According to Insee, in 2011, the 610,000 people of the highest percentile of the income distribution had 93,000 euros of taxable income per consumption unit.

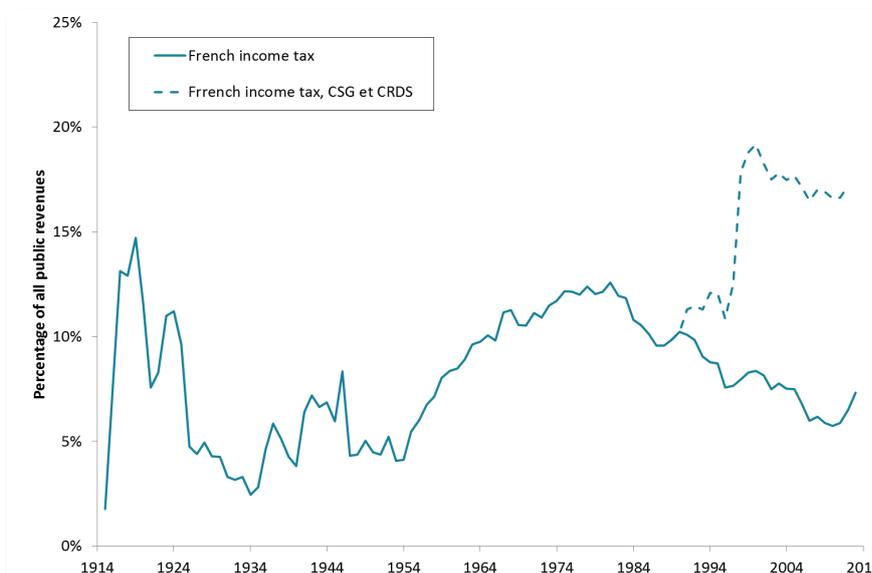
A comparison of the tax bracket threshold of the last tranche and the taxable income of the richest one per cent and 0.1 per cent reveals the effective application of the last tax bracket. **Between 1945 and 1960, the last tranche affected around one person in a thousand (the top 0.1 per cent); since 1967, it has applied to more than one in a hundred (the top one per cent).**

Figure 5 shows the change in the upper bracket and the marginal rate of the last tranche.

In 1920, for the first time the value of the higher rates passed 50 per cent and reached 90 per cent in 1924. As in France (at 65 per cent), in other countries the upper marginal rates were also higher at the beginning of the 1980s than at the end of the first decade of this century:

72 per cent in the Netherlands and Belgium, 62 per cent in Italy, 66 per cent in Spain, 53 per cent in Germany and 60 per cent in the U.K. In the post-war period, they even surpassed 90 per cent in the U.S. And the U.K. (see Alvaredo et al., 2013). Eurostat gives the value of the top marginal rate for the countries of Europe since 1995: **the marginal rate for high incomes dropped in the majority of European countries between 1995 (when it was an average of 47.7 per cent) and 2008 (when the average was 38.9 per cent)**, but the changes have diverged since then.

Figure 6: Average tax rate in France



Source: Average rate between 1915 and 1998 taken from Piketty (2001) and from the TAXIPP model for the period 1998-2014.

Lecture: In 1985, the last tranche showed a marginal rate of 65%, the richest 1% paid an average of 30.1% of their income in IR while the poorest 90% paid 4.5%.

Note: The average rates reflect all the parameters in use (tax base, deductions, increases, etc.) and are expressed as taxable income (before reductions and deductions).

Figure 6 compares the changes over 100 years to the real taxation levels of the richest one per cent with the value of this highest marginal rate. **Since the post-war period, the real taxation of the richest one per cent increased until 1982 (average rate of 34.2 per cent) then diminished (down to 25 per cent in 1998).** Since the 1970s the highest marginal rate has been about twice as high as the average taxation rate for the wealthiest one per cent. At the same time, the average tax rate for the least well-off 90 per cent never went above five per cent (in 1983) and was less than one per cent until 1957.

## What future for income tax?

In France, income tax has been at the heart of debates about taxation and redistribution for more than a century. Reforms regularly create political controversy: while the founding principle of a progressive taxation of income remains uncontested, many now call for the abolition of IR in its present form. After one hundred years of changes, it is considered "complex" by some, a "leaky bucket" by others, and represents a much reduced part of total public receipts. Giving this centenarian a make-over is a democratic issue. Such a step would require viewing the social and taxation system as a whole, a difficult task because it is a complex and opaque system thanks to its plethora of social deductions and the coexistence of two taxes on income (IR and the CSG).

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