Towards a Fair Tax Policy for Families

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Taxing families

Any tax/welfare transfer affects behaviour – no neutral tax policy for families

Tax impact on families should attempt to:

- Strengthen 'horizontal equity' (i.e. Tax varies by how many people depend on an income)

- Reinforce family self-reliance (i.e. Family

Traditional tax policy delivered all three

The Norm

Married parents, rare divorce, one income

The Government's role

· support widows and children who lose breadwinner

· ensure earnings are sufficient to support family

Core family policy

Based on the horizontal equity principle

The more people who depend on a wage, the less tax should be deducted from it. Hence:

· A personal tax allowance to cover the worker's own subsistence;

· A married man's allowance to cover his wife's subsistence;

· Child tax allowances to cover subsistence costs of children

Any top-up payments were flat rate because all children have same basic needs (also avoids work disincentives)

Horizontal equity (a) Why should we help with costs of dependent children?

- Prevent child poverty (adults can fend for themselves; children cannot) – but should be done thru welfare

- Compensate parents for 'public goods' benefit of producing children (stop free-riding) – but they are a private good too

- Key point: Parents are required by law to

Horizontal equity (b): Why should we help with costs of dependent spouse?

- Every adult has a right to tax-free subsistence allowance

- An adult who stops working to raise a child loses this 'income', but must still be supported

- A married couple's allowance recognises this: married couples can opt for separate or joint taxation

The 'Great Disruption' (Fukuyama)

· Decline of marriage, increased cohabitation, increased divorce and separation

· Increased ex-nuptial births (UK=40%, mainly different addresses)

· Result: 27 % families with children have only one parent

Reduced family self-reliance as sole parenting is rarely sustainable:

· 40% lone parents do no work, few work FT: those with children under 5: 10% FT, 19% PT, 70% none (cf 7% couples)

· 63% lone parents with 2 children rely on government for ½+ of income, c.f. 8% of couple parents with 2 children

· % of household income sourced from own efforts (averages):

  couples with children= 90%; sole parents = 42%

Great Disruption >
attack on trad family policy

Economic (vertical) equality arguments:

·   Tax breaks 'unfair' on single parents and welfare families (*but they get welfare*)

·   Tax breaks 'unfairly' help higher rate taxpayers more (*but they pay more too*)

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Gender equality (feminist) arguments:

- Married allowance 'demeans women' (*but it's voluntary, and can be claimed by either spouse*) and discriminates against cohabitees (*but no proof of sustained mutual support for cohabitees; marry to qualify*)

- Tax allowances claimed mainly by men – relies on intra-family redistribn (*but strong families = autonomous decision-making*)

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Economic efficiency arguments (OECD/EU/etc):

· Get more women into the labour force to solve ageing pop problem

New 'family policy' emphasises vertical, not horizontal, equity

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- 1975 Child allowance capitalised into Child Benefit

- 2000 Married couple's allowance scrapped

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BUT

(1) welfare focus is vertical, not horizontal, equity:

Neglect of horizontal equity > blatant unfairness

- Family on £30K pa pays £100.66 tax pw if 1 earner, £74.40 if split between 2 (IFS 2007). Yet their needs are identical

- Shows up in cross-national comparisons:

    One-earner family on average wage pays 25% more income tax in UK than EU average (40% more than OECD average)

- Shows up in historical comparisons:

    Single person on average wage pays same % of

But didn't tax credits compensate for loss of tax allowances?

Tax 'credits' are really welfare benefits:

- Paid weekly/monthly

- Claimed by principal carer, not earner

- Paid even if nobody working (child tax credit)

So CTC is a means-tested additional Child Benefit

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The fact that it is *means-tested* is crucial:

· Reduces horizontal equity (similar families

The loss of horizontal equity:

International comparisons (single income couples with & without children)

Earnings as % of average wage

0   50 100 150 200

Strong horizontal equity:

Germany   9   9

The loss of self-reliance
(How new tax policy created 5.5m middle class welfare dependents)

Equivalised disposable income decile

Bottom   **2nd**   **3rd**
4th   **5th**   **6th**   **7th**
8th   **9th**   **Top**

Average £ p.a.

Original income   *5205*   *8608*
15708   *21332*   *26599*   *33324*   *40922*

How do other countries do it?

- Radical individualist (no family tax pooling): UK, Hungary, Mexico, Greece

- Partially individualised (separate taxation of spouses, but unused allowances can be transferred to partner): DK, Netherlands

- Joint tax option (married couples can file singly or jointly – couples get higher allowance): USA, Aus, Ire (+ UK pre 2000)

- Pooled income schemes:

  Ger: Pool income, halve it, tax each half separately

  Fr: Divide total h/hold income among all members (children = 0.5), then apply tax and multiple up

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Restore family policy as distinct from welfare policy

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      - couples with dep kids only?

      - 1.5 x single allowance only? (equivalence)

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- Maintain principle of universal, flat-rate child benefit for working families (possibly front load?)

- Reform tax credits

  - end couple penalty?