FAIR TAXATION AND FAMILIES

A comparative study with a view to

a more equitable income tax

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Introduction

As government develop and expand their activities, their reliance on financial resources keeps pace. Government allowances, social security and supplementary provisions proliferate and the complexity of arrangements for residents of EU Member States, and their interrelationships become increasingly obscure. This is equally true of income tax, creating scenarios in which remaining single or getting a divorce could be fiscally advantageous.

In a number of countries, unmarried couples who are living together are paying less tax compared to their married counterparts on a comparable income, and married couples with both spouses in paid employment are often paying less tax than a family with a single wage-earner. The traditional breadwinner model gets a raw deal. The fiscal effects of similar joint incomes can vary immensely, raising the question of how can individuals and families be included in an income tax system which is levied as equitably and justly as possible?

In this commentary, we will be searching for approaches to solving these apparent contradictions and, in doing so, we will examine the situation in several member states of the European Union (EU) in greater depth. Our approach will be confined to the fiscal treatment of individuals and families: in some countries fiscal facilities may be available to families with children, for example, instead of (free) healthcare for children or parental leave arrangements, or vice versa.

Outline

The first chapter describes the various income tax systems that are theoretically possible, the tax brackets and the income tax based on an individual income or family income. The final part discusses how income tax treats children.

The second chapter addresses the basic norms and the Christian principles which the government should embrace when it levies tax. The shift towards adopting an instrumental approach in tax law damages the underlying basic principles whose purpose is to share the burdens fairly.

The third chapter provides an outline of the situation in the Netherlands, and is followed by chapters describing the situation in Germany, England, France and Sweden. How do these countries approach the taxation of families and individuals and what kind of fiscal facilities are there for children? The final part compares the countries in an attempt to gain greater insight into their differences.

The conclusion contains recommendations about income tax policies which could improve the way families and individuals are treated for tax purposes.

Responsibility

This publication is a summary of a more detailed study available in Dutch on the website, *www.wi.sgp.nl*, which also contains precise references to the literature that was consulted on this subject. The second chapter was written by Jan A. Schippers, MSc; the other chapters were contributed by Léon van Kruiningen, MSc LLB. Wim Oppelaar, MA, from bureau 'De Tekstwerker' produced the summary of the study. This publication was written at the request of the ECPF with a view to stimulating discussion among involved Christians throughout Europe.

Chapter 1 Theoretical framework

1.1 An income tax

Almost every country has a tax on the income of natural persons: these income tax systems attained their full development in the 20th century as government responsibilities expanded. An additional factor was the general change in perceptions of the character and objective of taxation. Income tax is closely connected to the personal circumstances of the taxpayer, which makes it extremely susceptible to any changes in the public's views on the world.

What kinds of income form the basis for income tax? What kinds of exemptions and allowances should be granted? And is a degressive, proportional or progressive rate applied?

The ability-to-pay principle

The ability-to-pay principle forms the basis for income tax. In this way, (significant) differences in income can be levelled out (to some extent). The tax levies can be used to distribute or redistribute income. The expression – the broadest shoulders should bear the greatest burden – conveys the meaning underpinning the ability-to-pay principle in everyday terms.

This does not automatically imply that income tax rates have to be progressive. The choice of tax rate structure is ultimately a political issue but it would be a good thing if governments allowed themselves to be guided by a sense of justice in society which finds wide support for a progressive rate. Very often the distinction between the ability-to-pay principle and the principle of redistribution is not made in ordinary everyday discussions.

The ability-to-pay principle says very little about the specifications of an income tax system. Because: how do you measure ability-to-pay? Nowadays, we measure someone's ability to pay by their income. According to the most current theory, income is the increase in an individual's purchasing power. To put it in a formula:

Income = Final capital -/- Initial capital + Consumption

This theoretical concept of income is not usable in practice. For reasons of efficiency not all increases in wealth can be included in the tax levy. In addition, it cannot be reasonably expected that tax would be levied on the proceeds from favours to a friend or from any work carried out within the family circle. In the final analysis, what should be included as income for the purposes of the tax base is a political choice.

Ancillary aims of income tax

Income tax has a budgetary function - that of financing government expenditure - to be precise, but policy-makers seem to forget this from time to time. Income tax is used increasingly often to guide behaviour: to stimulate the economy, boost employment or improve the quality of the environment. And this consistently diminishes the concept of income tax of being a levy based on the ability to pay. This can undermine the intrinsic legal value of the law, and an instrumental application such as this can also make regulations increasingly more complex and more detailed.

Income tax as consumption tax

Consumption can also be used as a measure of an individual's ability to pay because it shows the extent to which people lay claim to scarce means. People who use the same level of scarce means, should have the same amount of tax levied on them.

Academic theory, however, does not support this kind of taxation. Furthermore, a consumption tax imposes a relatively heavy burden on those who can least afford it, and it also offers those with high incomes the opportunity to avoid taxes, making the stability of government income more uncertain.

1.2 The tax object within an income tax: the individual's income or the family income?

The idea behind income tax is that any increases in an individual's ability to pay, measured as income, should be included in a tax levy. But which unit should be taken as the point of departure? Is it the increase of wealth of the individual or that of the family or of some form of cohabitation? Living in a joint household influences an individual's ability to pay. The increased scale of a household and home, and the possible presence of children, means that the ability to pay of a cohabiting sole wage-earner is lower than that of an individual who does not have a partner or children. By contrast, you could see the economies of scale from cohabitation and the value of household work as increasing the ability to pay because of the savings made.

Families are mutually and financially interrelated. Spouses, in almost every country, also have an obligation under civil law to support each other but unmarried people also experience a mutual financial interrelationship, as a recent Dutch study shows. A family, therefore, derives wealth from the joint income of both partners. Conclusion: the family income of a married couple or of two people in another form of cohabitation has a different significance than the same income of a single tax-payer. What implications does this have on the levying of income tax?

Joint, splitting or every man or woman for themselves?

Before 1973, the Netherlands had a joint system; the notice of tax assessment was sent to the husband and the incomes of both partners had to be added together and a deduction was allowed on the wife's income. The effects of this obligation to combine the incomes were limited because of the moderate rate of progression and the fact that double incomes were still fairly exceptional.

In an individualised system, the incomes of both spouses are kept separate for tax purposes. In a partially individualised system, the tax allowances are awarded to the sole breadwinner and these ameliorate the fiscal effects.

In a splitting system, the joint income is divided over both partners before tax is calculated. From this point on, we will examine the splitting system according to tax base, which is the most common variation. Countries with a splitting system automatically have, in effect, a progressive income tax system. In a splitting system, it makes no difference for the tax burden who contributes the income. There are various types of splitting systems. Some are directed at spouses, while others focus on families.

Individualised taxation systems		Splitting systems	
Fully individual	***Partially individual***	***Spouse-based splitting system***	***Family-based splitting system***
Austria	Belgium	Germany	France
United Kingdom	Denmark	Portugal	
Sweden	The Netherlands		
	Spain		

Table 1. *Overview of current tax systems in the European Union*

Splitting systems seem to be the preference throughout the world. The fully individualised system is the least popular but the individualised system in some form has been gaining ground over the splitting system in Europe since the Seventies.

A critical examination of the individualised system

Several – often neglected – disadvantages are attached to the individualised system which is common to Western Europe and which is gaining in popularity.

In actual fact, an individualised tax rate is no easier to operate than a levy imposed on both partners jointly; the opposite is more likely to be true. There is always the question as to how income should be allocated in a system which is based on the individual. In what proportion should the increases in wealth be divided between partners? And what about the joint bank accounts where it is impossible for the partners to distinguish between mine and thine? All these questions mean that additional regulation is necessary, accompanied by supervision by the tax authorities, because individualised systems contain strong incentives to wrongfully allocate wealth to the lower-earning partner (because of the lower marginal tax rate that the partner attracts). Research has shown that there is a tendency in individualised systems to ignore any imposed allocation regulations. In other words: one wonders how simple a fully individual tax collection system is. And whether it does justice to reality.

Moreover, individual collection is contrary to horizontal equality. A family shares all the costs and expenses so the family income should determine what its ability to pay is. The contribution to the income by the two tax partners should have no effect on the tax burden; if it did, this would violate the principle of equality.

1.3 The rates structures in income tax

Income tax can be levied according to a proportional, degressive or a progressive rate or to a combination of these.

Degressive

A system with a degressive rate is not suitable for an income tax system as the rate falls as taxable income increases. This rate structure conflicts with what is generally regarded as just, so it has therefore been automatically excluded from this discussion.

Progressive
A progressive rate seems to be the most defensible. This rate increases as taxable income increases and likewise the tax burden. There are many possible variations of the rates structure.

Proportional
Another name for a proportional tax is a flat tax: a system with one single fixed rate. This rate creates a very clear system. If a country which had a progressive rate structure with income tax based on the individual level introduced a flat tax, this would mean that individuals with higher incomes would profit the most whilst those least able to afford it would be contributing more under the single rate, which would be higher for them. This raises the question as to whether a flat tax would be desirable. Setting a threshold for exemption at the subsistence minimum could increase support for a flat tax. This creates the 'Bentham progression' – the combination of an exemption allowance and one single rate which results in a gradually increasing average tax burden up to the level of the fixed rate. A second rate could also be added: a so-called prosperity bracket or top incomes rate, which could generate greater support for a flat tax.

Arguments in favour of a flat tax are: administrative economies and greater transparency. Another advantage of the flat tax is that it does not discriminate as to household type: the income contributed by the partners in a family is no longer relevant.

One important drawback of the flat tax is that it undermines the ability-to-pay principle, but this can be balanced by allowances and tax credits; the important advantages of transparency and the reduction of bureaucratic procedures, however, disappear in that case.

The flat tax is gaining ground internationally. Many countries, in particular the Baltic States and Romania, for example, have already introduced a flat tax or are considering doing so. Often the introduction of a tax such as this is linked to economic growth. This picture is distorted and does not account for the different backgrounds and circumstances faced by the countries in which a flat tax has been or is going to be introduced. So far, no fundamental study of the effects on spending power has been conducted but the flat tax system continues to receive considerable interest throughout the world.

1.4 Facilities for the employed and families with children in income tax

Government expenditure on families is not channelled exclusively through tax levies. The Organisation of Economic Co-operation and Development (OECD) distinguishes between three types of public spending on families:

1. Child-related cash transfers to families with children, such as child allowances;
2. Public spending on services for families with children such as childcare and educational facilities;
3. Financial support for families through the tax system: child or family-related tax deductions and tax credits.

Tax allowances

A taxallowance is a useful instrument for allocating a tax benefit to a specific group. The tax advantage from the allowance is the same for everyone who is eligible as there is no progressive advantage, but tax allowances have their negative side too. It has been shown that not everyone who is entitled to the allowances can benefit from them: for instance, the tax they pay may be too low for them to take advantage – or full – advantage of the amount available. With tax subsidies this is not the case because these are paid whether tax is due or not. In addition, as people with higher incomes seem to benefit more from the tax allowances, whether tax allowances are a suitable method of influencing spending power habits remains questionable.

Opmerking [l1]: Wellicht tax subsidy gebruiken ofzo. Nu vind ik niet duidelijk genoeg dat het om een 'toeslag' gaat zoals in de NL tekst. Een tax credit hoeft niet te betekenen: een directe geldstroom van overheid naar onderdaan. Neem het woord subsidy of synoniem serieus in overweging.

Stimulating work

Taxation is used to encourage people to find work, and includes methods such as the provision of deductible items and credits. In the Netherlands, the employed person's tax credit is an important example of this and is a credit available to all. Similar facilities in other countries are often only applicable to people on low incomes and, as income increases, the facilities are reduced. A complex variation of this is the Earned Income Tax Credit (EITC). One disadvantage of schemes of this sort is that they are not transparent because of the complexity of the way the tax credit is phased in and out: they can also deter people from increasing their income.

Behavioural economics and fiscal management

Studies show that the effects of fiscal incentives are limited. They are only effective when they have exceeded a certain threshold value, and this effect decreases as the arrangement becomes more complicated. There is also a greater take-up rate of fiscal stimuli after these incentives have been in existence for a longer period of time. Providing information encourages more people to apply for them.

1.5 Income tax and employment participation

The days when people only seemed to work to support themselves appear to have passed. Participation in the employment market nowadays seems an essential precondition for individual freedom and joy of living: this is why a tax system focused on the individual is now viewed so positively. Critics of the flat tax and the splitting system argue that it is these very systems which have a deleterious effect on employment participation.

But it seems as if the chances of influencing employment participation through taxation have been proved, in reality, to be fairly slim. The emphasis in literature on the splitting system's alleged harmful effect on employment participation seems to be an exaggeration. For instance, in the Dutch situation, women seem to be perfectly content to work in part-time jobs and there is no financial necessity to work fulltime, but using tax measures to stimulate greater employment participation nevertheless leads, on balance, to lower income for the treasury. It puts the budgetary function of income tax under pressure. Proper consideration should also be given to the fact that non-financial aspects can also be very valuable. Placing great emphasis in taxation on an individual carrying out paid work means that forms of unpaid work which benefit society, such as voluntary work, receive much less esteem. Society would look completely different if parents didn't make any efforts to help their or other people's children, if there were no voluntary workers and/or if people had no free time. Complete, full-time employment participation by both sexes is undesirable from both an economic and a social point of view.

1.6 The financial position of families

Taxes serve to finance public services which everyone should, in principle, contribute to. But what, in general, is the financial position of the individual citizens? Are there any vulnerable groups and, if so, who are they?

Broadly speaking, in an international context, poverty occurs most often in one-parent families. Another general assumption is that families with children are the ones most likely to experience poverty. This seems to be particularly true for families with young children (who are too young to be left on their own). The most important cause of poverty is unemployment. The availability of work keeps most families with children above the poverty line. In addition, finding a partner is an important factor in improving a person's income position. The risk of poverty is clearly greatest in one-parent families and very often governments focus their financial support on this group in particular.

Chapter 2 It all began with tithes....

2.1 Introduction

As a Christian political think-tank, the ECPF wishes to apply Christian principles to all areas of political policy and in all aspects of society: its values and vision are founded in the Bible and the Christian tradition. This chapter briefly examines what the Bible says about levying taxation and, to a lesser extent, the payment of taxes. Are there any fundamental principles founded in the Bible which support a government's ability to impose taxation on its population? And, on the other hand, we want to trace which Christian principles apply to citizens; are there any moral obligations on citizens to pay taxes?

This chapter outlines the Christian principles which governments should follow when levying taxation. References (in brackets) will be made to biblical texts which discuss religious and civil taxation; we will then examine the significance of these principles and their impact on a reassessment of our current taxation system.

2.2 Basic principles for levying taxation in the Bible

In ancient times, when biblical history was being recorded, society was organised in a completely different way. The means of production were primarily agrarian with only a limited amount of commerce and transit trade. The temple service in God's honour played a central role in society. For this reason, in this chapter, we are going to examine the important principles underlying the levying of taxation which are given in the Bible. Providing a comprehensive account of all the taxes and levies would be less relevant for our age as taxes and levies are closely linked to the particular character and organisation of the society at that time.

An initial question is whether a government is entitled to levy taxes on its citizens. Is this infringement of the freedom to dispose of one's income admissible? This question is one which is answered in the affirmative in several places in the Bible.
The parable of the trick question put to the Lord Jesus is only too well known ....should the Jews pay taxes to a foreign overlord? (See Matthew 22, among others.) In His answer that one should render unto Caesar the things which are Caesar's and unto God the things that are God's, Jesus argues that subjection to the government is not, in fact, in conflict with obedience to God. The deeper, spiritual dimension behind this divine answer is: a person belongs to the image which he bears. By this, Christ is referring to the fact that man is shaped in God's image. Caesar only demands taxation, but God requires our whole being.

In the Letters to the Apostles, Christians are also called upon to pay their due taxes faithfully. Why? Because the government receives the authority to create justice, order and peace in society from God. In the Letters to the Apostles, the message made clear again and again is that one should obey the government and loyally pay the due taxes (Romans 13, 4.7; Titus 3, 1-2; 1 Peter 2, 13-17). This Christian obedience springs from a love of God and His Commandments. The conduct of Christians must be such that others are given no reason to speak ill of them (1 Peter 3, 15) and, by behaving in this way, Christians show that they recognise the government as an institution of God. If a government acts unjustly and promotes evil, it will have to answer to God for this. This does not allow

Christians to abdicate responsibility for fulfilling their obligations to pay obedience unless the government demands something that conflicts with God's Commandments. Christians are specifically requested to pray for their governments so that Christians can live in godliness and dignity and be able to win over others to the truth of the Gospel (1 Timothy 2, 1-4). Diligently paying all due taxation is even prescribed as an ethical obligation. The eighth Commandment says: 'Thou shalt not steal.' God orders that respect be shown for property rights in this commandment. It must not be forgotten that God is the owner of everything and mankind only has earthly goods on loan. This leads to the expression: 'I don't pay tax because it is *my* money' being manifestly unethical. According to the interpretation of the eighth commandment in Lord's Day 42 of the Heidelberg Catechism, the prohibition of theft also includes the obligation to fill in the details of one's tax return truthfully. If one is a servant of God, one may not steal from the government authorities. (See, for instance, Romans 13.) Avoiding paying one's taxes also means violating the ninth commandment ('Thou shalt not bear false witness against thy neighbour.').
The logical question to ask then is – what departure points, conditions or norms should a government authority consider when levying taxation? In other words: are there any limits to its freedom to levy tax or do the authorities have *carte blanche*, so to speak? The latter is certainly not true or the authorities might then start to display totalitarian tendencies. What departure point should an authority have and what norms should it conform to when it draws up its taxation policies?

2.3 Justice as a basic norm for government authorities

Promoting justice and affirming righteousness are the basic biblical norms underpinning all government policies. The concepts of justice and righteousness are central features in Christian political thinking about the tasks of government authorities. In the Bible, justice means first and foremost that there is a fair, correct and reconciliatory relationship between God and humankind. This has a salutary effect on the relationships which humans have amongst themselves. Righteousness points to the harmonious relationships to be striven for and achieved in society (see, for instance, Jeremiah 23, 5-6).

In regard to levying taxation, the primary task of the authorities is to make sure that the burdens are divided fairly. The tithe system, which we can describe in some ways as being the archetype of tax levying, points in this direction. A government authority violates the principle of righteousness if it requires taxes to be paid by its citizens which are too high and which reduce them to poverty. The Old Testament contains several pronouncements from the prophets against 'grasping' kings (see Isaiah 3, 14; Jeremiah 22, 13-17; Ezekiel 22, 27; Amos 5, 11; 8 ,4; Micah 3, 1-4).

The basic norm, for supporting the principle of righteousness, is defined and elaborated in more detail in the three principles of levying tax: generality, ability to pay and redistribution. These principles, which are derived from the Bible, will be discussed in the following sections.

The principle of equality

We find the principle of 'equality', in particular, in the individual levying of a half shekel for temple tax (Exodus 30, 11-16 and Matthew 17, 24-27). This payment applied to every (male) person above the age of twenty. The silver imperial coin given as tax to Caesar was also an individual tax, which everyone had to pay (Matthew 22, 15-22). On the basis of the principle of generality, levying taxation

Opmerking [JvdB2]: Volgens mij betaalde in de samenleving van toen alleen een man belasting, daarom vraagteken schrappen; maar laat 'male' wel tussen haakjes staan.

should be of a general character, with no exceptions for privilege or such like. This principle rules out any arbitrariness being exhibited in the selection of the person on whom the tax is imposed.

The ability-to-pay principle

The principle of 'the ability to pay' is a fiscal refinement of distributive fairness and is expressed in the norm of the equality of the tax burden. The ability-to-pay principle is a further refinement of the principle of equality: taxpayers who are in similar circumstances should be treated equally for tax purposes. According to this principle, the amount of tax due is based on the level of income or a person's disposable spending capacity. A government authority which places the burdens primarily on the poorest section of the population is acting in violation of the ability-to-pay principle.

The first evidence supporting this can be found in Leviticus (27, 2-8) where the highest rate (referring to the payment of a vow) is for adult males aged from 20 to 60 years old; for adult females there is a discount of 40 per cent; for boy and girls over 5 years of age the rate is reduced by 60 and 80 per cent, respectively. The rate is even lower for very young children, and anyone over 60 is exempted altogether. The ability-to-pay principle can be derived from this, in the sense that a person's production capacity or productivity must be taken into account when a special vow needs to be paid.

Taxing in proportion to the ability to pay is expressed most clearly in the payment of tithes (i.e. 10 per cent of the produce from agriculture, fruit farming and cattle breeding) paid to the Levites – payments which were made to support the temple services. (see Leviticus 27, 30-33). In addition to assisting at services of worship, the Levites were also responsible for teaching religious and civil law.

In Luke's Gospel (21, 1-2), we read about a pronouncement made by the Lord Jesus on the gifts which many people placed in the temple's treasury. There are rich people making gifts who want to make an impression by giving large donations, but a widow also came and she only offered two small mites for the temple service. Jesus valued her generosity much more highly because the poor widow was giving a lot more in relation to the other visitors. Although this example is not directly related to taxation, the way in which the Lord Jesus judged the matter clearly shows that a person's gift should not be judged on its size alone but on its size in relation to the giver's disposable income.

The principle of taxation based on one's ability to pay means that the taxpayer has the ability to pay without his own means of existence being affected. The tax base must therefore be determined on the basis of the *returns* on the taxpayer's property and everyone is entitled to be able to feed and clothe themselves and provide a roof over their heads. The church tradition refers to Paul's defence in his letter to the city of Corinth where he writes that a soldier does not pay his own wages, the owner of a vineyard also eats of his own vine and the shepherd drinks the milk of his flock (1 Corinthians 9, 7).

Does the ability-to-pay principle apply to the individual or to the family? Focussing on the individual shows a lack of appreciation for the many people who care for their spouses and any children they may have and their obligations. This way of thinking should, therefore, also be rejected (see also Section 1.2). Marriage has a high, elevated status. By basing its approach on the family's ability to pay, the government would be acknowledging the importance of this living unit and giving expression to the fact that marriage deserves respect.

The principle of social justice

We understand this principle as one which includes all the measures government authorities take to protect the weaker members of society: it is a principle which finds expression in the Bible in various ways. In the instructions that the corners of the fields must not be fully reaped, that the olive trees must not be shaken until they are empty and that the grapes in the vineyards which were too small for the first picking or which were initially overlooked must not be harvested. Likewise, the ears of corn that were left on the ground should be left for the poor, widows, orphans and strangers (Leviticus 19, 9-10; 23,22; Deuteronomy 24, 17-22; Ruth 2, among others). Such arrangements as the Sabbath Year and the Year of Jubilee (see Leviticus 25) also have a redistributive effect, especially in the settlement of debts as they temper any of the differences in prosperity which are too great – even though they are not tax levies in the strictest sense.

Furthermore, the voluntary celebratory tithe every three years was intended to be a thank-you meal in the city of the giver, to which he not only invited his close family and the Levite, but also the stranger, the orphan and the widow (Deuteronomy 14, 28-29; 26, 12-19). In this way, socially weaker members of the population could participate in the activities which showed the people's gratitude for all the blessings and richness of God which had been received.

A third example is that of King Menachem who had to pay a tribute and imposed a special tax of 50 shekels of silver only on the 60,000 richest members of the population, thus sparing the less prosperous section of the population from making any payment (II Kings 15, 19-20).

The comparison with the labourers in the vineyard (Matthew 20, 1-16) is another example. In this comparison, all the labourers received the same wages at the end of the working day, whether they had worked twelve, nine, six or even just one hour in the vineyard. Those who had worked the longest protested to the employer about their treatment and he pointed out the agreement that they had concurred with. They were willing to do their work for a penny, so they had not been treated unfairly. Furthermore, the employer is free to give the same wages to those who had worked fewer hours for him – which amounts to a higher hourly wage in fact. This comparison is not about the ability of the employer to act freely, as if he had the power of arbitrariness; on the contrary, the essence of the comparison is that the employer gives employees the wage necessary for their own sustenance which, in the end, is a question of justice. A daily wage of one penny is comparable to our modern social minimum. In the society of that time, this was the daily wage which labourers needed to earn to provide food, clothing and shelter for their families. The employer apparently wanted to behave correctly in this situation by ensuring this basic payment, no matter how much labour had been offered in exchange.

It is very important, however, to note that the principle of social justice is not directed at equalising incomes and wealth but at correcting the differences in affluence by sparing the poor in taxation or by offering them the opportunity to be able to feed themselves. This principle offers the authorities a tool to combat the exploitation and gross unfairness in the relationships between people. The testimony in the Bible allows room for enjoying prosperity but, at the same time, it emphasises the view that one should be aware that wealth is not so much due to one's own activities but to the goodness of God. And for this reason, richer people have a moral obligation to allow those who are less well off to share this (1 Timothy 6, 7-19; James 5, 1-6). Another conclusion of the foregoing is that the principle of redistribution further redefines the ability-to-pay principle. As already indicated in Section 1.1. , appealing to the ability-to-pay principle can represent a defence of proportional taxation and progressive taxation. In view of the foregoing, the ability-to-pay principle should be understood from a moral perspective in such a way that the more wealth starts to exceed the ability to pay, the more must be paid, relatively speaking, to the community (through the state) or to needy fellow-human beings (through gifts).

2.4 Effective taxation based on principles

What is the significance of these principles today? One might think that this is only a matter of financing government expenditure through the proceeds of taxation and that this can be enforced through proper legislation and regulations. It is clear that an individual interest (is there anyone who really likes paying taxes?) is incompatible with the general interest (a balanced government budget).

The 'real' intention of taxation, namely the financing of the government organisation and its expenditure, is supplemented with various kinds of secondary objectives. Examples of economic and political objectives where tax law is used as an instrument include: promoting employment participation, stimulating investment, reducing the financial burden of certain groups, such as the self-employed, compensating for childcare costs, encouraging owner-occupiers, reducing anti-pollution tax and attracting branches and head offices of international enterprises and so on. The effectiveness of the instrumental use of taxation very often appears to range from moderate to very little (see Sections 1.4 and 1.5) in practice, not to mention, the political reluctance to assess this kind of legislation.

The increasing use of taxation as an instrument is leading to the development of more and more comprehensive and complicated legislation and regulation, so much so that the original concept of ability to pay is being increasingly lost sight of. In this way the ground under the legal basis of an income tax is eroded: this is disastrous for the taxpayer's attitude to paying taxes. Income tax is seen as an incoherent complex of rules in which no – or no unambiguous – spirit or fundamental principle can be discerned.

Government authorities can mitigate this impression (that income tax is only made up of a set of separate rules with no coordinating meaning behind them) by being transparent in the way it brings the levying of taxes in line with the most important principles of taxation law. The moral tax principles which have just been examined should act as a guideline here: because everyone should contribute their *fair share*. Taxation should be levied – once more – according to the ability to pay. Taking the principle of redistribution gives greater substantiation to the idea of the ability to pay. Everybody's subsistence level should be spared and the better-off have the moral obligation to contribute more, relatively speaking, than the less well-off.

Putting the above into practice would restore taxation's normative character. If we further elaborate the basic norm of justice, we arrive at the point that the authorities must keep the costs of collection as low as possible. The influence of the authorities in private life must be kept to a minimum.

Financing the basic collective needs of the population (for example, security and water management) from the general funds, to which everyone contributes, conforms to the idea of justice. For other public services which do not affect citizens' basic requirements a different kind of tax is preferable, one which is based on the user-pays principle. For public services of this nature – the road system, for example – it is fairer that only the users pay towards them.

How can we translate these principles into more specific terms?

- ***The principle of equality:*** tax measures are of a generic nature, as far as possible, so that the same tax rules and rates apply to all citizens, families or businesses who are in similar situations; different situations are taxed dissimilarly in proportion;
- ***The ability-to-pay principle,*** *which is supplemented by* ***the principle of social justice:*** when tax is levied, poorer people and families should be spared, the subsistence level should be exempted, tax advantages should not predominantly benefit the middle and higher income classes, the family income is the tax basis and a progressive system enables levelling to take place automatically.

2.5 Conclusion

Relatively high (marginal) rates apply to income tax in some of the European Member States (see the following chapters). This is closely linked to the culture of the country in question and it would be difficult to give a general normative assessment of the situation there, but the decisive factor is whether the effective tax burden is fairly distributed among the population, in line with the principles described above. This can be effective in preventing the tax burden from becoming unbalanced. A good system of taxation adheres closely to the basic norm of justice and is characterised by its simplicity and transparency so that the principles and fundamental idea underpinning the system are clear to every taxpayer. An organisation and rates structure which taxpayers understand contribute in this way to the awareness that everyone is paying their fair share towards the total amount of taxation.

Chapter 3 The Netherlands

3.1 From a joint system to an individualised system

From 1973, the Dutch income tax system gradually evolved from a joint system into an individualised one. In 1984 new amendments gave (married) women greater fiscal independence and, since 1998, the personal tax allowance has been used as an instrument for boosting the employment market. This personal allowance was then broken down into a transferable and a non-transferable part: before that, the working taxpayer was the only one who could use the non-transferable part. This alteration gave double-income families a higher joint tax allowance than families with a sole earner and this broke up the fiscal neutrality of the role division of partners in a family relationship. In 2001 the income tax system was altered again and an even greater focus was placed on promoting employment participation.

3.2 Individual taxpayers and tax partners in the year 2011

The Dutch 2001 Income Tax Act [*Wet Inkomstenbelasting 2001*] (hereafter: IB 2001) is an individual tax which takes the joint income into consideration and, to a certain extent, the family's ability to pay, so the Dutch system of taxation is now a combined form of a splitting system and an individualised one.

Individual and joint income

The main rule is that the person liable for tax has to fill in the details of his or her income in their own tax return, with the exception of those income components which are statutorily defined as joint income. This is: the mortgage interest on a privately owned home, the proceeds from securities which represent a 5 per cent share in a company and the individual's own personal deductions. The importance of the joint income elements is that they may be allocated at will to one or other of the partners, or may be divided over both, as long as the total declared amounts to 100 per cent. All remaining income which is not joint income is taxed on an individual basis. The most important individual sources of income are income from employment, income from other activities (for example, freelance income) and profits from a company without share capital.

Partners under IB 2001

Only partners may decide how the joint income components are allocated. The existence of a partnership is also an important factor in determining whether there is an entitlement to personal deductions and tax credits. The law defines tax partners as:

- spouses;
- single adults who have entered into a cohabitation contract by notarial deed and who are registered at the same address in the municipal personal records database;
- taxpayers who are registered at the same address in the municipal personal records database and from whose relationship a child has been born or a child has been acknowledged, or who has been designated as a partner in the application of a pension scheme, or who shares a home with the taxable person which is classed as the principal residence.

3.3 The current rates structure

The combined income tax and collection of social insurance contributions in 'Box' 1 (=income from work and home) for those under the pensionable age are as follows:

Taxable income more than	But not more than	Income tax	Social insurance contributions	Total tax rate
-	€ 18,628	1.85%	31.15%	33,00%
€ 18,628	€ 33,436	10.8%	31.15%	41.95%
€ 33,436	€ 55,694	42%	-	42%
€ 55,694		52%	-	52%

Table 2 – *Rates structure of income tax in the Netherlands*

The average income in the Netherlands is € 44,858 (2010). Then there are the tax deductions which lower the basis for tax assessment and the tax-reducing tax allowances related to families and work, as these have paramount influence on the ability to pay when an individual is in a form of cohabitation.

Tax deductions: in order to determine a family's ability to pay the following is important: maintenance commitments, the costs of providing for children, expenses for specific care and weekend expenditure on the care of disabled people. The deductible maintenance obligations also specifically include alimony payments. Under certain circumstances, the costs incurred for providing care for children under 30 years are tax-deductible. Expenses related to specific costs of care, and weekend expenses for disabled people are also tax-deductible in certain circumstances.

Tax allowances

The following tax allowances are particularly relevant for the tax burden faced by families: the general tax allowance, the employed person's tax allowance, the income-dependent combination tax allowance, the parental leave allowance and the lone-parent allowance. Currently, the general tax allowance still applies to all taxpayers. Those enjoying income from employment are eligible for a special allowance which has been steadily increased over the course of time. In the meantime, the employed person's tax allowance could almost be regarded as being a subsidy for undertaking paid work. The income-dependent combination tax allowance is available for an employed person who has no partner or a partner with a low income. The parental leave tax allowance applies to taxpayers who have taken up parental leave. Single parents are also entitled to a tax allowance. However, the deduction of tax allowances may not result in a negative amount of income tax being due. 3.4 Non-fiscal arrangements for families and children

Whilst the Dutch system has many financial advantages for people with children, they are only available to those working in paid employment. Examples include pregnancy leave (roughly 25 per cent of an annual salary), parental leave and the childcare allowance. In its financial support for the family, such as the money paid out for child benefit and supplementary child benefit, the Netherlands are at the bottom of the league of European Union Member States. Because of their strong focus on work-related family support, the government authorities restrict parents' real freedom of choice to give ample personal attention and care to the upbringing of their children.

3.5 Is the tax burden dependent on the income contribution in a certain form of cohabitation?

Yes, the income contribution has a great influence on the total tax burden. It means, in fact, that a 50/50 income contribution in a family is the most favourable for tax purposes. The tax burden rises as this proportion changes and, when an income contribution is 100/0, the tax burden is at its highest. The most important causes of this increase in the tax burden are:

- The progressive tax rates structure;
- The employed person's tax credit which can only be used if the taxpayer is in paid employment;
- The income-related combination tax credit which allows dual earners with children a substantial tax deduction;
- The gradual phasing out of the general tax credit for the partner with little or no income.

All the tax incentives focus on the double-income model. Single persons and one-earner families pay the highest amount of tax, even after setting off any tax allowances. With two incomes, the tax burden on a household is lowered considerably. The tax burden for a single parent with children is also significantly lower than it is for a sole earner. Furthermore, it appears that the subsidy for childcare represents an important reduction in the tax burden.

Chapter 4 Germany

4.1 Family income or individual income?

In Germany, spouses can opt for an individual or a joint tax levy. If the latter is chosen, the splitting system applies. Here, all the income is added together and then divided between the spouses in a 50/50 ratio for each spouse, which adds up to a splitting factor of 2. Again: all married people can opt for this situation.

4.2 The rates structure

Three kinds of taxation are relevant for taxpaying individuals and families in Germany: income tax, solidarity surcharge and church taxes. As in the Netherlands, the income tax rate is progressive. The second kind of tax, the solidarity surcharge, was introduced to finance the reunification with East Germany and is a surcharge of 5.5 per cent on all income tax due. No surcharge has to be paid until an income level of € 972 is reached, and spouses who have opted for the splitting system are exempt up to a € 1,944 level. Church members also pay a church tax, which is assessed at 8 to 9 per cent and uses the same tax base as income tax but a church tax can, however, be declared as a fully deductible item on the income tax return.

4.3 Tax deductions

In Germany, no income tax is charged on incomes up to € 8,005 and, for this reason, there is no standard tax-deductible allowance. The most noticeable deductions are those made for an employed person's tax credit, child tax credits, maintenance payments and work-related expenses.

For each child, there is a tax credit of € 2,208 (1st and 2nd child), € 2,280 (3rd child) and € 2,580 (4th child and any subsequent children). There is an allowance of € 2,184 for child support and an extra credit of € 1,320 if a child still attends school. If parents opt for the splitting system, these tax deductions are doubled and if the total sum of the child-related allowances is less than the applicable deductions, the taxpayer may only declare the deductions. Only the option which is most fiscally advantageous may be taken up and none other. The doubling also applies to single parents who are not in receipt of maintenance. A single parent with a child who applies for child tax credit is allowed an extra deduction of € 1,308.

4.4 Fiscal and non-fiscal arrangements for families and children

In addition to the tax arrangements summarised above, families with children receive a child benefit payment of € 154 per child per month (from the fourth child this is € 179 a month). For a second child, there is a *Geschwisterbonus* or sibling bonus, which is paid until the older sibling is 24 months old.

Additional arrangements are in place to combat poverty among families with children, such as a supplement of a maximum € 140 a month for parents on a low income which is paid for unmarried children up to the age of 25. There is an extra allowance for single parents who receive no maintenance payments, plus a generous package of paid and unpaid leave and care facilities for parents.

With its family policy, the German government not only aims to fight poverty but it also wants to raise the birth-rate, so it is making it easier for mothers to combine work and care. In recent years, a great deal of effort has gone into making childcare more easily accessible and more widely available, and tax credits have been made available to help pay towards the costs of childcare.

4.5 Does the tax burden change in line with income contribution in different forms of cohabitation?

In a splitting system, it makes no difference to married couples who contributes what amount to the family income: all the income is added together and then divided by two. Unmarried people with children are taxed as individuals and each working partner is taxed individually under a progressive rates system. Tax arrangements for the children of unmarried taxpayers can turn out to be less advantageous than they are for married couples who have opted for the splitting system and who may sometimes be able to double their deductible items. Unmarried couples are not allowed this facility.

In Germany, the traditional breadwinner's concept is more advantageous for tax purposes. As well as the matters just referred to, social security also plays a part. A breadwinner earning twice the modal wage pays much less in social security contributions than a double-income family with the same total amount of income. In this, Germany is dissimilar to all the other member states of the European Union.

Chapter 5 France

5.1 Family income or individual income?

France has a splitting system in which the splitting factor is determined by the number of members in the family. For a married couple with two children the factor is 3 and, with a family income of € 30,000, the tax burden imposed is calculated over an income of € 10,000 and then multiplied by a factor of 3; thus France's progressive rate gives an immediate tax benefit. It also means that the personal tax allowance can be claimed three times but maximum amounts are set for allocating income to children.

The splitting system also applies to married couples and partners with a cohabitation contract (PACS). Unmarried couples who live together and single people are taxed individually. Children up to the age of 21 are included in the splitting factor. The first two children each count for a 0.5 part and subsequent children for one part. For a married couple with three children, the splitting factor is then four. There is, therefore, a splitting factor which applies to every family situation and an applicable maximum gross income which corresponds with this splitting factor.

5.2 Tax deductions

There is a tax deductible allowance of 10 per cent of salary for work-related expenditure, with a minimum of € 415 and a maximum of € 13,948. There is also a deduction for providing for children (up to a maximum of € 2,300). Maintenance payments are also tax deductible under certain conditions. For disabled people in paid work, a maximum tax deduction of € 2,276 is allowed.

5.3 Tax credits

France also has a bonus for working people: it is the French version of the Earned Income Tax Credit. For school-age children, there is a tax credit of between € 61 and € 183 per child depending on the kind of schooling. The costs of childcare for children younger than seven years are 50 per cent tax deductible up to a maximum of € 1,150 (net). A tax credit is also available for home help salaries. There are no tax facilities for medical expenses.

5.4 The rates structure

The rates structure of income tax in France is a progressive one. A separate tax is imposed for social services. If the total amount of tax imposed in both taxes is more than 50 per cent of annual income, a refund can be requested.

5.5 Fiscal and non-fiscal arrangements for families and children

France has an explicit family policy with a large range of child-related financial provisions, such as child benefit, help with the costs of primary school, supplements for the income of single parents up to a minimum income level, birth supplement, father and parental leave and childcare etc. Employed people who have brought up three or more children get an extra basic pension.

5.6 Does the tax burden change in line with different forms of cohabitation?

Yes, married couples with children derive full benefit from the effects of the French system. The contribution made to the family income is not relevant in this system but it is certainly advantageous if both partners are in paid employment. The French pay particular heed to children in their income taxation and the focus of the French system is on the family's ability to pay.

Chapter 6 United Kingdom

6.1 Family income or individual income?

Income tax in the United Kingdom (UK) is tailored to the taxpayer's individual ability to pay and its tax base is similar to that of the Netherlands. Earned income and investment income are the most important components of taxable income. Unlike the Netherlands, however, a person's own home is not relevant for income tax purposes and whether someone is married or not makes no difference to the fiscal treatment of individual income.

The UK has what is known as a 'couple penalty', which makes it financially disadvantageous for couples to live together; studies show that 95 per cent of single people with children have to confront this dilemma when they are deciding whether to marry or live together. Tax allowances allowed under the income tax system are partly to blame for the creation of this situation.

6.2 The rates structure

Income tax in the UK has a progressive rates structure and, in addition to paying income tax, employees also pay social security contributions.

The tax system and social security in this country have a redistributive effect.

6.3 Tax credits

There are two important credits: the Child Tax Credit (CTC) and the Working Tax Credit (WTC).

The Working Tax Credit is really a tax credit based on the number of hours an individual is in paid work and is applicable to both employees and the self-employed. Anyone who is 25 years or older must work at least 30 hours a week to qualify and sixteen-year-olds and over must work at least 16 hours a week to be eligible; this minimum also applies to people with a disability and to employees who are 50 years of age or older. Anyone who has to care for children, and is 16 years of age or older, must also have a minimum earned income of 16 hours work to be eligible for the WTC. The amount paid depends on the number of hours worked, whether children are cared for, the age of the person working and/or any particular special circumstances.

The Child Tax Credit (CTC) is a form of tax credit for families with children on a low or average income and is also available to parents who are not working (it is in fact a negative income tax). CTCs are available as standard for children younger than 16 years and children up to 19 years who are in full-time education. The amount depends on the family's gross income, the number of children, the family situation (single or with partner), whether and how many hours are worked, whether childcare has to be paid for and whether a child with a disability is involved. The standard allowance is £ 545 and there is a credit of £ 2,555 for every qualifying child, with an extra credit of £ 2,800 for a child with a disability and a further £ 1,130 for a child with a severe disability.

For a non-working person with children, the tax credits are at a maximum when the family income is £ 15,000. These maximum allowances then taper off until income reaches £ 45,000 when they become zero. Different maximum allowances are fixed for employed people, depending on the number of hours they work and whether they have any children. The structure remains the same: as income increases, tax credits decrease.

6.4 Tax deductions

Almost all deductions in the UK are strictly personal and cannot be transferred to a tax partner. In fact, over the past 45 years, the tax burden for a single person without children on an average income has not changed, but the tax burden in the same period for a one-earner married couple with two children and an income in the range of £ 25,000 to £ 34,000 (£ 0.88 = € 1) has actually doubled.

There is a general deductible allowance of £ 7,475 for incomes under £ 100,000: above this figure, this allowance is reduced, with the exception of the elderly who are entitled to higher deductions.

A deduction is also available for blind people and for married couples who are 75 years of age or older. Work-related expenses can also be tax-deductible under certain conditions but alimony payments cannot.

6.5 Fiscal and non-fiscal arrangements for families and children

The UK has no coherent family policy. Measures to support families are dependent on income and directed at fighting poverty and supporting children with a disability and their parents.

The arrangements include child benefit, a maternity grant (if parents are on benefit), and maternal, paternal and parental leave; there are also financial provisions for childcare for parents on low incomes.

6.6 Does the tax burden alter according to the form of cohabitation?

The UK has an individualised income tax with a progressive rates structure and, together with the WTC, this makes the two-earner system a lucrative one. The system in the UK is individual in name but there are, what are called, 'couple penalties' due to the fact that not all arrangements are based on a single individual. For some income-support provisions, the partner's income is also important and then there are maximum amounts in some provisions which grant cohabiting couples less than twice the maximum for a single person. Couple penalties are primarily caused by the income-supporting allowances like the CTC, the tax credit for job seekers and pension provisions.

There is some evidence that family formation is partly influenced by the couple penalties but the evidence is not substantial and the impact is small. The evidence of the abuse of the couple penalties is more convincing with people registering as singles when they are in fact cohabiting.

It has been clearly shown that a single person with a lower than average income and one or more children receives the most beneficial treatment for tax purposes. The difference between this and a single person without children and the same income is considerable.

Chapter 7 Sweden

7.1 Family income or individual income?

All the income of partners in Sweden is taxed separately, so there is an individual tax levy system.

7.2 The rates structure

The rates structure for income tax is a clearly progressive one in Sweden, ranging from 14 per cent for incomes up to SEK 50,000 (€ 1 = SEK 9.2) to 38 per cent for incomes over SEK 500,000. In addition, the Swedes also pay social security contributions of roughly 30 per cent, so the highest marginal rate in Sweden comes to 70 per cent.

7.3 Tax allowances

Sweden has a general tax allowance up to a maximum of SEK 33,000 tapering off to SEK 12,600 as incomes approach the highest tax bracket. Since 2007 there has been an Earned Income Tax Credit (EITC) available for employed persons, which reduces the tax burden for employees with low incomes. The EITC moderates the tax rates, and the progressive character is retained.

7.4 Tax deductions

Costs for commuting to work and other work-related expenses can be deducted if they exceed a certain threshold. Parents receive a benefit for each child, independent of their income: this benefit increases for each additional child, and for the fifth and subsequent children it amounts to SEK 25,200 (€ 2,740).There is no deduction for medical expenses. Healthcare is financed by the state. Household help is tax-deductible up to a predetermined maximum under certain conditions.

7.5 Fiscal and non-fiscal arrangements for families and children

Childcare and other provisions are widely available for parents in Sweden in line with the objective of providing equal opportunity in the employment market for both men and women. Each parent is entitled to 450 days' parental leave. Child benefits and a large number of additional allowances are available, such as special provisions for families with low incomes and families with children with a disability. The state also acts as guarantor for the maintenance payments for children of divorced parents.

7.6 Does the tax burden alter according to the form of cohabitation?

Income tax in Sweden is completely individual. The rates structure is progressive and the working tax credit makes working very attractive. In addition, there are extensive provisions for children and deductions may even be claimed for hired domestic help. The form of cohabitation is not the deciding factor: married couples receive the same tax treatment as all other taxpayers. This is reflected in the tax burden. Families with children pay the same amount in tax as families which have the same income but no children: it is the child benefit which accounts for the difference and through this, families with children have net more disposable income.

Chapter 8 Comparisons

8.1 Differences in tax systems

The differences between the countries in this study are reflected in their choice of taxable unit: the family as opposed to the individual. Some aspects of the various systems which were classified as individualistic do, however, reveal some of the characteristics of a family tax system. The rates systems and the work-related tax-reduction arrangements also differ.

Various splitting systems

Some splitting systems are only available to married couples, as in Germany, for instance. Other splitting systems are open to other forms of cohabitation, as it is in France. In some countries, the splitting system is mandatory for certain forms of cohabitation: in others, like Germany, it is optional. Yet another difference is the approach adopted within the system: France has a family-oriented splitting system, whereas Germany's splitting system focuses on spouses.

Maximum marginal tax rates for income tax of the sole earner without children in percentages

Country	Highest marginal rate of income tax
Germany	47.5
France	49.8
The Netherlands	50.0
United Kingdom	51.0
Sweden	56.5

Table 9 *– Maximum marginal rate of income tax in five EU member states (OECD 2009)*

Marginal tax rates sole earner without children, in percentages of the average gross income per country

Income level → Country ↓	67%	100% (= modal)	133%	167%
Germany	46.7	51.8	51.9	44.3
France	31.7	31.7	42.3	42.3
The Netherlands	43.3	41.7	50.1	50.1
United Kingdom	31.0	31.0	41.0	41.0
Sweden	28.5	31.5	51.5	56.5

Table 10 *- Maximum marginal rate of income tax at different income levels in five EU member states (OECD 2010)*

The rising tax burden falls substantially in Germany: for an income which is 167 per cent of the average it is even lower than it is for an income of 67 per cent of the average. In the Netherlands, the tax burden of average incomes is lower than it is for an income which is 67 per cent of the average. As a result, the progression which is achieved is imperfect. The rising tax burden in France and the United Kingdom can be best explained by the increasing tax brackets and the tapering off of income-related arrangements. As final comment here, the table above shows clearly that Sweden's tax burden is the one that rises the most. The highest and lowest rates in the table are found in Sweden, which is also the only country in this table with clearly different percentages in the four categories.

8.2 Differences in employment participation

Country	Participation rate of women in employment	Those working part-time in %
Germany	66.2	45.3
France	60.1	29.8
The Netherlands	71.5	75.8
United Kingdom	65.0	42.5
Sweden	70.2	41.2
EU-15	59.9	37.0

***Table 11** – Overview of employment participation of women in five EU member states (SCP & CBS 2009)*

Most striking

Employment participation is very high in the Netherlands. For women it is one of the highest in the world: in Sweden, too, employment participation is very high. The United Kingdom is known to have many lone-parent families but the employment participation of women is higher there than it is in France.

Of the five countries in the study, the Netherlands heads the number of women working part-time and, once again, France has the lowest score, while the other three countries have approximately the same percentage of women working part-time.

Is there a connection between the tax systems and the employment participation of women in the countries studied?

There seems to be no connection between the tax systems and rate of employment participation by women; Sweden has the highest marginal rates *and* extremely high employment participation.

France has lower employment participation figures in its splitting family-based system, but it has considerably more women working full-time than the other four countries. The results for Germany, which has a splitting system, and the United Kingdom, which has an individualised system, show a very close similarity, strangely enough.

It makes it impossible to attach general conclusions to the results and other factors seem to be decisive in understanding the reasons why one country has a higher employment participation than another. It is also difficult to fathom what induces women in one country to be more likely to opt for part-time employment than in another.

What the statistics on employment participation don't say

The generous subsidies for childcare are often given as the reason for the high level of employment participation in Scandinavia, but these are financed from tax revenues and the high tax rates could themselves have been caused by these liberal provisions. What came first: rising employment participation or improved childcare provisions? We know that large numbers of women in Denmark started work and then persuaded the government to arrange better childcare provision. So a prior improvement in childcare provision can encourage greater employment participation, but this is not always necessarily the case.

Other factors, independent of government intervention, have also caused employment participation to increase: modern technology has made housework easier, educational levels have improved and fertility rates have fallen.

Countries measure employment participation in different ways. For example, Scandinavian countries have mothers who take long-term leave and yet they are still included in the figures of the working population; this may distort the significance of the statistics.

Employment statistics usually include all paid work which is more than one hour a week, and this causes the percentages for employment participation to rocket. For example, the Netherlands has many women working part-time and it is a matter of debate as to whether the figures are a true reflection of reality if working hours of over just one hour a week are included.

8.3 Differences in the tax burden

The table below shows the effects of the various tax systems. Germany is similar to France in that it has a more tax-friendly approach to single people. The tax burden on the gross income of household with the same composition is lower for married couples than it is for unmarried partners. The tax system in these countries rewards not only the obligation to care for the children but also provides for the spouse without an income.

Household composition→ **Country ↓**	**Single no child**	**Single with two children**	**Married sole-earner no children**	**Married sole-earner with two children**
Germany	39.2	26.8	31.0	19.6
France	27.8	18.1	23.9	17.5
The Netherlands	31.9	18.1	28.1	23.8
United Kingdom	25.5	19.0	25.5	19.0
Sweden	24.7	17.3	24.7	17.3

Table 12 – *Average tax burden on gross income in five EU member states, according to household composition, single and married (OECD 2010).*

In the Netherlands, a single person without children is taxed more heavily than a married person without children but a single person with two children is paying less tax than a married sole-earner with two children. In the individualised system in the United Kingdom, a single person bears the same tax burden as a married person with the same wage and no children. If there are two children in a household, the tax burden is again the same for both the married and unmarried taxpayers (this may be different for higher income ranges). The same situation applies in Sweden but it should be noted here that this country has the most individualised system. At a different income level, there is probably no difference in the burden of a single and a married sole-earner (with the same household composition, of course).

Chapter 9: Conclusions and policy recommendations

9.1 Answering research questions

The key question posed in this study was whether individuals and families should be included in income tax systems in such a way that the tax is imposed as proportionately (equitably) as possible.

There are advantages and disadvantages in all of the different ways that problems related to the various forms of cohabitation are treated in income tax systems. Arguments can be put forward in defence of both a progressive rates structure and a flat tax, although there is a preference for progressivity. The concept of 'progressivity' can be regarded as a system of compensation for the higher benefits offered to the rich by the government. Another important issue arising from the foregoing discussion is that the family's ability to pay is the most correct reference point.

The presumed impact on employment participation must be viewed with a pinch of salt; the results from the countries in the study show that there is no link here with the financial incentives in the field of taxation.

Splitting system or flat tax?

A splitting system is preferable to a flat tax:

1) A family's ability to pay finds best expression in a splitting system;
2) The splitting system is the most suitable option if one wants to retain the progressive rates structure;
3) The splitting system removes the opportunity of arbitrary decision-making in allocating income components between partners because the partners must include 50 per cent of every taxable benefit in their tax return. At the same time, there is no longer any discrimination against earned income, a discrimination which prevents the most favourable tax allocation at family level from being applied, in contrast with other income elements.

The most suitable system appears to be one with a factor of 2: a different factor would lead to a kind of flat-rate assessment system developing. A formal, easily defined criterion should be chosen to define a partner.

The transition from a splitting system to an individualised tax regime will often involve a number of budgetary losses but some margins could be created by streamlining existing deductions and tax credits but maintaining one tax allowance to protect those at subsistence level. The shrewd course to achieve this would be to combine existing provisions. Another alternative would be to raise the tax base but this would depend on what the existing arrangements are for narrowing the tax base.

The flat tax system is also worth considering, as a second best. A flat tax with one single rate could be just as effective as a splitting system: the joint income would then be taxed on a basis which is unaffected by a partner's contribution to income. In this system, the tax allowance available to those on subsistence level would have to be transferable between both tax partners. Introducing a flat tax would remove the incentive to allocate any of the joint assets to the lower-earning partner. A feasible rate would vary for each member state: the Baltic States have low rates. Western European Member States could have a much higher rate; 38 per cent is regarded as a feasible rate for the Netherlands.

A third possibility would be to introduce a social flat tax with two rates, which would be split if one partner's income started to reach the highest tax rate and the other's remained low. Ideally speaking the highest rate should be no higher than 50 per cent as this would leave a minimum of more than half of a person's taxable income to be disposed of freely, which is considered to be psychologically very important. Research has shown that tax rates exceeding 50 per cent can lead to more tax arbitration and/or tax avoidance.

How can taxpayers be included in taxation and what are the pros and cons of the various systems?

Basically there are two possibilities – taxing individual income or the family income.

In an individualised income tax system, the withholding taxes are often the final levy. It is also a system which can adapt to developments in society but can lead to disputes as to allocation, giving rise to possibilities for arbitration, and is in conflict with horizontal equality.

In a splitting system, the progressive disadvantage of the sole earner is removed, there is no longer a choice as to allocation of wealth, it is line with the ability to pay and is often geared to civil law. Its disadvantages are: the demarcation of qualifying partners, its alleged tendency to reduce the incentive to work, its preferential treatment of sole earners with high incomes and its negative budgetary effects if the transition is not compensated in some other way.

Which rates structures are applicable and how do they relate to the principle of ability to pay?

Tax rates can be classified into three systems: degressive, progressive and proportional. The degressive rates system is not particularly compatible with society's perceptions of the ability to pay. There are reasons for arguing in support of the progressive and proportional systems, but preference should be given to progressive taxation because it corresponds most closely with society's idea of fairness. Under this system, the broadest shoulders bear the greatest burden. A further argument is that people in West European Member States benefit more, relatively, from the government as their wealth and income increases. Moreover, a progressive levy is a proper reflection of the Bible's concept of solidarity: those who receive great riches have an ethical obligation to share these with the less prosperous.

9.2 Lessons from a comparison of the countries

What lessons for making income tax more family-friendly can be drawn from the fiscal treatment of families and children in Germany, France, the Netherlands, the United Kingdom and Sweden?

Like the Netherlands, the focus of income tax in the United Kingdom (UK) and Sweden has moved from the family to the individual. Despite the fact that the UK has a very individualised income tax for natural persons, it still retains some elements of a joint levy. Of all the countries in the study, Sweden provides the most consistent example of an individual system.

The French splitting system looks wonderful at first sight but, when examined in detail, proves to be very complicated. The system is shot through with restrictions which are built into the advantages obtained from splitting. The idea is good but loses some of its shine in practice.

The elements which lower the tax base are often very similar in each of the countries examined. Deductions are available for maintenance, for incurred work expenses and for children; there is often a separate deduction for disabled children.

Who is the subject of taxation in the income tax system? Does the focus lie on individual income or the income of the form of cohabitation?

Germany has an optional splitting system for married couples; other forms of cohabitation are taxed individually. France has a family splitting system that is available for married couples and PACs (registered civil partnership) while other forms of cohabitation are taxed individually. The United Kingdom has individual taxation with some elements of a joint system. The same could be said of the Netherlands, although the latter has more joint elements than the UK. Sweden has the most individual tax levy of all the countries examined.

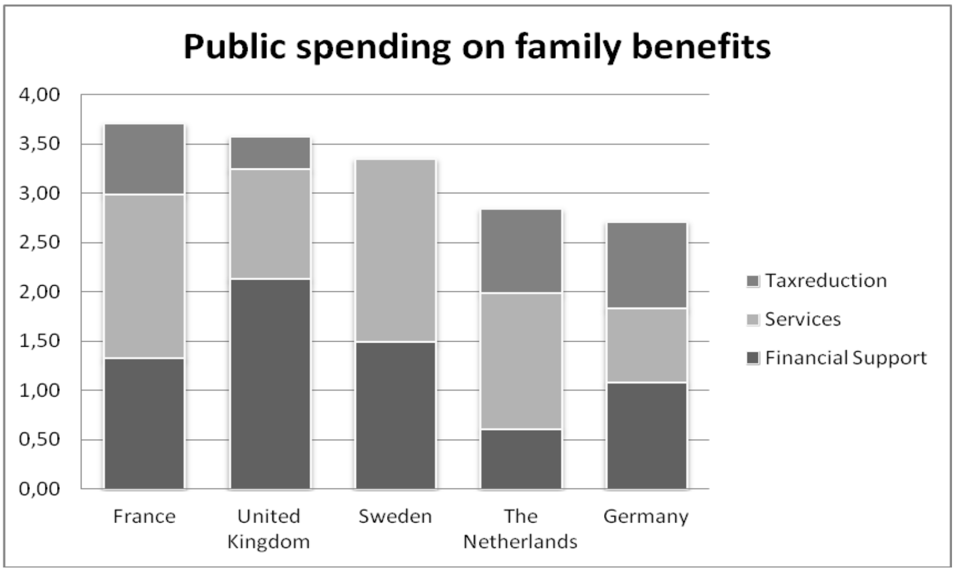
Are there any tax incentives for families in the tax system and how are they defined?

The German splitting system is, in essence, one that encourages families; there are also child allowances in Germany and a maintenance arrangement. The splitting system in France takes the presence of children into account and has a higher splitting factor. France also has a deduction for providing for children and there are tax credits for school-age children. A wide range of tax deductions are available to working parents in the Netherlands and there are also some specific deductions for children's living expenses. The United Kingdom has an income-dependent tax credit if there are any children in the family. In Sweden, a number of child-related arrangements are available and, independent of taxable income, parents receive a particular tax benefit for each child.

What kind of facilities do the tax systems have for children?

All five countries in the survey have an arrangement in place to provide financial support for poor families with children and separate provisions for single-parent families. France and Germany implement explicit family policies with 'pronatalist' traits which find expression in the generous provisions associated with the birth of children and the increased financial support given to families after the births of their third and fourth children. Sweden is most noticeable for its ample provision of services for families, especially childcare and parental leave but there are very few tax allowances for families with children. The United Kingdom is the most generous and provides child-related financial support for families but is rather more restrained in its provision of tax allowances. The Netherlands has a hybrid family policy and is downright parsimonious in its direct financial support for families; the provision of services is, however, relatively generous, in particular childcare.

The overview below (Graph 13) shows government support for families with children expressed as a percentage of Gross National Product. The countries discussed in this study spend more than the average of 33 OECD countries (2.2 per cent of GNP). Of the five countries included, Germany gives proportionately the least support to families and this is linked to the relatively low number of children there. It will come as no surprise to see that France heads the chart in light of the other findings in this study.



Graph 13 *– Government support for families, expressed as percentage of Gross National Product (data 2007). Source: OECD.*

What is the tax burden on a family compared to an unmarried couple with children, a cohabiting couple without children and an individual?

In Germany, the traditional breadwinner's model comes off best tax-wise; tax facilities for children can provide greater benefits for married couples than for those who are not married. The French splitting system works out best for families with children in France. The attitude of the individual system in the United Kingdom is not only neutral in regard to marriage but there is often a couple penalty. Sole parents with children receive the most favourable treatment in the tax regime while double earners with children are paying less tax in the Netherlands than a sole earner with children. On the other hand, in Sweden, attitudes to a person's civic status are neutral and it makes no difference to the tax authority whether a taxpayer is married or not.

9.3 Specific policy recommendations

On the basis of this study, the following five specific recommendations can be made to improve fiscal policy with regard to income tax.

Recommendation 1

The government should not interfere with the choice of which of the tax partners undertakes paid work and how many hours each partner works, and should either introduce or implement a splitting system to facilitate this. A second best option is that of a flat tax. This is a system that is becoming popular and is often linked to favourable economic consequences but some qualification is required here. To complete this recommendation, a social flat tax could also be introduced, but splitting the income must be possible under certain circumstances to prevent only one of the partners from falling under the second, higher tax rate.

Recommendation 2

The legislator should give up using income tax as an instrument of fiscal policy and should opt instead for an approach which is clear, which is based on a set of principles and on the ability to pay. Current income tax systems do not take the ability to pay seriously into account because they are often overburdened with all kinds of instrumental objectives. This masks the legal basis for an income tax and, as a result, undermines the taxpayer's attitude to paying his or her taxes. Furthermore, the effectiveness of using tax as an instrument is questionable and measure upon measure is piled on without any kind of thorough and impartial review ever being undertaken. The ability-to-pay principle must be taken as the central tenet when tax reforms are devised and new proposed measures are discussed. Using tax legislation as an instrument should either be discouraged or discontinued.

Recommendation 3

Very often a jungle of tax credits and deductions makes a taxation system over-complicated. The aim should be for simplicity so that the provisions to reduce the tax burden or the tax base are accessible to everyone. This could be achieved by scrapping many of the existing provisions and/or replacing all the arrangements with one umbrella deduction or tax credit. It would be better if this did not create a negative income tax situation but, if this is not a problem, the new provision could then replace all the other income-dependent tax support and credit provisions. It would be preferable if all these provisions were subsequently fully incorporated in the taxation system.

Recommendation 4

A legislator must implement standard definitions of income in income tax and social legislation because these are not always consistent, and this damages the fairness of taxation law. All provisions must be based on the joint income, which would make everything a lot clearer: whether a person is a tax partner, which has an effect on all their fiscal and other financial provisions, or whether a person is not a tax partner and is treated as an individual for tax purposes and other income-related provisions.

Recommendation 5

The government must use extreme caution in its attempts to use taxation as a way of directing the personal lives of its citizens. The way in which, and the extent to which, someone participates in the job market in the end boils down to a person's own responsibility. Life and society include more than just the economy: for people to be able to develop their talents and help others in society, outside the field of paid work, is a very valuable asset for any society.

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