Submission No: 192
Supp to sub no: 73
Authorised: MC 13/6/06

FAMILY TAXATION

Patricia Apps, Faculty of Law, University of Sydney.
Email: pfapps@law.usyd.edue.au

Working families are now taxed at rates set by four key policy instruments: the personal income tax rates, the low income tax offset, Family Tax Benefits (FTBs) and the Medicare Levy. The Howard Government has, over successive budgets, used these policy instruments to introduce changes in tax rates that shift the tax burden to two-earner families to such an extent that many now pay close to the same amount of tax as a family in which only one parent need work to earn the same income while the other works full time at home. This is a defining feature of joint taxation.

The central assumption of the argument for joint taxation is that the combined gross incomes of parents provide a reliable measure of family living standards and should therefore be used as the tax base. However, household survey data show that parents with the same gross wage rates and childcare responsibilities make widely different work choices. In a large proportion of families, one parent, typically the mother, works full time at home providing childcare and related services, and in an almost equally large number she works full time in the market and uses her income to buy-in substitute services. Thus, unless a mother who works full time at home is dismissed as unproductive,[1] joint taxation cannot be said to be fair.

Clearly, a young family in which both parents work full time to earn, say $40,000 pa, does not have the same standard of living as another in which one parent alone earns $80,000 while the other works full time at home. A family tax system that imposes equal, or near equal, burdens on two such families is obviously unfair. It is also seriously damaging to the economy because equal taxation of family incomes requires higher tax

[1] It also necessary to assume that her life of leisure at home is supported by an altruistic hand-out from her husband equal to half his income.

rates on the earnings of married mothers with highly responsive labour supplies. As a result, a joint tax system contracts the tax base required for family support and, moreover, the fall in female labour supply has been shown to be associated with a strong negative effect on household saving.[2]

In a recent study of working families based on data from the ABS 2002 Survey of Income and Housing I calculated that the average "in-work" family tax burden in 2005-06 was $14,116.[3] This is the sum of $7,923, the amount families would pay if all had only one earner, and $6,243, the additional amount they actually paid due having a second earner. In other words, if all families had only one earner or, equivalently, if all second earners withdrew from work in 2005-06, the average tax per family in the sample would have fallen from $14,708 pa to $8,358 pa, that is, by over 44 per cent. This dramatic fall was due to very high effective ATRs (in the order of 50 per cent in many cases) on second earnings.

I have now repeated the analysis for the 2006-07 Budget changes. The results reveal that the 44 per cent has risen to around 50 per cent and that the Government has also increased, in absolute terms, effective tax burdens on working mothers in average wage families. It is important to understand how this result has been achieved.

Consider, first, the changes in the tax rate schedule and the low income tax offset. Table 1 lists the personal income tax rate schedules for 2005-06 and 2006-07, followed by the effective MTR schedule in 2006-07 when the low income tax offset is included. The rise in the $21,600 threshold to $25,000 provides a tax cut of $510 pa for an individual within the income ranges of $25,000-$63,000 pa. At an income of $75,000 the individual receives an additional tax cut of $1,440, and at an income of $150,000, a total tax cut of $6,200. The low income tax offset has been increased to $600 pa, and is withdrawn at a rate of 4 cents in the dollar on an income over $25,000. Its effect is to raise the zero-rated threshold to $10,000 and to create a new MTR of 34 cents in the dollar from

[2] See Apps and Rees (2003).
[3] See Apps (2006a)

$25,000 to $40,000. The offset is, in fact, an entirely redundant policy instrument. The same changes could have been announced simply, and more transparently, as a new MTR schedule on individual incomes.

Table 1 MTRs after low income tax offset

2005-06 Income tax schedule		**2006-07 Income tax schedule**		**+ 2006-07 Low income tax offset**	
Taxable Income	MTR	Taxable Income	MTR	Taxable income	MTR
$0 - $6,000	0.00	$0 - $6,000	0.00	$0 - $10,000	0.00
$6,001 - $21,600	0.15	$6,001 - $25,000	0.15	$10,001-25,000	0.15
				$25,001 - $40,000	0.34
$21,601 - $63,000	0.30	$25,001 - $75,000	0.30	$40,001- $75,000	0.30
$63,001 - $95,000	0.42	$75,001 - $150,000	0.40	$75,001 - $150,000	0.40
$95,000 +	0.47	$150,000 +	0.45	$150,00 +	0.45

The usual justification for an offset of this kind is as follows. The aim of government is to reduce taxes on low and average income workers. One way of achieving this is to raise the zero-rated threshold to, say, $10,000 as in the Budget. However, the resulting tax cut of $600 goes to *all* taxpayers above this threshold, including those on $150,000. It is then usually argued that a more effective use of government revenue can be achieved by targeting the tax cut to the preferred group through a tax offset.

This is clearly not the concern of the Howard Government. To the contrary, the purpose of the offset is deny those within a wide band of lower to average incomes, specifically from $40,000 to $63,0000, the tax cut of $600, while simultaneously providing much larger tax cuts at higher income levels. Using the tax offset to raise the MTR to 34 cents in the dollar across incomes from $25,000 to $40,000 has this effect.

Not every parent within this income range is denied a more substantial tax cut. As in previous budgets, single-earner families, and those in which the second earner's income is more marginal, are compensated through the FTB system. It is only two-earner families with a more equal division of income who are left out in the cold. The increase in the lower income threshold for the withdrawal of FTB Part A from $33361 to $40,000 provides a tax cut of $1,238 for each child up to the lower threshold of the withdrawal of the base rate. For the two-earner family in which the second earner has a more significant workforce attachment, this gain can be entirely lost because FTB Part A is withdrawn on joint income. The following is an illustrative example for the case of a family with three children under 12, including one under 5 years.

Table 2 lists the tax paid, the ATR and tax cut at the upper threshold of income bands for $10,000 increments of income up to $80,000 pa. Table 3 shows how much tax a two-earner family pays as the second earner's income rises to $40,000, and also lists her effective tax, ATR and tax cut as her income rises. The figures are based on 2005-06 incomes and FTB amounts, and the lastest available Medicare Levy thresholds.

Table 2: Single-earner family – 2006-07 Budget

Taxable Income $pa	Tax $pa	ATR	Tax cut
$0 - $10,000	-$15,976	-1.598	$365
$10,001 - $20,000	-$14,476	-0.549	$365
$20,001 - $30,000	-$12,026	-0.309	$910
$30,001 - $40,000	-$8,049	-0.246	$1861
$40,001 - $50,000	-$2,876	-0.201	$1838
$50,001 - $60,000	$2,274	0.133	$1838
$60,001 - $70,000	$7,424	0.142	$2621
$70,001 - $80,000	$12,345	0.154	$2050

Table 3 Two-earner family* – 2006-06 Budget

Taxable Income $pa	Family	Second earner		
	Tax $pa	Tax $pa	ATR	Tax cut
$0 - $10,000	-$4,694	$3,355	0.336	342
$10,001 - $20,000	-$956	$9,005	0.450	342
$20,001 - $30,000	$5,747	$13,795	0.460	831
$30,001 - $35,000	$8,522	$16,570	0.473	-369
$35,001 - $40,000	$10,567	$18,593	0.465	-840

*Primary earner - $40,000 pa.

The "tax cut" figures for the second earner show that, as her income approaches that of the primary earner her effective tax burden actually rises. When her income reaches $40,000 she will pay $18,493 pa in incomes taxes, the Medicare Levy and loss of FTBs under the budget changes. Her family will pay $10,567 pa in tax. This is a gain of $1,020, that is, two $510 tax cuts due to the shift in the upper threshold for the 15 cents MTR from $21,600 to $25,000. This gain is not sufficient to compensate for bracket creep. In contrast, the single-earner family with the same joint income will receive a tax cut of $2,050, over twice the amount for the two-earner family with same joint income. This outcome is due to the increase in the upper threshold for the 30 cents MTR from $63,000 to $75,000 and the reduction in the MTR above $75,000 to 40 cents in the dollar. By giving a tax cut to single-earner families that is over twice that of the two-earner family with the same joint income, the 2006-07 budget has achieved a further shift towards joint taxation or, equivalently, towards income splitting.

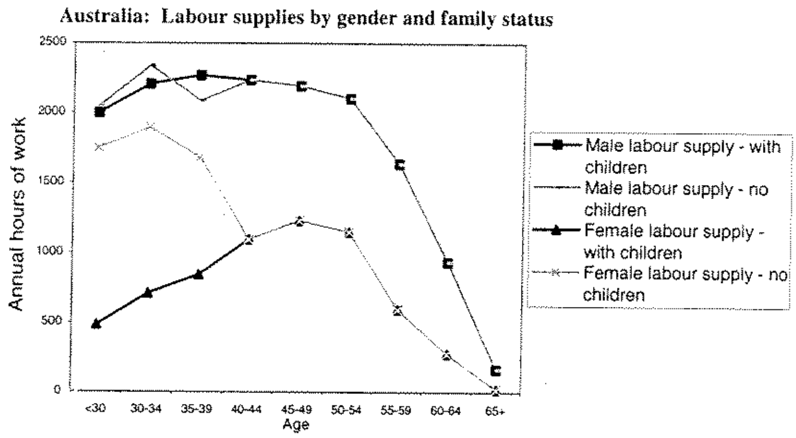
Changes of this kind apply across primary earnings from $40,000 to $63,000 pa, and raise average tax rates on second earners in families across quintiles 2 to 4 of primary income. It is by combining higher rates on second earners with lower average tax rates on primary earners that the 2006-07 budget has raised the share of the tax burden on working families financed by the second earner, from 44 per cent in 2005-06 to around 50 per cent.

High ATRs on second earners under this tax new system, together with the lack of access to affordable, high quality childcare, can be shown to have strong negative effects on female labour supply, not only during the child rearing years but throughout the life cycle. The result is a contraction of the tax base and in GDP growth that, in an ageing population, can be expected to make the current level of family tax benefits unsustainable.

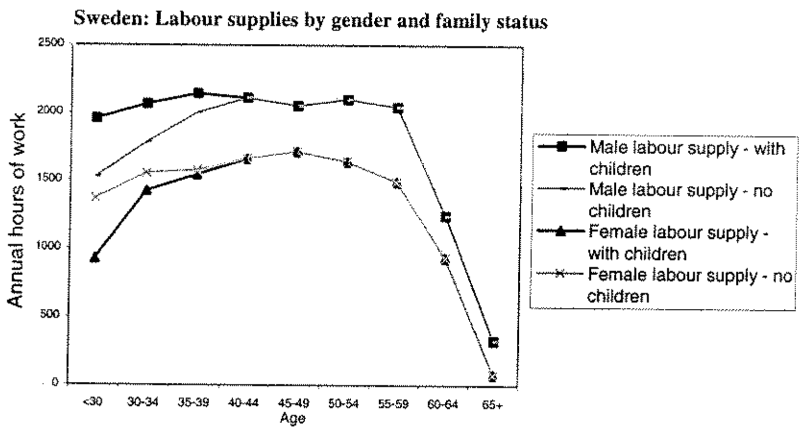
The following graphs compare Australian and Swedish live cycle profiles of the labour supplies of couples, by gender.[4] The sharply contrasting profiles for the two countries indicate the potential gains from switching back to a progressive individual income tax system, and from the development of high quality public sector childcare system.

[4] For further details, see Apps (2006b).

AUSTRALIA



SWEDEN



References

Apps, PF (2006a), Family Taxation: An Unfair and Inefficient System, Discussion Paper No 524, CEPR, Australian national Univesity, Canberra.

Apps, PF (2006b), Family Labour Supply, Taxation, and the New Discrimination, forthcoming Presidential Address for the XX Annual Conference of the European Society for Population Economics, Verona, June 23-26.

Apps, PF, and R Rees, (2003), Life Cycle Time Allocation and Saving in an Imperfect Capital Market, NBER Summer Institute Session on: *Aggregate Implications of Microeconomic Consumption Behavior*, Boston, July 21-25. (http://www.iza.org)