Tax treatment of families in modern industrial countries: The role of the NIT

by Joseph A. Pechman

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I have undertaken a study with Gary Engelhardt to compare the income tax treatment of the family in modern industrial economies. The eleven countries included in the study are Australia, Canada, Denmark, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. The purpose of the study is to see whether a comparative analysis would reveal practices or insights that might help in tax reform.

It turned out that there is very little uniformity in the tax treatment of the family in the sample of eleven countries used in the analysis. There are wide differences among the eleven countries in the exemptions and other allowances for single persons, heads of households, and married couples, the tax thresholds for families of different size, and the allowance for children.

Perhaps the most interesting development revealed by the comparative analysis is the treatment of households with children. In ten of the eleven countries, these families receive allowances in the form of refundable tax credits or cash grants (see Table 1). The European countries give allowances in the form of cash grants for children, while the non-European countries provide exemptions or tax credits under the income tax. Canada is the only non-European country offering a cash grant; it is also the only country in which the grant is taxable. In some cases—notably Italy, the Netherlands, Canada, Sweden, and France—the payments are rather generous. In all, nine countries provide grants for children, four countries provide exemptions, and three countries provide tax credits. Only Japan has the traditional personal exemption for children without a refundable credit or grant. The United States provides a refundable earned income credit, but the credit does not vary with the number of children.

The refundable tax credit and cash grants for children are similar to a negative income tax. In France, at the lowest earnings level, a married couple with two children receives over a third of its earnings as a payment. The payment declines as earnings rise and income becomes taxable; it disappears at 1.8 times the earnings of an average production worker. In Italy, the payment begins at about 27 percent and disappears somewhat below the earnings of an average production worker. In the Netherlands, the payment begins at 15 percent and disappears somewhat above the average production worker's earnings. In the other countries, the payments are more modest and do not extend very high up the income scale; in most cases, they disappear at less than 70 percent of the average production worker's earnings. Table 2 compares

Table 1

Tax Reliefs and Cash Grants for Dependent Children, 1989

Country	Exemptions	Credits	Cash Grants[a]	Percentage of Average Production Worker's Earnings[b]	Equivalent in U.S. Dollars
Australia			A$332[c]	5.1	2,319
Canada		C$65[d]	C$1,326[e]	29.9	6,809
Denmark			DKr 5,400	5.9	1,332
France			FF 8,101[f]	18.2	4,140
Germany	DM 2,484		DM 600[g]	12.9	2,934
Italy		L 96,000[h]	L 1,680,000	65.7	14,907
Japan	¥350,000[i]			10.8	2,446
Netherlands	Dfl 797		Dfl 3,104	43.5	9,879
Sweden			SEK 5,820	24.8	5,634
U.K.			£393[j]	14.2	3,225
U.S.A.	$2,000	$910[k]		8.8	2,000

Source: Official documents of each country. Figures for 1989 are projections from 1988 based on current law, including indexation where applicable.

[a]Per child for the first two children; in the form of direct cash transfers.

[b]Calculated on the basis of APW earnings in each country relative to APW earnings in the United States; credits and grants converted to exemption equivalents on the basis of the lowest non-zero bracket tax rates. Assumes husband earns 100 percent of income. Figures are rounded.

[c]Average for first two children. Does not include family supplement for low-income families of up to A$2,288.

[d]A refundable credit of up to C$559 is allowed for children 18 or under, depending on the parents' income.

[e]Subject to certain ceilings.

[f]Average of allowance for two children. Includes a family supplement of FF 9,054 per child, which is phased down above certain income levels.

[g]Amount is DM 1,200 for second child, DM 2,640 for third child, and DM 2,880 for fourth child and any children thereafter.

[h]Amount for a married couple. Child exemption for a head of household with two children is L 456,000. Each spouse is entitled to this exemption.

[i]Exemption from the local tax is ¥280,000.

[j]Family allowance for a head of household is £265.

[k]This is a credit of 14 percent of earned income up to a maximum of $910 for families with children with a phaseout in the income range of $10,240-$19,340.

Table 2

Effective Tax Rates for Married Couples with Two Children, Husband Earns 75 percent of Family Income, 1989

Ratio of Income to APW Earnings	Australia	Canada	Denmark	France	Germany	Italy	Japan	Netherlands	Sweden	United Kingdom	United States
0.50	−14.7	−12.2	9.1	−34.7	−8.0	−26.8	0.0	−15.2	3.2	−14.2	−5.3
0.60	−8.0	−6.0	15.6	−28.9	−3.6	−15.9	0.0	−11.5	8.3	−9.1	−2.1
0.70	3.7	−1.5	20.2	−24.8	−0.4	−11.5	0.0	−8.3	12.0	−5.1	1.9
0.75	8.3	0.3	22.0	−23.1	1.0	−5.9	0.0	−7.0	13.5	−3.5	3.6
0.80	10.5	1.9	23.7	−21.7	2.2	−4.4	0.0	−7.0	14.8	−3.5	3.6
0.90	12.4	3.9	26.4	−19.3	4.1	0.1	0.0	−3.5	17.7	0.2	6.1
1.00	14.3	6.4	28.7	−17.2	5.7	1.9	0.3	−1.4	20.3	2.2	7.3
1.10	16.3	8.9	30.5	−15.0	7.0	5.0	0.6	1.0	22.5	4.2	8.3
1.20	17.9	10.7	32.1	−13.2	8.1	7.6	2.4	2.6	24.3	6.0	9.2
1.30	19.3	12.1	33.4	−11.4	9.1	8.5	3.2	3.9	25.8	7.4	10.0
1.40	20.5	13.8	34.5	−3.0	10.1	10.5	3.9	5.0	27.1	8.7	10.7
1.50	21.5	15.6	35.5	−2.1	11.2	12.5	4.6	6.0	28.2	9.8	11.4
1.60	22.4	17.2	37.0	−1.4	12.1	13.2	5.2	6.8	29.8	10.7	11.9
1.70	23.2	18.7	38.6	−0.7	13.1	14.5	5.7	7.5	31.2	11.6	12.4
1.80	24.2	19.9	40.0	0.0	14.5	15.1	6.2	8.4	32.5	12.3	12.9
1.90	26.5	20.9	41.3	0.7	15.4	16.0	6.5	9.2	33.7	13.0	13.3
2.00	27.0	21.7	42.4	1.3	16.2	16.0	6.9	10.0	34.7	13.6	14.1
2.25	29.2	23.4	44.8	2.8	18.2	17.9	8.3	11.2	37.7	14.9	16.3
2.50	30.7	24.7	46.8	4.2	20.1	19.0	9.5	14.1	40.2	15.9	18.1
2.75	31.9	25.8	48.4	5.4	21.8	20.0	10.6	16.6	42.6	16.7	19.5
3.00	33.1	26.9	49.7	6.6	23.5	20.8	11.6	18.8	44.5	17.6	20.7
3.50	35.0	28.8	51.8	8.7	26.4	22.1	13.3	23.2	47.5	20.3	22.6
4.00	36.5	30.2	53.4	10.8	29.0	23.0	15.1	26.7	49.8	22.3	24.2
4.50	37.6	31.6	54.6	12.6	31.2	24.1	17.3	29.9	51.6	23.8	25.9
5.00	38.5	32.8	55.8	13.9	33.1	25.1	19.2	32.5	53.3	25.1	27.2
7.50	42.0	36.4	59.7	23.2	40.1	28.9	27.2	41.6	59.1	28.8	31.1
10.00	43.7	38.4	61.6	30.7	44.1	31.9	31.9	47.9	62.4	31.3	32.8
15.00	45.5	40.5	63.5	38.3	48.1	36.2	40.1	55.3	65.6	34.2	33.2
20.00	46.4	41.5	64.5	42.1	50.1	38.6	44.8	59.3	67.2	35.7	33.4
25.00	46.9	42.1	65.1	44.3	51.2	40.9	47.7	61.7	68.1	36.5	33.5

Source: Authors' calculations.
Note: APW earnings=earnings of an average production worker.

the tax rates in the eleven studied countries for married couples with two children, over a wide range of incomes.

The negative income tax is generally thought of as a universal grant to low-income households with or without children, whereas the credits and grants are given only to households with children. Moreover, the credits and grants are more modest than negative income tax payments are generally expected to be. A major impediment to converting the credits and grants to a negative income tax seems to be the hesitancy to provide assistance to people who might become malingerers. The existence of children in the family unit provides some assurance that the negative income tax payment will not act as a disincentive to work.

Although the similarity between credits and grants and the negative income tax is understood, there seems to be no movement toward the adoption of a full-blown negative income tax anywhere. However, the potential for moving toward the negative income tax remains. The refundable credits or grants could be gradually increased and ultimately adults could be made eligible to receive them, including adults without children. It will be interesting to see how long this will take and in what country the logjam will be broken first.

In the United States, there is increasing interest in using the earned income credit to supplement the earnings of low-income workers, partly to help free them from the welfare system and partly to avoid increasing business costs through the use of the minimum wage. President Bush's proposal to add a new child credit to the tax code is also a move in the direction of the negative income tax. These developments suggest that negative income taxation has a future even in the United States, but it must be kept a secret to avoid reviving the past bugaboos that prevented serious discussion of the negative income tax alternative to the welfare system.■