THE CENTRE FOR
INDEPENDENT
STUDIES

The Taxation of Shared Family Incomes

Terry Dwyer

Perspectives on Tax Reform (2)

The Taxation of Shared Family Incomes

Terry Dwyer

Perspectives on Tax Reform (2)

CIS Policy Monograph 61

2004

TO N.D. AND D.D.
Who cherish their jewels

Contents

Foreword by Peter Saunders vii
Executive Summary ix
Acknowledgements ix

1. Principles of Taxation 1
2. Taxing Individuals or Taxing Families? 2
3. The Inequity of Individual Taxation 2
4. How Naive Individual Taxation Violates Tax Neutrality 4
5. Options for a Neutral System 5
6. Advantages of Recognising Income Sharing 9
7. Disadvantages and Objections to Income Sharing Options 10
8. Anticipated Effects of Options Including Broader Social Impact 13
9. Conclusion 14

Endnotes 16

This paper is a shorter revised and edited version of a paper 'Family Taxation, Participation Rates, and Unemployment: A Report for the Taskforce on Employment Opportunities' written by T. M. Dwyer and published in 1993 by the Commonwealth Taskforce on Employment Opportunities. The paper has since been updated. Commonwealth of Australia copyright material is reproduced by permission. Views expressed in this paper are those of the author.

Foreword

The amount of individual income tax we pay depends on two things—marginal tax rates and tax thresholds. Although nominal marginal tax rates have declined in Australia over the last 20 years, most of us are losing a bigger slice of our incomes in tax than ever before. This is because tax thresholds have not kept up with inflation. This has affected taxpayers at all levels of income.

In 1980, people did not start paying the top rate of tax (then 60%) until they earned around $35,000—nearly three times the average income at that time. Today, however, we start to pay the top rate (47%) on earnings just one and a third times higher than the average. Australia today not only has one of the highest top tax rates in the whole of the OECD, but also levies this top rate at a lower income than almost all other advanced industrial nations. The top rate of tax starts at A$83,000 in France, A$84,000 in the United Kingdom, A$98,000 in Germany, A$115,000 in Canada and an astonishing A$549,000 in the United States. In Australia, it cuts in at just A$62,500.

If 'bracket creep' has made things bad at the higher end, its effect on the basic rate of tax has been devastating. In 1980, you did not pay any tax at all until you earned $4,041 per year (one-third of average earnings). Wages have gone up by 350% since then, but the tax-free earnings threshold has only risen by around 50%, to $6,000 (less than one-seventh of today's average earnings). Every worker now therefore pays tax on a much bigger proportion of their earnings than they used to. Had the 1980 personal threshold of $4,041 kept pace with earnings, it would now be over $14,000.

There is a strong case for restoring the value of the tax-free threshold to its 1980 level, for workers should be allowed to earn and retain at least a subsistence income before any tax is taken away from them. We can define the subsistence level as the minimum amount somebody would receive if they were unemployed and living on welfare benefits. At the time of writing, a single person on the lowest level of welfare payments would receive $12,567. It follows that, if we want to allow people to earn and retain their own subsistence income before they start to pay tax, the tax-free threshold should be raised at least beyond $12,567.

Because the value of the personal tax-free threshold has slipped to less than half what a single unemployed person gets in income support and rent assistance, the government now takes money away from us long before we have secured our own basic subsistence. Inevitably, it then has to give much of this money back again in welfare payments so those on lower incomes can maintain themselves and their families. This 'churning' makes no sense, and it should be a priority for any tax reform to reduce (or if possible eliminate) it.

Raising the tax-free threshold above the welfare floor is an essential first step in reducing churning and restoring incentives and the principle of self-reliance to the income tax system. But on its own, it is not enough, for even a tax-free income of $14,000 is insufficient to maintain more than one person. Clearly, where workers are earning a wage or salary which is supporting more than one person—for example a spouse, and/or dependent children—a more generous tax-free threshold is required if they and the rest of their family are to achieve self-reliance. This means we need to allow family members who do not earn a wage or salary to transfer some or all of their tax-free entitlements to other family members who do so that they can earn a family subsistence wage before they start to pay tax.

It is this question of how we should treat shared family incomes for tax purposes that Terry Dwyer considers in this, the second in a series of CIS monographs dealing with reform of the Australian tax system. Currently, although the welfare system assesses needs at a family or household level, the tax system treats individuals as distinct income units. Individuals are therefore taxed separately on their own earnings, irrespective of how many other people might eventually share that income. Dwyer shows why this is both inequitable and inefficient.

It is inequitable because it ignores the question of how many people have to be supported from any one individual's earnings. The welfare system recognises that, say, a family of two adults and two young children needs a bigger income than a single person household, but the tax system is blind to this. A single earner in a family of four starts to pay tax on earnings beyond

$6,000, just as a single earner living on their own does. But the former is sharing his or her income with three other people—his or her other family members are the ultimate recipients of a large chunk of the income, but they are not recognised for tax purposes. The earner therefore carries the cost of supporting four people, but can claim only one tax-free threshold.

Dwyer points out that this situation is also inefficient, because it skews people's preferences and behaviour. For example, the tax system creates an incentive for both partners in a family to go out to work, even if one would prefer to stay home. This is because it makes more sense for two people each to earn an average income than for one to earn a high income and share it with his/her spouse. Two earners will each receive a tax-free threshold and will only pay a basic rate of tax on the remainder, but a single earner will receive only one threshold and will get taxed at higher marginal rates on the additional income earned.

In recent years, the Federal government has tried to counter some of the inequity and inefficiency in the income tax system by giving certain categories of families a welfare top-up. Family Tax Benefit, Part B, for example, is paid to families where there is only one earner to try to compensate them for the disadvantages they suffer through the tax system. The result, however, is a tangle of money transfers in which people get tax taken from them only to have some or all of the cash returned in the form of welfare payments. This is not only costly, it is also wrong in principle. We should not be taxing families until they have secured their own subsistence, and a family's subsistence level will be higher than it is for single people or couples without dependent children.

In *The Taxation of Shared Family Incomes*, Dwyer explores the various ways in which the tax system could be reformed to recognise shared family incomes. He comes down in favour of a voluntary system in which family members can choose whether or not to pool part or all of their incomes for tax purposes, and he list various ways in which this might be done in practice.

One way of doing it is to allow family members to pool some proportion of their tax-free thresholds. We should not allow total pooling because household living costs are reduced by economies of scale (two people can live cheaper than one). If one person needs, say, $12,500 for subsistence (the current welfare minimum), two people living together do not need (2 x $12,500 = $25,000) to achieve the equivalent standard of living. Most 'equivalence scales' suggest they need about one and a half times what a single person needs (say $18,750), and the welfare system defines subsistence for a couple as $20,169. Ideally, therefore, the principle that you should not pay tax until you have earned a subsistence income would translate into a tax-free threshold of around $12,500 for a single person and something around $20,000 for a couple.

Under Dwyer's proposals, it would be for each family to choose how it wants to be assessed. Many working couples would probably prefer to continue filing separate tax returns so that each can retain their own tax-free threshold. They would be free to do so. Couples where there is only one earner, however (and especially those who also have dependent children) might prefer to transfer part of the threshold of the non-working partner to the working partner.

Indeed, if children were given their own thresholds (as Dwyer recommends), part or all of these could be transferred as well. The welfare system, for example, defines the subsistence income for a family of two adults and two children as $27,335. Currently, assuming only one earner, we tax such a family on every dollar earned over $6,000 and then pay them back through the Family Tax Benefit system. It would make more sense to allow them the option of earning something close to the $27,000 they need before taking tax away from them.

There is a pressing need for radical and fundamental reform of the income tax system. Part of any rethink should involve the recognition that families share incomes, and that an individual who earns a given income may not necessarily benefit from all of it. Terry Dwyer's paper makes a compelling case for recognising family income sharing for tax purposes, and his arguments and proposals should be central to any future discussion of how to achieve a fairer and more sensible income tax system in this country.

Peter Saunders
Social Policy Research Director
The Centre for Independent Studies

Executive Summary

Every schoolboy tax economist knows that tax systems should be 'neutral'. Treasury officials and economic advisers around the world repeat the theme with a regularity which is as boring as it is unenlightening. Few officials have ever seriously asked themselves, 'What does being "neutral" really mean when income is shared among family members?'. Is it true that (as was once remarked to the author by a Commonwealth Treasury official) that 'having a child is just like buying a yacht—it's a personal consumption decision'. If that is true, how do these 'consumption objects' called 'children' ever become 'persons' who pay tax?

This paper suggests that genuine neutrality in personal income taxation is quite impossible unless the tax law recognises private income sharing arrangements within families, just as it recognises such income sharing between partners in partnerships, or among beneficiaries of a trust. From this point of view, so-called 'income splitting' is not a form of tax avoidance but a logical attempt by taxpayers seeking a fairer tax system **which recognises the income sharing already going on.**

The social security system, family law, the child support levy and testator's family provision legislation are all predicated on the assumption that family income and assets are shared between family members, yet the tax system takes no account of the massive voluntary redistribution of income going on every day in millions of homes between family members. A tax system so inconsistent with the common experience of humanity is doomed to perpetual frustration.

A logical and truly neutral tax system should accept income transfers between family members. If person A is supported by person B then both the income tax and social security systems should recognise this. Full income-splitting between family members is one option, although the use of equivalence scales to determine final income tax would probably be the most neutral. For example, the total income of family members could be added up and divided by the sum of all the adults in the family plus one half for each child. Tax would then be applied an the average rate.

The failure of the tax and social security systems to be consistent has created very high equivalent marginal tax rates, which discourage family self-provision. Even worse, a tax system which does not recognise income sharing with family dependants may have a socially demoralising effect as taxpayers either unconsciously shed dependants onto the social security system or learn to 'play the game' and collude with their dependants to pick up from the social security system what the tax system denies them. If Australia is to prosper as a society, it needs a genuinely neutral tax system which accepts families as desirable social realities rather than degrading them to welfare dependency.

Acknowledgements

This paper owes much to many discussions with many people over many years, not least to the opinions of those who disagreed with me and forced me to refine my thoughts. It would be difficult to single out some and unfair to omit others. Practical experience of life has also played its due part, as it ought for any author writing in a 'social science' who wishes his theorising to be remotely relevant.

1. PRINCIPLES OF TAXATION

The principle of economic neutrality in taxation

In general terms economic theory assumes that in the absence of distortions, people will make choices which maximise their utility, that is their economic welfare. When a tax or transfer system is introduced it may well influence those economic choices. Sometimes this is deliberate, as in 'sin' taxes on gambling, smoking and drinking. However, tax theorists generally argue that a tax system should be as neutral as possible if economic welfare is to be maximised.

The meaning of economic neutrality is that a choice made after the introduction of a tax or transfer system should not be different from what it would have been before. Thus, if in the absence of a tax, a person would have preferred to work 40 hours a week the tax is neutral if the person wishes to work the same number of hours after its introduction. The tax does not modify desired behaviour.

Because people have different preferences, design of a neutral tax system is not easy. For example, some women may prefer not to have children and pursue full-time careers; others may prefer to pursue a career raising children; and others again may, over their lifetimes, wish to pursue both. Some households may prefer to get by with two wage earners but no onerous overtime or promotion; others may prefer more specialisation, with one partner earning market income and the other partner caring for children at home. A neutral tax-transfer system should not interfere with the preferences of these households. The choices households wish to make after the imposition of the tax and transfer system should be the same as before. There should be no bias in favour of the choice of a one-earner household or the choice of a two-earner household. There should be no bias for or against raising children.

Equity as a tax principle

One of the most intuitively appealing principles of taxation is that people in similar circumstances should be liable to the same amount of tax. Unfortunately, the principle is not easily translated into reality. What does treating equals equally mean? How does one achieve horizontal equity, as it is called, between one and two income families on the same total income?[1]

For example, a person living on $100,000 per year income from an inheritance appears to enjoy a higher capacity to pay tax than a person who has to work for it. For this reason, the Australian income tax system used to differentiate between income from personal exertion and income from property. Although that differentiation was abandoned in the face of practical and theoretical difficulties in deciding what was income from personal exertion and what was income from property, the theoretical point remains. At its deepest level people's preferences differ and a tax system cannot measure the subjective loss it inflicts on persons. How does one establish horizontal equity between them, in terms of their subjective utilities, if they manage to secure the same income? Their 'well-offness' in both cases will be different because they have essentially different preferences.

As a practical matter, writers on income tax such as Henry Simons and the many official Committees and Commissions of inquiry in many countries over the years have taken the view that equity in taxation can only be defined in terms of market income or in terms of goods and services such as those which are bartered and which can be readily converted to a monetary equivalent.[2] No writer on income tax has, for example, ever seriously suggested that a bearded man has greater ability to pay tax because he has no need to shave or that a man who shaves should pay more tax because he has produced more services. Indeed, to suggest that home activities represent untaxed production[3] seems tantamount to suggesting that citizens, all our waking and sleeping hours, are at the entire disposal of the Treasury. Such a view seems inconsistent with any concept of the liberty of the subject or the ethos of a democratic society which places the individual prior to the state.

A tax system should be as neutral as possible if economic welfare is to be maximised.

2. TAXING INDIVIDUALS OR TAXING FAMILIES?

When the United Kingdom introduced income tax in 1799, the incomes of husband and wife were added and taxed as one. Australia, however, since the introduction of Federal income tax in 1915, has always taxed husband and wife separately. This has also applied to children whose incomes have been taxed separately. But separate taxation of family members on their legal incomes ends up violating both of our key principles of taxation—it distorts people's behavioural choices, and it treats people in similar situations unequally.[4]

The Australian position on separate legal taxation of spouses reflects the change brought about by the Married Women's Property Act of 1882 which gave women the right to their own earned income. Prior to the passing of the Married Women's Property Acts in the United Kingdom and its colonies, the wages of working women belonged to their husbands.[5]

The Australian position has always been that income tax liability follows the ownership of income. Income is taxed in the hands of the beneficial owner. In the case of property income, it may be traced through trusts or partnerships to the ultimate beneficial owner. In the case of wage or salary income, the income is taxed in the hands of the person who earns it.

Even when income tax was introduced into Australia in 1915, it was quickly appreciated in Purcell's Case (1921) 29 CLR 464 that, with a graduated individual income tax scale, tax could be much reduced by splitting income between the family members who lived on it. In Purcell's Case a grazier executed a declaration of trust over his property which allowed the income to be split among family members. Although challenged by the then Commissioner, Purcell was victorious in the High Court. The principle was firmly established that property income may be freely alienated among family members if ownership of the property is transferred to them.

For many years it was thought that while property income could be split for tax purposes among family members, this was not true of personal exertion income.[6] However, in Everett's Case (1980) 10 ATR 608 the High Court had to consider an assignment of a share of a partnership, where the partnership was engaged in rendering professional services. The High Court held that the alienation of income resulting from the assignment under the State Partnership Act was valid. The partner, if he transferred the right to income to his spouse, was no longer taxable on the income, even though it was largely attributable to his personal activities. The basis for the decision was that what was transferred was a property right, through a share in the partnership, rather than personal exertion income itself.

Separate taxation of family members on their legal incomes ends up distorting people's behavioural choices and treats people in similar situations unequally.

Other methods have evolved over the years for transferring personal exertion income to other family members. For example, following Phillip's Case (1978) 8 ATR 783 professional partnerships could divert income through service companies to trusts for the benefit of other family members. Other taxpayers have from time to time employed arrangements such as profit sharing loans. Thus as far as the tax system is concerned, virtually all types of income can be shared between family members, except wage or salary income.[7]

3. THE INEQUITY OF INDIVIDUAL TAXATION

If one were to lay down a general principle for the allocation of income to taxpayers it would seem reasonable to state that income should be taxed once, and once only, and in the hands of the ultimate beneficial recipient.

Naive individual taxation—taxing individuals solely with regard to the income they legally own or control—fails when tested against this principle because it ignores income transfers. For example, Australia does not tax trustees on the income they control. Instead it allocates the income to the beneficiaries selected by the trustees and the tax liability follows the income.[8] If one were to apply the same principle to the situation of a family breadwinner, the income which is earned by that breadwinner is to some extent transferred to other members of the

family. From this point of view, family taxation is not a question of giving tax relief or a 'tax subsidy' to a breadwinner in respect of dependants. The question is more basic—who ultimately enjoys the income?

This logic has been accepted in some other countries. The Carter Commission in Canada took the view that the family and not the individual should be the unit of taxation.[9] Similarly in the United States it has been taken for granted that the unit of taxation should be the household, that is, the couple or the sole parent headed households or the individual. In the United Kingdom and many other countries the married couple was the tax unit.

Most committees of inquiry which have looked into the subject have argued that equitable treatment demands that where two or more people are dependent upon a given income it should be taxed less harshly than when that income is enjoyed by one person alone. The Irish Commission on Taxation recommended income splitting between spouses, arguing that 'incomes are shared in practice' and 'if the tax system is to be equitable it must recognize this fact'.[10] The New Zealand Task Force on Tax Reform recommended partial income splitting based on equivalence scales for married couples and the United States Treasury did not question the continuation of joint returns for married couples in its 1984 report on tax reform.[11] Similarly Belgium introduced a form of income splitting and the United Kingdom, while moving away from aggregation as being inequitable, continues to allow tax relief where a husband and wife are dependent upon one income.

In Australia in 1975 the Asprey Committee considered the question of family taxation. In regard to children it argued for replacement of tax deductions by child endowment.[12] But in regard to family taxation generally, and husband and wife in particular, the Committee argued against compulsory aggregation in favour of elective family taxation as a unit. It accepted the basic equity argument that two could not live as cheaply as one, having accepted the argument that a wife's income should not be added to and taxed as the husband's.

It is quite erroneous to assume that the only income transfers that are made in society are those which pass via the Treasury and emerge as income support payments. The greatest amount of redistribution of income clearly occurs within households. At an equity level, the argument that these intra-household income transfers should be recognised for income tax purposes simply amounts to an argument that an individual should not be taxed on income which is not enjoyed by him or her.

Family taxation is not a question of giving tax relief or a 'tax subsidy' to a breadwinner in respect of dependents. It is a question of who ultimately enjoys the income.

This principle is clear enough when parents split up. The National Maintenance Inquiry found that there are good arguments for considering that periodic maintenance should be excluded from the income of the payer and included as the income of the payee.[13] It argued that the transfer of income involved in maintenance should simply be recognised as such, as it is in the United Kingdom and the United States. But if the final recipient is the person taxed when couples separate, why not when they remain together?

The argument for family tax-splitting on equity grounds has been criticised, but the criticisms are rarely convincing.

Some argue that where income transfers are voluntary they should not be recognised for tax purposes; voluntarily transfers are made because they give the donor sufficient enjoyment. But this is not compelling. For example, if a husband takes his wife into a partnership in respect of business income, that is a voluntary act, but the income sharing which partnership law then creates is recognised by the tax law. Why should the obligation to share one's income with a marital partner be treated any less seriously by the tax system?[14] Why should marriage be the only form of economic partnership not recognised by income tax law?

Another objection to the recognition of income transfers in family situations is that there is joint consumption. Two or more may not be able to live as cheaply as one, but there are economies of scale in living together—one electricity bill, one mortgage, one television. But this is really an argument for a partial rather than per capita recognition of income sharing within families for tax purposes. It is about examining equivalence scales to see how much income

different households require to achieve the same material standard of living. We should recognise that families do share their incomes, but we should limit the extent of transfers allowable against tax to some point that falls short of full per capita income splitting among all family members. The use of equivalence scales is discussed in more detail later in this paper (p.8).

4. HOW NAIVE INDIVIDUAL TAXATION VIOLATES TAX NEUTRALITY

Not allowing family members to split tax liabilities on wage or salary income which they share is not only inequitable, but also leads to families on similar incomes being taxed differently according to the way they come by their incomes. This violates the principle of tax neutrality, and its impact is felt directly in the decisions that people make about their level of participation in the workforce.

Tax and social security treatment of families

Over the postwar years the treatment of families under taxation and social security arrangements has diverged. Whereas the social security system has always recognised in its scales for benefits the number of persons dependent upon a given income, tax allowances for dependants have gradually been removed from the taxation system altogether. Thus the social security system either pays a married (partnered) rate of pension larger than a single rate and splits it between the respective spouses; pays an additional benefit in respect of a dependent spouse to the claimant; or adds additional payments in respect of children. Social security also adds disregards of income for each child in the administration of its income tests.

The taxation system from 1915 to 1976 allowed deductions for dependants on the basis that a taxpayer's ability to pay was reduced by the amounts necessary for the subsistence of those dependents, but this has changed over time. Dependants' tax allowances were never large in relation to the cost of children and were steadily eroded by inflation over the postwar years until finally replaced by Family Allowances in 1976. Among the reasons for shifting allowances for dependants out of the tax system into the Social Security system were:

- some families had incomes too low to be able to claim any benefit from tax allowances;
- a desire to direct the payment specifically to the person with the care and the custody of children (usually the mother);
- a desire to bring together cash payments previously made as child endowment and tax rebates (formerly deductions) which recognised the extra costs incurred by taxpayers with dependent children.[15]

Whatever the weight of these arguments, the result has been that many families simultaneously pay tax and receive income tested benefits from the social security system in respect of children. The interaction of the tax system and income tested benefits means that for many families additional income brings little or no net benefit because for every extra dollar earned much is lost by way of additional tax, additional Medicare levy, and loss of Family Tax Benefit or AUSTUDY. For some families (on supposedly higher incomes), the net result has been they now get nothing at all for dependent children.

Many families simultaneously pay tax and receive income tested benefits from the social security system in respect of children.

The revamping of family payments as family tax benefits (FTB) received either as cash payments through social security (the Family Assistance Office) or as tax refunds reflected a perfectly justified reaction against family payments being seen as welfare handouts and was a re-affirmation of the role of horizontal equity. However family tax benefits represent an amalgam of income tested welfare transfers, plus differently income tested vanishing income tax rebates. The attempt to combine poverty alleviation payments with tax credits has unfortunately resulted in a system of such baffling obscurity that many families have had trouble reconciling their entitlements and have had to repay money.[16] Further, the recognition of horizontal equity is far from complete as increasing numbers of families exceed income test limits.

If revenue were raised by the Treasury in a neutral or non-distorting way (for example, rents or oil royalties from Crown lands), it would not matter so much what the Treasury paid out as child payments. However, most of the revenue Treasury raises comes from the taxpayers and the funding of income tested Family Payments via income taxes (largely on labour income) creates a double barrelled disincentive effect. Wage earners may be discouraged from entering the workforce or doing additional work by not only incremental tax but also the loss of income tested family benefits.[17] The efficiency costs to the economy from churning this money around may be large. If Treasury seeks to pay a dollar to a family it may cause considerably more than a dollar's loss of output as it seeks to impose the tax and income test the payment.[18]

Most of the revenue Treasury raises comes from the taxpayers and the funding of Family Payments via income taxes creates a double barrelled disincentive effect.

Because social security and educational payments are income tested on family income, the more the father or mother earns at certain levels of family income the less their entitlement to these benefits. Regardless of whether it is the first or second earner who earns the income, the income test tapers (shade-outs) for these benefits are based on total family income.[19] By increasing the income of the family on low earnings (the 'income effect') and imposing a penalty on extra earnings (the 'substitution effect'), these means tested payments are a double disincentive to labour force participation by family income earners. The disincentive effects can be considerable.

How many earners?

The first question a family faces is to decide who is to be the first earner. Is it to be the husband, the wife or both of them? It is clear that the taxation and social security systems are neutral whether it is the husband or the wife who becomes the primary income earner. Whoever enters the paid workforce will face the same pattern of equivalent marginal tax rates (EMTRs) as tax is imposed and social security benefits are withdrawn.

But suppose a couple feel they need more income to support the family. They may then have the choice of either earning more income through the first earner or adding a second earner to the family.[20] For example, the family may gain more income from extra overtime, promotion or a moonlighting job for the first earner or the spouse may seek to enter the labour market.[21] What then is the situation, assuming such a choice is available?

When one examines the pattern of EMTRs[22] faced by (a) the first earner and (b) the possible second earner, one sees a clear tax bias in favour of having a second earner. If the first earner seeks to earn more overtime he or she will be taxed at the higher marginal rates. But if the spouse enters the labour market as a second earner, he or she will gain the advantage of a new tax threshold and the lower marginal rates of taxation on additional income. Because the income tax is individual and graduated, there is a clear bias towards a family seeking to put a second income earner into the workforce.

However, two qualifications are commonly made to this conclusion. First, it is argued that the second earner is at a disadvantage because child care expenses are not deductible for income tax purposes. Second, it is argued that the secondary earner is disadvantaged because of the family's loss of imputed income in having to surrender another 40 hours, say, to the paid labour market.[23]

The argument that the non-deductibility of child care is a disadvantage to the second earner had some acceptance in the United States with the child care tax credit. It has also to some extent been accepted in Australia by the introduction of the child care allowance. But where there are no children, child care expenses are irrelevant: the tax bias in favour of becoming a two income couple stands. Where there are children, however, the question of child care costs needs closer examination.

Child care costs are not unique to two income families. Unless one is willing to make the sexist assumption that a spouse (typically a wife) is available as free labour to mind children, child care costs are equally incurred by one income families. The only difference is that the child carer happens to be the spouse of the income earner. If child care is accepted as a legitimate cost of earning an income, a child care deduction should be available equally to one

income and two income families. If, for example, a second earner in a two income family is allowed a deduction for expenses paid to a crèche, family day care or a relative to look after that family's children, neutrality requires the same deduction be allowed to a breadwinner paying a spouse to look after their children.

This kind of neutrality does not exist. Although steps have been taken to align more closely the degree of subsidy given to 'approved' and 'registered' child care (the former being more formal), the maximum rate of child care benefit for three children per week as at 1 July 2001 was $420.86 (or $140.28 per child) per week. By contrast, Family Tax Benefit Part B was a maximum of $105.56 per fortnight ($52.78 per week) where any child was under five years. This represents a maximum of $2,752.10 per annum (for any number of children). But, of this amount, $1,437 represents the dependent spouse rebate which is not meant for the care of children but for the maintenance of the spouse. So the maximum weekly payment for a one-income family's child care costs is $25.29 per week for any number of children (provided one was under five)[24].

Sometimes it is argued that the second tax-free threshold enjoyed by two earner families is a compensatory offset for the non deductibility of child care costs. This argument is not logical. The tax threshold exists not to cover costs of earning an income, but to cover the taxpayer's costs of subsistence. A taxpayer is not supposed to be taxed on an income so small that one could not live on it. If the tax threshold were related to otherwise non-deductible costs of earning an income it would be denied to income recipients such as pensioners or annuitants or persons living on income from property. But this is not the case.

The tax threshold exists not to cover costs of earning an income, but the costs of subsistence. A taxpayer is not supposed to be taxed on an income so small that one could not live on it.

Turning to the second argument that there is a tax bias in favour of the one income family because a two income family has to supply 40 hours or so extra labour to the labour market, this confuses different concepts. Essentially it is an argument for an earned income deduction to recognise the disutility involved in earning income. Arguably, it is as disagreeable for a single taxpayer or a first earner to supply 40 hours of paid labour to the market as it is for a second earner to supply 40 hours. To even up the scales between market and non-market work, an earned income deduction seems an appropriate measure, but there is no reason to restrict it to second earners. Non-deductible costs such as journey to and from work, the extra cost of meals taken away from home are, like child care, equally examples of extra costs indirectly incurred in gaining an income.

Neutral tax treatment of voluntary redistribution

One of the major purposes of a modern tax-transfer system is to redirect income from those who earn it to those who have no incomes. It is, however, often forgotten that this is only one social mechanism by which income is redistributed. Historically, voluntary transfers between family members have been much more important. Even in the absence of tax-transfer systems, spouses tend to support each other and their children. Likewise, children often support their adult parents while parents bequeath assets to their children.

The question arises as to how the tax system should treat such transfers of income within families. One option is simply to ignore them—they are neither excised from the income of the person making the transfer nor included in the income of the recipient. Another possibility is to exclude an income transfer from the income of the person making the transfer and include it in the income of the recipient. The third possibility is to double count an income transfer—to count it as income of the transferor but also include it as income of the transferee.

The last option is clearly not neutral in regard to private income transfers.[25] The first is generally consistent with the existing Australian position but is the second more neutral?

If one looks to the enjoyment of income rather than its earning then the truly neutral approach is the second option—to take full account of income transfers. If public policy wishes to encourage a more equal distribution of income per capita within families, it should not matter whether that redistribution of income is achieved either by private transfers or by government transfers. The question should be which is more efficient in the given circumstance.

5. OPTIONS FOR A NEUTRAL SYSTEM

In exploring options for a more neutral taxation arrangement for families in terms of labour force participation one must choose from two different ways of defining neutrality.

One option for achieving a more tax-neutral arrangement for families would take the view that all decisions to acquire or support dependants are voluntary, and that a neutral system should therefore refuse to recognise any income sharing within families, whether in terms of tax or social security payments. Expenditure in maintaining spouses or children would be treated as private consumption: no allowance would be made for it, any more than for the purchase of holidays.

If revenue considerations are allowed to stand forever against removal of tax distortions or a more equitable tax system, tax policy has little meaning.

A second position would be to assert that a neutral system should fully recognise the income sharing which naturally occurs within family units.[26] That is the view adopted in this paper, although there are different strategies for achieving it.

In setting out these options, budgetary considerations have been put to one side. Not only are they outside the scope of this paper, but any given net revenue result may be achieved through changes to the rate scale or by expenditure restraint. Therefore budgetary considerations are essentially irrelevant to the design of a neutral tax system. If revenue considerations are allowed to stand forever against removal of tax distortions or a more equitable tax system, tax policy has little meaning. Moreover, some options could involve offsetting savings on outlays. The extent or nature of those savings would depend on policy details, which may involve a re-ordering of other budgetary priorities.

Option 1. Remove all recognition of dependency from both the taxation and social security systems

This option would bring the taxation and social security arrangements into logical consistency by ignoring family income transfers. However the cost would be a worsening in the per capita distribution of income as no account would be taken of dependants in the social security system, any more than in the tax system.[27] This option might be thought to produce capricious results. For example, no payments or additional allowances would be made for children, but an unemployed spouse of a millionaire would be entitled to claim unemployment benefit in her own right as there would be no presumption of the income sharing associated with recognition of dependency. This option would represent one extreme pole and is rejected in this paper as being fundamentally mistaken.

Option 2A. Per capita income sharing

The other extreme would be to accept that income sharing does occur between individuals, especially within families, and to fully recognise it in both the taxation and social security systems. Taxpayers would be allowed to transfer, by mutual agreement, any amount of income to a spouse and children who would then be taxable on it at their own individual marginal rates.[28] On the same logic, all transferred income would be taken into account for any income testing purposes. To the extent that a spouse or child received transferred income, their entitlement to social security benefits would be reduced to the same extent.

Although quite consistently logical, this proposal might perhaps be thought too generous to families because it takes no account of economies in consumption.[29] It would allow all families the position available to families with property income before the 1978 imposition of the penalty tax on children's income. Income splitting on these lines is, of course, still available for families deriving income through inheritances. It is also possible where children's income can be described as earned income. This may occur where children are employed on a farm or a business. Hence while it may be considered too generous, any critic must admit that his criticism seems hollow when it is an option already open to a number of Australian families not deriving income by wages or salary. Another point which might be made is that if it is appropriate to take into account economies of consumption enjoyed

by families, then should not the tax system in calculating the ability to pay tax also take into account economies of consumption where several people share a house or where siblings reside together?

Option 2B. Equivalence scale sharing

An alternative would be to recognise income sharing between individuals within a family but to adjust the taxation scales so that the benefits of full splitting were reduced.[30] The theory behind such an arrangement would be similar to the French quotient system which regards each child as equivalent to half an adult. The total of the income of the family members would be added up and divided by the sum of all the adults in the family unit plus one half for each of the children. Tax should then be struck on the family income at the average rate applicable to the standardised income. The same result could be achieved by allowing unlimited transfers of income but applying different rate scales to the recipient of such transferred income (for example, children could have half thresholds and half the range of lower marginal tax rates).

One difficulty with equivalence scale systems is that there is a considerable degree of variation between different estimates for equivalence scales.[31] The second difficulty is in trying to reconcile equivalence scales for a family unit with an income tax administration based on individual returns. This latter difficulty can be resolved, as indicated above. For example, all adults in the family unit could be treated as one and children treated as half and given a halved rate scale with reduced thresholds and reduced bands for lower marginal tax rates. In that case, unlimited income transfers between family members could be allowed and tax computed on an individual basis in such a way as to achieve the effect of an equivalence scale of that kind. If, however, a second adult in the family unit were not treated as a full adult, intermediate rate scales would have to be developed to compute the appropriate amount of tax (for example, children might have a half threshold and half the lower tax rate bands and the second adult two-thirds). There might be questions as to who would be elected by the family as the standard individual taxpayer.[32]

Total income of family members would be added up and divided by the sum of all the adults in the family unit plus one half for each of the children. Tax should then be struck on the family at the average rate.

Notwithstanding these difficulties however, an equivalence scale approach to family taxation is probably the most neutral that could be devised. As John Maynard Keynes once remarked, it is better to be vaguely right than precisely wrong. Equivalence scales account for economies of consumption and with an earned income deduction could also take account of the disutilities involved in earning a second income.[33]

Option 2C. Threshold income transfers

Another version of tax-splitting would allow income sharing with family members to be recognised only up to the level of an appropriate threshold. Just as the first $6,000 is currently exempted in the case of an individual as a minimum subsistence income, so one could allow family members to effectively pool their thresholds.[34] Pensioner couples are allowed to pool their pensioner tax rebates, which is similar to allowing them to pool tax thresholds, so there can be no objection in principle to allowing similar treatment for working families. A United Kingdom Green Paper on personal tax reform suggested a variant of this, namely, that couples should be allowed to transfer their unused personal allowances.[35] However it would seem more appropriate that the actual income be transferred before recognition was given in the tax system. This would operate to make explicit the process of income sharing usually treated as implicit.

A system of only allowing income sharing to be recognised up to the level of tax thresholds is decidedly less neutral than a system of equivalence scales. It is also much less generous than the system of free alienation of property income which is available to some classes of families. It would, however, be a considerable improvement in recognising a family's ability to pay compared with the present arrangements under which tax burdens are essentially unchanged regardless of the number of people being supported by a given income.[36]

To the extent that income transfers are made, eligibility for direct government transfers

through the social security system could be adjusted. If a person acknowledges an income transfer from another family member then the transfer obviously ought to be taken into account in determining their need for income support from the social security budget. At the moment the system is biased: unemployed married women and young people at home are denied unemployment benefits on the basis that they are being supported by someone else's income yet that other person is denied any tax recognition for providing that income support.

Option 3. Do nothing

Another option is to do nothing. This implicitly assumes that the existing tax and social security arrangements are neutral and equitable, but such an assumption is unsustainable.[37] It also assumes that the system is not already engendering subtle changes of its own. As the Fringe Benefits Tax has been tightened on employees and the tax benefits of superannuation reduced, more and more people have discovered that the benefits of employee status have declined. More and more taxpayers have been exiting PAYE status and entering self employment to take advantage of arrangements which allow them to enlarge the scope of their business deductions to employ their children and to share their income with their spouses. Taxpayers are achieving recognition of family income sharing through their own means. This cannot be described merely as tax avoidance (though many stigmatise it as such, perhaps out of envy). It is really a case of taxpayers seeking to organise their legal affairs to bring them into conformity with the economic reality of the income sharing that actually occurs within family units.

Taxpayers are achieving recognition of family income sharing through their own means. This cannot be described merely as tax avoidance.

If the tax system is left as it is, with wages and salaries the only incomes which cannot be shared with family members, there will be increasing pressure, especially in a deregulated labour market, for employees to abandon that status. They will enter into services or consultancy arrangements instead of employment contracts especially at executive levels. Although the Commissioner of Taxation has had some success in resisting 'Friday night-Monday morning' shifts by employees to contracting arrangements and the use of companies or trusts to split personal exertion income, there is no general prohibition on anyone choosing to conduct a business with a spouse or other family members, nor should there be.[38]

6. ADVANTAGES OF RECOGNISING INCOME SHARING

All of the options involving some recognition of family income sharing have some advantages in common. These are:

- greater equity as between one income and two income families;
- greater recognition of reduced ability to pay where one income supports more than one person;
- greater neutrality as between the decision to send one or two income earners into the paid labour market;
- reduced equivalent marginal tax rates (EMTRs).

All these options can be implemented without making any stereotyped assumptions of dependency. By allowing income transfers to be made on a wholly elective basis by consent between the spouses, any woman who wishes to be taxed as an independent income unit remains free to do so.[39]

At the same time, recognition of income sharing could avoid one of the criticisms commonly levelled against 'family unit taxation', that is, the necessity for couples to file joint returns and thereby disclose to each other all their financial affairs. Income sharing can be recognised through income transfers but with each person continuing to file separate tax returns. The only knowledge required to pass between the two parties is the common acknowledgement of the transfer and the actual or constructive payment from one party to the other or into a joint account.

If an income transfer is only recognised where there is an actual cash payment from one

spouse to another (for example, into a joint account) it is even possible for the tax system to achieve the same result for spouses as was claimed for the introduction of family payments, that is, an actual payment received by a spouse.[40]

Another advantage of recognising income sharing between family members is considerably reduced pressure for tax minimisation. One of the most common and successful forms of tax minimisation is income splitting. Although some academic theorists argue that income splitting is contrary to the interests of women it is notable that, wherever it is possible, married couples seem to participate happily in it. Of the partnerships and trusts registered with the Commissioner of Taxation, the vast majority are family affairs. As more and more wage and salary earners enter the top marginal bracket the attraction of diverting some income to a spouse in the lower brackets has increased.

Recognition of income sharing can also be employed for social security purposes as well as tax purposes, thereby eliminating double dipping. When family allowances were introduced in 1976, income splitting households (where the children enjoyed income) lost nothing through the abolition of dependent rebates but were able to gain a windfall in eligibility for family allowances. The recognition of explicit income sharing could make possible the more logical adjustment of social security payments so that they were not paid to dependants to the extent that an explicit election to share in a family member's income was made by the recipient or, in the case of a minor, by both parents.

One of the greatest benefits of recognising family income sharing would be the contribution it would make to disentangling the overlap of the social security and the tax system. The major reason for the high EMTRs faced by many family taxpayers is that they are simultaneously paying tax and receiving income tested benefits. From a logical point of view this is absurd. If a family is so wealthy that it can afford to pay tax it should surely not be receiving income tested welfare payments. Conversely a family poor enough to be receiving welfare assistance ought not to be paying tax. Recognising income transfers in the tax system would delay the point at which families start to pay tax.[41] This would mean a reduced overlap of income tax marginal tax rates and social security income test tapers.[42]

Although some academic theorists argue that income splitting is contrary to the interests of women, it is notable that married couples seem to participate happily in it.

7. DISADVANTAGES AND OBJECTIONS TO INCOME SHARING OPTIONS

Workforce disincentives?

One criticism made of recognition of family income sharing in the tax system is that it is a disincentive to female labour force participation.[43] Thus Patricia Apps and Elizabeth Savage argue that as the elasticity of married women's labour supply is lower than men's they should ideally be taxed at a lower marginal rate to increase female labour supply.[44] They state that any system of taxation which takes account of spousal income is incorrect because it reduces the incentive for women to enter the paid workforce.

But a similar criticism could be levied at family allowances whether in the tax or the social security systems. Any form of income transfer to a spouse out of the paid workforce is going to increase her ability to decide to stay where she is, whether that income transfer comes from her husband or elsewhere. If incentives to labour force participation by married women are what is desired, one could just as well argue that a special head tax be imposed upon married women. This would reduce the ability of their husbands to support them and thus force them to enter the paid workforce.[45] Indeed if one were to pursue the workforce disincentive argument to its logical conclusion, one would equally forbid bequests of wealth to married women on the grounds that it might discourage them from entering the paid workforce.

Since the income sharing options can be adopted on an elective basis, as the Asprey Committee recommended, the question of disincentives dissolves. More importantly, increased

labour force participation is not the be-all and end-all of economic policy. Indeed, quite the contrary. The objective of a successful economy is to allow people the option of not working. Historically, increased real incomes have often been taken in the form of reduced working hours. People work to live, not live to work. Many, and not just women, gain their greatest satisfactions in life from their families rather than paid work.[46]

As Catherine Hakim has pointed out, different women and different families have different preferences. Many women do like paid work, some even to the total exclusion of family or children.[47] But many other women see their work as raising well-adjusted children and do not feel they need to be fulfilled by paid work—if they do it, it is because they and their families need the money. Many women like a balance of both work and family life. However women perceive their role in raising children, there is a clear social interest in respecting their different preferences. Few things could be more destructive of continued social existence than a public perception and a fiscal system which both scorn the labour of those dedicating themselves to the perpetuation of the nation.[48]

Independence of husband and wife?

It has sometimes been argued that any system of joint or family taxation is wrong as it is inconsistent with the legal emancipation of married women.[49] However, this argument is more correctly addressed to the old UK system of compulsory aggregation of husband's and wives incomes. It is not appropriate to a elective system of voluntary income sharing.

One can hardly be a partner with someone, whether in marriage or commerce, without some financial interaction.

Indeed it is a misconception in any case to assert that husbands and wives are totally financial independent. One can hardly be a partner with someone, whether in marriage or commerce, without some financial interaction. No matter how independent their financial arrangements, the Family Law Act imposes upon husband and wife an obligation to maintain the other. In some States, legal obligations of a similar nature are imposed in the case of de facto spouses. The law simply does not recognise the ability of the married man or women to assert: 'This is my income and my income alone and I will refuse to allow you any subsistence out of it.' Indeed property proceedings on dissolution of marriage are designed to secure a liquidated sum in discharge of that obligation of maintenance.[50]

At another level, since any income sharing would be elective and no other information would need to be transferred between spouses, it is hard to see that any financial privacy concerns arise in any case.

Regressivity?

Another argument sometimes employed against any recognition of family income sharing is that it would be regressive. However this confuses horizontal and vertical equity.[51] In analysing redistribution of income, it is necessary to work on the basis of equivalent family incomes.[52] For example, a taxpayer on $80,000 a year supporting a family of six will have a lower equivalent income compared to a single person on $30,000 sharing a flat with another taxpayer on $30,000. A tax increase on incomes of $80,000 to finance tax cuts for incomes of $30,000 will be regressive. It will transfer income from the less well off to the better off. This sort of phenomenon, implemented both by policy and 'bracket creep', can explain why two-income childless couples appear to have fared better over the postwar period than taxpayers supporting a family on one income.[53]

Before imposing any graduated income tax, one first has to determine who is really enjoying the income. Is it the person who earns it or is it some other person? What might appear to be a large gross income if it were for the support of one person alone appears much more modest if it has to be shared with others.

The income tax system ultimately taxes people according to their enjoyment of income. It is therefore necessary to trace income through to the final person who enjoys it. Where one person with a considerable business income takes in a partner and shares income with

the partner no one asserts that that the tax system is granting a subsidy. Why should it be any different when one person takes another as a marriage partner? In both cases there is a legal obligation to share an income formerly enjoyed by only one person. Indeed it is rather surprising that marriage, which represents the oldest form of partnership known to the law, is the only form of partnership not recognised as such by the taxation laws.

Finally, it is odd that transfers of income which would have the result of spreading the distribution of income among individuals more evenly (whether or not they be family members) should be regarded as regressive. Instead, such income transfers might be regarded as complementing the function of the tax-transfer system which also exists to redistribute income to those without incomes.[54]

Another tax expenditure?

Another objection which may be raised is that family income transfers would amount to another 'tax expenditure' which is considered 'bad'.[55]

Two points may be made about this. Firstly an adjustment of the tax system to recognise horizontal equity cannot really be described as a tax expenditure at all. No one describes the tracing of income through trusts to its ultimate beneficiary as a tax expenditure. Nor does anyone describe the splitting of income between partners in a partnership as a tax expenditure. In each case the object is to trace the income through to the person who ultimately beneficially enjoys it. The same objective is involved in recognising family income transfers.

The tax free threshold, which is designed to free from tax a minimum subsistence requirement for a taxpayer, is not regarded as a tax expenditure. But if a family of, say, six requires a larger subsistence and therefore a larger tax free threshold collectively, why should that be regarded as a tax expenditure if that result is to be brought about by allowing them to transfer income to use up their tax-free thresholds?

Nor is it correct to assume that all tax expenditures are bad. For example, tax concessions are allowed for superannuation arrangements on the basis that they provide a more efficient means of people providing for their retirement than leaving the burden wholly on the government and the old age pension. Similarly tax expenditures may be involved in accelerated depreciation or investment allowances, but these are justified on the basis of the contribution they may make to increasing the nation's productive capital stock.

Why then should it be any different with tax allowances for the support of dependants? If a nation has to invest in its physical capital stock to maintain its productive capacity it equally has to invest in the replacement of its human stock. To that extent, recognition of family income transfers to dependent children is simply the human equivalent of the depreciation recognised as normal and natural for income from capital.[56] It is mistaken to assume that all income from labour is surplus income capable of being taxed away without any regard to the costs of maintaining the human beings who generated it.

It is mistaken to assume that all income from labour is surplus income capable of being taxed away without any regard to the costs of maintaining the human beings who generated it.

Finally, a tax expenditure may be more efficient at increasing incentives for the desired activity than a direct outlays programme. For example no-one gets to take the advantage of a tax expenditure until they produce and declare the income necessary to absorb it. Whereas a means tested payment from the government gives people an incentive not to work or not to declare income, a tax allowance which recognises income transferred gives taxpayers an incentive to work and earn the income which they are proposing to transfer to family members. In that sense the recognition of family income transfers may not only be horizontally equitable but a more efficient method of encouraging the support of family members than income tested outlays.

Administrative objections

One argument sometimes used against recognition of family income transfers is that the lines

cannot be properly drawn. It is sometimes asserted that marriage is an unstable institution and the rise of informal relationships means that marriage is not a sound basis upon which to found tax policy.[57]

This is overstated. Several Australian States have moved to impose upon de facto relationships similar obligations to marriage. So much legislation has assimilated the status of legal and de facto relationships that arguments as to administrative difficulties have long since been swept aside by administrative practice.

From the administrative point of view, the basic principle is simply to enquire whether there is an obligation, either actual or implied by law, to share income with family dependents. In the case of a legal marriage or a de facto relationship in some of the States there is such a legal obligation imposed and all that is required is to obtain from the parties to the marriage a jointly signed statement of the transfer. If desired, one can also require on audit evidence that the transfer has been actually made in cash or paid into a joint account.

Where a legal system does not recognise the status of de factos as implying obligations and mutual support it would be possible to ask the parties to submit to the Tax Office a legally binding deed of covenant. As for keeping track of family transfers, this seems no more difficult than keeping track of the formation and dissolution of partnerships and annual income distributions from them.

Actual payment to spouse?

Income sharing between family members would be recognised only where there is consent by both spouses and where an actual income transfer is made into a bank account.

One objection to tax recognition of income sharing is that it may not occur.[58] For example in the past an objection raised against taxation allowances for dependants is that they were claimable by the breadwinner without any proof that expenditure was incurred on the dependents.

The objection can be answered by requiring that any form of income sharing with family members would be recognised only where there is consent by both spouses to the election and where an actual income transfer is made into a bank account which can be operated on by the spouse (this could be either a joint or an individual account). Any consent could be revocable at any time. Where consent was withdrawn by a spouse to any recognition of income sharing (for example, on the break-up of a relationship) that spouse would become eligible for social security payments on the new basis.

8. ANTICIPATED EFFECTS OF OPTIONS INCLUDING BROADER SOCIAL IMPACT

Reservation wage

Recognising family income sharing in the tax system would increase the reservation wage (the lowest wage for which people are willing to work) demanded by married women (and, sometimes, men) before entering the paid workforce. The greater the after-tax income of the family subsisting on one income the less need there is for that family to put a second breadwinner into the paid workforce.

To the extent that families were more able to survive on one wage there would be a higher reservation wage for workers generally. This could offset any downward wage pressure from greater deregulation of the labour market such as changes to the minimum wage. The removal of tax pressures for families to place more than one breadwinner into the labour market would strengthen the bargaining position of wage earners in a deregulated market.

Resilience of household economy

Recognition of family income sharing would lessen the impact on after-tax income when a two income family loses a job. This would strengthen the ability of families to ride out economic downturns. Just as the losses of one company in a group can be offset against the profits of another so the recognition of income sharing for families allows a family to cushion the impact of losses in income of a member. Instead of being a matter of necessity, a second income would

be more a matter of choice.

Unemployment rate

Elective family taxation may lead to labour force withdrawal by family members who prefer to do other, socially worthwhile things (such as spending more time with their children) and could assist in reducing involuntary unemployment.[59]

If unemployment can be characterised as 'too many workers chasing too few jobs', increased after tax family incomes through recognition of income sharing in the tax system could reduce the demand for jobs. The removal of tax pressures to have more than one family breadwinner could reduce pressures on the participation rate and hence on the unemployment rate.[60]

The removal of tax pressure to have more than one family breadwinner could reduce pressures on the participation rate and hence on the unemployment rate.

As regards the supply of jobs in the market this tends to depend on consumer demand. Tax relief for families could increase family purchasing power and consumer demand. One would expect that this would translate into increased job offers from employers to workers.

Economic efficiency

Recognition of income transfers between family members could reduce the combined EMTRs of tax and social security income tests over large income ranges. As reduced equivalent marginal tax rates (EMTRs) encourage less welfare dependency, one might also expect greater output and reduced budgetary expenditure.[61]

While any system of income tested benefits must necessarily create disincentive effects where those benefits shade out, the location of those income tests in the income range is very important. The question is how many families or wage earners are likely to be affected. A reduction of EMTRs for people around average weekly earnings and below could be expected to increase their incentive to work.

Equity considerations

Recognition of income transfers would be most beneficial to wage and salary income earning families. Families with other sources of income in many cases are already enjoying recognition of the income sharing through family arrangements that are recognised for tax purposes.[62] Horizontal equity can only be improved to the extent that households with similar incomes are treated similarly.[63]

9. CONCLUSION

The household economy and the market economy are vitally interconnected. Distortions which disrupt the functioning of the household economy and force excessive labour force participation may have negative impacts on long-term economic and social welfare.

As far as possible a tax-transfer system should be neutral as between different methods of household organisation. There should be no discrimination for or against households with one or two earners or with one full-time earner and a part-time earner.

Existing tax-transfer arrangements do not appear to satisfy this objective. There are considerable public subsidies paid for child care for married women entering the paid workforce.[64] Subsidies payable to mothers minding their own children are less, notwithstanding the narrowing of the difference through increased Family Tax Benefit Part B being paid to single income families. At the same time, the tax system treats extra family income earned by a second earner more favourably than overtime or promotion of a primary earner. Factors such as these may have contributed to a growth in labour force participation beyond the natural point of choice.

From time to time, arguments are made that the playing field should be levelled. Some would argue that equal subsidies should be paid to mothers at home as for child care for working women. This was the logic behind the introduction of Family Tax Benefit Part B as well as the 'baby bonus' for mothers leaving the workforce to raise children. But another

approach is to allow taxpayers recognition for the income transfers they make to their family dependants. This general approach can be justified on both equity and efficiency grounds. No income tax system can be described as fair which fails to takes account of the number of people depending upon a given income but that remains, to a very large extent, the basic Australian system.

A Treasury which refuses to regard horizontal equity for taxpayers with dependants as a function of the taxation system can hardly complain if it finds dependants being placed on the outlays side of the Budget. A Treasury which wishes to reduce outlays on 'middle class welfare' must find someone else to take the burden. It seems natural to allow taxpayers supporting dependants to help the Treasury solve its problem.

In the long run, a failure to recognise income transfers to family members can result in increased financial pressure for more family members to enter the paid labour force. As married women are forced to seek paid work (whether they really want to or not) there are effects on structural unemployment, on declining family fertility and there is reduced longer term consumer demand. Over-taxation of families, at the extreme, can contribute to the sort of depopulation and fiscal collapse seen in the later Roman Empire and now re-emerging again in high-tax European welfare states.

Over-taxation of famlies, at the extreme, can contribute to the sort of depopulation and fiscal collapse seen in the later Roman Empire and now re-emerging again in high-tax European welfare state.

No society has achieved or ever will achieve 100% labour force participation. Nor should any society aspire to such an objective, especially if it comes at the expense of its future existence, as married women abandon the raising of the next generation as an over-taxed and under-appreciated activity. There will always be persons dependent upon the sharing of the incomes of those in the labour force. A failure by the tax system to recognise this massive family redistribution of income tends to force those who cannot be supported by the incomes of other family members to enter the paid work force on their own account, quite possibly against their inclinations and at the expense of other socially worthwhile activities.

Endnotes

[1] One consequence of Australia's refusal to recognise income sharing within families is that a single breadwinner family can pay more tax and be worse off than a two breadwinner family with a much larger total income, because a two income family obtains the advantage of two sets of thresholds and lower tax rates. At the National Taxation Summit in 1985 (Canberra: Commonwealth of Australia, National Taxation Summit: Record of Proceedings Australian Government Publishing Service [AGPS], 1985), the Law Council asked: 'What possible justification is there . . . for a single income family earning double average weekly earnings to be taxed $10,000 when a double income family earning the same amount is taxed $5,000? Optional joint filing of tax returns has been vilified as income splitting but we say it is a simple matter of fairness. It is the view of the Law Council that the Government must not impose on a single income family a significantly greater level of income tax than is levied on the double income family, particularly where the family has children under 18 years old. This can be solved simply by giving husbands and wives the option but not the obligation, to file a single tax return.' Similarly, Professor Burley on behalf of the Australian Catholic Social Welfare Commission argued that individual taxation involved a subsidy from families with a traditional division of labour in favour of social changes on a horizontally unfair basis. He went on to argue that the Government's disposition to retain the individual unit system rested on a faulty appreciation, because its notion of fairness abstracted from sharing between individuals and its notion of distortion ignored welfare promoted by non taxable activity. Australian Catholic Social Welfare Commission, *A Fair Go for Families* (Melbourne: Collins Dove, 1989).

[2] Patricia Apps, *Tax and Social Security Reform: An Analysis of Equity and Disincentive Effects*, Occasional Paper No. 2 (Sydney: Australian Tax Research Foundation, 1987), p.10 argues that income is not a measure of economic welfare because it does not allow for hours of work. However, income tax has never pretended to be a tax on subjective utilities. It has always been recognised that differences in taste make it impossible to impose a tax on some abstract concept of economic welfare. It has also been recognised that, if an adjustment is to be made for hours of work, the most neutral method is either a different tax rate in income from personal exertion or an earned income deduction for all taxpayers.

[3] Harvey E. Brazer, 'Income Tax Treatment of the Family', in Henry J. Aaron and Michael J. Boskin (eds), *The Economics of Taxation* (Washington D. C.: Bookings Institution, 1980), pp. 231-232, argues that married couples with equal incomes do not necessarily have the same capacity to pay tax because of untaxed homemaker services in one earner households and the extra work related expenses in two earner households. However, he does not examine whether a one income household with several children has more untaxed homemaker services than a one income household with one or no children, nor does he appear to recognise that the problem of work related expenses is a general one which could be separately recognised by an earned income deduction. Professors Michael J. McIntyre and Oliver Oldman reject the view that two job couples typically enjoy less imputed income from self performed services and as a result should pay less tax. They argue that special allowances for two job couples create more inequities than they remove. They (p. 224) reject the view that 'in principle self performed services constitute income'. They therefore doubt that there is a case for a special allowance for two job couples on account of imputed income enjoyed by one job couples. They point out that if an allowance for imputed income is to be made in favour of two job couples it should also be made available to single persons since they have the same leisure on a per capita basis as two job couples. They also point out that persons working long overtime hours should get a similar allowance. Their observations illustrate the point that disutility of labour is not unique to two job couples. See: Michael J. McIntyre & Oliver Oldman, 'Treatment of the Family', in Joseph A. Pechman (ed), *Comprehensive Income Taxation* (Washington D.C., Brookings Institution, 1977), pp. 205-234.

[4] It encourages splitting of legal incomes whether by work splitting or otherwise and ignores the benefit one family member may get from sharing in the use of the legal income of another.

[5] The vesting of a wife's property and income in her husband was matched by his legal duty to maintain both her and their children. Civil law countries such as France took a different approach, vesting the income of both partners in them jointly rather than requiring one to maintain the other.

[6] Under ordinary case law rights under a contract of service are not assignable at common law especially where to do so could interfere with the performance of a statutory office, see J. G. Starke

QC, *Assignment of Choses in Action in Australia* (Sydney: Butterworths, 1972), pp. 58-61. Lockhart, QC, now Mr Justice Lockhart of the Federal Court, (see J. S. Lockhart QC, *The Assignment of Rights to Income*, Paper for the Taxation Institute of Australia, Convention Papers for the Sixth New South Wales Convention [June 1974], p. 6) states that 'there is something to be said for the view that the reasoning of the Courts and the Boards of Review in the cases that have involved attempts to alienate salary are inconsistent with *Shepherd's Case* and *Norman's Case*. If one applies the reasoning in *Shepherd's Case* and *Norman's Case* there is no present right to future salary at the date of assignment because the salary may never in fact fall due. For instance the employee may leave his employment or be dismissed, for example, for dishonesty but what of the case where there is an employment agreement for a fixed term and the agreement is so structured that the employer is obliged to pay the salary unconditionally. In such an instance it would be my view that the alienation would be effective, provided of course it was for consideration, or, if not, either complied with the *Conveyancing Act* or with the rules of Equity relating to voluntary assignments to which I have referred. Take for instance the case of a *retainer* which may be paid to an employee, consultant or agent of a company. If the retainer agreement is so structured as to impose an obligation upon the employer to pay the *retainer* so that it becomes payable unconditionally in the future, in my view, it could be the subject of a valid alienation of income. It is obvious that the implications of this could be far-reaching.'

Bernard Marks, *Alienation of Income* First Edition (Australia: CCH, 1978), p. 210, argues that there is no clear authoritative principle on the tax effect of assignments of rights to future personal service income. He quotes McKay to the effect that 'insofar as the personal services principle rests upon the *Parkins v Warwick* decision—and if it is to be found in the case law it must—it possesses a legal foundation which is both shaky and of poor workmanship'. At p. 216, Marks goes on to suggest that Division 6A implicitly recognises the effectiveness of assignments of rights to personal service income.

Professor R. W. Parsons, *Asprey Proposals for Family Unit Taxation*, in Taxation Institute Research and Education Trust, Taxation and the Family Unit: Report of Proceedings of a Public Seminar (Sydney, May 1979), p.5, observes there are many legal techniques to achieve income splitting. He also observes that he is not as certain as everyone else that a salary or wage earner could not assign any part of his income to anyone else. Professor Parsons (p. 7) also suggests it might be possible for ordinary law to be amended to create methods of transferring salaries. He notes that there would be a constitutional problem, if the Commonwealth Government were to attempt to interfere in the ordinary law of the States. Capital gains tax in such an assignment situation might be an added complication today but could perhaps be avoided by a State law or Family Court order declaring joint rights of parties over contractual rights to wage or salary income.

[7] The Commissioner of Taxation seems unhappy in 2004 with this situation and is apparently seeking to persuade the Courts to reverse their previous decisions, relying on Part IVA, the general anti-avoidance provision. But the then Treasurer, now Prime Minister, the Hon John Howard assured taxpayers in his second reading speech that Part IVA would not strike at family arrangements or at husbands forming partnerships with their wives. As the courts are required to have regard to such aids to interpretation, it would be remarkable if the Commissioner succeeded in establishing the proposition that Part IVA effectively outlaws husband-and-wife income splitting, contrary to the expressed intention of the then Treasurer.

[8] This is the usual position. Undistributed income is taxed to the trustee at the top marginal rate and a trustee may pay tax on behalf of a child but the general principle is, and always has been, to trace income through to the beneficiary wherever possible. A similar policy applies to partnership income and was applied to companies in the first income tax law of 1915.

[9] R. C. Gates, *The Effect of Taxation on Incentive*, Paper presented at First National Convention of the Taxation Institute of Australia (Canberra, May 1969), reprinted in John Dixon, *The Public Sector: Selected Readings* (Melbourne: Penguin, 1972), p. 223, quotes the 1966 Canadian Royal Commission on Taxation which declared: 'The tax system should ensure that the flow of goods and services is allocated among individuals and groups so that those who have little economic power or particularly heavy obligations and responsibilities are able to maintain a decent standard of living. With respect to the allocation of taxes this requires taxation according to ability to pay . . . and the recognition of the family, as well as the unattached individual, as a unit for tax purposes.'

[10] Irish Commisssion on Taxation, *First Report: Direct Taxation* (Dublin: Dublin Stationery Office, 1982), p 229)

The Commission also recommended couples be able to elect for individual taxation if they wished.

[11] United States Treasury Department, *Tax Reform for Fairness, Simplicity and Economic Growth: The Treasury Department Report to the President* (Washington D.C.: Office of the Secretary, Department of the Treasury, November 1984).

[12] It is sometimes suggested that tax equity for families does not matter because families can be 'assisted' through the Social Security system. However, as Jim Cox and Chris Foster, 'Tax Changes and Social Welfare', in J. G. Head (ed), *Changing of the Tax Mix* (Sydney: Australian Tax Research Foundation, 1986), p. 133, point out, one has to distinguish vary carefully between those who have low incomes and those who have low incomes in relation to their needs. An aged pensioner who owns his or her own home may have a low income but be comfortably off compared to a low income family in the workforce with children and who rent in the private market. They point out that the simple equation of poverty with low income is misleading. What is relevant is equivalent income, not gross family income. At p.148 they observe that attempts to compensate families for tax inequities through income tested Social Security payments may be seen as undesirable because they extend the welfare net further.

[13] See Attorney-General's Department, *A Maintenance Agency for Australia: The Report of the National Maintenance Inquiry* (Canberra: AGPS, 1984), para 16.25. Foolishly, this recommendation was ignored in the design of the child support levy. The resulting high equivalent marginal tax rates encourage avoidance and evasion of both maintenance obligations and income tax.

[14] Alicia Munnell, 'The Couple Versus the Individual Under the Federal Personal Income Tax' in Henry J. Aaron, Michael J. Boskin (eds), *The Economics of Taxation* (Washington D.C.: Bookings Institution, 1980), p.247, postulates that marriage neutrality as a principle involves that there should be no penalty for marriage and none for being single. For example, a man and a woman each earning $10,000 should pay the same amount in taxes whether single, married or divorced. However this does not seem to accord with the correct definition of neutrality. It is perfectly arguable that tax burdens *should change* upon marriage, just as they change when a person in a business takes in a partner and splits the income with that partner. The principle behind family law is that marriage is a partnership and that each partner to a marriage acquires a legal right to be supported by the other. Once this is recognised, one can argue that marriage neutrality means that the tax system *should* recognise the sharing of income with spouses and dependent children.

Meredith Edwards, 'The Australian Tax Unit: An Evaluation', in J. G. Head (ed), *Changing of the Tax Mix* (Sydney: Australian Tax Research Foundation, 1986), p. 330, likewise appears to define neutrality of the tax system with respect to marriage decisions on the basis that tax liabilities should not alter on marriage. However, it may be argued that neutrality involves the reverse. Upon the assumption of legal obligations to share income, the tax system should recognise the fact in order to be neutral. Thus for example both the *Social Security Act and Family Law Act* assume and impose an obligation of income sharing between spouses. It may be argued it is hardly neutral for the tax system to ignore that fact.

[15] Child endowment originated in the 1940s as a foregone wage increase allocated by all workers as payroll tax to those of their fellow workers with children, Tax deductions for children can be traced back to Pitt's first income tax of 1799. The wage restraint of workers in World War II was eventually repaid by payroll tax being given to the states as a 'growth tax' while child endowment was eroded away, the moral of the story being 'put not your trust in princes'.

[16] It seems to be a classic case of a camel designed by inter-Departmental committee. More cynical observers have been known to suggest that having taxpayers get the shock of unexpected bills was a public service contribution to government re-election strategy!

[17] There are, of course, only two classes of taxpayers—the well-advised and the rest. Well-advised taxpayers ensure that their incomes are kept below key family payment cut-offs but wage and salary earners are less able to employ strategies such as leaving income in a company.

[18] EPAC Council Paper discusses estimates of the deadweight loss or excess burden associated with tax financed redistribution of income. Excess burden or deadweight loss measures the cost to economic welfare created by non-neutral taxes. Excess burden can exceed tax revenue. For example, a $100 charge for crossing the Sydney Harbour Bridge would raise little revenue but impose enormous additional costs on the public which could in theory be quantified. Similarly, if a person would lose $880 out of a $1,000 of extra work, he or she may not do the work. The government then gets no

revenue and the economy loses $1,000 of output. (See *Economic Planning Advisory Council, Incomes Support Policies, Taxation and Incentives*, EPAC Council Paper No. 35 (Canberra: EPAC, October 1988).

[19] The apparent exception of Family Tax Benefit Part B being only income tested only on the secondary earner's income in 2 parent families reflects its origins in the dependent spouse tax rebate. For sole parent families, the complete lack of income testing reflects the judgment in the former sole parent tax rebate that ability to pay is less—in other words, these apparent exceptions are examples of implicit recognition of the need for taxing on the basis of equivalent incomes.

[20] Meredith Edwards, *Taxation and the Family Unit: Social Aspects,* in Taxation Institute Research and Education Trust, Taxation and the Family Unit: Report of Proceedings of a Public Seminar (Sydney, May 1979), p. 33, notes that the institutional reality is that in most households the wife makes her decision on whether to join the labour force on the assumption that her husband will work and will work full-time. In other words, the elasticity of the wife's labour supply is dependant on implied income transfers. However, there is no reason why this argument applies exclusively to wives. The same argument holds where a wife is a primary earner and the husband is, for example, disabled, studying or whatever. The comment also focuses attention on the fact that the real labour supply decision to be made by the household is a secondary income decision. What is relevant in efficiency terms is not male labour supply as such but incremental male labour supply, such as overtime or promotion. Studies done on male labour supply elasticities tend not to pick this up, see EPAC, *Incomes Support Policies*, p. 73 n. 3.

[21] John J. Beggs and Bruce J. Chapman, *The Foregone Earnings from Child Rearing in Australia*, Discussion Paper No. 190 (Canberra: Australian National University Centre for Economic Policy Research , June 1988), p. 4, note that most models of whether a married woman will or will not participate in the workforce assumes that women will work if their market wage rate exceeds their reservation wages. The reservation wage is the value placed on not working. It is determined by, among other things, husband's income and children. They find, in an empirical exercise, that the presence of children has a substantial negative effect on women's labour market participation. Moreover the younger the children and the more there are of them the lower is the probability of female labour force involvement. They also find (p. 21) that the working hours of wage earning women are affected by the presence age and number of children. This is of course entirely consistent with Hakim's point about the variability of women's preferences relating to work, children and families.

[22] It is wrong in economics, law and logic to refer to these as '**effective** marginal tax rates' as is commonly done. The withdrawal of a subsidy is not the imposition of a tax. To say a person on welfare facing a 100% income test is paying an **effective** marginal tax rate of 100% is hardly accurate when in fact that person may be paying no tax but receiving several thousand dollars from taxpayers. It hardly makes sense to talk of an **effective** marginal tax rate of 100% when the person has thousands of dollars to go before becoming a tax contributor at all. What we are really talking about is equivalence only in terms of marginal loss rates from earning extra income. This may seem a pedantic point but it is necessary to dispel a looseness of thought that sometimes infects the reasoning of otherwise respectable economists.

[23] J. R. N. Willis and P. J. Hardwick, *Tax Expenditures in the United Kingdom* (London: Institute for Fiscal Studies, 1978), pp. 18-19, rightly reject the view that an earned income allowance for a wife as a secondary earner is a proper part of a neutral tax system. They argue that the wife's earned income relief in the United Kingdom constitutes a tax expenditure rather than a part of the tax structure because the extra expense which a working wife may incur (for example, child care) is not an expense of the job itself. (This is not to say however they would not regard a general earned income allowance as inappropriate—all wage earners, not just married women, have to surrender time they would otherwise have.)

[24] Benefit levels from *Your Family's Guide to Our Services* (Australia: Family Assistance Office, July 2001).

[25] Henry Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), pp.136-137, admits that 'difficult questions arise here with regard to the family . . . our scheme would require that beneficiaries be taxed with respect to gifts without deductions on the part of the donors'. He then observes the question is raised as to whether such a scheme is grossly unfair to those who contribute to the support of others. 'It is a

common criticism of our income taxes that they differentiate meagrely, especially within the upper income taxes, between families of different size.' At p.138 he admits that concessions are necessary for families to obtain equitable relative taxation at persons with similar earnings and different family obligations. However, he fails to see that this admission really calls into question his whole idea of double taxing income transfers or gifts.

[26] K. W. Asprey, 'Aggregation of Incomes of Husband and Wife in Family Unit Taxation' in *Taxation Review Committee, Commissioned Studies* (Canberra: AGPS, 1975) notes that the 1967-70 Canadian Royal Commission on the Status of Women found against aggregation of husband's and wife's incomes on the basis, naturally enough, that this was a disincentive to married women's employment. In searching for a neutral system, however, the Royal Commission sought a system of taxation which would preserve the married woman's freedom of choice either to stay at home or enter the labour force and which would treat her fairly whatever her choice. The Canadian Royal Commission went on to recommend a system of taxation for married couples which permitted them to have the option of filing a joint return which would effectively allow averaging of incomes to some extent. The Canadian Royal Commission's view of tax neutrality is thus similar to the income sharing recognition proposals discussed in this paper.

[27] Meredith Edwards, 'Social Effects of Taxation', in J. Wilkes (ed), *The Politics of Taxation* (Sydney: Australian Institute of Political Science and Hodder and Stoughton, 1980), p. 156, notes that if one were to abolish any recognition in the tax system of the sharing of income with a spouse, one would logically have to do the same with the social security system. In other words an unemployed married person would be entitled to unemployment benefit in the same way as every other unemployed individual, as was recommended by the Myers Committee of Inquiry. While that approach has logical consistency in treating individual adults, it does raise questions. Taxpayers may generally wonder why an unemployment benefit should be paid to the wife of a millionaire or the husband of an heiress. Similarly, people might wonder why all social security benefits were not available for individuals under the age of eighteen. Why have ageism directed against young people?

[28] McIntyre and Oldman, 'Treatment of the Family', p. 217, argue that 'since children are the beneficiaries of some fraction of the income received by their parents, the benefit rule suggests that the children rather than the parents are the appropriate taxpayers on a portion of the family income'. The family income really has to be allocated to those who really enjoy it. Elsewhere in Michael J. McIntyre and Oliver Oldman, 'Taxation of the Family in a Comprehensive and Simplified Income Tax', *Harvard Law Review* 90:8 (June 1977), pp. 1573-1630, they observe that 'in the family context the special problem of determining the appropriate taxpayer is basically a problem of attributing an available pool of taxable income among family members . . . taxing the income to those who actually consume or accumulate it regardless of the source seems intuitively more equitable and provides a basic principle to govern how the tax system should take domestic sharing arrangements into account' (p.1577). William Andrews also argues that income tax should fall on the recipient of an income transfer rather than the donor, if one is to regard income as personal consumption plus accumulation. See William D. Andrews, 'Personal Deductions in an Ideal Income Tax', *Harvard Law Review* 86:2 (December 1972), pp. 348-349.

[29] But as Alan Tapper, *The Family in the Welfare State* (North Sydney: Allen and Unwin, 1990), p. 110, observes, two earner childless couples can be expected to enjoy very high equivalent incomes not just because they will both enjoy uninterrupted careers nor simply because they do not share their incomes with dependants; they also have the advantage of the economies of scale that come from shared living. Such couples are thus already taxed on a 'generous' per capita basis.

[30] This is something like the US position and is similar to recommendations of the Belgian Royal Commission and the New Zealand Task Force on Tax Reform (See *Report of the Task Force on Tax Reform* (Wellington: New Zealand Task Force, April 1982).

[31] Jane Gravelle, 'Equity Effects of the Tax Reform Act of 1986', *Journal of Economic Perspectives* 6: 1 (Winter 1992), pp. 37-38, observes that the construction of equivalence for families of different sizes does depend upon assumptions made as to economies of consumption. 'If all family members were similar and all goods consumed were purely private goods, a family of four would need twice the income of a family of two to maintain the same standard of living. Many goods consumed within families are in the nature of club goods, however, with enjoyment by one family member not affecting the enjoyment of other members by much. If half the goods were club goods, the family of four would need only 50% more income than a family of two to enjoy the same standard of living.' One may observe that assumptions of what are club goods may be overstated when the long run view

is taken. For example, a large family only needs one washing machine but with more intensive use it may be likely to wear out earlier. Similarly there comes a stage when more people cannot comfortably fit into the same house and a large extension is necessary. Nor does every family member always want to watch the same television programme.

[32] An advantage of recognising explicit income transfers within the family while retaining individual tax returns and assessment is that individual privacy can be respected. Neither husband nor wife needs to see the whole of each other's income tax returns if that is their preference.

[33] Earning a second income often involves considerable disruption to normal family life. Female labour supply is not some 'free resource'. Just as primary income earners face disutilities in earning income (and hence often want to retire as soon as they can afford to do so), so second income earners face disutilities, such as those involved in having to outsource the raising of their children. Like many parents and citizens today, Adam Smith in *The Theory of Moral Sentiments* 1759 (Indianapolis: reprinted Liberty Press, 1976), pp 363-364, did not think highly of the social value of such outsourcing, 'The education of boys at distant great schools, of young man at distant colleges, of young ladies in distant nunneries and boarding schools, seems in the higher ranks of life to have hurt most essentially the domestic morals, and consequently the domestic happiness, both of France and England. Do you wish to educate your children to be dutiful to their parents, to be kind and affectionate to their brothers and sisters? Put them under the necessity of being dutiful children, of being kind, affectionate brothers and sisters: educate them in your own house. From their parents' house they may, with propriety and advantage, go out every day to attend public schools; but let their dwelling be always at home. Respect for you must always impose a very useful restraint upon their conduct; and respect for them may frequently impose no useless restraint upon your own. Surely no acquirement which can possibly be derived from what is called a public education can make any sort of compensation for what is almost certainly and necessarily lost by it. Domestic education is the institution of nature—public education the contrivance of man. It is surely unnecessary to say which is likely to be the wisest'.

[34] Richard Goode, *The Individual Income Tax*, Revised Edition (Washington D.C.: Brookings Institution, 1976), p. 214, observes that personal exemptions have the function of freeing from tax income needed to maintain a minimum standard of living. He notes that the adequacy of the tax free minimum from this point of view must be examined on a family basis. This may involve the use of equivalence scales which may vary with family income for the age of children (pp. 219-220). Joseph Pechman, *Federal Tax Policy*, 3rd Edition (Washington D.C.: Bookings Institution, 1977, p. 94, notes that the major argument for recognition of income sharing in the tax system is that income is enjoyed jointly. He accepts that to the extent income is consumed, this argument appears to have weight. He points out, however, that income splitting between husband and wife does not allow for income sharing with dependent children. Pechman therefore suggests that one could differentiate among taxpayers by varying personal exemptions with the number of persons in a family (p. 95).

[35] UK Chancellor of the Exchequer, *The Reform of Personal Taxation* Cmnd 9756 March 1986 (London: Her Majesty's Stationery Office, 1986) p.12. The Paper also observed (at pp. 7-8) that, without transferable thresholds, the tax system bore most harshly upon couples at the stage of the life cycle when they could least afford it, namely, when they were down to one wage earner.

[36] Gravelle, 'Equity Effects of the Tax Reform Act of 1986', pp. 37-38, observes that even adjusting for so-called imputed income of non-earning spouses and using equivalence scales rather than a per capita approach, the increases in personal exemptions in the US Tax Reform Act of 1986 improved horizontal equity. The approach suggested in this paper of allowing families to transfer income up to their equivalent thresholds would be an analogous reform in Australia. It must be noted that the increases to family payments through notionally cashed out extra tax thresholds for children have improved the situation for lower income families. But larger, middle and higher income, family tax burdens still compare unfavourably with those of taxpayers without dependants on similar incomes.

[37] William Vickrey, *Agenda for Progressive Taxation (*New York: The Ronald Press, 1947; New Jersey: A M Kelly Publishers Clifton, 1972), p. 274, strongly criticises the pre-1948 United States tax position, which was similar to that currently pertaining in Australia. He remarks 'it is neither possible nor, in fact, desirable to attempt to consider each individual as an independent unit for tax purposes. To attempt to do so is to promote formal changes in the nominal financial relationships between members of the family for the purpose of avoiding taxes. Not only is the necessity for such change irksome to the taxpayer and in some cases moderately wasteful, but also inequities will result between those families in which such changes are relatively easy to make and those in which they are difficult

or impossible.' This comment quite aptly describes the current inequities between PAYE and non-PAYE families in Australia today. Whether, however, it is necessary to abandon the individual as the *administrative* unit for taxation is another question.

[38] The personal services income rules represent a bizarre but essentially futile attempt to stop people doing so. If there were effective tax rules against conducting businesses with marriage partners doubtless the divorce rate would rise. It would also be amusing to see the tax authorities and Parliament dealing with widespread objections by taxpayers that they were being discriminated against on the basis of their marital status.

[39] Many would choose to do so. Where husbands and wives both have separate incomes, whether from work or property, there would be little need to transfer income between spouses. This simply underpins the point that the tax system should recognise that different families have different financial arrangements.

[40] This idea was perhaps always charmingly naive in ignoring the fungibility of money. The idea that the Treasury could take money from the husband and put it into the wife's purse with no effect on housekeeping allowance he might give her may perhaps have been an exaggerated claim in the first place. Again, reminding ourselves of Hakim's warnings on different preferences, such stereotypes forget the not entirely uncommon cases where a wife handles all the household finances anyway and hands the husband his weekly spending money.

[41] Tapper, *The Family in the Welfare State*, pp. 142-144 (see n. 29) observes that tax allowances for dependants can improve incentives by reducing relevant marginal tax rates placed by family breadwinners. At p. 147, he observes that tax allowances for families can be preferable to cash payments, because they avoid the disincentives involved in imposing taxes in order to dole the money back to the taxpayer.

[42] The high EMTRs produced by the clash between the tax system and the social security system resemble the mountains thrown up by the collision of two great continental plates—jagged, high and hard to break through.

[43] In the Draft White Paper on Reform of the Australian Taxation System (Canberr: Commonwealth of Australia, 1985), p. 62, it was suggested that the individual unit of taxation minimised distortion of the choice between paid employment and non taxable activity (especially for married women); and was consistent with a policy of promoting equal employment opportunity and of furthering of the independence of women. The first statement may be questioned, because, on a primary/secondary earner model of employment, the existing Australian tax system creates a distortion in favour of the second income instead of additional primary earner income. Secondly it may be argued that a neutral system, rather than a distorting tax system, is what is required to promote equal employment opportunity. A system of elective family income sharing would appear to give women greater choice and greater employment opportunity than the present system. Many women tend to have low paid, low status, jobs. To the extent that tax recognition of family income sharing reduced their need for additional family income (the 'income effect'), their bargaining position in the labour market would be improved. They would not need to settle necessarily for jobs which they regarded as unsatisfactory.

[44] Michael J. Boskin, 'Factor Supply and the Relationships Among the Choice of Tax Based, Tax Rates, and the Unit of Account in the Design of an Optimal Tax System', in Henry J. Aaron and Michael J. Boskin, *The Economics of Taxation* (Washington D.C.: Brookings Institution, 1980), p. 154, uses the inverse elasticity rule to argue that wives should be taxed at lower marginal rates than their husbands. However, this conclusion is based on a simple model where each household has an identical utility function dependent only on consumption of goods and husbands' and wives' labour supplies. The model does not allow for different preferences between different households nor for the presence of children. Hakim has rightly criticised this sort of naive assumption that all women (or men) are the same.

Brazer, 'Income Tax Treatment of the Family', p. 224 (see n.3) notes that the traditional view among tax theorists—an article of faith—is that the family is the appropriate taxable unit. However, he argues that increased labour force participation for women and different lifestyles which do not include formal marriage suggest that the tax system should be neutral towards marital status. His view that the tax system should ignore marriage, because it is neither a necessary nor sufficient condition for establishing a household, may be questioned. Informal household arrangements do not necessarily involve any legally enforceable compulsion to share income with another person or with children. His major argument, as with Boskin ('Factor Supply and the Relationships Among the

Choice of Tax Based, Tax Rates, and the Unit of Account in the Design of an Optimal Tax System'), is that the greater elasticity of married women's labour supply suggests that they should be taxed at lower, not higher, marginal rates (pp 227-228). This argument is, however, a stronger argument against addition of husbands' and wives' income than against allowing elective income sharing. Indeed, elective income sharing allows the household to adjust its labour force participation to suit the circumstances of each.

Munnell, 'The Couple Versus the Individual', p. 261, see n. 14, notes that between 1940 and 1978 in the USA, the female labour force participation rate doubled from 27.4% to 49.1%, but the rate for married women more than tripled from 14.7% to 47.6%. She argues that equal treatment of households with equal incomes should not be a goal, because of extra work-related expenses when both spouses work and untaxed home services or leisure enjoyed by one income families (p. 263). She also argues that the inverse elasticity rule suggests that the tax rates on women's labour should be lower at the margin. Her conclusions that efficiency considerations support individual taxation (that is, no recognition of income sharing between couples) may, however, be questioned. The US system of income splitting did not prevent a very large increase in the labour force participation of married women. The identification of efficiency with increased market output may be rejected.

Edwards, 'The Australian Tax Unit', p. 328, see n.13, argues that 'if complete neutrality in decisions between market work and home activities were to be achieved the individual's value of time in non market activity would have to be taxed. An alternative means of achieving an efficiency gain would be to use a differentiated tax scale; the higher the elasticity of the labour supply of the tax payer, the lower the tax rate . . . but proponents of this efficiency solution admit that it might be unacceptable because of its equity implications.' An earned income deduction would appear to make more sense as a solution to the problem of the disutility of labour. An obvious problem with imposing the lowest tax rates on those with the most elastic labour supply arises as follows. Heiresses and the wives of very rich men would have the least need to work and therefore have the most elastic labour supplies. It would strike people as strange that they should then receive the lowest tax rates. Moreover, if the theory that the lowest tax rates should be imposed upon the most elastic labour supplies were to be applied consistently, overtime earnings by males and increments in income upon promotion would also be subjected to lower tax rates.

Patricia Apps and Elizabeth Savage, 'The Tax Rate Structure', in J. G. Head (ed), *Changing the Tax Mix* (Sydney: Australian Tax Research Foundation, 1986), p. 343, argue that, because estimated compensated labour supply elasticities for wives and female heads of households are substantially greater than those for prime age males, efficiency requires lower tax rates for females. However, it may be observed that studies of labour supply tend to be biased against picking up male labour supply responses (which tend not to take the form of variation of hours at work). Moreover, a smaller elasticity for a higher income earner could involve a greater deadweight loss (efficiency loss) when that earner is taxed than a higher elasticity in the case of a lower income earner.

Apps and Savage, 'The Tax Rate Structure', p. 351, claim that 'under the ideal tax structure, wives would face lower tax rates not only because of labour supply disincentive effects but because women are on average lower wage earners.' If one were purely concerned about labour supply disincentives one could take a different tack. One could introduce a poll tax or a hut tax similar to that levied in South Africa and other colonies. The purpose of such taxes was to force the natives to go to work in mines and on farms in order to earn the income to pay the tax. This, of course, created a pool of cheap black labour for white settlers. The inequity of such taxes seems apparent today, but they rested on theories about elastic labour supplies similar to some current discussions of female labour supply.

[45] A writer such as Hakim might argue that this is exactly what the present system has done—negate or restrict the preferences of family or child-centred wives by making it harder for their husbands to support them in their choices to have children and raise them in the home.

[46] Not every woman (or man) lives for a 'brilliant career' or marriage to a government or corporate bureaucracy. Students of Australian history may recall Robert Menzies' speech on the 'forgotten people' where he identified with those people, the bulk of society, whose greatest contribution was represented by the raising of the next generation rather than by any famous work or career of their own. Others may recall the Roman matron who scorned the ostentatious wealth of the nouveau riche socialite by turning to her children and declaring, 'These are my jewels!'.

[47] There is no pejorative implication in this. Some careers are intensely demanding and a wise person either finds a very special partner or recognises, perhaps with sadness, that marriage is a part of life

which may not be compatible with his or her chosen vocation. Nor are these preferences set in stone. Some women, for example, may enjoy and work hard in a profession such as the law and later decide to either not return after the birth of a child or to change to a smaller, more family-friendly, firm.

[48] I do not suggest that a tax system can bribe women to have children they do not want. But I do say that a tax system can make it very difficult for a woman to have as many children as she might have wanted. You cannot push on a rope but you can restrain and hold back. As for the long-term social implications, one has only to look at the demographic collapse of Europe where high-taxing treasuries are being confronted with a 'baby strike'. A society which over-taxes its families will end up with fewer of them and an empty treasury, as Gibbon well understood in chronicling the decline of the later Roman Empire. A large part of the modern problem is that voters in welfare states have written out pension and nursing home cheques for themselves at the expense of children other people were supposed to breed—the welfare state thus devours its children, like the Carthaginians or the god Saturn.

[49] Mr Justice Asprey, in his reservation on the taxpaying unit in the Committee's report (see Taxation Review Committee, *Full Report* [Asprey Report] [Canberra: Australian Government Publishing Service, January 1975], p. 141), argued that a married woman should be treated under general law and the taxation system as an individual in her own right and, in relation to income which was morally and legally her own, should pay no more and no less tax than if she were a single person. However, a system of elective recognition of income transfers does not violate that principle. No one would be taxed on income they had not elected to receive as a transfer. Thus individual taxation can be reconciled with recognition of family income transfers and equity.

[50] Professor Parsons in his reservations in the Asprey Committee report on income splitting (see Taxation Review Committee (1975) p. 158) observed that it was odd that some people opposed recognition of family income sharing in the tax system yet were prepared to argue that, on death or divorce, a spouse should be regarded as having contributed equally to the accumulation of family assets and should be entitled to them. He also observes that an elective system of family taxation could not be said to be in any way inconsistent with the independent status of women.

[51] Gates, *The Effect of Taxation on Incentive*, p. 255 (see n. 9) correctly criticises the idea that fixed allowances for dependants benefit higher income earners. As Gates remarks, allowances for dependants are surely intended as a recognition that, at any given level of income, ability to pay is smaller, the larger than the number of people for whom the income must serve. As he points out, this is a question of horizontal equity and if it is felt that the rich family man is not being taxed heavily enough in relation to the poor family man, the remedy is to adjust the graduation of the tax scales. Only in that way will all the rich, including the rich without families, who are at the same level of capacity to pay, be likewise be affected.

Professor Charles McLure in his comments on John F. Due, 'Personal Deductions', in Joseph A. Pechman (ed), *Comprehensive Income Taxation* (Washington D.C.: Brookings Institution, 1977), pp. 37-65, remarks that 'there is an unfortunate but pervasive tendency to prefer credits (that is, tax rebates) because they increase the progressivity of the income tax. I believe that in some instances tax relief should logically take the form of tax credits (tax rebates) and in others the form of deductions. While one may be willing to sacrifice logic in the design of tax policy on the altar of increased progressivity, he should recognise what he is doing and note that horizontal equity may be sacrificed as well.' He thus points out that deductions are appropriate for expenses which reduce ability to pay at any given level of income. Similarly, McLure argues that deductions are appropriate for personal exemptions as the correct method of allowing for basic necessities and family size. That is a certain allowance should be made in arriving at the amount of income that measures the ability to pay, regardless of how far above the minimum tax free income the family's income happens to be.

[52] See, Ann Harding, *The CEDA Vision and Enhancing Equity,* Paper presented at An Australia that Works: A Vision for the Future Conference Committee for the Economic Development of Australia (Sydney, 3-4 August 1993), p. 14.

[53] Ann Harding (p. 21) remarks, 'One of the striking features of the last decade was the rise and rise of the 'dinkies'—dual income couples without kids. In 1981-82 dinkies made up 29% of the richest 10% of the population. By 1989/90 this had increased to 36%. People living in two-income families—both with and without children—made up two-thirds of those individuals in the top decile by 1989-90, while those living in single income families dropped by 10% to 15% during the 1980s.' Similarly, Deborah Mitchell, *Taxation and Income Redistribution: The 'Tax Revolt' of the 1980s Revisited*, Paper presented at ISSA Conference, Comparative Research on Welfare States in

Transition (Oxford, 9-12 September 1993), p, 19, observes that over the US, UK, Sweden, the Netherlands, Germany, Canada and Australia, two income families are paying relatively less tax than in the past—where tax scales have been cut, they have gained twice.

Similarly, the Population Issues Committee (see National Population Council, *Population Issues and Australia's Future: Environment, Economy and Society—Final Report*, [Canberra: AGPS, December 1991], pp. 90-91), observed that 'Increasingly, income has become concentrated in Australia in the hands of families with few or no children while those experiencing financial difficulty are increasingly those with children (both one- and two-parent families). There is a real danger that Australia will follow the path of the United States where it is now recognised that unless public policy offsets some of these trends there will be greater polarization economically and psychologically among the young adults of the late 1990s and early 2000s.' The increases in family payments since the mid-1990s might be seen as a social reaction to these earlier predictions.

[54] Vickrey, *Agenda for Progressive Taxation*, p. 280 (see n. 37), remarks that there seems to be no justification for aggregating incomes just because people live together in a single household. On the other hand, 'A very good apology can be made for reducing the tax where two persons of unequal incomes live in a common household and share their resources: this sharing of resources can be considered a redistribution of income similar to that which the income tax itself is attempting to bring about.'

Ian Manning, *Incomes and Policy* (North Sydney: Allen and Unwin, 1985), pp. 123-124, observes that a great deal of redistribution, especially towards children, occurs in families. He notes that the justification for the minimum adult male wage with child endowment payments was to secure a redistribution towards dependants, such as children, out of the workforce. Because these redistributive mechanisms were neither entirely just or effective they have tended to be abandoned and the problem of redistribution transferred out of the wages system towards the Social Security system. Manning (pp. 167-168) also observes that internal transactions within families make a major contribution to the reconciliation of justice in exchange with justice in distribution. He observes that Government action should support such family transfers and not work against them. He suggests more could be done to explore how family income sharing could be encouraged.

Tapper, *The Family in the Welfare State*, p. 106 (see n. 29), observes that many more people depend on incomes rather than receive incomes. We cannot therefore impose tax burdens upon the recipients of incomes as earnings without any regard to how it is shared with others, such as family members. The concept of equivalent income is an attempt to allow for these transfers within families. Interestingly it may be noted that job sharing is sometimes advocated as a method of achieving more equitable income distribution. It is less well recognised, however, that income sharing achieves a similarly redistributive result. If one wishes a more even spread of income, recognising income sharing under the tax system should commend itself to those who advocate job sharing.

[55] Notwithstanding the scathing criticisms by Professor Boris Bittker and others of the abuse of the 'tax expenditure' concept, one still sees countless policy arguments put at this naïve level, even in textbooks on income tax law by legal academics ignorant of the history of debate on the concept in the US where it originated.

[56] This is where Hakim's point on the sociological variability of women's preferences for children and families cuts deeply into economics. Suppose that in a non-tax world of 100 women, 50 want no children and 50 want five children. Leaving aside whether wishes are always fulfilled, one might expect mild population growth with a net reproduction rate below 2.5. If the tax system makes it more difficult for men to support families and forces women to revise downwards their desired family size to three children the net reproduction rate drops to 1.5. The result is demographic collapse of the fiscal base.

[57] Edwards, 'The Australian Tax Unit', p. 336 (see n. 14), suggests that one reason for not recognising income sharing between couples is that marriage is no longer so stable a relationship and that women may not be financially dependent within marriage. This argument may be questioned. Every year thousands of partnerships are formed and dissolved yet the tax administration manages to cope with the consequences. Again, each year thousands of people move from paid employment into partnership or out of employment and the tax administration copes with that. There is no reason why the tax administration cannot deal with family income sharing as and when it occurs. Divorce, for example, or termination of election by a spouse for recognition of income sharing could be treated similarly to dissolution of a partnership.

[58] Edwards, 'The Australian Tax Unit', pp 332-333 (see n. 14), observes that income sharing may not occur equally within families. This has been used as an argument in favour of direct payment by

Government, for example to the spouse with dependent children. However if the tax system requires actual transfer of income to a family member for tax recognition the same effect can be achieved entirely outside the Budget sector. In practice, this point can be overstated as tax allowances which have been allowed for dependants have been far below the minimal cost of maintenance which would flow from living in a household.

It is inconsistent to argue, as some have done in the past, that household income is not shared, while treating a husband's loss of a dependent spouse rebate on account of a wife's earnings as a tax burden on the wife's earnings. It was generally assumed that the loss of the spouse rebate (cashed out as the home child care allowance and now part of Family Tax Benefit Part B) was a tax on the spouse's earnings and hence affects EMTRs faced by a spouse.

The Asprey Committee (1975), p. 135 (see n.29), agreed that normally a fair degree of income sharing occurs within families but noted that it would be a wide range. This was a reason for its recommendation that the Government develop a system of elective family taxation. The Committee was persuaded of the equity arguments for providing an option that recognises the reality of a large category of family relationships better than does individual taxation (see p. 139. para 10.33).

Tapper, *The Family in the Welfare State*, p. 148, questions the relevance of intra-family income distribution for tax policy. He notes that attempts to dissect who actually enjoys family income can be arbitrary, as in treating a husband's petrol and lunch money to go to work as personal consumption. He argues that Edwards' 1980 survey of 50 families in Queanbeyan does not necessarily support the argument that family income is not pooled and shared.

C. McArdle, *Taxation and the Family Unit: A Unionist's View* in Taxation Institute Research and Education Trust, Taxation and the Family Unit: Report of Proceedings of a Public Seminar (Sydney, May 1979), p. 44, argues that two income, low income working class families do pool everything. 'Women do not have the luxury of independence nor do men have the capacity to keep their money to themselves, in spite of complacent, self-satisfied generalisations. The hotel is not at all in the centre of the life of the vast majority of these men. There is simply no money to spend on beer. These families really are economic family units through sheer necessity and they actually do share things, most of all their income.' McArdle therefore objects to *aggregation* of family incomes to impose an extra burden on such families, because as he sees it their income is genuinely split. He does not appear to have addressed his mind to the different situation of tax recognition of family income transfers within such families.

[59] R. G. Gregory, 'Jobs and Gender: A Lego Approach to the Australian Labour Market', *Discussion Paper* No. 244 (Canberra: Australian National University Centre for Economic Policy Research, 1990), p. 21, notes that the share of all jobs held by females increased from 30 to 40% over the 1966/88 period. He also notes (at p. 22) that over the same period full-time employment for women adjusted for the growth in population increased 3.7% but part-time employment increased 143%. The labour force response associated with the rapid growth of part-time jobs, he observes is different from that associated with full-time jobs. He notes (p. 33) that, with the increase in the significance of part-time work, there is such a significant movement in and out of the labour force in response to changes in the job stock, the meaning and measurement of unemployment is more complicated than in the past. He suggests that instead of thinking of employment and unemployment as alternative states one has to look more closely at those such as married women, who enter and leave the labour force and bypass the unemployment pool.

[60] P.D. Groenewegen, *Taxation and the Family Unit: Some Economic Aspects* in Taxation Institute Research and Education Trust, Taxation and the Family Unit: Report of Proceedings of a Public Seminar (Sydney, May 1979), p. 16, notes that the strength of tax influences on secondary earners is difficult to assess. As in the general disincentive to work effect of income tax, one has to look at non-tax incentives to work (for example, nothing to do at home, interest in work, and so on) and also has to bear in mind that in low income, single income households the need for additional income may be the dominant motivation for the spouse entering the work force and may outweigh any marginal tax effect. Hence a decline in real after-tax male wages may be more important than the marginal tax rates applied to spouse income.

[61] The efficiency costs of income tested transfers are considerable. As Gary Burtless, 'The Economist's Lament: Public Assistance', *America Journal of Economic Perspectives* 4 (Winter 1990), p. 75, observes, statistical experience suggests that it can be expensive to taxpayers to raise the net incomes of the working age poor by $1. Thus programs such as additional family payment which depend on tax financed, income tested, transfers may involve larger losses of output than what is transferred to the recipients.

[62] Edwards, 'The Australian Tax Unit', p, 334 (see n.14), suggests that artificial income splitting should be treated as tax avoidance and legislated against. It is notable that from 1915 to the present no Government has been able to eliminate income splitting. There is a good reason for this. Rather than income splitting being described as artificial, the tax system is artificial in ignoring the reality of income sharing within families. Income splitting arrangements for tax purposes may then be seen as simply a means of self help by taxpayers to achieve a more equitable tax system. It is certainly illogical to argue that the individual should be the tax unit and then start attacking certain classes of taxpayers (for example, children) on the ground that their individual incomes do not fully reflect ability to pay tax because they enjoy income support from other family members.

Professor Parsons, *Asprey Proposals for Family Unit Taxation*, p. 7 (see n.6), observes that attempts to stop income splitting are inevitably illogical, because there will be many forms of property income arising between family members which cannot be described as the product of 'income splitting'. Professor Parsons (p 8) also notes that proponents of pure individual personal taxation, to be consistent, ought to have no objections to income splitting. He observes that one should not seek to tax someone who was once entitled simply because he was once entitled if he is no longer entitled. He goes on to observe that those who are opposed to income splitting are, in effect, suggesting that a person's liability to tax should not only reflect his own income but also the income of others with whom he shares. Hence opponents of income splitting are implicitly accepting that ability to pay has to take into account family income transfers. A similar inconsistency was observed among those who suggested that income sharing cannot be assumed within families and yet proceeded to describe the withdrawal of a spouse rebate from the husband on the basis of the wife's earnings, as a tax on the wife's earnings.

The Commonwealth Treasury, 'Personal Income Tax: The Tax Unit', *Treasury Taxation Paper* No. 6 (Canberra: Commonwealth Treasury, October 1974), p. 6, observes that wage and salary earners could not split their incomes for tax purposes but taxpayers with large amounts of business or property income could do so fairly readily. This equity problem remains unresolved. In strict logic it can only be resolved in two ways. Either income splitting can be eliminated or the tax system can recognise income transfers by all taxpayers to family members. Given the conspicuous failure of successive attempts to eliminate income splitting since 1915 and the knowledge that the only method of doing so (namely total aggregation of all family incomes and their taxation as the income of one individual) is manifestly inequitable, some may argue it is time to look at alternatives.

[63] Brazer, 'Income Tax Treatment of the Family', acknowledges that ignoring income sharing within families in respect of wage income while allowing the transfer of property income creates clear horizontal inequity (pp 242-243). He observes that this major problem with inequity (which Australia faces) is not satisfactorily solved by the British practice of taxing all of the couple's property income to the husband. He admits to having no solution for this basic horizontal equity problem.

[64] The fringe benefits tax exemption for employer-funded childcare is equivalent to childcare tax deductibility being provided on top of cash childcare benefits.

The Centre for Independent Studies

THE CENTRE FOR INDEPENDENT STUDIES is a non-profit, public policy research institute. Its major concern is with the principles and conditions underlying an open society with a particular focus on Australia and New Zealand. The Centre is actively engaged in support of an enterprise economy and a free society under limited government and deals broadly with social, economic and foreign policy.

The Centre meets the need for informed debate on issues of importance to democratic society in which individuals and business can flourish. In encouraging competition in ideas, The Centre for Independent Studies activities include:

- research
- lectures, seminars and policy forums
- publishing books and papers
- issuing a quarterly magazine, **POLICY**

For more information about CIS or to become a member, please contact us:

PO Box 92, St Leonards,
NSW 1590 Australia
Ph: +61 2 9438 4377
Fax: +61 2 9439 7310

PO Box 5529, Lambton Quay,
3785, New Zealand
Ph: +64 4 499 5861
Fax: +64 4 499 5940

Email: cis@cis.org.au

Council of Academic Advisers

Professor Ray Ball
Professor Jeff Bennett
Professor Geoffrey Brennan
Professor Lauchlan Chipman
Professor Kenneth Clements
Professor David Emanuel
Professor Ian Harper
Professor Max Hartwell
Professor Warren Hogan
Professor Helen Hughes
Professor Wolfgang Kasper
Professor Chandran Kukathas
Professor Kenneth Minogue
Professor R.R. Officer
Professor Suri Ratnapala
Professor Steven Schwartz
Professor Judith Sloan
Professor Peter Swan
Professor Geoffrey de Q. Walker

www.cis.org.au

About the Author

Dr Terry Dwyer B.A. (Hons), B.Ec. (Hons), M.A., Ph.D. (Harvard), Dip. Law. (Sydney) is a Visiting Fellow at the National Centre for Development Studies, Asia Pacific School of Economics and Government, Australian National University. His PhD thesis was on the history of the theory of land value taxation. He has advised Australian and overseas governments, Parliamentarians, businesses, charities and individuals on economic, taxation and regulatory issues since returning to Australia in 1980. His wife, Deborah, has a B.A. (cum laude) and an M.A. from Smith College, an LL.B. from ANU and a Masters degree in Comparative Law. They have six children and are self-employed in their Canberra consulting firm, Dwyer Partners.

CIS Policy Monograph • PM61 • ISSN: 0158 1260 • ISBN: 1 86432 086 9 • AU$9.95

Published March 2004 by The Centre for Independent Studies Limited. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers.
© 2004. The Centre for Independent Studies
This publication is available from The Centre for Independent Studies.
PO Box 92, St Leonards, NSW 1590 Australia • p: +61 2 9438 4377 | f: +61 2 9439 7310 | e: cis@cis.org.au
www.cis.org.au

www.cis.org.au