

CHiLD POVERTY ACTION GROUP

Child Poverty Action Group

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Income Splitting

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Child Poverty Action Group formed in 1994 because of profound concern that poverty among families is endemic in Aotearoa-New Zealand and becoming increasingly intractable.

The aim of our organisation is the development and promotion of better policies for children and young people.

Child Poverty Action Group comprises a group of academics and workers in the fields dedicated to achieving better outcomes for children. We represent a wide network, and our backgrounders and monographs are widely read and distributed. Our reports *Left behind: How social and income inequalities damage our children* (2008) and *Our children: The priority for policy* (2001 & 2003) can be found with other background material at our web site www.cpag.org.nz.

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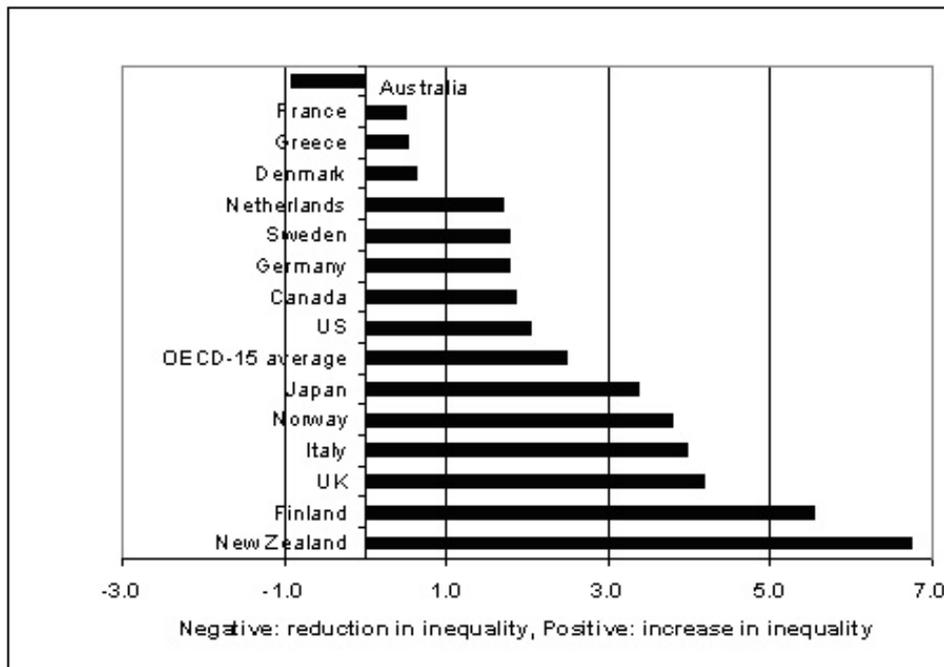
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We wish to be heard in support of this submission.

Introduction

[1] Between 1982 And 2000 New Zealand experienced the fastest growing income gap in the OECD (Figure 1). There is now a significant body of research showing that, for children, relative income is as important as absolute income. Some researchers suggest that in the absence of absolute deprivation, relative income is one of the most important determinants of health and wellbeing (Wilkinson, 2005).

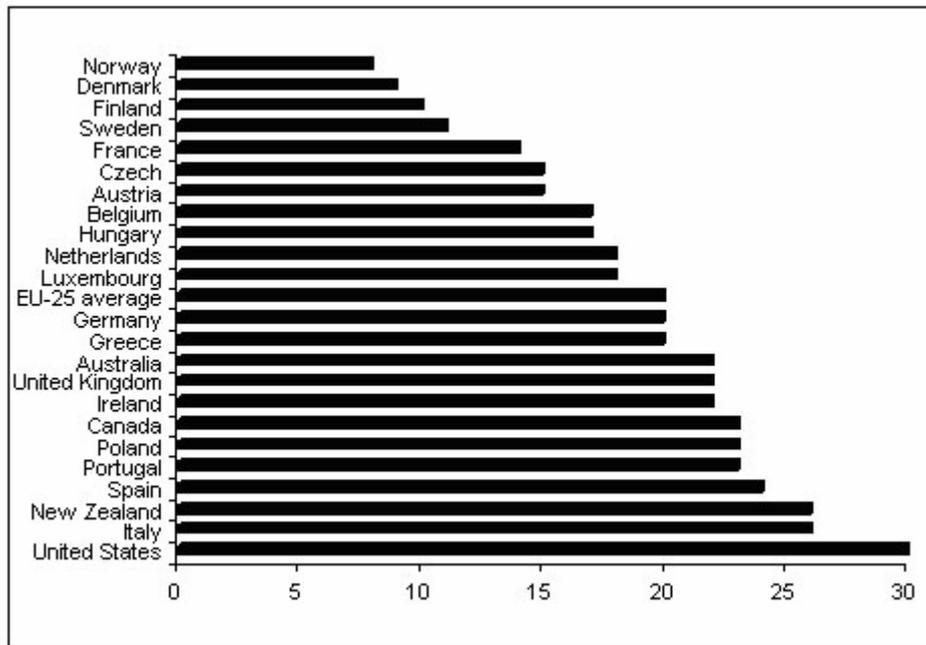
Figure 1: Changes to Gini coefficient for OECD-15 countries, mid 1980s-2000, disposable incomes



Source: OECD

The burden of the income disparity that now exists in New Zealand has fallen disproportionately on children, particularly children in sole parent households. Prior to the introduction of Working for Families in 2005 New Zealand's child poverty rate (60% of median household income) was one of the highest in the OECD (Figure 2).

Figure 2: Child poverty rates in the EU, US, Canada and Australia (%) ca 2003: 60% of before-housing-costs median income



Source: Ministry of Social Development

The negative social and economic consequences of New Zealand's income gap are wide-ranging. Consistent with the trends observed in other Anglo-Saxon economies children in low-income households are increasingly confined to low-decile neighbourhoods, often in overcrowded or substandard housing. New Zealand children have health outcomes among the worst in the developed world. Educational attainment is also influenced by socio-economic status. Maori and Pasifika students are over-represented at the bottom end of the scale, achieving significantly lower scores than the OECD average, and their Asian and Pakeha counterparts. Tellingly, a student's economic, social and cultural status has a greater effect on their academic performance in New Zealand than in any other OECD country (OECD, 2007, p. 192).

[2] Hence, it is for reasons of equity that Child Poverty Action Group does not support proposals to introduce income splitting as a means of assisting families with the costs of raising children. Income splitting is complex, and according to the discussion document will be expensive to introduce. With the greatest benefits going to those on the highest incomes CPAG believes this cost and complexity cannot be justified.

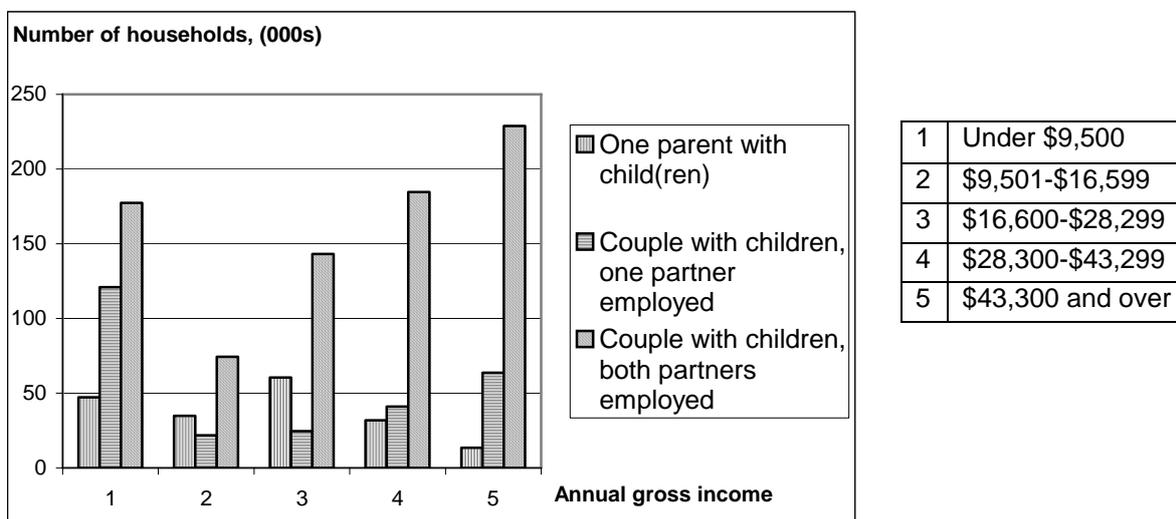
Income splitting: Not a common sense approach to child poverty

[3] Income splitting has been proposed as a way of ensuring that the tax system takes account of the costs involved in raising children. Income splitting would allow single-income families to treat their joint income as if it had been earned equally between the two partners, and thus pay less tax. For example, a family with an income of \$60,000 from one income, with a non-working partner and two children, currently pays \$15,435 tax.¹ Under income splitting, the \$60,000 would be treated as two incomes of \$30,000, with a total tax bill of \$12,218, a saving of \$3,217 per year.

[4] CPAG supports the stated policy aim of recognising the costs involved in raising children and assisting single income families and/or making it easier for one parent to remain at home. There are, however, two reasons to suppose that income splitting will do little to alleviate child poverty, while advantaging the highest income groups the most.

[5] Clearly, a key assumption is that children are growing up in families with two parents, only one of whom is employed. Yet, as Figure 3 clearly shows, this type of household is a minority. The greatest number of households with children have two employed parents. While income splitting may benefit couples with disparate earnings, it will not improve incomes where the partners' earnings are equal or approximately equal. Most importantly, it will do nothing to assist single parent households, and it is single parent households that are most likely to be in hardship.

Figure 3: Households with children by type and income



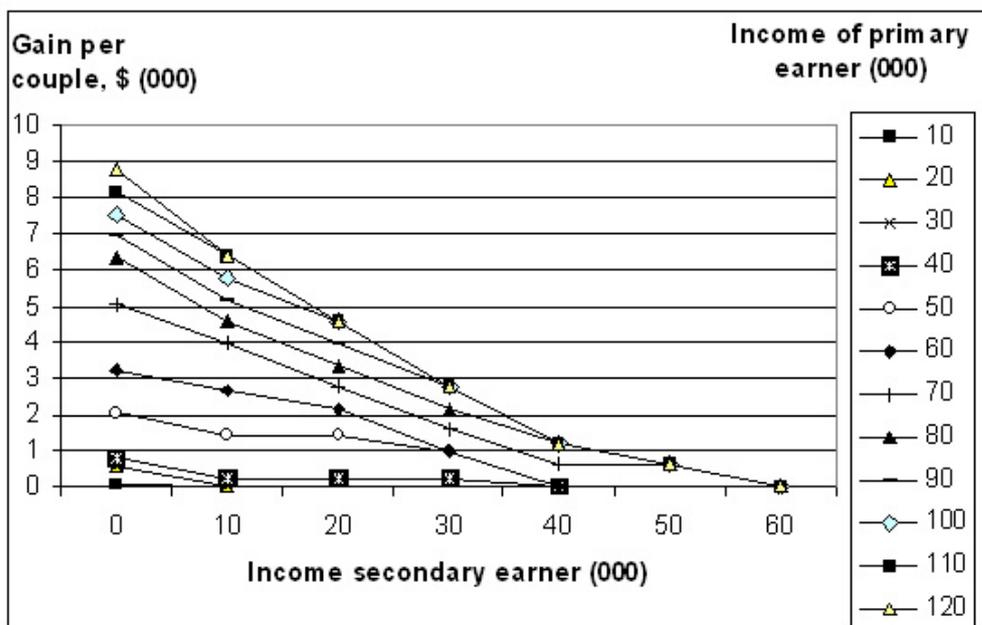
Source: Statistics New Zealand Household Economic Survey, 2004.

¹ All figures exclude family assistance for the sake of simplicity.

[6] Approximately 30% of New Zealand children live in sole-parent households so will receive no benefit at all from income splitting, whether their parents are in paid work or not. Of these children some 160,000 are in families with benefit income. According to the Ministry of Social Development, in cases where beneficiary families have no market income they may be struggling below the “very stringent 40% after housing costs poverty line” (Ministry of Social Development, 2007). It is this poorest group of households that face the greatest need but, as with other recent initiatives in the tax and social assistance arenas, stand to gain the least. Rather, this group risks being left even further behind if income splitting is implemented. Any policy purporting to address the additional costs of raising children must, in our view, address the needs of this group first.

[7] Income splitting has the potential to further contribute to New Zealand’s growing income inequality. As Figure 4 shows those on the highest incomes stand to gain the most. According to the 2007 Household Economic Survey (HES) (Statistics New Zealand, 2007) the median household income for 2006/07 was \$55,800. Figure 4 shows that at this level of income, assuming secondary earnings of zero, a couple with children stand to gain approximately \$3,000 per year. In contrast, a couple with primary earnings of \$120,000 with no secondary earnings gains \$8,730 – almost three times as much for a family on a little over twice the income. According to the 2007 HES only a small minority of children are in families in this upper income bracket, and virtually no sole parents. In other words, income splitting would favour only those children with parents able to conform to an artificially narrow, ideologically-driven construction of ‘family’.

Figure 4: Gains from income splitting, \$ per annum



Source: Inland Revenue (2008)

[8] According to the discussion document the single biggest group of beneficiaries of the income-splitting proposal would be couples where the primary earner earned \$60-70,000 and the secondary earner earned \$0-10,000. This group stands to gain \$37 million, yet comprises only 4% of couples. The largest single group of couples has primary earnings of \$50-60,000 and secondary earnings of \$10-20,000, yet stands to gain a rather more modest estimated \$18 million.

[9] It is difficult to avoid the conclusion that income splitting will act as a significant tax break for those in households with a high-earning primary breadwinner and a non-working partner. In households where the partners earn similar money income splitting is of no help, as evidenced by the data supplied in the discussion document. It is of course arguable that the benefits derived from income splitting would allow one half of a couple to give up work. While CPAG endorses the principle that parents should be supported to care for their children, it is inequitable that sole parents on benefits continue to be harassed into work regardless of their circumstances while the luxury of a well supported stay-at-home parent is available only to couples on relatively high incomes.

[10] CPAG is also concerned that it appears income splitting will be “very expensive” to implement and administer. On top of the family support delivered through Working for Families (WFF) and the tax cuts delivered in the 2008 budget, it is difficult to see how this policy can be implemented without cuts to the incomes of more vulnerable families or cuts to social services especially if, as predicted, the economy slides into recession. The idea that low-income families and those on benefits must bear the brunt of redistribution, the benefits of which will largely be enjoyed by a select minority, cuts across any concept of social justice or equity.

Alternative ways to help families with the cost of raising children

[11] The 2004 WFF package delivered substantial child-related assistance to low- and middle-income working families. For those families who were eligible the In-Work Tax Credit has been a welcome income boost. However it too was unavailable to families in receipt of social assistance, although it is available to superannuitants and families in receipt of a Veterans Pension so long as they meet the worktest. The IWTC is worth \$60 per week for families with up to three children and an additional \$15 per week per child thereafter. The threshold for abatement was raised in 2005 so IWTC does not start abating until joint parental income is \$35,000.

[12] The IWTC is flawed in a number of respects, but the key problem is that it attempts to combine assistance for the costs of raising children with a work incentive. CPAG has argued that it discriminates on the basis of work status, and that this child-related assistance should be available to all low-income families regardless of the source of family income.

[13] As noted earlier it is families on benefits with the lowest incomes that presently have the greatest need for assistance with the costs of bringing up their

children. CPAG strongly urges that the focus of social assistance shift to the needs of these children, and that we return to the principle of treating all low-income children the same. To this end we would support extending the \$60 per IWTC to all low-income families with children regardless of their parents' circumstances as a real and substantial means of assisting all low-income families with the cost of raising their children.

Conclusion

[14] New Zealand's income distribution is now more unequal than almost any other country in the OECD. While it remains more equal than that of the U.S. CPAG suggests this is not a goal to aspire to. Recent changes to social assistance and the tax regime have favoured working families and higher income earners at the expense of beneficiary families. It is these families that have the greatest need of financial assistance. Children in sole parent families, the group most likely to be under financial stress, gain nothing from this proposal. Moreover, by favouring higher-income couples, it risks further opening the gap between New Zealand's most vulnerable families and the rest.

[15] Given the substantial evidence about the personal and social costs of social and economic inequality it is remarkable that income splitting continues to occupy policy space, especially given the skewed nature of the likely benefits. Income splitting ignores the plight of New Zealand's poorest children, and in effect acts as a reward for complying with a somewhat dated notion of an ideal family type. For equity reasons CPAG believes child-related assistance must be targeted first and foremost at the most needy. Income splitting does not attempt to do this and therefore CPAG cannot support it.

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