Reforming the Personal Income Tax and the Family Allowance in Italy: a Proposal

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Abstract

We illustrate a proposal to reform the personal income tax and the family allowance in Italy which aims at attaining a fair tax treatment of the family, laying emphasis on the redistributive processes in favour of large and poor households. Our proposal is based on a simplification of the tax rate schedule (with a reduction of income brackets) and a new design of the tax credits for dependents which implies the fiscal exemption of a sort of basic income, which is decreasing as the income of the household increases. The new scheme of supplementary tax credits for dependents, related to family income thresholds, would match the need to keep into account the economic conditions of the household with the need to avoid the abandonment of the definition of ability to pay on individual basis. The proposal also aims at attaining a closer integration between the personal income taxation and the family allowance, with a sizable revaluation of the amount of family allowances and its extension to self-employee. The distributional analysis, using the tax-benefit model DIRIMOD, shows a slight revenue loss and a significant increase, with respect to the 1995 system, in both the progressivity and the redistributive impact of the income tax. The distributional effects are even stronger if we keep into consideration the reformed system of family allowances.

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1. Introduction

This paper illustrates a reform proposal of the personal income tax (*IRPEF*) and the family allowance (*assegno al nucleo familiare*) which aims at attaining a fair tax treatment of the family, laying emphasis on the redistributive processes in favour of large and poor families.

Among the major shortcomings of Italy's redistributive policies there are definitely those that are a result of the failure to consider the economic conditions of the family in the assessment of personal tax, as well as those that are a result of the increasingly more limited role played by the family allowance institute[1]. Quite naturally, a proper solution of these problems may not leave aside different aspects, including such requisites as the equity and neutrality of taxation with respect to an efficient allocation of resources; the coordination of personal income tax with schedular tax regimes relating to special categories; the simplification and transparency of the tax system; the elimination of unjustifiable discriminations among various categories of taxpayers and/or beneficiaries. These objects shall be taken into account by incorporating some of the issues that emerged from the debate on the reform of personal income taxation[2]. However, the core aspect of our proposal relates to the tax treatment of the family, as we believe that it is the preliminary issue to be solved. This is also due to the fact that the current system features some extremely striking gaps in the scheme of tax reliefs for dependents.

2. Personal taxation and economic conditions of the family

The economic conditions of the family may affect the personal income tax assessment to a considerable extent, whether directly or indirectly. They have a direct influence whenever it is the family, rather that the individual, to be selected as the tax unit and, therefore, the tax base coincides with the aggregated income of the family[3].

[1] See Franco, Sartor (1990) for a systematic analysis of the problems related to the tax/benefit treatment of the family, as well as for an evaluation of the Italian experience.

[2] See Messere (1993) and Sandford (1993) with respect to the international reform process of the 1980s. See Cnossen, Messere (1990) and McLure, Zodrow (1993) for an accurate synthesis of the theoretical debate that steered that process; for a critical review of the reform prospects in the Italian system see Bernardi (1989) and Visco (1992). As for specific proposals for the reform of the personal income tax in Italy, see the scheme devised by V. Visco (1988) and the more recent proposal included in the Tremonti White Paper. The preparatory studies for the implementation of such a reform, coordinated by L. Bernardi, have now been published in a monographic dossier in *Rivista di diritto finanziario e scienza delle finanze:* see Bernardi (1995). A synthesis of the main comments on the IRPEF reform proposal that was put forward in the Tremonti White Paper is included in Toso (1995).

[3] This is the system in force in some leading Western countries, such as the USA and France, which adopt the income splitting and the family quotient system, respectively. An authoritative support to the selection of a family-based tax unit is provided by the Carter Report, which marked a significant turn in the history of tax reforms giving practical implementation to the concept of comprehensive income [see the Royal Commission on Taxation (1966), vol. III, part A]. The joint taxation system was in force in Italy for quite a time, both at central government level, through the *Imposta complementare* introduced in 1923, and the personal income tax (IRPEF) in its initial application, before the ruling no. 176/76 sanctioned its unconstitutionality (see paragraph 5), and at local level, through the *Imposta di*

Within the context of an individual-based tax system, they have an indirect influence as one needs to take into account how the taxpayer's ability to pay is affected by its family situation.

Insofar as the choice between an individual and a family basis is concerned, the arguments that may make a solution preferable to the other crucially depend on the choice of objectives assigned to taxation, dealing with a series of aspects (equity, efficiency and administrative costs). It should be pointed out that, as a general rule, it is neither adopting extreme solutions (individual or family taxation) nor selecting likely combinations of these two criteria that one may come to a solution that univocally prevails over all the others. Therefore, the problem cannot be solved without a proper arrangement of the virtually pursuable objectives.

For instance, should the requirements of taxation include its neutrality with respect to the choice of marrying, it is obvious that while the choice of an individual basis reaches this object, the family solution does not. We get to the same conclusion when the requirement is stated in terms of the absence of any disincentive for either spouse to enter the labor market. On the other hand, if we promote the object of avoiding any discrimination of the overall tax burden of families with different individual income compositions, being the family income equal, it is obvious that the family taxation is to be preferred. Hence, it is unavoidable that a choice be made among likely objectives or, at least, their respective degrees of implementation.

In any event, income taxation must definitely take the economic conditions of the family into consideration, at least -as previously pointed out- on account of the fact that the latter affect the individual situation. This leads quite often to the adoption of systems that somehow mediate between the solutions founded on the individual and family basis. The most commonly used systems entail tax reliefs for dependents, splitting and family quotient[4] methods.

The tax credit for dependents granted to a single recipient is a method that is consistent with a definition of ability to pay on a strictly individual basis. It is the method adopted by our personal taxation system and, further to the suppression of the principle of income aggregation of spouses which characterized the initial phase of the

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famiglia. See the lucid remarks by C. Cosciani (1991, pp. 258-268) on the justifications of a joint taxation system. As a matter of pure curiosity, as proof of how natural it was to take as the tax reference the aggregated income of those living under the same roof rather than the individual sources of income, we should recall that in the original Meda reform project of 1919, the tax unit of the personal tax was extended to household members as a whole, "provided that they shared work and the fruition of assets, income and profits of any type whatsoever" rather than limiting it to the legal family. Such a formulation was abandoned in the De Stefani decree-law, where the concept of family was limited to the householder and "those persons who, being bound to the taxpayer by ties of relationship or affinity, are entitled to maintenance in pursuance of the provisions of the Civil Code and there is evidence that they exercise such a right". As regards this subject, see L. Einaudi (1932, p. 145 onwards).

[4] With the income splitting the sum of family incomes is imputed for tax purposes half to one spouse and half to the other, regardless of the share contributed by each spouse to the overall family income. The family quotient is a sort of per capita splitting revised for family needs. In fact, the formal rate scale is applied to the family income after being divided by a number (the quotient) which is equal to the sum of weights attributed to each family member. Once the basic tax is calculated, it is multiplied by the quotient itself in order to determine the total tax amount owing by the family.

tax application, is also the only tool for keeping into account the taxpayer's family situation. It should be borne in mind that the tax reforms of the 1980s led in most cases to an abandonment of family taxation in favor of individual-based systems[5].

Even accepting the concept of ability to pay on an individual basis, it would seem that one of the limitations of this method, from the point of view of equity, is that it neglects the fact that the extent to which the presence of dependents limits the economic means of the individual taxpayer depends in practice on the economic conditions of the family *as a whole*. This becomes particularly evident when the spouses have limited means and the entire income from all the recipients is assigned to expenditures that are to guarantee the survival of the household members.

The family quotient is not hindered by such a limitation. However, in assessing the tax according to an equivalence scale that keeps into account the needs of families having a different composition, this method is generally founded on the legitimacy of effecting a transition from a structure of individual preferences to one of familiar preferences that, from a methodological viewpoint, may appear rather questionable[6]. Furthermore, within the context of a personal conception of welfare and ability to pay, it is unquestionable that the most macroscopic limitation of the family quotient system is the fact that it entails tax cuts that may increase as the income of family members increases and, therefore, it seems more consistent with policies of demographic growth rather than with policies aimed to fight poverty.

The recourse to equivalence scales would seem to be a suitable means for defining poverty thresholds depending on household composition. If the family income is below these values, the taxation should be annulled, regardless of its apportionment among individual recipients, as it is clear that -being this the case- each individual income would be destined for the survival of the family. In other words, this would entail that the family should be entitled to a sort of fully tax-exempted basic income destined to guarantee the mere survival of its members.

As a general rule, this exemption threshold should be guaranteed -regardless of the income level of the recipients- through a system of abatements at the tax base, the amount of which should be measured against the needs of the family which may vary in relation to the various family typologies[7].

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[5] This was the case of Finland, Iceland, Great Britain, Belgium and Spain, in the end of the 1970s. The individual taxation principle is currently in force in over half of the OECD and European countries, with only a minority choosing the family as the tax unit (France, Luxembourg, Switzerland, Portugal and the United States) or allowing the possibility of opting for one or the other system (Germany, Ireland, and Norway). As regards this subject, see Messere (1993), pp. 248-162, and Oecd (1993).

[6] See Longobardi, Patrizii (1993, pp. 195-199) for a review of the conditions that are necessary to insure that family welfare can be used as an indicator of the welfare of its members. See Patrizii, Rossi (1991, chapter 2) for a conceptual analysis of the equivalence scales as indicators of family welfare.

[7] Having defined the family income threshold below which the tax exemption should be guaranteed and assuming that the definition of fiscal family is to apply only to married couples with minor children, the system of taxation on an individual basis could be implemented in practice as follows. Considering a one-earner family, the lump-sum exempt amount equal to the total basic income is deducted from the taxable base of the single recipient. Considering a two-earners family, the lump-sum exempt amount is divided in equal parts between husband and wife and, when filing

A more selective system might be founded on the logic of concentrating tax expenditures to a greater extent on individuals living in poor households, granting only partial tax cuts to those who are better off, within a context of a system acknowledging family maintenance costs which are decreasing as income increases. The choice of a more selective type of action may be warranted by the need to comply with strict public budget constraints without having to resort to exceedingly high increases in marginal tax rates which could give rise to disincentive effects on labour supply.

This is the rationale of the proposal being examined which, by pursuing objectives that may be concretely attained, aims at avoiding any exceedingly extensive breach with respect to the current system.

However, the pursuit of a redistribution in favour of needy families may make it advisable to resort to means other than tax reliefs. The recourse to other means, namely family allowances, can be justified by a number of reasons. Firstly, at moderate income levels, the extent of any relief granted through tax credits is limited by the amount of the tax itself which should be levied. Secondly, the tax cut does not bridge the likely gap between the taxpayer's income and the basic income that may be deemed advisable to guarantee to the family. Thirdly, the extent of the redistribution attained by the tax system in favor of large families may be considered insufficient even at higher income levels, given the partial nature of the acknowledgment of family maintenance costs which decreases as income increases, in relation to the impossibility of fully burdening the public budget with these costs. Hence, it might be advisable to integrate the distributive effects attained through the tax system with more powerful family allowances.

3. The reform proposal

The income tax reform being proposed is based on the assumptions and the purposes outlined below:

a) to maintain the central position of IRPEF in pursuing redistributive objectives without any relevant revenue loss;
b) to do away with the disincentive effects originating from an exceedingly complex structure of marginal rates;
c) to extend tax credits, directing the resources especially toward the poor families;
d) to integrate the redistributive role of the personal income tax with that one of the family allowance.

In order to attain these objects, we suggest the following changes:

1. reduction in the number of brackets as well as the range of tax rates;

their joint income returns, either one of the recipient is allowed to deduct, in addition to his/her own exempt amount, any amount in excess of the deductible amount of the other recipient with respect to her/his taxable income.

2. strengthening the role of tax credits to a considerable extent;
3. sizable appreciation of family allowances and their extension to self-employee.

1) reduction in the number of brackets

According to our proposal, the structure should move from the current seven brackets to four brackets, as shown in table 1.

Table 1 - Rate schedule in the current system and in the reform proposal

current income brackets (million Lire)	new income brackets (million Lire)	current tax rates	new tax rates	difference
0- 7,2	0-15	10%	20%	+ 10%
7,2- 14,4		22%		- 2%
14,4-15		27%		- 7%
15-30	15-30	27%	27%	--
30-60	30-60	34%	35%	+ 1%
60-150	>60	41%	42%	+ 1%
150-300		46%		- 4%
>300		51%		- 9%

The minimum rate increase is founded on a dual consideration. On the one hand, the sizeable appreciation of the role of tax credits to discriminate taxpayers on the basis of the economic conditions of their families allows a suitable graduation of the actual marginal rates notwithstanding the presence of a minimum rate that is considerably higher than the one currently applied. On the other hand, it may prove useful for a coordination with the schedular systems to be applied to capital income, even in view of a tax harmonization with the systems in force in other European countries.

The maximum rate reduction may limit disincentive effects, if any, on the labor market without any relevant revenue loss given the scarce density of the taxpayers to which such a reduction applies[8].

The considerable reduction in the difference between minimum and maximum rate is conducive to a potential reduction of the disparity of treatment of one-earner families with respect to two-earner families. In fact, according to our proposal, the maximum to minimum rate ratio drops from 5.1 to 2.1.

2) strengthening the role of tax credits

With reference to the tax reliefs for dependents that were already provided by the 1995 tax system, regardless of income limits, it is our opinion that they should be maintained in the reformed system, even though they should be suitably appraised.

[8] A representative sample of the 1993 income tax returns seems to point out that the density of taxpayers with a total taxable income in excess of 150 million Lire is merely 0.8 per cent of the total (Herr, 1995).

We are suggesting a slight revaluation of the tax credit for a dependent spouse with respect to the 1995 system, and a much more sizable appraisal of the tax credit for dependent children. The former should be raised from the current 818,000 to 1,000,000 Lire; the latter from 94,000 to 250,000 Lire.

Notwithstanding the reduction in the rate scale with respect to the current one, the limited extent of the increase in the tax credit for a dependent spouse does not do away with the differences in tax treatment between one-earner and two-earner couples, but for moderate income levels or very slight tax base differences among husband and wife. In our opinion, a less onerous tax treatment for two-earners couple is justified by a few objective disadvantages that the latter has with respect to one-earner couple, as it bears costs for the production of the second income, as well as the relative work effort, which are not suitably recognized from the tax system.

Besides, if the selected approach aims at discriminating in a right way the tax treatment of different family units, we are convinced that it is quite meaningless to differentiate two-earner from one-earner couples, but indeed one should differentiate within the context of one-earner couples whether the lack of a second source of income is occasioned by involuntary unemployment or the free choice of the individual. These are the reasons why we deem that the situation of one-earner couples should be protected, especially when it is characterized by a state of poverty, in line with the rationale of the introduction of further tax credits as outlined below.

The increase in the tax credits for dependent children pursues the object of keeping into account -and not merely in a symbolic manner- the costs for their maintenance. As previously pointed out, the proposed system substitutes for an ideal system of tax allowances to an extent equal to a minimum income that is the same for all taxpayers, as the latter would end up being too costly in terms of revenue loss. An appreciation in excess of 150% in the current tax credits is designed to bridge, in an however partial but significant manner, the gap with respect to that system.

The method of tax credits is founded on the logic of granting implicit deductions from income subject to tax, which decrease as income increases, in compliance with a principle of social solidarity that legitimizes a progressive reduction in the tax relief granted to families as their economic means increase.

Our proposal provides for a second type of tax credits which, indeed, characterizes it: additional reliefs should be introduced in support of poor families. This measure aims at acknowledging the right of indigent persons to adequate reliefs in order to avoid that taxation might cause them to fall below a poverty threshold, in line with the previously illustrated criterion of the basic income. Such additional tax credits should amount to 550,000 Lire per capita for taxpayers belonging to families with 1 or 2 members whose family income amounts to less than 10.9 and 19.5 million Lire, respectively. An additional tax credit is also awarded for dependent children in the amount of Lit. 300,000 per child if the family income is below the following thresholds (in million Lire): 26.1, 31.9, 37.2, 42, and 47 for families with 1, 2, 3, 4, 5 or more children, respectively[9]. In the event of one-earner families, the single recipient is recognized twice the extent of all the tax credits for dependent children, as well as the further per capita tax credit of Lit. 550,000 granted to married couples whose income is below 19.5 million Lire.

As far as the other standard tax reliefs are concerned, we suggest to maintain a lump sum tax credit for work-related expenses in favour of dependent workers, and to raise its amount from 785,000 to 1,350,000 Lire in order to take the new rate scale into consideration. Such a tax credit has no qualitative discrimination purposes as it offsets the impossibility of deducting cost items that are instead deductible on an analytical basis from self-employment and business income.

On the contrary, we deem advisable to do away with the current system of additional tax credits for workers in dependent employment and self-employed workers. In fact, beside being inconsistent with our logic of defining family rather than individual poverty thresholds, such a system features a number of irrational aspects on account of at least two reasons. Firstly, it defines the income limits to which the recognition of the tax relief is subordinated with reference to separate sources of income. This is definitely in conflict with the most elementary principles of progressivity. Secondly, it discriminates between dependent employment and self-employment in the definition of both the extent of any additional tax relief and the income limits it is subordinated to. This is in conflict with the general approach that characterizes our proposal.

3) *revaluation of family allowances*

In order to integrate the redistributive effects in favour of large and needy families, we are proposing to increase to a significant extent the family allowance through:

a) a sizable increase in favour of the current beneficiaries, that is the workers in dependent employment meeting given requirements with respect to income levels and family size;

b) the extension of such benefits to self-employed workers.

The need to increase the family allowance to a significant extent ensues from the ascertainment that such an institute entails benefits that are extremely limited in respect

[9] This additional tax credit is subordinated to income limits that identify thresholds of economic distress that correspond to the poverty line (defined according to international standards) increased by a 20 per cent figure. These thresholds are differentiated by family types on the basis of the equivalence scale used by the *Commissione di indagine sulla povertà e sull'emarginazione* (Commission of inquiry on poverty and deprivation). The equivalence scale adpteed by the Commission is founded on Engel's law which lays down that the consumer goods share of the expenditure destined for maintenance tends to reduce as the overall expenditure increases, as well as on the assumption that this share is a proper indicator of household welfare. Given this assumption, each value of the equivalence scale shows how much the overall expenditure should change in order that, as the household size change by a unit, the ratio of expenditure for foodstuffs to total expenditure, that is the household welfare, remains constant.

of both the other European countries and the past[10]. Suffice it to mention that, since the effective date of the family allowance regulations, we have witnessed a drop in absolute terms of the aggregate spending for this allowance from 6,400 billions in 1989 to 5,619 billions in 1994. This phenomenon was also occasioned by an extremely inadequate indexation system, as the latter is limited to the width of the family income brackets entitled to the allowance rather than being extended to the amounts of the allowance itself, which remained unchanged throughout that period, with a consequent progressive loss of its importance with respect to the amount of wages.

This tendency is due to a number of reasons, including the need to reduce the disparity of treatment in favour of dependent employment at a time when it was not at all easy to extend the system of allowances to additional categories. In fact, the shortcomings characterizing the assessment of income other than income from dependent employment and pensions could not guarantee that family allowances were granted only to those taxpayers in a state of actual need.

However, we believe that the objection raised with respect to an extension of the family allowance to self-employed workers is not an insurmountable obstacle, as the operation may be handled by two different administrations with separate funding. Indeed, we attach much importance to the extension of the family allowance to self-employed workers since in our proposal these allowances are no longer viewed as a defense of a given category, and they are to accomplish the more general function of supplementing the limited redistributive objectives that may be attained through income tax[11].

The establishment of a 60% revaluation of the allowance with respect to the 1994 system[12] meant to pursue the object of getting to an increase, however limited, of its amount in real terms as well as to a full recovery of the ground lost with respect to both the price index and the trend of wages[13]. It is unlikely that such an increase, as

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[10] The ratio of family allowance spending to gross domestic product dropped from 2.4% in 1960 to 0.3% in 1994. For a comprehensive view of the general problems and the specific inconsistencies of the current system of family allowances, introduced by the 1988 reform, see Franco, Sartor (1994).

[11] Quite recently, the Commission of inquiry on poverty and deprivation suggested an alternative proposal for reforming the family allowance institute. This proposal is characterized by the fact that the family allowance is turned into a child allowance which is extended to all the categories of workers within the context of a single contribution-handling administration. See Commissione di indagine sulla povertà e sull'emarginazione (1995). For an assessment of the redistributive effects of such a proposal, see Mantovani, Toso (1996).

[12] The 60% revaluation of the family allowance is net of the allowances in favour of household with minor children provided for by Law no. 451 of 1994 (a 20,000 Lire increase for each child, excluding the first one) and the Decree-Law no. 237 of 1995 (an 84,000 Lire increase for each child, excluding the first two). These provisions, which were meant to be initial measures in support of large and needy families, were followed by the Budget Law for 1996 which provided for a sizable family allowance increase (inclusive of the aforementioned 84,000 Lire allowance) approximating 1,900 billion Lire and a revaluation of IRPEF tax credits for one-earner families amounting to 900 billion Lire. The provisions for the current year include an increase (with decreasing step arrangement) in the IRPEF tax credit for dependent spouse for those having a taxable income below 100 millions, the extension of the allowance entitlement to families with three or more members and an income included in the two subsequent brackets with respect to those that are currently provided for, the increase in the amount of the allowance for households with at least four members and minor children, and a 25 per cent increase in the amount for one-parent households.

[13] From 1988 to 1995, the cost-of-living index for blue- and white-collar workers increased to 144.6, the index of actual wages for the economy as a whole to 149, and the index of industrial wages to 152.8. Therefore, it would seem

well as the extension of the benefit to self-employed workers, might be feasible without incurring in funding problems. As a matter of fact, there is no doubt that any increase in the provision has to be financed with a new levy as the sizable administration surplus was assigned to cover the social security deficit[14].

As we will later on see in paragraph 6, the measures we are proposing entail a spending increase close to 75% with respect to the 1995 spending. The higher spending is financed by contribution rate increases of 0.55 and 0.67% to be charged to workers in dependent employment and self-employed workers, respectively.

4. Role played by the new tax credits and the family allowance revaluation: an in-depth review

As previously pointed out, the system of tax credits provided for by the reform - and in particular, the introduction of additional tax credits for dependents living in poor families- is to guarantee significant exemption thresholds for the less well-to-do taxpayers whose income is destined for the most part for covering the costs incurred for the survival of family members.

We have also recalled that the revaluation of the tax credits for dependents aims at giving full recognition to the fact that the tax system takes into full consideration the issue of dependents, in terms of tax relief. However, out of respect for elementary principles of social solidarity, it was deemed advisable for the implicit tax allowances to decrease as income increases.

Besides, we have stressed that, within an individual approach to the concept of ability to pay, tax credits play an alternative role with respect to other methods which, designed to keep into due account the economic conditions of the family, apply when a family-based concept of ability to pay is adopted. In this paragraph we would like to provide some useful illustration of these two aspects.

Table 2 shows the tax base abatements equivalent to the tax credits[15] by the various income levels and the different family compositions, based on the assumption of a one-earner family, whose income recipient works in dependent employment. Acting on the same assumptions[16], table 3 shows the new amount of monetary support

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that the revaluation of the family allowance amount with respect to the level required in 1995 to maintain the purchasing power in real terms should be equal to 10.65%. A similar wage-related increase is set at 7.4% with respect to the national average and at 4.7% with respect to that of industry in a strict sense.

[14] This situation, which was also witnessed in the past, has been institutionalized with the reform of the public pension system. As a matter of fact, the 23rd paragraph of article 3 of law no. 335 of 1995 provides for a transfer of such a surplus to raise from 27% to 32% the rate of contribution to the Employee pension fund.

[15] The tax base abatements equivalent to the tax credits have been calculated by dividing the total amount of the tax credits (for work-related espenses and for dependents) either for the marginal tax rate of the corresponding income bracket or for appropriate averages between the latter and the inframarginal tax rates.

[16] We have assumed that the single recipient of income in the family is working in dependent employment. Nonetheless, it should be noted that in the event of a self-employed worker, the differences would be limited at a taxable income level of 10 million Lire, where tax credits would increase from 650 thousand to 2 million Lire. As a

to households, suitably broken down by tax credits for dependents and family allowances. Finally, table 4 compares income levels relating to the poverty threshold of families having different sizes, with income net of tax but before any monetary family support (tax credit + allowance) applicable at the various taxable income levels. In such a way, we meant to ascertain the suitability of our reform proposal for compensating the poverty gap, if any, that may be detected at the various taxable income levels for each household typology.

A joint reading of tables 2 and 4 may be expedient for a review of the major aspects of our reform proposal we are going to focus on.

A review of table 2 shows that the new tax credits system would entail a complete exemption for households with a taxable income of up to 15 million Lire, regardless of the household size. As for the income levels exceeding 15 million Lire, the implicit abatement made by the tax credits does not cover the entire taxable income for the household sizes taken into account. Considering a taxable income of 20 million Lire, it is equal to 68.4 and 77.5% for the two- and three-member household, respectively. However, a review of the data shown in table 4 allows to ascertain that, given the same taxable income value, the joint system of tax credits for dependents and family allowances does more than offsetting the poverty gap for married couples without children, while it offsets over three fourths of it in case of three member households. As for the families with more than a child, the taxable income is fully abated by the tax credits (see table 2), even though the overall system of reliefs presents a decreasing incidence with respect to the poverty gap, going down to 44.2% in case of couples with five children (see table 4).

Table 2 - Reform proposal: effects of tax credits in terms of implicit abatement of the tax base (one-earner households with householder in dependent employment), expressed in thousand Lire

	couples without children	couples with 1 child	couples with 2 children	couples with 3 children	couples with 4 children	couples with 5 children
taxable income	implicit abatement of taxable income					
10000	10000	10000	10000	10000	10000	10000
15000	15000	15000	15000	15000	15000	15000
20000	13675	15500	20000	20000	20000	20000
30000	8704	10556	17500	23000	28500	30000
40000	6714	8143	9571	11296	22037	26500
50000	6714	8143	9571	11296	12429	16587
60000	6714	8143	9571	11296	12429	13857
80000	5595	6786	7976	9167	10357	11548

matter of fact, since the lump-sum tax credits for work-related expenses are not applicable, the tax credits for dependents would apply to a greater extent and, in view of the moderate income level taken into consideration, they would compensate in full the gross tax.

100000	5595	6786	7976	9167	10357	11548
200000	5595	6786	7976	9167	10357	11548
500000	5595	6786	7976	9167	10357	11548

Table 3 - Reform proposal: support for dependents, in relation to the number of household members, by tax credits and family benefits, in one-earner households with householder in dependent employment (thousand Lire)

	couples without children		couples with 1 child		couples with 2 children		couples with 3 children		couples with 4 children		couples with 5 children	
taxable income	tax credit	family benefit	tax credit	family benefit	tax credit	family benefit	tax credit	family benefit	tax credit	family benefit	tax credit	family benefit
10000	650	1728	650	3072	650	4416	650	5760	650	7104	650	8448
20000	1735	1344	2100	2688	3000	3840	3000	5376	3000	6912	3000	8064
30000	1000	384	1500	1536	3200	2688	4300	4224	5400	6336	5700	7296
40000	1000		1500		2000	960	2500	2304	5400	5184	6500	5952
50000	1000		1500		2000		2500		3000	1920	4550	4416
60000	1000		1500		2000		2500		3000		3500	1920

Table 4 - Reform proposal: support for dependents and poverty gap in relation to the number of household members (one-earner households with householder in dependent employment) (thousand Lire)

Family type		Couple		C. with 1 child		C. with 2 children		C. with 3 children		C. with 4 children		C. with 5 children	
poverty line[a]		17498		23360		28557		33334		37621		42013	
taxable income	net income[b]	*poverty gap*	(1) + (2)	*poverty gap*	(1) + (2)	*poverty gap*	(1) + (2)	*poverty gap*	(1) + (2)	*poverty gap*	(1) + (2)	*poverty gap*	(1) + (2)
10000	9350	8148	2378 (29,2)[c]	14010	3722 (26,6)[c]	19207	5066 (26,4)[c]	23984	6410 (26,7)[c]	28271	7754 (27,4)[c]	32663	9098 (27,8)[c]
20000	17000	498	3079	6360	4788 (75,3)[c]	11557	6840 (59,2)[c]	16334	8376 (51,3)[c]	20621	9912 (48,1)[c]	25013	11064 (44,2)[c]
30000	24300	-6802	1384	-940	3036	4257	5888	9034	8524 (94,3)[c]	13321	11736 (88,1)[c]	17713	12996 (73,4)[c]
40000	30800	-13302	1000	-7440	1500	-2243	2960	2534	4804	6821	10584	11213	12452
50000	37300	-19802	1000	-13940	1500	-8743	2000	-3966	2500	321	4920	4713	8966
60000	43800	-26302	1000	-20440	1500	-15243	2000	-10466	2500	-6179	3000	-1787	5420

(a) The poverty line for the various family types is calculated on the basis of the Carbonaro equivalence scale
(b) Income net of tax and tax credit for work-related expenses, but exclusive of tax credits for dependents and family benefits
(c) Degree of coverage of poverty gap
(1) Tax credit for dependents
(2) Family allowance

The income fraction that is exempt owing to tax credits decreases to 29% for couples without children which have a taxable income of 30 million Lire. In this income bracket, a total exemption may only be found among families with seven members (see table 2). However, the joint system of tax credits for dependents and family allowances is effective in restoring economic conditions over the poverty threshold for families with less than five members. With respect to all the families with at least three children, the value of the poverty gap coverage coefficient remains quite high, in excess of 94 and 88% for families with five and six members, respectively, while it drops to 73.4% for families with seven members, in respect of which the tax credits have indeed the effect of cancelling the taxation in full. In income brackets in excess of 40 million Lire, the tax system before tax credits for dependents leaves the taxpayers above the poverty threshold in case of families with up to four members. For larger families we find once again a virtual poverty gap, but it is more than offset by the system of tax credits and benefits.

Assuming a taxable income that goes up to 50 million Lire, the same phenomenon appears in a more marked way, but only in respect of the last two family types taken into consideration (couples with at least 4 children).

Close to a taxable income of 60 million Lire, family allowances have no role at all (to the exclusion of couples with 5 children) and tax credits have an increasingly slighter role in determining exempt income fractions, owing to both income growth and a corresponding increase in the marginal tax rates. In fact, for an income close to 100 million Lire the rate of tax base implicit abatement drops to a mere 5.6% with respect to couples without children and 11.5% with respect to families with seven members. These figures drop to 1.1 and 2.3%, respectively, in case of taxable income levels of around 500 million Lire (see table 2).

The data shown in these three tables clearly stress how the new tax/benefit system, as suggested by the reform proposal, gives a particularly effective support to larger families in the lower income brackets, while this support becomes increasingly weaker as income grows, in line with the objects that the reform is striving to reach. In fact, while the reform aims at recognizing a considerable revaluation of the current monetary support in favour of all families, it does so with a logic of special effectiveness in the measures supporting needier ones.

As pointed out at the beginning of this paragraph, we are advocating a system of tax reliefs for dependents that relates to an individual-based tax system and, therefore, aims at keeping into account the economic conditions of poorer families through arrangements that differ from those peculiar to family-based tax systems. However, the horizontal and vertical equity effects of the reform may be appreciated even in terms of those systems and in particular in terms of family quotient.

Table 5 deals with the equivalence scales that are implicit in the IRPEF of the 1995 law and points to the weight ascribed by the legislator to such non-monetary characteristics as the household size with a view to determining the tax treatment of a family with one earner working in dependent employment[17].

Table 5 - Implicit equivalence scales in IRPEF (1995 system) for a one-earner family with householder in dependent employment*

income (million Lire)	effective average tax rate	single	couple without children	couple with 1 child	couple with 2 children	couple with 3 children	couple with 4 children	couple with 5 children
25	14,2	0,74	1	1,06	1,12	1,18	1,22	1,26
30	16,4	0,74	1	1,04	1,07	1,11	1,14	1,18
35	18,9	0,83	1	1,03	1,07	1,11	1,14	1,18
50	23,4	0,84	1	1,03	1,07	1,11	1,14	1,18
60	25,2	0,84	1	1,02	1,04	1,06	1,08	1,10
100	31,5	0,91	1	1,02	1,04	1,06	1,08	1,10

(*) Criterion of effective average tax rate parity. The family income on which the incidence is calculated is the income of the married couple with no children.

The little consideration paid to the presence of dependent children in the determination of the incidence on households with different size is immediately evident. In fact, the tax system treats in much the same way (in terms of effective average tax rate) a couple without children with an income of 25 million Lire and a family, let's say, with 3 dependents whose income is merely 18% higher than that of the couple with no children (therefore, equal to 29.5 million Lire) underestimating by far children maintenance costs.

The equivalence scale adopted by the Commission of inquiry on poverty and deprivation is a useful term of comparison to see how the system in force underestimates family needs, at different income levels. Being the number of household members equal, the scale values (that remain unchanged as income varies) show a particularly marked difference with respect to the implicit IRPEF values (see table 6).

Table 6 - Equivalence scale adopted by the Commission of inquiry on poverty and deprivation (Carbonaro scale)

number of household members	1	2	3	4	5	6	7
coefficient	0,6	1	1,33	1,63	1,90	2,15	2,40

[17] The implicit equivalence scale translates, in terms of monetary differences, a set of characteristics other than income which are ascribed an implicit relevance by the tax system in the assessment of the tax burden weighing on the different types of families. The calculation of the implicit scales in Table 5 is consistent with the horizontal equity criterion of the effective average tax rate parity (see Longobardi, Patrizii, 1993, pp. 202-210). The calculation method is as follows: given two families, A and B, with a different size but with the same monetary income, we have to estimate what would be the hypothetical income level of family A which would be subjected to the same effective average tax rate to which family B is subjected.

The system of additional tax credits for dependents that we are proposing is instead conceived in such a way that, for an equivalent family income equal to 22-25 million Lire of a childless couple (values that are just above the poverty threshold for this family type), the tax system reproduces an implicit equivalence scale quite similar to the Carbonaro scale (see table 7). Keeping to the previous numerical example, it may be noted that, further to the reform proposal, a family with three dependent children and an income of 29.5 million Lire would be burdened with a lower tax than that levied on a couple with no children and an income of 25 million Lire. An equal tax treatment in respect of the latter family type would be re-established at an income level for a 5-member family of 38.4 million Lire (see table 8).

Table 7 - Implicit equivalence scales in IRPEF reform proposal for a family with one-earner from dependent employment*

income (million Lire)	effective average tax rate	single	couple without children	couple with 1 child	couple with 2 children	couple with 3 children	couple with 4 children	couple with 5 children
21,5	11,19	0,71	1	1,23	1,50	1,74	1,96	2,19
25	13,40	0,71	1	1,15	1,33	1,54	1,73	1,93
30	15,67	0,71	1	1,09	1,17	1,31	1,48	1,65
35	18,43	0,80	1	1,09	1,17	1,26	1,34	1,47
40	20,50	0,83	1	1,09	1,17	1,26	1,34	1,43
50	23,40	0,83	1	1,09	1,17	1,24	1,29	1,34
60	25,34	0,83	1	1,05	1,10	1,15	1,20	1,25
100	32,00	0,90	1	1,05	1,10	1,15	1,20	1,25

(*) Criterion of effective average tax rate parity. The family income on which the incidence is calculated is the income of the married couple with no children.

The horizontal tax equity taken as the reference criterion (horizontal equity meant as effective average tax rate parity) features another interesting property: the implicit equivalence scale that results from the application of the aforementioned criterion coincides in full with the coefficients of the hypothetical family quotient which would lead to the same effects of the system in force in terms of tax treatment[18]. Therefore, it should be noted that, although our reform proposal does not give up a definition of ability to pay on an individual base, it simulates a family quotient system with variable coefficients whose weights seem to be substantially close -with respect to low income levels- to those of the reference equivalence scale (Carbonaro scale).

Quite naturally, having taken the road of lump-sum tax credits rather than tax credits growing with respect to income, the coefficients of the equivalence scales

[18] In fact, the equivalence scale which is implicit in a family quotient system is given directly by the coefficients of the quotient itself, as the application of this method implies the same effective average tax rate for families with different size whose incomes are bound by a relationship given by the values of the quotient itself.

implicit in the reform tend to move off more and more, as income increases, from those of the reference scale, causing the tax system to move progressively away from the scheme inherent in a family quotient system with fixed coefficients[19]. In concrete terms, this amounts to a sort of "calibration" of the reform proposal around family income levels that are just above the poverty line, and it is in their respect that the horizontal equity is satisfactorily ensured. In the light of the above consideration, this falls within the objects that we had in view for the reformed tax system which considers the reference to the family income justifiable only in respect of low and medium-low income levels, while a tax system based on more strictly individual criteria should be preferred in respect of higher incomes[20].

5. Income tax reform and constitutional law

There are a number of constraints that need to be considered in order to ascertain the feasibility of implementing a reform of the personal income taxation in relation to the tax treatment of the family. Some of the most pressing definitely result from a largely consolidated constitutional law which expressed itself through three rulings, namely no. 179 of 1976, no. 76 of 1983 and, more recently, no. 358 of 1995.

Starting from the first ruling, that did away with the joint taxation that had been provided for by the tax reform in pursuance of regulations introduced since 1958, the Court proposed a markedly individualist interpretation of the principle of ability to pay sanctioned by the first paragraph of article 53 of the Constitution.

Even though the Court recognized that cohabitation has an influence upon the ability to pay of both spouses owing to the reduction of overhead costs, cooperation and mutual assistance, it questioned "even on account of the large variety of possible hypotheses and concrete situations, that in all instances this influence leads to an increase in the ability to pay of the two subjects taken together". In different words, in the Court's interpretation, the addressee of article 53 which lays down that "all the people have to contribute to public spending in relation to their ability to pay" is no one else but the individual, rather than the family.

In the Court's reasoning, the aggregation of incomes of the spouses is justified only if it were one of the spouses to have the income of the other at his/her disposal, and not also when the incomes were at their joint disposal, thereby denying any systematic relevance to the family as a decision-taking unit on such matters as consumption, savings, and the spending for the maintenance and education of children.

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[19] As income increases, the weight of tax credits decreases. This leads to a lessening of the difference in the IRPEF incidence, being the monetary income equal and, consequently, also to a lessening of the difference among equivalent incomes and the income of the family which is taken as the numeraire.

[20] Finally, it should be noted that, notwithstanding the fact that the coefficients of the implicit equivalence scales move progressively closer as income increases, the values that are obtained with the reform in respect of incomes in the 60-100 million range point to a scale that is less flattened than the scale of the 1995 system in respect of incomes of 30 millions.

What follows from this premise is that the aggregation of incomes of the spouses is inevitably prejudicial to both the ability to pay principle, in relation to the fact that the income earned by the wife is not necessarily at the disposal of the husband, and the equity principle.

There is no doubt that the joint taxation determined distortions to the detriment of legal families and discouraged women from entering the labour market. Stressing how such a regulation was in conflict with the articles 29 and 31 of the Constitutions, the Court pointed to the need for a “moral and legal equality of spouses”, as well as the need to “facilitate through economic measures and other benefits the creation of families and the fulfillment of the relative tasks, with special regard to large families”.

At the same time, the Court pointed to the risk of the taxation of one-earner families where “it is not only the husband who has the income at his disposal, as it is at the disposal of both spouses”. Besides, the Court expressed its hope for more suitable regulations governing that matter and called upon the legislator to implement a tax system “facilitating the creation and development of the family and considering the position of the woman as a housewife and a worker”.

However, the attempt to give concrete implementation to the Court’s indications gives rise to problems that defy any easy solution just on account of the strictly individualist interpretation given by the Court to the concept of ability to pay. As a matter of fact, it is clear that it is indeed this interpretation that seriously hinders all those joint taxation systems, such as the family quotient and the income splitting, that presuppose a reference to a family-based concept of ability to pay.

The issue of the fiscal discrimination of one-earner and large families was brought up again in some recent judgments. The Court reaffirmed with even greater emphasis the need to find a solution to this problem, even though it could not allow the objections of unconstitutionality raised as regards this subject just on account of the fact that ruling no. 179 had done away with the legal presuppositions for their recognition.

In any event, we have no intention to enter into the merits of constitutional law on the matter of the tax treatment of the family[21]. What interest us is more simply to verify whether our reform proposal, founded on the criteria described in paragraph 2, is susceptible of objections as to its constitutionality.

Firstly, the concept of ability to pay is defined on a strictly individual basis, as it is at the level of individual incomes that both the rate scale and the tax credits apply. The family income is only relevant for defining that individual condition of economic distress to which the application of the system of additional tax credits is subordinated. As regards this subject, it may be noted that the conditions of economic distress of a household fall within those instances where the bonds of solidarity among spouses for the maintenance of their children make it absolutely reasonable to prospect an

[21] On this subject, see the lucid remarks made by F. Gallo (1977) and E. De Mita (1976) on the ruling no. 179/76. As for the recent ruling no. 358 of July 1995, De Mita’s comments (1995a, 1995b) appear extremely convincing.

economic unity of the family. Besides, such conditions seem relevant for the sole purpose of allowing additional tax reliefs that are granted on an individual basis. Therefore, this measure may indeed be viewed as one of the possible concrete ways to safeguard the development of the family with reference to article 31.

Secondly, the limited increase in the tax credit for the dependent spouse and the flattening out of the rate scale objectively appear to be re-equalizing measures in favour of one-earner families and this fact was stressed, even quite recently, by the constitutional Court notwithstanding the fact that its interpretation on a strictly individual basis of the concept of ability to pay makes a comparison between one-earner and two-earner families quite meaningless, *being family income equal*. In any event, the additional tax credits (for dependent children) anchored to a condition of family poverty operate in an indirect manner mostly in defense of one-earner families as the presence of a single income makes it more likely for a situation of poverty to occur and this is the condition for granting reliefs.

Finally, the sizable appreciation of the tax credits for dependents, which was made even greater in respect of poor families, aims at reducing if not even at cancelling the disparities of treatment to the detriment of large families.

From all these arguments, it follows that while the reform being proposed is not at all in conflict with the complex bonds of the constitutional law, it is indeed likely to afford the opportunity of putting into effect the suggestions voiced by the Court.

6. Redistributive effects of the reform

The IRPEF reform proposal has been reviewed by means of the static microsimulation model DIRIMOD. The model uses the sample data of the Bank of Italy's Survey on the Budgets of the Italian Families and allows to analyze the impact on revenue and on the personal income distribution of both the 1995 system and the hypothetical reforms concerning IRPEF, social contributions and family allowances. The distributive analysis was performed at the level of both the individual income recipient and the household, after having rearranged the latter by growing levels of equivalent income (Carbonaro equivalence scale).

The outcome of these estimates are shown in the tables below, which we will comment later on.

Table 9 - Proposed IRPEF reform vs. the 1995 system: effects on revenue, progressivity and personal income distribution (% values) - analysis by income recipient

	1995 system	reform proposal
revenue loss[a]	--	3,3
redistribution[b]	3,19	3,07
incidence[c]	15,67	15,34
progressivity[d]	17,39	17,42

redistribution[e]	3,23	3,16

[a] Thousands of billions Lire
[b] Difference in the Gini index between gross and net incomes
[c] IRPEF incidence on the gross income
[d] Difference in the index of concentration between tax liabilities and gross incomes
[e] Difference in the index of concentration between gross and net incomes.

Table 10 - Proposed IRPEF reform vs. the 1995 system: effects on revenue, progressivity and personal income distribution (% values) - analysis by household

	1995 system	reform proposal
revenue loss[a]	--	3,3
redistribution[b]	2,76	3,12
incidence[c]	15,67	15,34
progressivity[d]	15,32	17,56
redistribution[e]	2,85	3,18

[a] Thousands of billions Lire
[b] Difference in the Gini index between gross and net incomes
[c] IRPEF incidence on the gross family income
[d] Difference in the index of concentration between tax liabilities and gross incomes
[e] Difference in the index of concentration between gross and net incomes.

Tables 9 and 10 clearly show that the reform entails a slight reduction of the incidence that drops from 15.7% to 15.3% of the gross income, with a consequent moderate revenue loss estimated at 3,300 billion Lire, equal to nearly 2% of the overall revenue for 1995.

Table 9 shows that the redistributive effects at the level of income recipient, measurable through the traditional Kakwani indexes, appear to be substantially unchanged with respect to the 1995 system. On the other hand, the analysis by households points to an increase in the Kakwani redistribution index, notwithstanding the reduction in the incidence, due to an upsurge of the progressivity that increased by over 2.2 percentage points. The accentuation of the reform redistributive effects is confirmed by the variation of the differences in the Gini indexes of gross and net income, which moves from 2.76 to 3.12[22].

Table 10 bis points to an increase in both the progressivity and the redistributive effects of the reformed system which is particularly marked if one takes into consideration also the changes in family allowance and social contributions that are to guarantee its coverage.

[22] The redistributive effect measured by the difference in the Gini coefficients of income before and after tax includes, with respect to the better known Kakwani index, the reranking effect produced by IRPEF through the system of tax credits which, as it depends also on non-monetary characteristics, may cause a different ranking in the income scale in the passage from before-tax income to after-tax income.

The variation of the social contribution rates affecting the administrations in charge of dependent employment and self-employment is 0.55% and 0.67%, respectively[23] (table 11). On the basis of some preliminary estimates, the revaluation of the family allowance and its extension to self-employed workers would entail a total greater spending of nearly 5,900 billion Lire, broken down as follows: 3,900 billions in favour of families that are already granted the allowance and 2,000 billions to the families of self-employed workers. These two spending increases should be financed through a separate management of contributions.

Table 10 bis - Reform proposal (IRPEF and family allowance) vs. the 1995 system: effects on revenue, progressivity and personal income distribution (% values) - analysis by household

	1995 system	reform proposal
revenue loss[a]	--	3,3
redistribution[b]	4,24	5,16
incidence[c]	22,00	21,66
progressivity[d]	15,96	19,60
redistribution[e]	4,50	5,42

[a] Thousands of billions Lire

[b] Difference in the Gini index between gross and disposable incomes

[c] Incidence of IRPEF and social contributions (net of family allowance) on gross income

[d] Difference in the index of concentration between total revenue (IRPEF and social contributions, net of family allowance) and gross incomes

[e] Difference in the index of concentration between gross and disposable incomes.

Table 11 - Increase in family allowance spending and contribution rates with respect to independent workers and workers in dependent employment (money value in thousand billions) - analysis by income recipient

	increase in family allowance spending and social contributions	absolute variation of the contribution rate	% spending variation with respect to the 1995 system
Workers in dependent employment	3,900	+0,55	+49,1
Independent workers	2,000	+0,67	(*)
Total	5,900	+0,58	+75,4

(*) As the initial spending amount is null, the variation is a value tending to infinity.

With reference to the variations of the incidence by decile, the analysis by

[23] The outcome of the estimate of these rates should be taken with caution, as DIRIMOD does not consider any imputation procedure to allow for social contributions evasion, even though it does re-proportion the figures estimated on the basis of the sample of the Bank of Italy with respect to the statistics of the Ministry of Finance to keep indirectly into account the tax evasion problem.

income recipients (table 12) points to an incidence increase which is approximately equal to 2 points in the first decile and 1 point in the second and third deciles, a substantial invariance in the fourth and last decile and a reduction in the other five deciles that allows to assume an initially growing trend up to the seventh decile and then a decreasing trend until the ninth decile.

The increased incidence in the second and third deciles may be explained by the considerable increase in the marginal tax rates as well as by the suppression of the additional tax credits for both dependent employment and self-employment, which are replaced in the reformed system by additional tax credits referred to the economic conditions of the family.

The sizable increase in the first decile should not be a surprise as the analysis of sample data allows to note that this decile is formed in excess of 90% by persons who are not employed and, therefore, may be referred for the most part to the recipients of rent income, who are not entitled to allowances for work-related expenses, as the latter only concern workers in dependent employment and pensioners and their amount is readjusted to the new rate scale.

Table 12 - Reform proposal vs. 1995 system: IRPEF incidence by income recipient** deciles and absolute variation with respect to the law in force*

deciles	mean decile income (million Lire)	1995 system	reform proposal	*absolute incidence variation*
1	3,398	1,05	3,08	*+2,03*
2	8,817	1,21	2,28	*+1,07*
3	13,175	3,97	4,94	*+0,97*
4	18,520	9,72	9,65	*-0,07*
5	23,676	12,46	11,57	*-0,89*
6	27,801	13,81	12,88	*-0,93*
7	31,972	14,64	13,58	*-1,06*
8	37,131	15,85	15,02	*-0,83*
9	45,239	17,64	17,25	*-0,39*
10	77,297	22,21	22,29	*+0,08*
average	*28,707*	*15,67*	*15,34*	*-0,33*

(*) Incidence on gross income
(**) Income recipients ranked by gross income level.

On the contrary, the analysis by households points to a satisfactory redistribution of the incidence by decile of the reform (table 13). In fact, notwithstanding the increase in the marginal rate applied to incomes in the first bracket, the most relevant tax cuts are indeed concentrated in the lower income levels. These reliefs are in excess of 3 percentage points for households whose income is below 26,268 million Lire and in excess of 1 point for households whose income is included between that amount and 30,317 millions. Besides, the profile of the incidence differences with respect to the 1995 system is regressive from the second decile as the income grows until it translates into slight incidence increases for the households ranking in the last three deciles.

The trend of the redistributive effects appears even more evident if we take into consideration the family allowance changes (see table 13 bis). As a matter of fact, leaving out a decrease of about half a point in tax reliefs in the first decile, there is a marked strengthening of reliefs in the subsequent three deciles. On the other hand, considering the income range after the fifth decile, we may note a progressive increase in the net incidence as income grows, getting to a maximum increase of 0.83 in the last decile.

Table 13 - Reform proposal vs. 1995 system: IRPEF incidence by household** deciles and absolute variation with respect to the 1995 system*

deciles	decile mean family income (million Lire)	1995 system	reform proposal	*absolute incidence variation*
1	17,043	5,32	2,24	*-3,08*
2	26,268	8,88	5,63	*-3,25*
3	30,317	10,70	9,52	*-1,18*
4	38,520	12,24	11,64	*-0,60*
5	45,845	13,12	12,82	*-0,30*
6	54,125	14,01	13,86	*-0,15*
7	60,293	14,86	14,80	*-0,06*
8	70,884	16,17	16,22	*+0,05*
9	82,088	17,61	17,68	*+0,07*
10	122,152	21,38	21,62	*+0,24*
average	*54,772*	*15,67*	*15,34*	-0,33

(*) Incidence on gross family income
(**) Households ranked by equivalent income (Carbonaro equivalence scale).

Table 13 bis - Reform proposal vs. 1995 system: overall incidence by household** deciles and absolute variation with respect to the 1995 system*

deciles	decile mean family income (million Lire)	1995 system	reform proposal	*absolute incidence variation*
1	17,043	2,44	-0,06	*-2,50*
2	26,268	11,13	5,52	*-5,61*
3	30,317	14,32	11,89	*-2,43*
4	38,520	16,89	15,89	*-1,00*
5	45,845	19,1	18,84	*-0,26*
6	54,125	20,7	20,86	*+0,16*

7	60,293	21,88	22,29	*+0,41*
8	70,884	23,49	24,08	*+0,59*
9	82,088	25,14	25,76	*+0,62*
10	122,152	29,29	30,12	*+0,83*
average	*54,772*	*22,00*	*21,66*	*-0,34*

(*) Incidence of IRPEF and social contributions, net of family allowance, on gross income
(**) Households ranked by equivalent income (Carbonaro equivalence scale)

One should also consider the redistributive effects of the revaluation of the family allowance (including its extension to self-employed workers) on its own.

Table 14 shows a considerable impact in terms of vertical equity on the first 4 deciles of households. Monetary gains are substantial for the poor households, and their incidence decreases by over two percentage points in the second decile and close to five points in the first one. Moderate losses characterize the median quintile which would have its net contribution rate increased by 0.31%, while the households with medium-high income would get the worst of it. As for the latter, in terms of greater incidence, the cost of the reform should range around 5 tenths of percentage point.

Table 14 - Redistributive effects of the increase in family allowance and social contributions by household deciles (money value expressed in thousand Lire)*

deciles	decile mean family income (million Lire)	absolute variation of social contributions	absolute variation of family allowance	net variation	*variation of net contribution incidence***
1	17043	94	940	-846	*-4,96*
2	26268	148	769	-621	*-2,36*
3	30317	172	553	-381	*-1,26*
4	38520	217	373	-156	*-0,40*
5	45845	261	246	+ 14	*+0,31*
6	54125	313	146	+167	*+0,31*
7	60293	345	65	+280	*+0,46*
8	70884	404	25	+379	*+0,53*
9	82088	471	15	+456	*+0,55*
10	122152	708	2	+706	*+0,58*
average	*54772*	*313*	*313*	*0*	*0*

(*) Households ranked by gross equivalent income - Carbonaro equivalence scale
(**) Variation of the incidence of social contributions, net of family allowance revaluation.

Considering the redistributive effects of the reform with respect to family income, broken down by a few occupational qualifications (table 15), it may be noted that the tax incidence is reduced by little less than half a point for blue- and white-collar workers, while it increases by a similar percentage for self-employed workers and professionals whose incomes rank in the higher deciles in the Bank of Italy sample. Insofar as pensioners are concerned, their average tax rate remains substantially the same. A tax cut is noted in the first decile in respect of all the categories taken into consideration. As for the income of blue- and white-collar workers, this relief is substantial also in the second decile while, in the subsequent deciles, it tends to be regressive as income grows, in line with the incidence trend that may be observed in the aggregate distribution. The distribution of the differentials of incidence relative to self-employed workers is slightly more irregular and characterized by an increase in the mean rate in the second decile and a reduction in the third. A greater tax burden, which is not correlated to income, may be noted from the fourth decile onwards: it ranges from a minimum value of 0.3% in the sixth decile to a maximum value of 0.9 in the seventh.

The performance with respect to pensioners is much more regular as a rather substantial tax relief may be noted in the first two deciles (0.9 and 0.8 per cent), followed by a nearly unchanged incidence between the third and sixth decile and a slight increase in the last four deciles. The average tax rates applicable to the four categories taken into consideration amount to 13.4% for pensioners, 14% for blue-collar workers, 16.3% for white-collar workers and 18.9% for self-employed workers.

Table 15 - IRPEF reform proposal: incidence by household** deciles and occupational qualification, and absolute variation with respect to the 1995 system.*

deciles	Blue-collar workers	*variation with respect to 1995 system*	White-collar workers	*variation with respect to 1995 system*	Self-employed workers	*variation with respect to 1995 system*	pensioners	*variation with respect to 1995 system*
1	3,81	*-1,87*	1,23	*-3,21*	0,56	*-4,47*	1,35	*-0,92*
2	4,75	*-3,76*	6,79	*-3,21*	17,25	*+1,61*	4,31	*-0,86*
3	8,97	*-0,86*	9,16	*-1,88*	12,08	*-1,37*	7,32	*+0,05*
4	10,70	*-0,95*	11,04	*-0,58*	14,49	*+0,50*	10,26	*-0,01*
5	12,27	*-0,42*	12,50	*-0,94*	15,89	*+0,60*	11,21	*+0,06*
6	13,70	*-0,35*	13,89	*-0,85*	16,55	*+0,30*	12,70	--
7	13,50	*-0,37*	15,10	*-0,59*	16,75	*+0,94*	14,29	*+0,12*
8	15,20	--	16,13	*-0,44*	17,79	*+0,48*	15,01	*+0,11*
9	15,47	*-0,19*	16,97	*-0,28*	19,99	*+0,60*	16,50	*+0,12*
10	18,14	*+0,02*	19,48	*-0,26*	22,04	*+0,57*	20,69	*+0,28*
mean	*14,02*	*-0,39*	*16,35*	*-0,48*	*18,93*	*+0,52*	*13,39*	*+0,02*

(*) IRPEF incidence on gross income
(**) Households ranked by gross equivalent income - Carbonaro scale.

Extending the analysis of the incidence by occupational qualifications to the family allowance reform proposal (table 15-bis), we find a stronger redistributive effect and a distribution of reliefs by decile that, with respect to the categories of blue- and white-collar workers and pensioners, is perfectly in line with a trend of the differentials of incidence which is regressive as income increases and which, in the deciles after the fifth, turns into actual tax increases.

For these three categories the tax incidence remains rather constant and ranges between 16.5% on pensioners and 26.17% on white-collar workers. It may also be interesting to note how the redistributive effects of the family allowance have a tendency to revert the ranking between the latter category of recipients and self-employed workers with respect to the tax incidence, in relation to a different composition of dependents of these two categories. Self-employed workers enjoy an extremely substantial tax relief in the first decile where, however, this category of recipients is quite scarce. Some moderate tax cuts, amounting to 1.3 and 2% respectively, are present in the third and fourth decile, while an increased incidence, with a mean value close to 1.1%, characterizes all the other deciles.

Table 15 bis - Reform of IRPEF and family allowance: overall incidence by household** deciles and occupational qualification, and absolute variation with respect to the 1995 system.*

deciles	Blue-collar workers	*variation with respect to 1995 system*	White-collar workers	*variation with respect to 1995 system*	Self-employed workers	*variation with respect to 1995 system*	pensioners	*variation with respect to 1995 system*
1	-4,27	*-8,89*	-8,00	*-8,68*	-15,32	*-25,28*	-4,36	*-3,07*
2	4,45	*-6,17*	9,28	*-5,41*	23,28	*+1,34*	2,05	*-2,07*
3	13,63	*-1,94*	15,19	*-2,96*	20,47	*-1,33*	6,23	*-0,67*
4	17,17	*-1,16*	20,13	*-0,47*	18,23	*-1,98*	11,24	*-0,27*
5	21,22	*-0,02*	22,14	*-0,57*	23,16	*+0,87*	13,44	*+0,07*
6	23,04	*+0,17*	24,09	*-0,29*	23,63	*+0,69*	16,18	*+0,23*
7	23,28	*+0,16*	25,35	*-0,04*	23,70	*+1,54*	18,61	*+0,51*
8	24,89	*+0,58*	26,13	*+0,11*	24,99	*+1,14*	19,92	*+0,58*
9	25,11	*+0,36*	27,16	*+0,28*	26,66	*+1,28*	21,90	*+0,62*
10	27,83	*+0,60*	28,92	*+0,25*	28,48	*+1,19*	26,16	*+0,80*
mean	*22,82*	*-0,09*	*26,17*	*+0,01*	*25,66*	*+0,99*	*16,49*	*+0,10*

(*) Incidence of IRPEF and social contributions, net of family allowance, on gross income
(**) Households ranked by gross equivalent income - Carbonaro scale.

Tables 16 and 16-bis, broken down by the number of household members, show the apportionment by decile of the incidence and the differentials of incidence of IRPEF and the overall net tax payment (IRPEF and social contributions, net after the family allowance) with respect to the 1995 legislation.

The trend of the IRPEF average rate shows a considerable decrease as the number of household members increases. In fact, it drops from 16.1% in case of singles to 11.1% in case of seven-member families.

It is interesting to note that while there is a slight increase in the incidence with respect to the 1995 system in the families without children (either singles or married couples), for the families with at least a child there is an increasing tax relief as the number of members increases. As for the distribution by decile of the differentials of incidence with respect to the 1995 system, it may be noted that they are characterized by higher values in the first deciles, with a particularly wide range of variation for the families with at least four members. Besides, in respect of all the typologies, the differences are considerably smaller in the higher deciles. This clearly points to the re-equalizing role of the additional tax credit for dependent children.

The redistributive effects outlined above are confirmed and are even more marked if we keep into account also the reform of the family allowance.

Indeed the data shown in table 16 bis allow to note that the range of variation of the net incidence as the number of household members increases is much wider than that of the income tax alone. As a matter of fact, it drops from 22 per cent for singles to 12.6 per cent for households with seven members, with a reduction of the rate by 9.4 points as against of 5 points of the IRPEF alone.

Table 16 - IRPEF reform proposal: overall incidence by household** deciles and number of household members, and absolute variation with respect to the 1995 system.*

deciles	1	*variation*	2	*variation*	3	*variation*	4	*variation*	5	*variation*	6	*variation*	7	*variation*
1	0,25	*-0,85*	0,71	*-0,39*	2,28	*-1,24*	2,75	*-4,70*	2,87	*-4,25*	3,01	*-4,02*	4,53	*-4,10*
2	3,62	*+0,00*	2,46	*-1,17*	7,46	*-2,37*	6,32	*-4,60*	6,39	*-5,33*	6,25	*-3,60*	5,39	*-2,08*
3	6,27	*+0,93*	6,37	*-0,06*	10,11	*-1,04*	11,23	*-2,03*	11,02	*-2,58*	10,99	*-1,37*	11,48	*-3,39*
4	9,75	*+0,36*	9,88	*+0,18*	11,62	*-0,50*	13,08	*-0,79*	12,13	*-1,28*	12,16	*-0,77*	11,17	*-2,68*
5	12,10	*+0,20*	11,31	*+0,30*	12,50	*-0,15*	14,00	*-0,62*	13,27	*-0,73*	12,14	*-0,08*	13,22	*-0,53*
6	13,69	*+0,07*	13,28	*+0,30*	14,01	*+0,04*	14,20	*-0,44*	13,61	*-0,55*	13,55	*-0,21*	15,05	*-0,01*
7	14,70	*+0,13*	14,95	*+0,31*	13,99	*-0,16*	15,26	*-0,14*	15,47	*-0,22*	15,64	*+0,27*	12,87	*-0,27*
8	15,14	*-0,03*	15,76	*+0,25*	15,63	*+0,16*	17.04	*-0,11*	16,58	*+0,08*	15,49	*-0,07*	16,63	*-0,55*
9	17,17	*+0,17*	17,04	*+0,15*	17,23	*+0,08*	18,14	*+0,03*	19,46	*-0,15*	19,49	*+0,06*	16,65	*-0,10*
10	23,10	*-0,07*	20,28	*+0,40*	21,41	*+0,42*	21,63	*+0,27*	23,38	*-0,39*	23,33	*+0,01*	15,95	*+0,01*
mean	*16,12*	*+0,06*	*14,61*	*+0,18*	*15,80*	*-0,06*	*15,55*	*-0,67*	*15,12*	*-1,03*	*13,80*	*-0,79*	*11,06*	*-1,60*

(*) IRPEF incidence on gross family income

(**) Households ranked by gross equivalent income - Carbonaro scale.

Table 16 bis - Reform of IRPEF and family allowance: overall incidence by household** deciles and number of household members, and absolute variation with respect to the 1995 system.*

deciles	1	*variation*	2	*variation*	3	*variation*	4	*variation*	5	*variation*	6	*variation*	7	*variation*
1	1,80	*-0,29*	-6,72	*-3,48*	-4,80	*-5,63*	-3,89	*-10,13*	-8,95	*-11,49*	-15,13	*-12,14*	-7,13	*-13,69*
2	5,11	*+0,55*	-1,85	*-3,04*	8,18	*-4,68*	7,89	*-7,05*	6,16	*-9,08*	4,88	*-6,54*	3,96	*-7,14*
3	7,75	*+1,45*	4,20	*-1,46*	14,06	*-2,31*	15,44	*-3,25*	13,64	*-5,21*	13,63	*-2,75*	13,12	*-6,37*
4	11,43	*+0,89*	10,62	*-0,36*	16,12	*-0,90*	19,23	*-1,26*	19,08	*-1,57*	17,44	*-1,12*	17,33	*-3,12*
5	15,01	*+0,75*	14,14	*+0,27*	18,54	*-0,09*	21,89	*-0,58*	20,67	*-0,78*	16,42	*-0,60*	17,65	*-0,52*
6	18,78	*+0,64*	17,48	*+0,70*	21,77	*+0,35*	22,26	*-0,21*	20,49	*-0,27*	21,33	*+0,04*	20,52	*+0,40*
7	19,87	*+0,68*	20,35	*+0,85*	21,53	*+0,28*	23,99	*+0,36*	23,64	*+0,19*	21,93	*+0,41*	18,96	*-0,50*
8	20,36	*+0,49*	22,89	*+0,82*	23,09	*+0,67*	25,88	*+0,44*	24,89	*+0,61*	23,60	*+0,41*	23,83	*-0,24*
9	24,00	*+0,72*	23,81	*+0,71*	25,53	*+0,64*	26,55	*+0,58*	29,86	*+0,43*	27,96	*+0,71*	20,73	*+0,41*
10	31,72	*+0,49*	28,33	*+0,96*	30,13	*+1,02*	30,33	*+0,84*	32,03	*+0,20*	29,41	*+0,52*	22,42	*+0,52*
mean	*21,96*	*+0,61*	*19,33*	*+0,30*	*22,90*	*+0,13*	*22,74*	*-0,74*	*21,39*	*-1,49*	*17,76*	*-1,57*	*12,58*	*-4,02*

(*) Incidence of IRPEF and social contributions, net after the family allowance, on gross family income.
(**) Households ranked by gross equivalent income - Carbonaro scale.

Furthermore, the increase in the net incidence is regressive as the number of household members increases with respect to families of up to three members. Larger families allow to note a decrease in the tax burden which is positively correlated with the number of members. Tax increases of 0.6, 0.3, and 0.1% may be observed for singles, and households with two and three members, respectively, while incidence reductions may be observed with respect to households from four members upwards, which get up to four points for households with seven members.

The tax cuts in the first deciles are more marked and the distribution of the net incidence variations per decile is very regular with respect to the 1995 system, with a clear regressive trend as income grows for all the families with at least two members.

Tables 17 and 17-bis show the incidence of both IRPEF and the tax/benefit system, respectively, by one-earner and two-earner family deciles, and the variations with respect to the current legislation.

Both household types, whether characterized by one or two income recipients, show the usual trend of the incidence variation which is regressive as income grows until they turn into tax increases for higher income levels. It is particularly interesting to note that tax cuts are on the average much higher for one-earner families when compared with two-earner families, with a considerable increase of the incidence differential between the two types when the effects of the family allowance are taken into consideration.

Table 17 - IRPEF reform proposal: mean incidence by household** deciles, considering one-earner and two-earner households.*

deciles	one-earner households	*variation with respect to the 1995 system*	two-earner households	*variation with respect to the 1995 system*
1	2,12	*-4,06*	2,00	*-2,03*
2	6,86	*-3,89*	4,52	*-3,00*
3	11,21	*-1,23*	8,05	*-1,35*
4	13,56	*-0,77*	11,41	*-0,49*
5	15,12	*-0,40*	12,89	*-0,32*
6	16,26	*-0,02*	14,19	*-0,24*
7	16,16	*+0,05*	15,33	*-0,21*
8	18,01	*+0,11*	16,82	*-0,10*
9	19,50	*+0,14*	18,23	*-0,04*
10	23,82	*-0,05*	21,60	*+0,17*
mean	*14,91*	*-1,04*	*15,61*	*-0,34*

(*) IRPEF on gross income
(**) Households ranked by gross equivalent income - Carbonaro scale.

In fact, while the 1995 system provides for an identical mean IRPEF rate of 15.95% for both household types, and an aggregate tax/benefit rate of 22.83 and 22.54% for one-earner and two-earner families, respectively, the new system would provide for absolute reductions in both the incidence of IRPEF (-1.04%) and the aggregate incidence (-1.50%) that are much more sizable for the one-earner families than for the two-earner ones.

This is a further proof that the system of additional tax credits, related to the family income and supplemented by a revaluation of the family allowance, is an effective means to reduce the taxation of one-earner families as the presence of a single income recipient increases the probability of living in a poor family. The extent of tax reliefs is considerably bigger in the first deciles by the redistributive effect of the family allowance.

Table 17 bis - Proposal for the reform of IRPEF and family allowance: overall mean incidence by household** deciles, considering one-earner and two-earner households*

deciles	one-earner families	*variation with respect to the 1995 system*	two-earner families	*variation with respect to the 1995 system*
1	-4,89	*-8,28*	-8,03	*-8,13*
2	7,93	*-6,01*	3,33	*-5,66*
3	14,86	*-2,14*	9,09	*-3,03*
4	18,51	*-1,07*	15,49	*-0,86*
5	21,29	*-0,26*	19,16	*-0,24*
6	23,58	*+0,50*	21,51	*+0,18*
7	22,80	*+0,63*	23,59	*+0,33*
8	25,53	*+0,68*	24,98	*+0,46*
9	27,39	*+0,72*	26,65	*+0,53*
10	32,59	*+0,53*	30,29	*+0,74*
mean	*21,33*	*-1,50*	*22,26*	*-0,28*

(*) Incidence of IRPEF and social contributions, net of family allowance, on gross income
(**) Families ranked by gross equivalent income - Carbonaro scale.

7. Conclusions

The proposal to reform the personal income taxation, as outlined in this article (paragraphs 1, 2, and 3), focuses on both a reduction of the higher marginal rates and a simplification of the rate scale, but also and especially on a thorough review of the system of tax credits for dependents. In fact, it aims at getting to a fair tax treatment of the family, through the exemption of a sort of basic family income which decreases as income increases. In addition to ensuring the full exemption of the less well-to-do taxpayers, this system succeeds in determining effects in respect of moderate income levels that are not dissimilar from those that may be attained with the family quotient system (paragraph 4).

The system of additional tax credits, subordinated to family income thresholds, is an attempt to match the need to keep adequately into account the economic conditions of the family with the need to avoid the abandonment of the definition of ability to pay on individual basis, even with a view to getting over any objection raised in the matter of the tax constitutionality (paragraph 5).

Besides, it was deemed advisable to see to a closer integration between the tax treatment of the family and the institute of the family allowance, providing for both a sizable revaluation of its amounts and the extension of its benefits to self-employed workers in order to avoid that the application of what may turn into an effective instrument to reduce the poverty gap might be limited to a single category of taxpayers.

The analysis of the effects of the reform at a family level (paragraph 6) points indeed to a slight revenue loss, but also to a significant increase in both the progressivity and the redistributive impact of the tax. These effects result to be even stronger if we keep into account the effectiveness of the reformed system of family allowances whose increases are financed at a balance.

The re-equalizing effect of the reform takes concrete form in an apportionment by family deciles of the incidence variation of both IRPEF and the aggregate tax/benefit system that implies a mitigated fiscal burden on the lower deciles countered by slight increases in the higher ones. The same type of effects may also be found, notwithstanding a few irregularities, at the level of the individual categories of income recipients.

Special significance should be ascribed to the redistributive effects of the reform in the analysis that keeps into account the disaggregation by deciles as well as by household size. As a matter of fact, it points to a considerable increase -with respect to the 1995 system- of the tax reliefs provided for by the reform as the family becomes larger, as well as to decreasing incidence variations as income increases, leading to increases in the tax pressure on the deciles that are further away from the first.

Even the analysis by number of income recipients within the family clearly points to higher tax reliefs for one-earner families with respect to two-earner families, with a definite reversal of trend which appears particularly evident if the effects of the family allowance are taken into consideration.

The analysis of the redistribution impact of the reform proposal allows to conclude that, with respect to the current system, the reform is moving towards a considerable equalization of incomes as it removes a series of limitations that characterize the current regime.

Even though we are convinced that the reform being proposed is likely to mark a significant step forward in reducing a few significant lacks of the current system, there is no denying that the ability of income assessment by the tax administration is still affected by dramatic limitations. Not only is the reform unable to remove those limitations, but it may even make them more evident, notwithstanding the fact that it confines itself to suggesting solutions that may be realistically and immediately put into practice.

In particular, the redistribution of the fiscal burden among households on the basis of a combination of tax credits and family benefits, and the extension of the latter to self-employed workers within the context of an administration kept fully apart from that of workers in dependent employment, strengthens the need to find a remedy for the problem of fiscal evasion in order to avoid any effect that is likely to multiply tax injustice. Until a proper solution to this problem is found, no easy optimism may be voiced with respect to the re-equalizing capacities of any reform.

The problem of fiscal evasion needs to be dealt with and solved rather than being eluded by simply ignoring it or legalizing it through arbitrary systems of relief. Indeed, we are fully convinced that the actual difficulties in finding a solution to this problem should not be taken as a pretext for giving up an effective redistributive role of the tax system.

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