European Commission

# The EU Mutual Learning Programme in Gender Equality

## The impact of various tax systems on gender equality

Sweden, 13-14 June 2017

## Comments Paper - Finland

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*This publication is supported by the European Union Rights, Equality and Citizenship Programme (2014-2020).*

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# The Finnish tax system from the gender equality perspective

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## 1. Finnish income tax system

The Finnish tax system resembles the Swedish individual based tax system. The basic tax unit is an individual also when a household contains more than one taxable person. There are some tax credits that are transferable between spouses (e.g. tax credit on capital income's deficit). On the lower end of the income distribution, some subsidies, i.e negative taxes, are affected by a spouse's income and wealth (for example social assistance).

The Finnish path from joint taxation towards individual taxation started in 1930 when a new marriage law took effect and made spouses equal in front of the law. This meant that women could represent themselves in a court of law, sign contracts and govern their own wealth. For the first time, Finland adopted individual-based taxation already in the year 1935. All the income earned outside of the household were taxed individually almost for a decade before there was again a movement towards joint taxation in 1943. While in the 1930s the individual based taxation was justified by an increased female labour supply and the worry of joint taxation causing women not to marry, the decision to move back to joint taxation was justified by the agrarian nature of the economy and practicality (Haataja, 2010). It needs to be kept in mind that this period in Finnish history was the time when Finland was at war against the Soviet Union, and suffered heavy losses. This is reflected throughout the 40s in the family policies aiming to keep the demography sustainable.

The family tax system in force after 1943 was built on three layers where single individuals were taxed more heavily than couples without children and the lowest taxes were paid by married couples with children. In the 1940s there were many family policies created, for example the universal child allowance. The importance of family policies also shows in that the Family Federation of Finland, Väestöliitto, was founded in 1941 (www.vaestoliitto.fi) which has been promoting many of the family supportive policies legislated since the 1940s. The main aim of the Federation, especially in the early days, was to promote fertility through family friendly policies.

The return to individual based taxation occurred in 1976. However, the family was still the most important unit in the economy and thus many tax credits based on children or spouse's (low) income were legislated. These were mainly concerning men since women had lower earnings in partnerships. Finland faced a severe recession in the early 1990s and many benefit levels were cut. The focus was to move away from using taxation as an instrument for family policies and instead operate through child allowance which was universal and tax-free. (Haataja, 2010)

Today income taxation as such is gender neutral but the implications of tax policies are not. Since taxation causes behavioural responses, some of the tax items can affect another gender differently. Especially as women on average have lower incomes, the tax items targeted to the lower income individuals affect women disproportionally. Even though we have moved away from joint taxation, the joint decision-making is causing unequal consequences. The next section discusses the currently most severe disincentive structures.

# 2. Current debate on family policies in Finland

## 1. Female labour supply, taxes and social norms

From the gender perspective, the biggest issue now in Finnish discussion is the division of parental leave. This relates to the general theme that there is a need for labour market reforms to increase the overall employment rate. This has also been a specific target for the current government. One of the central problems with respect to labour supply is the weak attachment to labour markets of mothers with small children, especially from lower socioeconomic backgrounds. The primary focus in the discussion is that the mothers' work effort is also needed in the rapidly aging economy. The gender equality perspective is secondary.

While moving towards individual based taxation has especially improved the work incentives for women and couples with high earnings, the current family policies are weakening the work incentives especially for the women with lower earnings and especially for single parents. The state (and supplements from the municipalities) pays a child home care allowance for a parent who stays home to look after the child. This allowance can last until the child is three years old. The allowance is taxable and earnings tested. This means that in low earnings families where the income is a combination of housing allowance, income support and home care allowance, the labour market participation is biased towards staying home especially when the child care costs can be substantial. For example, one study by Kosonen (2011) shows that increasing child home care allowance by 100 euros decreases the labour supply by 3 percentage. Again, this affects women disproportionally more since they have on average lower earnings.

The law does not target the child home care allowance to mothers but instead the family can decide which parent uses that right. Approximately 7 percent of all home care allowance spells were taken by fathers in 2014 (Kela 2014). It has been suggested that the home care allowance could be earmarked partly to fathers as well. The current government is divided on this question and whether parental leaves need to be reformed at all. While two out of three governing parties at least weakly support reforming the parental leaves in a way that the state would promote more fathers staying home and women re-entering labour markets earlier, the third governing party is vehemently against this. This also reflects more generally that there are deep differences within the population in the views of women's roles in care taking and in society.

# 2. Other issues

Another issue raised in the public discourse regarding gender equality is the definition of family and its interpretation which varies in tax law and in the law of social assistance. While in tax law some tax credits are transferable between spouses who are either married or in civil union, the law of social assistance also considers cohabiting couples to belong to the same family even though there is no maintenance liability between cohabiting partners. This means that in calculating the social assistance benefit, spouse's income is as well considered. Before 2013 also basic labour market support was earnings tested against household earnings as well as students housing allowance before 2009.

The basic social assistance was moved to be paid by Kela, the Social Insurance Institution of Finland, in the beginning of the year 2017. Before that it was a responsibility of municipalities. During the first half of 2017 social assistance has been in the media quite often and the question of defining family or maintenance liability has been asked. At the moment cohabiting partners' maintenance liability can even mean being forced to spent savings for the cohabiting partner. It has been questioned whether this is justifiable in a modern society where people can live in many temporary domestic relationships during their life course. As yet there has been no sign of this becoming in political discussions. Some behaviour implications of this could be that individuals officially live in different addresses even though they effectively live under the same roof. However, there is no formal research done on the effects of the differing family definition on for example marriage rates or cohabiting rates.

Improving families' economic well-being is a popular target for every kind of government. During the last years, the return to joint taxation has been raised several times (e.g Prime Minister Vanhanen in 2008). However, this has not proceeded to committees and there seems to be quite wide consensus that joint taxation would have more problems than advantages. Besides, many of the issues raised (e.g low fertility) can be achieved with other policy instruments.

# 3. What to learn from Sweden?

Finland has followed the Swedish path towards the pure individual based taxation. However, Sweden has abolished the family taxation elements also in the unearned income while in Finland the tax credit on capital loss is transferable between spouses. While this does not create inequality between the gender as such, it harms the horizontal equity requirement of taxation. Now an individual without a spouse does not get an extra tax credit on the loss in the capital income. Also this kind of transferable tax credit is more favourable on average for men, since women below the top 10 % of the income distribution hardly have any income from the capital income source (Ravaska, 2017, forthcoming).

# 4. Conclusions and recommendations

With the means of direct taxation individual taxation is probably the closest we get to gender neutrality. However, it is the benefits most often connected to parenthood that create incentive traps and these affect disproportionally women. While changing the child home care allowance towards gender neutrality is politically unfeasible at the current state, women's labour market participation incentives could be improved by reducing the price and improving the quality of the day care services. This would not harm those families where women want to be the ones taking the main responsibility in care taking. As result, there would be effectively more gender equality without affecting the family's decision making with respect to care.

In designing a good tax system one needs to take into account the efficiency and equality considerations (known as equity-efficiency trade-off in optimal taxation literature). It is impossible to get a fully efficient (i.e not distorting individual or family decision making) yet equal tax system or the other way around. The equity part of the optimal tax is built on the idea of horizontal and vertical equity. In individual based taxation this means that people with the same level of income pay the same amount of tax and people with more income pay more taxes (with redistributive goals). Adding tax instruments as the means for achieving the targets set for family policies affects these equity concepts and as well creates incentives or disincentives to take part in the labour markets. Thus, the family policies should always also be evaluated as part of the whole tax system and not analysed in isolation from the targets set for the whole tax system.

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