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Supplement 1
Correction 1

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June 4, 2001

To: Members of the Executive Board

From: The Secretary

Subject: **Kingdom of the Netherlands—Netherlands—Selected Issues—The Labor Income Tax Credit in an International Perspective**

The following correction has been made in SM/01/151, Sup. 1 (5/23/01):

Page 9, para. 19: for "In the case of…then ceiling is FF 269,440. For part-time…likely to lose the PPE."
read "For part-time workers,…the ceiling is FF 269,440."

A corrected page is attached.

Att: (1)

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Department Heads

IV. THE PRIME POUR L'EMPLOI IN FRANCE

17. This labor tax credit was introduced in France in early 2001. As with the EITC and WFTC, the *Prime Pour l'Emploi* (PPE) is fully refundable and is phased out at higher income levels. All earners of labor income are eligible, though different regimes apply depending on family status. Each individual in a two-earner household is entitled to the credit, but the credit is more generous for single-income households. As with the EITC, the PPE is claimed at the time the income tax return is filed. Because low-income French households typically do not owe any income tax, the refund effectively offsets part of the employee's share of social security contributions.

18. The PPE can be claimed only if labor income falls between FF 20,575 and FF 146,257 (FF 96,016 for unmarried workers or married workers in a two-income family). For a married single earner with two dependent children, the credit accumulates at a rate of 2.2 percent of income up to a maximum of FF 2,400, or 3.5 percent of income (Figure 1). This ceiling is reached at an income of FF 68,583 (the full-time statutory minimum wage or about 46 percent of average income). For income between 1 and 1.4 times the minimum wage, the PPE is withdrawn at a rate of 5.5 percent. After that, the PPE remains constant until income reaches twice the minimum wage (FF 137,166). A second phase-out range starts at that income level, in which the withdrawal rate is again 5.5 percent. Finally, the credit falls to zero as the maximum eligible income of FF 146,257 is reached.

19. For part-time workers, income is determined on the basis of full-time equivalent income, thus excluding part-time workers who earn high hourly wages. In the case of a two-income household, both spouses can claim the credit, but the amount is less generous than for a single-earner household. In addition, there is a ceiling on household income beyond which no credit can be claimed which varies according to family status. For a married couple with two children, the ceiling is FF 269,440.

20. The PPE is fairly small at present, but it is expected to increase in 2002 and 2003, when the rate of accumulation in the phase-in range will be raised to 4.4 percent and 6.6 percent respectively. Nonetheless, the PPE will remain smaller than the U.S. and U.K. credit. Compared to the LTC, the PPE is more targeted because it is phased out and it excludes individuals who earn high wages but work a small number of hours. The latter is achieved at the cost of some administrative complication, as part-time workers must declare their full-time equivalent income when they file their tax return to establish eligibility. The French credit allows both workers in a two-income family to claim tax relief. Thus, even though ceiling on family income puts an upper bound on what the second worker can earn without losing the credit, the PPE should create less disincentives for labor market participation of secondary earners relative to the EITC and the WFTC.

V. Conclusions

21. Compared to its U.S. and U.K. counterparts, the LTC is likely to have more limited effects on incentives for primary-earners to enter the labor force, because of the smaller size of the credit. The EITC, the WFTC, and the PPE also create fewer windfall beneficiaries, since the credit is phased out at relatively low levels of income and spouses of high-income earners are not eligible. Without introducing a phase-out range, any significant increase in the LTC to strengthen its effect on the still large poverty trap in the Netherlands is likely to be extremely expensive.

22. But how can the credit be withdrawn without encouraging individuals in the phase-out range or secondary earners to reduce hours worked? Given the easy availability of part-time employment and the high marginal tax rates, the reduction in hours worked could be substantial in the Netherlands. One possibility would be to introduce a minimum work hour requirement, along the lines of the WFTC. Accordingly, eligibility for the credit would be restricted to individuals working more than, say, 20 hours a week. A lower threshold could be applied to single parents, so as not to discourage their labor force participation.[14] A minimum work hour requirement would render ineligible high wage individuals who work only a few hours a week, but it would involve additional administrative costs, and the experience of both the United Kingdom and France would provide useful information in this regard.

[14] In the U.K. the minimum work requirement was lowered from 24 hours to 16 hours per week in 1993 to encourage participation by single mothers.