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THE FISCAL AND MACROECONOMIC EFFECTS OF THE PARENT INCOME TAX REFORM

BOX 2: THE FISCAL AND MACROECONOMIC EFFECTS OF THE PARENT INCOME TAX REFORM¹

Overview

In the [Budget Speech 2026](#), the Government has announced a new Personal Income Tax (PIT) cut. Unlike the broad-based tax cuts announced in the 2025 Budget, this year's measure is specifically targeted to financially support parents and potentially incentivise families to have additional children, with the final aim of boosting the currently low fertility rate across Maltese households.² Given its targeted structure and design, the new policy may have important implications with respect to the channels through which it influences economic activity, fiscal outcomes and the income distribution in the economy.

This box describes the reform announced in the latest Budget speech and attempts to estimate the fiscal, distributional and macroeconomic impact that this measure is expected to have in Malta over the next four years. It is however important to stress that the economic models used in this analysis might not be able to fully capture the intricate nature of the policy reform. In particular, at the current juncture, simulating the economic effects that this policy is expected to have in the near future is quite complex, especially due to the uncertain effects this policy might have on hours worked per household. Moreover, the design and scale of the latest tax cuts differ significantly from similar policies in other developed economies, making it more difficult to benchmark results against existing studies. Therefore, the macroeconomic results presented in this note should be treated with caution.

Policy setup

Malta's existing income tax framework is composed of three classes of tax brackets, labelled 'single', 'married' and 'parent'. Each of these computation classes is made up of four brackets with tax rates ranging between 0% and 35%. Parents of children who are either under 18 years of age or aged up to 23 and still in education are eligible to be taxed under the 'parent' schedule. Married individuals, whether parents or not, may be taxed under 'married' rates. The existing system does not make any distinction by the number of children of the taxpayer under either of these two computation types.

The reform announced in this year's Budget widens tax bands under both 'married' and 'parent' structures, and introduces a revised band structure with bracket thresholds that vary according to the number of dependent children. As shown in Table 2a, the measure will be introduced gradually over three years, with the final changes taking place in 2028.

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² See Cumbo, L. (2025), [The native Maltese population: Projections and implications on the labour supply](#). Policy Note 01/25, Central Bank of Malta.

Table 2a
TAX SCHEDULE FOR PARENTS, 2025-2028⁽¹⁾

	2025		2026		2027		2028	
	From	To	From	To	From	To	From	To
Married (1 child)								
0%	0	15,000	0	17,500	0	20,000	0	22,500
15%	15,001	23,000	17,501	26,500	20,001	30,000	22,501	33,500
25%	23,001	60,000	26,501	60,000	30,001	60,000	33,501	60,000
35%	60,001	and over	60,001	and over	60,001	and over	60,001	and over
Married (2+ children)								
0%	0	15,000	0	22,500	0	30,000	0	37,000
15%	15,001	23,000	22,501	32,000	30,001	41,000	37,001	50,000
25%	23,001	60,000	32,501	60,000	41,001	60,000	50,001	60,000
35%	60,001	and over	60,001	and over	60,001	and over	60,001	and over
Parent (1 child)								
0%	0	13,000	0	14,500	0	16,000	0	18,000
15%	13,001	17,500	14,501	21,000	16,001	24,500	18,001	28,000
25%	17,501	60,000	21,001	60,000	24,501	60,000	28,001	60,000
35%	60,001	and over	60,001	and over	60,001	and over	60,001	and over
Parent (2+ children)								
0%	0	13,000	0	18,500	0	24,000	0	30,000
15%	13,001	17,500	18,501	25,500	24,001	33,500	30,001	42,000
25%	17,501	60,000	25,501	60,000	33,501	60,000	42,001	60,001
35%	60,001	and over	60,001	and over	60,001	and over	60,001	and over

Source: Ministry for Finance (2025), *Budget Speech 2026*. Available at: finance.gov.mt/wp-content/uploads/2025/11/Budget-Speech-2026.pdf

⁽¹⁾ The table shows the thresholds, in Euro, between which each tax rate applies under each computation type.

Fiscal and distributional impact

The impact of this measure on PIT revenues was estimated independently by the Bank using EUROMOD, a tax-benefit microsimulation model developed by the European Commission's Joint Research Centre (JRC). The model enables a detailed assessment of the fiscal and distributional effects of tax and benefit policy changes, applying country-specific policy rules to representative microdata on households and individuals. The estimates presented in this box are based on the 2023 EU Statistics on Income and Living Conditions (EU-SILC) dataset. Income and monetary variables in the dataset are adjusted with appropriate indices to reflect their nominal levels in the policy years under consideration, based on the latest Central Bank of Malta projections.

The granular nature of the model allows for a detailed decomposition of the cost of the measure to government, in terms of foregone tax revenue, by family structure and computation type. That said, it is important to point out that EUROMOD is a static and non-behavioural microsimulation model. Therefore, the simulated impacts of the policy presented below only capture mechanical changes in household tax liabilities given the revised tax system

parameters, and do not account for any second-round effects or behavioural changes that the policy might induce, such as decisions on labour force participation.

Table 2b presents the reduction in income tax revenue attributable to this measure for each year between 2026 and 2028, the year by when the measure is fully implemented. Our simulations take into account the phasing-in process of the revised income tax brackets and distinguish between subgroups of affected taxpayers. The cost for each year is derived by comparing estimated tax revenue given the revised tax structure applicable in each year, to the estimated tax revenue if the tax system remained unchanged (i.e., as in 2025) over the whole period. In this simulation, it is assumed that parents eligible for both married and parent computations select the computation that minimises their tax liability.

Table 2b
FISCAL COST OF MEASURE BY COMPUTATION TYPE

(EUR millions)

	2026	2027	2028
Reduction in tax liabilities	62.6	117.8	170.3
<i>of which:</i> Parent (1 child)	15.8	31.1	47.8
Parent (2+ children)	35.8	66.3	94.9
Married (1 child)	1.3	2.5	3.7
Married (2+ children)	9.8	17.9	23.9

Source: Authors' calculations.

Note: Figures represent impact on tax liability in each year compared to a no-policy change scenario. Totals might not add up due to rounding.

We estimate that the measure will imply a €62.6 million reduction in tax revenue in 2026, which increases to €117.8 million in 2027 and €170.3 million in 2028, reflecting the gradual implementation of the measure. The majority of the fiscal cost arises from households assessed under the parent computation. This reflects both the higher generosity of the new parent tax rates and the greater prevalence of dual-earner families in the microdata. The low extent of revenue losses through the married computation is also expected given that typically this tax class of brackets is most advantageous for households where one member is not employed or earns a relatively low income. In turn, families with two or more children account for the majority of the revenue loss across both married and parent computations, consistent with the design of the reform, which significantly raises tax-free thresholds and widens tax bands for larger families.

Table 2c presents the distributional impact of the phased reform on equivalised household disposable income between 2026 and 2028. As in Table 2b, effects for each year are presented against a no-policy change scenario. The results indicate that the percentage increase in equivalised disposable income are most pronounced in the middle of the income distribution, with gains tapering off towards the lower and upper deciles. This pattern reflects the interaction between the tax framework and the targeted design of the

Table 2c**INCREASE IN HOUSEHOLD EQUIVALISED DISPOSABLE INCOME***(percentage increase)*

	2026	2027	2028
Decile 1	0.06	0.10	0.13
Decile 2	0.68	0.97	1.17
Decile 3	1.12	1.85	2.28
Decile 4	1.11	1.92	2.50
Decile 5	1.22	2.20	2.97
Decile 6	1.05	1.91	2.68
Decile 7	0.90	1.69	2.45
Decile 8	0.74	1.37	1.96
Decile 9	0.69	1.33	1.93
Decile 10	0.23	0.43	0.64
All	0.70	1.27	1.76

Source: Authors' calculations.

Note: Figures represent increase in household equivalised disposable income in each year compared to a no policy change scenario. Deciles are based on the distribution of household taxable income and include all households (including non-beneficiaries).

measure. As the reform benefits households up to a certain threshold of taxable income, the relative improvement increases with income but peaks in the middle deciles. For lower-income households, gains might be more modest due to the limited number of tax liable individuals and the already low effective tax liabilities arising from other targeted benefits and allowances. Conversely, higher income households experience diminishing relative gains, which may indicate a combination of the plateau in absolute gains for individuals whose income exceeds a specific threshold, and possible differences in the composition of these households in terms of both eligibilities, share of individuals that are parents, and the number of dependent children.

Macroeconomic effects

To gauge the macroeconomic impact of these results, we compute a scenario analysis using MEDSEA (Rapa, 2016, 2017), which is a New Keynesian general equilibrium model that contains a detailed fiscal block.^{3,4} The scenario under analysis is modelled as a cut in the aggregate effective labour income tax rates corresponding to a drop of 0.25 percentage points, 0.44 percentage points and 0.59 percentage points in ex-ante government income tax revenue expressed as percent of GDP. These correspond to the estimated foregone tax revenue estimated in Table 2b, as well as the Bank's projections of nominal GDP.

Results in Table 2d indicate that the reform is expected to add around 0.18% to the level of GDP for the period 2026-2028. The decline in the income tax rates lead to a lower wedge between gross and net wages which leads to some downward pressure on marginal costs of production and is therefore expected to improve the price competitiveness of Maltese exports. Meanwhile, the drop in household tax bill boosts income and private consumption.

³ Rapa, N. (2016). [MEDSEA: A small open economy DSGE model for Malta](#). Working Paper 05/2016, Central Bank of Malta.

⁴ Rapa, N. (2017). [Estimates of Fiscal Multipliers using MEDSEA](#). Working Paper 04/2017, Central Bank of Malta.

Table 2d
MACROECONOMIC IMPACTS

(percentage deviations from steady-state levels)

	2026	2027	2028
Real GDP	0.05	0.09	0.18
Private consumption	0.20	0.32	0.40
Real wages	0.71	1.37	1.82
Labour income tax revenue (% of GDP)	-0.20	-0.41	-0.56
HICP	0.03	0.01	-0.03
Government balance	0.12	0.30	0.45
Government debt	0.03	0.24	0.60
Hours worked	0.09	0.13	0.22

Source: Authors' calculations.

The results shown here are the normal effects that one would expect in a broad-based cut in income tax. Once again, however, the nature of this policy reform raises the possibility of alternative outcomes, in particular in terms of the labour supply response. Therefore, these macroeconomic results should be treated with this qualification in mind.

Implications for the projections

The latest reduction in PIT for parents follows a broad-based tax cut introduced in 2025. In both instances, the measures significantly increase household disposable income, which in turn supports stronger household consumption. Owing to the design of the tax cut, middle-income households gain the most, although lower and higher-income households also benefit substantially.

Consequently, household disposable income and private consumption have been revised upwards. The saving ratio has likewise been revised upward to reflect the fact that higher-income beneficiaries have a lower average/marginal propensity to consume and may save a bigger share of the tax liability reduction. This, in turn, also helps to explain part of the upward revision to GDP growth over the period 2026-2028.