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Cut the Tax Cut

In its November 2014 *Update of Economic and Fiscal Projections*, the federal government unveiled a set of measures for families with children that will take effect in 2015. The reforms are noteworthy in that they are expected to comprise the centre-piece of both the upcoming federal Budget and the election platform of the Conservative Party.

One of the major changes, the Family Tax Cut (also known as 'income splitting'), caught most of the media attention. But that tax cut was only one component of a larger package. Several associated measures were brought in at the same time – partly to offset the criticism that the government knew would be coming its way on the flagship Family Tax Cut [Battle and Torjman 2014].

The Tories had announced in their 2011 election platform an earlier version of income splitting, which was subject to widespread condemnation. Even the late Minister of Finance Jim Flaherty mused that this proposed policy required a major re-think. The version of income splitting announced in November 2014 was modified somewhat in direct response to earlier negative comments. The additional changes to other child benefits were intended to help sell the new Family Tax Cut more easily to Canadians.

There is no question that the altered plan is more palatable than its earlier design. But we still don't like it. Neither should the vast majority of Canadian families with children. Here's why.

The new version of income splitting will allow a spouse in a family with children under the age of 18 to transfer up to $50,000 of taxable income to a spouse in a lower tax bracket. The credit will provide tax relief up to a maximum $2,000 to those households. While the plan may sound good on paper, in the real world it has lots of problems.

First, the tax savings under this new scheme will go disproportionately to higher-income households. Only an estimated 13 percent of Canadian households will benefit from the newly-designed measure and the average income of those beneficiary households will still be a relatively high $123,000 [Kesselman 2014: 30].

Second, the new tax cut comes with a relatively high price. The $2.88 billion estimated cost could be put to far better use – notably income support for families struggling to pay the rent and feed the kids [Hurtig 2000]. For many households, it is often impossible to do both.

In order to make the proposal more palatable, a set of changes to other child benefits was announced. All families with children will be eligible for a few goodies from Ottawa.

The monthly $100 Universal Child Care Benefit (UCCB) paid to families with children under age 6 will increase to $160 a month. In addition, the UCCB will be extended to families with children between the ages of 6 and 17. These households will now receive $60 a month, purportedly in respect of child care costs.

Since the introduction of the Universal Child Care Benefit in 2006, Caledon has made known our concerns with this measure [Battle 2008: 15]. It is a paltry sum that barely offsets the true cost of child care. In fact, it may not even be used for this purpose. The UCCB is a taxable benefit (though not for single parents) and is therefore worth less than the stated amount – even though it is always advertised as its pre-tax value. Finally, the UCCB has not been indexed since it was introduced and has therefore lost value in real terms over the past eight years in the amount of the inflation rate.

The *Update of Economic and Fiscal Projections* also announced the dismantling of the non-refundable Child Tax Credit worth a maximum $300 a month in tax savings. Caledon has long argued for this change. The measure was of disproportionate benefit to higher-income households. The estimated annual expenditure of $1.6 billion [Finance Canada 2013] could be far better spent if redirected toward low- and modest-income households.

The Fiscal Update introduced yet another significant modification to benefits for families. Effective 2015, the limits for the Child Care Expense Deduction will increase by $1,000 to compensate for losses over time from freezing the maximum amounts. These limits will rise from $7,000 to $8,000 for children under age 7, from $4,000 to $5,000 for children ages 7 through 16 (and infirm dependent children over age 16), and from $10,000 to $11,000 for children eligible for the Disability Tax Credit.

This change is not welcome. Deductions are the most regressive form of tax cut because they provide the greatest tax savings to taxpayers in the highest tax bracket.

But now the government can claim that all families with children will 'win' as a result of the new package of reforms. While they may all gain small amounts, some will certainly win more than others. The Family Tax Cut is worth a maximum annual $2,000 for one-earner families in addition to existing child benefits while other households will get only a maximum annual increase of $720 over current benefits.

The *Update of Economic and Fiscal Projections* presents several case examples to illustrate how the changes will affect different family types. The document explains in detail the ways in which the new measures will interact to produce the following results [Finance Canada 2014]. In Example #1:

> Dale and Kelly are a two-earner couple with two children aged 7 and 3. Kelly earns $95,000 and Dale earns $25,000. For the 2015 taxation year, the family would receive a net federal benefit of $2,835 as a result of the proposed new measures. This is in addition to the $2,000 in tax relief the couple would be receiving in early 2015 when they claim the Family Tax Cut on their 2014 returns.

In this first example, a two-earner couple with combined **earnings of $120,000** will be eligible for **$4,835 in tax relief**. The household in Example #2 has only one earner.

> Isabelle and Marc are a one-earner couple earning $60,000. They have two children aged 2 and 4. As a result of the proposed new measures, this family would benefit from about $1,605 in federal relief for the 2015 taxation year. This is in addition to about $1,055 in tax relief they would receive in early 2015 when they claim the Family Tax Cut on their 2014 returns.

In this second example, the one-earner couple with **earnings of $60,000** will be eligible for **$2,660 in tax relief**. While the single parent in Example #3 needs the most help from government, she will receive the least.

> Alison is a single parent raising one child age 4 and earning $45,000. As a result of the proposed new measures, Alison would benefit from about $420 in federal relief for the 2015 taxation year.

In this third example, the single parent with **earnings of $45,000** will qualify for only **$420 in tax relief**. The couple in Example #4 receives a relatively small amount as well.

> Thomas and Matty are a two-earner couple with two children aged 3 and 6. They each earn $60,000. For the 2015 taxation year, the family would receive a net federal benefit of $875 as a result of the proposed new measures.

In this fourth example, this two-earner couple with **earnings of $120,000** is eligible for **$875 in tax relief**.

Isabelle, Marc, Alison, Thomas and Matty need to have a serious conversation. They need to understand why they will receive such limited financial assistance while the well-off household with children is deemed to deserve a tax windfall.

To make matters worse, the unfairness will not be corrected in future. There will be few fiscal crumbs to scatter in the coming years as the new Family Tax Cut devours a large slice of the fiscal surplus, pegged at $1.6 billion for 2015-16 [Curry 2014b]. However, this amount is teetering on a slippery slope in light of recently falling oil prices and associated revenues [Curry 2014a].

Isabelle, Marc, Alison, Thomas and Matty need to understand how different policy choices could result in a far more fair and equitable distribution of income. They should be demanding answers as to why Dale and Kelly, with their relatively high incomes, are getting such a big tax break and whether this questionable reward is the most effective use of a small and shaky fiscal surplus.

Most important, Isabelle, Marc, Alison, Thomas and Matty should be asking thoughtful questions about equity and fairness, and why the current government feels compelled to help the rich get richer. These families need to have a conversation about the Canada they want for the next five years – and beyond.

Sherri Torjman

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