CALEDON
INSTITUTE OF SOCIAL POLICY

Child Benefits and the 2015 Federal Budget

by

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Child benefits are a powerful social program to combat poverty and inequality. They help not only low-income families but also the middle class. The federal and provincial/territorial governments over the years have achieved significant progress in strengthening the architecture of child benefits in Canada.

But the Conservative government wanted to put its own stamp on child benefits when it came to power in 2006. It launched a series of flawed schemes intended to help not only low- and middle-income families – the traditional target of child benefits – but also well-off households that do not need help from the government.

The Caledon Institute believes that Ottawa should get child benefit policy back on track and build a single, strong and progressive Canada Child Tax Benefit – one that packs a harder anti-poverty punch and improves income security for modest- and middle-income families.

Objectives

The term ***'child benefits'*** refers to income payments on behalf of children, delivered either in the form of cheques or income tax reductions. The federal government is the major provider of child benefits, which total $18.6 billion. The provinces (with the exception of PEI) and territories also offer child benefits.

There are two fundamental aims of child benefits, characterized as the ***poverty reduction*** and ***parental recognition*** objectives.

Under the ***poverty reduction*** objective, child benefits supplement low incomes and help fill the gap between the earnings of low- and modest-wage parents and their families' income needs. This objective is based on the long-recognized reality that a market economy does not vary wages and salaries to take into account the number of family members dependant on that income.

The ***parental recognition*** objective views child benefits as an important way for society to provide some financial recompense for the fact that parents with children bear expenses that childless households at the same income level do not.

These objectives assume that society has an interest and obligation to help parents with their child-rearing costs because children are a form of 'public good' or 'social investment.' Children grow up to become workers, taxpayers and citizens, and so it is in the interest of everyone – including those without children – that parents not face undue financial strain in the child-rearing work which they perform on behalf of everyone in society.

The poverty reduction objective acknowledges that lower-income families have the least financial capacity and also seeks to mitigate the greater personal and societal risks of child poverty, in terms of children's immediate and long-term health, learning capacity and educational performance.

Integrated child benefit

When they took office in 2006, the Conservatives inherited from the Liberals the Canada Child Tax Benefit – the achievement of decades of effort. This architecture is what is known as an 'integrated child benefit' and contains the following key elements:

- single large program, replacing previous multiple benefits that conflicted in design and impact
- progressive income testing, gearing the amount of benefits to need as measured by family income. Low-income families get the most and payments decline as incomes increase
- child benefit pays the same amount to all families with the same income, regardless of the sources of that income, where they live or what their family type
- benefits are not taxed, so what you see is what you get
- portable and indexed, providing a stable and assured supplement to income no matter where families live or move in the country
- transparent, understandable and non-stigmatizing
- can piggyback other child-related benefits, such as the Child Disability Benefit and the Canada Learning Bond
- operated by the provinces and territories as well as the federal government
- welfare-embedded child benefits in the provinces and territories have been displaced by federal child benefits under the National Child Benefit reform
- seeks to achieve both the poverty reduction and parental recognition core aims of child benefits system
- seeks to reach a target maximum payment equal to the cost of raising a child in a low-income family.

Progress towards an integrated child benefit

The integrated child benefit was achieved in two steps.

First, in 1993 the federal government created the Child Tax Benefit, in a large structural reform that replaced Family Allowances and the refundable and non-refundable Child Tax Credits with a single, geared-to-income program.

Second, in 1998 the federal and provincial/territorial governments launched the National Child Benefit reform. The Child Tax Benefit was restructured and renamed the Canada Child Tax Benefit (CCTB). It is composed of two layers – a basic benefit for low-income and most non-poor families and a National Child Benefit Supplement (NCBS) targeted to low-income families.

As Ottawa incrementally increased payments under the NCBS portion of the Canada Child Tax Benefit, the provinces and territories were expected to reduce their welfare child benefits by the amount of the federal increases. The provincial and territorial governments agreed to 'reinvest' the resulting savings in other programs and services for low-income families with children – such as early learning and child care services, supplementary health care, income-tested child benefits (now offered by all jurisdictions except for PEI) and earnings supplements.

The National Child Benefit architecture succeeded because it made both good politics and good policy – an all too rare combination. All provinces and territories signed on. Each order of government made joint structural changes to their respective child benefit systems that they could not have accomplished on their own.

Empirical evidence from government, think tank and academic researchers indicates that the National Child Benefit reform has had positive income and behavioural effects – reducing poverty, improving school test scores, decreasing aggression and maternal depression, and easing hunger [Milligan and Stabile 2009] as well as helping lower the welfare wall as recipients move from welfare to work [Milligan and Stabile 2006].

But the Conservative government wanted to go its own way by increasing child payments for middle-class and well-off voters and offering families cash instead of services for their child care. They reached into the past and resurrected two social policy dinosaurs – the Universal Child Care Benefit (similar to the old family allowance) and the non-refundable Child Tax Credit.

Back to the future: the Universal Child Care Benefit (1996)

The Universal Child Care Benefit (UCCB) is a classic case of social policy by stealth.

Benefits are subject to federal and provincial/territorial income taxes, so most families do not get the full $1,200 annual per child once they pay tax on the payment. Many families likely do not know that what they see on their monthly cheque is not what they end up with after taxes. And even if they are aware of this feature, they do not know how much of the Universal Child Care Benefit they lose to taxes.

Families of different types (i.e., single parents, one-earner and two-earner couples with children) but with the same income get different amounts of after-tax benefits. For most of the income range, one-earner couples end up with larger benefits than two-earner couples with the same total income. To add insult to injury, single parents are exempt from taxation on their Universal Child Care Benefit and so keep the full $1,200 benefit. Families with the same level of income also receive different amounts of after-tax payments depending upon the province or territory in which they live.

Despite its title, the Universal Child Care Benefit is not tied to use of child care: Families can spend it however they wish. Even if used for child care, its $1,200 per year (less after taxes) buys little in the way of decent and affordable child care.

Another stealthy feature is that the Universal Child Care Benefit is not indexed, so loses value each year by the rate of inflation. The $1,200 payment in 2006 is now worth only $1,029 in constant 2006 dollars (a loss of $171 or 14 percent). A recent study by the Parliamentary Budget Officer estimated that the Universal Child Care Benefit as a share of household spending on child care declined from 47 percent in 2007-08 to 41 percent in 2013-14 due to non-indexation [Malanik 2015: 5].

The federal government recently announced that the Universal Child Care Benefit will be enriched. Its maximum benefit will increase in 2015 from $1,200 to $1,920 a year for children ages 5 and younger (as it is paid monthly, from $100 to $160 per month). The program will expand to pay $720 a year ($60 a month) for children ages 6 to 17. Some four million families will benefit from the enhanced Universal Child Care Benefit. But it remains un-indexed and thus automatically erodes each year, and is still meagre in view of child care costs.

There are more smoke-and-mirrors at play. The federal government has ended the non-refundable Child Tax Credit (a little-known child benefit discussed in the next section) to help pay for the enhancements to the UCCB. Once we take into account the demise of the Child Tax Credit, worth an estimated $345 this year, the picture is not as pretty.

Take the case of a single-parent family with one child under age 6. Their Universal Child Care Benefit currently pays $1,200 per year and will rise to $1,920, for an increase of $720. But that family also will lose their Child Tax Credit, worth an estimated $345. So they will gain only $375, not $720, from the enhanced UCCB.

A couple with one child under 6 will also see its $1,200 from the Universal Child Care Benefit increase to $1,920. But we have to dig a bit deeper to get to the bottom of this issue.

Unlike single parents, couples have to pay income tax on their UCCB. Assuming this family's lesser earning parent's marginal tax rate is 22 percent (for taxable income between $43,953 and $87,907), they would pay federal income tax of $264 on their current UCCB, reducing it from $1,200 to $936. Add in the $345 Child Tax Credit, and the family ends up with $1,281.

The enhanced UCCB is $1,920 in gross terms; federal income tax is $422, lowering after-tax benefits to $1,498. But the Child Tax Credit is gone, so the family's after-tax enhanced UCCB benefit remains $1,498 – a mere $217 more than the current $1,281. Instead of coming $720 ahead under the enriched program, this family will see an actual advance of just $217.

It gets worse: Provinces and territories also tax the Universal Child Care Benefit, which further reduces its real value.

Back to the future: *the non-refundable Child Tax Credit (2007)*

The 2007 federal Budget continued the federal government's back-to-the-future changes to child benefits by announcing a "$2,000 child tax credit" payable on behalf of children under 18. The "new $2,000 Child Tax Credit" was neither new (it existed in the 1980s) nor worth $2,000 (in truth it was worth 15 percent of $2,000, or just $300). The non-refundable credit paid $300 to all non-poor families – the wealthy included – but nothing to the poorest.

As part of their recently-announced family policy package, the Conservatives cancelled the non-refundable Child Tax Credit – which many families and pundits doubtless will not miss since they never knew it existed. The resulting savings – $1.8 billion in 2015-16 – will help pay for the enriched Universal Child Care Benefit.

Family income splitting (2014)

The newest child benefit is a tax break in the form of family income splitting, inspired by the pension income splitting provision launched in 2006 [Tamagno and Battle 2006].

Family income splitting is intended to correct an alleged inequity in the tax system – the fact that a couple with children and one earner pays more income tax than a family with the same income earned by both parents. The same problem holds for two-earner couples in which one spouse earns significantly less than the other. The one-earner family is the traditional mom at home caring for the kids with dad in the workforce – a disappearing institution purportedly beloved by the government's hard core voter base.

Under the recently announced Family Tax Cut, family income splitting effectively will shift taxable income up to a limit of $50,000 from the spouse in a higher tax bracket to the spouse in a lower bracket (who traditionally is not in the labour force or works part time). As a result, the higher-income spouse pays less tax while the lower-income spouse pays more tax. Overall, the family's total income tax will be less.

The amount of income tax savings is calculated as the product of the amount shifted between spouses and the difference between their two marginal tax rates. Tax savings from splitting will arise only if the spouses' taxable incomes are in a different tax bracket. The Family Tax Cut will be delivered as a non-refundable tax credit worth up to $2,000.

Family income splitting has been roundly criticized by experts and commentators. Here are some key criticisms:

complex

In a paper published by the Caledon Institute, economist Jonathan Rhys Kesselman – a leading expert on the tax/transfer system – pointed to the complexity of family income splitting. He noted that the use of a non-refundable credit "adds considerable complexity to the operation of the provision, taking four pages to explain in the Notice to Amend the Income Tax Act" [Kesselman 2014: 2].

The Department of Finance made a valiant but surely fruitless attempt to explain family income splitting it to ordinary Canadians:

> Pat and Chris are a two-earner couple with two children. Pat earns $60,000 of taxable income and Chris earns $12,000, for a combined taxable income of $72,000.
>
> Pat faces a marginal federal tax rate of 22 per cent. Chris is in the first tax bracket, where income is taxed at 15 per cent. Since the value of his non-refundable tax credits is greater than the tax on taxable income, Chris does not pay federal tax.
>
> For federal tax purposes, under the proposed Family Tax Cut, Pat would be able to, in effect, transfer $24,000 of taxable income to Chris. This would bring their taxable incomes for the purposes of calculating the credit to $36,000 each, which puts both of them in the 15 per cent tax bracket. In addition, Chris would be able to use up his unused non-refundable tax credits with the notional transfer of income. As one person in the couple may claim the Family Tax Cut, they decide that Pat would do so. The Family Tax Cut would reduce Pat's tax payable by about $1,260 in 2014, taking into account both the reduced tax on their taxable incomes, and the additional value of the non-refundable credits that Chris is able to use [Department of Finance Canada 2014].

one-income versus two-income families

Proponents of income splitting contend that families with similar total money income should pay similar amounts of tax, according to the principle that equals should be taxed equally. Tax experts call this the principle of horizontal equity.

Analysis supports the argument that many one-income families with children pay more income tax than two-income families with children. The average tax burden of families with children is higher when most of their income comes from one spouse. Comparing families in which the lower-income parent earns less than 15 percent of income with families where the lesser earner makes more than 35 percent of family income, the tax burden on one-earner couples is heavier between family incomes of $50,000 and $80,000 by $500 to $1,500. The same holds for incomes above $100,000 [Laurin and Kesselman 2013: 3].

Critics of family income splitting argue that concentrating on cash income leads to a narrow view of income. A broader conceptualization of families' total economic resources is required that takes into account the value of in-kind home-produced services – e.g., housework, cooking and child care. Such home-produced services are generally worth more if one spouse spends less time, or no time, in the paid labour force.

For their part, two-earner families face work-related costs such as transportation, clothing and purchased child care [Laurin and Kesselman 2013: 3]. So the actual income gap between one- and two-earner families with children is much smaller, if at all, once in-kind services and work-related expenses are taken into account.

Fans of family income splitting contend that it will help parents spend more time caring for their children in the home. This argument fails to acknowledge that income splitting would favour upper-income one-earner families that are already most able to reduce one parent's paid work, and would least benefit lower- and modest-income couples with lesser ability to do so. Besides, income splitting would do nothing at all for single parents, who typically have lower incomes from low-paid jobs [Laurin and Kesselman 2013: 3-4].

Another criticism of the government's family income splitting scheme is that it includes older children up to age 17, the age of eligibility for child-related benefits such as the Canada Child Tax Benefit. Families most need assistance in caring for their children at home when they are infants or preschoolers. But Ottawa's income splitting plan will extend throughout the school years.

tightly targeted program

Family income splitting is a tightly targeted program. It will reach just 13 percent of all households [Kesselman 2014: 10] or 1.7 million families. It is intended to favour one-income couples with children and two-income families in which one parent has significantly more income than the other parent. The government views these households as carrying an unfair tax burden. The Family Tax Cut will be expensive – a hefty $1.9 billion in 2015-16.

The family income splitting measure will exclude single adults living alone (who make up a large 46 percent of households), single parents (6 percent of households), childless couples (31 percent), and couples with children and low incomes (5 percent) that are below the taxpaying threshold [Kesselman 2014: 30]. The scheme will exclude low- and modest-income families where neither parent earns more than the bottom tax bracket ($44,793 in 2015), or if both spouses have earnings that place them in the same tax bracket.

who gains from family income splitting?

Income splitting targets two-parent single-earner families with children. This is a small demographic. Only 22 percent of women with school-age children and 34 percent with preschoolers are not in the paid labour force [Jackson 2014].

Family income splitting is a regressive and elitist scheme, favouring high-income one-earner couples that least need government assistance. The higher their income, the more likely they are to receive the Family Tax Cut and the larger their benefit will be.

A recent study from the Parliamentary Budget Officer found that the family income splitting program will distribute most if its benefits to medium- and high-income households [Scholz and Shaw 2015: 3]. The Family Tax Cut is supposed to support parents who choose to stay out of the workforce and care for young children. But the scheme favours high-income families – whose incomes already allow for this choice [McInturff and Macdonald 2015: 26-27].

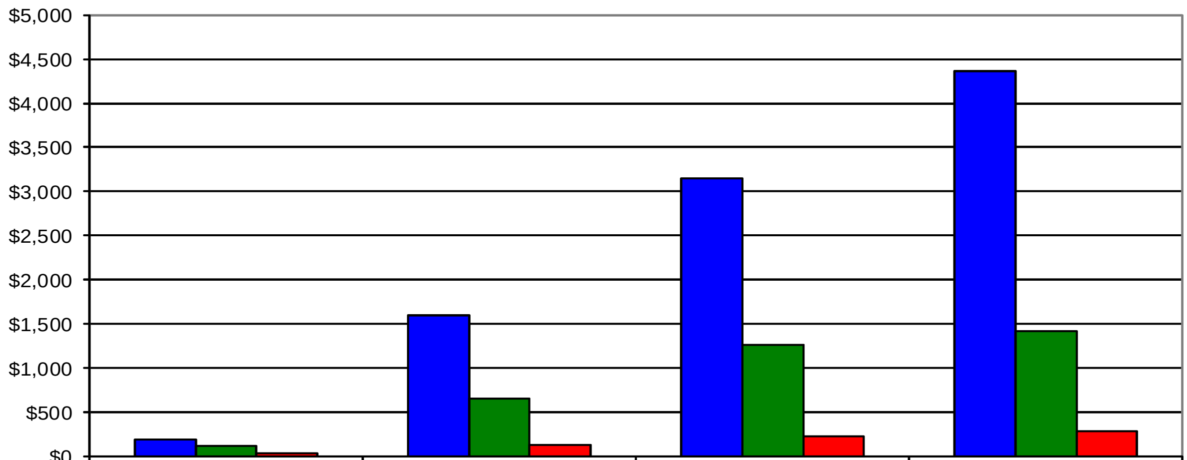
Figure 1 shows average federal tax savings from income splitting for three types of family according to the lesser earning spouse’s share of family income: 0-15 percent (shown in blue bars), 15-35 percent (green bars) and 35-50 percent (red bars). Average federal income tax savings for families in which the lower-income spouse earns less than 15 percent of family income range from $190 for families with incomes of $58,000 or less to $1,597 for families between $58,001 and $94,000, $3,142 for those between $94,001 and $139,000, and $4,368 for families with incomes of $139,001 or more [Kesselman 2014: 31].

Figure 1 shows that Family Tax Cut savings are smaller for families in which the lower-income spouse has income between 15 and 35 percent, shown in green, but they are still regressive. Tax savings come to an average $119 for families with incomes of $58,000 or less, $656 for families between $58,001 and $94,000, $1,259 for those between $94,001 and $139,000, and $1,425 for families with incomes of $139,001 or more.

While tax savings are smallest for families in which the lower-income spouse earns between 35 and 50 percent of family income, shown in red, they too are regressive: an average $41 for families with incomes of $58,000 or less, $128 for families between $58,001 and $94,000, $221 for those between $94,001 and $139,000, and $288 for families with incomes of $139,001 or more [Kesselman 2014: 31].

In short, the greatest tax savings from income splitting arise for one-earner couples particularly at the highest levels for the working partner [Kesselman 2014: 4]. Dividing families into three groups according to the lower-income parent’s share of family income, average federal

Figure 1
Average income tax savings from income splitting, by family income and percentage of income earned by lower-income parent, 2015



	$58,000 or less	$58,001-94,000	$94,001-139,000	$139,001+
0-15 percent	$190	$1,597	$3,142	$4,368
15-35 percent	$119	$656	$1,259	$1,425
35-50 percent	$41	$128	$221	$288

data: Kesselman 2014

tax savings are $1,771 for those in the 0 to 15 percent group, $929 for those in the 15 to 35 percent group and $192 for those in the 35 to 50 percent group [Kesselman 2014: 31].

The Family Tax Cut is projected to cost a hefty $2 billion in 2015-16. Costs could be even larger over time to the extent that family income splitting affects work incentives. Income splitting can raise the 'marginal effective tax rate' – i.e., the rate of tax increases and decreases in income-tested programs for every dollar of earnings on the lower-earning parent:

> Income splitting would induce some married spouses – mostly women – to reduce their hours of work, others to withdraw from the labour force, and still others to choose not to re-enter the labour force after withdrawing to mind infants or young children. All of these responses would reduce that spouse's taxable earnings and taxes paid [Laurin and Kesselman 2013: 12].

Summary*: *current child benefits

With the federal government's numerous changes, the child benefits system has become complicated all over again, if not more so. Table 1 shows how.

The biggest program is the Canada Child Tax Benefit (CCTB), which costs an estimated $10.6 billion in 2015-16. The maximum payment for one child is $3,761, payable to families with net incomes of $26,380 or less. The program is progressive, paying the largest amount to low-income families and the least to upper-income families. Benefits go to families with children under age 18.

The Universal Child Care Benefit (UCCB) costs a net (after-federal tax) $4.4 billion in 2015-16. The maximum benefit is $1,920 for children 5 and under, and $720 for children ages 6 to 17. The program pays a flat-rate benefit to all recipients in each age category, but is roughly progressive because it is taxable (except for single parents, who pay no income tax on their benefits).

Family income splitting (aka the Family Tax Cut) will cost $1.9 billion. It will allow eligible families up to $2,000 in tax relief and is regressive, giving the most to families that already have the most.

A fourth child benefit is the Child Care Expense Deduction (CCED), which provides a tax reduction to families that incur child-related expenses required to earn employment or business income, pursue education or do research. Ottawa has increased the dollar limits on contributions by $1,000 – from $7,000 to $8,000 per child under age 7, from $4,000 to $5000 for each child between 7 and 16, and from $10,000 to $11,000 for children who receive a Disability Tax Credit. This tax break costs $1.7 billion. Its maximum federal tax saving is $2,320 for children under 7 and $1,450 for those between 7 and 16 years old.

Table 1
Federal child benefits, 2015

program	cost ($ billions)	maximum payment ($)	age of child	distribution of benefits
CCTB	10.6	3,761	under 18	progressive
UCCB	4.4 (net of federal tax)	1,920 720	under 6 6-17	roughly progressive
income splitting	1.9	2,000	under 18	regressive
CCED	1.7	2,320[1] 1,450	under 7 7-16	regressive
total	18.6			

1. The CCED maximum federal tax savings indicated here are for single parents in the top tax bracket. The picture is more complicated for two-parent families because the CCED deduction must be claimed by the lesser-income parent, who typically falls into a lower tax bracket.

This measure is regressive. Higher-income taxfilers are more likely to claim the CCED, they deduct more and they enjoy larger federal and provincial/territorial income tax savings because the program reduces their taxable income.

Good news

We have been critical of the Universal Child Care Benefit for its several design flaws. However, the recent increases in UCCB benefits, when added to the Canada Child Tax Benefit, reach a social policy milestone – maximum child benefits should be set at the cost of raising a child in low-income families, which is an estimated $5,700 in 2015.

The maximum Canada Child Tax Benefit ($3,761) plus the Universal Child Care Benefit ($1,920 for a child 5 and under) together amount to $5,681 for children under 6 and $4,481 for children 6 to 17, so Canada will reach the integrated child benefit target in 2015 for younger children. However, the Universal Child Care Benefit is not the best way to reach the $5,700 target. The best way is by investing in the superior Canada Child Tax Benefit.

Recommendations

Canada should put its child benefits system back on the path of progressive reform – by investing incrementally in a strong, integrated child benefit. The federal government should dismantle the current hodgepodge of different child benefits in favour of one big program in the form of an enhanced Canada Child Tax Benefit.

The challenge is to improve the Canada Child Tax Benefit for middle-income families, while also increasing benefits for low- and modest-income households.

An integrated child benefit should set it maximum payment as the cost of raising a child in low-income families. That amount is an estimated $5,700 this year, so we have reached it already for young children under the current system. However, further increases to the Canada Child Tax Benefit are required (above the current $3,761) to bring us to the target $5,700 since we strongly recommend a single program – the Canada Child Tax Benefit. This increase is $1,939 ($5,700 minus $3,761) and should be enacted immediately.

The $5,700 target was decided on many years ago, at the Caledon Institute, so it would be prudent to update it. Note that a $5,700 maximum amount should not be set in stone to preclude further real improvements in benefits. One suggestion would be to adjust the maximum amount annually by inflation plus 1 percentage point.

To improve benefits for modest- and middle-income families, we would increase the base benefit that goes to the large majority of families, rather than the National Child Benefit Supplement targeted to those with low incomes. Despite the crucial emphasis on child benefits as a key poverty reduction instrument, their parental recognition performance is equally important and must be enhanced – especially for families with modest and middle incomes.

Table 2 compares Caledon's proposed integrated child benefit with the current federal system according to their major characteristics.

Table 2
Current child benefits sytem versus Caledon proposal

characteristic	current	Caledon
simple or complex	complex four programs (CCTB, UCCB, income splitting, CCED) with different designs	single program easy to understand its income-tested delivery
transparent or stealthy	what you get is not what you keep: most families must repay in income taxes part of their UCCB to federal and provincial/territorial governments UCCB not taxed for single parents UCCB not indexed CCTB is not taxed and is indexed	families keep what they get: CCTB not taxed indexed
distribution of benefits	CCTB is progressive UCCB is roughly progressive income splitting is regressive	progressive

Table 2 (continued) Current child benefits sytem versus Caledon proposal		
characteristic	current	Caledon
treatment of family types	income splitting and CCED are regressive CCTB treats all family types the same UCCB generally favours one-earner couples over single parent and two-earner couples income splitting targets one-income couples	treats all family types the same
coverage	CCTB covers large majority UCCB covers all families income splitting favours minority of well-off families (mainly one-income couples and two-earner couples with a large difference in each parent's income)	covers all but high-income families

This paper focuses on child benefits, but also proposes a major change to child care. The regressive and expensive Child Care Expense Deduction should be included on our to-eliminate list of child benefits. Its $1.7 billion cost would better be redirected to high-quality child care. A government-financed scheme does not automatically mean that there is only one type of child care arrangement. But it does mean that there is a public commitment to the quality of that service [Battle and Torjman 2014: 2].

The elephant not in the room

Few Canadian families likely have a clue what they actually get from child benefits or how these programs operate. The names of the multiple programs and their accompanying acronyms make for a confusing jumble. Confusion reigns and perhaps not by accident. Social policy by stealth is alive and well in Ottawa.

An astonishing omission from the current debate over child benefits is the Canada Child Tax Benefit, which was rarely mentioned – with the exception of one journalist who said Child Tax Benefit when he meant Universal Child Care Benefit.

The Canada Child Tax Benefit is a superior social program – powerful, poverty-fighting, progressive, fair, inclusive, non-stigmatizing, transparent and efficient. Yet today this biggest of child benefits is scarcely acknowledged – the elephant not in the policy room.

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