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# The Incredible Shrinking $1,200 Child Care Allowance: How to Fix It

*by*

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April 2006

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ISBN 1-55382-194-7

Published by:

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Since the election, the debate over child care has been framed as a fight between the new government's proposed cash-to-parents $1,200 per year Child Care Allowance and the previous government's cash-to-provinces investment in a national child care system.[1] But wherever one stands in this clash of philosophies, the $1,200 Child Care Allowance proposal itself has significant design flaws and will result in unfair treatment of families of different types and incomes. There is both more and less to the Child Care Allowance than most people think.

The Caledon Institute published the first ever analysis of the proposal in its January 2006 paper *The Choice in Child Care Allowance: What You See Is Not What You Get*, and a February 15 op ed in the on-line Globe and Mail, *Finding Common Ground on Child Care*. This new paper is an update and elaboration of that critique, followed by an exploration of ways to fix the flaws in the Child Care Allowance before it is launched.

## *What's Wrong with the Child Care Allowance*

This analysis of the Child Care Allowance is based on the little information that has been made public to date about the design of the initiative: It will be paid on a monthly basis on behalf of every child 5 years of age and under. It will be taxable in the hands of the lower-income parent in couples and the parent in single-parent families. And it will replace the Canada Child Tax Benefit's young child supplement for children 6 and under.

These features indicate serious flaws in the design of the Child Care Allowance. While the federal government may be committed as a matter of principle to paying cash to parents, surely the specific design of the cash payment is only a pragmatic choice of the fairest, most efficient design. We hope the government will consider our criticisms and our suggestions for remedying these problems.

### *Lack of transparency: virtually no families will end up with $1,200*

The Choice in Child Care Allowance is an example of 'social policy by stealth' – the use of arcane and poorly understood technical mechanisms to implement public policy changes without public explanation of their real consequences. Classic examples of policy by stealth are partial de-indexation of the personal income tax system and child benefits between 1986 and 2000, the non-indexation of welfare benefits and the freeze of the Canada Pension Plan's year's basic exemption.[2] Policy by stealth subverts the goals of transparency and accountability that governments today purport to cherish and pursue vigorously.

The Child Care Allowance will pay $100 a month – $1,200 a year – for every child under 6. But this promise is deceptive: Virtually no family will end up with this amount, and many working poor and modest-income families will get considerably less.

There are three reasons why the Child Care Allowance will be worth less than $1,200 a year.

First, because it is a taxable benefit, the Child Care Allowance will increase families' federal and provincial/territorial income taxes; as their taxable incomes rise, so will their income taxes. This feature will affect the large majority of Canadian families with children, which pay income tax, exempting only those with very low incomes.

Second, if the Child Care Allowance is included in the calculation of net family income – as is the case for other major income benefits such as Old Age Security, the Canada and Quebec Pension Plans, Employment Insurance and social assistance – then it will increase families' net income and so will reduce their benefits from geared-to-income programs such as the federal Canada Child Tax Benefit and refundable GST credit, as well as provincial/territorial child benefits, earnings supplements and refundable tax credits. This feature will affect lower-income and modest-income families that are the main recipients of income-tested programs (the exception being the broad based Canada Child Tax Benefit, which also serves most families with above-average incomes).

Third, the Child Care Allowance will replace the Canada Child Tax Benefit's young child supplement, which currently (July 2005-June 2006) pays an extra $243 per year for children 6 and under, rising to $249 for July 2006-June 2007 when the Child Care Allowance will launch. However, if families claim the child care expense deduction, they usually do not receive the young child supplement. The child care expense deduction is used mainly by higher-income families with receipted child care expenses, while the young child supplement goes chiefly to low- and modest-income families that do not claim the child care expense deduction. This feature of the new program will right off the top – before we even count income tax hikes and benefit reductions – lower the $1,200 Child Care Allowance from $1,200 to $951 for families (most of them with low or modest incomes) that currently receive the young child supplement under the Canada Child Tax Benefit.

Of course, we hope that the actual design of the Child Care Allowance, when it is revealed in the upcoming federal Budget, will attempt to avoid at least some of these problems. However, the tax system is a complex web of credits and benefits, so while the most extreme consequences may be mitigated, there are others that may well pass unseen. In the meantime, as there has been no suggestion to the contrary, we have to analyze the proposal as it has been presented.

Take the example of an employed single parent living in Ontario with one young child and net family income of $30,000, which is in the middle-income range for that type of family (estimated average income for an employed single parent in 2006 is $33,900). The family will receive a Child Care Allowance of $1,200 for a year. But that $1,200 in additional income means that the family will pay $337 more in federal and Ontario income taxes. If none of the Allowance's effects on income-tested benefits are mitigated, the family will receive $561 less from geared-to-income federal and Ontario tax credits and child benefits (whose payments fall as incomes rise). The total tax increase and benefit reduction comes to $899. Thus the net (after tax and benefit reductions) Child Care Allowance is $301 – just one-quarter of the promised $1,200.

Table 1 shows the gap between gross and net benefits from the Child Care Allowance for one-earner couples, single parents and two-earner couples at various earnings levels. We assume that one-parent families and two-earner couples with net incomes of $50,000 and higher claim the child care expense deduction and so do not get the young child supplement.[3] All families will end up with less than $1,200 per child under 6 once resulting income tax hikes and benefit reductions (including the loss of the Canada Child Tax Benefit's young child supplement) are factored in. These figures are for Ontario, but the same general pattern will apply to other jurisdictions.

About the only situation we can conceive in which a family would keep the full $1,200 Child Care Allowance would be the rare and likely purely theoretical instance in which a family with very low employment income does use the child care expense deduction (this tax break is claimed by the lower-income parent in the case of couples or by the single parent), does not receive the young child supplement and is below the taxpaying threshold. In the case of Ontario families, that would be only families with incomes under $2,000, since the $1,200 Child Care Allowance will reduce Ontario property and sales tax credits even at very low incomes. For all intents and purposes, virtually *no* family will get to keep the full $1,200 Child Care Allowance.

It is especially ironic and unfortunate that the families which do worst are working single parents and two-earner couples with modest incomes – precisely those who Canadians probably think most in need of affordable and accessible child care.

### ***Lack of transparency: it's a child benefit, not a child care program***

The Child Care Allowance is a stealthy program in another significant way. Despite its name, the Allowance is not a child care program in the usual sense of that term, because it is not designated for child care uses – unlike the child care expense deduction in the income tax system, which reduces federal and provincial/territorial income taxes for families in which the claiming parent incurs child care expenses to work or study, and unlike child care subsidies for low-income parents, which are built into provincial/territorial child care systems.

The Child Care Allowance is really a child benefit because – like the federal Canada Child Tax Benefit and income-tested child benefits and earnings supplements offered by provinces and territories – families use the money as they decide, though most doubtless spend much or all of it on their children. While a child benefit can be used for child care, it is not tied to that use.

### *Unfair to modest-income families*

The federal Canada Child Tax Benefit and GST credit and provincial/territorial child benefits and refundable tax credits are *income-tested* programs: The amount they pay is geared to level of income, so that low-income recipients get the maximum payment and non-poor recipients receive a smaller amount that decreases as incomes increase, eventually to disappear.

For example, the Canada Child Tax Benefit at its July 2006-June 2007 rates will deliver its maximum payment of $3,449 for families with one child (under 7) with net income under $20,435, $2,282 to families with net income of $30,000, $1,232 to those at $50,000, $732 at $75,000, $232 at $100,000 and zero once net family income exceeds $111,578.[4]

By contrast, the Child Care Allowance will not distribute its benefits in a rational or fair manner. In fact, it will pay its lowest benefit to families with modest incomes in the $30,000 range, as shown in Table 1 and pictured in Figures 1 and 2. We assume that all families have one child eligible for the Child Care Allowance; the single parent has one child and the couples have two children.[5]

**Figure 1**
**Net Child Care Allowance for one child,**
**by family type and income, Ontario, 2006**

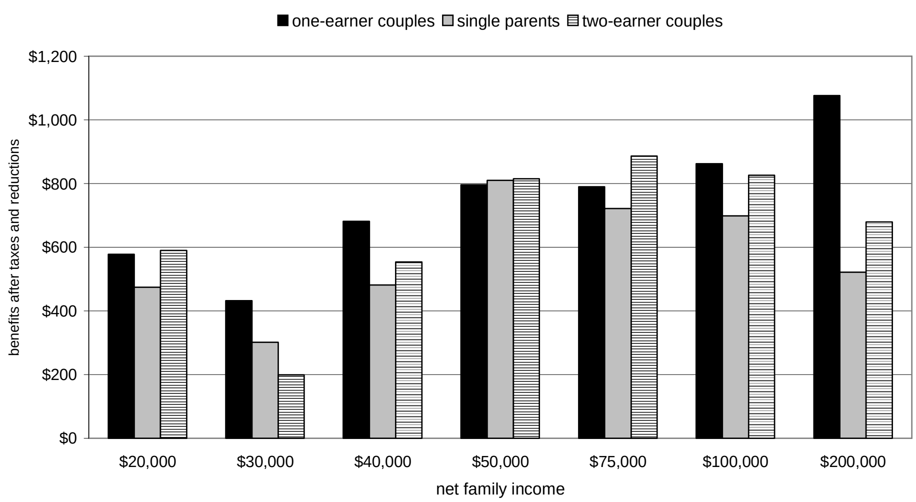
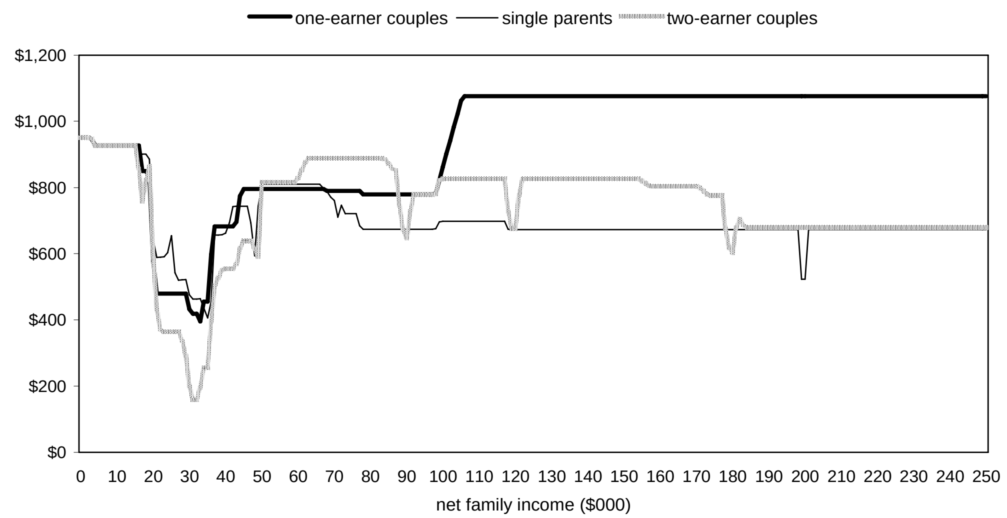


**Table 1**
**Gross and net value of Child Care Allowance for one child, by family type and income, Ontario, 2006**

| net family income | government gives (gross benefit) | governments take (taxes & reductions) | families end up with (net benefit) |
|---|---|---|---|
| | $ | $ | $ |
| $0 | | | |
| one-earner couple | 1,200 | 249 | 951 |
| single parent | 1,200 | 249 | 951 |
| two-earner couple | 1,200 | 249 | 951 |
| $10,000 | | | |
| one-earner couple | 1,200 | 273 | 927 |
| single parent | 1,200 | 273 | 927 |
| two-earner couple | 1,200 | 273 | 927 |
| $20,000 | | | |
| one-earner couple | 1,200 | 622 | 578 |
| single parent | 1,200 | 726 | 474 |
| two-earner couple | 1,200 | 610 | 590 |
| $30,000 | | | |
| one-earner couple | 1,200 | 768 | 432 |
| single parent | 1,200 | 899 | 301 |
| two-earner couple | 1,200 | 1,001 | 199 |
| $40,000 | | | |
| one-earner couple | 1,200 | 518 | 682 |
| single parent | 1,200 | 719 | 481 |
| two-earner couple | 1,200 | 646 | 554 |
| $50,000 | | | |
| one-earner couple | 1,200 | 404 | 796 |
| single parent | 1,200 | 390 | 810 |
| two-earner couple | 1,200 | 385 | 815 |
| $75,000 | | | |
| one-earner couple | 1,200 | 410 | 790 |
| single parent | 1,200 | 479 | 721 |
| two-earner couple | 1,200 | 313 | 887 |
| $100,000 | | | |
| one-earner couple | 1,200 | 338 | 862 |
| single parent | 1,200 | 502 | 698 |
| two-earner couple | 1,200 | 274 | 826 |
| $200,000 | | | |
| one-earner couple | 1,200 | 124 | 1,076 |
| single parent | 1,200 | 678 | 522 |
| two-earner couple | 1,200 | 521 | 679 |

**Figure 2**
**Net Child Care Allowance,**
**by family type and income, Ontario, 2006**




The irrational distribution of Child Care Allowance net benefits is clear to see. Take the case of two-earner couples, illustrated in the third bar in each cluster in Figure 1.

Two-earner couples with zero earnings end up with a net Child Care Allowance of $951, while those at $10,000 get $927, falling to $590 at income of $20,000. Net benefits plunge to a mere $199 at $30,000 and then rise to $554 at $40,000, $815 at $50,000 and $887 at $75,000, declining to $826 at $100,000 and $679 at $200,000. The $30,000 two-earner couples end up with the lowest net Child Care Allowance – $199 or just 16.6 percent of the gross payment of $1,200. Thus the net Child Care Allowance for two-earner couples earning $30,000 ($199) is $616 less than the benefits of families with net income of $50,000 and even substantially below those of upper-income families at $100,000 ($627 less) and $200,000 ($480 less).

Another striking comparison is between the lowest and highest net Child Care Allowance. The smallest net benefit – $159 – goes to two-earner couples at $31,000 and $32,000. The largest net benefit – $1,076 – goes to one-earner couples with net incomes of $106,000 or more.

Figure 2 expands the analysis to look at the net Child Care Allowance for the three family types over a broad range of net family income from zero all the way to $250,000. Benefits plummet between $20,000 and $40,000, then rise again in amounts that fluctuate according to family type and income level.

Why will modest-income families in the $30,000-$40,000 range fare worst under the Child Care Allowance? The answer is that they will be hit by a double whammy: Not only will they pay more income taxes, like other families, but they also will be hit hardest by reductions in income-tested benefits that are targeted to them, such as the Canada Child Tax Benefit, GST credit and provincial/territorial refundable tax credits and child benefits.

Note that these losses in geared-to-income benefits do not mean that the programs like the Canada Child Tax Benefit and GST credit are faulty: By design and purpose, their payments decline as family incomes rise. The fault is with the design of the Child Care Allowance.

### *Unfair to single parents and two-earner couples*

Unlike the Canada Child Tax Benefit, the Child Care Allowance will treat some families better than others even though they have the same net income and number and age of children. Overall, one-earner couples will end up with larger net benefits than single parents and two-earner couples. This makes no sense if we consider the Child Care Allowance to be in fact for child care, as families that pay for out-of-the-home child care have higher expenses than do those with a work-in-the-home parent.

The reason that the Child Care Allowance favours one-earner couples is that the benefit will be taxable in the hands of the lower-income spouse, who in the case of one-earner couples has no income and thus pays no federal or provincial/territorial income tax on the Allowance. However, even one-earner couples end up with less than the full $1,200. Unless their incomes are above $106,000, their disappearing point for the Canada Child Tax Benefit, they will lose the $249 young child supplement. The Allowance also will reduce the married credit claimed by the other spouse, thus resulting in a small income tax increase for the taxpaying parent. As well, the lower-income spouse’s net income will increase, thus reducing the family’s income-tested federal and provincial/territorial benefits. So most one-income families will not end up with the full $1,200 Child Care Allowance, though they fare much better than single parents and two-earner couples with the same incomes.

The differences are strikingly inequitable. Only at low income levels do the three family types get the same benefit. At $30,000, one-earner couples end up with $432, as opposed to $199 for two-earner couples and $301 for single-parent families. The one-earner couple advantage extends to higher income levels as well. At $100,000, one-earner couples would receive $862, versus $826 for two-earner couples and $698 for one-parent families. The largest net Child Care Allowance of all shown in the table goes to one-earner couples at $200,000, who end up with $1,076, as opposed to $679 for two-earner couples and $522 for single parents.

### *It could raise the welfare wall*

The 'welfare wall'[6] refers to the fact that welfare recipients receive both cash and in-kind benefits that are normally not available to the working poor. These benefits include welfare payments for family members, supplementary health and dental care, and supports for persons with disabilities. Canadians who leave welfare for work lose these benefits at the very time that they struggle to get by on (typically) low wages that are reduced by income and payroll taxes, and stretched by employment-related expenses such as clothing and transportation. The welfare wall creates obstacles for moving off welfare to work, and treats working poor Canadians unfairly. The welfare wall perversely creates incentives to stay on welfare and disincentives to get and keep a low-wage job.

One of the achievements of the National Child Benefit reform is that it has lowered that part of the welfare wall that had been created by child benefits. Before the National Child Benefit, welfare families received about double the amount of child benefits as working poor families. Substantial increases to the federal Canada Child Tax Benefit, coupled with compensating reductions in provincial/territorial welfare-embedded child benefits in most provinces, have pretty much closed the child benefits gap between families on welfare and the working poor, so that all low-income families receive the same amount of child benefits regardless of their other sources of income.

The Child Care Allowance threatens this hard-won progress by adding another layer to the welfare wall. If provinces and territories allow welfare families to keep the $1,200 Allowance, as several (Saskatchewan, Ontario, New Brunswick and PEI) already have announced, they will end up with $1,200 less the $249 young child supplement, or $951. But working poor families will receive less. For example, a working poor single-parent family in Ontario earning $20,000 will lose $726 in taxes and benefit reductions, for a net Child Care Allowance of $474 – $477 less than a welfare family. Adding to this inequity is the fact that, in some jurisdictions, families on welfare already have fully or almost fully subsidized child care, whereas many working poor families are unable to find quality, affordable child. This is not to say that families on welfare will get too much, but that low income working families should get the same net amount as those on welfare – not less.

The National Child Benefit reform took Canadian social policy a giant step forward by ending the unequal treatment of poor families whereby working poor families got about half the level of child benefits of families on social assistance. The Child Care Allowance threatens to erode this progress by creating another invidious distinction within low-income families with children.

### *Inadequate recognition of child care costs*

Setting aside for a moment the issue of the gap between gross and net benefits, the Child Care Allowance falls short of its promise in another way: It will not buy much child care, especially quality, regulated care.

The most recent figures (for 2003-04 in most cases) indicate that parent fees for full-time centre-based regulated care range, for infants, between around $6,000 and $12,000, and for toddlers and preschoolers from about $5,000 to $8,000. (These figures exclude Quebec, which offers a relatively low $7 per child per day fee, the rest being paid for by taxpayers generally). Doubtless families will welcome an extra $1,200, but that will not go far – all the more so once we factor in the Allowance-triggered tax hikes and benefit reductions.

Most families still use private, unregulated child care, whose cost is not known but likely ranges from modest for some family-based care to expensive for nannies and designer child care centres. The proposed Child Care Allowance will provide a windfall subsidy to upper-income families that already enjoy a significant federal and provincial/territorial income tax savings from the child care expense deduction. But the Allowance will do little to ease the often heavy financial burden of child care expenses for the large majority of families with low or middle incomes that do not have access to subsidized child care, get little or nothing from the child care expense deduction and often cannot find affordable, good quality care.

### *Demand will not create supply*

The new government's Child Care Allowance embodies a 'demand-side' philosophy in which public funds are paid directly to parents, allowing them to purchase child care on their own. Most child care advocates and social groups, as well as the Liberals and NDP, argue instead for a 'supply-side' approach that focusses on creating a system of quality, affordable services financed largely by the taxpayer (supplemented by parental fees) – much like earlier generations of Canadians built public education and health care systems in every province and territory.

Most Canadian families need and use child care outside the home so that both parents can work in the paid labour force or study. The reality is that most children will continue to be cared for by paid caregivers outside of the home, regardless of what government does. So the real issue is about the quality of child care that these children receive. The basic idea of a supply-side focus is to ensure that children cared for outside of the home have high quality care that will stimulate them and allow them to develop into healthy youngsters and adults. In other words, the supply argument is not about the parents: It is about the children.

The $1,200 Child Care Allowance can be used to buy any kind of child care, regulated or not. Indeed, the Allowance does not have to be used to buy child care. So the Child Care Allowance, which will cover only a fraction of the cost of care for most families, will do little if anything to increase the supply of affordable, quality child care – the most pressing need.

### *Federal intrusion into provincial/territorial fiscal and social policy*

Over the years, the federal and provincial/territorial governments have made increasing use of the personal income tax system to deliver social and economic benefits to Canadians. In recent years, the provinces and territories have been allowed more leeway to design their income tax systems, up to a point (they must follow the same definition of taxable income as the federal government). However, the two orders of governments' tax/transfer systems remain closely connected. Unilateral changes in federal programs can have ripple effects on provincial/territorial benefits and revenues – and even on other federal programs that are delivered through the tax system.

Because the proposed Child Care Allowance will be taxable (in the hands of the lower-income parent or the single parent), the provinces and territories will enjoy some revenue gains, for two reasons. First, they will collect more income tax and, in the case of Ontario and Alberta, more health premiums. Second, their expenditures on income-tested refundable credits and child benefits will decline if the Allowance is counted as net family income.

The provinces and territories doubtless will welcome the windfall revenue gains generated by Ottawa's introduction of the Child Care Allowance. But the same cannot be said for the reductions in payouts from their geared-to-income programs, which will amount to a federally-imposed cut in provincial/territorial benefits – a reduction that will most affect working poor and modest-income families with young children, which will end up with a fraction of their $1,200 Allowance.

The federal government also will see some savings for the same reasons. Its expenditures on the Canada Child Tax Benefit and GST credit will diminish, while it will collect more income tax. Again, though, the Child Care Allowance will cause collateral damage to working poor and modest-income families with young children, who will pay a hefty price for their $1,200 benefit.

### *Threatens to halt decades of slow progress towards a fair and effective child benefit*

Child benefits are among Canada's oldest social programs, dating as far back as 1918 with the creation of the children's tax exemption. Family Allowances arrived in 1945 and the refundable child tax credit in 1979.

By the early 1980s, Ottawa was operating three major child benefit programs that differed in terms of their objectives and designs, resulting in a distribution of total benefits that was not rationally related to income level. Successive Liberal and Conservative governments made a series of reforms to federal child benefits in the 1980s and 1990s that culminated in the 1993 Child Tax Benefit – a single, income-tested program delivered through the tax system providing its maximum payment to low-income families and smaller amounts to non-poor families that gradually decline as incomes increase. All types of family – single parents, one-earner and two-earner couples – with the same net income receive the same benefit.

A quantum leap forward came in 1996 with the launch of the National Child Benefit. This federal-provincial initiative expanded the reform of child benefits to include provincial and territorial welfare-embedded child benefits, which were transformed into geared-to-income child benefits paying equal benefits to all low-income families. Similar in design to the federal Canada Child Tax Benefit, child benefits in a number of provinces and territories are being delivered through the federal child benefit machinery.

Years of effort to build an integrated, rational and efficient child benefit system in Canada – which still requires further investment to reach an adequate level of payments – now could come to a halt. The Child Care Allowance will re-create some of the design flaws of programs past and will make further investment in the effective poverty-fighting Canada Child Tax Benefit unlikely.

## *How to Fix the Child Care Allowance*

The new government is determined to follow through on its election promise to launch the Child Care Allowance. The proposal as analysed above constitutes a 'worst case scenario.' What can be done to avoid the pitfalls identified in this paper?

### *Option 1: save the young child supplement*

The very least the federal government should do is to retain the Canada Child Tax Benefit's $249 young child supplement. Its loss will affect mainly lower- and modest-income families and so will widen further the large Child Care Allowance gap between them and upper-income families.

Abolishing the young child supplement creates another problem. The young child supplement is payable on behalf of children age 6 and under, whereas the Child Care Allowance will go to children 5 and under. If the federal government axes the young child supplement, it also will hurt many families with children 6 years old: Not only will they lose the $249 young child supplement, but they also will not receive the $1,200 Child Care Allowance.

Figures 3 and 4 show the results. While the net Child Care Allowance is larger because the young child supplement is retained, the same irrational and unfair pattern of benefits remains.

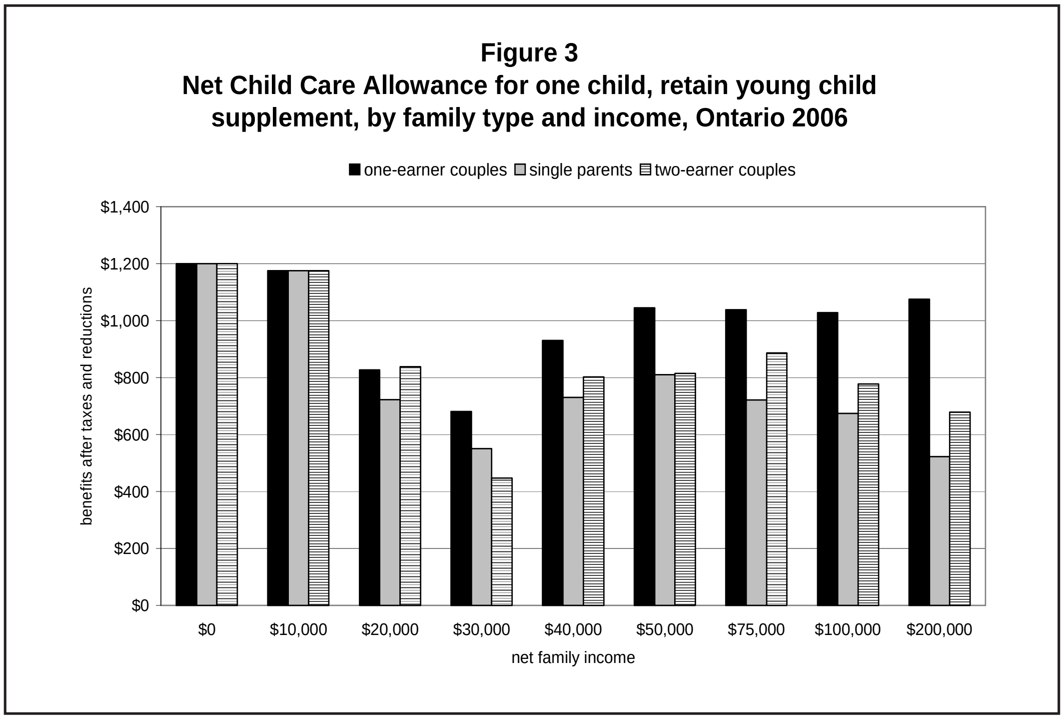


Figure 3
Net Child Care Allowance for one child, retain young child supplement, by family type and income, Ontario 2006
one-earner couples
single parents
two-earner couples
$1,400
$1,200
$1,000
$800
$600
$400
$200
$0
benefits after taxes and reductions
$0
$10,000
$20,000
$30,000
$40,000
$50,000
$75,000
$100,000
$200,000
net family income

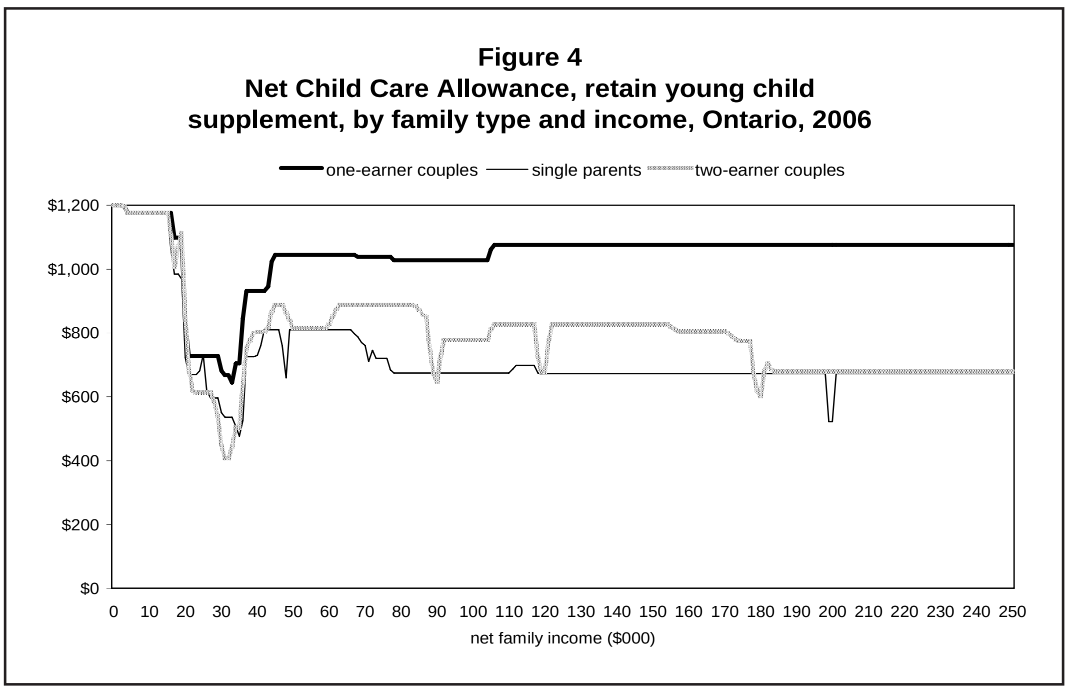


Figure 4
Net Child Care Allowance, retain young child supplement, by family type and income, Ontario, 2006
one-earner couples
single parents
two-earner couples
$1,200
$1,000
$800
$600
$400
$200
$0
0 10 20 30 40 50 60 70 80 90 100 110 120 130 140 150 160 170 180 190 200 210 220 230 240 250
net family income ($000)

***Option 2: exempt the Child Care Allowance from net family income***

One obvious fix is to exempt the Child Care Allowance from the definition of net family income used by income-tested federal and provincial/territorial programs. This change would avoid the unfair treatment of working poor and modest-income families that benefit most from income-targeted programs and so will suffer most from the reductions caused by the $1,200 increase to their income.

Presumably this solution would require only a change to the income tax form, though a timing problem will still arise because Ottawa plans to launch its new program in July 2006. The provinces and territories would have to follow suit in order to prevent the Child Care Allowance-triggered reduction in their various child benefits, earnings supplements, refundable tax credits and other income-tested programs. The Child Care Allowance would still be taxable, in the hands of the lower-income parent or single parent.

An alternative approach with the same effect would be to increase payments from income-tested federal and provincial/territorial benefits to compensate for the Child Care Allowance's impact. However, exempting the Allowance from net income would be simpler.

***Option 2a: exempt the Child Care Allowance from net income and retain young child supplement***

Figures 5 and 6 illustrate the distribution of the net (after-tax) Child Care Allowance among the three types of family at different income levels. We assume that the young child supplement remains in place.

The lowest-income families, up to about $15,000 or $16,000 depending on family type, keep the full $1,200 Child Care Allowance because they are below the taxpaying threshold. As families rise above this level, they pay federal and provincial/territorial income tax on the Allowance, so net (after-tax) benefits decline as families move into higher income tax brackets.

The picture is very different when the Child Care Allowance is not counted as part of net family income but is only taxed. The distribution of benefits – so irrational and unfair when it reduces income-tested benefits – becomes progressive because the income tax system is progressive: Net benefits decline as incomes increase, and the dramatic drop in net benefits in the $20,000-$40,000 range caused by including the Allowance in net income is avoided.

However, there are still significant differences in the net Child Care Allowance allocated to different types of family. One-earner couples fare best by far, with net benefits only slightly below the gross payment of $1,200 due to a slight increase in the higher-income parent's income taxes. Two-earner couples see a larger income tax bite, though less than single parents up to $180,000, where they converge.

**Figure 5**
**Net Child Care Allowance for one child, exempt from net income and retain young child supplement, by family type and income, Ontario, 2006**

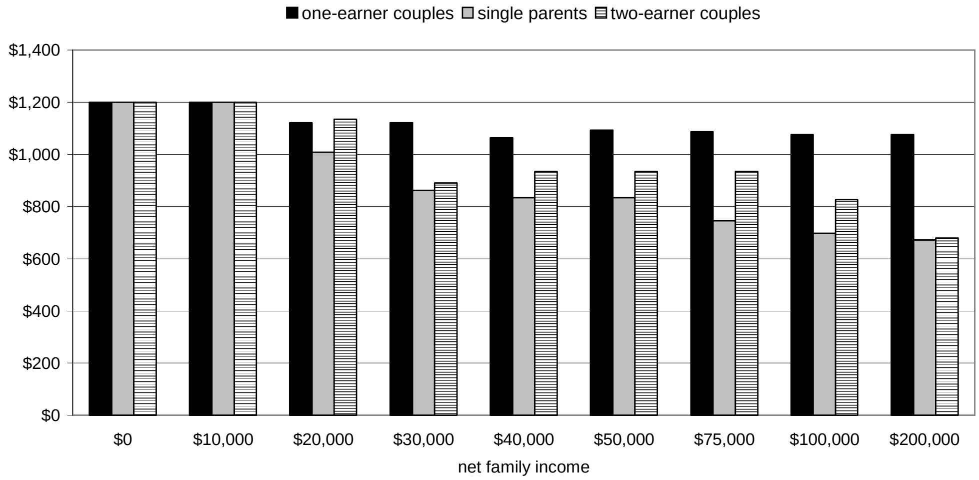
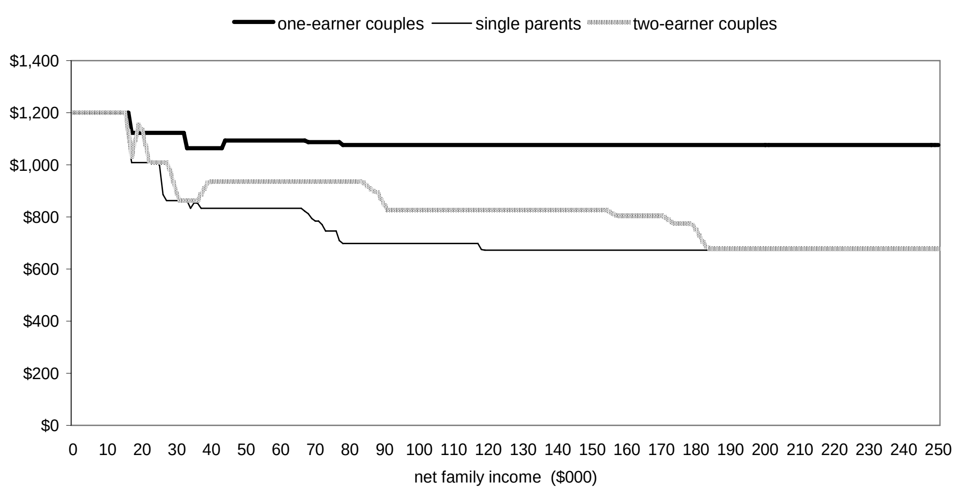



**Figure 6**
**Net Child Care Allowance for one child, exempt from net income and retain young child supplement, by family type and income, Ontario**



Exempting the Child Care Allowance from net income so that it is only a taxable benefit redresses the vertical inequities of the proposed version: Benefits are distributed in a progressive fashion, declining as incomes rise. But significant horizontal inequities remain, as different types of family get different benefits even when they have the same income. One-earner couples are still favoured under this option

### *Option 2b: exempt the Child Care Allowance from net income and abolish young child supplement*

If the federal government were to exempt the Child Care Allowance from net income but still carry through on its plan to abolish the young child supplement in the Canada Child Tax Benefit, then the picture becomes complicated, confusing and inequitable, as illustrated in Figures 7 and 8.

Once again, no family ends up with the full $1,200. Low-income families up to $10,000 get the largest net Child Care Allowance – $951 – but don't get the full $1,200 because they lose their $249 young child supplement. Net benefits (after taxes and loss of the young child supplement) decline as incomes increase to $40,000, as shown in Figure 7. But we assume that families with

**Figure 7**
**Net Child Care Allowance for one child, exempt from net income and abolish young child supplement, by family type and income, Ontario, 2006**

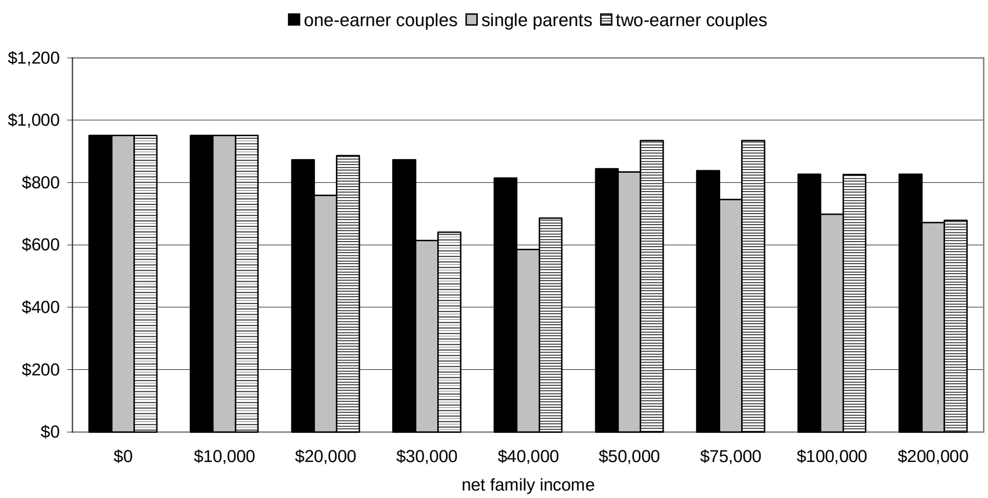
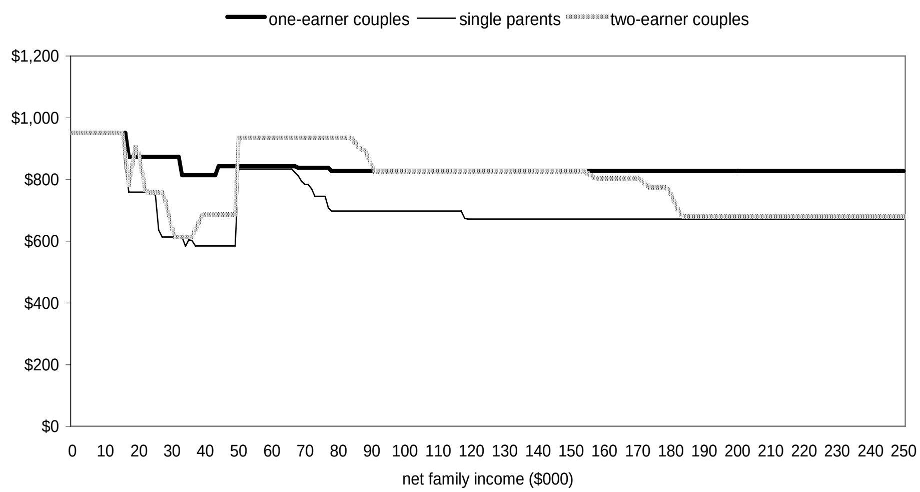


**Figure 8**
**Net Child Care Allowance, exempt from net income and abolish young child supplement, families with one child, by family type and income, Ontario, 2006**




$50,000 or more claim the child care expense deduction and so do not get the young child supplement under the current Canada Child Tax Benefit – thus will not lose it under this Child Care Allowance option. Net benefits increase from $40,000 to $50,000 but then decline again as higher income taxes kick in.

This option also creates inequality according to family type, though the pattern is complicated. One-earner couples between $20,000 and $40,000 and above $160,000 get larger net Child Care Allowances than single parents and two-earner couples. Between $50,000 and $90,000, two-earner couples fare better than the other types of family.

### *Option 3: a universal non-taxable Child Care Allowance*

An easy fix to the problems noted in the above designs for the Child Care Allowance is to make it a non-taxable flat-rate benefit that is exempt from net income. Every family would receive $1,200 for each child under age 6, but would not repay to governments any of this money in the form of income taxes and benefit reductions. Figure 10 pictures the results, assuming the young child supplement is retained.

The drawback to this option is that it departs radically from the current philosophy of income-tested child benefits, in which the poor get the most and the well-off the least. It also would be the most expensive design, since every family – regardless of income – would receive the full $1,200 for children under 6.

### *Option 4: deliver the Child Care Allowance through the Canada Child Tax Benefit*

We already have an established and effective social program that pays a non-taxable child benefit, but which is geared to income – the Canada Child Tax Benefit.

The Canada Child Benefit avoids all of the Child Care Allowance's pitfalls: The Canada Child Tax Benefit is a modern income security program that treats all families (two-earner couples, one-earner couples, single parents) at the same income level equally; it is a non-taxable benefit, so what you see is what you get; it has no impact on provincial/territorial tax/transfer systems or on their revenues; it is a progressive program that gears the amount of its benefits to family income; and it is a proven and powerful poverty reduction instrument. It is a broad-based program that serves the large majority – about nine in ten – of families, excluding only those with high incomes.[7] And the Canada Child Tax Benefit enjoys multi-party and multi-governmental political support.

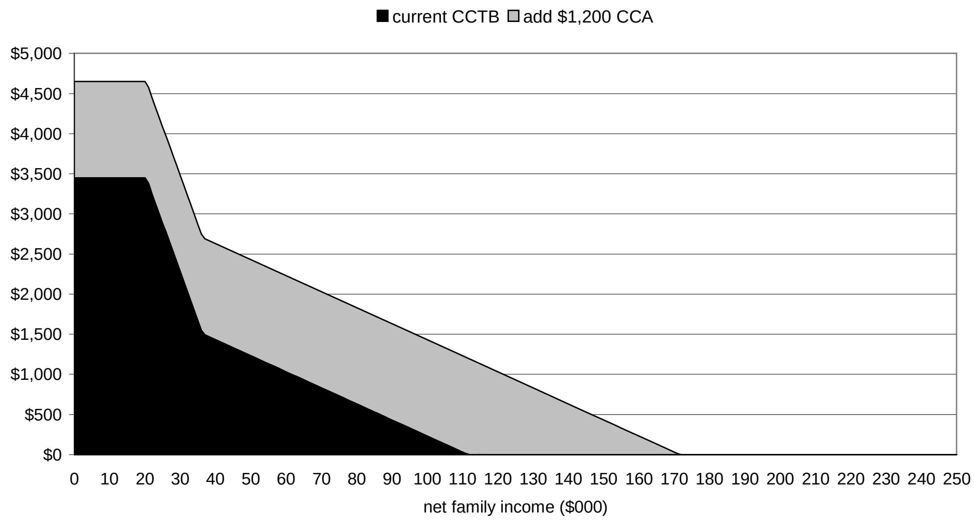
There is precedent for using the Canada Child Tax Benefit (CCTB) as a platform to deliver other benefits. In 2003 Ottawa added a Child Disability Benefit, and a number of provinces deliver their child benefits through the CCTB. In 2004 the federal government created another CCTB-delivered program, the Canada Learning Bond. Intended to help low-income families save towards their children's post-secondary education, the Canada Learning Bond pays $500 at birth and $100 each year thereafter (to a cumulative total $2,000) for each child in families that receive the Canada Child Tax Benefit's National Child Benefit Supplement (i.e., that portion of the CCTB that is targetted to low-income families). The extra administrative cost should be almost zero. Therefore, delivering the Child Care Allowance through the CCTB would be a proven and cost-effective way to mount the new program.

The Child Care Allowance would be just as politically visible delivered through the Canada Child Tax Benefit than as a stand-alone program. Each month, families would receive a cheque, which could be broken down into its Child Care Allowance and Canada Child Tax Benefit portions.

Delivering the Child Care Allowance through the Canada Child Tax Benefit platform also would bolster Ottawa's anti-poverty capacity. The Canada Child Tax Benefit at its 2004 rate – a maximum $2,958 for a child under 7 – reduced the rate of family poverty by 26 percent.[8] Adding the $1,200 Child Care Allowance to the $3,449 maximum CCTB (for July 2006-June 2007) would raise the combined maximum payment to $4,649 – not far off the estimated $5,000 target for a mature, adequate child benefit program. The poverty-reduction power of the CCTB/CCA would be all the stronger. Moreover, the $1,200 Child Care Allowance would – when combined with the

Canada Child Tax Benefit – substantially improve child benefits for non-poor families as well. Figure 9 illustrates the current Canada Child Tax Benefit for one child and what it would look like if it also delivered the Child Care Allowance.

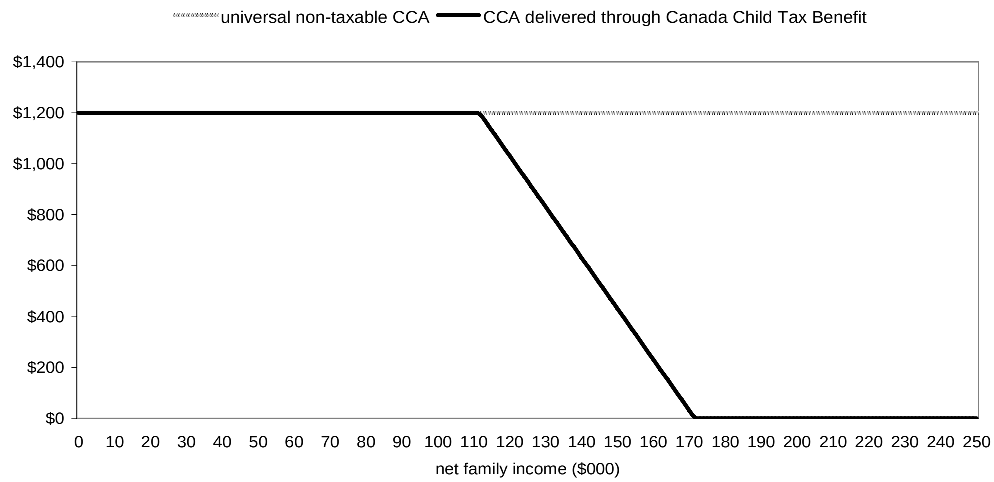
**Figure 9**
**Deliver Child Care Allowance through the Canada Child Tax Benefit, families with one child, 2006**




Adding the $1,200 to the base CCTB would strengthen both the anti-poverty and horizontal equity objectives of the child benefits system. Both poor and non-poor families would enjoy a significant boost in their federal child benefit. For example, the full $1,200 for families with one child would go to families with net incomes up to $112,000, with partial benefits paid above that until the disappearing point of $172,000. The disappearing point for such a family would rise from the current $112,000 to $172,000. And these are net family incomes: At such high levels, gross family incomes are substantially higher (because of RRSP and RPP contributions, child care expenses, etc.)

Figure 10 compares option 3's universal non-taxable benefit and option 4 – the Child Care Allowance delivered through the Canada Child Tax Benefit. They both deliver the full $1,200 to the large majority of Canadian families, though the CCTB delivery option reduces benefits over net family income of $112,000 (for families with one child) and ends at $172,000, whereas the universal nontaxable option pays $1,200 to the wealthy as well.

**Figure 10**
**Universal non-taxable CCA versus CCA delivered through the Canada Child Tax Benefit, families with one children, Ontario, 2006**




### *Comparing the options*

With the several options and sub-options explored above, comparing the results becomes a complicated process. But the analysis suggests some major conclusions.

Included in the government's proposed Child Care Allowance is the abolition of the young child supplement for children 6 and under, which is paid through the Canada Child Tax Benefit. Low- and modest-income families benefit most from the young child supplement ($249 a year as of July 2006) because higher-income families typically claim the (much more lucrative) child care expense deduction and do not receive the supplement. Ending the young child supplement compromises the $1,200 promise, since no family – not even the poorest – will end up with $1,200 because they will forfeit the young child supplement. The poorest families would end up with $951 – $249 or one-fifth less.

The same problem applies to the option in which the Child Care Allowance is exempted from the calculation of net family income. If the young child supplement is not abolished, then this option produces a generally progressive distribution of benefits and avoids the damage wrought by reductions to income-tested benefits, such as the federal Canada Child Tax Benefit and GST credit and provincial/territorial child benefits and refundable tax credits. But if the young child supplement is ended, then this option's distribution of benefits becomes less progressive, and lower-income and modest-income families will get substantially less.

First and foremost, then, Ottawa should not go ahead with its plan to end the young child supplement.

Our second conclusion is that the federal government should exempt the Child Care Allowance from the calculation of net family income. This feature causes the horrific drop in net benefits for working poor and modest-income families in the $20,000 to $40,000 range. To be effective, though, the provinces and territories would have to follow suit and exempt the Child Care Allowance from their income tax systems' definition of net family income.

Options that subject the Child Care Allowance to income taxation create inequities according to type of family. The proposed Child Care Allowance – with or without the young child supplement, and whether or not counted in net income – will create significant inequalities in the net benefits to families of different type but the same income. Overall, one-earner couples enjoy superior treatment over single parents and two-earner couples. Only a non-taxable Child Care Allowance can avoid this problem.

That leaves us with two ways to go to create a non-taxable $1,200 Child Care Allowance. The simplest but most expensive route is to send every family – regardless of income level – a non-taxable benefit of $1,200 a year for children under 6.

Alternatively, the Child Care Allowance could be delivered through the well-proven Canada Child Tax Benefit. While different design variations are possible, simply adding $1,200 to the base child tax benefit would deliver $1,200 to all but very high-income families.

The best option is to use the Canada Child Tax Benefit platform to deliver the Child Care Allowance. This method would be less costly than a universal non-taxable benefit; would improve child benefits for all poor families and the large majority of non-poor families; and would substantially boost the federal child benefit system's poverty-reduction capacity. This is a win-win way to shrink poverty and better help families pay for the cost of raising their – and Canada's – children.

**Table 2**
**Child Care Allowance options,**
**by family type and income, Ontario, 2000**

| net family income and family type | Proposal CCA end supplement | Option 1 CCA keep supplement | Option 2a exempt from net income, keep supplement | Option 2b exempt from net income, end supplement | Option 3 non-taxable universal Benefit | Option 4 CCA via Canada Child Tax Benefit |
|---|---|---|---|---|---|---|
| $0 | | | | | | |
| 1ec | 951 | 1200 | 1200 | 951 | 1200 | 1200 |
| 1par | 951 | 1200 | 1200 | 951 | 1200 | 1200 |
| 2ec | 951 | 1200 | 1200 | 951 | 1200 | 1200 |
| $10,000 | | | | | | |
| 1ec | 927 | 1176 | 1200 | 951 | 1200 | 1200 |
| 1par | 927 | 1176 | 1200 | 951 | 1200 | 1200 |
| 2ec | 927 | 1176 | 1200 | 951 | 1200 | 1200 |
| $20,000 | | | | | | |
| 1ec | 578 | 827 | 1122 | 873 | 1200 | 1200 |
| 1par | 474 | 723 | 1008 | 759 | 1200 | 1200 |
| 2ec | 590 | 839 | 1135 | 886 | 1200 | 1200 |
| $30,000 | | | | | | |
| 1ec | 432 | 681 | 1122 | 873 | 1200 | 1200 |
| 1par | 301 | 550 | 863 | 614 | 1200 | 1200 |
| 2ec | 199 | 448 | 890 | 641 | 1200 | 1200 |
| $40,000 | | | | | | |
| 1ec | 682 | 931 | 1063 | 814 | 1200 | 1200 |
| 1par | 481 | 730 | 834 | 585 | 1200 | 1200 |
| 2ec | 554 | 803 | 935 | 686 | 1200 | 1200 |
| $50,000 | | | | | | |
| 1ec | 796 | 1045 | 1093 | 844 | 1200 | 1200 |
| 1par | 810 | 810 | 834 | 834 | 1200 | 1200 |
| 2ec | 815 | 815 | 935 | 935 | 1200 | 1200 |
| $75,000 | | | | | | |
| 1ec | 790 | 1039 | 1087 | 838 | 1200 | 1200 |
| 1par | 721 | 721 | 745 | 745 | 1200 | 1200 |
| 2ec | 887 | 887 | 935 | 935 | 1200 | 1200 |
| $100,000 | | | | | | |
| 1ec | 862 | 1028 | 1076 | 827 | 1200 | 1200 |
| 1par | 698 | 674 | 698 | 698 | 1200 | 1200 |
| 2ec | 826 | 778 | 826 | 826 | 1200 | 1200 |
| $200,000 | | | | | | |
| 1ec | 1076 | 1076 | 1076 | 827 | 1200 | 0 |
| 1par | 522 | 522 | 672 | 672 | 1200 | 0 |
| 2ec | 679 | 879 | 679 | 679 | 1200 | 0 |

**Endnotes**

1. The federal government's other initiative is a Community Childcare Investment Program intended to create 125,000 new child care spaces over five years, through one-time capital assistance to employers and non-profit community organizations; the Speech From the Throne added "provinces and territories" to this list.

2. Battle, Ken. (1999). *Credit Corrosion: Bracket Creep's Evil Twin*. Ottawa: Caledon Institute of Social Policy, December.

3. Families with net income above $106,000 do not qualify for the Canada Child Tax Benefit and so will not lose the young child supplement (because they don't receive it in the first place).

4. These Canada Child Tax Benefit payments include the young child supplement, payable on behalf of children 6 and under for whom the child care expense deduction is not claimed.

5. Net Child Care Allowance is calculated as the difference between disposable family income with the Allowance and without the Allowance. We assume that, in two-earner couples, one parent has 40 percent and the other 60 percent of earned income. In one-earner couples, one parent has all the earnings.

6. The term was coined by Sherri Torjman, Vice-President of the Caledon Institute of Social Policy.

7. Using July 2006-June 2007 rates, the Canada Child Tax Benefit for families with one or two children disappears above net family income of $99,128, though in terms of gross income, this figure easily could be upwards of $115,000 once deductions such as RRSP and Registered Pension Plan contributions and child care expenses are factored in.

8. Department of Finance Canada. (2002). *Tax Expenditures and Evaluations 2002*. Ottawa: Her Majesty the Queen in Right of Canada. This estimate is for the CCTB at its 2004 rates.