



# **More Than a Name Change: The Universal Child Care Benefit**

*by*

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Michael Mendelson**

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ISBN 1-55382-196-3

Published by:

Caledon Institute of Social Policy  
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The 2006 federal Budget virtually destroyed Canada's fledgling national child care system, introduced a slightly-less-bad-than-it-could-have-been child benefit and announced some modest improvements, such as disability tax measures. Caledon will review these various changes in a subsequent document. In the meantime, we focus here on the federal government's first major social policy initiative, the 'Universal Child Care Benefit' – formerly known as the Choice in Child Care Allowance. More than the name has changed, which is a good thing. However, two big flaws remain uncorrected, creating a deeply inequitable program.

As proposed before the Budget, the new program will pay \$100 a month or \$1,200 a year for each child under 6. It will be taxable in the hands of the lower-income parent in the case of couples, and the parent in the case of single-parent families. To help pay for the Universal Child Care Benefit (UCCB), the Canada Child Tax Benefit's young child supplement (\$249 annually as of July 2006 for children under 7) will be abolished. Both these design features make the Universal Child Care Benefit a stealth program: All families will receive \$1,200, but all of them will effectively repay part of this money to the federal and provincial/territorial governments.

As demonstrated in Caledon's previous critiques of the proposed Child Care Allowance,<sup>1</sup> if the new program had been counted as net family income – as is the case for other taxable income security programs like Old Age Security, the Canada and Quebec Pension Plans and Employment Insurance – it would have reduced payments from income-tested benefits, including the federal Canada Child Tax Benefit and GST credit and provincial/territorial child benefits and refundable credits: As net family income increases, payments from income-tested programs decrease. That factor would have hurt working poor and modest-income families, which benefit most from income-tested programs and so would have suffered from their reduction. Fortunately, the Universal Child Care Benefit is being designed to avoid this problem, since the federal government will not count it as net family income. However, the provincial and territorial governments will have to follow suit and exempt the UCCB from their definition of net family income as well.

Unfortunately, the Budget failed to fix two other design flaws in the Universal Child Care Benefit – its taxability mechanism and its associated abolition of the young child supplement. These features interact to create serious inequities in the distribution of net benefits according to income level and family type.

As a taxable program, the Universal Child Care Benefit will increase families' taxable income by \$1,200 a year. The poorest families, typically those on welfare, are below the taxpaying threshold and so will pay no income taxes on their new benefit (although they will lose the \$249 young child supplement and so will end up with only \$951, as explained below). The large majority of families will pay federal and provincial/territorial income taxes on their \$1,200 UCCB.<sup>2</sup>

The resulting distribution of after-income tax UCCB benefits is progressive, meaning that after-tax benefits fall as taxable incomes rise. Welfare families owe no income taxes on their UCCB; working poor and modest-income families pay a small amount of taxes on their UCCB; middle-income families pay more and upper-income families the most on their UCCB.

So far, so good. Now for the bad.

### **flaw # 1**

The Universal Child Care Benefit will be taxed in the hands of the lower-earning parent in the case of couples and the single parent in the case of one-parent families. As a result, families of different type but with the same income will end up with different after-tax benefits.

Take, for example, the case of families with net income of \$50,000.<sup>3</sup> In the case of two-earner couples, the lower earner will pay federal and provincial/territorial income tax on the \$1,200 Universal Child Care Benefit. Using Ontario as an example, that family's total federal and Ontario income tax payable on the \$1,200 would come to \$265.<sup>4</sup> The one-earner couple will pay only \$213 on its UCCB; the lower-earner parent still owes no income tax even with the extra \$1,200, but the higher-earning spouse will get a smaller married credit (whose value is linked to the lower earner's income) and so will pay more federal and Ontario income tax. The single parent adds \$1,200 to her taxable income and so pays the most federal and Ontario income tax – \$374.

In summary, federal and Ontario income taxes payable on the \$1,200 UCCB range from \$213 for one-earner couples to \$265 for two-earner couples and \$374 for single parents, resulting in after-tax benefits of \$987, \$935 and \$826, respectively. But that's not all.

### **flaw # 2**

The decision to axe the young child supplement throws a second monkey wrench into the design of the Universal Child Care Benefit. Low- and modest-income families typically receive the young child supplement (worth \$249 annually as of July 2006) in the Canada Child Tax Benefit because they do not claim the child care expense deduction, and vice versa for higher-income families (for whom the child care expense deduction is worth much more in tax savings).<sup>5</sup> The loss of the young child supplement further reduces net UCCB benefits for lower-income and modest-income families, and creates a divide between them and higher-income families (which will not lose the young child supplement because they do not receive it in the first place).

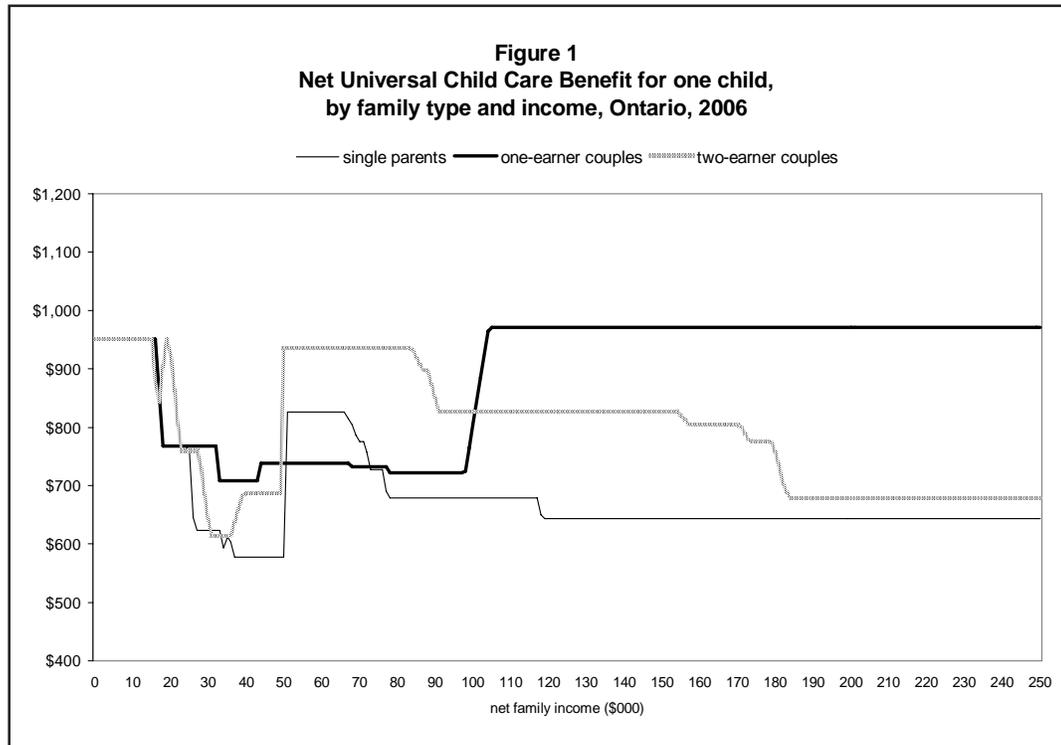
The resulting distribution of net UCCB benefits, taking into account the loss of the young child supplement and income taxes paid on the \$1,200, is complex, confusing and inequitable.<sup>6</sup> Figure 1 illustrates the results.

No family ends up with the full \$1,200. Welfare families net \$951, while working poor and modest-income families are in the \$600-\$800 area. Two-earner couples in the middle-income range for that type of family – \$50,000 to \$90,000 – get about \$900. In the upper-income \$100,000-plus range, one-earner couples get \$970, two-earner couples between \$850 and \$680, and the very small group of single-parent families from \$680 to \$640.

Low-income families, with incomes up to \$15,000, get a net Universal Child Care Benefit of \$951 because the loss of their \$249 young child supplement reduces the \$1,200 payment. Net benefits (after taxes and loss of the young child supplement) decline as incomes increase to \$40,000, as shown in Figure 1. But we assume that families with \$50,000 or more claim the child care expense deduction – thus do not get the young child supplement under the current Canada Child Tax Benefit and will not be affected by its removal. Net benefits increase from \$40,000 to \$50,000 but then decline again for single parents and two-earner couples as higher income taxes kick in. However, one-earner couples’ net UCCB jumps between \$98,000 and \$105,000 as their young child supplement declines and then disappears.

The distribution according to family type varies according to income level, illustrated in Figure 1. At the lowest income levels, all three family types get the same net UCCB (\$951). Net benefits drop for all family types with incomes between roughly \$20,000 and \$40,000, though single parents fare worst. Two-earner couples do best between \$50,000 and \$100,000. One-earner couples enjoy the largest net UCCB between \$25,000 and \$49,000 and from \$101,000 upwards.

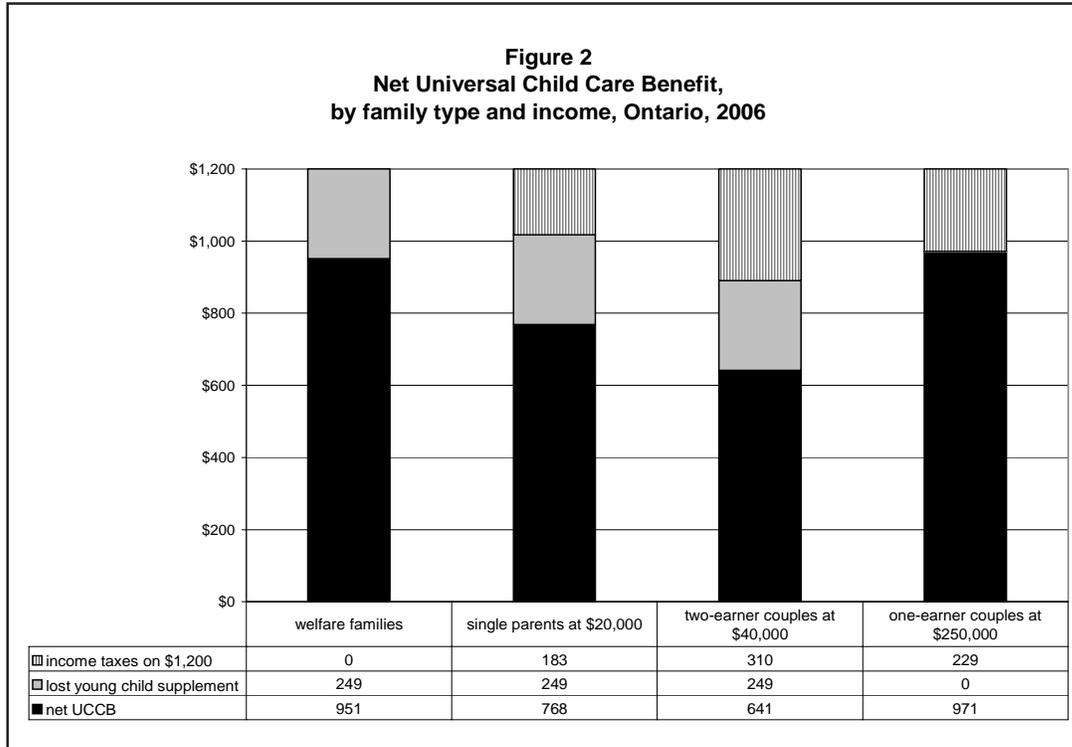
The disadvantaged position of single-parent families and the advantaged position of one-earner couples under the new scheme are striking. Above \$25,000, single parents end up with the smallest after-tax UCCB at all income levels (save \$51,000-\$74,000, where one-earner couples get least), while one-earner couples for the most part fare best. Yet it is precisely single parents who most need assistance for



child care as they have no other options. One-earner couples typically have little or no expenses for out-of-home child care, yet they will usually receive the largest net Universal Child Care Benefit. In fact, despite its title, the Universal Child Care Benefit is not really a child care program, but rather simply another form of child benefit, like the (much better designed) Canada Child Tax Benefit. Families can spend the money as they see fit, on child care or whatever.

Consider these results: One-earner couples with net family income above \$105,000 will end up with a net Universal Child Care Benefit of \$971 – \$20 more than the \$951 net benefit for low-income families earning \$15,000 or less. The UCCB will raise the welfare wall because welfare families will receive more (\$971) than the working poor (e.g., \$768 for a single parent at \$20,000).

Figure 2 shows net UCCB benefits for several types of families at various income levels. The black portion of each bar show net benefits, the gray shaded part the loss of the young child supplement and the vertical bar portion federal and Ontario income taxes payable on the UCCB. There is no rhyme or reason to the way that the new program will distribute its net benefits.

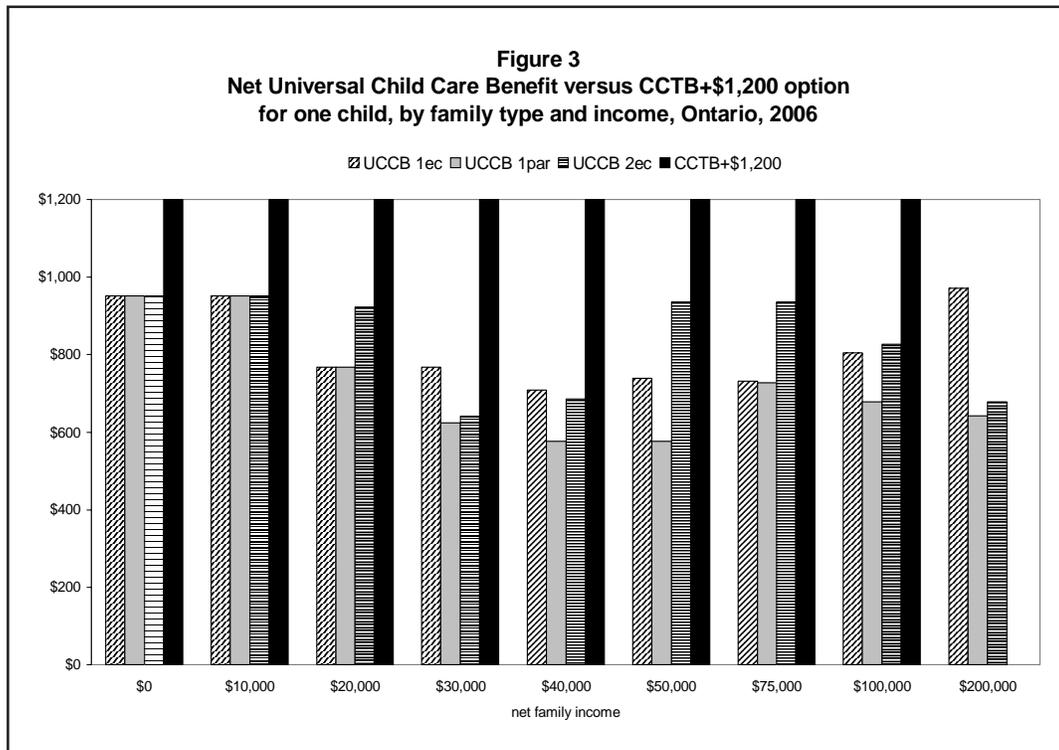


## a better way

At the very least, Ottawa should save the young child supplement. This would go some way to correcting the flaws in the new Universal Child Care Benefit, although the unequal after-tax benefits for different family types – especially the unfair treatment of single parents – would remain.

A better design is to deliver the \$1,200 through the existing Canada Child Tax Benefit (CTTB), maintaining the young child supplement. Figure 3 compares the Universal Child Tax Benefit and Caledon’s proposal to add \$1,200 to the base CTTB; all but high-income families fare far better under the Caledon option. The add-\$1,200-to-the-CCTB option is better than the Universal Child Care Benefit according to almost all reasonable criteria, as summarized on the chart below. The add-\$1,200-to-the-CCTB option would cost an estimated \$2.4 billion on a full year basis, compared with the net federal cost (including ending the young child supplement and additional federal income tax revenues) of \$2.1 billion in 2007-08 for the Universal Child Care Benefit’s first full year of operation.

We find it hard to comprehend the reason for rejecting this simpler and fairer option.



**Universal Child Care Benefit versus \$1,200  
Increase to Canada Child Tax Benefit**

<b>critrion</b>	<b>Universal Child Care Benefit (UCCB)</b>	<b>\$1,200 increase to Canada Child Tax Benefit</b>
transparency	families pay back part of their \$1,200 to governments	families keep what they get (\$1,200 for all but high-income families)
collateral damage to other social programs	families lose \$249 per year young child supplement	no impact on other social programs
progressive distribution of benefits	complex, confusing and inequitable distribution of net benefits	progressive and straightforward distribution of benefits
treats all family types equally	generally favours one-earner couples over single parents and two-earner couples	treats all family types the same
coverage	covers all families with children under 6	covers all but high-income families with children under 6
increases child benefits for poor families	poorest families end up with \$951 per child under 6	poor families get and keep \$1,200 per child under 6
increases child benefits for non-poor families	increases range from \$577 to \$971, varying by family type and income	almost all families get and keep \$1,200 per child under 6
child care costs	pays only part of child care cost for most families	pays only part of child care cost for most families
poverty reduction	net UCCB and CCTB total \$4,400 for poor children under 6	CCTB and extra \$1,200 total \$4,649 for poor children under 6 – close to \$5,000 target
welfare wall (disincentive to leave welfare)	many working poor families get lower net benefits than welfare families	treats all low-income families the same, so does not raise welfare wall
impact on provincial/territorial tax and benefit systems	provinces/territories must decide whether to flow through the \$1,200 to welfare families	provinces/territories must decide whether to flow through the \$1,200 to welfare families
	increases provincial/territorial income tax revenues	no impact on provincial/territorial income tax revenues

## Endnotes

1. Battle, Ken. (2006). *The Choice in Child Care Allowance: What You See Is not What You Get*. Ottawa: Caledon Institute of Social Policy, January. Battle, Ken. (2006). *The Child Care Allowance: How To Fix It*. Ottawa: Caledon Institute of Social Policy, April.
2. The provinces and territories (except Quebec) have to use the same definition of taxable income in their income tax systems as the federal government. However, Premier Binns of PEI has said that his province will not tax the UCCB.
3. The single parents have one child. The one-earner and two-earner couples have two children, one of whom is under 6 and thus eligible for the UCCB.
4. We assume that one parent has 40 percent and the other parent 60 percent of net family income.
5. Some lower-income families receive subsidized child care, while others pay for child care provided by caregivers that do not supply the receipts required to claim the child care expense deduction (because they do not claim that income on their income tax return). Note that one-earner couples, including many with high incomes, generally do not claim the child care expense deduction and so receive the young child supplement (unless their net incomes are so high that they do qualify for the Canada Child Tax Benefit).
6. We assume that the provinces and territories levy income tax on the UCCB, exempt it from the definition of net family income and flow through the \$1,200 to welfare families, with no reduction in their social assistance.