

A Proposal for Restructuring the Universal Child Care Benefit

Purpose

The purpose of this note is to propose a restructuring of the new Universal Child Care Benefit that will address some of the criticisms that have been made of the program. The suggested changes would still achieve the objectives of the Conservative government and provide some additional advantages.

Introduction

The Universal Child Care Benefit (UCCB), recently introduced by the federal Conservative government, has been criticized at two levels – at the policy framework level, and at the design level

With regard to the policy framework, the criticism has been that federal financial support should focus exclusively on the provision of regulated child care spaces rather than providing funding to parents. The author does not support this criticism in principle. Regulated child care

is clearly not the preferred or only acceptable method of child care for many parents in all circumstances. If the federal government is going to financially support the provision of child care, it is difficult to see why parents should not be treated equitably in exercising their choice.

Design Criticisms

At the design level, the UCCB has been criticized for several design flaws, particularly by the Caledon Institute of Social Policy [Battle 2006a and 2006b, Battle et al. 2006]:

- the UCCB's taxability mechanism (federal and provincial/territorial income taxes will be levied on the lower-income parent) means that the program will deliver different amounts of after-tax benefits to families of different types (single parents, one-earner couples and two-earner couples) but the same income, thereby resulting in horizontal inequities.

- the elimination of the Canada Child Tax Benefit's young child supplement (benefiting mainly low- and modest-income families) creates vertical inequity.
- these two design features result in a combined distribution of net benefits (i.e., after taxes and loss of young child supplement) that Caledon characterized as "complex, confusing and inequitable" [Battle et al. 2006: 2]. To avoid these problems, the Caledon Institute recommended that the \$1,200 UCCB be delivered as part of the base Canada Child Tax Benefit, retaining that program's young child supplement.
- Another potential design flaw was pointed out by the Caledon Institute in its pre-Budget critique of the Choice in Child Care Allowance, the original name for the proposed program that became the UCCB in the 2006 Budget. Payments from taxable income security programs such as Old Age Security, the Canada/Quebec Pension Plan and Employment Insurance are counted as net family income. Because eligibility for and the amount of benefits from income-tested programs – e.g., the federal Canada Child Tax Benefit and GST credit and provincial/territorial child benefits and other refundable tax credits – are based on net family income, then increased income from a taxable program like the new child care scheme would result in a reduction in payments from both federal and provincial/territorial income-tested benefits. Lower-income families would have been hardest hit because they are the main beneficiaries of geared-to-income programs. [Battle 2006a: 3]. Caledon recommended that the federal and provincial/territorial governments exempt the new child care allowance from the definition of net income, and the federal government did just that when it announced

the Universal Child Care Benefit in the 2006 Budget.

- A fourth design issue pertains to how the provincial and territorial governments decide to treat the additional income from the UCCB (\$1,200 a year) in terms of welfare payments. If social assistance systems reduce their benefits by the amount of the UCCB, welfare families will see no real gain. However, it appears that the provinces and territories intend to exclude the UCCB for purposes of welfare.

Assessing the Design Criticisms

The different treatment of families of different types (i.e., single parent families, two-parent families with one working parent and two-parent families with both parents working) arises, fundamentally, because the personal income tax system is based on individual income, rather than combined parental or family income. This taxation structure has long been criticized for treating families of different type inequitably at a general level. By contrast, income-tested child tax credits in Canada are determined based on combined (net) income of parents, and this is generally accepted as an equitable basis of treatment.

The problem of equitable treatment under the UCCB, for example, can be seen by comparing the value of the benefit for a single working parent and two-parent families with only one working parent. Since the UCCB is taxable in the hands of the lower income parent, at any family income level, the two-parent family would receive a higher net benefit. Similarly, comparing two-parent families with one earner and two earners, the single-earner family would retain a higher net benefit at any given family income level.

It should be noted that the UCCB, without the elimination of the young child supplement, is progressive in nature for single-parent families and two-earner parent families; that is, the benefit level declines as marginal tax rates increase. Some would argue that the UCCB is not progressive enough; it is certainly less progressive than the CTTB. However, this author would argue that it is not completely unreasonable for the UCCB (or other benefits for children) to provide somewhat greater horizontal equity between families with and without children at higher income levels, at the expense of greater vertical equity among families with young children. Ultimately, this is a matter of personal views with regard to the appropriate balance between vertical and horizontal equity.

The third design issue, that the UCCB could result in a reduction in federal and provincial/territorial income-tested benefits credits, has been addressed by the federal government¹ and a number of provincial governments to date. The author speculates that it is highly likely that all provincial and territorial government will modify their tax systems to avoid any reduction in their tax credits and welfare benefits.

The author agrees strongly with the Caledon Institute's argument that the young child supplement should not have been eliminated. The young child supplement was created in order to provide greater equity between parents with young children who could not benefit from the Child Care Expense Deduction and those who can.² Eliminating the young child supplement (worth a maximum \$249 annually for each child age six and under for whom no Child Care Expense Deduction is claimed) creates greater inequity between families in these circumstances.

It is interesting to note that a windfall result stemming from the UCCB as a taxable benefit is that some of the benefit will enrich

provincial and territorial governments, since they will collect income taxes on the federal UCCB. This seems a rather strange way for the federal government to provide funding to provincial and territorial governments.

Proposal for Restructuring

My proposal consists of the following changes to the UCCB:

1. Apply the (marginal) personal income tax rate at *one-half* of family income to determine the net benefit of the UCCB.
2. To simplify administration, base the UCCB on family income in the prior tax year, as is the case with the Canada Child Tax Benefit.
3. Thus, the Canada Revenue Agency (CRA) could calculate the marginal tax rates (federal, provincial and territorial) based on one-half family income, in order to determine the of UCCB for the current year.
4. Deliver the net UCCB as an add-on to the Canada Child Tax Benefit that would *not* be taxable by either order of government.
5. As a tax credit, the UCCB delivered in this way would not be included in net family income and, thus, would not result in a reduction in other tax credits
6. The estimated tax payable to the provincial and territorial governments would be used to help pay for restoring the young child supplement.

This proposal is not as complicated as it may appear. The Canada Revenue Agency would do all the calculations, as it does now

for the Canada Child Tax Benefit (and RRSP deduction limits).

Let's review the rationale for the components of the proposal:

1. Using one-half of family income as a basis for determining the tax rate to be applied in determining the net UCCB would provide for greater equity among families of different circumstances. For example, it would treat two-parent families with one and two earners on a comparable basis. However, compared to the current system, two-parent families would get less after-tax UCCB, particularly those with only one earner. Single working parent families would be treated comparably with two-parent families with one earner and would be better off than now.

In most cases, the calculations to determine net benefits could be done much more cost-effectively and accurately by the CRA. There is no particular reason why the UCCB could not be based on income in the previous year, as is the Canada Child Tax Benefit, to enable the CRA to make the calculations for the current year.

Once these calculations have been done, the UCCB could be delivered along with the Canada Child Tax Benefit. It should be noted, in this regard, that the Canada Child Tax Benefit and provincial/territorial child benefits in many cases are delivered in one combined cheque even though they are funded by different governments. Surely, the UCCB and the Canada Child Tax Benefit, that are both funded by the same government, could be delivered in the same cheque.

It is most important to note that the effect of this proposal is to transform a taxable benefit, with the personal income tax system's

degree of progressivity, into a tax credit. Thus, progressivity based on personal income tax rates, rather than that of the Canada Child Tax Benefit, would be maintained under this proposal.

Under this proposal, the CRA could calculate the provincial and territorial tax payable on the UCCB for the provinces and territories.

With the UCCB structured as a federal tax benefit, Ottawa can exercise choice as to how to allocate the estimated provincial and territorial taxes that would be payable. These options include:

- (i) Pay the taxes to the provincial and territorial governments.
- (ii) Do not withhold the taxes from UCCB beneficiaries.
- (iii) Retain the funds for other than child care purposes.
- (iv) Use the funds to contribute to a restoration of the young child supplement.

Under the circumstances, the author believes that option (iv) should be the preferred choice under this proposal.

Summary

The author does not have access to either the data or analytical tools to properly assess the financial implications of the proposal outlined above for restructuring the UCCB at either the family or the overall fiscal levels. However, the proposal offers a number of advantages over the current design and does not require any significantly new administrative processes for implementation. Moreover, it would not com-

promise the basic objectives of the Conservative government underlying the measure. Hopefully, the federal government will see fit to further explore this proposal.

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Endnotes

1. In fact, the method that will likely be employed to avoid this problem, will involve a small innovation to the personal income tax system. In particular, it will require reporting the UCCB as part of taxable income but not part of net income, which is the income measure generally used to reduce tax credits. This will require creating a new line on the income tax form below net income but before taxable income. The innovation will be that this will be the only line item in this category that will involve an increase, rather

than a decrease, in net income in computing taxable income.

2. In the author's view, the weakest link in terms of equitable treatment of parents with regard to child care is the Child Care Expense Deduction, which is highly regressive. This Deduction should be restructured as a tax credit or, ideally, all federal government supports for child care should be better integrated with a view to more equitable treatment of families with young children.

References

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