AND THEN THERE WERE NONE

by Derek Rogusky

One of the greatest services *families provide to society is the bearing and rearing of children. In doing so, Canadian parents provide the next generation of producers, investors, consumers, volunteers and taxpayers. However, for several years the birth rate in Canada has remained well below replacement levels. And as many parts of Europe have discovered, serious economic and social challenges follow when countries fail to replace themselves.*

There is growing recognition of the problem, but unfortunately little is being done. Just as the issue has society-wide impact, it will take a society-wide commitment to address it. One area worth examining is the impact tax policy has on families. A quick review of comments on family tax policy reveals three key issues in need of attention:

1. There is insufficient recognition of the financial costs that families with children bear;

2. Single-income families can face more than double the federal tax bill that similar double-income families face; and,

3. Some lower income families are forced to deal with obscene marginal tax rates.

Together, these issues result in a tax policy that penalizes families with children at a time when discouraging child rearing is one of the worst policy moves Canada could make.

Recognizing the Cost of Raising Children

For nearly every Canadian parent, their children are a great source of pride and joy. Some even say children are a gift from God. Children may be a gift, but raising the next generation is still expensive. One study pegged the basic costs of raising a child from birth to the end of the eighteenth year to be in excess of eight thousand dollars per year.[1] And that does not include college or university tuition. However, for many families, Canada's tax policy fails to recognize the full extent of these costs.

Some will claim that families with similar income should pay similar taxes regardless of whether they have children or not. However, there are valid reasons why Canadian tax policy should recognize the financial impact of children on families.

Spending on children is non-discretionary. Once you have children there are some expenses that are absolutely essential. There are basic needs (clothing, food, shelter, etc.) that simply cannot be avoided. There is certainly a difference between designer sneakers and a basic pair of shoes, but there is a minimum level of expenses that parents must cover. In fact, a parent who fails to provide these basic needs can face severe legal consequences.

It is also true that parents generally control the decision to have children (although the exact timing of childbirth is harder to control). However, children are very different than consumer goods. They are not objects; rather, they are human beings with necessary and essential living expenses. Yet, as Canadian economist Jonathan Kesselman pointed out in 1993, "…the costs of raising children are [treated, as if they are] simply consumer outlays like the childless family's choice to purchase a fancy boat."[2]

A 2001 Status of Women Canada study stated:

> *The principle of horizontal equity would seem to demand that taxpayers responsible for dependent children should be treated differently than families without dependent children for tax purposes. Despite this, there has been no universal recognition of the effects of children on ability to pay in Canada since 1992. At that time, an income-tested benefit replaced the child tax credits and the Family Allowance formerly available to all Canadians. Canada became only one of two Organization for Economic Cooperation and Development (OECD) countries to have a tax system which fails to recognize the effect of children on their parents' ability to pay.*[3]

To achieve horizontal equity there must be some recognition of these non-discretionary expenses that all families with children face.

Raising children is a public good. Successfully bringing up children provides a benefit that goes beyond them and the other family members. If Canadian parents collectively raise their children into a productive, energetic and respectful generation of producers, investors, consumers and volunteers, all of society benefits immensely, whether they have children or not. Whereas, if Canadian families collectively maintained their "fancy boats" in mint condition, the benefit to all of society would be minimal. In other words, Canadian parents as a whole provide a free service to the rest of Canadians.

With a dramatically aging population, that service is now more important than ever. Yet, one of the top reasons parents give for putting off having children are financial challenges.[4] Recognizing the non-discretionary expenses associated with child rearing and the public good parenting serves, may raise fertility rates.

The Single-Income Penalty

Canada's tax system penalizes single-income families when compared to double-income families. In 2006, a typical double-income family of four, earning $40,000, paid about $783 in federal income taxes. Meanwhile, a typical single-income family of four also earning $40,000 could expect to pay $2,950.[5] That is more than double the level of taxation the double-income earner family faces.

2007 Federal Income Tax Amounts

Total Income	One-Income Family of Four	Two-Income Family of Four	Difference
$30,000	$(900)	$(301)	$1,201
$40,000	$2,950	$783	$2,167
$60,000	$7,646	$3,928	$3,718
$75,000	$10,968	$6,636	$4,332

This difference results primarily from the progressive nature of Canada's income tax system and the Child Care Expense Deduction (of which double-income families are more likely to make use). Under Canada's approach to income tax, individuals with higher income not only pay more taxes, they also pay a higher rate of tax. Thus, a double-income family with one individual making $30,000 and the other making twenty thousand dollars ends up paying less tax than a single-income family of four with one individual making fifty thousand dollars. Both families face similar financial demands, yet the single-income family pays over twice the amount in taxes. Although the new $1,200 per year Universal Child Care Benefit recognizes the contribution of all parents, the inequity in taxes still remains.

Given that a stay-at-home parent is often kept very busy, it could be argued that when one family member chooses to stay at home, that family receives a benefit in services (such as handling family finances, household cleaning, preparing meals, etc.), tax free. However, with the exception of possibly the highest income families, it is rare that a similar double-income family is purchasing these household services in a significantly greater quantity and thereby paying taxes on the same services. The exception, of course, is child care and work-related expenses. As was already mentioned, child care costs are covered by the CCED. The question must be asked if those additional expenses justify double the tax bill.

Beyond the simple issue of fairness, it is important to note that families with a stay-at-home parent tend to have more children. If a low fertility rate is a challenge for economic and social policy, does it make sense to penalize single-income families?

Canada's Regressive Taxation System?

As a result of the claw back provisions in the Canada Child Tax Benefit (CCTB), some lower income families are hit with the highest marginal tax rates in Canada. The marginal tax rate is the amount of tax on the next dollar an individual earns. Economists are generally more concerned with marginal than average tax rates because the decision to work more is impacted by how much of that new money a worker actually gets to keep.

Since the various programs that make up the CCTB are income-tested, as a family's income increases they become eligible for a smaller portion of the CCTB. This means that every extra dollar a family earns, through a raise or overtime, is offset to some extent by a reduction in the benefit they receive. Combine that with progressive tax rates as income increases and according to reports, some lower income families experience marginal tax rates as high as 70 per cent.[6] Although recent measures to lower overall tax rates have reduced this marginal rate, lower income families can still face some of the highest marginal tax rates in Canada. Keeping only thirty or forty cents of each new dollar earned is discouraging for working families that are trying to get ahead for the sake of their children.

Reducing the high marginal tax rates faced by lower income families will go a long way in developing a family-friendly tax policy. So will eliminating the differences in taxes paid by single-income families compared to those with two incomes and recognizing the non-discretionary costs that families with children face. With an ageing population, a shrinking domestic labour market and growing global competition for immigrants, it is simply good policy, at the very least, reduce the financial burdens that discourage families from having children.

endnotes

1 Manitoba. Manitoba Agriculture and Food. (2002). *Family Finance: The Cost of Raising a Child: 2002*. Retrieved August 27, 2003 from http://www.gov.mb.ca/agriculture/homeec/cba28s02.html.

2 Kesselman, J.R. (1993). The Child Tax Benefit: Simple, Fair, Responsive? *Canadian Public Policy*, 19(2), 109-132.

3 Canada Status of Women. (2001, March). *Mothers as Earners, Mothers as Carers: Responsibility for Children, Social Policy, and the Tax System*. Freiler, C., Kitchen, B., & Stairs, F., with Cerny, J. Ottawa: Ministry of Canadian Heritage and Status of Women and Government Services Canada, p. 36.

4 The Strategic Counsel. (2002). *Canadian Attitudes on the Family: A Focus on the Family Canada National Survey Conducted by The Strategic Counsel, 2002* Langley: Focus on the Family Canada. p. 20.

5 Canada. Department of Finance, Budget 2006. (2006). *2006 Tax Savings Calculator*. Retrieved May 17, 2006 from http://www.fin.gc.ca/budget06/mm/flash_e.html.

6 Poscmann, F., & Richards, J. (2000). How to Lower Taxes and Improve Social Policy: A Case of Eating your Cake and Having it Too. *Commentary*, 136, p. 7.