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MANDATE

The tax treatment of families with dependent children has become the subject of considerable debate in the media, amongst the public, and in the House of Commons. Concern has been expressed about the standard of living of Canadian families, Canadian tax policy, and the perception that government support to families with children has eroded over time.

On 4 March 1999, it was moved in the House of Commons by the Official Opposition "That, in the opinion of this House, the federal tax system should be reformed to end discrimination against single-income families with children." As a consequence of the diversity of opinions expressed during the ensuing debate, the Minister of Finance asked the Standing Committee on Finance to examine this subject matter. On 17 March 1999, the Standing Committee passed the following motion:

The House of Commons Standing Committee on Finance will establish a Sub-Committee to study the tax and transfer system as it applies to families with dependent children. This investigation is to examine the impact of federal policies and determine if they treat families with dependent children in an equitable manner.

The Sub-Committee is to consider the situation of different family configurations (single parent, dual parent-single earner, dual parent-dual-earner) at various income levels to establish if the above noted goals are being consistently met.

In this respect, the Sub-Committee will hear from expert witnesses and other interested parties, and report its findings to the Standing Committee on Finance by 15 June 1999.

The Sub-Committee Report should include estimates of the financial impact on families and the fiscal consequences to the government of any recommendations it might make.

For the purpose of our study, we assumed that the basic characteristics of the current tax system will remain in place. This includes the concept of a progressive rate structure and the fact that the basis of taxation is the individual.

The Sub-Committee commenced its investigation by hearing officials from Status of Women Canada. We also heard from officials of the Department of Finance, and Human Resources Development Canada. Subsequently, we heard from a wide range of experts and individuals in Ottawa and across the country.

As the mandate suggests, this study was originally viewed as an exercise in tax comparisons. In our travels across the country we met many Canadians who helped us to put a human dimension to this issue. We learned about the

choices that parents face when having children, the sacrifices they make and challenges they encounter. It is because of this that we, in fact, go beyond our original mandate in delivering this report.

Much of the current debate as to whether the policies of the Government of Canada treat families with dependent children equitably has focused on the *Income Tax Act*. However, since many benefits to families are provided outside of the income tax system, it is necessary to look at both the tax system and our social benefits programs on a combined basis to assess the question of equity.

Prior to the reform of the child benefits system in 1992, the income tax system contained a non-refundable credit for dependent children that was available to all taxpayers. Families with children were also eligible to receive the family allowance and the child tax credit. Effectively, these measures gave some recognition to the cost of raising children. However, as a result of the 1992 reforms, the non-refundable tax credit, the family allowance, and the child tax credit were removed from the income tax system and amalgamated, to cut program costs, into one program now known as the Canada Child Tax Benefit. As a result of the 1992 reforms, the personal income tax system ceased to contain general provisions recognizing the cost to families of raising children. (See Appendix C for a history of child benefits and Appendix D for a summary of tax and transfer measures related to families with children.)

In Canada, the basic unit for taxation is the individual and not the family. While family status may be taken into account for determining the applicability of certain tax measures, every individual with taxable income is subject to tax on a stand-alone basis. In addition, the federal personal income tax system is a progressive one, which means that the amount of tax to be paid is linked to a taxpayer's ability to pay. Currently, the first \$29,590 of taxable income is taxed at a federal rate of 17%. The next \$29,590 is taxed at 26% and taxable income over \$59,180 is taxed at 29%. Provincial governments also collect income taxes and their rates vary from province to province. The average provincial income taxes are approximately 50% of the basic federal tax payable.

Within the *Income Tax Act*, there remain three main provisions which may directly or indirectly relate to children. In the event that the spouse of a taxpayer has little or no income, the taxpayer may be eligible to claim a spousal amount, which is a non-refundable tax credit often referred to as the spousal exemption. This would be applicable in the case where a parent provides direct parental care in the family home but also applies in the case of a childless couple or couples with grown children where only one spouse works in the paid labour force. Secondly, in the case where a taxpayer has no spouse but has other dependent family members or eligible dependents, the taxpayer may claim an equivalent to married non-refundable tax credit. Each of these provisions can provide a benefit even if there are no children in the family and therefore are not exclusively benefits for families with children.

The third provision is the Child Care Expense Deduction which is available to families where both parents have earned income and incur child care expenses. This is also available to lone-parent families with earned income. Families in which one parent provides direct parental care in the family home cannot claim this deduction even if they incur child care costs such as nursery school. This is the only remaining tax provision which relates directly to costs of raising children, but as noted above, it is not available to all families with children.

Based on the foregoing highlights of the income tax system and its provisions, it is apparent that families with dependent children pay almost as much income tax as families without dependent children who have the same level of income. In addition, because of progressivity and the individual basis of taxation, the one-earner couple will typically pay more income tax than a two-earner couple with the same level of family income. This is true regardless of whether the couples have dependent children or not.

In view of the foregoing, after taking into account the effects of progressivity, the substantial debate has to do with whether the benefits provided to families with dependent children from both the income tax and transfer systems are fair and equitable between families where both parents earn income and those where one parent provides direct parental care in the family home. The tax system has traditionally been judged against two equity criteria. A tax system satisfies the criterion of vertical equity if those taxpayers with a greater ability to pay (i.e. greater discretionary income), pay a higher proportion of their income in tax than those with less ability to pay. A tax system satisfies the criterion of horizontal equity if those in similar economic circumstances pay the same amount of tax. The combined tax and transfer system is judged in the same way.

THE TAX AND TRANSFER SYSTEM: NO SYSTEMATIC INTEGRATION

In order to make a full assessment of the net tax position of families, it is necessary to view the tax system and the transfer system as a whole. The tax system does more than just raise revenue for the government. It is a mechanism by which benefits are delivered to individuals and families. Over time, these benefit programs have been reformed yet they still do not form a comprehensive complement to the tax system.

It is widely recognized that family income is the appropriate basis upon which transfers are delivered to households. Income tested benefits are more precisely delivered to those in need when family income is used. But government transfer programs have been designed, and have evolved over time, to meet a variety of needs and to respond to a

variety of circumstances. Thus what we refer to as the tax/transfer system amounts to an amalgamation of many different programs without any common goal or rationale. It is difficult, therefore, to reconcile all of these elements at the same time.

WHY DO FAMILIES PAY DIFFERENT AMOUNTS OF TAX?

In respecting the mandate of this Committee, we requested that the Department of Finance present a detailed explanation of the income tax system, showing the factors that cause tax liabilities to vary according to family configuration. According to data provided by the Department of Finance, there are two major reasons for the different tax treatment of single-earner and dual-earner couples. With a family income of \$60,000, a dual-earner family, where family income is split 60% and 40% amongst the two earners, could pay as much as \$3,850 less in taxes than a single-earner family. This is true whether or not they have children, and it is due to the fact that the personal income tax system is both progressive and applied to individuals, and not families.

In this particular example, with total family income of \$60,000, the one-earner couple without children has more than half of its total income taxed at the middle marginal tax rate where the combined federal-provincial rate is about 39%. The dual-earner couple without children has less than 11% of its total income taxed at this rate. The majority of its family income is subject to the lowest tax bracket, where the combined rate is 25%.

If, in the case of the dual-earner family, income were split evenly amongst the two spouses, their tax burden would fall even further. No income would be subject to the combined federal-provincial rate of 39%. Seventy percent of income would be taxed at the lowest rate, with the remainder subject to no tax.

If we consider only families with children and recognize the fact that the Child Care Expense Deduction (CCED) can be used to reduce taxes even further, this differential can grow to as much as \$5,875. The CCED is available only to families meeting certain criteria, one of them being to provide to Revenue Canada the name and social insurance number of the individual providing child care or the name of the institution. These deductions are generally allowed only with respect to a parent who works or goes to school. This deduction is not available with respect to other child related expenses, or any expenses incurred by stay-at-home parents.

The Canada Child Tax Benefit (CCTB) is based on family net income, and not family total income. As a result, the dual-earner family in this example receives almost \$200 more in CCTB than the single-earner family. This is true even though the single-earner family is eligible for an additional benefit of up to \$213 per child under the age of seven, by virtue of the fact that it had claimed little or no child care expenses.

In the example provided by the Department of Finance, two-thirds of the tax differential between single-earner and dual-earner couples is a result of progressivity. Only one-third of the differential is due to the effects of the Child Care Expense Deduction.

These results obviously depend upon the numerical examples used. They do give a sense, however, as to the relative importance of the various factors that can produce these results.

The following table is based upon data provided by the Department of Finance. (It should be noted at the outset, that the Committee does not believe that this type of analysis is appropriate.)

It is based on the following assumptions:

- In the dual-income family, the spouse with the higher income earns 50% more than the other spouse.
- Each adult in the workforce incurs additional work-related expenses amounting to \$125 per month (\$1,500 per year).
- Each family has two children, one aged 8 years and the other aged 4 years.
- The dual-earner family incurs child care expenses which equal the maximum deduction then available in 1996, namely \$5,000 for the child under 7 years of age and \$3,000 for the child older than 6 years of age. This is in contrast to the average CCED claim of \$2,600 per family actually taking advantage of this deduction in the 1996 taxation year.
- CPP/QPP and EI premiums are treated as pure, non-discretionary expenditures and no benefits are attributed to them.

There are two main observations that can be made from this table. In the first place, as noted above, the largest component of the tax differential arises from elements of the tax system that have nothing to do with children. This can be seen in the fourth line of the table, entitled "Income Taxes (Excluding CCED)".

The other observation that is evident from this table is that dual-earner couples are likely to be worse off financially than single-earner families, although the exact extent of the gap is not perfectly clear. The Department of Finance

calculates disposable income by deducting taxes paid and other expenditures from total income. Some of these deductions are arbitrary, however. For example, premiums paid for Employment Insurance and CPP/QPP, while involuntary, constitute the purchase of valuable services, either protection against income loss due to unemployment or child rearing, or future income in the form of a pension. Dual-earner families are able to buy more of these services than single-earner families with the same total income, yet the calculation of disposable income by the Department does not take this benefit into account. Indeed, the reader of such a table would conclude that the family buying more of these services is worse off.

Disposable income is not a well-defined concept. To the extent that it is a measure of discretionary income, the bottom line of the table is subject to some debate. For example, child care outside the home entails expenses that are, to some extent, also incurred when child care is provided within the home. Yet the example highlighted by this table does not recognize that fact.

This table highlights two unsatisfactory features of this whole debate. In the first place, it has, to some extent, been driven by concerns that are not on target. In other words, the tax system does not appear, for the most part, to favour one type of family with children over another type of family with children.¹ In our view, the comparison of the two-earner versus one-earner family with the same total income is not an appropriate way to look at the taxation of families with children.

In defending, or at least explaining, the status quo, the Department of Finance also muddies the water to some extent by comparing the tax position of families with children on the basis of disposable income, defined in a very arbitrary way. This defence is also mired in the two-earner/one-earner distinction.

The Committee believes that this analysis, and conclusion, is inappropriate, not just because of the arbitrariness of some of the basic assumptions. It is inappropriate because it asks the wrong question. It is not representative of the choices facing families when they have children. They do not have the option of earning \$60,000 per year through the labour force efforts of one parent or through the labour force efforts of two parents. What they will face is the choice of care arrangements for their children. Both parents could continue to work in the paid labour force and use third-party care, or one could forego market income to provide care in the home.

In the following table, we consider the implications of a family that makes the choice between having both parents work, earning \$60,000 in total income, or having one parent stay-at-home with a decline in total income to \$36,000. In the latter case, this family would experience a drop in total disposable income of over \$8,650. While this family would pay less tax, receive more benefits through the Canada Child Tax Benefit, incur fewer work related expenses and pay less CPP/QPP premiums and EI premiums, none of these is sufficient to offset the significant decline in disposable income. It is this bottom-line result that is the important conclusion in this example. Who gets a tax break and who doesn't get a tax break is not the relevant question to ask.

Thus it is clear that families who choose to forego one income to care for children make a significant financial sacrifice. Furthermore, this sacrifice is not limited to families who "have the financial resources to make such a sacrifice." As the data presented to the Committee by Richard Shillington show, this decision is made almost equally by families of all income levels and is not affected by the income of the father. The following chart from the presentation of Mr. Shillington, using 1994 data, shows quite clearly how parents' decisions about participation in the paid workforce are not affected by the income status of the family. It shows that the proportion of mothers working full time for the full year, in families with preschool children, varies from about 25% to 40%, amongst the income classes. There is, however, no significant and systematic pattern based on the income of the husband.

In its 1996 report to the Government of Canada, the National Forum on Health points out that Canada is the only Western industrialized country that does not take into account the cost of raising children when determining how much tax families with children should pay, compared to those without children. The Forum concluded that there was an urgent need to invest in children and recommended that changes to the tax system be made, to provide greater horizontal equity between families with and without children.

This general conclusion, also applies to dual-earner families who make use of the Child Care Expense Deduction. Although this deduction has the effect of making the tax burden more equal, it is still likely that the family with children pays a disproportionate tax burden in relationship to the one without children. It should also be noted that Canada does not compare favourably with other countries. According to a study by Shelley Phipps,² with the exception of the United Kingdom, households with children generally pay considerably less tax than households without children, with the same before tax income.

THE ROLE OF CHILD BENEFITS

It is not the mandate of this Committee to look at the tax system in general but rather to examine how it affects families with children. The mandate of the Committee was not to consider general tax reform, even though such reform would have an impact on families with dependent children. Instead, we are concerned with those elements of government policy designed for families with children, to see if they are appropriate and applied in a consistent manner.

The Canada Child Tax Benefit which is delivered on the basis of family net income, is largely neutral with respect to family structure. Single-earner couples are for the most part treated the same as dual-income earners and lone-parent families are treated largely like dual-parent families. The only element of non-neutrality arises from the fact that the benefit is based on net income and not total income. It is thus affected by child care expenses and RRSP contributions deducted from income.

Much confusion has surrounded the Canada Child Tax Benefit and the National Child Benefit (NCB) during our hearings. The National Child Benefit was introduced as a replacement for the working income supplement that was previously part of the Child Tax Benefit. This working income supplement was designed to help low-income families who were in the workforce. This supplement was originally designed as compensation for many of the in-kind benefits (dental plans, drug plans, etc.) available to those on social assistance and not available to those in the workforce.

Canadians who are on social assistance receive the National Child Benefit but their social assistance entitlement is often deducted dollar for dollar by the provinces. According to officials at Human Resources Development Canada, all provinces except New Brunswick and Newfoundland are currently reducing social assistance payments to those families in receipt of the National Child Benefit. Provinces that impose these reductions are expected to reinvest the savings into other programs for low-income families. There is no "clawback" of the Canada Child Tax Benefit by the provinces. It is subject only to the 5% reduction (2.5%, in the case of one-child families) that is applied to family income.

Consequently, our concern here is principally with the Child Care Expense Deduction. Statistics from Revenue Canada for the 1996 tax year indicate that this deduction is being used by about 760,000 claimants, with about \$2 billion in total deductions in 1996. Only a small proportion of families with child care expenses (less than one third) actually made a claim under the CCED. We can only speculate as to why so few Canadians make use of this claim. About 30% of those claiming the deduction had income between \$20,000 and \$30,000 per year. Three-quarters of claimants had income between \$10,000 and \$40,000. The average deduction is \$2,600, with the value of the benefits, at this average, ranging between \$650 and \$1,300. As a deduction, the value of the benefit is greater for those with higher incomes.

According to the Department of Finance publication, *Government of Canada Tax Expenditures 1998*, this deduction cost the federal government about \$415 million in 1996, or about \$685 per average taxable claimant. When provincial taxes are also considered, the average tax reduction would stand at just over \$1,000.

Whether or not this is regressive depends upon the nature of the benefit. If, as claimed by many supporters, it is an employment related expense, then it makes sense to allow a deduction. The CCED is used in the calculation of discretionary income, the basis upon which the personal income tax is to be applied.

Despite the fact that, throughout our hearings, the Committee heard support for retaining the Child Care Expense Deduction, we recommend that it be re-examined to determine whether it effectively achieves its policy objectives. Our concern is simply to ensure that it constitutes a valuable element of government programs assisting families with children. This review should address the potential impact of a national day care program on the CCED. In Quebec, for example, the provincial government has started to introduce a day care program that costs parents \$5 per child per day. As a result of large provincial subsidies, parents who use this service face extremely low child care costs. Consequently, the aggregate value of the CCED tax benefit will be minimal to those families. The Quebec subsidy provides an equal benefit to all families making use of this day care program. This stands in contrast to the varying benefit of the CCED.

THE CURRENT APPROACH

The current approach to child benefits is very much the product of the large deficit environment of the late 1980s and early 1990s. With deficits seeming to be almost impossible to control or eliminate, governments sought to restrict the scope of policies so that benefits could be concentrated in those families where they were most needed. Universality was considered unaffordable. Selectivity was a necessary, if not a desirable characteristic of social programs.

Any general recognition of the costs to the family, and value to society, of raising children was abandoned. The selectivity that currently characterizes the system of child benefits is now viewed, by many analysts and witnesses before the Committee, as a serious flaw. Not only is it flawed because it fails to recognize the costs to families of raising children and fails to recognize the value to society of child rearing, this selectivity creates economic inefficiency by subjecting families to extremely high marginal tax rates that severely penalize attempts to improve their economic situation. Workforce participation is discouraged for a large segment of lower income families. As a result of the selectivity of child benefits, these high marginal tax rates apply primarily to families with children. Frances Woolley, of Carleton University, concluded that universal benefits were best because they reach families with children and because they do not produce the high marginal tax rates associated with selective, income-tested benefits.

The Child Care Expense Deduction, while primarily considered to be a work related expense deduction, can also be thought of as a government benefit for those raising children, and not just the incremental costs associated with workforce participation. This is due to the fact that some of the eligible expenses go beyond those that would merely allow a parent to enter the workforce.

The Committee faces a dilemma however. On the one hand it is difficult to determine the proportion of the Child Care Expense Deduction that is related to expenditures on children that are also undertaken by stay-at-home parents. On the other hand, unlike other government benefits with respect to children, we cannot calculate the value to families. This value depends upon the cost of child care and the tax position of the parent who is able to claim this deduction. This latter point could be resolved by converting the CCED into a non-refundable tax credit which would provide a level benefit for all claimants.

What the Committee would like to do is resolve any potential inconsistency in the treatment of families with children (this is consistent with our mandate) and on the other hand provide a general recognition of the parental costs and social value of child rearing (this is where we go beyond our mandate).

ELIMINATING THE DISPARITY BETWEEN SINGLE-EARNER AND DUAL-EARNER COUPLES

As noted earlier, dual-earner couples with the same family income as single-earner couples likely pay less tax. This is due to the progressive nature of our income tax system and the fact that taxes are levied on individuals and not families. The Committee has also argued earlier that the distinction between dual and single-earner couples with the same family income is a misleading one, which masks the true issue. Nevertheless, any reform to the income tax system, and any reduction in tax rates, will likely affect this disparity and the Department of Finance presented the Committee with several possibilities for reform.

For example, a reduction in the middle-income tax rate will reduce the gap for families with average incomes, everything else being held equal. According to the Department of Finance, reducing the middle-income tax rate by one percentage point would cost the federal government \$1.1 billion and lower the tax differential by approximately \$350. This is less than 10% of the calculated tax differential for families with total income of \$60,000, as shown in the first table.

Another way to reduce the disparity is to increase the spousal credit so that it is equal to the basic credit. This reform would cost the federal government \$430 million and reduce the differential by \$180. It should be pointed out that taxpayers can receive the full spousal credit even if their spouses have as much as \$538 dollars in income. If the spousal credit were to be made equal to the basic credit, this \$538 income exclusion should be eliminated.

The gap would also be reduced if the tax system were reformed to be a flat tax. A flat tax, however, would be a major reform to the tax system and would require much more of a justification than any apparent discrepancy in the tax treatment of single-earner and dual-earner families. The Department of Finance also provided data on the cost of this option. A revenue-neutral flat tax would require a marginal tax rate of 22% (5 percentage points higher than the current low marginal tax rate) and would result in a substantial redistribution of after-tax income. For example, 80% of taxable filers would see an increase in their tax liabilities. A flat tax-rate of 17%, while not increasing the tax burden on anyone, would cost the federal government \$17.8 billion.

Moving to a flat tax represents a significant reform of the tax system. Any such examination would be based on considerations that go far beyond the mandate of this Committee. Hence we mention this option only because it was presented to the Committee.

1. INCOME SPLITTING

Many witnesses came before the Committee with numerical examples that compared the tax position of one-earner and two-earner families. They noted the discrepancy in taxes paid, and often suggested income splitting as a solution to this discrepancy. At the same time, they recommended that the Committee study the matter carefully, in recognition of the fact that it might not be the solution in all situations.

Income splitting allows couples subject to different marginal tax rates to even them out in such a way that reduces total family taxes paid. By transferring income to the lower income partner, this technique has the effect of altering the basic nature of the tax system - the degree of progressivity is reduced and the unit of taxation becomes the family.

As demonstrated in the first table, a dual-earner couple with the same total income as a single-earner couple is not as well off as the latter. Not only are there additional employment related expenses that must be incurred with respect to the second worker, the value of unpaid work in the home, or leisure, must also be taken into account. While difficult to quantify, the principle must be recognized. Thus income splitting must be subject to certain limits. The Department of Finance estimates that a simple income splitting mechanism, applied to families with children, would cost the federal government \$4 billion. This proposal would provide no benefit to lone-parent families. It would only benefit those dual-earner families where the two adults are in different marginal tax brackets.

2. JOINT FILING

Another approach to reducing this discrepancy is to apply tax on the basis of family income rather than individual income. This also poses its own set of problems. It would discourage labour force participation by secondary earners since they would be subject to high marginal tax rates even on low income levels as explained by Robin MacKnight of the Canadian Tax Foundation. Thus family taxation, implemented in its most simple form, (i.e. one which does not sufficiently increase basic exemptions or tax bracket thresholds), would not be neutral. The Department of Finance estimates that a simple form of family-based taxation will only create losers (about 84% of taxable filers) and would result in additional federal tax revenues of \$8.5 billion. Many of these adverse effects could be offset by making family taxation revenue neutral, however it would still have the effect of taxing marriage - married couples would have to combine their incomes into one whereas common law couples could not be forced to do the same.

EXTENDING THE MANDATE OF THE COMMITTEE: VALUING CHILD REARING

In conducting these hearings, the Committee realized that it would be very difficult to stay within the scope of its mandate. While the policy debate that led up to our study was quite limited, focusing almost entirely on the issue of single-earner vs. dual-earner taxation, our hearings led us to realize that the subject could only be addressed within a much broader context.

Some of the suggestions mentioned above in fact go beyond our mandate. But even those are too limiting.

It is important that the tax/transfer system be fair, and be seen to be fair. The system of child benefits must be more than fair. It must achieve the appropriate social goals, namely to recognize the social benefits of child rearing, especially in the early years.

If there are social benefits to child rearing, and we believe there are, then government policy should seek to ensure that those benefits are maximized. Early childhood development is crucial to the formation of healthy, well-rounded individuals. In the early months and years, parents are crucial. This issue is currently being studied by another Committee of the House of Commons, the Sub-Committee on Children and Youth at Risk of the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, which will report separately to the House.

When parents have a child the choices they confront are not to be a single-earner family earning \$60,000 or a dual-earner family with the same income. The choices they face are generally to be a single-earner family with \$36,000 of total income or a dual-earner family with \$60,000 in total income, and higher expenses. And the choice between staying at home and re-entering the labour force is typically a short-run and a long-run decision. Most stay-at-home parents eventually re-enter the labour force.

Raising children is expensive and requires many sacrifices. It is also one of the most important roles in our society, which benefits us all. In suggesting that child rearing should be recognized by the government, we are not suggesting that all of the costs should be borne by the government. This has never been the case in the past, nor should it be the case in the future. However, while we were conducting hearings across the country, we heard witnesses in Calgary telling us that they were ready to make sacrifices when they decided to have children.

Accepting the fact that the standard of living of the family would decrease was a part of this sacrifice. Nevertheless, they did not want an extra penalty resulting from the choice of having a parent stay-at-home. This sentiment remained with the Committee throughout its hearings.

A number of witnesses outlined a variety of ways in which universal recognition of child rearing could be introduced into the tax/transfer system. The following are some of the principal arguments and suggestions that were expressed during our hearings:

1. A UNIVERSAL FAMILY ALLOWANCE AND A NON-REFUNDABLE TAX CREDIT

One suggestion was to reintroduce a universal family allowance. Now that, after years of restraint, the government is able to make some new investments in social programs, the reintroduction of universality seems appropriate.

Another approach would be to reinstitute a non-refundable credit for families with dependent children. Both of these measures would deliver benefits only to those families with children and would be consistent with our traditional system of child benefits. These benefits would be targeted to all families with children, whether or not they actually stay-at-home to raise those children. The non-refundable credit would only benefit those who are in a taxable position. As noted by John Richards of Simon Fraser University, a credit would have the advantage of being equitable. Giving a family a cash allowance and subjecting it to tax would leave families with a "bad taste." A simple credit would be more efficient and fair. Moreover, middle-income families, who suffer more than anyone else from a tax inequity, would be the more advantaged by this approach.

The two options also differ in another very important respect. The family allowance has traditionally been delivered to the primary caregiver typically, but not always, the mother. The tax credit is a benefit that is delivered directly to the taxpayer claiming it. In the case of a one-earner family, that would not be the primary caregiver. It is the view of the Committee that any new initiative be delivered to the primary caregiver.

Prior to the reforms of this decade, the federal government offered both of these simultaneously. In each instance it is assumed that the new universal benefit could replace all or part of the existing Child Care Expense Deduction. The CD Howe Institute proposed that there be a universal \$2,000 deduction for parents with children. The CCED would be reduced by a similar amount. According to this plan, those who now use the CCED would be no worse off than before. Those who do not take advantage of the CCED would be better off than before. This proposal, however, is regressive in the sense that higher income earners would receive a greater benefit. Those who are in a non-taxable position would receive no benefit. The proposal is also costly. According to the CD Howe Institute, the annual cost would be \$3 billion.

2. REFUNDABLE CREDIT TO PARENTS WHO FOREGO EARNED INCOME

Another possibility to improve horizontal equity is to deliver a non-taxable benefit only to those parents who give up market income and employment opportunities to raise children. In such a case, the benefits would be restricted to parents who forego earned income. For example, a parent could be eligible for a benefit for each eligible child, for every month that the parent had no earned income. The amount could be linked to the value of the benefit currently provided by the CCED. In addition, it could be delivered as part of the CCTB but not be subject to the family-income test. The Committee believes this would provide some equity for parents who provide direct parental care. There are obviously administrative and reporting details that must be worked out to make such a proposal administratively feasible.

3. PENSIONS FOR CHILD REARING

Another way of recognizing the value of child rearing is to provide the option to participate in the CPP/QPP for parents who forego the opportunity to work in the paid workforce in order to provide care in the home for their children. While not providing immediate financial assistance to parents, such initiatives support child rearing by minimizing any potential future costs associated with withdrawal from the workforce.

The Committee heard much testimony while travelling about the financial sacrifices made by parents who choose to stay-at-home with their children. They also subject themselves to future income insecurity by reducing their pension entitlements.

At present the Canada Pension Plan and the Quebec Pension Plan provide dropout provisions for stay-at-home parents which protect their future pension entitlements from reductions as a result of these years of zero income (up to seven years per child). We could extend this measure by allowing those parents to make current or future contributions to the CPP/QPP related to their stay-at-home years. A variety of details need to be worked out to ensure, for example, that these contributions are not subject to double taxation. Other details to be worked out include: the earnings base upon which contributions are made and pension benefits calculated, and who is to pay the employers contribution.

Similarly, the income sacrifice made by stay-at-home parents could be recognized by allowing RRSP contributions to be made for the benefit of such parents. At present, taxpayers may contribute to a spousal RRSP. This provision may be employed whether or not a spouse stays home to raise children. Additional RRSP room could be made available for parents who stay-at-home to raise children, and this room could either be carried forward or added to the RRSP room of the working spouse, on condition that it be used for a spousal RRSP. In designing any such program, it is important that it be advantageous to the stay-at-home parent and not subject him or her to double

taxation. The government should consider options for stay-at-home parents to contribute to pension plans with respect to their caregiving years. We believe such provisions would be an important and significant recognition of the value of child rearing.

4. EXPANDED EI BENEFITS

The EI program provides support to parents who temporarily leave the paid workforce to care for children. This is accomplished by the maternity and parental benefits of the EI program.

Employees with at least 700 hours of work are entitled to these benefits upon the birth or adoption of a child.

Benefits are calculated as 55% of insured earnings, to a maximum of \$413 per week. Maternity benefits, available only to the natural mother, can extend up to 15 weeks. Parental benefits of an additional 10 weeks are available to either parent, for either a birth or an adoption. A further five weeks is available if the child has special needs. In total, these benefits cannot exceed 30 weeks. After having been on maternity leave, women must meet the full 700-hour requirement to qualify for any further maternity benefits. This is true even if they have a long history of uninterrupted workforce participation. In the view of the Committee, this policy should be reviewed.

In order to provide greater income support to new parents it has been suggested that these benefits be extended to one year in total, in contrast to the 25 weeks (which can in some cases be extended to 30 weeks) now available and that the period during which benefits are taken be made more flexible, so as to facilitate transition into the paid workforce.

Moreover, additional changes have been recommended with respect to the waiting period before which benefits are paid. The Committee endorses these recommendations. In the first place, we see no reason why a two-week waiting period should apply to these parental benefits. If the government is willing to provide 15 weeks of maternity benefits, why must the mother endure 2 weeks without income? There is no policy rationale for this waiting period. Another anomaly relates to the second waiting period that applies in certain circumstances. If the mother chooses to take parental leave in addition to the maternity leave, there is no additional waiting period. If, on the other hand, the father chooses to take parental benefits a second two-week waiting period is imposed. This penalizes parental sharing of child rearing. Moreover, if it makes no sense to impose the first waiting period, it makes even less sense to impose the second waiting period.

5. SOME OTHER ISSUES

Several issues were raised by witnesses that deal with some of the specific mechanics by which programs are delivered. It is these mechanics that result in certain perceived inequities.

One such example concerns the inability of divorced couples to split the equivalent to married amount amongst those who care for or support children. We report this concern and ask that the departments of Finance and Justice address the matter in current legislation.

Another concern frequently expressed by witnesses relates to the time lag in the adjustments to the Canada Child Tax Benefit when the circumstances of families change. Where a parent withdraws from the workforce to provide direct parental care, the monthly benefits continue to be based on the prior year's family income. While this is eventually rectified, the benefits are not received when they are most needed.

THE CHOICES FACING PARENTS WHO HAVE CHILDREN

When couples have children they are faced with a variety of options. One of the parents may stay-at-home for a short period of time to raise the child, and re-enter the workforce soon thereafter. Re-entering the workforce increases the financial resources available to the family, while at the same time subjecting the family to a variety of additional expenses.

One of the parents may stay-at-home for a prolonged period of time to provide child rearing. In this case the financial resources available to family will be less, but so will be the monetary outlays.

Families with children make a number of trade-offs. They trade off financial income for time and greater amounts of unpaid home work, primarily child care. Depending upon the financial status of the family, they might make the decision to forego market income and to provide home-based child care. In other instances families give up time to earn more income.

These decisions are largely independent of the financial position of families. Some interesting statistics were presented to the Committee by Richard Shillington, and are presented in the chart, earlier in this Report. According to his data, no matter what the income level of families, roughly the same proportion of families have both parents working full-time, all year. Looked at in a slightly different way, the probability that a mother would choose to work full-time in the labour force is, for the most part, independent of the income of the father. This point was confirmed by Status of Women Canada when, in their discussion of family realities, they stated that "Fathers income does not have a large effect on mothers employment status." Once again, this is a choice made by parents. It is not related to family income and it is one society should respect.

Thus the issue of single-earner vs. dual-earner families is not one of rich vs. poor or middle income vs. upper income. It is very much an issue about the choices that parents face and make, in what they think are, in the best interests of their families. This is what we believe to be the real issue.

The Committee believes that these choices should rest with the family. The government should neither encourage nor penalize caregiver choices. That is one reason why we favour a more universal approach to child benefits. Universality leaves parents free to choose, as much as possible, the manner in which they will care for their children. Nevertheless, we recognize that child benefits, like other government policies cannot be completely universal. Public policy, by its very nature, is discriminatory. Not all will be treated the same, but they should be treated equitably.

SOME PRINCIPLES AND CONSIDERATIONS GUIDING THE COMMITTEE

In attempting to come up with a consensus amongst members of the Committee as to the nature of the current debate and possible solutions, we have been guided by several broad principles that we believe should apply to policies related to families with children.

These are, generally:

- Our policy should be child centred and promote the best interest of the child to the greatest extent possible.
- Our policy should presume that parents are the primary caregivers and that they are in the best position to determine what constitutes the best possible care arrangement for their children.
- Our policy should provide flexibility, options and choices which will make it feasible for either parent to be the caregiver or to be in the paid workforce.
- Our policy should be inclusive and responsive to the social realities, circumstances and preferences of parents and their children. Specifically, it should be sensitive to the situation of lone parents, stay-at-home parents, those with disabled children, the self-employed, students with children and those on social assistance.
- Our policy should be fair and equitable and neither encourage nor penalize caregiving choices.

SUMMARY

The Committee was given the mandate to examine the tax and transfer system in order to determine if the system treats families in an inequitable manner. We heard testimony from a large number of witnesses and have studied the matter closely. Most of the difference in the way single-earner and dual-earner families are treated is due to the nature of the tax system. Since the tax system has a progressive rate structure, applied to individuals, the Committee has concluded that the tax system treats families in an equitable manner because they are taxed as individuals. Any changes to the basic nature of the tax system would constitute broad tax reform, which is well beyond the mandate of this Committee. There are, however, certain provisions that provide greater benefits to some families.

While we recognize that some of our suggestions go beyond our mandate, we are prepared to highlight four of them at this stage, based on the testimony heard and our analysis. We believe them to be consistent with the stated principles that have guided the Committee throughout its study.

I) The government should consider reviewing the Child Care Expense Deduction in order to ensure that it is meeting its policy objectives in a way which is most efficient and effective for Canadian families with children.

II) The government should consider options for stay-at-home parents to contribute to pension plans with respect to their caregiving years. We believe such provisions would be an important and significant recognition of the value of child rearing.

III) The government should consider improvements to, and greater flexibility of, the maternity and parental leave provisions of the EI program. We support an extension of the supported leave period to one year. In addition, we see no policy rationale for a waiting period applying to maternity and parental benefits.

IV) The government should consider introducing a new refundable tax credit under the Canadian Child Tax Benefit to be available to parents who provide direct parental care. We believe that such a measure would improve the equity of the tax transfer system and provide recognition of the value to society of child rearing.

¹ As is noted later on in the report, where a family with children becomes divorced, the tax system provides some additional support to what are now two households by allowing one of the parents to claim the equivalent to spouse credit.

² Shelley Phipps, "An International Comparison of Policies and Outcomes for Young Children," Canadian Policy Research Network Study No. F05.
