

Costly and unfair: Stephen Harper's income-splitting scheme ^[1]

The Broadbent blog

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Source: Broadbent Institute

Format: Article

Publication Date: 7 Oct 2013

AVAILABILITY

Full blog online ^[2]

Excerpts from the version of this article posted on iPolitics, 9 Oct 13:

During the last federal election, Stephen Harper promised that his Conservative government would introduce a new way to tax families with children after balancing the federal budget.

We are likely to hear a lot more about the merits of Harper's 'income-splitting' proposal before the 2015 election.

The Conservatives continue to slash spending and erode public services precisely in order to create the fiscal room for this promised tax cut. Never mind that Mr. Harper's aggressive agenda of tax cuts has already helped turn a \$16 billion surplus in 2006 into annual deficits.

The Conservatives will frame their income-splitting plan as needed tax relief for middle-class Canadian families. What Harper won't tell us, however, is that it isn't designed to benefit the families most in need. In fact, it promises to exacerbate - not reduce - existing income and gender inequality.

Harper will try to obfuscate how his income-splitting scheme will further shrink the federal tax base with little economic or social gain for most families. What it will achieve is the hamstringing of future federal governments, whose ability to make needed public investments and fund critical social programs like child care, parental leave, good pensions, or world-class public health care will be blunted.

What is income-splitting?

Currently, parents are taxed primarily as individuals. (Child benefits are paid to families based on total family income.) Each parent pays income tax on their individual earnings at a federal rate of 15 per cent on taxable income of less than \$43,561, plus 22 per cent on earnings between \$43,561 and \$87,123, plus 26 per cent on earnings between \$87,123 and \$135,054, plus 29 per cent on earnings of more than \$135,054.

Under the Harper government proposal, parents with children under 18 would be allowed to split up to \$50,000 of income with their partner, meaning that some additional income could be declared for tax purposes by the spouse in the lower tax bracket, thereby reducing the overall taxes paid by the couple. This would primarily benefit families where one partner had no earnings, or low earnings from a part-time job, and the other partner paid a much higher tax rate on high earnings, especially those in the top tax bracket.

While some families in which one parent works full-time and the other works part-time would benefit from income-splitting, the largest share of the benefits would go to high-income families, mainly because one parent has a very high income, putting them in one of the higher tax brackets.

Tellingly, the Conservative approach to income-splitting would provide no benefit at all to single-parent families - despite the fact that more than a quarter (28 per cent) of all children live in families headed by a single parent. Nor would there be any benefit at all to families where both partners work and have incomes below \$43,561, and are thus both taxed at the same 15 per cent rate.

Effectively, this proposal provides no relief to families with children who are most in need, including those who live in poverty. Just under one in five (17.7 per cent) Canadian children live in low-income homes as defined by the Low Income Measure - meaning their family has less than half of the median income of comparable families.

Instead, the maximum income-splitting benefit of about \$6,500 per year would go to high-income families, those in which one partner has an income of \$50,000 over and above the 29 per cent top tax rate threshold of \$135,054 (ie. more than \$185,054) and the other partner has no, or very low, income. Such a family would be able to transfer the full \$50,000 of income from the higher to the lower-income spouse, who would then pay tax on \$50,000 at a rate of 15 per cent instead of 29 per cent.

The target of this significant tax cut is blatantly narrow: two-parent, single-earner families with children. They are, in fact, very uncommon. In 2010, less than one in five (18.4 per cent) two-parent families with children had just one earner.

A detailed analysis for the C.D. Howe Institute calculates that 40 per cent of the benefits of family income-splitting would go to families earning more than \$125,000. David Robinson of the Canadian Centre for Policy Alternatives calculates that 61 per cent of the benefits

would go to families earning more than \$100,000.

Clearly, the Conservatives' income-splitting plan does not stand to benefit most Canadian families.

So what is the case for income-splitting?

There has been a long-standing lobby for income-splitting from social conservatives such as REAL Women of Canada, who wish to support 'traditional' one-earner families with a stay-at-home spouse, usually the mother. They claim it is unfair that a single-earner, high-income family often pays more income tax than a working couple with the same total income. For example, a couple where one partner works and earns \$100,000 per year currently pays more income tax in total than a working couple where both partners earn \$50,000 per year.

These kinds of calculations and appeals to fairness ignore important points.

Families in which both partners work usually face significantly higher costs. Obviously, single-earner families, or couples in which one partner works part-time, have less need to pay for child care for young children. Those with two full-time earners typically face high child care costs which are only partly offset by the child care tax deduction (which has to be claimed by the lower-earning spouse). Dual-earner couples also usually pay much more for transportation and commuting.

It also has been noted that families in which one partner stays at home or works limited part-time hours can save money since they have more time for work at home.

Taking these factors into account, the Conservative income-splitting scheme clearly fails the sniff test for fairness.

Would income-splitting help families make choices?

Income-splitting has the worthy objective of making it easier for two-parent families to choose to have one parent not work, or work part-time, in order to spend time caring for children. Realistically, however, this is not an option available to most of today's families who need two full-time incomes in order to meet their basic living costs, including the costs of looking after children.

Not working for pay simply isn't an option for single-parent families - nor is it realistic for couples where both partners work in lower-paid jobs. And many middle-class working families rely upon two full-time jobs to pay for a mortgage.

One also has to question why income-splitting, as proposed by the Harper government, would be available to parents of school-age children, including teens, who do not need full-time care.

If we wanted to support real choices for parents of young children, a better option would be to increase benefits for maternity and parental leave and/or extend eligibility for such leaves beyond their current one-year term. Employment Insurance benefits for maternity and parental leave are currently just 55 per cent of previous earnings. Many parents with lower earnings cannot afford to take a leave from paid work that will cost them at least 45 per cent of previous earnings, and many face an even bigger reduction since the maximum weekly benefit is capped at \$501.

Gender equity

While it may seem reasonable to allow families to pool their income for tax purposes, this could have the unwelcome result of discouraging women from entering, returning to, or remaining in the workforce.

Taxing families on the basis of their joint income would mean that a family with one high-income/high tax rate wage earner would see a significant increase in taxes should the lower earning partner (often, but not always, a woman) decide to return to the paid workforce, or to move from a part-time job to a full-time job.

While some social conservatives want to discourage women from working outside the home, this is surely not an appropriate goal for Canadian tax policy.

Studies show that women who stay out of the paid workforce for extended periods of time often experience poverty in the common event of a marital breakdown. They also face significant difficulties finding work and at lower pay than would otherwise have been the case when they do choose to return to the job market.

What would income-splitting cost?

While more research is needed to understand the consequences of the lost annual revenue in 2013, the 2011 cost of income-splitting to the federal government has been estimated by C.D. Howe's Alexandre Laurin and Jonathan Rhys Kesselman to be \$2.7 billion. If the provinces followed suit, that cost would be at least 30 per cent higher.

In order to fund this unfair tax cut, the federal government has already made significant programming cuts, including new limits on the growth of federal-provincial transfers for health care and social programs which benefit a wide range of Canadians.

It is important to put the projected lost revenue in context.

That sum - \$2.7 billion - amounts to almost 10 per cent of the annual \$30 billion cost of the Canada Health Transfer, and almost one-quarter of the annual \$12.2 billion cost of the Canada Social Transfer, which supports provincial spending on post-secondary education, social assistance and social programs such as child care and early child development.

That \$2.7 billion is three times as much as the annual cost to the federal government of the child care expense tax deduction (\$935 million) and more than a quarter of the annual \$10 billion price tag for the Canada Child Tax Benefit. Imagine that money being put, for example,

towards funding a national child care program.

All of this begs the question: what other parts of the generous system generations of Canadians have built will Harper put on the block to finance the annual revenue loss of such an unfair tax cut?

Costly and unfair

The Conservative income-splitting proposal would see a massive reduction in federal tax revenue. If passed, it would limit Canada's ability to make important public investments and cripple our means to reform or re-imagine our social programs.

It would also be unfair. As designed, the plan would increase income inequality by delivering a significant tax break to a small number of higher-income families. Most families with children, including single-parent families and dual-earner families where both partners earn less than \$43,561, would see no benefit at all.

The proposal also would increase inequality of economic opportunity between women and men. Little wonder it comes from the social conservative wing of the Conservative party and is intended to restore a 'traditional' family model which is neither desirable nor realistic for most of today's parents.

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