

TRISTAT RESOURCES

The Tax Debate over One- and Two-Earner Families

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Introduction

Debating tax fairness could be never ending. Most Canadians would rather pay less tax and welcome justification to reduce their tax burden in the name of fairness.

One current theme for the debate receiving increased attention is that of the tax treatment of one-earner and two-earner families. Some see as unfair that the higher tax burden of one-earner families compared to two-earner families with the same income. A motion in the House of Commons in 1999 on tax inequity drew a great deal of attention.

“That, in the opinion of this House, the federal tax system should be reformed to end discrimination against single-income families with children.” (Sub-Committee on the Tax Equity of Canadian Families with Dependent Children).

This assertion was that the tax system discriminates against one-earner families because their child care costs can not be deducted while two-earner families have the Child Care Expense Deduction (CCED). Beverly Smith, an advocate for children, made the same complaint to the United Nations. A Subcommittee of the Finance Committee was struck, held hearings and reported in the spring of 1999 on this issue of tax fairness.

Unfortunately, this debate has not advanced the interests of families. It could have explored how tax fairness is denied to all families. More often it turns families against themselves; each side looking for assistance for a particular kind of family (one-earner, two-earner).

Before discussing the one-earner two-earner tax debate this paper will present some background material. It will:

- review the economic circumstances of families.
- review tax principles which, we are told, guide tax policy.
- compare the tax burdens of selected hypothetical families.
- discuss a number of tax issues which are closely tied to the one-earner / two-earner debate; the tax unit, tax recognition of children, the Child Care Expense Deduction (CCED), and the Married Credit.
- assess the tax debate around one-earner and two-earner families.

Economic Circumstances of Parents

On average the incomes of two-earner couples was \$70,017 in 1996; far more than the \$50,131 in families where one parent was not employed.

Of course, average earnings and poverty rates will depend on the hours and duration of employment, full-time versus part-time and full-year compared to part-year.

Family Income and Poverty Rates*, 1996

	Average Family Income	Poverty Rate
Couples with Children (0-17)		
Two Earners	\$ 70,017	5.9%
One Earner	\$ 50,131	21.8%
Single Parents	\$ 28,533	53.9%

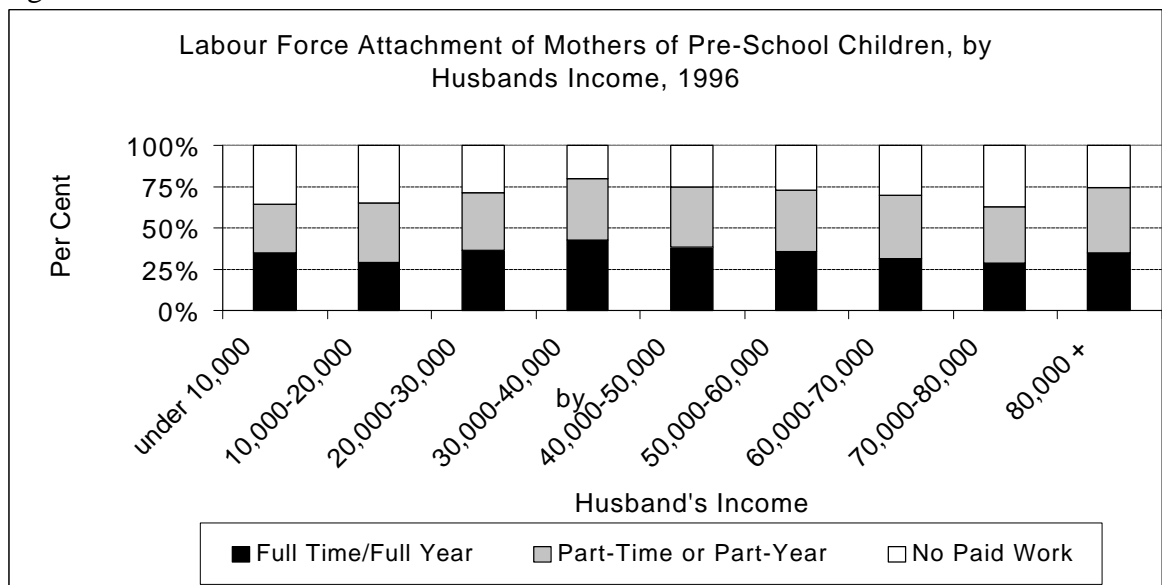
* Using 1992 Low Income Cut-Off's

Special Tabulations: Survey of Consumer Finances, Statistics Canada, 1996

This substantial income difference affected the poverty rates, about 6% for two-earner families, 22% for one-earner families.

Too often the one-earner / two-earner debate ignores single parents. Their average income of \$28,533 makes a poverty rate of 54% and underlines that single parents raise children with fewer economic and time resources than either one-earners or two-earners.

Figure 1

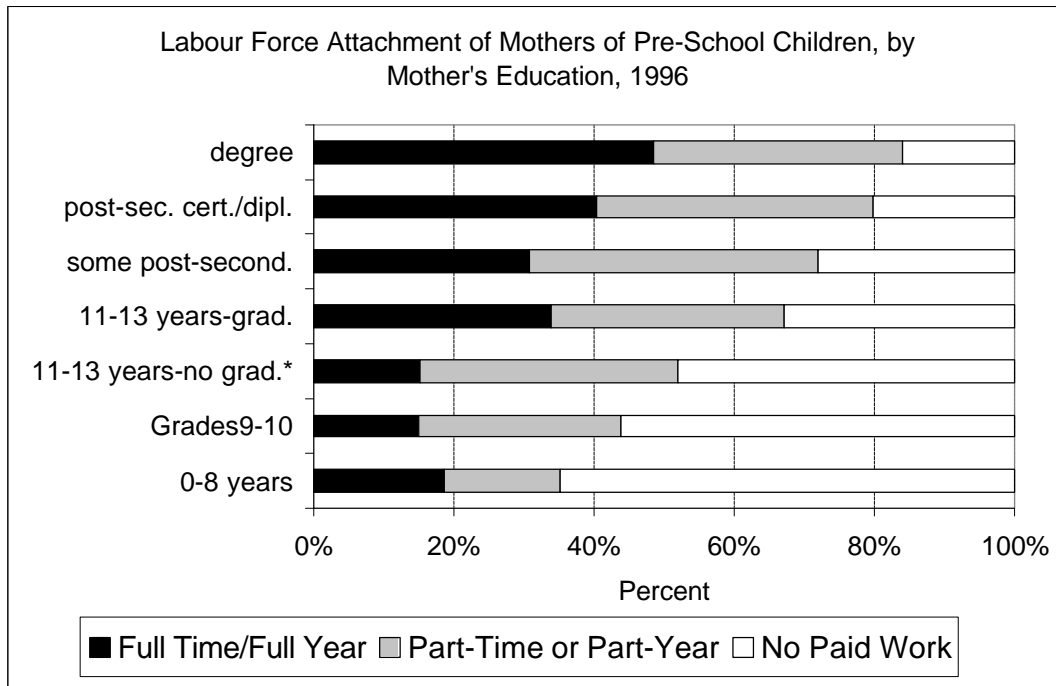


Deciding how to combine paid employment and parenting is complex. It is usually a decision about the extent of the mother's employment. Clearly, it is affected by a number of factors, the family's economic and emotional resources, career aspirations and investment, the employment opportunities of the parents, available maternity benefits and quality child care.

Figure 1 demonstrates that the labour force attachment of women does not appear to vary with husband's income in any consistent fashion. Thus any assumption that "stay-at-home" mothers are disproportionately economically secure or married to high-income professionals is not substantiated.

This does not mean though that economics are unimportant in the mothers' employment decision. Figure 2 indicates that the education of a mother is an important factor in the decision to seek employment likely due to her increased potential income.

Figure 2



Before leaving this section, we should nuance the use of stereotypical family roles. The use of the terms "one- and two-earner" simplifies the discussion but also can lead to a simplistic perception of families. First, the employment patterns of parents change over time. Most women who "stay at home" do this only on a temporary basis. Second, the employment in two-earner couples will not necessarily be full-time. For many families employment which is part-time, temporary or casual will, for many parents, be the best match to parenting responsibilities.

It remains typically the mothers career which is interrupted, limited or ended. This is due to a variety of factors but could be ameliorated by adequate child care, maternity/parental leave, financial support and family friendly employment practices.

Tax and Other Principles

For taxes to be seen as “fair” there needs to be a clear consensus on how you impartially determine each taxpayer’s share. Contemporary Canadian tax policy finds its ideological roots in the Carter Commission and the concept of “ability to pay”.

“Allocated in proportion to the ‘discretionary economic power’ of tax units.” (Canada 1996, Royal Commission on Taxation [Kenneth Carter, chairman]. Report. Ottawa. Queen’s Printer).

“Ability to pay” is reflected in two equity criteria, horizontal and vertical equity. Horizontal equity implies first that like circumstances are taxed equally and second that circumstances which affect “ability to pay” will be reflected in the tax system so that people with similar economic power will be taxed the same. Vertical equity addresses how taxes are distributed among persons with different economic power and is addressed by progressivity; the tax burden, as a percent of income, increases with increased income.

The concept of “horizontal equity” implies that composition of families (one earner, two earner, with or without children), affects the fair tax burden if it affects discretionary economic power.

Vertical equity, progressivity, is achieved in two ways; by a progressive tax rate structure but also by having personal credits (Personal, Married and Child Credits).

Why the personal credits? Because families with no discretionary spending, low-income families, should pay no income tax (they pay enough consumption taxes). The personal credits also reflect an objective of ensuring that the basic income needed to make minimal survival needs is not subject to income tax.

If one accepts that subsistence income should not be taxed then part of the design of personal credits involves assessing the subsistence income of different family configurations.

“Ability to pay” is perhaps the most important principle but there are other important considerations:

- The assumptions for different tax policies about intra-family economic sharing. Although the income of each family member of a family affects the

living standard of the family as a whole, fairness in sharing income within the family cannot be assured.

- The impact on economic autonomy of who actually receives the support. Is the tax credit paid to the father or mother in a family?

An additional issue of importance is the tax treatment of household production. By household production we are referring to household chores, gardening, car repair. Someone who purchases these services pays for them with after-tax income. Thus, theoretically this production should be taxable. It isn't taxed because it is virtually impossible to quantify.

Tax Situation of Various Families

Before discussing principles, let us compare the tax burden of some hypothetical families. The example of families with \$60,000 incomes was used by the Finance Sub-Committee and the press.

The income tax burden of the two-earner family is lower than a one-earner by more than \$5,000. It should be somewhat lower because of the higher employment related expenses of two-earner families but most of the observed difference is because we tax on an individual basis (were there no child care expenses the difference would be about \$4,000).

The difference in tax burden is only one step in comparing standards of living. Figures published by Finance suggest that after adjusting for employment related expenses, two earner families actually have less disposable income despite their lower income taxes. Their analysis though overstated the issue by deducting CPP and EI premiums which purchase benefits. The actual determination of which families are better-off depends on a range of factors; income tax, child care arrangements and costs and other employment related expenses. Broad generalization will be difficult.

The more informative comparison was suggested by the Finance Subcommittee: between the one-earner family with an income of \$36,000 and a two-earner family with an income of \$60,000. Their analysis suggests that adding the second income of \$24,000 only increased disposable income by \$8,700. This comparison suggested that there remain substantial employment disincentives for the lower-income spouse because so much of the employment related costs are not deductible.

I have included an additional comparison: two two-earner families one with incomes split \$30,000/\$30,000 and the other \$40,000/\$20,000. Both families have employment related expenses and two children. The difference in tax burden is about \$1,200. This is because they are being taxed as individuals. The two families

receive the same CTB because they are assumed to have the same “need”, yet they pay very different income taxes. This comparison illustrates that most of the 1-earner vs. 2-earner difference in the tax burden has nothing to do with children.

A final tax comparison speaks to horizontal equity. A one-earner family at \$60,000 with two children pays the same income tax as a two-earner family without children at \$70,800. If the childless couple is maximizing its RRSP's their income could be closer to \$83,500. This totally perverse result can not be squared with “ability to pay” tax principles.

The assessment of the taxes and disposable income of different families is complex because each family is different. Two-earner families will have higher a employment related costs and therefore should be less tax, how much is difficult to say.

Contemporary Debates

Taxation Unit

Canada uses the family unit to assess need for income support (social assistance, the Guaranteed Income Supplement, and the Canada Child Tax Benefit). The individual remains the basis for assessing “ability to pay” for income taxes. This reflects the contradictory assertion that the family unit is the best way of assessing “need” for assistance but that the individual best reflects “ability to pay.”

There is really no alternative but to use families for administering transfers. In doing so though, there remain significant human rights problems and issues of assumed financial obligations of cohabitants.

There is little choice but the family unit for administering transfers, like welfare. As suggested by the Quebec White Paper, we are not likely to give welfare to stay-at-home wives of wealthy husbands.

“On the other hand, it is the only feasible solution, given the costs and the consequences implicit in choosing the individual as the transfer unit.” (Quebec 1984, White Paper on the Personal Tax and Transfer Systems, Ministry of Finances).

The choice of the individual or family as the basic tax unit is open to reasonable debate; the family unit was recommended by the Carter Commission and is operating in several countries (O’Donoghue, Cathal and Sutherland Holly, 1998). Using the family as the taxation unit though would have its own problems. It would likely give inadequate recognition to employment related expenses and also would pose a significant work disincentive for women.

“From the perspective of the autonomy of women, the most important argument against changing the tax unit in Canada to the

family relates to the impact of such a change on the labour force participation of women.”
Ontario, 1993; Fair Taxation in a Changing World: Highlights; Report of the Fair Tax Commission; University of Toronto Press.

The choice of the individual as the taxation unit reflects a policy trade-off that we will tolerate some tax unfairness on an “ability to pay” basis rather than create a major work disincentive for women in families.

Although M.P. Paul Szabo has recently proposed some limited form of income splitting, there is no significant push today for family based taxation in Canada.

Horizontal Equity - Tax Fairness for Parents

Children reduce the discretionary spending and hence “ability to pay”. This is self-evident to parents, although not reflected in today’s income tax system. Again, the Carter Commission is elegant in its principled simplicity.

“We believe that couples with dependent children have a smaller fraction of their total income available for discretionary use than childless couples. The more children the couple have, the smaller the fraction of income available for discretionary use.” (Canada 1996, Royal Commission on Taxation [Kenneth Carter, chairman]. Report. Ottawa. Queen’s Printer).

The budget of 1992 announced the elimination of the Family Allowance and the Non-Refundable Tax Credit for children thus ending children’s tax recognition. This was recognized at the time as a violation of tax fairness but justified by the need to reduce the deficit at the time. Curiously, at the same time, in the midst of the same fiscal crisis, RRSP limits were being increased, justified by tax fairness.

The following quotes demonstrate that although Finance has abandoned the “ability to pay” principle for parents, it does not acknowledged it.

“ the tax system must recognize special circumstances that affect the ability to pay tax.”

“special circumstances of taxpayers are recognized, so that two Canadians with similar incomes but different abilities to pay because of particular needs, may pay different levels of taxes depending upon their particular needs.”
Finance Canada, Tax Fairness, February 1997

These general principles affect *all* parents.

“The CTB recognizes that the cost of raising children reduce the ability of modest- and middle-income families to pay tax.”
Finance Canada, Budget Plan, February 1997

The Finance document, Tax Fairness, fails to mention that changes to the CTB have reduced support for all parents except the working poor and eliminated tax fairness for upper-income families.

The Quebec White Paper summarizes how horizontal equity can be combined with an individual tax system in their 1984 report.

“Quebec settled on the individual as the taxpaying unit because it is the unit which presented the fewest administrative or other difficulties, and because Quebec recognized the need for uniformity with the federal system and with other systems in effect in North America. Such a choice may, however, have the effect of overvaluing the ability to pay of households with one breadwinner if the system does not attempt to allow for dependents by means of exemptions, deductions, various allowances or tax credits. (Quebec 1984, White Paper on the Personal Tax and Transfer Systems, Ministry of Finances).

A number of reports have pointed out the unfairness of the current tax treatment of children (C.D. Howe, 1999; National Forum on Health, 1998).

Taxation of Child Care – What is the Role of the CCED

Many of the varied opinions expressed about the tax treatment of one-earner and two-earner families hinges on the assessment of the Child Care Expense Deduction (CCED).

Some will see child care costs like an employment related expenseⁱ and the CCED like a business deducting rent or printing expenses; that is, money spent in order to earn an income. In that case, the CCED does not recognize parenting so much as employment and thus is not a subsidy to two-earner families.

The following excerpt argues that the CCED is more tied to children since it recognizes a child related expense. By this view, the CCED recognizes the child related expenses which all families share but does it unfairly since it is denied to one-earner families.

“The argument that the child care expense deduction recognizes legitimate cost of earnings income was defensible when tax policy instruments existed that recognized children in all families, but this argument has lost its force in the current context.” (Boessenkool K.J.; 1999).

While the CCED is no more generous than it should be, it is more generous than other aspects of the tax code. For example, there is no tax recognition for the vast majority of employment related expenses. It is the only child related expense which is deductible. Also, two-earner couples can deduct costs under the CCED which are not strictly employment related including housekeeping by nannies and a share of summer camp fees.

On the other hand, while the CCED is pivotal to the one-earner two-earner debate one should bare in mind that many two-earner families have informal child care expenses which are not recognized in the CCED because of difficulties in

obtaining receiptsⁱⁱ. Also, the CCED reduces the employment disincentives of secondary earners.

Child care provides custodial services and enhances child development. The custodial aspects of care facilitate employment and should be tax deductible. The child development aspects are valuable and would benefit all children (one-earner or two-earner). If the tax system subsidizes child development aspects, it should do so equally for all children. This suggests that nursery school costs should receive tax recognition for all children.

Should the CCED be a deduction or credit? If one sees it as an employment related expense then the CCED should be a deduction, so that we are taxing income after expenses. If the CCED is a child benefit then one could argue that it is regressive, since it delivers the greatest benefit to high income families.

The only out-of-pocket expenses recognized for many families with children are those recognized in the CCED. This could lead many one-earner families to feel discriminated against. They perhaps would not feel that way if the Canadian tax system were at least fair to parents in general so that the CCED would not look like such a special benefit.

Perhaps one-earner families would be better served if they could also deduct that part of the cost of child development of child-rearing which can be covered by the CCED.

Role of the Married Credit

The Married Credit is available to one-earner families and has been part of the tax system since its inception. Its abolition has been advocated by the Ontario Fair Tax Commission and recently by the Caledon Institute.

The Married Credit is available to taxpayers when one spouse, usually the women, earns little or no income. Under current rules, the first \$13,000 of income is exempted from tax for both one earner and two earner families. Simply stated two earner couples receive two personal credits, one earner couples receive one personal credit and one married credit (which is worth slightly less than the personal credit).

The analysis of the Married Credit is often confused with parenting since many, but not all, beneficiaries are mothers. As well, the discussion of the Married Credit has been complicated by myth that stay-at-home mothers are privileged.

To simplify the discussion let's ignore children and first compare a single individual to a one-earner couple without children. Should the couple receive a tax credit for the second adult?

There is a strong temptation to ask what the spouse is doing to justify a credit. Are they parents of children who have not left home? If not parenting, are they

contributing to society? Do they do volunteer work? Are they caring for elderly relatives?

All these questions presume that eligibility for tax recognition should be based on whether one's activities are "worthwhile". Yet if one wants to make social contribution a precondition for a tax credit, why is this being raised for the married credit and not the personal credit? Why a higher hurdle for stay-at-home spouses?

I am tempted to point out that some spouses without income are often disabled, temporarily or permanently unemployed or active in volunteer activities but such an argument would accept the approach that eligibility for the married credit needs to be justified by the activities of the spouse. Which should not, to my view, be the basis of tax policy and certainly not if we don't apply the same principle to other personal credits in the tax system.

To some the Married Credit is unnecessary. One-earner families are in fact subsidized since household production is not subject to taxation. But since all families do housework (two earner couples may do it in different ways), both family types benefit from its non-taxation. The difference in households is more one of leisure time than housework.

The Ontario Fair Tax Commission recommended the elimination of the Married Credit because of its assumptions about dependency. If eliminated, the tax burden of a higher-income single individual would equal that of a couple, with or without children. In this case, the tax spread between one- and two-earner families would increase.

The Commission's justification that "we can see no reason why the tax system should recognize spousal dependency, especially when it no longer recognizes dependent children" would be reasonable only if one presumed that the lack of recognition for children were reasonable.

Recall that the Married Credit, like other personal credits, serve two purposes. First, to ensure that couples would pay less tax than individuals because of their reduced discretionary spending regardless of income. Second, to ensure that the income earned to meet basic necessities is not taxable. Families begin to pay income tax currently at about \$7,000 for individuals and \$13,000 for childless couples.

Does anyone think that the income necessary to meet basic needs a couple equal that of an individual? The operation of basic income support programs is premised that it is. Social Assistance and GIS for a couple is greater than for an individual. No one questions this.

Those who accept that the income which meets basic needs should be income tax exempt will support the Married Credit.

Regardless, the delivery of this tax recognition for a spouse can be improved. There should be no objection to proposals to make the married credit refundable to the spouse at home. This would be supported by those who believe that paying it to women would improve economic autonomy, and the spending on children. It should not be opposed by those who contend that families share equally.

If the Married Credit remains non-refundable then it might be more easily understood if it were simply changed to a Personal Credit which is transferable between spouses.

Why is taxation of imputed income being questioned only for the separating role of stay-at-home mothers and for the other housework, for example, gardening, home and care repair? Why is it not questioned for others with leisure time? One suspects this debate has more to do with the changing roles of women and seeing stay-at-homes as privileged than the arcane tax principles.

Tax Treatment of one-earner and two-earner families

We now turn to the tax treatment of one-earner and two-earner families which has received a great deal of attention lately.

Much of the disquiet is due to the individual tax unit which implies tax burdens which vary based on a family's income mix. Some observers view this as unfair.

The comparison of one-earner and two-earner families also hinges on how one sees the CCED and the Married Credit. This is simply because, the CCED is not available to one-earner families and the Married Credit is not available to two-earner families.

If the CCED is seen more as a recognition of the cost of children rather than the cost of earning an income, then it is hard to justify it not being available, in some form, to one-earner families especially when there is no tax recognition for one-earner families. For those who see the CCED as strictly an employment related expense then denying it to one-earners is justified.

As already indicated, views on the Married Credit are equally important. To some, a Married Credit is part of fairness, reflects "ability to pay" and exempts subsistence income from income tax. To others it smacks of dependence, discourages women's employment and benefits not the at-home spouse but the taxpayer (usually the husband).

The discussion of tax policy has lost its grounding in "ability to pay". Without that principle, tax recommendations are based mostly on the objectives of social engineers. Tax policy rests on opinion about ideal family relationships, (for some prescribing a return to traditional family values and relationships, to others discouraging parents from opting for a stay-at-home spouse). Thence, the varied opinions about one-earner / two-earner tax fairness.

Conclusions

Comparing the tax burden of one-earner and two-earner families depends first and foremost on an agreed set of principles for assessing taxes. The “ability to pay” principle has been paramount but policy is also affected by factors like work incentives and assumptions about dependency.

We have accepted inconsistent set of principles for assessing standards of living, an inconsistency which muddies the intellectual waters. We assess “need” for transfers like the CCTB based on family income but “ability to pay” for income taxes on the basis of individual income.

The adoption of the individual as the unit of taxation is justifiable but implies that families with different income mixes and comparable total income could pay very different taxes.

Given an individual tax unit which compromises our “ability to pay” basis for taxes it becomes paramount that the tax system reflect family obligations. Instead, Canada has compounded the tax unit compromise by ignoring horizontal equity for dependent children. Thus, a one-earner family with children pays far more tax than the two-earner family without children.

Once taxes are not longer based on fairness or principles, the discussion of CCED and the Married Credit, and the assessment of fairness for one-earner and two-earner families, can depend mostly on personal values and judgements about child care and the roles of women.

This argument is further complicated by the various views of stay-at-home mothers.

- Their position can be seen as a sacrifice – they have forgone an income. Far from feeling privileged they feel they make a sacrifice. The Finance Sub-committee put it as follows “all parents sacrifice, they do not want to be further punished for their decision to stay home”. (Finance Sub-committee, 1999).
- On the one hand, some would see stay-at-home mothers as privileged. Far from vulnerable, they can afford to be home and are already assisted by the tax system in that their household production is not subject to income tax. (Ontario Fair Tax Commission, 1993)
- For many, women should be discouraged from staying-at-home since, many of them will end up divorced and most single-parents are poor. Thus, mothers who stay at home risk their economic autonomy and future poverty.

Thoughtful and informed opinion on this issue spans the complete political spectrum. At one extreme the Finance Subcommittee and the C.D. Howe Institute view the current system as discriminatory against one-earner families. At the same, time Ontario's Fair Tax Commission sees the Married Credit as a subsidy to one-earner families and recommends its abolition.

The fact that these opposite and informed positions can be advocated suggests little acceptance of the "ability to pay" principle or a great deal of confusion about its implications.

The one-earner, two-earner debate then can become a battle between struggling families to claim which is most disadvantaged, *most* unfairly treated. The debate is regrettable because:

- The remedies tend to ignore single parents; surely the most disadvantaged families by any measure, income, poverty and work versus parenting time pressures.
- They lead to recommends which tend to pit one family type against another. When all parents are being discriminated against it is easy for comparisons to be one of comparing their relative disadvantage.
- The debate can be also become one of choosing the better parent style (that is, having a stay-at-home parent versus two-earner family). The debate can only be destructive and almost always leads to angst and guilt for all parents, particularly mothers.

Various proposals are in circulation. Too often the recommendations follow an assessment of which family type, one-earner or two-earner, is "truly" aggrieved or is considered "best" and then advances support for that family; either at the expense of the other family type or without benefit to the other family type.

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ⁱ In fact, child care discharges a personal responsibility so that the individual is available for employment and as such isn't purely a business expense.

ⁱⁱ These families along with one-earner couples are eligible for a top-up to the Child Tax Credit subject to family income.