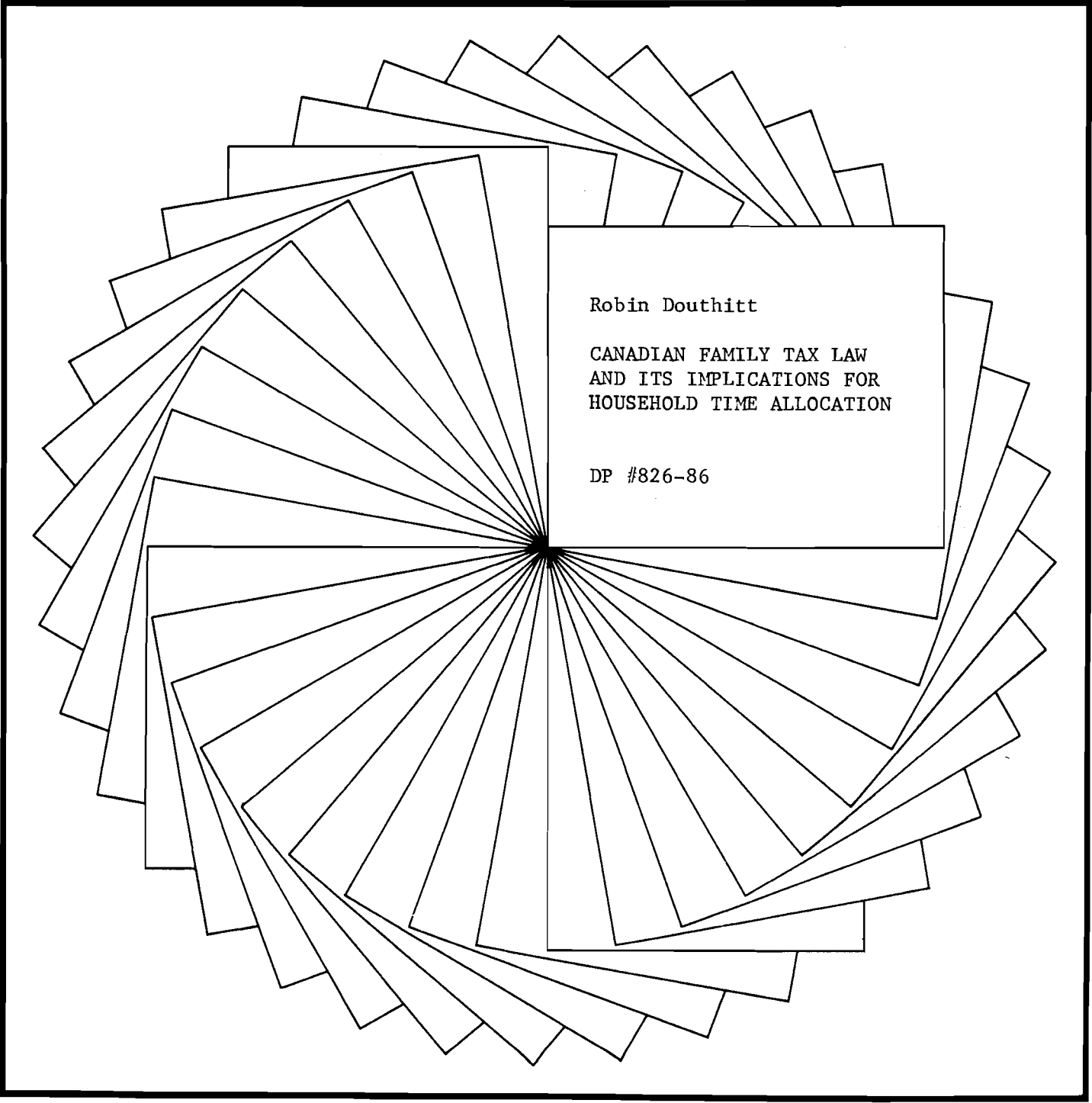


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# IRP Discussion Papers

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CANADIAN FAMILY TAX LAW  
AND ITS IMPLICATIONS FOR  
HOUSEHOLD TIME ALLOCATION

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Canadian Family Tax Law and Its Implications for  
Household Time Allocation

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## Abstract

This paper reviews federal Canadian family tax policies and discusses their implications for household time allocation decisions. It finds that the present tax code has few consistent effects on those decisions. Proposals for change that are recommended include review of (1) the treatment of government child support subsidies, (2) the treatment of full-time homemakers, and (3) gender-specific biases under present provisions.

## Canadian Family Tax Law and Its Implications for Household Time Allocation

The observation by Aaron and Galper (1985) that United States tax policies before the 1986 reform had "become a swamp of unfairness, complexity and inefficiency" (p. 1) seems equally appropriate when applied to Canadian tax policy. The present tax system in Canada reflects a series of concessions directed largely at special interest groups (including families), with little thought concerning the relationship of such concessions to either an underlying social welfare function or the overall distribution of income.

Tax incentives by their very nature are designed to influence human behavior. The premise of this paper is that we must either (1) give careful consideration to what common purposes we as a society wish to reward or discourage monetarily, and revise family tax law accordingly; or (2) abolish all special tax considerations and institute a tax system that serves strictly to raise needed government revenues and does not attempt to manipulate behavior through large-scale social intervention like that simulated under our current tax system.

This paper focuses on the relationship between tax policies and family time allocation patterns. It assesses current impacts and suggests the direction that family tax reform might take. First, a review of the present tax code is in order.

## THE CANADIAN TAX SYSTEM

Canadian personal income tax policies are based on two major philosophical premises: that income be taxed progressively, and that the unit of taxation be an individual (rather a household).

The underlying principle of a progressive tax system is that taxes assessed on the last dollar of (taxable) income are levied at a rate that is positively related to income. More simply stated, the higher an individual's income, the higher the proportion of income he or she will pay in taxes. A progressive tax system promotes vertical equity among taxpayers. Vertical equity requires that specific account be taken of the taxpayer's ability to pay when assessing what proportion of the tax burden each should bear. Horizontal equity requires that taxpayers with similar incomes bear similar tax burdens. In this respect, our progressive system taxes equal amounts of income equally, but at a progressive rate. For example, a taxpayer who reports \$100,000 of taxable income pays the same amount of tax on the first \$10,000 of that income as does the taxpayer who reports a total annual income of \$10,000. However, not only will taxes be levied against additional income of an earner, but a greater proportion of those moneys will be subject to taxation.

The premise of using individuals as the unit of taxation entails levying taxes on the income of each taxpayer without regard for income of other family members.<sup>1</sup> In this respect each Canadian income earner is required to file an individual income tax return. Theoretically, each person's tax rate is determined independently of income earned by other

household members. An example of using the family as the unit of taxation can be found in the United States, where families may file joint income tax returns on which total household income is reported and then taxed at a single rate. Practical differences which emerge in choice of tax unit relate to vertical and horizontal equity.

In the absence of countervailing tax policies, choosing the individual as the tax unit means that all taxpayers with similar incomes are treated equally under the tax system (horizontal equity): a married woman earning \$20,000 per year would pay the same amount of taxes as a married man earning \$20,000 or a single woman earning \$20,000. This policy is consonant with vertical equity among individuals: those with higher incomes pay higher proportions of their income in taxes. However, to the extent that the married working couple with a total annual income of \$40,000, who are presumably more able to bear a higher marginal tax burden, do not pay proportionately more in taxes than the single woman earning \$20,000 per year, the system is not vertically equitable. That is, although the married couple will pay more taxes in absolute terms, the system is vertically inequitable since the couple will not pay a higher percentage of their income in taxes than the single woman with half the income.

In practice, many tax provisions undermine the two basic premises of progressivity and individual taxation. One may even argue that the premise of individual taxation is a priori at odds with the object of a progressive tax system.<sup>2</sup> However, for purposes of this paper, tax policies that undermine the premise of progressive taxation are defined to include those which serve differently to reduce the marginal tax rate

faced by any income group to a rate less than or equal to that levied on individuals reporting (relatively) lower incomes. Tax policies that undermine the premise of individual taxation include those which require reporting of other household members' income to determine taxable income and thus individual tax rates. Any tax benefits that are family means tested would fall into this category. Descriptions of specific family tax policies are presented below followed, by a discussion of their implications for family time allocation.

#### FAMILY TAX POLICIES

In Canada at present there are several specific tax policies that provide economic incentives for families to adjust not only the way in which total family time is allocated between home, market, and leisure activities, but also intrafamily time allocation patterns.<sup>3</sup> They include (1) family allowance payments, (2) dependent child exemptions, (3) child care deductions, (4) child tax credits, (5) child exemptions equivalent to adult exemptions, and (6) spousal exemptions. A brief description of each follows.<sup>4</sup>

1. Family allowance payments are monthly cash transfers paid to families with children under the age of 18. They are a universal, taxable benefit payable to the mother of a child.<sup>5</sup> Although the revenues used to fund this program all come from federal sources, provinces administer the funds and set the exact payment levels.

2. Annually the government allows individuals to exempt part of their income from taxes if they have dependent children under the age of 18 in their household (hereafter referred to as child exemptions). The

exemption may be claimed by either parent, but the parent who elects to take the exemption must also claim as taxable income the family allowance payment. In practice it is to the economic advantage of the family if the individual with the highest taxable income claims this exemption. As a result, in most cases, although family allowance benefits are paid to mothers, the benefits are claimed as taxable income by fathers.

3. Child care deductions may be netted from taxable income by mothers (fathers are not eligible) who incur child care expenses in order to participate in the paid labor force. Benefits are calculated on a formula which in part takes into account the number of children under the age of 14.

4. The federal child tax credit is a family income-tested benefit payable to the parent who receives family allowance payments. It is a flat amount payable for each child eligible for a family allowance and may either be deducted from the individual's tax bill or claimed as a negative tax in the event the parent has no taxable income. Benefits are means tested, and the break-even point for a family with three children is about \$50,000.

5. The federal government affords single, divorced, or widowed parents the opportunity to exempt from taxable income, at the level of an adult exemption, the expenses of raising one child. Dependent adult exemptions are approximately five times the value of dependent child exemptions.

6. Individuals whose spouse's annual net income is less than \$500 are afforded a spouse exemption. As spouse net income increases, the exemption is taxed away dollar for dollar.



## IMPACT OF TAX POLICIES ON FAMILY TIME ALLOCATION

A preferred approach to examining the effect of our tax system on time allocation might be to discuss its overall impacts in terms of government revenue or policy objectives. Unfortunately, as will soon become apparent, it is impossible to pull any such common thread from the analysis, and the actual impact of each underlying premise and policy will therefore be discussed separately. Assumptions which underlie the economic predictions made with regard to family time allocation in this paper are not discussed in detail. One point, however, does merit review. Analysis of tax policies that influence after tax wage rates are evaluated with respect to changes in the taxpayer's marginal (rather than average) tax rate. The reader interested in a more thorough treatment of this assumption and remaining theoretical underpinnings is referred to Douthitt and Zick (in press).

Because family allowance payments and dependent child exemptions are treated jointly for purposes of taxation,<sup>6</sup> their impacts on time allocation are examined concurrently.

Since all parents are paid the same per capita family allowance benefit regardless of income, all else equal, one would expect them to respond to this benefit by increasing the amount of time spent in leisure activities. However, as many politicians argued in the recent debate over universality of family allowance payments, their middle- and upper-income constituents already effectively "repaid" their benefits to the government by virtue of the progressive tax scheme under which they were taxed.

In other words it was charged that the family allowance is already effectively income tested through existing tax policy. This would imply that the time allocation patterns of higher income families are less influenced than originally thought.

Yet when the child exemption and family allowance benefits are examined jointly, it becomes apparent that this effect is illusory. In fact, after taxes, high-income individuals will enjoy a larger (absolute) economic advantage. The point is perhaps best made by example. Consider two taxpayers who both have one child, collect an annual family allowance benefit amounting to \$360, and are entitled to child exemptions amounting to \$710. For tax purposes the only difference between the two is that the taxable income of one falls into the 15 percent marginal tax bracket while the other is in a 45 percent marginal tax bracket. The question becomes, what is the difference in after-tax benefits that each are entitled to receive? First, consider the individual whose taxable income falls in the 15 percent marginal tax bracket.

Since family allowance benefits are taxable income, the low-income taxpayer will have to pay \$54 (15 percent of \$360) in additional taxes on the family allowance benefits. Further, in our example the individual also claims the dependent child exemption. This benefit amounts to approximately \$107 (15 percent of \$710). Thus the low-income taxpayer receives a net benefit in support of meeting child-rearing costs of \$413.

The higher-income individual will pay \$162 (45 percent of \$360) in additional taxes on family allowance benefits, and the dependent child exemption benefit is worth approximately \$320 (45 percent of \$710). Thus the high-income taxpayer receives a net benefit of \$518 to assist in

meeting child-rearing costs, over \$100 more in after-tax income than the low-income individual. It also bears noting that the person who is the biggest loser in this analysis is the poor parent with no taxable income who will receive no benefit from the dependent child exemption. In fact some provinces may include those benefits in means testing for social assistance eligibility.

The implications for family time use are that all families would be encouraged to spend more time in leisure activities. Further, if one assumes that all families respond to an increase in a dollar of income in the same way, then one may also conclude that higher-income individuals will be induced by these policies to spend more (additional) time in leisure activities than their poorer counterparts.

If one were to stop at this point and try to construct an underlying premise to these policies, it might be as follows. The Canadian government is committed to providing assistance to families in meeting direct child-rearing costs. The tax system acknowledges that child-rearing costs are directly related to standard of living (proxied here by taxable income), and thus larger benefits are afforded those individuals with higher incomes.<sup>7</sup> However, examination of the next tax policy, the child tax credit, will contradict this conclusion.

In economic terms the child tax credit would also induce families to spend more time in leisure activities. However, since the benefit is independent of the claimant's marginal tax bracket, upper-income individuals would not differentially benefit from the policy. In fact, the credit is family income tested and effectively benefits low- to upper-

middle-income families more than it does upper-income families. Such a policy of course violates the basic premise of using individuals as the unit of taxation, but at the upper-income levels serves to strengthen vertical tax equity.

In addition to its effect on decisions regarding time allocation among home, market, and leisure activities, the child tax credit also serves to influence intrafamily time allocation. To the extent that taxpayers respond as individuals (as our unit of taxation would imply) to government tax incentives, then any policy that confers either benefits or losses based on an inalterable characteristic such as gender will serve to distort decisions regarding household division of labor based on economic considerations. Thus, to the extent that mothers will usually be the taxpayers claiming these benefits, there is an incentive for their labor to be associated with child rearing.<sup>8</sup> I am of course not the first researcher to make this association. Although neither author considers this tax policy explicitly, both Julie White (1983) and Pat Armstrong (1984) discuss the implications of institutional policies that encourage women's part-time employment. The child tax credit can be classified as falling within this genre of policies as it encourages mothers who are already labor force participants to reduce their contributions to market work.

Armstrong (1984, p. 134) supports the conclusion that would follow from economic considerations alone--that such a gender-specific tax policy "perpetuates the differences between women and men in and out of the labour force [and supports] the continuation of segregation, of unemployment, of unequal incomes and of a double day for women." White

(1983, p. 22), however, argues that "changes in the labor market [activity of women] have no relationship to the socially-determined role of women," and that in the absence of such gender-biased tax policies there is no reason to suppose that men will spend any additional time in domestic work. Although clearly my sympathies from a disciplinary point of view lie with Armstrong, debate on the subject is deferred for later discussion in the paper.

The child care deduction influences not only the real hourly market wage rate earned by the mother but also potentially reduces the marginal tax rate she faces. Both influences have the economic effect of encouraging (1) homemakers to enter the labor force and (2) current labor force participants to increase their market contributions at the expense of time spent in home production. It does not encourage fathers or other responsible adults to increase their contributions to work in the home, but rather causes a substitution of market-purchased goods and services (fast food and day care, for example) for lost home production (home-cooked meals and mother's child supervision). By virtue of the fact that this benefit is also gender-specific in nature, it will reduce the burden of women's work in the home, but will not contribute to a more equal division of labor in two-parent households. Note also that the net effect of such a policy is not necessarily to reduce the total work burden of the mother. Studies have in fact shown that there is little difference between the total time spent in all work activities (both home and market) by employed and nonemployed married women (Adler and Hawrylyshyn, 1977).

After considering the effective impact of such sex specificity, one is left wondering about its purpose or legislative intent. The impact of this policy on two-parent households is to encourage mothers to enter the labor force and to provide some economic relief for dual-earner households to meet increased direct child care costs. Yet it also provides a subsidy to families who practice a nontraditional division of labor. For example, the two-parent family with a single female earner can still deduct from her taxable income babysitting expenses even though the male is providing full-time homemaking services. Further, the deduction would not be available to single male parents. In sum, while discouraging traditional parental roles with regard to time allocation, the child care deduction does provide some economic advantage for mothers (relative to fathers) who have sole custody of children.

The spousal exemption exemplifies another tax policy that violates the basic premise of using individuals as the unit of taxation. Entitlement to the benefit is dependent on spousal income. Further, since the exemption serves to reduce the wage earner's taxable income, it provides a tax benefit to eligible recipients proportional to his or her marginal tax bracket. This implies that higher-income taxpayers realize a greater absolute tax advantage than their lower-income counterparts. At minimum the benefit increases the unearned income of both spouses and encourages the wage earner to substitute out of market work and into leisure activities, while inducing a similar substitution out of home production by the homemaker. The exemption is large enough also to cause a reduction in the marginal tax faced by the wage earner. In this

circumstance the wage earner would respond by increasing his or her contributions to the paid labor market, and the net effect on time allocation would be indeterminate. The similarities in impact of this and the child exemption bears noting, in that individuals who, like their spouses, have little or no taxable income will receive no benefit from this exemption.

In the past, proposals to amend the spousal exemption have stimulated some of the most heated tax policy debates either on or off the floor of Parliament. The fervor which politicians and others bring to these debates ranks second only to that generated by proposed amendments to the Crow's Nest Pass Freight Agreement (crow rate) and family allowance payments. In the absence of a firm idea of its legislative intent, reasonable alternatives to the exemption are difficult to assess. However, given the demonstrable concern expressed over this policy, I will briefly review the policy and issues surrounding its debate.

For nearly as long as there has been an income tax, the government has afforded taxpayers with a spouse exemption. An exception occurred in the period between July 1942 and January 1947, when the Canadian government withdrew the exemption to encourage married women to enter the paid labor force during World War II. Considering its suspension a wartime measure "justified only by the extreme state of emergency," the government reinstated the exemption (Pierson, 1977, p. 135) after the war, inducing an exodus of married women from the paid labor market.

More recently the Royal Commission on the Status of Women (1970) recommended abolishing the exemption, as did Judy Erola (see Hay and

Baer, 1983), then the minister responsible for the status of women. These critics claimed that the exemption unfairly favored the middle- to upper-income families who could afford for one spouse to remain out of the paid labor force. The policy was also accused of discouraging market work by poor families who needed two incomes to meet basic needs. Ms. Erola further proposed that the additional revenues generated by abolishing the exemption (\$1.3 billion in 1983) be reinvested in child care (Hay and Baer, p. 13).

Opponents to abolishing the spousal exemption argued that it monetized women's societal contribution as nurturers of children and that its repeal would be paramount to devaluing such efforts. While it is true that many claimants of this benefit are husbands whose wives work full time in the home caring for dependent children, the exemption can be claimed by a taxpayer regardless of whether dependent children are present. Further, most women, regardless of whether their spouses qualify for the spouse exemption, are likely to be the primary care-giver whose contributions should also be recognized if "motherhood" is what the tax break is designed to reward.

#### NET IMPACT OF TAX POLICIES ON TIME ALLOCATION

Assessing the net effects of the various Canadian family tax policies on family time allocation is a difficult task. Benefits (family allowance payments, for example) are given with one hand and taken away with another, since benefits are taxable. Economic incentives are offered mothers to enter the labor force (child care deduction), while



penalties are levied against married women who do (spousal exemption). Nonetheless, I will attempt to summarize what is known.

In 1982 the National Council on Welfare calculated the net value of government transfers made on behalf of dependent children to families with different levels of income. Included in its assessment were family allowance payments, dependent child exemptions, and the child tax credit.<sup>9</sup> Its calculations showed that in absolute dollar amounts such tax policies clearly favored the middle- to upper-income family. To the extent that these policies primarily amount to granting unearned income, they imply that (compared to behavior in the absence of tax allowances) child-related tax benefits serve to discourage middle-income women (relative to their lower- and upper-income counterparts) from market work in favor of leisure activities.<sup>10</sup> The Council's analysis does not allow one to examine what, if any, effects these policies have on income distribution, but it does exemplify one way in which the progressive nature of the Canadian tax system is undermined.<sup>11</sup>

In a recent article Blomqvist and McKee (1986) estimated the impact of the Erola proposal on time spent by married couples in labor market activities. They also examined (1) the effect of applying generated revenue savings to increasing the child tax credit, and (2) whether any economic efficiencies could be gained by such actions. From predictions based on empirical work originally done by Nakamura and Nakamura (1981) the authors concluded that abolishing the spousal exemption would cause a significant increase in the proportion of married women working outside the home. Especially affected by the change would be wives aged 25-29

and over 45. They were predicted to increase their labor force participation rates by as much as 6 percent.<sup>12</sup>

In sum it appears that the time allocation of low-income families is influenced very little by the family tax policies discussed in this paper. Middle-income families are afforded the greatest incentive of all families to reallocate their time along traditional division-of-labor lines. Net impacts on upper-income families are indeterminate.

To this point discussion has focused on the impact of tax policies on time allocation of married-couple households. However, given that 40 percent of all Canadian marriages now end in divorce (Statistics Canada, 1983), no contemporary work on the Canadian family can be considered complete without at least some discussion of single-parent families. This analysis will focus on two major tax policies that pertain to custodial parents of dependent children; taxation of child support payments and the child exemption as equivalent to the adult exemption.

Under current Canadian tax law child support payments made by non-custodial parents are exempt from income taxes. The payments are, however, considered as taxable income of the custodial parent. At first blush it appears that the impact of this tax policy will be to provide a disincentive for the custodial parent to allocate time to labor market activities. Such a conclusion could be drawn from two facts. First, it is possible that these payments place the custodial parent in a higher tax bracket, thus effectively reducing his or her after-tax wage rate. This would afford an incentive to substitute home production for labor market activities. Second, regardless of whether the custodial parent's

marginal tax bracket is influenced, an unearned income effect provides a further employment disincentive. Closer examination of the impact on custodial parents reveals, however, that the long-run consequences of taxing support payments are not as straightforward as one might expect.

Because child support payments are tied to custodial parents' income, the long-run ability of that parent to provide for his or her children will depend on whether those benefits are keyed not only to the rate of inflation, but also to his or her earnings capacity (marginal tax bracket). The point is best made by example. Suppose that a non-custodial parent is ordered by the court to provide \$1,000 per month in child support payments to the custodial parent. Since custody is usually given to the mother, who is likely to be the parent less economically able to provide for the child, further assume that the parent making these payments faces a 35 percent marginal tax bracket while the custodial parent works part time in the paid labor force and faces a 10 percent marginal tax bracket. Effectively, the monthly after-tax cost to the noncustodial parent would be \$650, while the after-tax benefit to the child would be \$900. Unless some mechanism is incorporated in the court order to adjust future payments in accord with changes in both the cost of living<sup>13</sup> and the marginal tax bracket of the custodial parent, long-run consequences of tying child support payments to the income of custodial parents will further deter participation in the paid labor force while reducing after-tax benefits to the child.

To focus on effects of changes in the custodial parent's marginal tax bracket, assume that child support payments are indexed to inflation.

Next, suppose that once a child reaches school age the custodial parent considers increasing to full time his or her labor market activities. Although working full time would result in a net increase in income, the after-tax child support payment would amount to less. For example, if full-time earnings increase the marginal tax rate of the parent to 25 percent, after-tax child support payments will only amount to \$750 per month. If the parent were earning \$10 per hour, this would mean that he or she would have to work 20 additional hours each month just to make up for the \$150 lost in after-tax child support payments. While the example of increasing hours of paid work more pointedly demonstrates the tax policy impact, long-run increases in real wages will have the same effect. Ultimately, however, this erosion of real income results in an indirect increase in child-rearing costs to the custodial parent and will cause him or her to increase labor supply in order to maintain the child's standard of living. If we relax the assumption that child support payments are tied to the cost of living, the latter effect will be even stronger.

One tax policy which will in part mitigate the effect of custodial parent "bracket creep" is the child equivalent of the adult exemption. By its very nature, the benefit of this tax policy will be positively related to the custodial parent's marginal tax bracket. Assuming that the exemption amounts to \$3,000 annually, the increase in tax rate from 15 to 25 percent would amount to a \$25 monthly tax savings.

Unfortunately, there have been no Canadian studies that examine the impact of these policies on time allocation of single-parent families. It is clearly a direction of future research that would have implications

not only for better understanding family organization, but also for establishing government tax policies.

FAMILY TAX LAW REFORM: WHERE DO WE GO FROM HERE?

Present Canadian family tax policies reflect no clear underlying philosophy with regard to family organization. Perhaps the best characterization of the net benefits would be a "little something for everybody." Although specific policies offer distinct behavioral incentives for families, one can often point to another policy with a counterbalancing effect. A pessimist might view the policies as simply ways in which legislators have redistributed the progressive impact of our tax system to benefit their middle-class constituents. An optimist might view the diversity of policies as necessary to avoid potential interference by "big brother" in the natural order of human behavior.

In my opinion, the time for tax reform is now. Either we move toward a flat tax system and eliminate tax incentives which serve to distort human behavior, or we step back and carefully review the purpose and impact of every tax policy with an eye to reformation which will reflect our underlying philosophies regarding the economic organization of Canadian families.

In his February 1986 Budget Papers, Michael Wilson identified the present government's efforts to reform social and tax policies as being "based on the twin tests of social and fiscal responsibility." Although noble goals, neither test as expressed provides sufficient foundation upon which consistent and fair tax policies can be built. In the same document the minister announced that yet another tax credit, the

refundable federal sales tax credit, was being added to the myriad of existing tax policies, at an annual cost to the government of \$330 million. While incorporation of the new credit can be applauded because it is directed at low-income families and will thus serve to strengthen vertical equity in our tax system, the offsetting factor is that rather than getting at the cause of inequality it represents yet another reactive rather than proactive solution to rectifying distortions in the tax system.

If the present system, which uses tax law to influence human behavior, is to be retained, there clearly exists a need for tax reform. Specific underlying statements of philosophy and intent are needed to guide the reformation. With regard to family tax law, there are at least three major philosophical areas of concern to the home economist: considerations for the provision of care and services for our nation's children, the treatment of citizens with intermittent attachment to the labor force, and the impact of gender-specific policies.

With regard to provision of care and services for children, present tax policies reflect at least two distinct philosophies. The first is that all of society should be in part responsible for assisting parents in meeting direct costs associated with child-rearing. The second is that assistance to parents should bear some relation to their standard of living--i.e., high-income parents are entitled to larger subsidies for raising their children than are low-income families, since their actual expenses will be greater.

Eichler (1983, p. 131) identifies the "principle of shared social responsibility" in the rearing of children. She maintains that society should bear at least some responsibility for assisting all families in

meeting these costs. However, ascertaining the extent to which society should contribute toward those costs is a far more difficult task. In addition to the direct tax subsidies that have already been outlined, society presently shares in the cost of education and health care as well as many other community services for children. Thus the real question is where to draw the line. That is, to what extent are children public goods in whose future every citizen has an interest, and to what extent are they private goods whose benefits accrue primarily to the family? The answer to this double question is crucial in assessing the need for child care as it is related to tax reform. Once answered, the next step is to ensure, as Eichler maintains, that such benefits are equitably distributed without regard for family structure. For example, similar support should be provided for meeting the costs of children raised in single-parent as well as two-parent, two-earner households.

A major cost associated with raising children is time. The care of young children is particularly time intensive. This cost is usually borne either indirectly by the parent or directly through the purchase of day care services. Given that there will always be a need for both types of care, the question for tax reform becomes: How can we design a tax policy that will not economically favor either choice (unless of course we determine that one type of care is preferable to another)? We need to design a child support policy that deters a parent neither from remaining home to care for a child nor from participating in the paid labor force if he or she so desires. While the spousal exemption and child care exemption could be viewed as such counterbalancing policies, the spousal exemption is not linked to the presence of dependent children and serves

to levy a more substantial penalty for labor force participation on families who face higher marginal tax rates.

The final philosophical question with regard to tax policies that influence the provision of care and services for children concerns whether higher-income families should be provided more support (in absolute dollar terms) than low-income families. Essentially, it amounts to what society's responsibility is in providing child support beyond basic needs and to whom such support should be provided. As discussed earlier and as reported by the National Council on Welfare (1983), child-related tax benefits accrue primarily to families of middle to upper incomes. Child care deductions provide greater economic benefits to higher-income mothers than to lower-income mothers. Child exemptions provide a greater benefit to high-income (usually) fathers. Even family allowance payments, which on their face appear to provide "equitable" support to all families, turn out upon closer inspection not to do so. If child welfare is what is at issue, one would certainly not envy the policymaker required to explain to the child from a low-income family why his or her parents get fewer child support moneys from the government than does the child from an upper-income family. This is exactly the question that needs an answer before meaningful tax reform can be initiated.

Finally, it is necessary to consider treatment under the tax code of families who by choice decide to refrain from engaging in labor force activities at some point in their lives.<sup>14</sup> At present, the Canadian tax code affords tax subsidies to households in which one spouse has little or no income. This provides incentives, particularly to upper-income families, for one member to engage solely in home production activities.



Philosophically, society must decide on what basis that provision should be made. If the intent of the exemption is to consider such homemakers dependents who use rather than provide services, then policymakers should review work by Adler and Hawrylyshyn (1977) and others regarding the value of home production. Those studies would indicate that families with full-time homemakers enjoy a considerably enhanced standard of living as compared to families with a similar amount of income and no full-time homemaker.

If the intent of the spouse exemption is to "recognize" the contributions of those homemakers, we return to the question of whether the services provided by homemakers are of a public or private nature. That is, to what degree does society and to what degree does the family benefit from their contributions? As suggested earlier, society could decide that homemakers caring for young children are deserving of financial compensation to help defray the opportunity costs of child-rearing.

However, if the spousal exemption is to be the policy tool through which compensation is made, at least two points with regard to its impact need to be considered in tax reform. First, the present policy provides an incentive for any spouse, regardless of whether there are dependent children in the household, to reduce time spent in labor market activities. Consideration should be given to restricting that exemption to only those households in which young children are present. Second, careful consideration should be paid as to whether high-income families should receive greater (in absolute dollars) compensation than low-income families for the contributions of the homemaker.

Although a homemaker does indirectly enjoy economic benefits when his or her spouse receives a tax break, one should question whether the spousal exemption is the best policy tool for the job. If the intent of the policy is to defray the opportunity costs associated with child-rearing, then alternatives such as contributions to Canada Pension on behalf of the homemaker would be a more appropriate means of compensation. Such a policy would not only be a more equitable (across individuals) arrangement, but would also begin to get at the root cause of poverty among older women.

Finally, it is my view that all tax law should be gender neutral. That is, without sound philosophical reason for doing so, no policy should have the effect of distorting intrafamily time allocation patterns. Present policies that are directed only at women, such as family allowance payments, child care deductions, and child tax credits, serve no purpose except to reinforce a traditional division of labor within the household. Earlier, other writers' views on this subject were discussed. Pat Armstrong takes a stand similar to mine, while Julie White would dissent. If White's assertion that changes in labor market activities of women have no relationship to the socially determined role of women, then one would expect that a man's contribution to home production should be invariant to whether his spouse is employed. However, simple tabulations from the 1971 Halifax study of family time use indicated that men did spend more time in home production when their spouses were employed (Adler and Hawrylyshyn, 1977). Further, it is impossible to estimate from any studies to what extent our gender-specific tax policies are distorting present time allocation patterns.

## CONCLUSIONS

This paper has put forth arguments to support the premise that Canadian family tax policy is in need of reform. It demonstrates that many of our current tax policies are inefficient and convey no consistent philosophical positions. Unless tax code is rewritten to eliminate the element of social intervention, the public policy areas of finance and taxation are ones in great need of input from home economists with training in family resource management. It is only with a careful analysis of tax policies taking into account all aspects of family resource allocation that equitable and fair tax laws can be drafted.

## Notes

<sup>1</sup>See Eichler (1983, p. 124) for a more complete treatment of this subject.

<sup>2</sup>See Eichler (1983, p. 127) for analysis of vertical equity and the resulting effect on family income distribution.

<sup>3</sup>It can be argued that the whole social welfare system operates to distort the time allocation patterns of families, but those policies will not be discussed here. For a general discussion of the impacts of government welfare programs on time allocation see Killingsworth (1983, p. 392).

<sup>4</sup>More detailed information on any of these policies would be available from a regional Revenue Canada office.

<sup>5</sup>Benefits are payable to a father only if he is the custodial parent in a household where the natural mother is either not present or not legally competent to manage her own financial affairs.

<sup>6</sup>Recall that the parent claiming the dependent child exemption must also claim family allowance payments as taxable income.

<sup>7</sup>It should be noted here that because the individual is the unit of taxation, two-earner families who earn the same total amount of income as a single-earner family will receive a smaller tax benefit for their child, since only one parent can claim the child exemption. This will be true despite the fact that the two-parent family with a single earner probably enjoys a higher full income by virtue of the likelihood that one person engages in full-time home production.

<sup>8</sup>Remember that the child tax credit is payable to the parent who is eligible to receive family allowance payments (usually the mother), not the parent who claims them as taxable income (usually the father).

<sup>9</sup>Excluded from the analysis was the child care deduction.

<sup>10</sup>For simplicity in interpretation, the reader may wish to substitute the economic term "leisure" with the word "consumption." That is to say, in this example middle-income women are less likely to be labor force participants and more likely to spend more (leisure) time "consuming" child services (like talking or playing with children) from which they derive satisfaction.

<sup>11</sup>This paper does not incorporate an analysis of the impact of taxes collected and distributed for social assistance programs. If these moneys were included in an overall assessment of taxation and income distribution, a lesser degree of vertical inequality would likely be observed.

<sup>12</sup>Further results of the study indicated that only small potential gains in economic efficiency to society are possible when the spouse exemption is replaced by an increased child tax credit. Unfortunately, the analysis by Blomqvist and McKee is based on an assumption that results in their estimates of economic efficiency erring on the conservative side.

The authors measure efficiency of policy enactment as the difference between the value of additional labor supplied the market by husbands and wives and the opportunity cost to society of giving up home production. The former is measured in terms of before-tax labor earnings and the

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latter as after-tax earnings. While this measure is both simple and intuitive, it fails to capture one of the major costs to women and society of their nonparticipation in the labor force--foregone pension benefits. Presently in Canada, older women as a group face one of the highest risks of being poor. Among women 65 and over who do not live with a spouse, two-thirds face financial hardship and are likely to be in part supported by social assistance (National Action Committee, 1983, p. 1). Thus, in light of the fact that pension and other fringe benefits have been estimated to cost employers as much as 31 percent of employee wages (Ostry and Zaidi, 1979, p. 202-203) omission of their value in Blomqvist and McGee's calculations constitutes a major oversight.

<sup>13</sup>Assuming that the initial judgment did account for actual after-tax costs of raising the child.

<sup>14</sup>The word "choice" is key here and is used explicitly to exclude those persons who do not participate in the labor force because of mental or physical disability.

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