

Tax Options for Childcare that Encourage Work, Flexibility, Choice, Fairness and Quality

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May, 2017

How should child care expenses be taxed?

Current Child Care Expense Deduction:

- Deduction from taxable income, up to \$8,000/yr per child.
- Deductible by lower income spouse; $\leq 2/3$ rds of earnings.
- Tax Expenditure of about \$1.3 billion/year.

Why done this way?

- Traditional 'ability to pay' view of tax expenditures: adjust taxable income for expenses necessary to earn income.
- Alternative view 1: tax expenditures are spending (Neil Brooks)
- Alternative view 2: optimal taxation approach (Boadway)

Let's flip the table on the tax treatment of child care

- Take the \$1.3B from CCED.
- Add \$1.2B of new money.
- Replace CCED with Quebec-style refundable tax credit.
 - Sliding scale: 75% for under \$34K → 26% over \$153K



The credit rate schedule:

Table A1: Quebec's Refundable Credit Rate Schedule, 2015

Family Income (\$)		Tax Credit Rate (percent)	Family Income (\$)		Tax Credit Rate (percent)	Family Income (\$)		Tax Credit Rate (percent)	Family Income (\$)		Tax Credit Rate (percent)
more than	but not more than		more than	but not more than		more than	but not more than		more than	but not more than	
0	34,425	75	43,355	44,625	67	94,350	135,450	57	144,440	145,720	40
34,425	35,700	74	44,625	45,890	66	135,450	136,740	54	145,720	146,995	38
35,700	36,980	73	45,890	47,180	65	136,740	138,020	52	146,995	148,285	36
36,980	38,250	72	47,180	48,455	64	138,020	139,300	50	148,285	149,565	34
38,250	39,525	71	48,455	49,730	63	139,300	140,590	48	149,565	150,860	32
39,525	40,795	70	49,730	51,000	62	140,590	141,875	46	150,860	152,140	30
40,795	42,085	69	51,000	52,280	61	141,875	143,150	44	152,140	153,425	28
42,085	43,355	68	52,280	94,350	60	143,150	144,440	42	153,425	or more	26

Source: Quebec, Revenu Québec, Income Tax Schedule C, 2015.

The upside:

- i. More work.
- ii. Better gender balance.
- iii. Helps lower-income most.
- iv. Flexible / choice.
- v. Higher quality.
- vi. Perhaps no net cost.

I will go through each of these six claims in turn.

i) More work:

We calculate the change in the net price of childcare with/without this new subsidy.

Then assume a 0.24 elasticity of extensive labour supply response

- This is in the middle of estimates from the literature.

Result is about 69 thousand more working mothers.

New workers:

Table A2: Computation of New Employment by Mothers of Young Children – Two Childcare Expense Deduction Scenarios

Family Income (\$)	Mothers of Children Ages 0–6 in Two-Parent Families		Percent Reduction in Net Childcare Costs		Participation Elasticity Value	Resulting Change in Probability of Participation (percent)		Mothers Entering Workforce, Short Term				Mothers of Children Ages 0–15 in Two-Parent Families	Mothers Entering Workforce, Long Term				
	Number	Employment Rate (percent)	Scenario A	Scenario B		Scenario A	Scenario B	Scenario A		Scenario B			Number	Scenario A		Scenario B	
								Number	Share of Stay-at-Home Mothers (percent)	Number	Share of Stay-at-Home Mothers (percent)			Number	Share of Stay-at-Home Mothers (percent)	Number	Share of Stay-at-Home Mothers (percent)
Under 25,001	234,588	46	41.1	32.1	0.24	9.9	7.7	10,593	8	8,262	6	398,939	18,015	9	14,050	7	
25,001–50,000	216,067	71	40.5	31.1	0.24	9.7	7.5	15,002	24	11,503	19	390,201	27,093	32	20,774	24	
50,001–75,000	218,293	76	38.9	30.0	0.24	9.3	7.2	15,502	30	11,970	23	385,278	27,361	33	21,127	25	
75,001–100,000	200,943	79	37.2	28.0	0.24	8.9	6.7	14,210	34	10,692	25	384,687	27,203	41	20,468	31	
100,001–150,000	305,952	81	16.8	7.9	0.24	4.0	1.9	10,055	18	4,734	8	554,263	18,216	26	8,575	12	
over 150,000	226,207	86	8.9	-1.2	0.24	2.1	-0.3	4,131	13	nil	0	482,046	8,802	17	nil	0	
All	1,402,050	73	33.9	24.8	0.24	8.1	5.9	69,494	19	47,160	13	2,595,414	126,691	22	84,994	15	

ii) Better gender balance:

Childcare is at the core of gender differences in home and workplace and for long-run economic outcomes.

Cheaper childcare pushes toward a more level gender balance.

iii) Helps lower income most:

Current CCED gives biggest benefit to highest earners.

- Over half of the lowest earners are constrained by the 2/3^{rds} income rule.
- Our proposal flips this by offering most generous benefit to the lowest earners; still generous to high earners.

Table 1: Use of the Federal Child Care Expense Deduction (CCED) by Canadian Families, by Family Income, 2015

Family Income	Eligible Families* Claiming the CCED		Amount Claimed	Average Amount per Claiming Family	Percent of Claiming Families Bounded by Maximum Deduction Limit per Child	Percent of Claiming Families Bounded by Income Limit (2/3 of lower-income spouse)
	(\$)	(thousand)				
Min.–25,000	142.6	29	320.7	2,248	2	59 !!!
25,001–50,000	148.5	31	429.7	2,893	5	33
50,001–75,000	180.6	37	551.4	3,053	1	31
75,001–100,000	211.2	43	862.1	4,082	3	22
100,001–150,000	310.1	48	1,222.4	3,942	7	18
150,001–max.	244.1	44	1,546.8	6,338	23	10
All	1,237.1	39	4,932.9	3,988	8	26

* Eligible families are census families with children younger than age 16; student parents excluded from the analysis.

Source: Authors' calculations using Statistics Canada, SPSD/M (2015).

iv) Flexibility and Choice:

Our proposal preserves the choice currently seen in the CCED.

- Offers more flexibility than the Quebec CPE model.
- Staffing, curriculum, schedule, and more.
- Markets are very good at matching heterogeneous desires.

But...what if parents aren't able to assess childcare well?

- Some evidence suggests that parents “don't price quality”.
- Perhaps they can't assess quality well...
- We note that our proposal is no worse than status quo CCED; but we have more to say on quality....

v) Higher Quality:

We have two prongs to our 'quality' strategy.

A. Can now afford more quality.

A low or middle earner might face a \$1500/month price tag for quality care. With a 75% tax credit, this now becomes affordable.

- We expect a substitution from unregulated to regulated care.

B. Make tax credit dependent on quality indicator.

Could restrict the tax credit to child care operators that meet a quality standard.

- How to do this? Piggy-back off provincial regulations?

Other idea: could do a 'public option' alongside private market?

vi) Net cost could be small:

69 thousand new workers earn more money for their families

- But also more revenue for the government.

We simulate using SPSD/M, accounting for federal/provincial taxes/benefits.

We try one model for 'short run'; one for 'long run'.

- The long-run simulations assume employment boosts persists after kids hit school ages. Research indicates this may be true.

Compare 'static cost' (assumes no change in behaviour) to simulated cost.

Table 2: Net Federal and Provincial Fiscal Changes under Two Childcare Expense Deduction Scenarios

Change	Scenario A: Provincial Childcare Expense Deduction Kept in Place		Scenario B: Provincial Childcare Expense Deduction Eliminated	
	<i>Short Term</i>	<i>Long Term</i>	<i>Short Term</i>	<i>Long Term</i>
<u>Static net federal fiscal cost (\$ million)</u>	1,188	1,188	1,188	1,188
Mothers entering workforce (<i>number</i>)	69,494	126,691	47,160	84,994
New employment income (<i>\$ million</i>)	2,616	4,768	1,775	3,199
New childcare expenses to support employment (<i>\$ million</i>)	448	561	312	397
New benefits paid out (<i>\$ million</i>)	234	293	171	216
Change in federal taxes (<i>\$ million</i>)	576	1,027	417	742
Change in federal income-tested benefits (<i>\$ million</i>)	-205	-367	-124	-214
<i>New net federal fiscal cost (\$ million)</i>	641	87	818	447
Provincial costs (<i>\$ million</i>)	-303	-556	-524	-696
<u>Consolidated federal-provincial net fiscal cost (\$ million)</u>	337	-468	294	-249

Note: All figures represent the net value compared to the status quo federal CCED.

Source: Authors' calculations as described in the text.

Summary:

- Replace existing CCED with a generous refundable tax credit.
- Proposal improves work, gender balance, flexibility, fairness, and quality—all for a small net cost!