

The role of taxes in social policy

Frances Woolley
Carleton University

Outline

1. What does taxation as social policy mean?
2. Earned income tax credits: taxation as social assistance policy
3. The boutique tax credit: Canada's social policy innovation
4. Charitable donations

1. What does using taxation as social policy mean?

- Social policy: policies aimed at achieving social goals, e.g.
 - reduction of poverty,
 - protection and development of children,
 - support for the aged,
 - good health
- Every tax system has social policy consequences. Examples:
 - Choice of rate structure, e.g. basic personal amount, impacts poverty levels
 - Choice of tax unit, i.e. family or individual, affects
 - incentives to marry and form families
 - Incentives for second earners to participate in labour market
 - Choice of tax rates in consumption taxes
 - “Sin taxes” on alcohol, tobacco
 - Non-taxation of merit goods e.g. education, health care, religious activities

“Taxation as social policy”

- Using tax system to achieve social policy goals traditionally achieved through non-tax means, for example:
 - Earned income tax credits replace welfare
 - Refundable tax credits replace family allowances
 - Credits for public transport users replace direct subsidies to public transit
- Not always clear what counts/doesn't count:
 - Are charitable donations tax credits social policy?
 - Special tax status of religious organizations?

2. The first wave: taxation as social assistance

What?

- Refundable tax credits
 - Earned Income Tax Credit (US)
 - Canada Child Tax Benefit, National Child Benefit Supplement, Working Income Tax Benefit (Canada)
- replaced or augmented traditional social assistance/welfare in 1980s, 1990s

Why?

- **Reduction in wages, employment opportunities for unskilled workers**
 - Old-style social assistance programs always had high effective marginal tax rates
 - Now high MTRs (“welfare walls”) affected far more people
 - Without reform, social assistance loads would have exploded?
- **Family policy**
 - Perception (in US) welfare encouraged single parenthood
 - Desire to focus funds on working families with children
- **Ideology** economists such as Milton Friedman advocated negative income taxes (US Earned Income Tax credit expanded under Reagan)
- Administrative costs of traditional-type programs (???)

Effectiveness

- **Impacts in theory:** ambiguous
 - Reduction in social assistance tax back rates have to be accompanied by one of:
 - Lower benefits to least well-off recipients
 - Reduced tax revenues
 - Higher marginal tax rates elsewhere
 - Net impact of reform not obvious *a priori*
- **Impacts in practice:** generally seen as positive.
 - Increasing employment and reducing poverty
- **For surveys**
 - US: [2006 Brookings Institute Survey](#) with extensive bibliography, Bruce Meyer in 2010 volume “Tax Policy and the Economy”.
 - Canada: research by [Milligan and Stabile](#); Kerr McKenzie & Mintz [Tax Policy in Canada](#)
 - UK: Mirlees review: <http://www.ifs.org.uk/mirrleesReview>

Have we hit the tax credit wall? Unresolved issues

- **Good policy v. good luck**
 - Success of tax credits achieved in expanding economy
 - Hundreds of papers on US experience, much less research on:
 - Canada, Australia, other countries
 - Earned income tax credit post 2008 financial crisis
- **The Craigslist Economy**
 - Incentive to combine tax credits and under-the-table payments
 - Self-employment income as reported for tax purposes may be poor indicator of need
 - Role for asset, wealth tests?
- **Psychology of taxes**
 - Is simplicity and transparency a good thing? If people knew what their effective marginal tax rate was, would they still work/report income?
- **Responsiveness to income shocks**
 - Credits assessed on annual basis non-responsive:
 - may be good thing for work incentives
 - Limits ability to alleviate immediate financial hardship
 - WITB allows for advance payments – take-up?
 - Overpayments + benefit reductions cause severe hardship
- **Incidence of tax credits**
 - By subsidizing work, allow employers to offer lower wages, so benefit firms as well as (instead of?) workers? (e.g. [here](#))

Canadian challenges

- **Two v. one-adult households**
 - Canada Child Tax Benefit thresholds the same
 - Equity?
 - Marriage/cohabitation penalty?
 - WITB differentiates
- **Vancouver v. Shediac**
 - Responsiveness to differences in wage rates, living costs?
- **Fertility impacts**
 - UK research finds fertility effects exist, but are small (Stuart Adams), Canada?
 - Reason for introduction of WITB not enrichment of child-related benefits?
- **Increasing diversity in family types**
 - Multi-generational, multi-family households
 - Example: 2011 Budget eliminated rule that no more than one person per household could claim Child Tax Benefit (Department of Finance, [2011 Tax Expenditures](#))
 - See Law Commission of Canada [Beyond Conjugalinity](#)

3. The boutique tax credit: Canada's tax policy innovation

- See <http://www.theglobeandmail.com/report-on-business/economy/economy-lab/why-politicians-love-boutique-tax-credits/article547999/>
- Use of tax credits to achieve specific social policy goals:
 - Tax credits for children's sports, arts
 - Public transport tax credit
 - Volunteer firefighter tax credit
 - Caregiver, disability tax credits
- Not as widely used in US, UK, Australia

Why?

- **Technology:** tax preparation software eases collection of information, calculation of taxes
- **Federal-provincial division of powers:**
 - Federal government lacks jurisdiction over education, social spending
 - Tax credits and deductions one way federal government can, e.g., promote children's fitness, subsidize child care
- **Self-assessment** (as opposed to UK-style Pay As You Earn)
 - People can see, are aware of, individual tax credits
- **Individual, not social provision:**
 - Tax credits subsidize individual initiatives, e.g. cost of hockey registration
 - Don't build arenas, field houses, baseball diamonds
 - Reflects **individualist ideology**? Or diversity - **social heterogeneity**?

Why con't

- **Psychology:**
 - Rewards for doing "good things", e.g. volunteer fire fighting – validates people's identities
 - Increases tax compliance, satisfaction with taxes?
 - One study found unexpected refunds increased future tax compliance, unexpected payments decreased it ([Kirchler and Maciejovsky](#))
 - Individuals like tax avoidance opportunities?
 - *All of this makes credits very popular!*
- **Equity between employed, self-employed?**
 - E.g. public transport tax credit, Australia's deduction for work-related car expenses.

What about effectiveness in achieving policy goals?

The children's fitness tax credit: Uniformly condemned

"Panel members expressed little confidence that economic instruments, as defined within the scope of the report (tax and/or subsidies), was an effective means to increase population level physical activity.

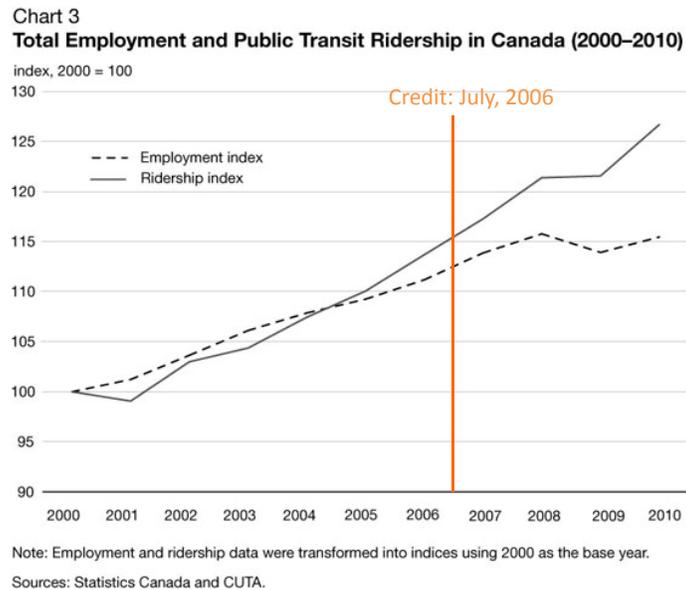
" [2010 report](#) to Canadian Heart and Stroke Foundation

"Non-refundable Tax Credits Are an Inequitable Policy Instrument for Promoting Physical Activity Among Canadian Children" 2012, [Can J. Public Health](#)

Issues:

- **Distribution:** Non-refundable credits don't reach those most in need of support – very low income families
 - Ontario's children's fitness credit, which is refundable, is better
- **Incentives:** Most spending is infra-marginal, i.e. to people who would be registered in sports in any event
- **Individual v. collective action:** Does not address major barriers to sports participation, e.g. lack of facilities
- **Gender**
 - Provincial surtaxes create incentive for highest earning partner to claim all credits
 - Does this matter?
- Other potential issues: **administrative costs, take-up, incidence**

Public transit tax credit: the challenges of evaluation



Exemplifies difficulty of evaluation

- [Department of Finance \(2011\) Tax Expenditures](#) makes valiant effort, but:
 - Steady upwards rise in transit ridership
 - Almost impossible to separate out effects of tax credit from
 - Changes in gas prices
 - Changes in employment, demographics, urbanization
 - Introduction of u-passes
 - New transit infrastructure, e.g. Canada Line

Similar issues to children's credits

- Incentives to marginal users
 - **No subsidy for occasional riders**
- Non-refundable
- From 2006 to 2008, increase in claims far greater than increase in public transit ridership
 - Greater awareness
 - Incorrectly filed returns??

4. Charitable donations: Random thoughts

- Take it for granted that charities are A Good Thing
- Many charities do fine work, some more like for-profit businesses
- Charitable status is rarely revoked
 - 100% [revocation tax](#) on all assets
 - Too costly!
- Would more flexibility in designation of organizations (charity, non-profit, for-profit) be good?

Are there ways of inducing more giving/more effective giving?

- Give subsidy to receiving organization instead, e.g. \$1 donation = \$1.40 for charity
 - Advantage: encourages all, not just taxpayers, to give
- (Craig Alexander)
 - Synchronize charitable donation deadline and RRSP deadline
 - People might give more to reduce taxes owing to zero.

Conclusions

- Taxes as social policy combines all major issues in
 - Tax policy: efficiency/incentives, equity/redistribution, administrative cost
 - Social policy: best way to build a good society
- Challenging!