The role of taxes in social policy

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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**
  - Canada: research by [Milligan and Stable](http://example.com); Kerr McKenzie & Mintz [Tax Policy in Canada](http://example.com)

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](http://example.com))
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 Conjugal

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

• 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
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!