

## **AN EARNED INCOME TAX CREDIT FOR CANADA**

### **The U.S. Earned Income Tax Credit**

An Earned Income Tax Credit (EITC) is a refundable tax credit available to low income working taxpayers. The United States has had an EITC for a number of years, which was significantly expanded in the Omnibus Budget Reconciliation Acts of 1990 and 1993. Under the current EITC in 1998 for every dollar low income workers earn up to a limit, as much as 40 cents is added to their compensation in the form of a tax credit. The maximum amount of the credit was \$2,271 for a family with one child and \$3,756 for a family with two or more children. In the 1998 tax year, 19.7 million workers were expected to claim EITC, receiving an average credit of \$1,547. The total cost of the credits was around \$30.5 billion. The EITC is larger for families with children. In 1998 16.5 million or almost 84 per cent of the claims were for families with children, who will receive an average credit of \$1,807.

### **The Economic Impact of the EITC in the U.S.**

The EITC is credited by the Council of Economic Advisors with removing 4.3 million persons from poverty in 1997, over half of which were children. The CEA cites a study that attributes as much as 60 per cent of the increase in employment of single mothers since 1984 to expansions in the EITC. Other studies of the positive impact of the EITC are also cited. (Council of Economic Advisors, pp.4-5.)

### **Administrative Problems with the EITC in the U.S.**

While simple in theory, the EITC is administratively complex (see attached forms and schedule). Nevertheless, the take-up rate was estimated to be in the 81 to 86 per cent range in 1990 which is higher than other antipoverty programs such as the AFDC (62 to 72 per cent in 1986/87) and Food Stamps (54 to 66 per cent in 1986/87). (Council of Economic Advisors, "Good News for Low Income Families: Expansions in the Earned Income Credit and the Minimum Wage," December 1998, p.3.) The EITC has had a non-compliance problem. The IRS estimated that of the \$17.2 billion in EITC claimed in the 1994 tax year, taxpayers overclaimed about \$4.4 billion or 26 per cent. The largest source of taxpayer errors relate to the eligibility of qualifying children and the child residency test. (U.S. General Accounting Office, "Earned Income Credit: IRS' Tax Year 1994 Compliance Study and Recent Efforts to Reduce Noncompliance," July 1998, p.1-2.)

## **Earned Income Tax Credits in Canada**

Canada already has its own experience with an EITC. The Working Income Supplement (WIS) that was established in 1993 as part of the Child Tax Credit was modeled on the U.S. EITC. It started at earnings of \$3,750, reached a maximum of \$500 per family at earnings of \$10,000, and was reduced to zero at family incomes over \$25,921. In 1997, the WIS was enriched, establishing a benefit of \$605 for the first child, \$405 for the second, and \$330 for the third and additional children. The WIS was phased in at family earnings of \$3,750 and reached a maximum at \$10,000. It was gradually reduced above family incomes of \$20,921. The reduction rates were 12.1 per cent for families with one child, 20.2 per cent for families with two or more children and 26.8 per cent for families with three or more children. In 1998 the WIS was replaced by the Canadian Child Tax Benefit national Child Benefit Supplement, which was no longer based on earnings.

### **An Illustrative Canadian EITC**

To show how a EITC might work in Canada and how much it might cost, an illustrative proposal was simulated for the 2001 taxation year using Statistics Canada's Social Policy Simulation Database/Model. Because Canada already has a generous National Child Benefit, the Canadian illustrative EITC was kept simple and not differentiated by the number of children. The EITC would be extended to all individuals or families. It would be 10 per cent of the combined earned income of the head of household and spouse up to a maximum of \$1200 at \$12,000, remains at \$1200 til \$15,000, and then be gradually reduced at a 10 per cent rate until eliminated at \$27,000. Almost 700 thousand Canadian families would receive average benefits of \$652 from the proposal. Of these 261 thousand would be below Statistics Canada's Low Income Cut Off (LICO). The total cost of the EITC would be \$456 million, of which \$175 million would go to Canadian families below the LICO. Not taking into account any induced increase in earnings which would be expected to be the main impact of an EITC, the number of families below the LICO would be reduced by 8,000. These families would be made up of 28,000 people. More detailed information on the distribution of benefits by nuclear families is given in Table 1-3.

Table 1: Selected Quantities for Nuclear Families

Earned income tax credit (M)	456.0
Average Benefits(\$)	652
Received EITC(Gainer) (000)	699
No. of Nuclear Families (000)	3894
No. Below LICO in Base (000)	1051
Change in No. of Fam. Below LICO	-8
Gainers Below LICO(000)	261
Change in Income Below LICO (M)	174.9

Table 2: Selected Quantities for Nuclear Families by Below LICO

	Below LICO		
Quantity	Yes	No	Both
No. of Nuclear Families (000)	619	3276	3894
Earned income tax credit (M)	174.9	281.1	456.0
Average Benefits (\$)	669	642	652
Received EITC(Gainer) (000)	261	438	699

Table 3: Selected Quantities for Nuclear Families by Base disposable income group

Base disposable income group	Earned income tax credit (M)	Average Benefits (\$)	Received EITC (Gain) (000)	No. of Nuclear Families (000)	No. Below LICO in Base (000)	Gainers Below LICO (000)	Change in No. of Ind. Below LICO (000)	Change in Income Below LICO (M)
Min-5000	24.9	617	40	91	104	29	-1	17.2
5001-10000	35.5	628	56	118	105	34	-3	22.3
10001-15000	77.9	720	108	238	180	58	-9	44.2
15001-20000	107.5	686	157	440	317	75	-8	50.8
20001-25000	97.6	625	156	497	224	51	-5	31.0
25001-30000	49.4	630	78	561	92	13	-2	8.8
30001-35000	28.1	638	44	494	25	1	-0	0.7
35001-40000	8.0	534	15	424	2	0	0	0.0
40001-45000	6.6	659	10	293	4	0	0	0.0
45001-50000	3.7	730	5	205	0	0	0	0.0
50001-60000	4.7	655	7	256	0	0	0	0.0
60001-Max	12.1	560	22	276	0	0	0	0.0
All	456.0	652	699	3894	1051	261	-28	174.9