*Child Tax Benefits: A Comparison of the Canadian and U.S. Programs**

This note describes and compares the Canadian Child Tax Benefit program with that of the Earned Income Credit program of the United States. Both programs were designed to assist families with dependent children and are based on yearly income of the family. Although similar in intent, the programs differ in universal structure and payment amounts. Discussed are legislative changes, family income, income taxation, and payment amounts.

Canada's Child Tax Benefit

Canada's first attempt to provide financial assistance to families with dependent children was the Family Allowance Act of 1944, which went into effect in July 1945. Benefits were payable for children under age 16. These benefits ranged (in 1945 current Canadian dollars) from $60 to $96 per year, depending on the age of the child. Benefits were reduced by $1 a month for the fifth child, $2 a month for the sixth and seventh child, and $3 a month for the eighth and subsequent children.

The family allowance program was revised in subsequent years to provide benefits to children until age 18, make benefits subject to income tax, and to provide for price indexation. Legislation in 1979 reduced the family allowance rate from $25.68 a month to $20.00 and established the refundable Child Tax Credit (CTC). The CTC was designed to provide additional assistance in meeting the costs of raising children for low to moderate-income families. This credit was available to any parent or guardian who received family allowances on behalf of a dependent child under age 18. The benefit payable was $200 per year for each child if family income did not exceed $18,000, and was indexed for price increases. The benefit was reduced by 5.0 percent of family income above $18,000.

Since 1918, the year income taxation was introduced, Canadians had always been allowed a tax exemption for each child. This provided a benefit in the form of federal and provincial income tax savings. The higher the taxfiler's tax rate, the larger the benefit. However, as part of the 1988 tax reform, the former children's tax exemptions was converted to a flat-rate nonrefundable credit providing the same income tax savings to all taxpayers with children.

The Canadian Child Tax Benefit program was enacted in 1992 and became effective in January 1993. Legislation for this program represents the most recent development in the 50-year history of Canadian programs designed to assist families and children. The Child Tax Benefit holds to the principles of Canada's social policy tradition but also reflects changes in values and goals. New provisions under the program include:

- simplifying the existing system;
- providing more generous benefits for low and moderate income families;
- supplementing the earnings of low-income working families; and
- providing greater responsiveness to family circumstances.

The Canadian program combined benefits from three separate Government programs—monthly family allowances, refundable child tax credit, and nonrefundable credit for dependent children programs—into a single tax-free monthly benefit. Benefits also contain an earned income supplement for lower income working families with children. Payments for each 12-month period—July through June—are based on income tax return information for the prior calendar year and are paid on a monthly basis. The amount of the benefit is based on the number of children in the family, the ages of the children, family net income on last tax return, family working income on last tax return, and deductions for child care expenses. Based on information from the latest income tax return of the parent and cohabiting spouse, a notice is mailed each July with the amount of entitlement for the upcoming 12 months.

The two types of income used in making eligibility determinations are:

- Family net income, or the total amount that a parent and cohabiting spouse list on their tax return as net income. It includes Old-Age Security supplements, social assistance, and workers' compensation payments. It excludes certain deductions, such as contributions to pension plans, child care expenses, and moving expenses.
- Family working income, or the total amount that a parent and cohabiting spouse report on their tax return as total employment income (including tips and gratuities), training allowances, net research grants, net self-employment income, and the taxable portion of scholarships, fellowships, and bursaries.

Under the Child Tax Benefit program, the benefit amount paid for the first two children under age 18 is $85 per month or $1,020 per year per child. For the third and each subsequent

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child there is an additional $6.25 per month or $75 per year. For each child under age 7, there is a supplement of $17.75 per month or $213 per year, which is reduced if child care is claimed on the tax return. The total basic benefit is the sum of the $1,020 benefit, the under age 7 supplement (after the child care reduction, if applicable), and the supplement for the third and each subsequent child.

The earned income supplement is equal to 8 percent of annual family working income in excess of $3,750, up to a maximum supplement of $500.

The total basic benefit is reduced at a rate of 2.5 percent of family net income in excess of $25,921 for families with one child and at a rate of 5 percent for families with two or more children. The supplement for a child under age 7 is reduced by 25 percent of the amount of child care expenses claimed for income tax purposes. The earned income supplement is reduced at a rate of 10 percent of family net income in excess of $20,921.

The parent who primarily fulfills the responsibility for care and upbringing of the child—generally the mother in a two-parent family—qualifies for the child tax benefit. A cohabiting spouse is a married or common law spouse who is living with the qualifying parent. A common law spouse is a person of the opposite sex who is cohabitating with the qualifying parent in a conjugal relationship and has either cohabited for 12 consecutive months or is a parent of the child.

Child Tax Benefits are adjusted monthly for (1) the birth or death of a child, (2) a child attaining age 18, (3) a change in custody, or (4) a change in martial status. Payments are also updated each July on the basis of family income reported on tax returns for the previous year. The Child Tax Benefit and the threshold are partially indexed—to the amount that inflation exceeds 3.0 percent. However, the Canadian government reviews benefit levels from time to time and makes ad hoc adjustments as conditions permit.

The Provinces can request that the federal government vary the amount of the Child Tax Benefit that their residents receive based on the age or number of children in the family, provided that the overall benefits paid within the Province are the same as they would have been without the variations. For example, Alberta varies the basic benefit of $1,020 a year to the following amounts based on the ages of the children in the family:

$935 for children under age 7;
$1,004, ages 7-11;
$1,133, ages 12-15; and
$1,205, ages 16-17.

Quebec varies its basic benefit of $1,020 a year to the following amounts:

$869 for the first child;
$1,000, second child;
$1,597, third and each additional child.

Quebec also provides an additional $103 for each child aged 12-17.

U.S. Earned Income Credit Program

The Earned Income Credit (EIC) program was first enacted as the Earned Income Tax Credit (EITC), which was part of the Tax Reduction Act of 1975. The credit was designed as a means of helping the working poor—families with income below the poverty level despite having working family members. It was initially authorized for only one year. However, the Revenue Adjustment Act of 1975 extended the EITC through the 1976 tax year. This seemed to set a precedent and each the year the credit became a part of tax provisions that extended its authorization. It wasn't until the Revenue Act of 1978 that the credit became permanent. In 1986, the Tax Reform Act indexed the credit amount and the phaseout levels for inflation.

Over the life of the provision, major need-based assistance programs treated benefits under the EITC in a variety of ways. However, under the Omnibus Budget Reconciliation Act of 1990, benefits were not counted as either income or assets when determining family eligibility or benefit amounts under many federally supported assistance programs. For additional information and a more detailed description of the history of the EIC program, see "Social Security Program in the United States," *Social Security Bulletin*, Winter 1993, Vol 56, No. 4.

The Omnibus Budget Reconciliation Act (OBRA) of 1993 extended the EITC (which was now referred to as the EIC) in a modified form to low-income workers aged 25-64 without qualifying children but whose family income is below a specified amount. The refundable Federal income tax credit is calculated as a percent of annual earnings and the amount rises with earned income, up to a statutory limit on creditable earnings. The maximum credit amount applies to any eligible taxfiler with earnings at or above the creditable limit and whose earnings (or adjusted gross income (AGI), if greater) are at or below a specified threshold income level. Beyond the threshold level, the credit amount is reduced by a phaseout percentage, declining as income rises, and falling to $0 at a "break-even" income level. At this level, "excess" income above the threshold completely offsets the maximum credit amount.

The EIC is administered by the Internal Revenue Service as part of its responsibility for the collection of income taxes. The credit provides the family with either a reduction in income tax

Table 1.—United States: Earned income provisions in 1994

Provision	Families with—		
	One child	Two or more children	No children
Creditable earnings	$7,750	$8,425	$4,000
Credit rate (percentage)	26.3	30.0	7.65
Maximum credit	$2,038	$2,528	$306
Threshold income	11,000	11,000	5,000
Phaseout percentage	15.98	17.68	7.65
Break-even income (credit reduced to 0)	$23,757	$25,293	$9,000

liability or, if the credit exceeds tax liability, a direct payment of the amount by which tax liability is exceeded. A worker may elect to receive the EIC on an advance basis by furnishing a certificate of eligibility to his or her employer. For such a worker, the employer makes an advance payment of the credit at the time wages are paid. However, the advance is limited to 60 percent of the maximum credit available to a worker with one qualifying child. This limit enables the worker to avoid large end-of-year tax liability.

The maximum amount of earned income that may claim the EIC and the income threshold for the EIC phaseout are both indexed for inflation. The EIC provisions effective in 1994 are shown in table 1. For a family with one child, the credit rate is 26.3 percent. The rate increases to 34 percent of annual earnings for 1995 and thereafter. However, the limit on creditable earnings drops to an estimated $6,170 for 1995. (This is a $6,000 base in 1994, adjusted for projected inflation.) The phaseout rate remains at 15.98 percent of annual earnings.

For a family with 2 or more children, the credit rate is 30.3 percent. For 1995 and 1996, the rate will increase to 36 percent and 40 percent, respectively. The creditable earnings limit does not change except for inflation indexing. The phaseout rate is 17.68 in 1994, 20.22 percent in 1995, and 21.06 percent for 1996 and thereafter.

The availability of tax exemptions for children under the U.S. income tax system provides a benefit to low-income families in addition to the EIC. Also, the definition of a child is quite broad under the EIC: In addition to children under 18, it includes students under age 24 and persons of any age who have been permanently and totally disabled since childhood. However, in 1994, the exemption for an adult or child is $2,450. The standard deduction (where deductions are not itemized) for a married couple filing jointly or a qualified widow(er) is $6,350; for head of household, the deduction is $5,600.

With an annual income of $11,000, a married couple would not be liable for taxes, even without the child exemption. A head of household would have $2,950 taxable income to which a 15 percent tax rate is applicable. The exemption of $2,450 for each child would offset all but $500 of taxable income for the head of household with one child and all liability for a head of household with more than one child.

With an income of $20,000, a married couple would have taxable income of $8,750 and a tax liability of $1,312.50 (15 percent), that amount would be reduced by $367.50 for each child exemption. For a head of household, taxable income would be $11,950 without child exemptions.

Program Comparisons

The Canadian program continues to reflect its origin as a universal family allowance program, with subsequent modifications to provide more adequate and targeted benefits for low-income families. These changes have resulted in an increase in benefits for families with moderate income and a reduction or ending of benefits to higher income families. Tables 2 shows the phaseout of benefits and break-even points by annual income.

Under the Canadian income tax system, exemptions for children[1] are not available separately but are subsumed with the Child Tax Benefit. However, the United States income tax system provides exemptions for dependents of $2,450 in 1994. These give a tax saving of $367.50 per child where the income tax rate is 15 percent, $686 at 28 percent, and $759.50 at 31 percent. Exemptions begin to phaseout when adjusted gross income for a married couple filing jointly exceeds $167,700.

The two examples below compare the programs in terms of benefits and family composition. They assume adjusted gross income in the United States and family net income in Canada of $11,000 and $20,000, all of which is earned income. The first child is age 7 or older and the second is under age 7 in a two-child family.

For families with income of $11,000, each program would pay the maximum at this income level without any reduction. The

Table 2.—Canada: Child Tax Benefit provisions for families with annual income exceeding $25,291, or with income of $25,291or less, July 1994

Provision	Families with— One child	Two children	Three children
Basic benefit[1]	$1,020	$2,040	$3,135
Threshold income	25,921	25,921	25,921
	Families with income exceeding $25,291		
Phaseout percentage	2.5	5.0	5.0
Break-even income[2] (benefit reduced to 0)	$66,721	$66,721	$88,621
	Families with income of $25,291 or less		
Earned income supplement			
Creditable earnings	$3,750 - $10,000	$3,750 - $10,000	$3,750 - $10,000
Credit rate percentage	8.0	8.0	8.0
Maximum supplement	$500	$500	$500
Threshold family net income	$20,921	$20,921	$20,921
Phaseout percentage	10.0	10.0	10.0
Break-even income (supplement reduced to 0)	$25,921	$25,921	$25,921
Maximum amount (basic benefit plus earned income supplement)	$1,520	$2,540	$3,635

[1]Parents who do not claim child care expenes are eligible for an additional $213 for each child under age 7.

[2]Assumes all children age 7 or older.

Canadian Child Tax Benefit

Income Level: $20,000
(Basic benefit + earned income supplement = payment
Payment + under age 7 supplement = total payment)

1 child	***2 children***
$1,020 + $500 = $1,520	$2,040 + $500 = $2,540
$1,520 + $0 = $1,520	$2,540 + 213 = $2,752

U.S. Earned Income Credit

Income Level: $20,000
(Earned income – threshold income = phaseout deduction;
Phaseout deduction x phaseout percentage = amount;
Maximum credit – amount = benefit;
Benefit + tax exemption(s) = total payment)

1 child	***2 children***
$20,000 – $11,000 = $9,000	$20,000 – $11,000 = $9,000
$9,000 x 0.1598 = $1,438	$9,000 x 0.1768 = $1,591
$2,038 – $1,438 = $600	$2,528 – $1,591 = $937
$600 + $367.50 = $967.50	$937 + $735 = $1,672

Child Tax Benefit would pay $1,520 for one child over age 7 ($1,020 basic benefit plus $500 earned income supplement) and $2,753 for two children ($2,040 basic benefit plus $500 earned income supplement plus $213 under age 7 supplement for the second child). The EIC would pay $2,038 for one child and $2,528 for two or more children. (However, in 1995 the EIC credit rate for two or more children increases to 36 percent which would provide a benefit of $3,033.)

However, for families with income of $20,000, the Child Tax Benefit would pay a higher amount than the EIC for earners with either one or two children (see illustration above for this income level). The threshold income, where a reduction in benefits starts, is $11,000 for EIC and $25,921 for the Child Tax Benefit. The EIC will be reduced to $0 (this occurs at $23,753 for one child and $25,293 for two children) before there is a reduction in the Child Tax Benefit.

Notes

[1] The Canadian income tax system permits a dependent deduction for a child over age 18 who is physically or mentally infirmed.