SMOKE AND MIRRORS: IS THE MIDDLE CLASS *REALLY* BETTER OFF?

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Introduction

Focus of current federal government has been the Canadian Middle Class

The recent federal budgets are titled as:

Budget 2016 –Growing the Middle Class”

Budget 2017 – Building a Strong Middle Class

Budget 2018 – Equality and Growth for a stronger Middle class

Budget 2019 - Investing in the Middle Class

Disclaimer

- This presentation is intended to be an objective analysis of the recent benefit and tax policy changes implemented to support the Canadian Middle Class
- It is not intended to be an opinion of the overall performance of the current federal government.
- It is intended to analyze the merits and outcomes of the policy changes only and assess if they are successfully meeting their stated goals
- Not intended to draw opinion about appropriateness of policy itself.

Retrospect is 20/20

- Critique and review the true impact of government benefit and tax policies to assess the effectiveness
- Delay is necessary to get the "real picture"
- Indicator of how to set expectations for new initiatives
- Look through the "smoke and mirrors"

- Aggregate impact of changes to improve taxpayer's "after tax cash flow"

Who is the Canadian Middle Class?

The titles of all of the recent federal budgets reference the "Canadian Middle Class"

Who is it?

Net Income for Tax Purposes	Province	Age	Income type *Employee vs business owner*

WHO IS MIDDLE CLASS?

Why target the Canadian Middle Class?

They really need the help?

- Difficult to make ends meet
- No man's land – make too much to get low income benefits but too little to afford lifestyle

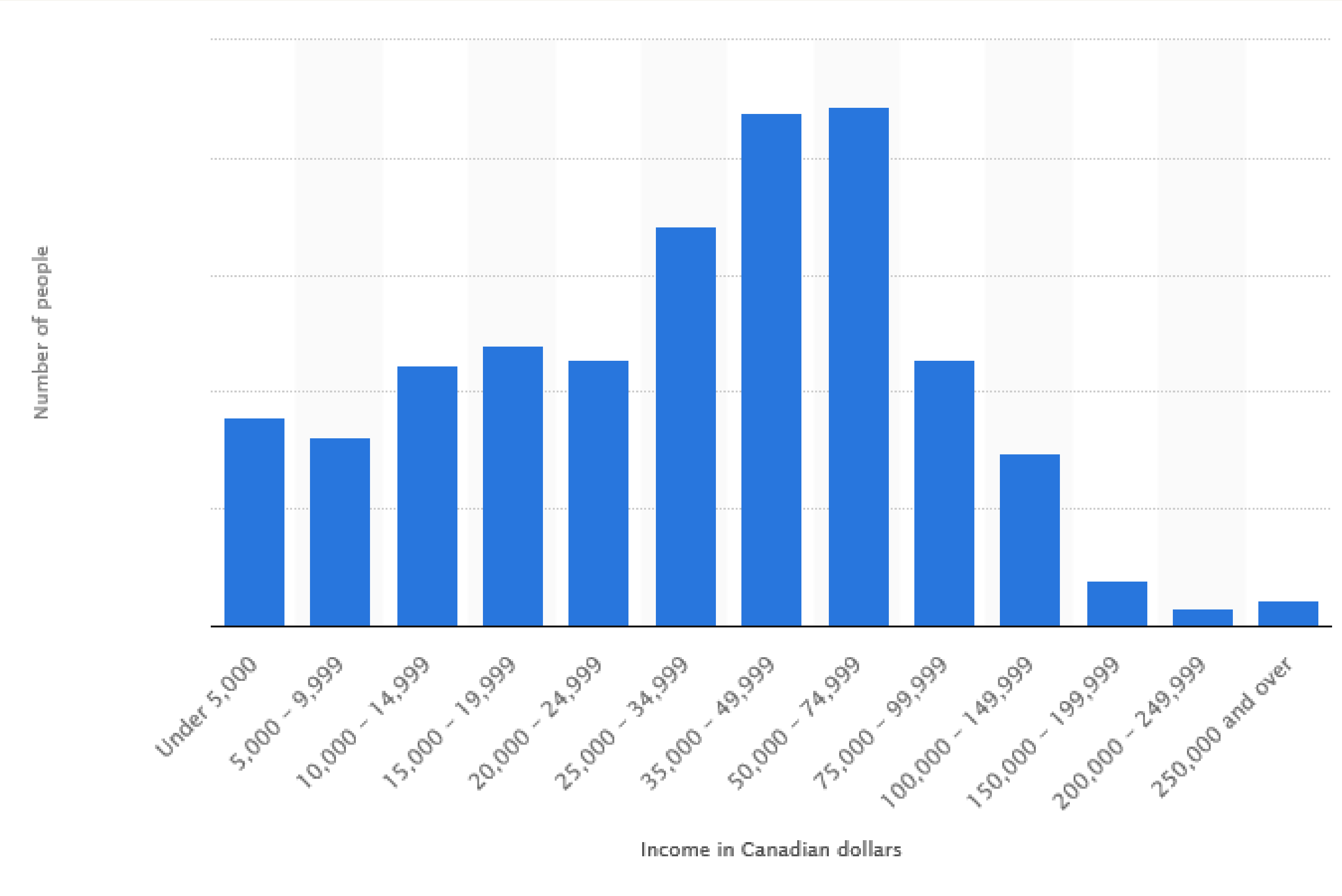
Representation of total population?

- Middle class is largest demographic group of Canadian population
- Recent initiatives have also focused on lower class — "striving to be in the middle class"
- More inclusive

Inequities existed in the system that favour other demographic groups

- Perceived or Real?
- Does elimination of these inequities help?
- Are voters appeased when they are "favoured"?

Canadian population – Income Distribution



Middle Class: Can one policy fit all?

- Single vs Married?
- No Children vs Family?
- Other demographics
  - Province

Middle Class:

What makes the policy resonate with Canadians?

Actual Amount that it helps the middle class?

Perceived impact of the transfer of liability from middle class to upper class

Fairness and accessibility

Comparison of new policy to old policy

Emphasis on why new policy is net improvementbetter

Middle Class: How to grade the policy?

Did it achieve its stated objectives?

Was there impact?

Appreciated by target audience

OR

Isolate other audience

Perception?

Other unexpected repercussions?

New Canada Child Benefit (CCB) (2016 & 2018)

- *"This is an initiative that's going to help Canadian families in a significant measure"*

  Prime Minister Justin Trudeau

- Why?
  - *Simpler*
  - *Tax Free*
  - *Better targeted to those who need it most*
  - *Much for generous*
    - Average increase of $2,300

- Families with less than $30,000 in annual net income receive these maximum yearly benefits:
  - *$6,400 per child under the age of 6.*
  - *$5,400 per child aged 6 through 17.*

New Canada Child Benefit (CCB)

Income tested benefit

- Only those who “need” the benefit will receive

Eliminate taxation on the CCB

- Government funding should not be taxable

Benefit amounts increased for most Canadian families

- 9 out of 10 families receive more
- Average increase of $2,300 in first year

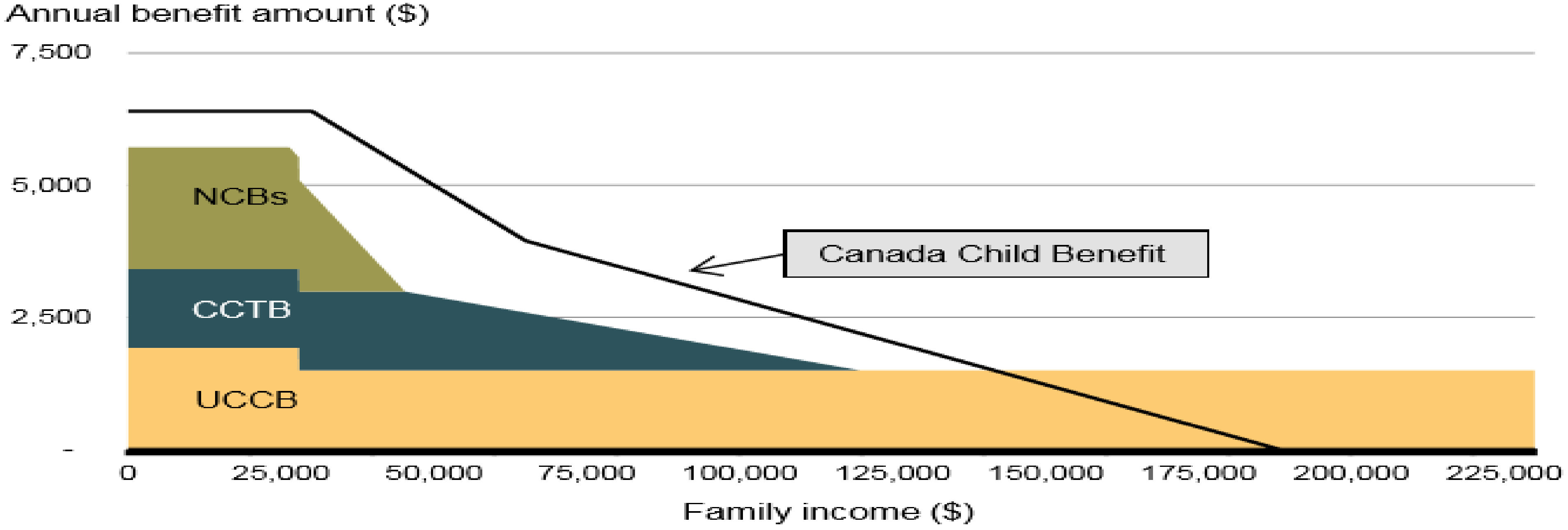
Amounts eliminated for higher income recipients was less significant.

- UCCB was $140 and $60 /month – less noticeable for higher income

New CCB – One child under 6

Chart 1.2B

CHILD BENEFITS FOR ONE CHILD UNDER 6, 2016–17 BENEFIT YEAR (DETAILS ON CURRENT SYSTEM)



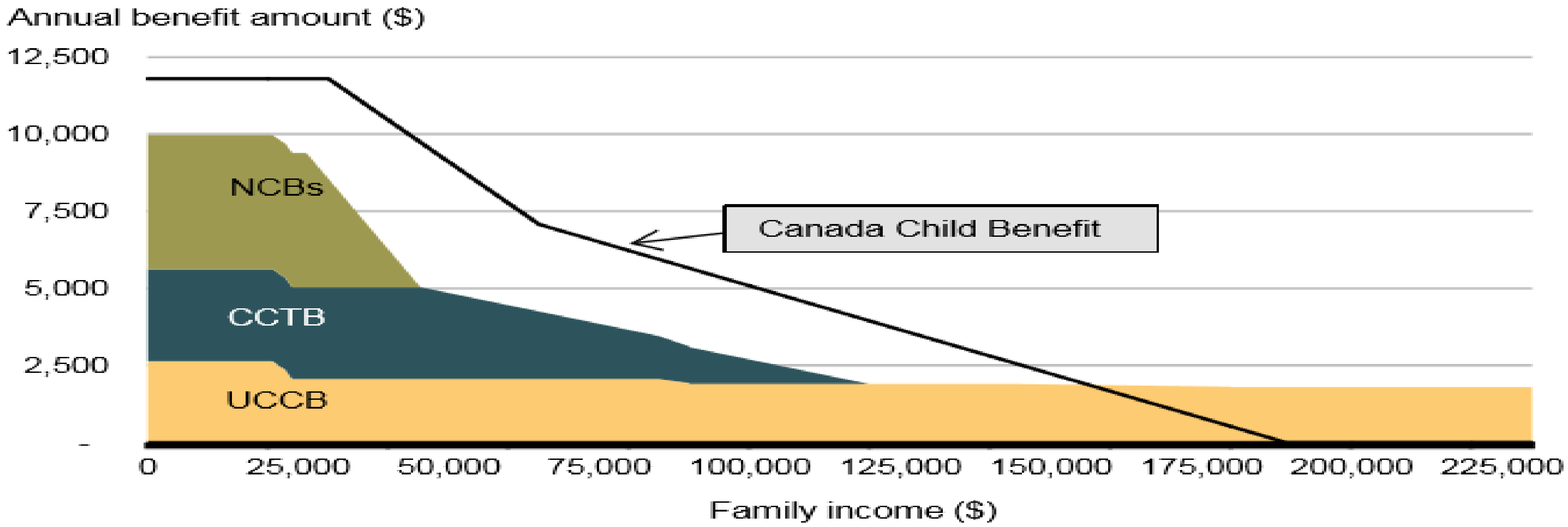
Notes: Benefits received under the current system are illustrative and reflect federal and provincial/territorial taxes paid on the Universal Child Care Benefit. The actual after-tax amounts would depend on the family's province or territory of residence. It is assumed that the single parent includes the Universal Child Care Benefit in the child's income. The family income referred to in this chart is known as "adjusted family net income." This income is a family's net income (the net income of the individual and the individual's spouse or common-law partner reported on line 236 of the income tax return) minus any Universal Child Care Benefit and Registered Disability Savings Plan income received plus any Universal Child Care Benefit and Registered Disability Savings Plan amounts repaid. Adjusted family net income will be used to determine entitlement to the Canada Child Benefit.
NCBs = National Child Benefit supplement; CCTB = Canada Child Tax Benefit; and UCCB = Universal Child Care Benefit.

Source: Department of Finance.

New CCB – Two Children (<6yrs & 6yrs+)

Chart 1.3B

CHILD BENEFITS FOR TWO CHILDREN (ONE CHILD UNDER 6 AND ONE CHILD OVER 6), 2016–17 BENEFIT YEAR (DETAILS ON CURRENT SYSTEM)



Notes: Benefits received under the current system are illustrative and reflect federal and provincial/territorial taxes paid on the Universal Child Care Benefit. The actual after-tax amounts would depend on the family's province of residence and the amount of income earned by each spouse. The family income referred to in this chart is known as "adjusted family net income." This income is a family's net income (the net income of the individual and the individual's spouse or common-law partner reported on line 236 of the income tax return) minus any Universal Child Care Benefit and Registered Disability Savings Plan income received plus any Universal Child Care Benefit and Registered Disability Savings Plan amounts repaid. Adjusted family net income will be used to determine entitlement to the Canada Child Benefit. NCBs = National Child Benefit supplement; CCTB = Canada Child Tax Benefit; and UCCB = Universal Child Care Benefit.

Source: Department of Finance.

New CCB – Income Tested

- Based upon Family “Net Income for Tax Purposes”
  - *Is this the appropriate base for this benefit?*

- Taxpayers can increase their eligibility for the New CCB through tax deductions:
  - *Child Care expense*
  - *RRSP Deductions*
  - *Spousal Support Paid*

- *Is this a “double dip”?????*

- Conversely, one’s CCB can be increased by:
  - *Spousal Support Received*

New CCB – Encourage right behaviour?

Consider the following clients:

Ed and Christine have a busy family. They have Joshua, age 7, Jordan, age 5 and twins age 3. Ed is a sales manager who earns $145,000 per annum. Christine is an administrative assistant within a mid sized company earning $45,000.

Current daycare cost is $20,000 because the children stay with their in-laws.

However, once the CCB was announced, they started to question if it was worthwhile for Christine to work at all?

How to measure the quantitative and qualitative aspects of this decision?

How do you grade the CCB?

Most expensive initiative in Budget 2016 Measures – will cost over $5.370 Billion per year.

Net Gain for the Low/ Middle Class

- Noticeable gain from this initiative for most families
- Is this a viable income source for families?

Net Loss for $100,000 + income earners

- Do they really notice?
- No income inclusion (higher income earners gave back UCCB at MTR)

Huge initiative geared towards the "middle income family"

- Middle income single person or family with no children are excluded

How do you grade the CCB?

A

B

C

D

F

Cut Tax Rate for Second Tax Bracket

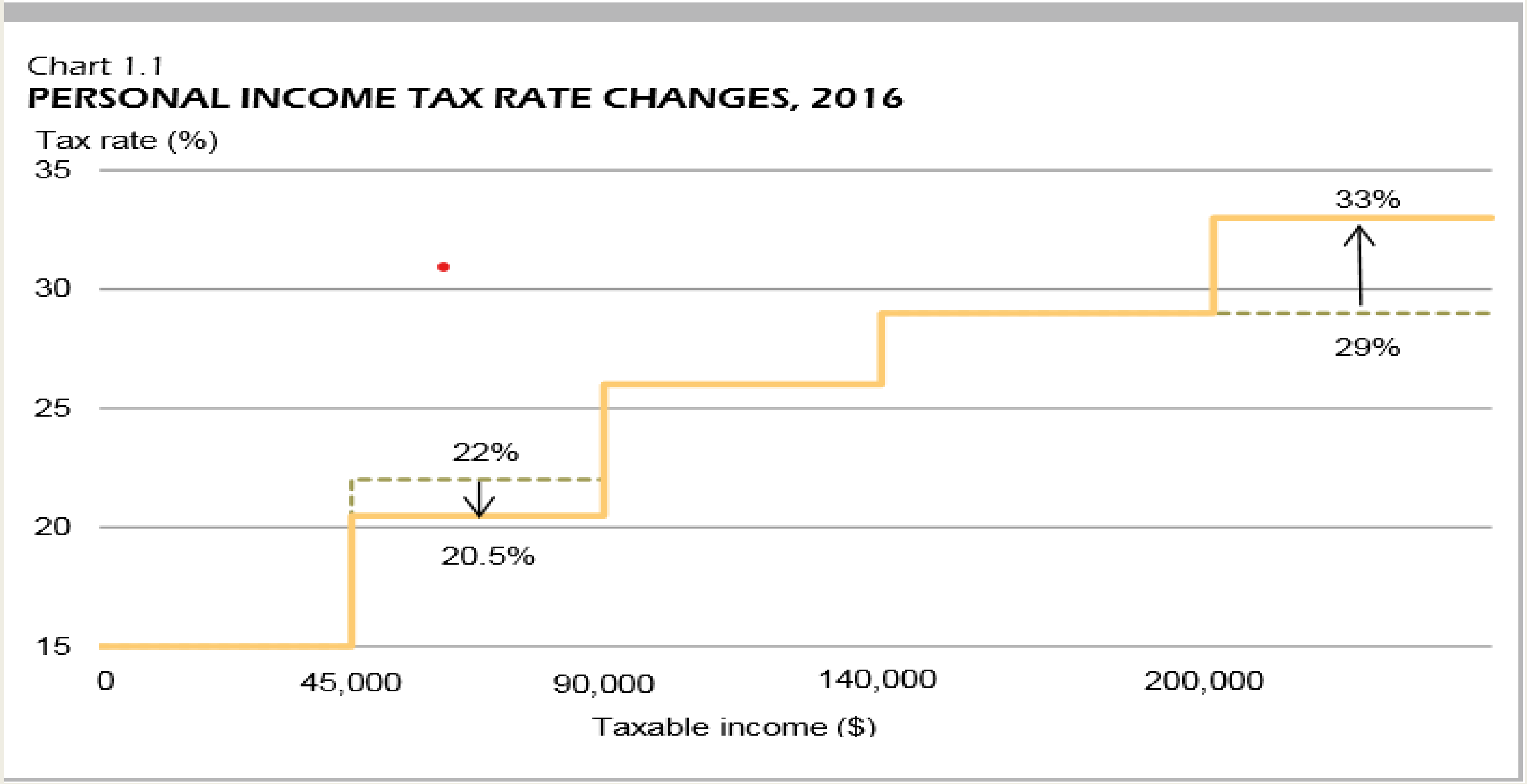
- Policy:
  - *Reduce the federal tax rate for second tax bracket from 22% to 20.5%*

  - *Impacted 9,000,000 Canadians as individuals*
    - Single Canadians save ~ $330 (average)
    - Canadian couples save ~ $540 (average)

- Middle class Canadians, by definition, will not benefit the most

- Not revenue neutral
  - *Net cost of $1.265 Billion*
  - *Government assumes that they will "get this back" through growth.*

A Bird's Eye View – Numbers look good



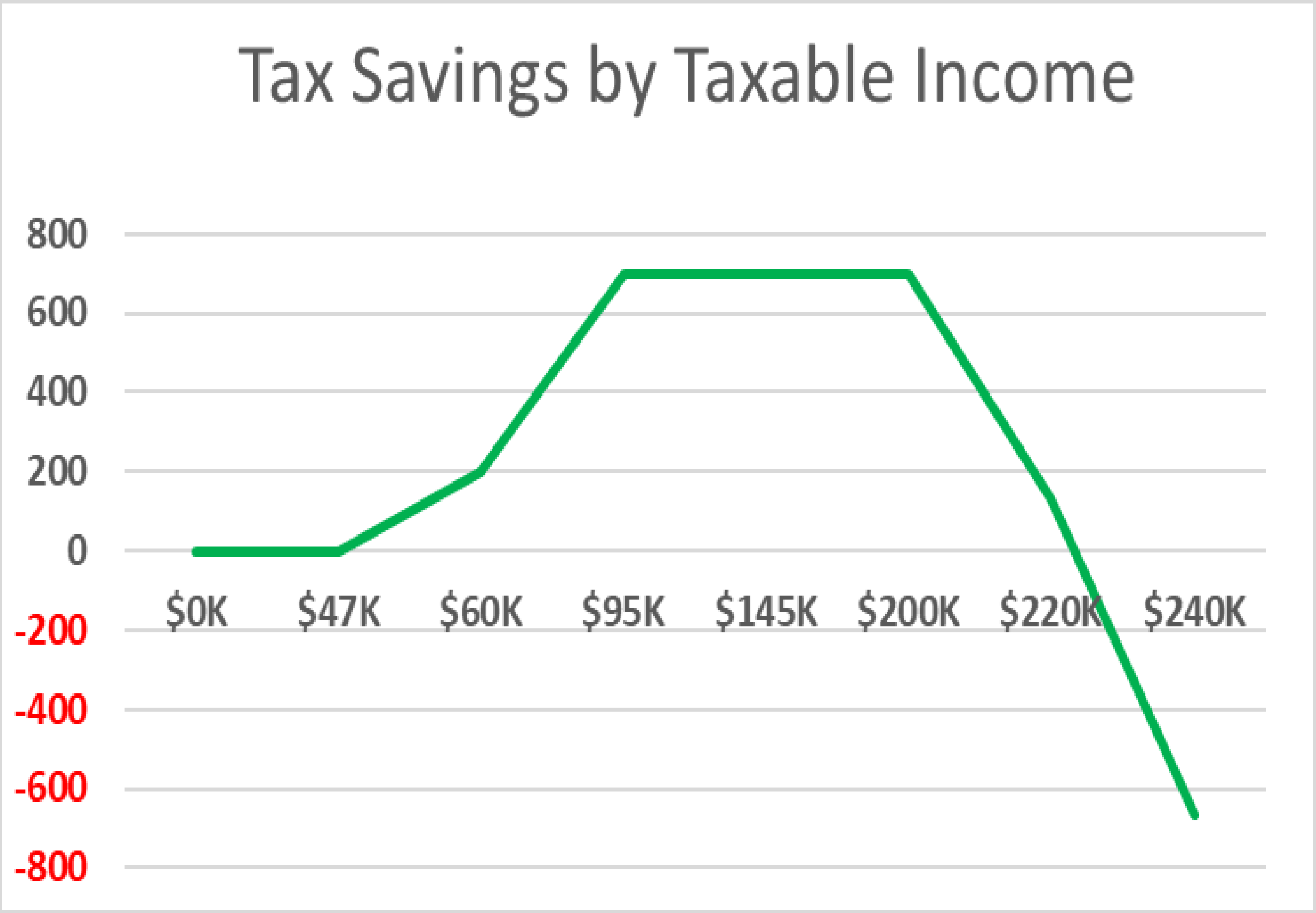
Who really saves? (based upon 2018 rates)

Taxable Income	Old Federal Tax Rates(A)	New Federal Tax Rates (B)	*Tax Savings (A) - (B)*	*Percentage Savings*
$60,000	$ 9,938	$ 9,737	*$ 201*	*2.02%*
$95,000	17,709	17,010	*699*	*3.94%*
$145,000	30,725	30,026	*699*	*2.28%*
$200,000	46,675	45,976	*699*	*1.50%*
$220,000	52,475	52,342	*133*	*0.25%*

Break-even point is $220,402
All taxpayers above $46,605 up to $220,402 will pay less federal income tax
Taxpayers < $46,605 save nil
Taxpayers > $220,402 start to pay more

WHO REALLY SAVES?

(BASED UPON 2018 RATES)



Who really saves?

- Low Income Canadians - no benefit
- Middle Income Canadians - $46,605 to $93,208 will realize increased tax saving to maximum
- All other taxpayers above $93,208 up to $205,842 will realize the maximum tax savings also
- Only taxpayers above $220,402 will see increase in total tax payable.

Who really saves?

- Since it is based upon taxable income === focus on the individual?

- Single vs Couple?
  - *What if couple making $93,208 each will be the first taxpayers to receive maximum savings*
  - *Couple making $200,000 each will get the same tax savings*

- Positioned as a transfer of income tax burden from middle income to high income individuals
  - *Numbers indicate differently*

How do you grade the middle class tax cut?

A

B

C

D

F

Who is paying for tax cut?

- Election platform implied that the tax cut would be revenue neutral

- Did it resonate well with Canadians that top 1% were paying for the tax cut?
  - *Do Canadians like that rich take up more of the burden?*
  - *Was this a selling feature beyond the numbers?*
  - *Do Canadians REALLY care who is paying for it?*

- Listing of Economic Impacts of Budget Measures lists the “middle class tax cut” as costing $1.2 Billion
  - *Other reports suggest closer to $1.4Billion*

Who is paying for tax cut?

- Net revenue lost from tax cut was higher than additional revenue generated by tax hike in highest tax bracket.

- Why?
  - *Taxpayer adversity to highest income tax rate*
  - *Calculation Error?*

- What about the taxes payable in final tax returns that will have substantial exposure to the highest tax rate?
  - *Impetus for re-evaluation of retirement income streams*
  - *Tax efficiency in retirement is replaced with tax efficiency upon death*

Middle Income Tax Cut – Who is really paying?

- If the 1% of taxpayers are not paying for the tax cut, who is?

- The summary of 2016 measures indicate that the net cost of the tax cut is more than offset by:
  - *Tax Fairness Measures*
  - *Other 2016 Budget Measures*
    - *Changes to Post Secondary Education*
    - *Eliminating family income splitting*
    - *Eliminating other misguided tax credits*

- In order to assess this policy in full, do we need to look at the losers in the other tax initiatives that were cut in 2016 and onwards?

Changes to Post Secondary Education

Help students pay for school with enhanced grants

Grants were increased for low income, middle income and part time students

Net Cost of $0.468 Billion

- Elimination of the textbook and education amount tax credit.
  - *All students were "penalized" as the textbook and education tax credit was eliminated*
  - *Almost offsets the net cost of student grants exactly – savings of $0.445 Billion*

- Minor modification to the repayment of Canada Student Loans Program

- Flat rate student contribution
  - *Canada Student loans and grants won't rely on their annual income*

Elimination Education/Textbook tax credit

- Tax credit for textbook and education amount would end in 2017
  - *" Not targeted based on income"*
  - *"Provides little direct support to students at the time they need it most"*

- Implies that it does not help students because they don't have enough taxes payable to use full tax credit in any given year

- Silent on fact that it can be transferred to supporting parent, spouse of grandparent

Changes to Post Secondary Education

Summary of Changes to Post Secondary Education (8 months)				
		Maximum Increase in Grant	Tax Savings lost	Net benefit/(loss)
Low Income	Full Time	$1,000	($ 558)*	$442
Middle Income	Full time	$400	($558)*	($158)
	Part time	$600	($168)**	$432

*8 x $465 = $3,720 x 15% = $558
** 8 x $140 = $1,120 x 15% = $168

Elimination of Fitness/Arts Tax Credit

- One of the initiatives to "eliminate the misguided tax credits"

- An effort to :
  - *"simplify the tax code"*
  - *" better target and support families with children"*

- Tax savings of $0.25 Billion (250 Million) to fund the net cost of the middle class tax cut and the CCB

- More clearly articulated – elimination since it applies to all children (no matter what income level)

Elimination of Transit Tax Credit

- Lower/Middle class inclined to rely upon public transit
  - *Tax credit modified to end midway through 2017*

- Relatively silent change in the federal budgets
  - *Not mentioned under middle class initiatives*

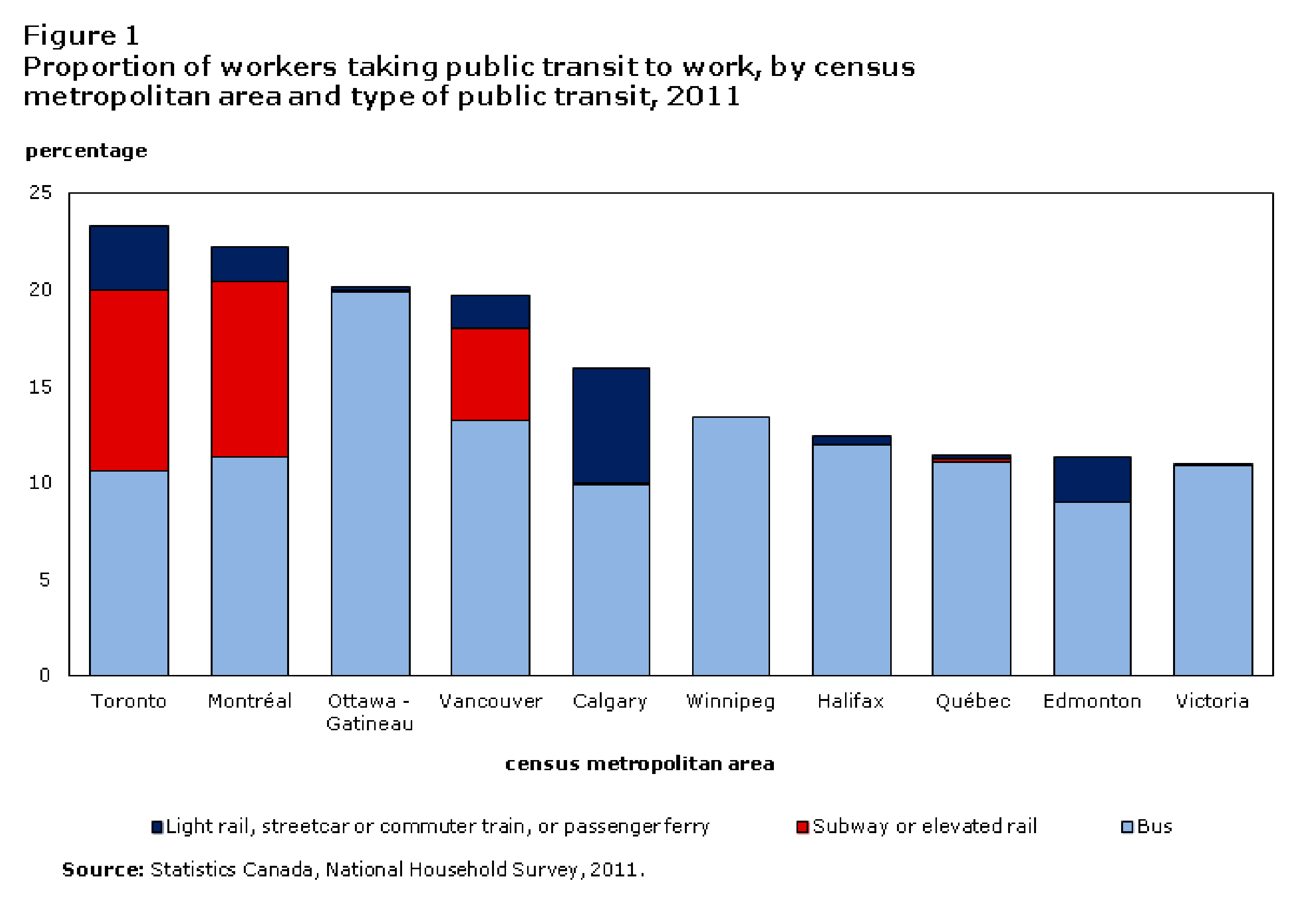
- Why? *"Available evidence suggests that this credit has been ineffective in encouraging the use of public transit and reducing greenhouse gas emissions"*

- If misguided since all income classes benefit, could have made it income tested (clawback on tax credit base)

WHO TAKES PUBLIC TRANSIT?

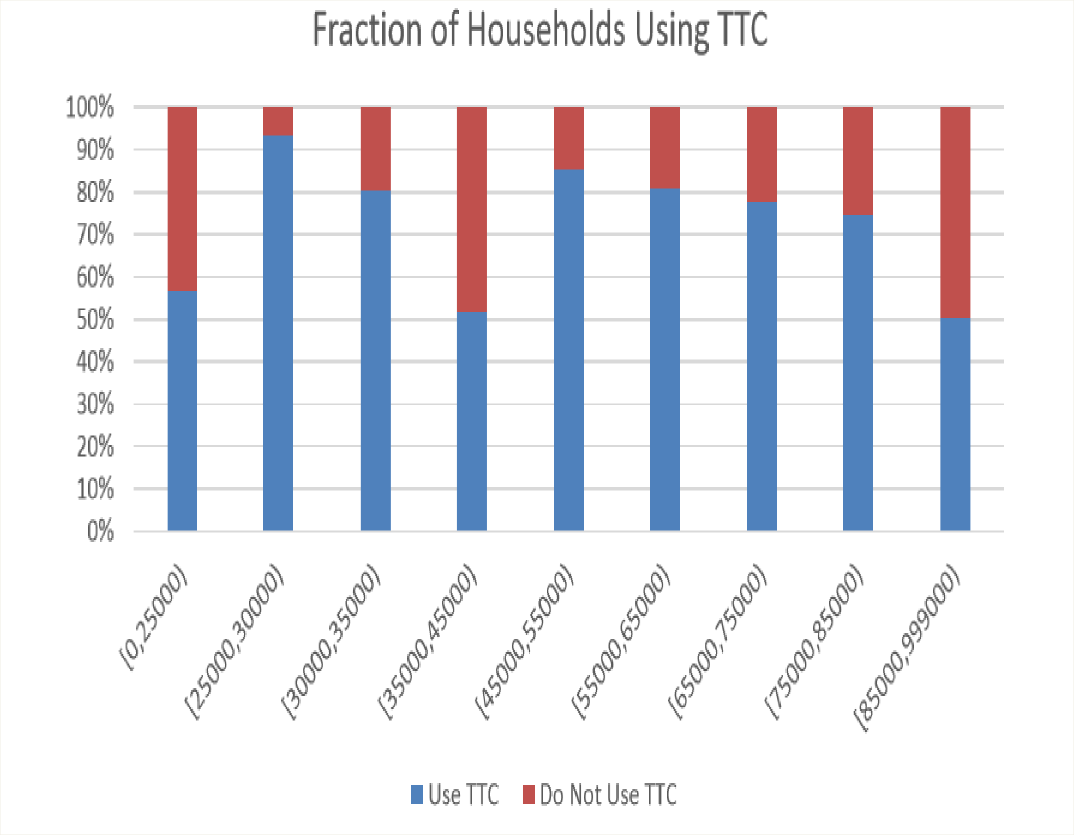
Proposed Rationale:

- Could have been that the tax credit favours urban demographics
- Cost of living higher in those areas?
- Elimination of a tax credit that favours specific demographics



WHO TAKES PUBLIC TRANSIT?

- Distribution consistent except for $35,000 to $45,000 income level
- No concern about the affordability of the TTC
- 20% discount is substantial cost cut when considering the cost of public travel
- Far reaching impact for those who rely on it for:
  - *In city travel*
  - *Substantial commute from suburbs*
  - *Tradeoff : Time vs cost*



Elimination of Income Splitting for Couples with Children

- Income splitting opportunity for parents with children under age of 18

- Unlike pension income splitting, not a transfer of income from one spouse to another (in calculation of Net Income for Tax purposes)

- Tax credit that would reflect the potential transfer of up to $50,000 from one spouse to another
  - *Most effective, high income to low income*

- Maximum tax credit was $2,000.

Elimination of Income Splitting for Couples with Children

- Net savings of $1.9 to $2.0 billion per year

- “To better deliver help to those families who need it most”

- This could be significant policy to those who are still considered “middle class”
- High profile election platform promise
  - *Appealing due to perception that it was an income re-distribution ?*
  - *Tax credit is dollar for dollar savings – impact may be more far reaching than voters thought.*

How do you grade the “Other tax initiatives”

A

B

C

D

F

Summary

- Looking at these tax changes, geared toward the normal family, how did the government fare?

Policy Initiative	Projected Annual net cost/(savings) in Billions
CCB (increased cost over old programs)	$ 5.370 B
Middle Tax Rate Cut	$ 1.180 B
Post Secondary Education (net)	$ (0.016) B
Eliminate Fitness/Arts Tax Credit	$(0.245) B
Eliminate Income Splitting	$(1.980) B
	$4,309 B
* Transit was “reallocated” to infrastructure spending for transit – no data found	

Middle Class – On a brighter path?

Ed and Christine have a busy family. They have Joshua, age 7, Jordan, age 5 and twins age 3. Ed is a sales manager who earns $145,000 per annum. Christine is an administrative assistant within a mid sized company earning $45,000.

Current daycare cost is $20,000 because the children stay with their in-laws.

However, once the CCB was announced, they started to question if it was worthwhile for Christine to work at all?

How to measure the quantitative and qualitative aspects of this decision?

Eddie and Christine – Old Regime

Before 2016 Federal Budget Changes					
		Eddie		Christine	
Taxable Income		145,000		46,000	
				(20,000)	
UCCB				7,680	
Adjusted Taxable Income		145,000		33,680	
Taxes payable		30,725		4,147	
Basic personal	12,000		12,000		
Employment	1,118		1,118		
CPP	2,580		2,104		
EI	930		768		
Fitness	4,000				
Arts	2,000				
	22,628	(3,394)	15,990	(2,398)	
transfer income splitting		(2,000)			
Total Taxes Payable		25,330		1,749	
					Total
After tax cash flow (including UCCB)		119,670		31,931	151,601

Eddie and Christine – New Regime

After eliminating family income splitting, tax cut and elimination of random tax credits					
		Eddie		Christine	
Net Income		145,000		46,000	
Childcare				(20,000)	
Adjusted Net Income		145,000		26,000	
Taxes payable		30,026		3,900	
Basic personal	12,000		12,000		
Employment	1,118		1,118		
CPP	2,580		2,104		
EI	930		768		
Fitness					
Arts					
	16,628	(2,494)	15,990	(2,398)	
Total Taxes Payable		27,531		1,502	
					Total
After tax cash flow		117,469		24,498	141,967
Add CCB					3,664
After tax cash flow after CCB					145,631

Eddie and Christine – New Regime

Christine decides not to work					
		Eddie		Christine	
Taxable Income		145,000		-	
Childcare		-		-	
Adjusted Taxable Income		145,000		-	
Taxes payable		30,026		-	
Basic personal	12,000		-		
spousal	12,000				
Employment	1,118		-		
CPP	2,580				
EI	930				
	28,628	(4,294)	-	-	
Total Taxes Payable		25,731		-	
					Total
After tax cash flow		119,269		-	119,269
Add increased CCB					4,900
					124,169
			Childcare not paid		20,000
					144,169

Summary: Smoke and Mirrors

- Every middle income Canadian will respond differently to the changes in the tax and social policy changes implemented

- Majority of middle class do not feel huge difference

  - *CCB has power because it is a monthly deposit to them*
  - *Many middle class disappointed when doing their tax returns*
    - Unexpected tax liability = lost tax credits were higher than their middle rate tax cut

- Many policies rested on transfer of tax burden – appeared that high income was paying for it but, could be smoke and mirrors.

Looking ahead…… Canada Pension Plan (CPP)

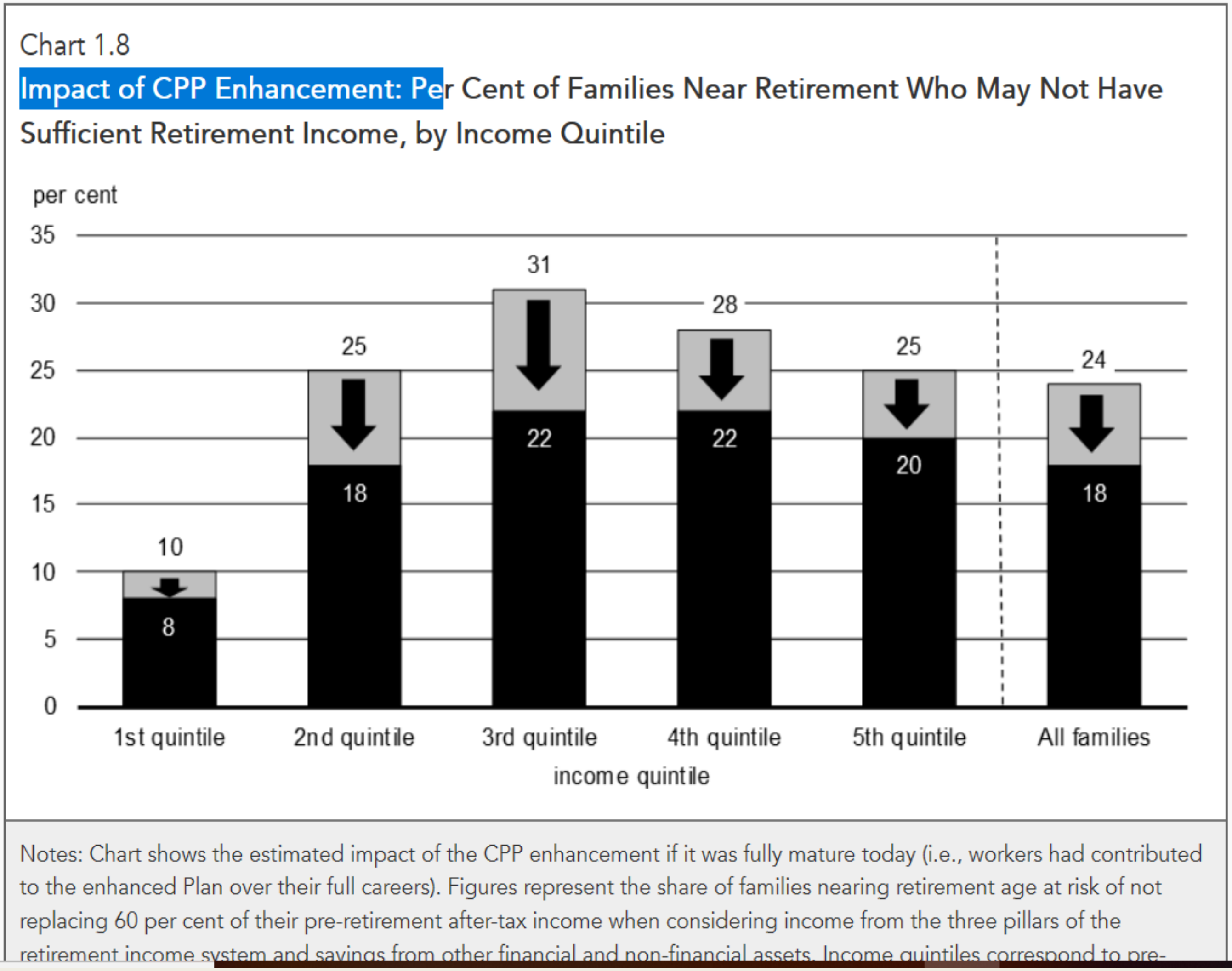
Canada Pension Plan – What's next?

- In June 2016, agreement in principle to "enhance" the CPP Retirement benefits:
  - *Current CPP program does not serve the middle income well*

- *It will provide a secure, predictable benefit in retirement, so Canadians can worry less about outliving their savings and be less anxious about the safety of their investments.*
- *Benefits will be indexed, which means that they will keep up with the cost of living.*
- *It will be a good fit with young workers entering Canada's changing job market, helping to fill the gap left by declining workplace pension coverage.*
- *It will be portable across jobs and provinces, including in Quebec where the Quebec Pension Plan has been enhanced in a similar fashion.*

Canada Pension Plan – What's next?

- Objective is to reduce the percentage of families that do not meet 60% replacement rate

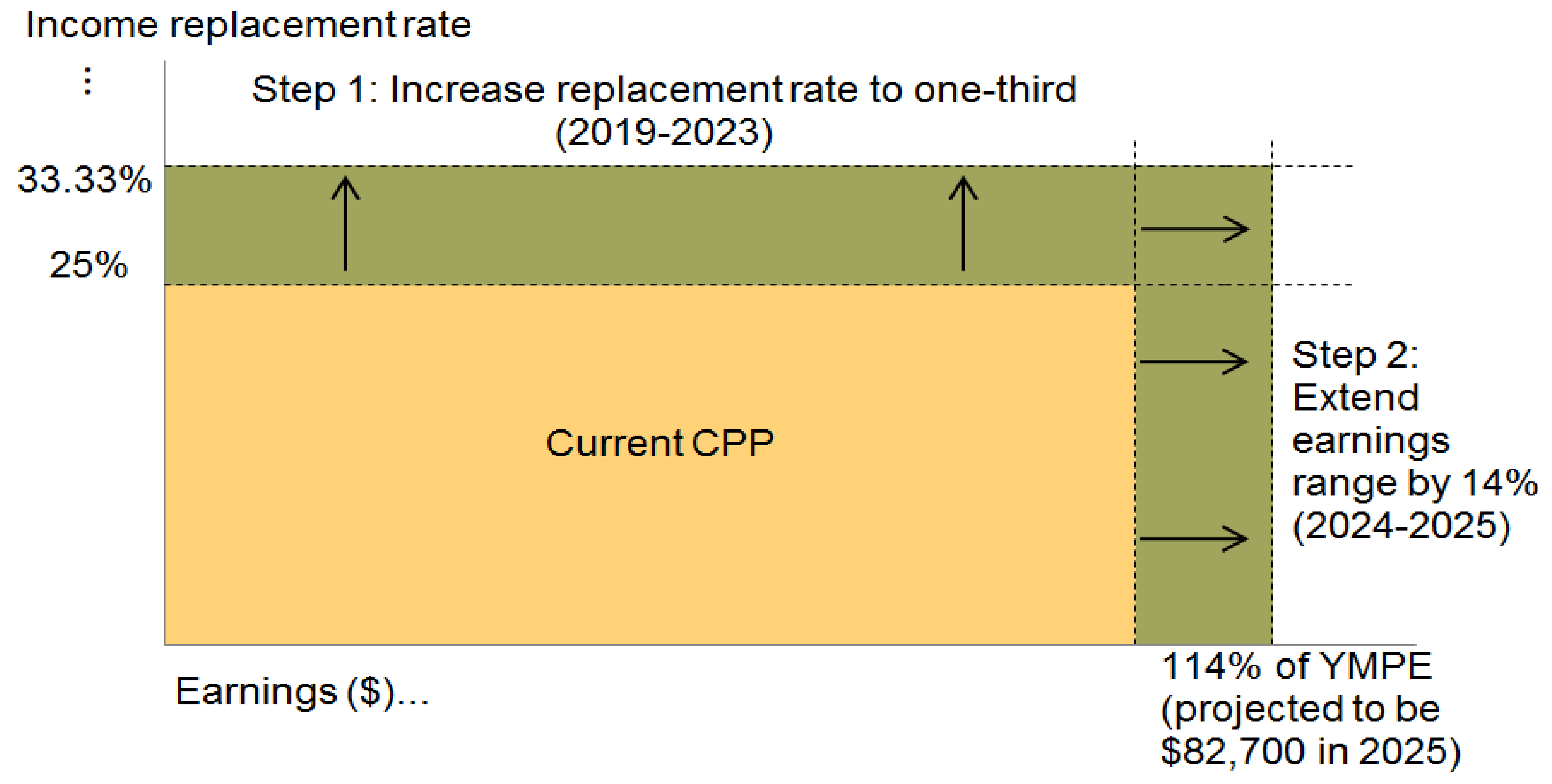


Canada Pension Plan – What's next?

- Proposed plan in 2 phases:
  - *1) Increase replacement rate to 33% (2019 – 2023)*
  - *2) Enhanced limit YMPE to increase by 14%* (2023 to 2025)

- At time of announcement (2016),
  - *CPP entitlement of $13,000 → $17,160*
  - *YMPE of $54,900 → Upper limit YMPE $62,500*

Canada Pension Plan – What's next?



Canada Pension Plan – What's Next?

	Current rules	New Rules
Replacement Rate	25% of the YMPE*	33% of the YMPE
YMPE	At full implementation, YMPE is projected to be $72,500	Same YMPE with enhanced upper limit as second layer with benefits up to $82,700 (enhanced limit increases YMPE by 14%)
Contributions	4.95% for employee/employer	5.95% (phased in starting in 2019)
Tax treatment- Employee contributions	Non-refundable tax credit for the contribution to YMPE	Non-refundable tax credit for contribution up to YMPE Tax deduction for the contributions relating to enhanced layer.
Employer contributions	Tax deduction for entire CPP contribution	Tax deduction for entire CPP contribution
Benefits for low income family	none	Enhanced Working Income Tax benefit to assist low income families afford the increased rate of contributions

Canada Pension Plan – What's next?

What is the impact? Will it meet its objectives?

- Forced savings (sacrifice now for later)
- CPP retirement income will represent higher proportion of set retirement income
  - Income replacement ratio for retirees will improve
  - Indexed for inflation
  - Ability to gross up entitlement by waiting
    - *Exponential effect from the increased amount*
  - Annuity for life

CPP Changes – Change in Replacement Rate

What is a responsible Replacement Rate for CPP Program?

- Was 25% the right rate?
- Is 33% too high?
- Will GIS be jeopardized in the future ?

- How do we rank compared to OECD countries?
- How “good” do Canadians want to be forced to be?

How to balance spending today vs saving for tomorrow?

- Mandatory expense today for tomorrow
- Real increase in “savings ratio” of Canadians

- REAL INCREASE IN COST FOR EMPLOYERS ACROSS THE ENTIRE PROGRAM

What is the “right” YMPE?

- Current YMPE is not sufficient ($57,000)
  - *Barely hits the lower threshold of 2nd tax bracket*

- Overall YMPE increase does not hit the top of the 2nd tax bracket

- The middle class has least propensity to save for retirement on own
  - *If they saved in RRSP would get a deduction from income*
  - *Many use TFSA to eligible for GIS?*

- Enhanced YMPE – just like a contribution to a RRSP
  - *CPP contribution for enhanced YMPE will give deduction from income*
  - *Professional Management by CPP Investment Board*
  - *No/Low fees or commissions*
  - *Mandatory*

Will CPP changes meet objectives?

- Increase in YMPE — offers consistent replacement rate of 25% for those who need it

- Increase in Replacement rate – Replacement rate goes up for all – not just middle class
  - Low income – can have negative repercussions now?
    - *They were meeting replacement ratios with GIS*
  - Middle income – a big help but is it targeted to them?
    - *Is it contrary to all we talked about today?*

- Excerpt from my 2010 paper that analyzes the policies around the pillars of retirement income system in Canada.

Other Policies covered in CE Module

- CPP Policy Changes – An Analysis
- Recent Incentives for First Time Homebuyers
  - Enhanced withdrawal Limit, Homebuyers Program
  - CMHC's First time homebuyer incentive Program
- Canada Training Benefit
- Eliminating Tax Evasion

THANK YOU!

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