Policy Forum: Kids Are Not Boats

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P R É C I S
Dans cet article, je soutiens, premièrement, que l’intervention du gouvernement pour modifier les options de l’économie de marché pure ou encourager les comportements bénéfiques à la société peut être justifiée. Deuxièmement, je soutiens que le régime fiscal, y compris les « crédits d’impôt à la pièce » souvent tournés en ridicule, est un moyen acceptable d’y parvenir. J’aborde ensuite six situations où le gouvernement peut et doit modifier positivement les comportements au moyen du régime fiscal : lorsqu’un particulier 1) fonde une famille, 2) a des enfants, 3) engage des dépenses pour gagner un revenu, 4) possède une maison, 5) économise pour l’avenir, 6) améliore la société civile.

A B S T R A C T
In this article I argue, first, that government intervention to alter pure market alternatives, or to promote socially beneficial behaviours, can be justified. Second, I argue that the tax system—including often-derided “boutique tax credits”—is an acceptable vehicle for such intervention. I then discuss six areas where government can, and should, positively alter behaviour using the tax system: when someone (1) starts a family, (2) has children, (3) incurs costs to earn income, (4) owns a home, (5) saves for the future, or (6) improves civil society.

KEYWORDS: TAX CREDITS ■ TAX DEDUCTIONS ■ TAX EXPENDITURES ■ TAX POLICY ■ TAX REFORM ■ FAMILY ALLOWANCES

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The point, remember, is not just that statecraft should be soulcraft. My point is that statecraft is soulcraft. It is by its very nature. Statecraft need not be conscious of itself as soulcraft; it need not affect the citizens’ inner lives skillfully, or creatively, or decently. But the one thing it cannot be, over time, is irrelevant to those inner lives.


**INTRODUCTION**

The central argument of George Will’s book *Statecraft as Soulcraft: What Government Does*¹ is that governments by their very nature affect not only the external behaviour but also the “inner life” of citizens. To put it another way, government cannot be neutral on matters of social values. Or, as Brian Lee Crowley asks, “What do governments have to do with the character of the people who live under them?”²

The role of government in shaping social values is generally not thought to be controversial for “thou shalt nots,” which are embodied in legislated sanctions. Criminal law is the most obvious evidence that our government is not neutral with respect to certain forms of behaviour, such as murder and stealing. This is not to say that social values are not matters of difficult and vigorous public debate and do not change or shift—as they have, for example, on the question of adultery.

But what about “thou shalts”? In this article I argue, first, that government intervention to alter pure market alternatives, or to promote socially beneficial behaviours, can be justified. Second, I argue that the tax system—including often-derided “boutique tax credits”—is an acceptable vehicle for such intervention. I then discuss six areas where government can, and should, positively alter behaviour using the tax system: when someone (1) starts a family, (2) has children, (3) incurs costs to earn income, (4) owns a home, (5) saves for the future, or (6) improves civil society.

**WHEN GOVERNMENTS INTERVENE . . .**

Not so long ago, the Canadian tax system implied that the government’s preference for children decreased with the income of the family in which those children resided.³

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In fact, until recently, middle- and upper-income families received the same tax treatment for having children that they received for purchasing a boat.4 Should government be neutral with respect to the choice between purchasing a boat and having a child; between purchasing a boat and preparing for and getting a job; between purchasing a boat and starting a family (once called marriage); between purchasing a boat and purchasing a home; between purchasing a boat and saving for retirement; between purchasing a boat and contributing to civil society? If you are not persuaded a priori by any of these choices, or by the fact that all, or nearly all, governments of advanced economies have tax preferences for employment, marriage, children, a home, retirement savings, and the improvement of civil society, consider Thaler and Sunstein’s book Nudge.5 The authors argue that there are circumstances in which people can be “nudged” toward outcomes that are patently superior when, because of the way the human brain is wired, they would otherwise choose the inferior. According to Thaler and Sunstein, real people (as opposed to the libertarian utopia of pure economic automatons) need a bit of “libertarian paternalism” to nudge them to make better choices when faced with such challenges as short-term pain for long-term gain; the inability to learn from practice for life’s big and/or difficult decisions; and the degree of difficulty that some choices pose.

Thaler and Sunstein define “nudges” as follows:

A nudge, as we will use the term, is any aspect of the choice architecture that alters people’s behavior in a predictable way without forbidding any options or significantly changing their economic incentives. To count as a mere nudge, the intervention must be easy and cheap to avoid. Nudges are not mandates. Putting fruit at eye level counts as a nudge. Banning junk food does not.6

Nudging is almost always a matter of changing or adjusting incentives so that they overcome the challenges listed above. Thaler and Sunstein talk about both financial and non-financial nudges. While governments can create non-financial nudges (through government advertising, using its bully pulpit, etc.), the focus here will be on financial nudges, and more particularly financial nudges delivered through the tax system.

. . . THEY SHOULD CONSIDER USING THE TAX SYSTEM . . .

Why nudge via the tax system? I argue that the tax system can be an efficient, simple, and fair delivery mechanism.

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6 Ibid., at 6.
Tax policy specialists look through three lenses to see if a tax system is well designed:

1. **Efficiency.** Are we minimizing bad economic distortions and maximizing good ones (nudges)?
2. **Simplicity.** Are we delivering policy in the most cost-effective manner?
3. **Equity or fairness.** Are we respecting ability to pay?

Efficiency first. Zelinsky suggests that there are three types of efficiency that one can use to evaluate a tax system. 7 “Universal market efficiency” is closest to the libertarian utopia in which people are assumed to be pure economic automatons. Such a world would reject tax expenditures completely. “Sectoral efficiency” has to do with the allocation of resources across sectors of the economy. This view provides some guidance as to how the tax system might be used to improve investment decisions. Of more interest to the nudge view of tax credits is the third type of efficiency, “technical efficiency,” which has to do with bang for the buck—how do we get the largest incremental change in taxpayer behaviour? 8

Jenn’s analysis of the technical efficiency issue concludes:

> [T]he diminishing marginal utility of consumption means that the government can most cost-effectively induce its desired behavior by offering the marginal incentive at as low a rate as possible to as broad a group as possible. 9

In other words, nudges are best delivered by altering behaviour on the margin using a low rate—something that can be done relatively easily using the tax system, but becomes more complex using an expenditure program. The tax system is also efficient at reaching the largest group possible.

Tax breaks can also maintain a greater preference for private choice over government involvement. Indeed, this is the argument frequently used to justify tax credits for children rather than the provision of, say, government-provided institutional child care.10 Levmore argues that we should use the tax system rather than direct spending in cases where “there is some desire to encourage private action (such as

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8 Ibid., at 992.
9 Brian H. Jenn, “The Case for Tax Credits” (2008) 61:2 *Tax Lawyer* 549-97, at 574. Jenn adds that this holds whether the public good is additive (with no diminishing returns) or non-additive. See also Zelinsky, supra note 7, at 977.
volunteering for the charities to which one contributes) or where the people have more information than their legislatures.  

The underlying point here is that asymmetric information between the public and the government could make programs delivered through tax breaks more efficient, and respond better to individual preferences, than the same program delivered as spending from a government department. Or, to use political jargon, it is better to leave money in the hands of taxpayers for them to determine how to spend it than to give the money to governments for direct spending on specific programs. As an example, if we decide that we want government to encourage fitness, should the government design a program to subsidize gyms and choose which ones should get public money, or allow Canadians to deduct the cost of fitness programs from their taxes and make those choices themselves? Surely better outcomes would be achieved by encouraging individual experimentation rather than imposing top-down policy design. By the same reasoning, the administration of tax credits should be biased toward flexibility rather than rigidity.

To put it another way, given the same amount of resources, would we prefer a tax break for children or for child-care expenses over a government-run day-care program?

Simplicity usually refers to the administrative burden (for the government) or compliance costs (for the individual or the economy) of a tax measure. Critiques of boutique tax credits often are fronts for saying we shouldn’t be doing anything at all—a position that I have addressed in the introduction. But if we accept that something should be done, then we should try and do it in a way that minimizes administration costs, or avoids duplicating them. The tax system already collects much of the data required to adjust incentives, and the administration of the tax system is increasingly automated. Subsidy programs generally require application and evaluation forms and processes to be created, and separate bureaucracies to be set up to administer those programs. Banning the use of boutique tax credits where something should be done would foolishly increase the costs of administering a program.

While additional tax credits may make the tax system itself more costly to administer, the question is whether the increased cost would be less if the government tried to achieve the same thing via a subsidy program. The real question, therefore, is whether the criterion of simplicity ought to be applied across government or just narrowly to the tax system itself.

To come at this question another way, Shaviro states, “The basic claim of tax expenditure analysis, that certain tax rules are ‘really’ spending, is not quite correct, because ‘taxes’ and ‘spending’ are not coherent categories to begin with.”

11 Ibid.
argument finds its roots in Musgrave’s distinction between the allocative and distributional branches of public finance, where allocation refers to “the amount, use and character of all assets in society, while distribution affects who has what.”14 Starting with those distinctions, taxing and spending are “two sides of the same coin and there is no well-defined correspondence between these nominal categories and the more theoretically coherent categories of allocation and distribution.”15 In short, when we want to deliver a nudge, we should be, a priori, agnostic about whether that is done through tax or expenditure mechanisms. As Weisbach and Nussim say,

[i]f we mistakenly look only at the tax system instead of overall government policy, we will draw the wrong conclusions. Putting a program into the tax system makes the tax system look more complicated, but there is unseen simplification elsewhere. The tax system will seem less efficient, but the efficiency of government policy is unchanged.16

They conclude by suggesting that the decision as to whether a program should be delivered through the tax system or through an expenditure system should be driven by the degree to which the functions of a program “complement those performed by the tax system.”17

The third principle of good tax design is that taxes ought to respect ability to pay. Ability to pay is commonly separated into two buckets, vertical equity and horizontal equity. Vertical equity is straightforward: those with more income should pay more in tax. Vertical equity is largely concerned with tax rates—how much you are taxed.

Horizontal equity is straightforward conceptually: those in similar circumstances should pay the same amount of tax while those in different circumstances should not. Horizontal equity is largely concerned with the tax base—what is taxed.

For example, someone with a child has less ability to pay because of obligations to that child. The same does not hold for someone who buys a boat. Children, unlike boats, bring benefits to society at large that go beyond the benefits to the individual family, so we should recognize those benefits by reducing the family’s tax burden. Families have a continued obligation to care for their children, whereas boats can be sold. Families can also accidentally have additional children, but there are no cases of

14 Ibid., at 188.
15 Jenn, supra note 9, at 558. Jenn thus describes the charitable deduction as follows: “Although the operation of the deduction is not as stark as if a 25 percent marginal rate taxpayer wishing to direct $100 to her favorite cause wrote a $75 check to the charity herself and then instructed the government to write a $25 check on her behalf, the final distribution of resources in the case of the deduction is the same as if the government were writing checks on behalf of private citizens.” Ibid., at 561. See also David A. Weisbach and Jacob Nussim, “The Integration of Tax and Spending Programs” (2004) 113:5 Yale Law Journal 955-1028, at 957-59.
16 Weisbach and Nussim, supra note 15, at 958.
17 Ibid., at 961.
families accidentally acquiring a boat. In short, a certain amount of the family's income should be considered non-discretionary, and thus omitted from taxable income.

And so to those who rage against the distribution of benefits through boutique tax credits, the proper response is that a differing distribution of benefits across taxpayers is precisely the point. These credits are responding to differences in ability to pay attributable to differences in circumstances, which society has decided ought to result in differential tax burdens. To put it another way, I am making a case against neutrality with respect to certain types of spending. Kids are not boats.

...TO ENCOURAGE THE FOLLOWING THINGS

In practice, nearly all countries adjust their tax base—make horizontal equity adjustments—to take account of the differing ability to pay for individuals who

1. start a family,
2. have children,
3. incur costs to earn their income,
4. own a home,
5. save for the future, or
6. improve civil society.

And so we have arrived at a defence of targeted tax credits. Now let's look at how this might work itself out in the six categories above.

Starting a Family

Given the widespread social advantages of starting a family,18 folks doing so should not pay higher taxes than individuals living alone; we need to eliminate what used to be called "the marriage penalty." Equalizing the personal and spousal exemptions has largely done this. The move to income splitting for families and seniors, and in Alberta until recently the single-rate tax, has moved toward a family basis for taxation.

Having Children

Our tax and benefit system today is much fairer to families with children across income levels. In addition, there are a number of specific tax breaks for child-related

expenditures (for example, for participation in arts and sports programs) that provide for a reduction of tax for parents or guardians who incur such expenses. There are also tax breaks for families who set aside income for their children’s education through registered education savings plans (RESPs) or, in case of children who are disabled, through registered disability savings plans (RDSPs). There are also adoption tax credits to offset the considerable costs of adopting children.

**Earning an Income**

In addition to tax breaks for saving for education (through RESPs), further tax breaks have been created to recognize the costs of getting and keeping a job, such as the following:

- the child-care expense deduction (one of the few remaining deductions)
- apprenticeship tax credits
- the tools tax credit
- the public transit tax credit
- the employment credit
- moving expense tax credits
- the textbook tax credit
- the medical expense tax credit

**Owning a Home**

Research generally supports the proposition that home ownership generates positive externalities. Glaeser and Shapiro find that homeowners generate positive externalities by taking better care of their property than non-owners and demonstrate greater civic engagement by supporting investments in their local community. Dipasquale and Glaeser find a positive and likely causal relationship between home ownership and social capital.

There are two different ways in which tax systems are used to promote home ownership. The US approach encourages debt through mortgage interest deductibility. The Canadian system encourages equity with the exemption from capital gains for a primary residence, and during the recent federal election campaign, the Conservatives proposed to make permanent the previous home renovation tax credit,

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19 Both the RESP and the RDSP have a tax-sheltering component and a government contribution component. The latter could arguably be called spending rather than a tax break.

20 Compared with tax credits, deductions are more consistent with the concept of horizontal equity in that they exempt certain amounts of income from tax, rather than merely giving a credit at the lowest rate of tax.


which allows a credit for a portion of the costs of renovating a home. In addition, first-time homebuyers can withdraw funds, up to a specified amount, tax-free from their registered retirement savings plans (RRSPs) to put toward the purchase of their first home, so long as those funds are paid back over a specified period of time. First-time homebuyers can also access the first-time homebuyers tax credit to offset the costs of purchasing their first home.

**Saving for Retirement**

Canada has significantly increased the ways in which Canadians can save for retirement:

- RRSPs provide the foundation with tax-deductible savings.
- Tax-free savings accounts allow savings to grow tax-free, and pooled registered pension plans allow smaller businesses or organizations, or even self-employed individuals, to participate in pooled savings plans to reduce administration costs.
- Deferred profit-sharing plans allow tax deferral on profit-sharing plans for employees.

Together, these various savings vehicles provide greater flexibility to meet the needs of Canadians than a one-size-fits-all spending approach, such as expanding the Canada Pension Plan. In addition, there are some narrower tax credits to assist with saving such as the tax credit for carrying charges, pension income credits, and various tax breaks related to registered retirement income funds.

**Improving Civil Society**

Tax provisions that encourage the improvement of civil society include charitable donation credits, the first-time donor’s super credit, political donation credits, and tax breaks for voluntary firefighters. During the recent election campaign, the Conservatives proposed a tax break for service club memberships. Again, nearly all governments provide some or all of these types of tax breaks. Our society does, and ought to, rely on the voluntary sector to provide services that could be provided by government.

The deduction for charitable contributions and similar civil society deductions effectively delegate to citizens the ability to direct a “government subsidy to a third party engaged in activity generating public benefits.” Thus, the charitable deduction can be viewed as a “social choice mechanism.” Levmore argues that the charitable deduction “measures and aggregates citizens’ preferences” and “may be

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24 Jenn, supra note 9, at 587-88.

25 Levmore, supra note 10, at 404-5.
superior to conventional voting.”26 This social choice mechanism generates greater pluralism in outcomes than would be achieved if government made the choices itself.

CONCLUDING THOUGHTS
In conclusion, let’s circle back to George Will with some political economy observations. In addition to the arguments above, I would argue the value of various tax credits as “signals” that government sends to promote certain types of activities and behaviours. The public widely accepts and supports such signals; for example, we accept the imposition of punitive taxes aimed at reducing tobacco and alcohol use as part of our collective signal to stop (in the case of tobacco) or moderate (in the case of alcohol) these activities.

In a similar manner, broad public support for having and raising children, charitable giving, volunteer firefighting, owning a home, and working is reflected in the tax treatment of these things. The public is signalling, through their governments, support for these things quite aside from any technical or efficiency arguments for such preferential treatment.

The flip side of the coin is also worth noting, namely, that the public can signal to governments, via political parties and elections, things that they wish the government to positively (or negatively) support.27 In fact, there is some evidence that the public prefers that governments use tax credits rather than spending to accomplish such goals—or, at the very least, are more accepting of such nudges delivered through the tax system rather than through spending programs.28

After all, on the big nudges identified here—to get a job, start a family, have children, buy a home, save for retirement, and improve civil society—government should not, indeed cannot, be neutral.

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26 Ibid., at 389.

27 Full disclosure: I was working on one such campaign while completing this article.