Personal tax credits and all-inclusive resorts

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November 24, 2014

If you have met me, you'll know I am a tax geek with the uncanny ability to find parallels between everyday life events, tax practice and policy. I'm fresh back from an all-inclusive Mexican resort vacation and, naturally, the experience reminded me of tax.

So what does tax and all-inclusive resorts have in common? While away, it got me thinking how some of the recent personal tax credits announced by the Conservative Government resemble certain characteristics of an all-inclusive resort. All-inclusive resorts are a people-watching mecca but more famously are known for their numerous all you can eat buffets and unlimited alcohol (good, bad and ugly). To parallel the two, while there are certainly good sides to the recent amendments to the Children's Fitness Tax Credit, the Universal Child Care Benefit ("UCCB"), Child Care Expense Deduction and the new "Family Tax Cut" credit, there are many distasteful aspects as well.

Let me first preface my comments by reminding the reader that these are my views and may not be popular amongst the mainstream or non-tax practitioners (or the committed all-inclusive jet setters). Let me start by saying that I'm not a fan of personal tax credits – period. The Income Tax Act is more than just a set of tax rules… it is a horrifically complex body of law that encompasses a collection of social policy objectives. Every time the Income Tax Act is used as the instrument to carry out a social policy objective, the Act becomes more complex and more difficult to administer. I have long questioned whether the Income Tax Act should be the statute that is the "go to" body to carry out election promises or "feel good" social policies.

I won't spend a lot of time writing about the recent amendments. Many commentators and mainstream media have already "reported the news" and therefore you can easily find it. Here is a very brief summary:

1. On October 9, 2014, the federal government announced that the Children's Fitness Tax Credit, which was first introduced in 2007 as a $500 non-refundable tax credit under section 118.03 of the Income Tax Act (the "Act"), was to be doubled to $1,000 for the 2014 and later taxation years. For the 2015 and subsequent tax years, such a credit will be refundable (meaning that such a credit may result in a tax refund – or increased tax refund as the case may be – whereas the existing non-refundable tax credit simply reduces taxes owing). The doubling of this credit was promised in the Conservative Party's 2011 election platform and ultimately this promise will now be fulfilled. Making the tax credit refundable was a 2008 Conservative Party election promise and thus this promise will also be fulfilled.

In 2011, the Conservative Party also promised to introduce an Adult Fitness Tax Credit but the October 9, 2014 announcement did not contain any amendments to introduce this.

2. On October 30, 2014, the federal government announced a multitude of changes including:

- The new "Family Tax Cut" credit under proposed section 119.1, that will enable certain

income to be shifted from a higher income spouse / common law partner to a lower income spouse / common law partner. Such income shift can be to a maximum of $50,000 but the tax savings will have a ceiling of $2,000 for couples with children under the age of 18. This new non-refundable tax credit will have effect for the 2014 and later taxation years.
  - The UCCB will increase from $100/mo for each child under the age of 6 to $160 /mo effective January 1, 2015.
  - The UCCB will be expanded to include children between the age of 6-17. Parents of such children will now receive $60/mo effective January 1, 2015.
  - The Child Care Expense Deduction limits, as set out in subsection 63(3) of the Act, will be increased by $1,000 per eligible child effective for the 2015 calendar year.
  - The existing Child Tax Credit, under paragraph 118(1)(b.1) of the Act, is to be repealed effective for the 2015 calendar year. The 2014 Child Tax Credit is $2,255.

So what's the "good" about the introduction of the new personal tax credits (and miscellaneous other amendments)? People who can obviously benefit from the modest tax savings set out above, then it is hard to argue against such a benefit. For example, the increase in the UCCB from $100 to $160 is good for lower income families who rely on the income to allow their households to run. The increase in the Child Care Expense Deduction limits is also an improvement and hard to criticize.

So what's the "bad and ugly"?

Many personal credits are "small dollar" in nature. For example, let's look at the Children's Fitness Tax Credit. Currently, the non-refundable credit is $500. The Federal tax credit is 15%. Accordingly, the maximum reduction in federal taxes payable for a family is $75 ($500 x 15%). While I appreciate that $75 is certainly better than zero, I have never met a single person, regardless of income level, who will enroll their children into fitness activities simply because they can receive a tax credit. And isn't that supposed be the underlying social policy… to encourage parents to enroll their children into fitness activities? Am I surprised by my anecdotal evidence? Nope. In my view, the Income Tax Act as a motivator of personal behavior has its limits. I often say to my clients: "*Don't let the tax tail wag the dog*". In other words, tax savings as a reason to behave is usually misguided.

Using the Department of Finance's statistics provided in its October 9, 2014 release, the existing Children's Fitness Tax Credit currently costs the federal government $115 million per year. The proposed changes to the Children's Fitness Credit will cost the Federal government an additional $35 million per year for a total cost of $150 million per year. While that number may sound large to the average person, it is tiny as a line item in the federal Budget.

Do all of the provinces grant equivalent personal tax credits every time the federal government introduces a new credit? No… it's a mixed bag thus adding an additional level of complexity.

What about the administration of such personal tax credits? Is it easy? The answer is an emphatic "no". Again, using the Children's Fitness Tax Credit as an example, the October 9, 2014 announcement was accompanied by a 5 page *Notice of Ways and Means Motion to Amend the Income Tax Act and the Income Tax Regulations*. Good luck to the average person trying to understand such a document. This is reserved for tax professionals, like me, and believe me, trying to piece such material together is very challenging.

The preparation of personal income tax returns to claim such a credit is challenging. I honestly don't think many people today can correctly prepare their own returns using the old fashioned method of pen and paper. Personal tax software or professional preparation is almost a necessity these days. I challenge you to find one professional tax preparer who thinks that the addition of personal tax credits is a good thing. It often involves the professional wading through the numerous receipts to determine eligibility and make the ultimate claim. The Canada Revenue Agency will often review such claims after the filing of the returns thus adding an additional layer of complexity and time to the tax preparation process. In a world where software and the internet has made professional tax preparation a commodity rather than a value added service, it makes it more and more difficult for professional tax preparers to profit from their services where price is often the only motivator for the client to retain their services.

Here's a list of personal tax credits that have been introduced in the last decade or so:

1. Child Tax Credit – paragraph 118(1)(b.1) – to be repealed for 2015 forward as earlier discussed;
2. Canada Employment Credit – subsection 118(10);
3. Adoption Expense Credit – section 118.01;
4. Transit Pass Credit – section 118.02;
5. Children's Fitness Credit – section 118.03;
6. Children's Art Credit – section 118.031;
7. Home Renovation Credit (for 2009 only) – section 118.04;
8. First Time Home Buyer's Credit – section 118.05;
9. Volunteer Firefighter Credit – subsection 118.06(2);
10. Search and Rescue Credit – subsection 118.07(2);

While all of the above are crowd pleasers, the credits come with the negative implications that I have laid out above. In my view, if the federal government truly wants to motivate certain behavior, then the Income Tax Act should not resemble a buffet restaurant that exists at an all-inclusive resort. While it is tempting to continue to add "new dishes" to the buffet, personal tax credits should not serve as those – instead, I believe that the federal government could implement small dollar social policy objectives or election promises with direct investments perhaps by way of subsidies. I realize that is easier said than done and alternative investments carry with them negative implications as well. It is time to shrink the buffet line by eliminating the excess "side dishes" at the all-inclusive resort known as the Income Tax Act.