Income splitting and anti-avoidance legislation: evidence from the Canadian "kiddie tax"

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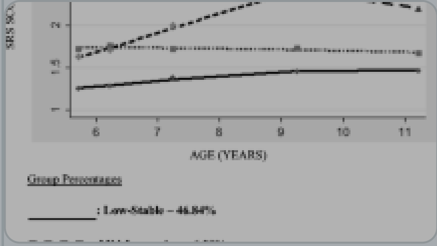
much larger than the increase in capital gains income. Hence, our analysis suggests that the "kiddie tax" is an effective method to deter income splitting.



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3. For example, please see *Individual Income Tax Returns Publication 1304* (Complete Report) available through the IRS website.

4. Although it would be preferable to have available age groups that are completely consistent with the effective age of "kiddie tax" legislation (i.e., 17 and under), we believe that our empirical age groups are acceptable. The percentage of the under-20 population aged 18 and 19 is between 10.0 and 11.9 % from 1997 to 2009 (*Statistics Canada*, CANSIM tables), and thus, any miscategorization in our provincial analysis is relatively minor and would bias against potential findings. If more income is split with children 17 and under, the inclusion of 18- and 19-year-olds lowers the average income share for the under-20 group and reduces the difference between minor and non-minor children. Conversely, if more income is split with children 18 and over, then the inclusion of 18- and 19-year-olds in the under-20 age group raises the

(2010) for the USA, and Donnelly et al. (2000) and Ideias (2014) for Canada.

8. Capital gains are taxed when realized and no legislation exists to prevent a minor child from holding transferred property until they reach the age of 18, when attribution in Canada normally ceases to apply (Donnelly et al. 2000). As a caveat, however, a gift of shares typically results in immediate taxation to the transferor on any unrealized capital gains. Furthermore, capital gains can be volatile and difficult to predict, and could result in losses, likely making it a less preferred activity prior to "kiddie tax" legislation.

9. Provincial data are not available prior to 1997. We exclude 1997 from the provincial sample because, conceptually, it may not be comparable to the other years in the pre-legislation period. The Supreme Court decision in *Neuman* ,

reported, it is irrelevant that the composition of our three age groups implicitly changes throughout the sample period (e.g., some minor children will become non-minor children). What is relevant is the total share of income each respective age group implicitly chooses to report in each year or period of the sample. The income shares are not cumulative, so the amounts reported each year, where applicable, represent a decision in that year about whether or not to shift income.

13. For example, Slemrod (1996) and Saez (2004) also employ a simple multivariate regression model where the dependent variable is the total taxable income of a group as a share of total taxable income with respect to a given province/state in a specific year.

legislation was a preventative step by the government which merely preserved the status quo of little use of these structures.

17. In 1988, the capital gains inclusion rate increased from one-half to two-thirds, and in 1990, it increased again to three-fourths. In 2000, it was reduced twice, from three-fourths to two-thirds, and from two-thirds back to one-half.

18. This specification is validated by likelihood ratio tests based on Box-Cox regressions that do not reject the use of a log specification. Although a power transformation is most suitable, the empirical results and model fit are highly similar with either a log or power transformation. For ease of interpretation, we report the semi-log specification.

only, since population, a component of the dependent variable, is unaffected by the legislation.

22. Saskatchewan is the omitted province in our model.

23. Data on dividends in the Report are recorded as taxable amounts, which reflect a dividend gross-up. We have removed the gross-up in our data to reflect actual dividends paid. Different gross-up rates have been available in Canada over our sample period: 1/3 for 1975–1977 and 1987; 1/2 for 1978–1986, 1/4 for 1998–2005, and both 1/4 and 9/20 for 2006–2009. We use our previously noted decomposition technique for eligible and non-eligible dividends to calculate the actual dividends paid for 2006–2009.

and statistically significant at the 1 % level, yields an overall decrease of 73.5 % in minors’ share of dividend income from pre-legislation to post-legislation. Thus, the conclusion that the legislation has a large and statistically significant negative effect on minors’ share of dividend income persists where non-minor children are not used as a control group.

28. The sum of $\textit{DLEG}_\textit{it}$ and $\textit{DAGE36}_\textit{ijt}*\textit{DLEG}_\textit{it}$ (with Kennedy’s adjustment) implies that the adult age group has a 13.5 % increase in its share of dividend income from the pre-legislation period to the post-legislation period.

29. The sum of coefficients $\textit{DLEG}_\textit{it}$ and

respective average aggregate taxable dividends reported by all age groups. A similar procedure is used for the capital gains estimate.

32. If we measure these revenue estimates using the total change for minor children (i.e., $\beta _{1}$ + $\beta _{3}$, with Kennedy’s adjustment), dividend income decreases by $660 million and capital gains increase by $23 million. Thus, the offset of increased revenue from capital gains splitting would be 3 %.

33. As an alternative, untabulated test, we re-estimate Eq. (1) without observations from 1999. The coefficient estimates of $\textit{DLEG}_\textit{it}$, $\textit{DAGE1}_\textit{ijt}*\textit{DLEG}_\textit{it}$, and

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