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

Published: 06 November 2014

Volume 22, pages 909–931, (2015) Cite this article

International Tax and Public Finance

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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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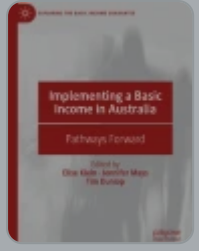

Optimal income support for lone parents in the Netherlands: are we there yet?

Article | 27 March 2023

Notes

1. As Brunson (2011) suggests, little research has been conducted to assess the effectiveness of these rules in any country. Furthermore, the empirical literature on tax avoidance through intra-household income shifting is relatively thin. Maki (1996), Dunsky and Follain (2000), and Gervais and Pandey (2008) focus on the impacts of mortgage deductibility on the portfolio of non-residential assets and liabilities held within a household. Stephens Jr

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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 average share. Again, the result is a smaller difference between minor and non-minor children.

5. For example, a child could invest $1 in a company, provide no labor effort, and yet receive thousands of dollars in dividends. Such strategies were of low cost and could be easily adjusted according to changing financial circumstances of family members. This activity was at issue in both the *McClurg* and *Neuman* cases, two of three cases that had primary influence on the enactment of the "kiddie tax" legislation in Canada (i.e., *McClurg v. Canada*, 1990 CanLII 28

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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* , released early in 1998, overturned an earlier lower-court decision (to the surprise of tax practitioners) and thus effectively created the primary market for dividend splitting with minors beginning with that year; supra footnote 5. However, our analysis is robust to the inclusion of 1997 in our provincial sample.

10. Investment income for purposes of this study refers to the total of bond, bank and mortgage interest, income from trusts, and foreign interest and dividends.

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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.

14. Population figures are from Statistics Canada, CANSIM database, table 510001, matrix 3604.

15. We solve a system of two equations and two unknowns. Let E be actual eligible dividend, and N be actual non-eligible dividend. Then, Total Taxable Dividend = $E*1.45 + N*1.25$ and Total Dividend Tax Credit = $E*1.45*0.1897 + N*1.25*0.1333$. As total taxable dividend and tax credit are known, we solve for E and N. The resulting estimate represents a lower bound because private corporations can pay eligible dividends (when

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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.

19. Our results might be skewed, given that most observations occur post-legislation. However, this result holds with the addition or subtraction of a few years of data also. We thank an anonymous referee for suggesting this sensitivity test.

20. Within the Report, age categories 25–34, 35–44, 45–54, and 55–64 are tabulated separately. The results and inferences of our subsequent analyses are unchanged if we estimate individual coefficients for each of these

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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.

24. Refer to http://www.cra-arc.gc.ca/tx/ndvdls/fq/txrts-eng.html for more details.

25. Given the small number of provinces (10), we cluster by province-year and use an accompanying bootstrapping process recommended by Cameron et al. (2008); clustering only by year or province yields consistent results. Results are consistent also when using generalized least squares in order to correct for first-order autocorrelation.

26. See Kennedy (1981), with respect to interpretation of indicator variables in

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share of dividend income from the pre-legislation period to the post-legislation period.

29. The sum of coefficients $\textit{DLEG}_\textit{it}$ and $\textit{DAGE1}_\textit{ijt}*\textit{DLEG}_\textit{it}$ for capital gains, while positive, is not statistically significant at conventional levels. Thus, an increase in minors' overall share of capital gains from pre-legislation to post-legislation is not statistically evident.

30. To the extent that the share of employment income is jointly determined along with our four income shares of interest, its inclusion as a control variable could bias our estimates. If share of employment income is omitted from the model, untabulated results are consistent with the evidence in this

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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 \(\textit{DAGE36}_\textit{ijt}*\textit{DLEG}_\textit{it}\) are nearly identical to the respective coefficients reported in Table 4.

34. The sign and significance of these coefficients remain the same or improve if 2002 and/or 2001 are also excluded.

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https://doi.org/10.1007/s10797-014-9342-z

Keywords

"Kiddie tax" | Income shifting | Income splitting | Anti-avoidance | Canada

JEL Classification

D13 | H24 | H31 | K34

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