

3.10 After this point, the value of credits tends to be lower than the value of the exemptions and deductions they replaced. As a result, the net gain from tax reform declines steadily until about \$47,500, after which the net gains begin to rise again. Essentially, the pattern mirrors the marginal rate profile portrayed in Figure 1. Once the income level exceeds the \$55,000 threshold, where the top marginal rate becomes applicable, what dominates the gains is essentially the fact that the combined federal-provincial pre-reform top rate of about 52.7 percent (an average over the provinces) drops to about 45 percent. As long as all income is in the form of wage income, the dollar benefits will continue rising as income increases. In percentage terms (that is, the dollar gain expressed as a percentage of income) however, the gain is 3.5 percent at about \$15,000 and roughly one percent at \$55,000.

3.11 Figure 2 also portrays the gains for families with one child and with three children. The gains follow the same general pattern as those for a childless family, except that they are progressively smaller the more children there are in the family. Indeed, Figure 2 indicates that they become negative for a time for a family with three children and obviously would be more negative for a family with more children. Several factors are influencing this result.

3.12 First, tax reform converts the existing personal and spousal exemptions to credits at a rate of roughly 24 percent. Specifically the personal and spousal tax credits are \$1,020 and \$850, compared to the existing deductions of \$4,270 and \$3,740. In contrast, the \$65 tax credit for children is equal to 17 percent of the existing \$388 family allowance. However, the existing child exemption is \$470. Thus the child tax credit is only 14 percent of the existing deduction. This affects the comparison between families with and without children.

3.13 Second, strictly speaking, Figure 2 applies only for 1988. The May 1985 budget proposals set in motion a process whereby the child exemptions would eventually decrease to the level of the family allowances. As noted in the previous paragraph, Figure 2 assumes that the pre-reform value of the exemption will be \$470, whereas the steady-state value of the exemption will be \$388, the value of the family allowance. Correcting for this would not increase post-reform incomes for families with children, but it would decrease their benefits under the existing system by roughly \$21 per child. Thus, incorporating this change into Figure 2 would increase the gains for the three-child family by \$63, enough to remove that part of the curve which exhibits negative gains as a result of tax reform. More generally, it