Study: Intra-household Labour Income Responses to Changes in Tax Rates Among Older Workers

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Amid an aging society and rising labour market participation rates among older Canadians, it is important to understand the factors affecting the employment decisions of older workers. Although there is a large research literature estimating the effects of income taxes on the labour supply decisions of young and middle-aged workers, the ways in which older workers respond to income taxation has received relatively little attention.

A new study released by Statistics Canada examines the employment responses of Canadians in their fifties and sixties to changes in income tax rates resulting from policy changes, including pension income splitting. The analysis uses the tax returns of approximately 535,000 individuals, as well as the tax returns of their spouses, and takes into account a broad range of characteristics affecting employment and retirement, such as age and household income.

The study finds that a decrease in income tax rates affect the labour supply decisions of older workers in several ways.

First, an increase in after-tax income resulting from a reduction in income taxation induced some older workers to leave the work force. Specifically, each 1% increase in total after-tax income was found to lower the probability that older workers remained employed by around 2 percentage points, suggesting that higher after-tax incomes allowed some individuals to retire.

Second, higher after-tax incomes also encouraged those older workers who remained in the workforce to increase their labour supply. Specifically, among those who remained employed, a 10% increase in the average "take-home" rate (defined as one minus the tax rate) was found to result in a 4.2% increase in their labour income. This was over and above the increase in total after-tax income associated with a lower rate of taxation. Such increases in labour supply were slightly more evident among older workers at the higher end of the income distribution.

Third, changes in individuals' tax rates were also associated with changes in the employment decisions of their spouses – with increases in individuals' total after-tax incomes associated with reductions in the employment of their spouses.

Finally, the study also found that workers responded more to changes in the average tax rate than the marginal tax rate. This is consistent with the hypothesis that individuals use average rates as a proxy for marginal rates when faced with nonlinear, complex taxation schedules.

Definitions, data sources and methods: survey number 4107.

The research paper "Intra-household Labour Income Responses to Changes in Tax Rates Among Older Workers," part of the *Analytical Studies Branch Research Paper Series* (**11F0019M**), is now available.

For more information contact us (toll-free 1-800-263-1136; 514-283-8300; **STATCAN.infostats-infostats.STATCAN@canada.ca**).

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