

Impact of Income Testing

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To:	Community Development and Recreation Committee
From:	General Manager, Children's Services
Wards:	All
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SUMMARY

This report describes a regulation change under the *Day Nurseries Act* to the method of determining eligibility for child care subsidy. Effective January 2007, the Province introduced income testing as the method of determining eligibility for child care subsidy. Income testing will make more families eligible for child care subsidies, but will result in an estimated annualized loss of \$15 million in revenue from parent fees. Options to mitigate the loss of revenue to Toronto's child care system are presented in the report. The Division will be consulting with parents and other stakeholders on the options and will report in June 2007 on the results of the consultation and a recommended strategy to address the lost revenue.

FINANCIAL IMPLICATIONS

This report has no financial implications.

DECISION HISTORY

City Council on April 25, 26, and 27, 2006 adopted the staff recommendations in the Recommendations section of the report, *Models of Funding Child Care Services*. Included in the Recommendations were Guiding Principles for a Best Start Funding Framework. Within the Guiding Principles are General Parameters of an Income Test. The characteristics of a "good" income test are, that it is fair and equitable, easy to administer, promotes access to quality care, capable of being universal, easy to model, manipulate and adapt, and easy to implement. Council positions support the change to income testing for determining eligibility for child care subsidy. See http://www.toronto.ca/children/pdf/funding_models.pdf

ISSUE BACKGROUND

The Province of Ontario's *Day Nurseries Act* and Regulations establish the requirements for providing child care services and subsidies. The Province also issues Guidelines and Policy Statements that outline more specific requirements for subsidy eligibility. Subsidized child care, also known as fee subsidy, is available to parents to assist them with the costs of child care while participating in an approved activity e.g., working, attending school or a training program. Reduced child care fees are also available to parents not necessarily in approved activities, but who need child care because they or their child has special needs.

The Province has amended O. Regulation 262 under the *Day Nurseries Act* effective January 1, 2007, by replacing the needs test with an income test.

Income testing was promised in the Best Start Plan outlined in *Excellence for All, The Ontario Liberal Plan for Education*, in the Liberal Party platform 2003. The intent is that more families across a broad range of income levels will be eligible for fee subsidies and more families will be in receipt of partial subsidies.

The previous method of determining eligibility for child care fee subsidy in Ontario was a "needs test" that calculated fees that parents paid for child care. The needs test was based on a formula that took into consideration liquid assets, net income and eligible expenses. Families were then assessed a user fee that was payable directly to the child care program or agency they selected.

The City has also been using an income test in addition to the provincial needs test for about 15 years. It introduced the income test as a result of reduced provincial funding and as a measure to increase funds for child care. After applying both tests, families paid the higher amount they were assessed. All other Provinces use an income test to determine eligibility – see attached chart, Appendix 1.

Child care subsidies are cost shared on an 80/20 basis with the Province and the City, net of parent fees. Parents pay their fees directly to the child care operator, and the City pays the operator the remaining approved rate. The number of subsidy spaces that the City can provide is determined by considering all parent fees and the combined Provincial and City funding available.

COMMENTS

The City of Toronto supports the move to an income test as a fairer means of determining parental contribution for child care fees. The new Provincial income test assesses parent contribution on "adjusted income". Adjusted income equals net income from line 236 on personal income tax forms less any Universal Child Care Benefit (UCCB) payments and approved costs for children with special needs. Income testing is simpler, is considered to be less intrusive, and more transparent than the needs test. Because income testing removes the barrier of asset ceilings for eligibility, more families will be eligible for

support with the cost of child care from a broad range of income levels. However, without additional fee subsidies to address the increased families eligible for child care subsidy, the City's waiting list for child care, currently at 9,600 children, will grow.

How does Income Testing Work

Families with an adjusted income of \$20,000 or less will not pay any of the cost of child care for their children.

Families with an adjusted income of \$20,000 - \$40,000 will pay 10% of their adjusted income towards the cost of their child care.

Families with adjusted incomes over \$40,000 will pay an additional 20% of their adjusted income over \$40,000 (that is: 10% of their adjusted income from \$20,000 - \$40,000 plus 30% of their adjusted income over \$40,000) towards the cost of their child care.

New clients will be assessed under the new method of determining eligibility. Current clients will be assessed throughout the year as they come due for their annual assessment.

Grandparenting rules will apply - there are provisions to protect families where there are children in the family who are not yet in Grade 1, and the first income tested fee is higher than the fee that was in effect on December 31, 2006.

How Our Clients are Affected

At the end of 2006, the City provided child care fee subsidy to almost 16,500 families, 50% of which paid no fee, and for the remaining 50% who paid fees, their average annual fee was \$1,368. The total revenue from parent fees under needs testing was \$21.6 million in 2006.

Children's Services currently has income tax data on 93% of families in receipt of subsidy. A review of this data indicates that under income testing 70% of the families in receipt of subsidy at the end of 2006 will pay no fee, and for the remaining 30% who pay fees, their average annual fee will be \$1,495. By way of illustration, it is useful to consider the impact of income testing on the Division's average client an employed single parent with one child. Under the previous method of determining eligibility, this parent paid an average of \$1,663 per year (\$6.40/day) but, under the new income test, this parent will pay \$422 per year (\$ 1.62/day). In general, families of all income ranges will benefit from income testing. Appendix 2 outlines the impact of income testing on current families by family type. Students receiving funding under the Ontario Student Assistance Program (OSAP) will benefit in particular, because the proceeds of student loans are not considered income for tax purposes, and thus, are not included.

The Division will continue to monitor and analyze the impact of income testing on parent revenues throughout 2007 as new assessments and eligibility reviews occur. Because income testing will be phased in, the lost revenue in 2007 is not expected to exceed \$7.5

million. The full impact of \$15 million in lost parent fees will be felt in 2008 as total revenues from parents are expected to be reduced to \$7.5 million annually from \$21.6 million. Unless action is taken to offset the lost parent fees, up to 1,500 fee subsidy spaces will be lost.

Options to Mitigate the Revenue Shortfall

The City's Child Care Service Plan, amended by Best Start, reflected funding expected under the Early Learning and Child Care (ELCC) Agreement growing to \$125.0 million by 2008. There would have been more than sufficient funds available to absorb the impact of Income Testing estimated at \$15 million annually. As a result of the cancellation of the ELCC agreement, the City's revised annual allocation under Best Start was reduced and is now \$27.478 million, and there is not sufficient revenue from Best Start to offset the impact of the lost parent revenue without service cuts.

The City has asked the Province to ensure that the policy change to income testing does not have the unintended outcome of making child care subsidy less available by reducing service levels. The Minister of Children and Youth Services has indicated that 2007 will be a transition year in which the ministry will identify implementation issues and work with municipalities to achieve solutions. The City needs a solution to this problem no later than June 2007 if it is to avoid the loss of 1,500 subsidy spaces.

In the event that the City is unable to secure Provincial funding to offset the revenue loss, there are some options which the City could consider to mitigate the revenue shortfall. The City can only address the loss of \$15 million by reducing expenditures, replacing lost revenue from other sources. Potential strategies for discussion with stakeholders include:

- Implement a service loss of 1,500 child care subsidy spaces.
- Introduce surcharge to parents to make up the lost revenue.
- Change service mix of clients to increase parent revenue and reduce expenditures.
- Eliminate City funded non – mandatory services.
- Draw on Child Care Expansion Reserve Fund until it is exhausted (2008).
- Revise calculation and payment of rates.

It is unlikely that any of these strategies on their own will resolve the revenue shortfall and the solution will likely require a mix of strategies unless provincial funding is secured. All of these strategies will have serious impacts on both the users and providers of child care and come at a time when the child care system is already facing serious financial pressures.

The Division has begun a consultation process to discuss strategies for addressing the loss of user fee revenue with stakeholders. Facilitated discussion of the strategies will inform future policy options and identify the impact on the major stakeholders in Toronto's child care system including:

- Families currently in receipt of subsidy

- Full fee clients
- Families waiting for subsidy
- Child care system (operators and community infrastructure)

The consultations will be broadly publicized and provide access across the City. The information gathered will inform a report in June 2007 on the results of the consultation and a recommended strategy to address the lost revenue.

As noted before, the Province is gathering information on the impact of income testing during the first year of implementation and has announced its intention to identify financial pressures created by the introduction of the income test. The City has indicated that it needs to know no later than June 2007 if additional support will be forthcoming from the Province, otherwise, the City will have no choice but to implement strategies to address the lost revenue or face the loss of 1,500 child care subsidy spaces.

City officials will continue to work with staff from the Ministry of Children and Youth Services to ensure that they have the most relevant and recent information concerning the impact of income testing.

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SIGNATURE

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ATTACHMENTS

- Appendix 1 - Net income eligibility levels for full and partial child care fee subsidies by Province/Territory - 2003/04
- Appendix 2 - Impact of Income Testing