

# LABOUR SUPPLY RESPONSES TO INCOME TAX REFORM AMONG OLDER COUPLES

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Worker shortages pose significant challenges for labour markets in Canada. For example, more than one-third of businesses report that recruiting skilled workers is an obstacle. These shortages are partly driven by retirements of baby boomers, particularly since the COVID-19 pandemic. To counteract these challenges, governments have grappled with ways to keep older workers in the workforce longer. Proposed strategies often involve changes to the tax and transfer system.

Is the tax code a viable policy lever for influencing retirement decisions? This is an important question for understanding how policy can address current labour shortages. This study examines this question by looking back at the effects of pension income splitting in couples, a 2007 federal reform that explicitly targeted the income tax bills of older workers.

This research finds that:



Older couples are very sensitive to their tax bills and strategize effectively to reduce total liabilities taking advantage of income splitting for tax planning.



Changes in total after-tax income brought on by the tax reform directly affect retirement decisions.

*For example, a tax cut that increases after-tax income by 10% leads to a 4% greater likelihood of retiring, on average.*



Changes in total after-tax income of spouses also affect people's retirement decisions. However, this cross-spouse effect is smaller, suggesting tax filers respond primarily to changes in their own tax bills.

*For example, a tax cut that increases spouse's after-tax income by 10% leads to almost a 1% greater likelihood of retiring, on average.*



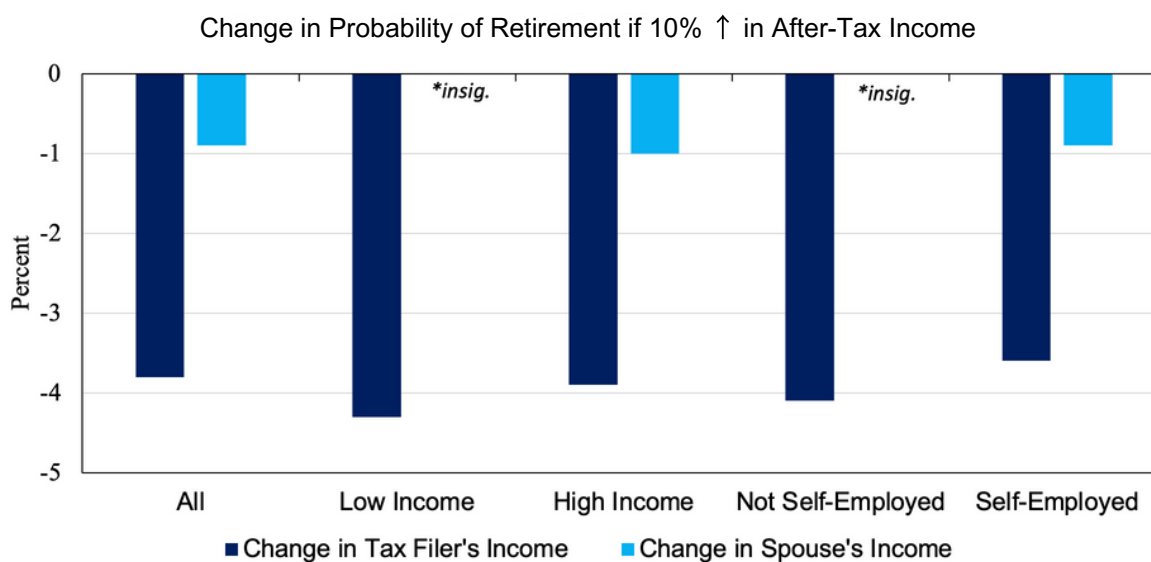
Conditional on staying in the workforce, older workers respond to the tax reform by adjusting how much they work.

*For example, a tax cut that increases after-tax income by 10% leads to a 2.2% decrease in labour earnings, on average.*

# POTENTIAL POLICY IMPLICATIONS

- Tax reform is likely an effective policy lever for influencing work and retirement decisions among older workers and tackling labour shortages.
- There is a trade-off between offering programs that ease tax burdens of seniors and incentivizing older workers to remain employed. Tax allowances, credits and deductions that are not tied to labour force participation may induce retirements.
- To the extent that the tax and transfer system affects labour supply decisions of older workers differently than younger and middle-aged workers as this study suggests, there may be a role for greater use of age-dependent taxation. This refers to designing tax and transfer programs in a way that varies based on the tax filer's age.

## Key Figure – Tax Reform and Retirement Decisions



\*insig. = not statistically significant and therefore displayed as zero.

The full-length manuscript, titled “Labor Supply Responses to Income Taxation among Older Couples: Evidence from a Canadian Reform,” is forthcoming in *American Economic Journal: Economic Policy*. An earlier iteration of this research was published as a [working paper with the Retirement and Savings Institute](#).

### NOTE ON METHODOLOGY

Using administrative data for a 20% sample of Canadian tax filers and their spouses, this study centers on a reform that targeted the tax bills of older couples with at least one pensioner—specifically, the 2007 introduction of pension income splitting.

Analyzing this reform is ideal since the eligibility rules include an age component, hence it is a reform that could potentially have a large effect on retirement. The causal effect of the reform is obtained by estimating how labour supply changed around the time of the reform for tax filers who were eligible to split pension income, benchmarked against tax filers with similar incomes but who were otherwise ineligible.