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Recognizing or Disregarding Close Personal Relationships Among Adults? The Report of the Law Commission of Canada and the Federal Income Tax

David G. Duff*

KEYWORDS: TAX POLICY ■ PERSONAL INCOME TAXES ■ INCOME TAX CREDITS ■ HOUSEHOLDS ■ FAMILY ■ SPOUSE

INTRODUCTION

Beyond Conjugal, the report of the Law Commission of Canada on close personal relationships among adults,¹ is an important document for the future of federal and provincial legislation for which such relationships are relevant. Affirming as fundamental values both the equal recognition of different types of relationships and individual autonomy regarding the kinds of relationships entered into, the report rejects the traditional reliance on conjugality as a key criterion for legal regulation, favouring instead a functional approach attuned to the specific policies pursued for different legal purposes.

The report reviews a number of federal statutes in which legal consequences turn on specific kinds of relationships among adults, and it proposes a new methodology for assessing existing or proposed legal rules that employ relational terms in order to accomplish their objectives.² According to this methodology, lawmakers should ask the following four questions:

1. Are the objectives of the legal rule legitimate?
2. If the rule's objectives are sound, are close personal relationships among adults relevant to these objectives?
3. If close personal relationships among adults are relevant to the rule's objectives, can individuals be allowed to designate the relevant relationships themselves?
4. If relationships matter and self-designation is neither feasible nor appropriate, can the rule be revised to better reflect the kinds of relationships that are relevant to its objectives?

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Where the legal rule fails the first of these tests, according to the report, it should be repealed or fundamentally revised. Where it satisfies the first test but fails the second, it should be revised to remove unnecessary relational references.³ Where the rule satisfies the third test, it should be revised to permit self-designation of the included relationships.⁴ Where self-designation is neither feasible nor appropriate, the final step encourages lawmakers to devise functional definitions of the relationships that more accurately target the specific legislative objectives.⁵

Applying this fourfold methodology to the federal Income Tax Act,⁶ the report concludes

- that the individual should remain the basic unit for the personal income tax,⁷
- that the tax credit for spouses and common law partners should be repealed,⁸
- that the goods and services tax (GST) credit should disregard close adult relationships altogether,⁹
- that tax credits for caregivers and infirm dependants should be available regardless of conjugal or blood relationship whenever taxpayers provide unpaid caregiving or financial support,¹⁰ and
- that rollover provisions should be made available to all persons “living together in economically interdependent relationships.”¹¹

In order to arrive at these conclusions, the report conducts a careful analysis of each of these aspects of the income tax, addressing tax and broader public policy considerations in an impressively concise and readable form.

In this comment, I do not question the report’s general conclusion that federal legislation should look beyond conjugality to recognize the diversity of personal relationships among adults, or the proposed methodology for evaluating legal rules that employ relational terms. Indeed, I endorse the report’s affirmation of relational equality and individual autonomy as fundamental values that should guide federal and provincial legislative reform. I also do not question the report’s persuasive case for the individual as the basic unit for the personal income tax on the grounds that

- individual taxation is simpler to administer and more respectful of personal privacy and autonomy than is taxation based on conjugal or family units;
- individual taxation has a less distorting effect on individual decisions to enter into relationships and to participate in the paid labour force than does taxation of other units; and
- individual taxation best corresponds to the purpose and structure of the income tax by applying to income over which individuals exercise effective control, rather than income from which they may derive some benefit.¹²

It is beyond the scope of this brief comment to examine each of the report’s proposed amendments to the ITA. Instead, I shall address what I consider to be the most significant recommendations: that the tax credit for spouses and common law partners should be repealed and that the GST credit should be fully individualized.

Questioning both of these recommendations, I draw some general conclusions on the report's vision of close personal relationships among adults, at least as these affect issues of income taxation and support.

THE TAX CREDIT FOR SPOUSES AND COMMON LAW PARTNERS

Traditionally available only for a married person supporting a spouse, the tax credit for spouses and common law partners was extended in 1993 to persons of the opposite sex cohabiting in a conjugal relationship,¹³ and in 2000 to cohabiting gay and lesbian partners.¹⁴ For the 2001 taxation year, the credit increased the basic personal amount of \$7,412 by an amount equal to \$6,294 less the spouse's or common law partner's income for the year above \$629.¹⁵ As the maximum additional amount allowed under this provision is less than the basic personal amount that would be available to an income-earning spouse or common law partner, some have argued that the credit discriminates against single-income couples.¹⁶ Canadian legal academics, however, have generally criticized the credit as an unwarranted subsidy for single-income couples, which encourages economic dependency among stay-at-home partners (who are generally women) by discouraging their participation in the paid labour force.¹⁷ *Beyond Conjugal* adopts the latter view.

Consistent with its proposed methodology, the report evaluates the credit for spouses and common law partners by first asking whether the provision fulfills a legitimate objective within the structure of the income tax. For this purpose, it considers both "technical" tax policy criteria like equity, neutrality, and simplicity, and "tax expenditure" justifications involving other public policy objectives pursued through the income tax.¹⁸

Beginning with technical tax policy considerations, the report rejects the argument that the credit recognizes the reduced ability to pay of a taxpayer who supports a spouse or common law partner with little or no income. It states:

[I]ndividuals who enter into relationships in which they choose to support other individuals capable of supporting themselves do not have reduced ability to pay, as this term is understood in tax policy analysis.¹⁹

In addition, the report suggests:

Far from reducing the ability to pay of the partner working in the paid working force, supporting a partner who works in the home will often increase the working partner's ability to pay because it will substantially reduce the services they will have to purchase in the marketplace.²⁰

Moreover, the credit "provides an incentive for one spouse or common-law partner to remain economically dependent on the other" by decreasing as the income of the "dependent" spouse or common law partner increases, thereby in effect taxing income that would otherwise be exempt under the "dependant's" basic personal

amount.²¹ As a result, the report concludes, the credit contradicts technical tax policy criteria of equity and neutrality.

The report also argues that the credit cannot be defended as a legitimate tax expenditure providing “income support to those families in which one spouse is looking after children in the home or acting as a caregiver for elderly parents,”²² since it does not depend on such caregiving and is given to the supporting spouse or common law partner rather than to the caregiver or those in need of care. As a result, the report concludes, the credit does not pass the first of the commission’s four tests: “it is a law that employs relational terms but does not serve a legitimate government objective—and should, therefore, be repealed.”²³

While I agree with the commission’s conclusion that the tax credit for spouses and common law partners cannot be justified as a reasonable tax expenditure to support caregiving for children or elderly parents, I question its view that the credit contradicts the “technical” tax criterion of equitable taxation according to ability to pay. Moreover, the argument that the credit encourages economic dependency is not sufficiently supported to outweigh equitable considerations that might justify its retention. Indeed, the commission’s own emphasis on recognizing different kinds of close personal relationships among adults might favour something like the credit for spouses and common law partners and other tax measures to ensure relational equality.

Beginning with the criterion of ability to pay, it is not obvious that individuals who support a spouse or common law partner with little or no income “do not,” as the report concludes, “have reduced ability to pay, as this term is understood in tax policy analysis.”²⁴ On the contrary, to the extent that support obligations are mandated under provincial family law regimes, basic costs associated with these obligations appear to constitute involuntary expenses that reduce the supporting person’s ability to pay. Nor does the possibility that supported persons may be “capable of supporting themselves”²⁵ necessarily undo the involuntariness of the support obligation, since the supported person’s “choice” to earn little or no income is not always voluntary.²⁶ Further, the initial choice to enter into a close personal relationship should not outweigh the involuntariness of a subsequent support obligation, so long as these relationships are regarded as a social norm that (as the subtitle of the report itself suggests) legal rules are intended to recognize and support. Finally, the value of any household services should not enter into the supporting person’s “ability to pay,” since “imputed income” is consistently ignored in defining the income tax base and is rightly ignored in any tax that respects personal autonomy.²⁷ In any event, there is no assurance that a spouse or common law partner with little or no income necessarily performs any more household services than an income-earning spouse or common law partner with respect to whom the credit cannot be claimed.²⁸

As for the argument that the credit discourages supported spouses or common law partners from participating in the paid labour force, the magnitude of any effect is likely quite small, as the report itself acknowledges.²⁹ Indeed, while the credit is reduced on a dollar-for-dollar basis as the supported individual’s income

increases from \$629 to \$6,294, it is unaffected thereafter, creating a combined effective tax rate of nil not only on the first \$629 earned by the supported individual but also on income between \$6,294 and \$7,412. The report does not cite any empirical study that has attempted to measure this effect of the credit on participation in the paid labour force. As a result, where a credit for spouses and common law partners can be supported on equitable grounds, it should not be rejected on the basis of its alleged impact on personal decisions.

In addition to these considerations, the commission's emphasis on relational equality provides further justification for a credit and other tax measures recognizing support obligations and economic mutuality among economically interdependent adults. Where a supported spouse or common law partner cares for children, for example, a credit provides at least some recognition for the economic value of these services, which do not currently qualify for the child-care expense deduction. Indeed, to the extent that child care is a joint responsibility of both parents, which may be fulfilled by third-party providers or by a division of labour in which one parent becomes the primary caregiver, I have argued elsewhere that the child-care expense deduction should respect these different choices by permitting one parent to deduct payments to the other up to the maximum amounts allowed by the deduction.³⁰ Better than a credit for "supporting" individuals, such a reform would explicitly recognize the economic value of these child-care services, enable caregivers to claim the basic personal amount themselves, and lessen their economic dependence on partners participating in the paid labour force. It would also further relational equality by recognizing the diversity of child-care arrangements in which parents choose to engage.

Whether a credit for spouses and common law partners is ultimately justifiable under the commission's fourfold methodology depends not only on whether it serves a legitimate purpose in the income tax but also on whether close personal relationships are relevant to this purpose, whether individuals may be permitted to designate the relevant relationships themselves, and whether recognition of alternative relationships might better serve the legislative purpose. Without examining these questions in detail, one might reasonably conclude that self-designation is inappropriate³¹ but that the credit should be available for any relationship in which support obligations are mandated by law. While the specification of these relationships is itself a matter of normative debate, this debate involves matters of family law and is beyond the scope of this comment.

THE GST CREDIT

The GST credit is a refundable tax credit, enacted when the federal GST was introduced in 1990 and intended to offset the regressivity of this consumption tax by providing quarterly payments to low-income Canadians. For 2001, the credit pays a maximum annual amount of \$205 for each individual plus an additional amount up to \$107 for individuals without a cohabiting spouse or common law partner.³² Where the individual's "adjusted income" exceeds \$26,284, the amount of the credit is phased out at a rate of 5 percent for each dollar above this threshold.³³

The term “adjusted income” is generally defined as the combined income of the individual and the individual’s spouse or common law partner.³⁴ As a result, the amount of the credit depends on conjugal relationships in two ways: determining the maximum amount that an individual may obtain, and computing any reduction in this amount where the individual’s “adjusted income” exceeds the dollar threshold.

The traditional justification for these references to conjugal relationships is twofold. With respect to the maximum amount of the credit, the lesser amount for cohabiting spouses and common law partners reflects the assumption that “by living together in such a relationship the individuals will realize economies in household production and consumption that will result in a higher standard of living for each.”³⁵ The reduction in this amount based on the individual’s “adjusted income,” on the other hand, reflects the empirical assumption that a low-income individual is “not likely to be in need” if accommodation is shared with a spouse or common law partner with sufficient income,³⁶ and a normative judgment that the primary obligation to support a cohabiting spouse or common law partner with little or no income rests on the other spouse or common law partner, not on the state. Notwithstanding these arguments, the commission opposes any reference to conjugal relationships in the GST credit, recommending that the computation of the credit should be completely individualized.

Beginning with the maximum amount of the credit, the report offers three reasons why it should not be reduced for cohabiting spouses and common law partners. First, it explains, “the validity of the factual assumption that there are consumption economies when two individuals cohabit in a conjugal relationship is at best questionable.”³⁷ On the contrary, it observes:

[S]ome individuals who enter into personal relationships might have been living with others, such as parents or roommates, before the relationship. For these individuals, cohabiting with another individual in a conjugal relationship might result in a loss of consumption economies. For other individuals, cohabiting with someone in a conjugal relationship might involve moving out of a single-bedroom apartment and into a two-bedroom apartment or even a house. For these individuals, consumption economies are likely to be small or nonexistent.³⁸

Second, the report continues, even if cohabiting individuals require fewer resources to attain the same level of economic welfare as persons living alone, the realization of these economies should not be penalized through the tax and transfer system.³⁹ Indeed, since economies can also be achieved “by buying goods in bulk, sharing consumer durables or car pooling, for example,”⁴⁰ the commission considers it questionable to single out economies attributable to cohabitation for special treatment. Third, the report emphasizes, even if such economies exist and should be taken into account in computing government transfer payments, “conjugal cohabitation has become an increasingly poor proxy for the identification of such economies.”⁴¹ Since non-conjugal co-residents retain any economies of scale from these arrangements, the report concludes, the GST credit discriminates against conjugal relationships.

With respect to the phaseout based on the combined income of spouses or common law partners, the report is somewhat less definitive. On the one hand, it observes, “it is not inconsistent for a control-based tax system to be based on individuals, while a needs-based income support program would combine the income of individuals who live together in interdependent relationships.”⁴² On the other hand, it continues, there are three reasons why individualization might be preferred. First, by reducing the credit for cohabiting couples, “the use of . . . combined income . . . in determining eligibility for income-tested benefits creates troubling disincentives” to the formation of conjugal relationships.⁴³ Second, by supporting low-income individuals regardless of the income of their spouse or common law partner, “an individual income test promotes autonomy and gender equality . . . [r]educing women’s economic dependence” on spouses or common law partners.⁴⁴ Finally, to the extent that the combined income test is designed to measure the individual’s economic well-being, the use of conjugality is a questionable proxy and the definition of other relationships is difficult to determine.⁴⁵ On balance, therefore, the report finds the case for individual income testing “compelling.”⁴⁶

While I agree with the report’s critique of reductions in the maximum amount of the GST credit for cohabiting spouses and common law partners, I am not convinced that the income phaseout should depend on individual income alone. Although the use of combined income can impose a financial penalty on the formation of conjugal relationships,⁴⁷ this cost is not substantial and may be outweighed by economies resulting from shared accommodation.⁴⁸ Although the report cites no empirical studies on the magnitude of any effect, US studies on the much greater impact of joint filing suggest that these financial costs affect only the timing of marriages, not the marriage rate itself.⁴⁹ Moreover, the GST credit, which provides a maximum annual benefit of \$312, cannot do much to promote autonomy and gender equality. These goals are more likely to be advanced through other tax and public policy measures, such as the repeal of income attribution rules for spouses and common law partners,⁵⁰ and the amendment of the child-care expense deduction to permit one parent to deduct payments to the other up to the maximum amounts allowed by the deduction.⁵¹ Finally, it is not impossible to define the relevant range of relationships for which incomes should be combined for the purposes of a phaseout, where the purpose of this combination reflects a normative judgment that the primary support obligation rests with one or more individuals rather than the state. For this purpose, however, as with the credit for spouses and common law partners examined earlier, it is necessary to refer to family law.

GENERAL CONCLUSIONS

For a report that affirms the recognition and support of close personal adult relationships as “an important state objective,”⁵² it might seem odd that the two most significant tax reform proposals disregard these relationships altogether, recommending that the tax credit for spouses and common law partners be repealed and that the GST credit be fully individualized. As the discussion in this comment

suggests, however, these recommendations reflect the commission's vision of close personal adult relationships as freely chosen by autonomous individuals whose rights and obligations relate mainly to the state rather than to one another. An alternative view is that close personal adult relationships are inevitably interdependent, creating mutual rights and obligations that are rightly taken into account in defining each individual's rights and obligations vis-à-vis the state. Given my objections to the commission's recommendations regarding the tax credit for spouses and common law partners and the GST credit, I suppose that I find the latter vision more attractive than the former.

NOTES

- 1 Law Commission of Canada, *Beyond Conjuality: Recognizing and Supporting Close Personal Adult Relationships* (Ottawa: Public Works and Government Services, 2001) (herein referred to as "the report" or "*Beyond Conjuality*"), available online at <http://www.lcc.gc.ca>.
- 2 *Ibid.*, chapter 3, part 1, at 29-37.
- 3 *Ibid.*, recommendation 2, at 32.
- 4 *Ibid.*, recommendation 3, at 33.
- 5 *Ibid.*, recommendation 4, at 36.
- 6 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA").
- 7 *Supra* note 1, recommendation 19, at 71.
- 8 *Ibid.*, recommendation 22, at 77. In addition to this recommendation, the report suggests that the credit should be replaced with "enhanced or new programs that more carefully target caregivers and children for direct income support."
- 9 *Ibid.*, recommendation 23, at 82, and recommendation 24, at 87.
- 10 *Ibid.*, recommendation 20, at 73. In addition to this recommendation, the report suggests that consideration be given to making these credits refundable or converting them into direct grants delivered outside the tax system.
- 11 *Ibid.*, recommendation 25, at 89.
- 12 *Ibid.*, chapter 3, part 2, section VIII.B, at 65-71.
- 13 See former subsection 252(4) of the ITA, added by SC 1994, c. 7, schedule VII (SC 1993, c. 24), section 140(3), applicable after 1992. For a detailed discussion of the implications of this amendment, see David M. Sherman, "Till Tax Do Us Part: The New Definition of 'Spouse,'" in *Report of Proceedings of the Forty-Fourth Tax Conference, 1992 Conference Report* (Toronto: Canadian Tax Foundation, 1993), 20:1-33.
- 14 See the definition of "common-law partner" in subsection 248(1) of the ITA, added by SC 2000, c. 12, section 139(2).
- 15 See paragraph (a) of the description of B in subsection 118(1) of the ITA.
- 16 See, for example, the statement of Eric Lowther, MP for Calgary Centre in Canada, House of Commons, *Debates*, February 2, 1999, 11345-47.
- 17 See, for example, Maureen A. Maloney, "What Is the Appropriate Tax Unit for the 1990s and Beyond?" in Allan M. Maslove, ed., *Issues in the Taxation of Individuals* (Toronto: University of Toronto Press in cooperation with the Ontario Fair Tax Commission, 1994), 116-54, at 135-37; Neil Brooks, "The Irrelevance of Conjugal Relationships in Assessing Tax Liability," in John G. Head and Richard Krever, eds., *Tax Units and the Tax Rate Scale* (Melbourne: Australian Tax Research Foundation, 1996), 35-80, at 72-73; and Claire Young, *What's Sex Got To Do with It? Tax and the "Family"* (Ottawa: Law Commission of Canada, May 2000), 52-59.

- 18 See the discussion of these issues in *Beyond Conjugalit*y, supra note 1, chapter 3, part 2, section VIII.A, at 63-65.
- 19 Ibid., chapter 3, at 75.
- 20 Ibid., at 76.
- 21 Ibid.
- 22 Ibid.
- 23 Ibid., at 75.
- 24 Ibid. While “tax policy analysis” is rarely clear on the concept of “ability to pay” and the report itself does not define the concept, the notion that the income tax should apply to income over which individuals exercise effective control suggests a concept that recognizes adjustments for costs that must be incurred to obtain the income and involuntary expenses associated with personal circumstances. This, at any rate, is the way that I understand the report’s concept of ability to pay.
- 25 Ibid.
- 26 Although the case for involuntariness is clearest where a supported spouse or common law partner is disabled, a taxpayer in this circumstance might be expected to qualify for the caregiver or infirm dependant credit; therefore, a separate credit for spouses and common law partners is not required. Even “capable” persons, however, can incur losses or experience involuntary unemployment.
- 27 For a persuasive critique of the idea that imputed income should be subject to income taxation, see Thomas Chancellor, “Imputed Income and the Ideal Income Tax” (1988) vol. 67, no. 3 *Oregon Law Review* 561-610.
- 28 Consider, for example, a spouse or common law partner enrolled in a university or college program that may leave less time for household chores than would a part-time job.
- 29 *Beyond Conjugalit*y, supra note 1, chapter 3, at 76, observing that “the effect of the loss of this credit on the work choices of the dependent spouse may not be significant.”
- 30 David G. Duff, “Disability and the Income Tax” (2000) vol. 45, no. 4 *McGill Law Journal* 797-889, at 857-58.
- 31 As the report itself concludes in its discussion of the credits for caregivers and infirm dependants, “relying solely on self-selection of qualifying dependency relationships may not be feasible since the potential for abuse is too great.” *Beyond Conjugalit*y, supra note 1, chapter 3, at 73. To the extent that these credits are viewed as tax expenditures designed to encourage taxpayers to support other individuals with little or no income, however, self-designation through the actual provision of care or financial support is entirely appropriate. Indeed, the report’s recommendation that the credits for caregivers and infirm dependants be available whenever taxpayers provide unpaid caregiving or financial support is consistent with this approach.
- 32 See subsection 122.5(3) of the ITA.
- 33 The credit is computed annually on the basis of the individual’s adjusted income in the previous year.
- 34 See the definitions of “adjusted income” and “qualified relation” in subsection 122.5(1) of the ITA.
- 35 *Beyond Conjugalit*y, supra note 1, chapter 3, at 78.
- 36 Ibid., at 83.
- 37 Ibid., at 80.
- 38 Ibid.
- 39 Ibid. Interestingly, if the credit for spouses and common law partners is retained, this argument would support increasing it to twice the basic personal amount.

- 40 Ibid.
- 41 Ibid.
- 42 Ibid., at 83.
- 43 Ibid.
- 44 Ibid., at 84.
- 45 Ibid., at 84-85.
- 46 Ibid., at 86.
- 47 In the most extreme example recounted in the report, two individuals earning \$25,000 would lose GST credits worth \$624 by choosing to cohabit in a conjugal relationship. See *ibid.*, at 84.
- 48 Although I concur with the report's view that these economies should not be taken into account in determining the maximum amount of the credit, they are relevant to evaluating the incentive effects associated with a phaseout based on combined income.
- 49 See, for example, David L. Sjoquist and Mary Beth Walker, "The Marriage Tax and the Rate and Timing of Marriage" (1995) vol. 48, no. 4 *National Tax Journal* 547-58.
- 50 See, for example, Brooks, *supra* note 17, at 74; and David G. Duff, "Neuman and Beyond: Income Splitting, Tax Avoidance, and Statutory Interpretation in the Supreme Court of Canada" (1999) vol. 32, no. 3 *Canadian Business Law Journal* 345-83, at 379. As Lisa Philipps notes in her contribution to this discussion, the lack of any commentary on the attribution rules is a curious omission in the report, particularly since two background studies prepared for the commission called for a review of these rules. See Kathleen A. Lahey, *The Benefit/Penalty Unit in Income Tax Policy: Diversity and Reform* (Ottawa: Law Commission of Canada, September 2000), 117-20; and Young, *supra* note 17, at 40-49.
- 51 See the discussion in the text accompanying note 30.
- 52 *Beyond Conjuality*, *supra* note 1, chapter 1, at 7.