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# THE IMPACT OF CHANGING PERCEPTIONS OF SOCIAL EQUITY ON TAX POLICY: THE MARITAL TAX UNIT\*

BY JACK R. LONDON\*\*

## I. INTRODUCTION

This conference is dedicated to a retrospective of the fate of a glorious and unparalleled piece of tax policy work: the Carter Royal Commission on Taxation.<sup>1</sup> In this paper, primarily by reference to the concept of a marital tax unit, I will look at what has happened to the recommendations made by the Commission on the appropriate impact that the federal income tax ought to have on women, and vice versa. In so doing, I will ignore the obvious impact that all of the recommended reforms would have had on all taxpayers, whatever their gender or status. I also intend to propose a redefined tax reform agenda insofar as it relates to families, and women in particular.

My overall theme is the impact of changing perceptions of social equity on tax policy in the context of women and taxation. My purpose, since I wrote so extensively on this subject in the early

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<sup>1</sup>Canada Royal Commission on Taxation *Report* (Ottawa: Queen's Printer, 1966) (Chair: K. LeM. Carter) [hereinafter *Report*].

to mid-1970s,<sup>2</sup> is to compare the change and growth in my own thinking on this issue throughout the intervening period with the actual systemic responses. Moreover, my recent experience as a member of the Federal Tax Force on Child Care<sup>3</sup> has left me less certain about relying on traditional and absolute notions of equity in the face of the pressing political and economic needs of disadvantaged groups, like women and children. However, to some extent, I must say, I feel a bit uncertain about my conclusions, much the way that sometimes I feel a certain discontinuity between my intellectual acceptance of much feminist philosophy on the one hand and my emotional responses, so long ago conditioned, on the other.

My thesis is fourfold. First, Carter would have treated married persons, indeed families, as both social and economic, *and therefore* taxable, units for all purposes of income determination and income tax assessment. The Commission would have aggregated income from all sources of both spouses and subjected it to special rates. It also would have exempted inter-spousal property transfers from recognition of immediate tax consequences.<sup>4</sup> The systemic response, to the contrary, at least on this first point, has been to maintain the pre-Carter notion of treating spouses as unattached individual tax units for most, though not all, purposes. But, at the same time, there has been added to the *Income Tax Act*<sup>5</sup> a long list of circumstances in which spouses are treated as if, indeed, they formed a marital tax unit. The result has been to exacerbate the schizophrenic and incoherent focus of the tax system on who should comprise the appropriate human tax units. The federal income tax

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<sup>2</sup>Law Reform Commission of Canada, *Tax and the Family*, by J.R. London, Background Paper (Ottawa: Law Reform Commission of Canada, 1975); J.R. London, "Taxation of the Family United" in *Proceedings of the 26th Tax Conference - 1974* (Toronto, Canadian Tax Foundation, 1975) 297; J.R. London, "Taxation of the Family: The Family as the Basic Tax Unit" (1979) 1 Can. Tax. 4.

<sup>3</sup>Appointed in May, 1984. Chaired by Katie Cooke. Canada, *Task Force on Child Care Report* (Ottawa: Status of Women, 1986) produced and published March, 1986 [hereinafter *Cooke Report*].

<sup>4</sup>*Report*, vol. 3, *supra*, note 1 at 142-49.

<sup>5</sup>R.S.C. 1952, c. 148, as amended. [Hereinafter sometimes referred to as "the *Act*." All statutory references herein are to the *Act* unless otherwise stipulated.]

system, more than ever before, lacks an intellectually or rationally defensible perspective on whether married persons are, or ought to be, considered tax units requiring aggregation of their joint incomes from all sources. In the result, the system is less equitable, both horizontally and vertically, than it could be, or than it would be, under an ideal tax system, when *only* tax equities are considered.

Second, I would argue that the system's schizophrenia and the inequity inherently resulting, (from the benchmark of an ideal tax system), was properly called into question, and attacked, by Carter in 1966. But I would further argue that changed economic and political equities and realities have rendered aggregation of all spousal income today, particularly earned income, impossible politically and unacceptable when viewed from the perspective of a number of new social equities. The most important of the new factors follow. On the one hand, there has been a vast increase in the participation rates of women in the work force. We also have seen the proliferation of marital property laws that favour deferred sharing of conjugal capital and marital assets, while concurrently reducing the extent of the traditional obligation of post-conjugal support owed by spouses, usually husbands.

The changes in marital property laws support the notion that marital units, while they exist, are economic partnerships that for tax purposes ought to lead to aggregation of marital income. The fact that property-sharing rights generally are deferred mitigates the weight of that conclusion but does not deny its essential validity. Similarly, increased labour participation rates of women, and the resulting income growth in their hands, make the decision on the appropriate tax unit more important than ever before.

On the other hand, in the years since Carter, we have witnessed significant increases in the divorce rate and in the formation of what one might once have called "non-traditional" family units: unmarried, heterosexual and homosexual. Moreover, we have also witnessed the growth of many new and different forms of income sharing and expenditure control patterns, even within what once would have been called "traditional" marital and family units.

These changes argue strongly in favour of greater and more secure forms of economic independence for women, both as of right and in the ever more important battle to stem the feminization of poverty. That, in turn, argues for treating women who earn income

as independent tax units so that they may benefit from the legislated income-splitting that occurs when the system does not aggregate marital income.<sup>6</sup> Even more significantly, as a society, we more clearly, though still embryonically, recognize the rightful independence of women from their husbands' economic control. It is, therefore, quite impossible, now, in a self-assessing system that depends on reasonable acceptance of its assumptions by the population, to aggregate the income of both spouses, as one, in a marital unit, even if it is then subjected to a special rate schedule taking into account that two cannot live as cheaply as one on the same gross income.

Therefore, I have changed my view. From purely the perspective of tax equity, I would argue, the marital unit made sense then and makes sense now, notwithstanding the evolutionary changes earlier identified. However, emotionally and politically, it no longer makes any sense at all, at least with regard to the aggregation of earned income.

My third premise generalizes the second. Experience since Carter demonstrates the fragile and temporal nature of the notion that tax equity, in preference to efficiency and even neutrality, is, or perhaps ought to be, the touchstone or fundamental principle of tax policy development. The politics of tax reform, it turns out, are equally important in all but the most fantastic, theoretical sense.

Fourth, and last, given the death of even the possibility of aggregating the income of marital partners, I would suggest that the tax reform agenda, as it affects women in particular, should be re-focused instead on a number of important details, including in particular:

1. Renovation of the marital status deduction<sup>7</sup> and the re-application of the some \$1.3 billion of annual tax expenditure

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<sup>6</sup>The phenomenon of income-splitting is well-known. It occurs when lower marginal rates of tax are applied to income. The inherent, and controversial, assumption here is that marital income, particularly earned income, is indeed unitary, so that the individual taxation of the spouses can be appropriately described by a term like income-splitting, which most often is associated with more obvious tax avoidance techniques.

<sup>7</sup>*Income Tax Act, supra*, note 5 at s. 109(1)(a)(ii), as indexed, by s. 117.1(1)(a).

that it involves at the federal level<sup>8</sup> (not to mention the quantum of provincial tax foregone).

2. Replacement by direct grants, in the long run, of the child care expenses deduction<sup>9</sup> and some \$115 million of tax expenditure it occasions.<sup>10</sup>
3. Provision, notwithstanding the inherent flaunting of pure principles of tax equity, of major tax incentives to employers and property developers in order to induce them to provide community-based and workplace day care facilities, to the benefit and relief of children and women.
4. Exemption of services, benefits, or vouchers for child care from recognition as a benefit in the income of employees, under certain circumstances.
5. Removal of the prohibition against the deduction of lump-sum alimony and maintenance payments,<sup>11</sup> in favour of a scheme of amortized deductions.
6. Reconsideration of the attribution rules,<sup>12</sup> yet once again, either to repeal them or to more fully aggregate joint marital income from property and from the disposition of property, regardless of the originating source of the invested funds.

I now propose to expand on each of the four parts of the thesis, in turn.

## II. TAX UNIT

The significant characteristics of the pre-Carter world were these:

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<sup>8</sup>As of 1983. Canada Department of Finance, *Account of the Cost of Selective Tax Measures* (Ottawa: Supply & Services Canada, 1985).

<sup>9</sup>*Income Tax Act*, *supra*, note 5 at s. 63.

<sup>10</sup>Task Force on Child Care, *Government Spending on Child Care in Canada* by C. Blain, Background Report (Ottawa: Status of Women Canada, 1985).

<sup>11</sup>*Supra*, note 5 at ss 60(b),(c), and (c.1).

<sup>12</sup>*Ibid.* ss 74.1-74.5.

1. Married persons did not file joint returns; rather, they filed as individuals.<sup>13</sup>
2. In computing taxable income, deductions were available to an income-earning spouse, say the husband, who supported a spouse, say the wife, who did not have income exceeding a relatively low threshold amount.<sup>14</sup>
3. Within that threshold amount, income earned by the wife effectively was taxed at the husband's marginal rate because he lost the married person's deduction as the dependent's (wife's) income increased. Income earned by the wife above the threshold was taxed as though she were an individual, and at her own rates.
4. Certain income, that is, income from property transferred from one spouse to another, was aggregated through the mechanism of the attribution rules; business income and property income on investments unilaterally originating with a spouse was not attributed.<sup>15</sup>
5. The imputed income derived from household services was not recognized.
6. Spouses could not deduct salaries paid to each other, even for legitimate income earning services.<sup>16</sup>
7. The Minister of National Revenue had discretionary power to reallocate the income of a spousal business partnership to one or the other spouse.<sup>17</sup>

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<sup>13</sup>*Frank Sura v. Minister of National Revenue* (1961), 62 D.T.C. 1005, [1962] C.T.C. 1 (S.C.C.).

<sup>14</sup>*Income Tax Act*, *supra*, note 5 at s. 109(1)(a)(ii), as previously designated and amended from time to time. The income limitation has varied over the years. Prior to the general reforms of 1971, the provision was found in s. 26 of the *Act*.

<sup>15</sup>*Ibid.* as amended up to but not including the general amendments of 1971 [hereinafter sometimes referred to as "the old *Act*"].

<sup>16</sup>*Ibid.* at ss 21(2)-(3).

<sup>17</sup>*Ibid.* at s. 21(4).

8. Child care expenses were not deductible.<sup>18</sup>
9. Periodic alimony and maintenance payments were deductible to the payer, usually the husband, and were included in the income of the recipient, usually the wife. Lump sum payments were not recognized for income tax purposes.<sup>19</sup> The restrictions on the form of deductible payment were many and were irregularly applied.<sup>20</sup>
10. Gifts and bequests were subject to gift and estate tax, and succession duty.<sup>21</sup>

Carter, drawing on the fact that virtually every other industrialized Western country at that time recognized the marital unit in some way,<sup>22</sup> recommended: aggregation of marital income from all sources, tax-free transfers of property between spouses, and recognition of the expenses of working women through the provisions of modest tax credits for working women with children. The income of the marital unit would be subjected to a separate rate schedule that would have relieved any additional tax on marriage resulting from aggregation at low income levels. The recommendations went further, in that a family tax unit, including dependent children, was proposed; but that is not our subject here.

Essentially, and very simplistically, the Commission favoured family joint filing of aggregated income for the following reasons:

1. It assumed, I would argue correctly at that time, that the family and the individual (not to mention the corporation) were the

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<sup>18</sup>Such expenditures were considered personal and living expenses the deduction of which was prohibited by *ibid.* at s. 12(1)(h), now 18(1)(h).

<sup>19</sup>*Ibid.* at s. 11(1)(l) and 11(1)(la) of the old *Act*.

<sup>20</sup>For example, *Sproston v. M.N.R.*, [1970] C.T.C. 131 (Exch.); *Trottier v. M.N.R.*, [1968] C.T.C. 324 (S.C.C.); *Brown v. M.N.R.*, [1965] C.T.C. 302 (Exch.); and *Foxcroft v. M.N.R.* (1963), 3 Tax A.B.C. 415.

<sup>21</sup>Gift tax was imposed under Part IV of the old *Act*. Estate tax was levied under the federal *Estate Tax Act* S.C. 1958, c. 29. Succession duties were levied provincially by Ontario, Quebec, and British Columbia.

<sup>22</sup>See O. Oldman & R. Temple, "Comparative Analysis of the Taxation of Married Persons" (1960) 12 *Stan. L. Rev.* 585.



predominant institutions in our community, both in social and in economic terms.<sup>23</sup>

2. Absent joint filing on aggregated income, basic principles of tax equity were offended. At the horizontal level, family units of equal income were not taxed similarly, preference being given to those family units with more than one earner. The more equal the distribution of income among earners in the unit, the greater the benefit from income-splitting. In other words, then, as now, one-earner units were discriminated against. Vertical inequity also results. The object of a progressive tax system, and graduated rates, is to redistribute income appropriately from those who have more to those who have less (the so-called ability-to-pay principle, in the allocation of the tax burden).<sup>24</sup> To do so properly requires an appropriate definition of economic capacity in measuring income. Since married people, according to the first point, constitute an economic unit, vertical equity could be maintained only if the income of the married couple was measured, through a process of aggregation, against the income of other properly defined units.
3. Principles of tax neutrality would not be offended by aggregation because the decision to marry, it was assumed, would not be affected by a moderate increase in the fiscal burden on marriage.<sup>25</sup>
4. Tax free transfers of property between spouses and other family members were desirable and not to be inhibited. Indeed, that conclusion evidenced the real economic mutuality of the marital unit and argued for aggregation. Aggregation would also mitigate the long-acknowledged problems in the sieve-like system of attribution rules, while reducing the frequency and wastefulness of efforts on the part of taxpayers to avoid them. Aggregation would dispense with the need for attribution.

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<sup>23</sup>Report, vol. 3, *supra*, note 1 at 123.

<sup>24</sup>For a comprehensive discussion of progressivity, see W.J. Blum & H. Kalven, *The Uneasy Case for Progressive Taxation* (Chicago: University of Chicago Press, 1978).

<sup>25</sup>Report, vol. 3, *supra*, note 1 at 123.

5. For the first time in Canadian fiscal thought, the Commission assumed that the costs of child care affected a unit's ability to pay tax; that those costs were dissimilar to other personal consumption choices; and therefore, that they should be recognized by way of modest tax credits.<sup>26</sup>

In my own work, I supported aggregation and joint filing essentially for those reasons.<sup>27</sup> The government of Canada did not. In the *White Paper* on tax reform<sup>28</sup> and in the legislation that followed,<sup>29</sup> it rejected aggregation of all income of married persons and joint filing, though it left the door open for future reconsideration. The rejection was founded on two bases:

1. Aggregation would lead to an unacceptable tax on marriage, in that a husband and wife, each having an income, would together pay more tax than two unmarried persons having the same income. It was also noted that the effect of the marital unit generally would be to subject the woman's income to a higher rate of tax than it would have borne if she were single.
2. The government was unprepared then to undertake the design of mechanisms, like separate rate schedules, that would alleviate the burden, at least at low-income levels. Rather, it deferred consideration to "a further installment of reform," which has never arrived.<sup>30</sup>

In other words, I would argue, the federal government chose to maintain one inequity rather than another. By rejecting the marital tax unit in 1971, the federal government continued to favour families with one income, earned or unearned, whose after-tax income would be less than the after-tax income of two-earner couples of identical income. Both the woman and man in a one-earner, married couple were adversely affected. On the other hand,

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<sup>26</sup>*Ibid.* at 227-29.

<sup>27</sup>Indeed, as did Carter, I recommended a family as well as a marital unit.

<sup>28</sup>Hon. E.J. Benson, Minister of Finance, *Proposals for Tax Reform* (Ottawa: Queen's Printer, 1969) [hereinafter *White Paper*].

<sup>29</sup>*Income Tax Act, supra*, note 5 as am. S.C. 1970-71-72, c. 63.

<sup>30</sup>*White Paper, supra*, note 28 at 15, s. 2.5.

the same policy decision ensured the further inequity that two-earner married couples would have essentially the same after-tax income that they would have if they were not married and cohabitating, notwithstanding the economies of cohabitation.<sup>31</sup> The government's preference was expressed in order to avoid a so-called tax on marriage, justifiable though such a tax may have been.

In retrospect, the inarticulate premise of the government, conscious or not, was to support and prefer, in a small way, working women and women with capital, to women who worked in the home or who had no capital. That preference arguably was understandable, given the fact that the imputed income of those women who worked in the home was also not recognized. But then, neither were any of the other forms of imputed income.<sup>32</sup>

Therefore, from a perspective of pure tax equity, and given the then general acceptance of the married couple as an economic unit, the government's decision was wrong because it perpetuated both the horizontal and vertical inequities earlier referred to in this paper.

Indeed, a simple catalogue of the amendments promulgated to the *Act* since Carter substantiates the conclusion that married persons were, and are, considered, in fact, to be an economic unit; whether one uses the test of income-pooling, sharing of benefits received from expenditure, or saving of joint incomes. That conclusion is somewhat less defensible, and perhaps dependent on income level, if the test applied is whether one of the spouses, usually the husband, typically controls the level and character of expenditure and saving.<sup>33</sup>

Back to the catalogue; first, of those changes since 1966 that are neutral in the debate. They include:

1. Periodic changes in the rate schedule and in the quantum of deductions and credits, including indexing. Arguably, increases

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<sup>31</sup>Given changed social standards, it should be noted that such economies then were more clearly associated only with couples who were legally married.

<sup>32</sup>For example, the imputed income derived from owner-occupied housing.

<sup>33</sup>See, for example, L. Dulude, "Taxation of the Spouses: A Comparison of Canadian, American, British, French and Swedish Law" (1985) 23 *Osgoode Hall L.J.* 67 at 89.

in the amount of the marital exemption have given special benefit to dependent spouses at home. But there has been no change in principle, only in amount.

2. Since 1971, the recognition of gain and loss on the disposition of property; that is, capital gains and capital losses,<sup>34</sup> the specification of the fair market value rule as the deemed consideration in non-arm's-length transactions,<sup>35</sup> and deemed realization of property immediately before death.<sup>36</sup> In fact, the expressed exceptions to these rules, outlined below, are the more crucial phenomena.

The amendments to the *Act* in the intervening period, that can be said to have recognized the economic individuality of spouses, notably women, are as follows:

1. The repeal of the prohibition on the deduction of salary expense paid by one spouse to another (or to a spouse from a partnership of which the other spouse was a member.)<sup>37</sup>
2. Repeal of the ministerial discretion to allocate all or part of the income of a partnership of spouses to one or the other of the spouses.<sup>38</sup>
3. Substantial revision and enlargement, over the years, of the deduction to the payer of alimony and maintenance payments, with consequent inclusion of those amounts in the income of recipients, generally wives.<sup>39</sup> Though arguably these amendments have been neutral for purposes of the current debate, they can be viewed as representing increased recognition of the

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<sup>34</sup>*Income Tax Act, supra*, note 5 at s. 3(b).

<sup>35</sup>*Ibid.* at s. 69.

<sup>36</sup>*Ibid.* at s. 70.

<sup>37</sup>*Ibid.* at ss 74(3)-(4) repealed by S.C. 1980-81-82-83, c. 48, s. 40(1), applicable with respect to remuneration paid after 1979 for services rendered as an employee after 1979.

<sup>38</sup>*Ibid.* at s. 74(5) repealed by S.C. 1980-81-82-83, c. 48, s. 40(1), applicable to fiscal periods ending after 11 December 1979.

<sup>39</sup>*Ibid.* at ss 60(c.1) and 60.1.

independence, economically and socially, of separated spouses prior to divorce. They are therefore included in this listing.

4. Removal of attribution, in 1987, in the case of property transactions between spouses at market values.<sup>40</sup>

Contrasted with those changes that either have been neutral or have at least evidenced a politically sensitive notion of the economic independence of married persons, is a much longer list of promulgated amendments that reiterate and re-confirm the intuitive notion that married persons do in fact represent an economic unit that should be recognized as having tax-paying capacity. They are as follows:

1. Implementation of the child care expenses deduction, which not only recognized the impact of having children on the ability of working spouses to pay tax, but limited the availability of that deduction to the lower-earning spouse.<sup>41</sup>
2. A number of provisions in the system that allow for the transfer of deductions from one spouse to another in order to maximize their utility — for example, pension-income deductions and the \$1000 interest, dividend, and capital gains exemption.<sup>42</sup>
3. The 1985 amendment of the attribution rules, intended to close loopholes by aggregating income from property lent from one spouse to another,<sup>43</sup> or transferred or lent to corporations controlled by one's spouse or family members,<sup>44</sup> and to prevent reverse attribution schemes that would benefit the marital unit.<sup>45</sup>
4. The promulgation of rollovers, both *inter vivos*<sup>46</sup> and on death,<sup>47</sup>

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<sup>40</sup>*Ibid.* at s. 74.5(1).

<sup>41</sup>*Ibid.* at s. 63.

<sup>42</sup>For example, *ibid.* at s. 110.3.

<sup>43</sup>*Ibid.* at ss 74.1 and 74.2.

<sup>44</sup>*Ibid.* at s. 74.4.

<sup>45</sup>*Ibid.* at s. 74.5(11).

<sup>46</sup>*Ibid.* at s. 73.

in the case of transfers of property between spouses. The rollovers constitute exceptions to the general rule requiring realization of inherent income or loss on the disposition of property at any time, or on death,<sup>48</sup> and the normal recognition, at that point, of capital gains, capital losses,<sup>49</sup> and recapture of capital cost allowances<sup>50</sup> or terminal loss.<sup>51</sup> The provisions clearly acknowledge the marital unit.

5. Extension of the prohibition against the deduction of superficial losses<sup>52</sup> in situations not only where the taxpayer himself or herself reacquires the property within the limited time period, but in situations where his or her spouse reacquires that property.<sup>53</sup>
6. Provision for the deduction of contributions made on behalf of a spouse to a registered retirement savings plan and certain other deferred-income plans.<sup>54</sup>
7. Recognition of spouses as preferred beneficiaries, thereby allowing for a deduction by trusts of accumulating trust income, contrary to the general rule.<sup>55</sup>
8. Repeal of the federal gift tax and estate tax, and provincial succession duty legislation, with inherent benefits to spouses, even acknowledging the spousal rollover provisions that were therein generally provided.

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<sup>47</sup>*Ibid.* at s. 70(6).

<sup>48</sup>*Ibid.* at s. 70.

<sup>49</sup>*Ibid.* at s. 39.

<sup>50</sup>*Ibid.* at s. 13(1).

<sup>51</sup>*Ibid.* at s. 20(16).

<sup>52</sup>*Ibid.* at s. 40(2)(g)(i).

<sup>53</sup>*Ibid.* at s. 54(i).

<sup>54</sup>*Ibid.* at s. 146(5.1).

<sup>55</sup>The definition of "preferred beneficiary" is found *ibid.* at s. 108(1)(g). The exception to the general rule is in s. 104(12). The general rule is found in s. 104(6)(b).

9. A series of adjustments of the surrogate liability for payment of tax by a spouse under section 160 of the *Act*, where property has been transferred between spouses and on tax refunds. The changes generally have the effect of recognizing the economic mutuality of marital relationships and the likelihood of collusion to avoid payment of tax.
10. The required rollover of the cumulative eligible capital of a business proprietorship on a transfer of the business to a spouse or to a controlled corporation, thereby denying deduction to the unit of what otherwise would have been a deductible loss in an arm's-length situation.<sup>56</sup>
11. Protection of the exemption of principal residences from recognition of capital gains income after being transferred to a spouse or a spousal trust. That is, the character of the principal residence, while owned by the transferor spouse, is carried over to the transferee spouse.<sup>57</sup>
12. Allowing the deduction of moving expenses, job- or school-related, including those of one's spouse and household.<sup>58</sup>
13. The provision of a refundable child tax credit, having the unique and progressive feature under which it begins to vanish at joint spousal income levels above \$23,500 as of 1986.<sup>59</sup>
14. As a result of amendments to the Canada Pension Plan, effective 1 January 1987, Canada Pension Plan benefits may be divided between spouses upon the application of either spouse. The notion of spouses being an economic unit is recognized. Normally, such a transfer would have resulted in attribution of the income for income tax purposes. The 18 February 1987

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<sup>56</sup>*Ibid.* at s. 24(2).

<sup>57</sup>*Ibid.* at ss 40(4)-(5).

<sup>58</sup>*Ibid.* at s. 62(3).

<sup>59</sup>*Ibid.*

budget proposed to except such payments from the attribution rules.<sup>60</sup> Here, contrarily, the individual notion is recognized.

15. The introduction, in 1986, of the section 122.4 refundable tax credit, designed to offset, for low-income earners, the concurrent increase in federal sales tax rates effective April 1, 1986. The credit vanishes at \$15,000 of aggregated spousal income.<sup>61</sup>

I conclude, then, on this first point, in this way. Before Carter and after Carter, the federal income tax fundamentally treated, and treats, married persons for tax purposes as individuals, because it does not require joint filing of aggregated income from all sources. From a purely tax-equity perspective, that treatment is not defensible. It produces both vertical and horizontal inequity in the allocation of the tax burden because of the income-splitting inherent in individual filing. Central to these observations are two assumptions: first, that married persons do, in fact, represent an economic partnership; and second, that adopting the marital unit arbitrarily would be a reasonable compromise, a kind of shorthand, in the otherwise inevitably impossible, but necessary, search to find those units, married, family, or household, that *actually* pool and share their incomes and whose members' incomes therefore should be taxed in aggregate.<sup>62</sup>

Moreover, legislative amendments since Carter have exacerbated the patchwork of the system by focusing overwhelmingly on the premise that marital partners are tax units. Those amendments have been motivated by a perceived need either to reduce the efficacy of tax avoidance mechanisms, which split income within the marital or family unit (itself the tip off to economic mutuality), or to mitigate the revenue loss of various tax expenditure programs. Indeed, even the most ardent advocates of individual taxation usually favour measuring entitlement to social assistance benefits, whether delivered by direct or tax expenditures, according

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<sup>60</sup>Hon. M. Wilson, Minister of Finance, *Notice of Ways and Means Motion Relating to Proposed Amendments to the Income Tax Act* (Ottawa: Department of Finance, 1987) at cl. 19.

<sup>61</sup>*Ibid.* at s. 122.4(2).

<sup>62</sup>The alternatives that might be considered are more fully canvassed in *Tax and the Family*, *supra*, note 2 at 13-16.



to aggregated spousal income levels.<sup>63</sup> The result, simply stated, is an unfocused, incoherent, and irrational system.

### III. TAX INEQUITY VS. POLITICAL REALITY

Having said that, and being aware of how much has not been said, I move on to the second point. As I indicated earlier, politically and emotionally the idea of employing the marital tax unit as a means of aggregating spousal income from all sources is dead and, perhaps, rightly so. Many knew that long before I did, even in 1966. Some argued that taxation of the unaggregated individual was a matter of civil rights.<sup>64</sup> Others could find no satisfactory criteria on which to decide between the various approaches.<sup>65</sup> Most agreed that the real issue was not whether one used the marital unit but how one treated it in the scheme of progressivity.<sup>66</sup> Some simply said, and say, that spouses are not a unit at all, though they generally acknowledge that tax avoidance schemes involving family members need to be stopped.<sup>67</sup>

I have said already that the importance of the issue has been magnified by the increase in women's labour participation rates and, therefore, income share. Moreover, I have argued, the fact of the economic marital partnership has been confirmed by the proliferation of provincial marital property laws and amendments to the *Income Tax Act* promulgated these last twenty years, on top of those provisions already there in 1966 — most of which act as signposts pointing to joint filing, as a marital unit, of aggregated income.

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<sup>63</sup>See, for example, Dulude, *supra*, note 33.

<sup>64</sup>R.D. Brown, "The Family Unit" in *Proceedings of the 20th Tax Conference - 1967* (Toronto: Canadian Tax Foundation 1967) at 109-110.

<sup>65</sup>Blum & Kalven, *supra*, note 24 at 16.

<sup>66</sup>Great Britain, Royal Commission on Taxation on Profits and Income *Report*, vol. 2 (London: H.M. Stationery Off., 1954) at 35.

<sup>67</sup>For example, B.T. Bittker, "A 'Comprehensive Tax Base' as a Goal of Income Tax Reform" (1976) 80 Harv. L. Rev. 925 at 976.

The other hand is more weighty in the result. First, there is the growth in divorce rates, which test the stability of the institution of marriage and hence the economic partnership notion, not to mention its impact on the feminization of poverty. Add in the increase in the number of non-traditional living units and the varying patterns of fiscal management found within them, and in the more traditional variety. Finally, there is the important, indeed crucial, intuition that labelling women as anything but independent persons is politically unacceptable and, more important, is harmful to the growth and development of equal gender rights, both social and economic. All of these argue for individual, not joint, unit status.

The equitable approach then, viewed dispassionately, and taking only tests of equity into account, must yield, in this case, to the new social and political paradigm. Fiscal policy that favours and facilitates the emerging economic independence of women who earn income is to be given primacy of place.

#### IV. TAX EQUITY – A FAILING PRINCIPLE OF CONFLICT RESOLUTION

Which brings me to my third point. The Carter notion, on which so many of us have depended for so long, that in the case of a conflict of objectives, tax equity should prevail, seems to be crumbling, if it is not already gone. I may overstate some, but not by much.

Perhaps, once, I was simply naïve. I dismissed as indefensible the tendency of tax legislation to prefer increased yield to fair distribution, incentive to justice, popular acceptance to correct action, and politics to equity.

I have since learned much. For example, I have learned that the best of policy intentions is irrelevant if it cannot easily be translated into a relatively manageable line on the tax return. I have also learned, and have now internalized, the lesson that whatever one might have done in designing a system not yet in place, there are certain pillars of a system already in place that are virtually impossible to recast. The nonrecognition of the marital or family unit for all purposes of tax burden allocation is just such a pillar.

What then remains of tax equity as a decisional tool? How would one recast the Carter philosophy so that it more realistically may be employed?

Carter suggested four objectives for the Canadian tax system:

1. to maximize the growth of output;
2. the equitable distribution of output (which included the subordinate concepts of taxation according to ability to pay, the recognition of the family as a unit for tax purposes, reduced tax burdens on those with non-discretionary expenditures, and the avoidance of special concessions to industries or kinds of income);
3. the protection of individual rights and liberties; and
4. the strengthening of federal—provincial relations.<sup>68</sup>

Those objectives survive intact and ought to be universally accepted, even today. However, while Carter acknowledged that there would be conflict between those objectives and that compromise would be situational, the Commission gave "equity" primacy of place, though even it would yield in appropriate cases.<sup>69</sup> It seems to me that it is this conflict resolution principle in favour of equity that must be recast if the family, or at least married persons, are not to be tax units. I would argue that my own shift in perspective, and the death of even an intrigue with the joint return system, lead exactly to that conclusion; that is, equity will not inevitably be the resolving principle.

The four Carter objectives more or less frame the decisional process in matters of tax policy. When there is conflict between objectives, equity, defined in traditional Carter terms, should normally prevail. But, even Carter-like equity must yield in certain circumstances. For our present purposes one of those circumstances will be where, *at least in a transitional period*, a disadvantaged group, like women, seeks to equalize its bundle of social and economic rights. Under such circumstances, pure tax equity tests must yield to the social and economic equities of equalization. To be sure, as Carter said, the *onus* clearly remains on those who would argue

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<sup>68</sup>Report, vol. 2, *supra*, note 1 at 7, 18-19.

<sup>69</sup>*Ibid.* at 19 n.4.

against employing fiscal equity as the resolution principle to demonstrate the necessity of departure therefrom. But if the onus is met, as it seems to have been in this case, tax equity must yield, even to the extent of discriminating against one part of the disadvantaged group, in this case, women who form part of one-earner family units, or more precisely, marital units in which taxable income is unequally earned by the spouses.

## V. TAX REFORM

Let me then turn to my last series of points, a revised tax reform agenda insofar as it directly and particularly affects the taxation of women. I have suggested five agenda items, which I will now briefly canvass in turn.

First, the marital dependency deduction, otherwise known as the married status deduction.<sup>70</sup> Its repeal has often been suggested, most recently by the former Minister Responsible for the Status of Women,<sup>71</sup> and by the Carter Commission and the Royal Commission on the Status of Women before her.<sup>72</sup> The deduction, in 1987, amounts to \$3700 for a taxpayer whose spouse earns less than \$520, above which income level it vanishes, dollar for dollar earned. If the deduction can be defended, the defense rests on 3 grounds:

1. It arbitrarily offsets the income-splitting preference the system now gives two-earner couples, and it reduces the relative burden of a married couple who together have the same quantum of income as an unattached individual, but which income must support two rather than one. However, if one considers also the non-inclusion of imputed household income, together with the

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<sup>70</sup>*Income Tax Act, supra*, note 5 at subs. 109(1)(a)(ii).

<sup>71</sup>Judy Erola then was the Minister Responsible for the Status of Women. Her suggestion touched off a storm of protest which caused her to back down; that is, politics, not equity, triumphed. See, "Cut back spousal tax break Erola says," *The Globe & Mail* (6 January 1983) 1; "Mrs. Erola errs," *The Globe & Mail* editorial (7 January 1983) 6; "Erola's proposal to curb spouse tie called thoughtless," *The Globe & Mail* (11 January 1983) 6; "The spousal deduction," *The Globe & Mail* editorial (11 January 1983) 6.

<sup>72</sup>Royal Commission on the Status of Women in Canada, *Report* (Ottawa: Information Canada, 1970) (Chair: F. Bird) at 293, para. 11.

non-deductibility of many kinds of working expenses, the argument is substantially weakened.

2. The deduction provides the one tangible form of recognition offered by the tax system to women at home. A matter of pride and self-image is at stake for those who choose, or are forced, to work in the home without market wages.
3. If increased public funding is to be provided for a public national day care system, the marital status deduction arguably provides a measure of fiscal balance for women (or men) who would stay home to care for their children. The argument, of course, is weakened substantially by the fact that the deduction is universally accessible, whether or not there are dependent children in the unit. Moreover, where a spouse works at home, the unit already is the beneficiary of a large tax subsidy through the non-inclusion of imputed income from such services.

The arguments favouring reform of the deduction, on the other hand, are more persuasive:

1. First, the deduction, like all deductions, delivers an upside-down benefit; greatest to those who need it least. At worst, the deduction should be converted into a credit favouring lower-income taxpayers.
2. It stigmatizes women who work in the home as "dependent". It therefore has a negative labelling effect, which was the reason the Royal Commission on the Status of Women recommended its abolition.<sup>73</sup>
3. It encourages the dependency of women and provides something of a disincentive to part-time employment, particularly for women, since the first dollars earned are taxed, in effect, at the husband's higher marginal rates. Since first-time labour force entry often is on a part-time basis, the disincentive can be quite onerous.

In my view, the deduction should be converted to a credit, available only to those units with dependent children at home, that vanishes as income increases. If that were done, no further argument of policy could reasonably be heard for diverting more

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<sup>73</sup>*Ibid.*

public funds to those who care for children at home at the expense of badly needed funding for public child care.

I turn now to the child care expenses deduction.<sup>74</sup> The current deduction is the major source of federal contribution to non-parental child care in Canada. Recently, I had occasion to review the deduction as part of my work as a member of the Federal Tax Force on Child Care. I will here summarize our findings, with which I concur.<sup>75</sup>

1. The provision of stable, good-quality, and universally accessible and affordable child care, in the long run, will be enhanced by public funding directed to those who supply the services. Parents will more clearly benefit from that policy option than from an option that would direct public funds, particularly by way of a tax expenditure, to users. Funding users will not produce a rational, national child care system. Therefore, in the long run, the child care expenses deduction should be phased out, but only after universal, quality child care services are available to all who choose to access them. In the meantime, the current deduction should be retained, as is, in order to bridge the time gap to a fully funded system. But additional expenditures of public funds will better be made, in the interim period, by direct grants to service suppliers.
2. The deduction is popular. To a certain extent it offsets the negative, anachronistic effects of the married status deduction; somewhat balances the untaxed preference given non-market household services; and is relatively neutral in terms of choice of care format, though given its deduction limits it favours less expensive, lower quality care.
3. On the other hand, like all deductions, it gives an upside-down benefit; the inherent, absurd assumption being that need rises with income. Also, because in a two-parent family the lower-earning spouse must claim the deduction, its benefit is not

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<sup>74</sup>*Income Tax Act, supra*, note 5 at s. 63.

<sup>75</sup>*Cooke Report, supra*, note 3. A summary of our Recommendations is found in Appendix B at 373-78. A full analysis of the child care expenses deduction is found at 165-75. Recommendations with regard to it, and other related matters, are found at 295-301. The comments that here follow are all there to be found.

available to families without taxable income or those in which one of the parents has little or no income, for example in a loss year. Students are particularly disadvantaged. The support derived from the deduction arrives after the tax year ends, though month-to-month support normally is required. Moreover, because much child care is provided in the grey market without receipts, though receipts are a requirement for the deduction, many parents cannot use the deduction. Many do not take advantage of it simply because of the complexity and difficulty in understanding it. In fact, our research disclosed that most parents having children in non-parental care do not take advantage of the deduction.

Therefore, its long-term utility is problematic. If the child care expenses deduction were to continue to be a financing format for child care, which is not recommended, then reform should proceed along the lines of converting the deduction into a refundable tax credit of much greater amount, which would reflect the true cost of child care as an expense of earning income. Current limits on the deduction are unreasonably low.

The Task Force recommended that a number of measures be introduced into the tax system to provide incentives designed to increase the supply and accessibility of public child care spaces in Canada. The recommendations include the following:

1. All capital costs of child care facilities, incurred either by employers on behalf of employees, or by owners of revenue-producing property, should form a new class of depreciable property bearing a capital cost allowance rate of 100 percent, which should not be subject to the rule that reduces the allowance by 50 percent in the year the cost is incurred.<sup>76</sup>
2. At the present time, it is unclear whether the provision by an employer of free or subsidized child care services constitutes a taxable benefit to employees under section 6 of the *Act*. The Task Force, with my concurrence, has recommended that child care benefits provided by employers to employees (whether in the form of cash payments, facilities, or services) not be included in employment income so long as the services provided or

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<sup>76</sup>*Income Tax Regulations*, C.R.C. 1977, c. 945, s. 1100(2).

purchased are licensed by a provincial authority and the benefit is universally available to all employees, regardless of rank.<sup>77</sup>

The motivation for these tax reforms is the need to increase the availability and supply of child care places in Canada, in order to ease the current child care crisis. The Task Force recognized that, in making these recommendations, notions of both horizontal and vertical equity would be offended. For one thing, the value of a non-taxable fringe benefit is greater to those in higher income brackets. For another, child care fringe benefits would be treated more favourably than other forms of fringe benefits. Lastly, we would be using the less preferable mechanism of a tax expenditure rather than the more accountable and efficient mechanism of a direct expenditure grant.

However, consistent with my argument that tax equity may no longer be necessarily the exclusive principle by which to resolve conflicts between objectives, I would defend the Task Force recommendations on political grounds; that is, the need to act quickly and effectively to remedy a crisis that, to a large extent, affects two disadvantaged groups, children and women. It is one thing to argue in theory. It is another to deliver programs in practice.<sup>78</sup>

I now turn to the tax treatment of alimony and maintenance payments.<sup>79</sup> As an analogue to the deduction allowed for capital cost allowances in computing business and property income, I would recommend allowing amortized deduction for lump sum payments made in fulfillment of alimony and maintenance obligations. Such payments are not to be confused with transfers or divisions of marital property under provincial deferred marital property-sharing laws.

The current tax system, which requires periodicity of payment as a prerequisite for deduction, suffers from a serious defect: it is not neutral. Because the income-splitting features of the deduction are compellingly attractive, it encourages the structuring of marital

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<sup>77</sup> *Cooke Report, supra*, note 3 at 300.

<sup>78</sup> *Ibid.* at c. 15.

<sup>79</sup> I return here to an idea first promulgated by me in *Tax and the Family, supra*, note 2 at 289-97. The notion is there more comprehensively and clearly canvassed.



settlements on a continuing, periodic basis. That, in turn, often leaves women dependent for years after dissolution of cohabitation, still at the mercy of their husband's ability or willingness to make the payments on time, or at all. Many husbands use the tool as a hammer.

Since, in many cases, payment can be accommodated either on a periodic or lump-sum basis, the tax deduction is simply an element, though a key one, in determining quantum. The tax system, presumably with little or no revenue loss, could be amended to make the choice of payment-format relatively tax-neutral. In order to prevent artificial tax-avoidance planning and to ensure that short term separation does not lead to inordinate tax benefits, the system could, for example, provide that lump sum payments be deductible at the straight-line rate of, say, 20 percent each year for five years. Equal amounts would be included in the income of the recipient. Given the current trend towards short-term "rehabilitative maintenance,"<sup>80</sup> the neutrality of the system, and its equity, would be enhanced. More important, the long-term dependency of some women would end.

Lastly, I address the need, yet once more, to amend the attribution rules, both with regard to income earned from property and capital income realized on the disposition of property. Two quite distinct alternatives might plausibly be considered. On the one hand, perhaps the attribution rules should be repealed entirely, as was the prohibition against deducting salary expense paid to a spouse or the spouse of a partner.<sup>81</sup> If, in fact, married persons do not constitute an economic and marital tax unit, and if one chooses to encourage transfers of property ownership to spouses, notably women (perhaps subject to a requirement that there be a truly effective change in control), then the attribution rules are nonsensical and problematic.

If the rules were repealed, three results are predictable. First, the burden would be more accurately, and therefore more equitably, focused on the legal owner of the income. Second, the

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<sup>80</sup>For example, C. Davis, *Principles Involved in the Awarding of Spousal Support* (1985) 46 R.F.L. (2d) 210.

<sup>81</sup>*Supra*, note 37.

current schizophrenia of the *Act* on unit selection would be significantly reduced. And third, given the obvious and large benefits to be obtained from income-splitting, significant transfers of ownership and control of property would be effected, at least between spouses, presumably to the benefit of women.

On the other hand, if, as I believe, the main beneficiaries of such income-splitting arrangements are higher-bracket taxpayers, then repeal of the attribution rules would be more regressive than is tolerable. Here, I prefer equity to affirmative action. Therefore, repeal, in my view, would not be progress.

Indeed, quite to the contrary, since the very object of the attribution provisions is to prevent income-splitting, it is hard to comprehend why the attribution provisions apply only to property that has once been transferred or lent by one spouse to another, or property substituted therefore. Surely the underlying rationale and theory of such a system must be the economic and social unity of the family or, at least for the purposes of this discussion, spouses. The attribution rules should therefore apply to all investment income of a marital unit and all capital income of that unit, regardless of the original source of the investment funds. The marital tax unit may be dead in time, but there is no reason to prevent restricting the effects of its demise essentially to matters of earned income, while continuing to consider unearned income for aggregation.

And so, it seems, one comes full circle. The marital, let alone the family, tax unit is dead and rightly so. Perhaps the reason is that circumstances and institutions have changed so significantly in the past decade that married couples really can no longer be assumed to be economic units with tax-paying capacity. It is more likely, however, that, given a feminist agenda, political and social equities have outweighed pure tax equity in the selection of the appropriate tax unit.

But I end with the caution that the concession is not absolute. Where, as in the case of the attribution rules, the effect of preferring politics to tax equity would lead to an outrageous transgression of both horizontal and vertical notions of tax equity, the latter still should prevail.

