CANADA

STUDIES

of the

ROYAL COMMISSION ON TAXATION

Number 10

Taxation of the Family

by

E. J. Mockler, B.A., B.C.L., LL.M.
Hanson, Gilbert & Mockler,
Fredericton

John G. Smith, B.A.(Law)
Russell & DuMoulin
Vancouver

Claude Frenette
B.A., B.Com., LL.L., M.A., M.Com.
Office of the Minister of Forestry
Department of Forestry
Ottawa

June 1964

Available by mail from the Queen's Printer, Ottawa,
and at the following Canadian Government bookshops:

HALIFAX
1735 Barrington Street

MONTREAL
Æterna-Vie Building, 1182 St. Catherine St. West

OTTAWA
Daly Building, Corner Mackenzie and Rideau

TORONTO
221 Yonge Street

WINNIPEG
Mall Center Bldg., 499 Portage Avenue

VANCOUVER
657 Granville Street

or through your bookseller

Price $1.50 Catalogue No. Z1-1962-1-1-10

Price subject to change without notice

ROGER DUHAMEL, F.R.S.C.
Queen's Printer and Controller of Stationery
Ottawa, Canada
1967

This is one of a series of studies that have been prepared for the Royal Commission on Taxation. Although these studies are published under the auspices of the Commission, this does not necessarily imply that the Commission agrees with the views expressed.

TABLE OF CONTENTS

CHAPTER 1—INTRODUCTION AND PRESENT SITUATION IN CANADA

INTRODUCTION

One of the advantages of the personal income tax over other taxes is its potential equity through flexibility. It can be related to an individual's resources and activities, geared to the size of his income by progressive rates, and fitted by means of exemptions and allowances, to his particular economic circumstances engendered by family responsibilities. Indirect taxes cannot, by their very nature, have regard to such subjective problems. Their simplicity is outweighed by their inequity, while the personal income tax can allocate the tax burden in accordance with the twin ideologies of equity and ability to pay; at the same time, it is able to raise a large proportion of the national revenue, and also to redistribute wealth.

Such a powerful weapon must be constructed with care; from the standpoint of the taxpayer, after the basic problem of the concept of income and the related problems of deductions allowed to arrive at net income have been decided on, the following broad areas concern him most:

(1) the tax unit,

(2) initial exemptions and allowances,

(3) the rate structure.

Although separately considered, the interrelation of these subjects means that each must be considered in the light of the others. Only an overall plan involving all three makes any sense.

In this study we shall be concerned with the treatment of the family by the tax laws. We shall deal with transactions between family members, with tax avoidance possibilities through income-splitting, the present taxation of employer-employee relations in the family setting, the gift tax laws, the uses and taxation of trusts in a restricted setting and the uses of the personal corporation for purposes of income splitting. Alternative plans with revenue implications are set out together with a general discussion of these methods.

There has been, of recent years, much public clamour for more equitable treatment of the family in tax law. 1/ Those involved in this outcry hark back to the religious and social view of marriage which characterizes the man and wife as one. The argument is further advanced in declaring the family an "economic" unit. In this connection reference is made to the words of the British Royal Commission on Marriage and Divorce when it said:

> In the first place we fully endorse the view that marriage should be regarded as a partnership in which husband and wife work together as equals and that the wife's contribution to the joint undertaking in running the home and looking after the children is just as valuable as that of the husband providing the home and supporting the family. We think that the importance of the wife's contribution is not always sufficiently recognized. 2/

If this view is acceptable to Canadians, or if it, in fact, expresses the opinion of Canadians, then our tax laws have lost contact with that opinion and cry out for revision. Let us therefore proceed to examine the present law to see how far, if at all, it implements this philosophy and what may be done to further our aims in this direction.

Under the 1917 Income War Tax Act, tax was levied on individuals without regard to their family status. Thus, a man and wife who each had income were taxed separately. This treatment is continued under the Income Tax Act. 3/

Notwithstanding this separate treatment of each individual in the family, the tax laws have always recognized, through the exemption provisions, that to some extent taxation must make allowances for the differences in tax-paying ability between individuals and families of varying sizes.

Although separate treatment was, and is, accorded by the tax laws to each individual, many provisions of the same laws have recognized the unity of the family and the opportunities available in this unit to split income with the intention of avoiding tax. Prohibitions against this splitting have been in our tax laws for many years and continue to the present day. It is both interesting and instructive to consider the family tax avoidance problem in more detail.

TAX AVOIDANCE IN THE FAMILY

Income Splitting

Progressive rates of tax increase the desire of taxpayers to find lower brackets for their income. Thus, if a man earning $10,000 per year could have it taxed at the rate applicable to $5,000, he would save money. Realizing this basic fact of progressive taxation, many taxpayers attempt to split their income among various family members to gain an advantage, while retaining economic control over the income or deriving economic advantage from it.

In the myriad ingenious methods and schemes devised by "tax consultants" to achieve beneficial income splitting, we have witnessed something close to a rebirth of the 19th century art of thimblerigging. It is useful to review briefly these manoeuvres together with the legislative responses to them.

TRANSFERS OF INCOME-PRODUCING PROPERTY

By transferring property which produces income, to his spouse, child, or some other person, the taxpayer effectively reduces his income and, therefore, his tax. Sections 21(1) and 22(1) have been enacted to deal with this problem. These provisions say that where a taxpayer transfers property to his spouse or to a person under 19 years of age, then the income from that property, or property substituted for it is deemed to be the income of the transferor, and is taxable to him.

As a general rule, these provisions have been effective but they can be avoided; thus, it may be said with confidence that the more sophisticated and shrewd taxpayers have not fallen within its ambit. A full analysis of these provisions as they exist in the law today follows later in this chapter of the study. It might be noted that all transfers between husband and wife, but only transfers to children under 19 (not necessarily the transferor's) are caught by the sections.

SPLITTING THROUGH PARTNERSHIPS

The formation of partnerships between members of a family is perfectly legal. The Income Tax Act looks with suspicion on it, however, and gives the Minister discretionary power to apportion the income where a partnership exists between husband and wife. 4/ In addition to this, one spouse cannot in effect receive remuneration from a partnership in which the other spouse is a member. Such remuneration will be added to the partnership spouse's income and taxed in his hands. 5/ Moreover, any salary paid to his spouse by a taxpayer running an unincorporated business will not be allowed as a deduction of the business, nor will it be included in the spouse's income. 6/

The rules just mentioned do not apply to partnerships between, say, father and son; a father may hire his son as an employee and the Department will recognize him as such. However, in Shields v. M.N.R. 7/ the Department showed it was ready to attack so-called "partnerships" between father and son as mere shams when taxpayers merely go through the forms of creating a partnership never intending, and, in fact, not treating the relationship as one of partnership.

SPLITTING THROUGH TRUSTS

Sections 21(1) and 22(1) which deal with transfers of property between husband and wife, and adults and children, include transfers in trust. The trust may, however, be used in other areas to extreme advantage. The Income Tax Act recognizes this fact and provision is made in section 22(2) to deal with it. Under this section if property has been transferred in trust in such a manner that the transferor has in effect "let go" of the property, any income from it is taxable to the beneficiary. But if, for instance, the trust is revocable, income from the trust property is taxable to the settlor of the trust.

In addition to section 22(2), the rules prescribed in section 65 are important. This latter provision is designed to prevent avoidance by preventing a taxpayer from using income from trust property for his own benefit even though it is not received by him. Specific rules are provided in section 63 for the taxation of income from a trust.

Although sections 22(1) and 22(2) are broad, they fail to encompass the case where property is placed in trust, the income from which is to accumulate for unborn persons until the death of the settlor. In this instance the income would be taxable under the rules applicable to trusts found in section 63. Specifically, each year the <u>trustee</u> and not the settlor would be bound to pay tax on the income of the trust. If the taxpayer were in a very high bracket, this would be an effective split with substantial benefits.

If children were born after the trust was created, section 22(1) would not apply as its language is limited to transfers "to a person" which necessarily contemplates the existence of a person. After the person is born, although the requirement of existence is satisfied, there is no transfer.

SPLITTING THROUGH PERSONAL CORPORATIONS

The Act prevents the avoidance or postponement of income tax in some circumstances by the legislative rules creating the personal corporation. However, these rules can be avoided without too much mental fatigue and may be turned to good use for income-splitting purposes. A transfer by a husband, not a shareholder, to a personal corporation in which his wife is the only shareholder avoids section 21(1) entirely. If additional benefits in the form of postponement are desired, just depersonalize the personal corporation.

SPLITTING BY TRANSFERS OF INCOME

Section 23 prevents income splitting by declaring that a taxpayer who transfers or assigns to a person with whom he does not deal at arm's length the right to an amount which, if not transferred, would have been included in computing the taxpayer's income because it would have been received or receivable by him, must pay the tax on the amount. However, if the income is from property and the property has also been transferred, the rule does not apply.

In effect, this rule prevents income splitting by looking through an anticipatory assignment of income from property arising in the future. Thus, the transfer of the right to dividends from shares, as and when paid, without a transfer of the shares, would not shift the tax on the dividends from the hands of the transferor.

Detailed Study of Sections 21(1) and 22(1)

PURPOSE

The purpose of these rules is to prevent income splitting by transferring income-producing property. It should be noted that a transfer under these sections may also be subject to gift tax.

HISTORY

These provisions are as old as federal income tax law. Their history may be set out as follows:

(1) The Income War Tax Act, Statutes of Canada, 1917, chapter 28, section 4(4), provided that income from property assigned by one spouse to the other or by parents to children would be taxed to the transferor unless the Minister was satisfied that the assignment was not made to evade tax.

(2) The Income War Tax Act Amendments, Statutes of Canada, 1926, chapter 10, section 7, repealed section 4(4) and enacted that income from property transferred to a transferor's children was taxable to the transferor unless the transfer was not made to evade tax. But in transfers by one spouse to another, the income was taxable to transferor.

(3) The Income War Tax Act Amendments, Statutes of Canada, 1934, chapter 55, within section 16(a), repealed section 4(4) and made income from property transferred to minors under 18 taxable to the transferor. Such income was taxable after a minor reached 18 if the Minister thought tax evasion motivated the transfer.

The provision kept this form until 1948 when it was altered to its present structure.

It should be noted that these sections were directly tied in with tax evasion. Why the shift was made to the present form is not explained in the House of Commons Debates. It can probably be traced to the desire in 1948 to clean most traces of ministerial discretion out of the Act.

DEFINITIONAL PROBLEMS

These provisions refer to transfers of property by a person to his spouse, or to a minor, and deems the income from such property to be taxable to the transferor. The sections contain no definition of the word transfers. However, there is case law on the problem.

The guide-lines for the definition of transfer are set out in The Executors of the Estate of David Fasken v. M.N.R., 8/ where it is stated by Mr. Justice Thorson:

> The word "transfer" is not a term of art and has not a technical meaning. It is not necessary to a transfer of property from a husband to his wife that it should be made in any particular form or that it should be made directly. All that is required is that the husband should so deal with the property as to divest himself of it and vest it in his wife, that is to say pass property from himself to her. The means by which he accomplishes this result, whether direct or circuitous may properly be called a transfer. 9/

In this case a company owed Fasken approximately $1,860,757. The company acknowledged this indebtedness to certain trustees under a trust created by Fasken for his wife and covenanted to pay the sum with interest. It was held that the interest paid by the company to the trustees was income from property transferred to Mrs. Fasken and, therefore, taxable to Fasken. It was contended that the property was transferred with the right to income under the trust and it was from this right that income was derived. The Court disregarded the novation and treated the transaction as a transfer in trust for the wife of Fasken.

It has been suggested that the word transfer would not include a sale for adequate consideration. This argument has been rejected by the Tax Appeal Board where it was held that a transfer "embraces any passing of ownership".10/ It should be pointed out that in this case the Board held the transaction to be a "sale in name only". 11/ Thus, it may still be open to a taxpayer to argue that a sale is not a transfer within the meaning of the Act. This argument receives support from St. Aubyn v. Attorney General 12/ where it was held that payment in cash of the subscription price of shares was not a "transfer of property".

Notwithstanding the wide definition given in the Fasken case to the word transfer, it has been held that a loan is not a transfer. 13/ This decision of the Exchequer Court is interesting because it is directly contrary to the decision of the Tax Appeal Board in an appeal by the same taxpayer a few years earlier. 14/ In this case Board Member Fabio Monet, Q.C., said that the word transfer "should be interpreted as a word of global meaning including every form of conveyance of property". 15/

The Department is satisfied with the view that a loan is not a transfer. However, this interpretation does open up a very large loophole.

An interesting problem arises in connection with transfers to a husband to allow him to use the property for security. In Brayley v. M.N.R. 16/ it was held that a wife was liable for tax on the income from a boarding house transferred by her to her husband and used by him as security to finance a business operation. This decision was made even though the husband had retransferred the property to the wife. In this case it could be argued that the wife merely lent the property to the husband. It should be noted that this decision came down before the last Dunkelman case and might be decided differently today.

A variation on this theme may occur if property is transferred by a husband to his wife to secure a loan from her to him. Is this a "transfer" within the meaning of section 21(1)? The implications of the second Dunkelman case are that it would not be.

One other problem connected with section 21(1) concerns the words "to his spouse". Would a transfer of property by A to a corporation controlled by A's wife be a transfer to A's spouse? Although section 21(1) refers to transfers, directly or indirectly, by means of a trust or by any other means whatsoever, it is submitted that a transfer to a corporation controlled by the spouse is not a transfer to the spouse. In Potts Executors v. C.I.R., 17/ the House of Lords held, in connection with a provision of the English Income Tax Act, that a payment by a trustee to the creditor of A at the direction of A was not a payment to A. Section 40(1) of the Finance Act, 1938, provided in part that "any capital sum paid, directly or indirectly, by trustees of a settlement to the settlor is to be treated as income of the settlor to the extent of the available income arising under the settlement". This section resembles quite closely the wording of section 21(1) so that the decision on it might apply in Canada.

Lord Simonds made an interesting comment on the words "directly and indirectly" when he stated:

> I do not think it matters whether the words "directly or indirectly" qualify in the payment or the receipt. I will assume they qualify both or either. 18/

And he went on to say:

> So far, my Lords, I have not specifically dealt with the words "indirectly". It is sufficient to say that it cannot so enlarge the words "paid to the settlor" for his own use and benefit. I do not feel called upon to determine positively what transactions it might be apt to cover. It may be that it is not apt to cover any that are not already covered by the normal meaning of the words [paid to the settlor]. 19/

One last comment on the terms of the section refers to the words "or by any other means whatsoever". It has been held that these words do not enlarge the meaning of the word "transfer" but refer only to the means or procedure by which transfers may be accomplished. 20/

SUGGESTED REVISION

Both sections 21(1) and 22(1) should be revised by changing the words "to his spouse" or "to a minor" to "to, or for the benefit of his spouse" or "of a minor". This would avoid the Potts Executors case problem.

GENERAL CRITICISMS

Both sections apply even though the transfer was made while the transferor was not resident in Canada, if he subsequently becomes resident. Thus, persons coming to Canada may inherit tax liability never contemplated while living outside the country. Possibly the Department would not enforce the section in this manner but it is certainly open to it to do so. On the other hand, if the Department does not enforce the provision strictly, people may avoid the section by giving up Canadian residence for a time, making their transfer, then returning to Canada.

One significant point is that section 22(1) is unlimited in its application. It is not limited to transfers made by a father to a son but encompasses all transfers of property by any person to a minor under 19 years of age.

Why section 22(1) is so broad is hard to determine. A clause of this nature is surely designed to prevent income splitting in a family unit. If someone outside the family unit wishes to exercise his benevolence, our tax law surely misses the mark in penalizing him. It is suggested that section 22(1) should be limited to transfers between parent and child.

Another problem which applies to both sections 21(1) and 22(1) concerns their constitutional validity. It is proposed to discuss this question with reference to section 21(1) but the arguments apply equally to section 22(1).

CONSTITUTIONAL VALIDITY OF SECTION 21(1)

Under the British North America Act the provinces are granted jurisdiction to regulate Property and Civil Rights in the province. 21/ Parliament is given the power, *inter alia*, to "The raising of Money by any Mode or System of Taxation". 22/ In the exercise of this power Parliament has enacted the Income Tax Act. But clearly, the power to enact tax laws does not give the power to legislate respecting property and civil rights in the provinces. Any tax levied by the Parliament of Canada must be for "The Raising of Money" and cannot legally purport to affect, directly, the property rights of individuals between themselves. It is my contention that section 21(1) contains these basic rules and is therefore *ultra vires*.

The section states in part:

> Where a person has ... transferred property ... to his spouse ... the income for a taxation year from the property ... shall, during the lifetime of the transferor while he is resident in Canada and the transferee is his spouse, be deemed to be the income of the transferor and not of the transferee.

If this section is literally interpreted then its effect is to divest one spouse of the ownership of income from property (which is itself property) and invest the other spouse with that ownership. It states clearly that the income from the property shall be deemed to be income of the transferor and not of the transferee. Admittedly the ownership is limited in duration "to the lifetime of the transferor while he is resident in Canada and the transferee is his spouse". But this does not change the fact that ownership has been shifted.

Force is added to the argument by D. Romero v. Read. 23/ This is an Australian decision which held section 83 of the Income Tax (Management) Act, 1928, (N.S.W.), voided transactions for all purposes. The section stated that:

> Every contract agreement made or entered into, in writing or verbally, whether before or after commencement of this Act, shall, so far as it has or purports to have the purpose or effect of in any way, directly or indirectly—(a) altering the incidence of any income tax; or (b) relieving any person from liability to pay any income tax or to make any return; or (c) defeating, evading or avoiding any duty or liability imposed on any person by this Act; or (d) preventing the operation of this Act in any respect, be absolutely void, but without prejudice to its validity in any other respect or for any other purposes."

In this case the court declared void a covenant in a deed of separation made by the deceased before his death under which he covenanted to pay £10,000 to his wife during her lifetime. The deed has the effect of altering the incidence of tax because the covenantor has also covenanted to pay taxes legally eligible from the covenantee or to reimburse the covenantee for taxes payable by her. This covenant was held absolutely void not only as against the tax authorities but also as between the parties. 24/

The degree of pertinency of the De Romero decision to our problem becomes crystal clear when we consider the contrary arguments supporting section 21(1) as intra vires.

It may be said that section 21(1) was enacted to prevent tax avoidance. Keeping this purpose in mind, we may then argue that the section must be limited in application to the Income Tax Act, or, that implied in the section are the words "for the purposes of this Act". But this is the same argument advanced by the plaintiff in the De Romero case which failed to carry the Australian High Court.

Adding to the burden of the contrary argument are two rules of statutory construction. On the one hand is the plain meaning rule admonishing the interpreter to read the words of the statute and if they are clear and unambiguous, to apply them. There is, under this rule, no reason to ask "what is the 'purpose' of this provision?" The statutory rule of construction is that:

> Where by the use of clear and unequivocal language capable of only one meaning, anything is enacted by the legislature, it must be enforced even though it be absurd and mischievous. 25/

It is submitted that this rule of construction applies to section 21(1). The section is clear and unambiguous. On the other hand, is the rule of strict construction related to taxing statutes? This rule says that to enact a tax or to gain a deduction the words of the Act must be clear and certain. Nothing will be implied.

In Cape Brandy Syndicate v. I.R.C., 26/ Rowlatt, J., stated the rule as follows:

> ... in a taxing Act one has to look at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.

Many Canadian decisions have reiterated and followed this rule. Although the argument declaring section 21(1) ultra vires is not concerned with whether it levies a tax or grants a deduction, it is concerned with whether anything may be implied in the section. For this reason the rule of strict construction applies.

Now it may be contended with strength that the words of section 21(1) are clear and unambiguous, but in favour of holding the provision intra vires. The words "shall ... be deemed to be the income of the transferor and not of the transferee" are used in the section. If the word "deemed" is construed as a "rebuttable presumption" then clearly a spouse could introduce evidence showing he or she, in fact and law, owned the property. The word "deemed" has been interpreted to mean a "rebuttable presumption" but it has also been construed as an "irrebuttable presumption". This latter meaning is now accepted in tax cases. 27/

In addition, it seems clear that section 21(1) did not intend to establish a "rebuttable presumption"; otherwise, it would be open for a spouse to rebut the presumption and defeat the purpose of the section.

This entire argument revolves around the interpretation of the word "deemed". It has been suggested that where the word "deemed" is used you are entitled to look to the purpose of it. In Ex Parte Walton it was stated by James L.J.:

> When a statute enacts that something shall be deemed to have been done, which in fact and truth was not done, the Court is entitled and bound to ascertain for what purposes and between what persons the statutory fiction is to be resorted to. 28/

These words are in favour of implying into section 21(1) the phrase, "for the purposes of this Act".

The problem of section 21(1) has been discussed in the context of English tax law. The Income Tax Act, 1918, Sch. D., Case III, V. 16 provides:

> A married woman ... entitled to any property or profits to her separate use, shall be assessable and chargeable to tax as if she were sole and unmarried, provided that—(1) the profits of a married woman living with her husband shall be deemed to be the profits of her husband, and shall be assessed and charged in his name, and not in her name or in the name of her trustee ....

In Walker v. Howard 29/ the words "shall be deemed to be the profits of her husband" in the proviso to Rule 16 were given a literal construction. Rowlatt, J., said:

> I have come to the conclusion that I have not any right to limit the words of this Rule so as to make Rule 2 of Case III have any special effect. There it is. Her profits are to be deemed his profits and there is nothing to limit that in any way and I do not think I can do it. If he and she had profits in the same year they would be simply assessed together. They happen to have acquired them at different times and this problem arises, but I think I must take no notice of that and just give effect to what the words say. 30/

Although these words were uttered in a tax decision on a pure tax question, nothing in the language indicates that they are to be restricted to tax cases. However, in Leitch v. Emmott 31/ the Court of Appeal disapproved of this broad interpretation by Mr. Justice Rowlatt and suggested a much narrower construction. Lord Hanworth, M.R., said:

> It appears to me that the rule is intended to convey the same meaning as in section 45 of the Act of 1842 and definitely to impose a charge upon the married woman in respect of her profits, although collection is to be made from the husband and the profits of the wife are in that sense and for that purpose to be deemed the profits of the husband. 32/

and Lawrence L.J., said:

> This provision does not, in my judgment, operate to convert the income of the wife into income of the husband further than is necessary for the purpose of collecting the tax: ... 33/

On a superficial view of these statements one could easily conclude that they dismiss the argument for holding section 21(1) ultra vires; yet there are significant differences in the wording of section 21(1) and that of the English section being interpreted in Leitch v. Emmott. This difference is disclosed clearly by Sanky L.J., in Leitch v. Emmott, when he says:

> Founding myself upon those words, I turn to the proviso to n. 16, and it is to be observed that in the proviso what is being dealt with are "the profits of a married woman living with her husband." It starts with that assumption and then says that in that case—namely, when the profits are the profits of a married woman living with her husband, they shall be deemed to be the profits of the husband and shall be assessed and charged in his name: but they still remain the profits of the married woman living with her husband because that is the subject with which the proviso is dealing. 34/ (Emphasis added.)

Clearly section 21(1) is much different. There is no assumption that the income from property is the transferee's. It is not based or premised on that situation. All it purports to do is deal with income from property transferred and in so doing declares that the income "shall be deemed to be income of the transferor, and not of the transferee". In other words, section 21(1) never allows the income to vest in the transferee. It vests that income in the transferor and for this reason interferes with ownership of property, thereby conflicting with the exclusive jurisdiction of the provinces over "property and civil rights".

Moreover the words, "and shall be assessed and charged in his name", found in the proviso to Rule 16 of the English Statute make it easy to read into the section a purpose—namely, to collect tax from the husband.

No similar words are found in section 21(1) and if a purpose is to be implied "for a taxation year" in section 21(1) it is not tax collection but tax avoidance.

Another argument supporting the proposition that section 21(1) does affect the ownership of income from property transferred to a spouse is found in a reading of section 21(1) of the Act. This is the charging provision of the Act and it states:

> An income tax shall be paid as hereinafter required upon the taxable income for such taxation year of every person in Canada at any time in the year. (Emphasis added.)

The possessory "of" found in the charging section makes it clear that section 21(1) used the words "income of the transferor" deliberately. By so doing the transferor fits squarely within the charge. If section 21(1) were intended merely as a collection rule it could easily have said tax on the income of the transferee shall be paid by the transferor as if that income were included in computing his income. This was the effect of the predecessor to section 21(1) found in section 32(2) of the Income War Tax Act which stated:

> Where a husband transfers property to his wife, or vice versa, the husband or the wife as the case may be, shall nevertheless be liable to be taxed on the income derived from such property or from property substituted therefor, as if such transfer had not been made.

One last argument opposed to this contention is the interpretation rule that courts will lean in favour of constitutionality. In Severn v. The Queen, 35/ Mr. Justice Strong stated the rule:

> It is, I consider, our duty to make every possible presumption in favour of such Legislation Acts, and to endeavour to discover a construction of the British North America Act which will enable us to attribute an impeached Statute to a due exercise of constitutional authority, before taking upon ourselves to declare that, in assuming to pass it, the Provincial Legislature usurped powers which did not legally belong to it.... 36/

And in Heweson v. Ontario Power Co., 37/ Taschereau, J., said after stating that the appellant had tried to impeach the Act as ultra vires:

> Now, upon him was the burden of establishing the soundness of that contention; the presumption in law always is that the Dominion Parliament does not exceed its powers. 38/

In other words, if two interpretations are open—one favouring constitutional validity and one opposed—the Court will choose the former and reject the latter. Although this rule makes the argument in favour of ultra vires a little more difficult to advance to acceptance, it would not constitute a permanent block.

The two following examples will serve to illustrate how this whole problem could arise:

1. Tax Case: A, the husband, is assessed for tax on income from property transferred to W, his wife. W receives the income and treats it in all respects as her own. A objects to the assessment on the ground that his wife's income is not his income and that section 21(1) is ultra vires.

2. Non-Tax Case: A husband transfers property to his wife as a gift. Over a period of years the wife receives the income from the property and accumulates it in a separate bank account. The wife has an auto accident and is found liable. In an action by the judgment creditor attempting to seize the bank account, the husband is joined and he defends on the grounds that section 21(1) transfers ownership of the account to him and, therefore, his wife's debts may not be satisfied out of it. The judgment creditor says if the section has that effect is is ultra vires.

Comments on Sections 21(2), (3), (4)

The provisions of sections 21(2), (3) and (4) are designed to prevent earned income splitting. But, they go too far. The hardship created by the predecessor to section 21(4)—section 31(1) of the Income War Tax Act—has been judicially noted in W. Klamzuski v. M.N.R. 39/ This case presents an excellent example of the injustice created by the section because, on the facts, it was clear that the wife had worked long and hard to help earn the income from farming operations.

Such sections should be aimed at the artificial reduction of income by a husband for the purposes of income splitting. Where the wife does, in fact, work and contribute toward the success and support of a business, then the income is hers and she, not the husband, should pay tax on it under the present structure of our tax law.

Section 21(4) which contains one of the few vestiges of ministerial discretion remaining in the Act should be repealed. It is difficult to find the reason for maintaining ministerial discretion in this area when it has been removed from so many other important areas of tax law. Provisions like this suggest that marriage is a sinister device created by evil taxpayers, which must be guarded with all the wrath and vengeance of an angered god. A section aimed at all partnerships to prevent unreal divisions of partnership income would be more in line with consistent tax legislation, and yet accomplish roughly the same result as section 21(4). The new provision might take on some of the trappings of section 137(1).

Although partnerships between husband and wife are scrutinized under section 21(4), a partnership between father and son is allowable. However, the Department looks upon such arrangements with scepticism and the Courts review with care all the circumstances of a so-called partnership transaction to make sure that the transaction has the legal attributes of a partnership. Merely entering into a written partnership agreement is insufficient; the parties must have intended to become partners and must have acted as partners. 40/ In other words, a mere simulated agreement will not be allowed to override the realities of the case.

In the United States, family partnerships are allowed, 41/ but are reviewed carefully by the tax authorities to insure that they are bona fide and real. The Supreme Court has stated the necessity for a "business purpose" in family partnerships 42/ but the Internal Revenue Service does not insist on this condition on the transfer of a partnership interest to a relative. The Service is concerned about the validity and binding effect of the transfer.

The United States family partnership rule applies only for the purpose of recognizing "ownership of a capital interest" in the partnership, thus allowing income splitting. The ordinary rules apply where the partnership is one involving the provision of services. The Service recognizes that income from a partnership may be derived through services or capital.

The same rules apply in Canada except for section 21(4) dealing with allocation of partnership income between husband and wife and the problems incident to sections 21(1) and 22(1) dealing with transfers of property. One important point arising in this connection is whether income from a partnership is income from a business or from property. If it is the former, then section 21(1) can be avoided through the transfer of a partnership interest. In Robins v. M.N.R., 43/ Mr. Justice Noel found that section 21(1) cannot apply where income is from a business. It might even be argued that the income is neither from property or a business but from a partnership. The Act expressly recognizes partnership as a source of income. Section 15(1) refers to income of a partner from a partnership in contra-distinction to income of a sole proprietor from a business. And section 3(1) recognizes that there may be other sources of income than those listed, since the listed sources are merely stated "without restricting the generality of the foregoing" and the foregoing refers to "all sources".

In our view section 137(1) is sufficient for the Department to keep artificial arrangements between husband and wife in check. That section says that no deduction may be made, in the computation of income, for expenses or disbursements that, if allowed, would artificially reduce income. A classic illustration of the use to which the Department may put this provision is found in Shulman v. M.N.R. 44/ In this case a lawyer incorporated a company to which his law firm paid a management fee. The fee was held non-deductible by the law firm as falling within section 137(1). If a husband were to pay his wife a salary for which she does not work, then the Shulman rule would apply with equal force.

By attempting to prevent income splitting between husband and wife the Act has, in fact, penalized small businessmen and put a premium on incorporation. The penalty follows from the fact that if the taxpayer hired some third party to work for him, the salary would be deductible. Yet salary to his wife, who may work harder and more earnestly, is not deductible. Again, if the husband incorporated his business, his wife could work for the corporation and salary paid to her would be deductible.

In the end the clearest conclusion which emerges from a review of these provisions is that they are outdated, outrageous and ossified.

They ought to be excluded from the Act and section 137(1) be allowed its proper and progressive function.

Detailed Study of Section 22(2)

INTRODUCTION

To avoid income splitting between spouses, and majors and minors, sections 21(1) and 22(1) were enacted. Outside their limits Canada does not prevent income splitting. Section 22(2), however, emphasizes that income splitting will be allowed only if the transfer of income-producing property is absolute and complete and if the transferor has relinquished control of the property. This provision was first enacted in 1936. 45/ It was added to the Income War Tax Act as subsection 3 of section 32 and was substantially the same as the present section 22(2) which it became under the 1948 Act.

In the following cases the income from property transferred in trust will be taxed to the grantor:

(1) Where the property transferred or property substituted therefor may revert to the grantor.

(2) Where the property may pass to persons determined by the grantor subsequent to the creation of the trust.

(3) Where the trust stipulates the property shall not be disposed of during the grantor's lifetime except with his consent or in accordance with his direction. 46/

This section is more noticeable for what it does not cover than for what it does cover. Before reviewing what is not covered, let us consider some of the interpretative problems in the section.

INTERPRETATIVE PROBLEMS

(a) "By a trust created": Who must create the trust? That is, must the trust be created by the same person who grants the property to it?

(b) "... is held on condition that it ... may revert to the person ... from whom ... it was ... received": These words relate to the right of reversion. They are important when considered in the light of the first question. Thus, must the reversion be contained in the grant itself or would it be sufficient if the reversion were established as a term of the trust? The use of the word "may" suggests that it does not matter how the reversion arises if it does in fact exist.

The question becomes important in short-term trusts. For example, A grants property in trust to B for five years upon the following terms: (i) to pay the income from the property to A's mother; (ii) to pay over the corpus to the Red Cross, if A's mother dies in five years; (iii) to terminate the trust and give the property to A at the end of five years if A's mother has not died in that time. In this case, does A have a reversion under the trust instrument; under the grant; or at all?

Another problem connected with this area is that of postponed powers. Is a power to revoke, only after ten years and the fulfilment of certain conditions thereafter, within the words "may revert"?

It is pointed out that a reversion, strictly speaking, arises only by operation of law. However, oftentimes such reversions are extremely remote possibilities. For example, A grants to B in trust for the life of C, and on C's death for the children of C, and in the event that C has no children, then to D absolutely, and if D not be alive at C's death, then to D's children equally. In this case, there is a possibility of reversion to A. All the eventualities provided for may arise but, in addition, D's children may all be dead on D's death. In this situation, the law says A has a reversionary interest. It is a reversion by operation of law—which is the only true reversion at common law.

Do the words "may revert" cover cases where the grantor can only get the property back upon one month's notice? Again what if the reversion is a very remote contingency? It appears that these cases are caught by the word "may". But should they be caught? What purpose is served by so rigid an application of the provision? What if the reversion or revocation of the trust were limited to circumstances where the grantor "became sick or in some other emergency"? This limitation is something clearly outside the grantor's control. Again the word "may" seems wide enough to cover this situation. But is it intended to be so broad?

If the grantor reserved the right to get back all the property except a small portion, could it be said that the "property or property substituted for it" may revert to the grantor? In other words, do the quoted words refer to the totality of the thing granted or to portions of it? Although it is true that the greater includes the lesser, it is also true that the Act does not refer to portions of the property, and for this reason it may be that section 22(2) could be circumvented in this manner.

An example of how section 22(2) works is found in No. 40 v. M.N.R. 47/ In this case, a father sold shares of stock to his sons. Under the sale agreement, the shares were to be held by a trustee until the purchase price was paid, and in default of payment, shares were to revert to the father. Until default, the sons were entitled to all dividends from the shares. The Minister assessed the father for tax on the dividends. On appeal, the Tax Appeal Board upheld the taxpayer and vacated the assessment.

This decision has been criticized 48/ on the ground that section 22(2) refers to the creation of a trust "in any manner whatsoever". In finding for the taxpayer the Board said the trust was merely incidental to the transaction of sale. I think the decision is correct because no trust is created. The so-called trust was purely a conveyance in escrow, or alternatively, a conditional sale agreement whereby the sellers had merely conveyed their title to the shares in trust.

PROBLEMS NOT COVERED BY SECTION 22(2)

Section 22(2) is designed to prevent abuse of permissible income splitting. What it says in effect is if a taxpayer wishes to get the advantage of income splitting he must relinquish control of the property from which the income flows. This is reasonable enough because if a man still controls the property from which income flows he has really not divested himself of it and the income from it should be taxed to him.

We have related the circumstances where the section applies. Let us now consider under what circumstances it does not apply and then balance the two with a view to ascertaining how closely it is realizing its objective. It is contended that because the section does not apply in so many circumstances it really fails in its purpose.

In reviewing those cases outside of section 22(2) we may make a division relating to corpus and income.

Corpus

Powers in Non-Adverse Parties: If a grant of property is made in trust by A for his children over 19, with a power to A's wife to encroach upon capital or terminate the trust in her favour, then section 22(2) does not apply. In this case there may be a question whether the grant of the power to A's wife is a gift to her or a transfer of property to her for section 21(1) purposes. The answer to both these problems rests upon the further question: Is a power property?

At common law it is clear that a power is not property. Lord Justice Fry said in Ex parte Gilchrist. 49/

> No two ideas can well be more distinct the one from the other than those of "property" and "power" .... A power is an individual personal capacity of the donee to do something. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property. The power of a person to appoint an estate to himself is, in my judgment, no more his "property" than the power to write a book or to sing a song .... Not only in law but in equity the distinction between "power" and "property" is perfectly familiar, and I am almost ashamed to deal with such an elementary proposition.

Is there a difference between "property" at common law and "property" for income tax purposes. Section 139(1)(ag) defines "property" as follows:

> "property" means property of any kind whatsoever ... and includes a right of any kind whatsoever, a share or a chose in action.

Although this definition appears world-wide, it adds little to the common law definition of "property". If a "power" is included within this definition it must be by virtue of the words, "a right of any kind whatsoever".

It is suggested, however, that the word "right" must be strictly construed and, so interpreted, does not include a "power". In jurisprudence the distinction is made between the two concepts and has been long accepted, though, admittedly, confused in application. A good statement of the distinction is as follows:

> Distinction between right and power. - On the face of it the distinction is obvious; a right is always a sign that some other person shall conform to a pattern of conduct, a power is the ability to produce a certain result .... The power itself has no duty corelative to it. 50/

Accepting this statement as correct then, clearly, "power" does not come within the scope of sections 22(2) and 21(1). What, then, is the effect of this? It may be that the effect is to allow the taxpayer to split his income and yet keep virtual control over the property through his wife who, we may assume, will act on his instructions.

We have suggested that the power given to A's wife to terminate the trust and vest the property in herself or to encroach on capital would circumvent sections 22(2) and 21(1). Obviously many other varieties of powers are available to maintain A's control, and the same result would obtain.

Power to Alter Distributive Shares of Beneficiaries: This kind of power is not dealt with in section 22(2). The words "pass to persons to be determined by him at a time subsequent to the creation of the trust" in section 22(2)(a)(ii) would not apply if the grantor retained the right to alter shares among beneficiaries already named. In these circumstances the grantor retains a very substantial degree of control.

Joint Power: A could grant property in trust and retain the powers set out in section 22(2)(a)(ii) and (b) jointly with some other person and not be within the section. This is so since the words of the section refer "to him" and "with his consent" and "with his direction". Again, if the joint power is held with a person not adverse in trust, i.e., a wife, then A retains effective control of property.

Administrative Control:

(a) Power to Vote Corporate Stocks: If the property granted by the grantor is corporate stock and he retains the right to vote it, then he has effectively retained control of the property but is outside section 22(2).

(b) Power to Sell or Exchange Property for Less than Actual Value: A grantor might retain this power and still not be within the section.

(c) Power to Borrow from Trust: A grantor could give a trustee power to lend to him at no interest and without security. Again, he effectively retains control of the property but splits the income therefrom.

(d) Power to Direct and Re-direct Investments of the Trust: The same comments apply as above.

(e) Power to Re-acquire Trust Property by Substitution of other Property: Such a power might be construed as a possibility of reversion under section 22(2)(a)(i). In answer to this, however, one could argue with force and logic, that there is no reversion but a mere power to do something. It would be stretching language to inordinate lengths to call a power a "possibility of reversion".

(f) Power to Amend Trust Provisions Other than Those Covered in Section 22(2)(a)(b): The same comments as above apply *mutatis mutandis*.

(g) Power in Trustee to Pledge Trust Property as Guarantee for Loans of the Grantor: Here again the grantor retains virtual control of the property.

(h) Power in Grantor to Substitute Trustees: Probably this kind of power ought not to be affected by section 22(2) in any way.

(i) Power to Alter Beneficiaries: If the beneficiaries are named in the trust, section 22(2)(a)(ii) is satisfied. This is so since the property will pass to persons already determined. Is a power to alter the beneficiaries a "condition that it or property substituted therefor may pass to persons to be determined ... subsequent to the creation of the trust"? We do not think so because the word "condition" in our view relates to the grant of the property. That is to say, it must be a part of the grant itself that property is to be held in trust "for persons to be subsequently determined". If it is granted to A in trust for B, C, E, & D, then the persons to whom it may pass are determined. The mere fact that the grantor reserves the power to alter those persons does not change the grant.

Clearly, on this question there is much room for argument and the contrary contentions are too clear for recitation.

Income

Note: Section 22(2) deals solely with reserved rights and reversions respecting the property transferred in trust. It is not concerned with reserved rights to income. This is a serious oversight as the following paragraphs will show.

Power to Trustee (discretionary) to Apply Trust Income for the Maintenance and Support of Grantor's Children: The benefit of this kind of "power" may be illustrated with the following example. A grants property in trust to B in trust to invest the property and pay the income therefrom to X (A's son over 19) and on A's death to pay over the corpus to unascertained beneficiaries. The trustee is given power in his discretion to apply the income for the support and maintenance of A's younger children. The trustee exercises this discretion, thus relieving A of the duty to support, with the result that the income used to support A's children is taxed at a lower rate. Note that section 22(1) (transfers to minors) does not apply because A transferred nothing to minors.

Power to Pay Insurance Premiums on Policies Insuring Grantor's Life: This power enables the trustee to use the income to pay for insurance on a grantor's life and at the same time is not affected by section 22(2). The grantor enjoys income splitting.

Obviously, the grantor may be relieved of other obligations by means of this device. The net effect is, of course, that he enjoys split-income rates for income which ultimately is used by him.

Notice that the result might be different in cases like the one posed depending upon whether the power in the trustee is discretionary or mandatory. If the trustee had to pay the income out to meet the grantor's obligations, then the income could be taxed to him on the basis of constructive receipt. But if the trustee's power is purely discretionary, it cannot be that the doctrine of constructive receipt applies.

Power to Pay Income to Grantor or his Wife Annually in Accordance with their Respective Needs: This kind of provision would also be outside section 22(2). It needs no comment in the light of (iii) above.

Section 65(1) and (2) is relevant in a consideration of section 22(2). These provisions make the value of all benefits "from or under a trust, estate, contract, arrangement or power of appointment" includible in income for the taxation year. An exception is made if the benefit is in the form of a "distribution or payment of capital".

Where a trust or estate pays out of its income the reasonable expenses of upkeep, maintenance or taxes on property, that under the terms of the trust or will is required to be maintained for the use of a tenant for life or a beneficiary, the amount expended is taxable to the life tenant or beneficiary. Section 63(4) provides that such part of a trust's income as is included in the beneficiary's income by virtue of section 65(2), is deductible by the trust. This rule obviously prevents double taxation of the same amount.

Section 65(2) was enacted in response to Malkin v. M.N.R. 51/ In this case the taxpayer transferred the contingent proceeds of a life insurance policy, the family residence and corporate stock to a trustee. The trust was irrevocable and in favour of his children. Under the trust the taxpayer retained the right for life to vote the corporate stock and was entitled to occupy the family residence by leave of the cestuis que trustent. An assessment against the taxpayer based on the income paid by the trust to maintain the family residence was dismissed. It has been suggested that section 65(2) would cover this situation, 52/ but there is doubt that this is so. In the Malkin case the taxpayer was neither life tenant nor beneficiary. Section 65(2) is clearly limited to those classes of persons. 53/

It has also been argued that the reservation of the right to vote stock held by a trustee may imply a power to prevent disposition of the beneficial interest in such stock without the consent of the settlor of the trust, and such a power could render the income of a trust taxable to the settlor under section 22(2)(b). 54/ This suggestion was made in the context of the Malkin case where the taxpayer had in fact retained the right to prevent sale of the shares without his consent. It is doubtful that where this right were not retained, section 22(2) could apply.

It may also be pointed out that the Income War Tax Act was amended after the Malkin decision and was again litigated in Malkin v. M.N.R; 55/ the Department lost again on the same facts as the original Malkin case.

Non-Arm's Length Concept

GENERAL NOTE

Basically, non-arm's length is a concept designed exclusively to counteract tax avoidance. However, because of the definition applied by the Act, the concept does discriminate against the family unit. It will be seen that the definition precludes relatives from dealing at arm's length. Let us consider the definition.

INCOME TAX PROVISIONS

Section 139(5)(a) declares that related persons are "deemed not to deal with each other at arm's length", and section 139(5)(b) says where parties are not related it is a question of fact whether or not they deal at arm's length. The Act purports to deal with relationship between (1) individuals, (2) individuals and corporations, (3) corporations and corporations. The pertinent provisions of section 139(5),(5a), (5c), (5d), (6), (8), (9) have been summarized as follows:

(A) Individuals connected by blood relationship, marriage or adoption:

(1) Blood relationship: If the first person is (a) the son or daughter, (b) the grandson or granddaughter, or (c) the brother or sister of the second person, each is related by blood, and so is unable to deal with the other at arm's length.

(2) Marriage: If the first person is (a) the husband or wife, (b) the son or daughter of the husband or wife, (c) the father or mother of the husband or wife, (d) the grandfather or grandmother of the husband or wife, or (e) the brother or sister of the husband or wife of the second person, each is related by marriage, and so is unable to deal with the other at arm's length.

(3) Adoption: If the first person is (a) an individual, (b) a son or daughter of an individual, (c) the grandson or granddaughter of an individual, (d) the father or mother of an individual, or (e) the grandfather or grandmother of an individual who in law or in fact adopted the second person, each is related by adoption, and so is unable to deal with the other at arm's length.

(B) A corporation and a person who controls that corporation, (if it is controlled by one person) are related persons and cannot deal with each other at arm's length (section 139(5a)(b)).

It should be observed that a person who has a right under a contract, in equity or otherwise, either immediately or in the future, and either absolutely or contingently, to acquire shares in a corporation, or to control the voting rights of shares in a corporation, shall be deemed to have had the same position in relation to the control of the corporation as if he owned the shares.

The foregoing assumption does not apply where the right is not exercisable until the death of the individual designated in the contract (section 139(5d)(b)). Where a person owns shares in two or more corporations he shall, as a shareholder of one of the corporations, be deemed to be related to himself as shareholder of each of the other corporations (section 139(5d)(c)).

(C) A corporation and a person who is a member of a related group that controls the corporation are deemed to be related persons and cannot deal with each other at arm's length (section 139(5a)(b)).

It should be noted that a related group means a group of persons, each member of which is related to every other member of the group (section 139(5c)(a)).

(D) A corporation and any person who is related to
- (i) a person who controls the corporation (if it is controlled by one person), or
- (ii) a person who is a member of a related group that controls the corporation are deemed to be related persons and cannot deal with each other at arm's length (section 139(5a)(b)).

(E) Two corporations are deemed to be related and are unable to deal with each other at arm's length, if
- (i) they are controlled by the same person, or
- (ii) they are controlled by the same group of persons (section 139(5a)(c)).

(F) Two corporations are deemed to be related and are unable to deal with each other at arm's length, if

(i) each corporation is controlled by one person, and

(ii) the person who controls one of the corporations is related to the person who controls the other corporation (section 139(5a)(c)).

(G) Two corporations are deemed to be related and are unable to deal with each other at arm's length, if

(i) one of the corporations is controlled by one person, and

(ii) that person is related to any member of a related group that controls the other corporation (section 139(5a)(c)).

(H) Two corporations are deemed to be related and are unable to deal with each other at arm's length, if

(i) one of the corporations is controlled by one person, and

(ii) that person is related to each member of an unrelated group that controls the other corporation (section 139(5a)(c)).

It should be observed that an unrelated group is defined to mean a group of persons that is not a related group. A related group means a group of persons, each member of which is related to every other member of the group (section 139(5c)(a) and (b)).

(I) Two corporations are deemed to be related and are unable to deal with each other at arm's length, if

(i) any member of a related group that controls one of the corporations is related to

(ii) each member of an unrelated group that controls the other corporation (section 139(5a)(c)).

(J) Two corporations are deemed to be related and are unable to deal with each other at arm's length, if

(i) each member of an unrelated group that controls one of the corporations is related to

(ii) at least one member of an unrelated group that controls the other corporation (section 139(5a)(c)).

(K) Where two corporations are deemed to be related to the same corporation, they are deemed to be related to each other (section 139(5b)).

(L) The 1955 amendments to the Act introduced section 105B which imposes a new 15% or 20% tax upon designated surplus which is absorbed through the medium of a non-resident corporation, a tax-exempt organization, or a dealer or trader in securities.

For purposes of section 105B members of a partnership are deemed to be unable to deal with each other at arm's length (section 105B(5)(b)). 56/

RATIONALE AND CRITICISMS OF THESE PROVISIONS

At the time when the impact and relevance of income taxation to the national treasury were slight the English courts formulated the rule of strict construction of tax statutes. This judicial creation was, in itself, relatively harmless. However, it begot a monster when it sired the rule that a taxpayer is entitled, within the legal framework, to arrange his affairs so as to pay the least amount to tax. This monster lives amongst us today under the name of "legal avoidance". Much casuistry and subtlety have characterized the activities of those who work to maintain this monster. And the monster continues to grow—fed on the nourishment which the national treasury loses.

To counteract the raids on the treasury by means of legal avoidance, the arm's length doctrine has been implemented and utilized to a greater extent each year. The Income Tax Act has a number of provisions declaring that this or that will be the result where a transaction is consummated between persons not dealing at arm's length. While admitting the validity of the arm's length concept to counteract present day tax psychology and practice, it is suggested that the definition goes further than necessary and may have a penal effect.

A review of the Act shows that the non-arm's length rule applies directly to many sections such as 17(1), (2), (3), (4), 18(1), (2), 20(4), 23, 28(3), 85(1)(b), 85A(1)(c)(d), and 137(2), (3). Its application to these sections is justified in most cases. However, it is in the few cases where it ought not to be applied that we are concerned. For example, should section 20(4) apply between brothers? The deferral of recapture between father and son will in most cases be reasonable, but more often brothers deal very much at arm's length.

The basic problem, then, lies with section 139(5)(a), which irrevocably presumes that related persons do not deal at arm's length. The scope of the definition of related persons ought to be narrowed and the scope of section 139(5)(b) broadened. That is, only immediate descendants and not collaterals ought to be irrevocably presumed not to deal at arm's length. In other cases it should be a question of fact, or we might limit it to a "revocable presumption".

At present the word "deemed" in section 139(5)(a) is treated as an irrevocable presumption. This means the taxpayer cannot rebut this presumption and is saddled with the consequences even though in his case he dealt at arm's length. By limiting "deemed" to a "rebuttable presumption" a taxpayer, in a given case, may be able to show the transaction was at "arm's length". As previously stated, we suggest that some cases, i.e., father and son, remain as irrebuttable presumptions for arm's length purposes but there are clear situation, i.e., brother and brother, which should not be based on irrebuttable presumptions. It may even be argued that in every transaction between related persons the presumption should be rebuttable and that the taxpayer be allowed to show that his case was at arm's length. This last view has more merit in that it permits taxpayers a right to appeal where they feel aggrieved. And, in addition, since the Department is only really concerned with what are in fact non-arm's length transactions, this change would not in any way affect that policy. It is suggested that in most cases of related persons the onus of proving that they were dealing at arm's length will not be overcome, and therefore the revenue will not suffer.

On the whole, it cannot be said that the Income Tax Act has cast any undue or perverse burden on small businesses or family transactions by the use of the arm's length concept. It has, however, taken away the right of appeal on certain questions. The elimination of appeal rights is only palatable in our society if absolutely necessary to the policy it is designed to perpetuate, and if that policy is acceptable. To prevent tax avoidance is an acceptable policy but it is not necessary to take away appeal rights to achieve it.

Related Areas of Gift and Estate Tax Laws

Under the present system of law there are three concepts of transfer. A transfer under estate tax law may be quite different from a transfer for income tax purposes and both may differ from a transfer for gift tax purposes. There is, therefore, no consistency of tax incidence resulting when property is disposed of. For instance, under section 21(1) a grantor remains liable for tax on income from property transferred to his wife and he is liable for gift tax on the value of the transferred property. However, provided he is outside the three-year inter vivos gift rule, no estate tax will be levied on the transfer. On the other hand, if property is given away to a person over 19 who is not the donor's wife, gift tax is payable, but no income or estate tax is exigible. Chapter 3 of this study shows the great variety of results flowing from various transfers under existing gift, income and estate tax laws.

The solution to the whole problem of integration and correlation rests mainly in the accurate definition of the word "transfer". A definition of this word which would attract tax for all purposes would be invaluable.

Quebec Community of Property Law

Where taxpayers in Quebec are subject to the community of property laws a great benefit accrues to them under estate tax law. Since each spouse is considered to own one half of the property in the community on the death of one spouse, only one half of the community is subject to tax. This is a benefit not enjoyed in the common law provinces.

On the income tax side the Supreme Court of Canada has held that taxpayers under Quebec community of property do not have the right to split income. In Sura v. M.N.R. 57/ Mr. Justice Taschereau said that income tax was a tax on the person, computed according to the amount of his income. Moreover, he found that under the Quebec community of property laws the wife was not entitled, as of right, to a share in the husband's earnings. Her right was merely to have the community property properly administered and the husband had clear and unfettered ownership of the income he earned and was consequently subject to tax on the total of it.

These remarks on Quebec law are especially important to remember in reviewing any United States writings which advocate income splitting. In the United States, court decisions 58/ did allow taxpayers in community-of-property states to split income and it was the inequity between taxpayers in community and non-community states arising out of these decisions which instigated and culminated ultimately in the United States split-income provision, as well as the marital deduction of the estate tax law. In Canada, only the inequity pertaining to estate taxes exists, and this is relatively minor because of the light load of such Canadian taxes and, more especially, because estate tax is, in the main, a provincial tax, since 75% of the revenue is distributed to the provinces.

REFERENCES

1/ See the briefs to the Royal Commission on Taxation by the Association of Canadian Distillers, United Electrical, Radio & Machine Workers of America, Canadian Federation of University Women, Lt. Col. Earle E. Olmstead, Canadian Federation of Property Owners, Canadian Institute of Chartered Accountants, Canadian Federation of Business & Professional Women's Clubs, National Council of Women of Canada.

2/ British Royal Commission on Marriage and Divorce, Second Report, Her Majesty's Stationery Office, London, 1956, p. 175.

3/ R.S.C. 1952, c. 148. In this chapter all references are to its provisions unless otherwise specifically noted.

4/ Section 21(4).

5/ Section 21(3).

6/ Section 21(2).

7/ 62 DTC 1343.

8/ [1948] Ex. C.R. 580; 49 DTC 491.

9/ Supra, p. 497.

10/ See D.F. Campbell v. M.N.R., 63 DTC 493 at p. 495.

11/ Supra, p. 494.

12/ [1952] A.C. 15.

13/ Dunkelman v. M.N.R., 59 DTC 1242.

14/ Dunkelman v. M.N.R., 51 DTC 107.

15/ Supra, p. 109.

16/ 51 DTC 4.

17/ [1951] 1 All E.R. 76.

18/ Supra, N. 10., p. 80.

19/ Ibid., p. 81.

20/ Supra, N. 6., p. 1246.

21/ B.N.A. Act, s. 92(13).

22/ B.N.A. Act, s. 91(3).

23/ 48 C.C.R. (1932), 649.

24/ Section 260 of the Income Tax and Social Services Contribution Assessment Act, 1936-1950, (CTH), Australia, contains the words "as against the Commissioner" in order to avoid the effect of the De Romero decision.

25/ Maxwell on Interpretation of Statutes, 11th ed., p. 4.

26/ [1921] 1 K.B. 64 at p. 71.

27/ See the following cases: No. 25 v. M.N.R., 51 DTC 331 in which Mr. Fordham, Q.C., held "deemed" to mean "conclusively considered". (Fabio Monet concurring.) Mr. Fisher Q.C, dissented, holding that "deemed" in section 127(5)(c) (arm's length between brothers) was a rebuttable presumption; Western Printers Association Ltd. v. M.N.R., 51 DTC 345. Members Fordham & Monet again interpreted "deemed" as an irrebuttable presumption while Mr. Fisher stuck to his original view. In Benedet v. M.N.R., 54 DTC 51, Mr. Fisher stated at page 52 that: "The majority of this Board has held, in previous judgments that the word 'deemed' as used in this Act is to be interpreted as 'conclusively considered'". This phrase demonstrates his final conversion to the majority view.

28/ Ex Parte Walton 17 Ch. D. (1881), 746 at p. 756.

29/ 13 T.C. (1927-28), 313.

30/ Ibid., pp. 317-318.

31/ [1929] 2 K.B. 236.

32/ Ibid., p. 243.

33/ Ibid., p. 247.

34/ Ibid., p. 248.

35/ 2 S.C.R. (1879), 70 per Strong J., at p. 103.

36/ Ibid., p. 103.

37/ 36 S.C.R. (1905), 596.

38/ Ibid., p. 603.

39/ 52 DTC 51; 5 Tax A.B.C. (1951) 357, per W.S. Fisher, Q.C., at pp. 359-360.

40/ See Shields v. M.N.R., 62 DTC 1343.

41/ I.R.C., 1954, s. 704(e).

42/ Comm. v. Culberston, 337 U.S. 733, 93 L.Ed. 1659.

43/ 63 DTC 1012; [1963] C.T.C. 27 at p. 30.

44/ 61 DTC 1213; affirmed, Supreme Court of Canada without written reasons, 62 DTC 1166.

45/ Statutes of Canada, 1936, c. 38, s. 13(b).

46/ Section 22(2).

47/ 52 DTC 16.

48/ MacDonald, Canadian Income Tax, S. 232, p. 139.

49/ 17 Q.B.D. (1886), 521 at 531.

50/ Dias, R.W.M. and Hughes, G.B.J., Jurisprudence, London: Butterworth & Co. (Publishers) Ltd., 1957, pp. 266-267.

51/ [1938] Ex. C.R. 225; 1 DTC 456.

52/ McDonald, Canadian Income Tax, Toronto: Butterworth & Co. (Canada) Ltd., 1963, s. 23.2, p. 138.

53/ It might be taxed by virtue of I.T.A. ss. 5(1)(b) and 139(1)(ae), as a receipt of personal or living expense.

54/ McDonald, Canadian Income Tax, (op. cit.), p. 138.

55/ [1942] Ex. C.R. 113; [1942] C.T.C. 135; 2 DTC 587.

56/ See Gilmour, Arthur, W., Income Tax Handbook, 1962-63, Richard DeBoo Ltd., pp. 140-143.

57/ [1962] S.C.R. 65; 62 DTC 1005.

58/ See U.S. v. Robbins, 269 U.S. (1925), 315, and Poe v. Sanborn, 282, U.S. 101.

CHAPTER 2 —FOREIGN EXPERIENCE

INTERNATIONAL COMPARISONS

Before investigating the various possibilities and problems in the choice of a tax unit we shall first set out briefly the system prevailing today in some other countries of the world.

Sweden

To compute national progressive income tax, the income of husband and wife is lumped together. Taxpayers are treated as married couples in the year after the year in which they were married. Spouses living apart for most of the taxation year are treated as separate taxpayers.

Each spouse submits an information return showing his or her income. If the spouses lived together most of the taxation year, one spouse may use any general deduction available to either of them, including an allowable loss to which the other spouse was entitled but could not use because his or her income was too low. If each spouse has assessable income, half of the personal allowance available to a couple is then deducted by the tax authorities from the income of each. The income of each is then added together and tax, according to the rate applicable to married taxpayers, is computed.

It is noted that the personal exemption for a married couple is twice that of a single person and the rate scale applicable to the combined income of married persons is different from that applied to single persons.

The difference in rates applicable to single and married taxpayers is greatest in the lower income brackets and narrows progressively until the same rates are applied to incomes over S KR 60,000. Couples in the middle income brackets bear a small increase in total tax burden. In the very high brackets the tax burden of married couples very closely approximates that of single persons.

The following are tables showing rate schedules for married and single taxpayers:

Married taxpayers, family trusts and estates of deceased persons:

Taxable income		
First	12,000 kr.	10%
Next	4,000 "	20%
"	4,000 "	30%
"	10,000 "	38%
"	10,000 "	43%
"	20,000 "	48%
"	40,000 "	54%
"	50,000 "	59%
over	150,000 "	65%

Single taxpayers:

Taxable income		
First	6,000 kr.	10%
Next	3,000 "	20%
"	3,000 "	25%
"	4,000 "	30%
"	4,000 "	36%
"	10,000 "	41%
"	10,000 "	45%
"	20,000 "	49%
"	40,000 "	54%
"	50,000 "	59%
over	150,000 "	65%

There is a basic allowance of 4,500 kr. for married persons and for single persons supporting a child; the allowance for other single persons is 2,250 kr. There is no child allowance, but a tax free subsidy is paid by the state of 550 kr. per child per annum.1/

United Kingdom

The following are the high lights of the British system :

(1) Husband and wife are treated as one unit.

(2) The income of each is added together and rates are applied to it as if it were one.

(3) The system has been modified to some extent with respect to a wife's earned income.

(4) Either party may elect to have tax assessed separately, but election will not reduce total tax liability.

(5) The effect of the British system is that married taxpayers at the lowest levels of income are taxed less heavily than two corresponding single persons, because of generous earned income allowances.

The British have however, evolved the curious device of covenants in their tax system. In the Income Tax Act, 1842, any annual payment, whether payable by virtue of a charge on the property of the payer, or merely as a personal debt or obligation by virtue of a contract, was to be treated as income of the recipient and not as income of the payer, provided it was payable "out of profits or gains brought into charge to tax". This provision has persisted to the present and has allowed the avoidance of surtax through income splitting with children. 2/

Realizing the loss which could arise from this system, steps were taken in 1922 and subsequently to limit the covenants which could be used for this purpose. Certain conditions must be met before a deduction from income can be taken for a payment made under covenant. Roughly, these are the following:

(a) The money must be payable to or for the benefit of the covenantee for a period of not less than six years.

(b) The money must be paid so that no part of it reverts to the covenanter, i.e., payment to a child of the covenanter if the child is an infant and unmarried. Such payments merely replace the obligation to support the child. Similarly with covenanted annual payments to servants; these merely replace the covenanter's obligation to pay remuneration.

(c) The covenant does not qualify if payment is made to corporate bodies or charities.

The British use of covenants could not be fitted logically into the Canadian tax system. Indeed, the reason for allowing this system in England is difficult to understand. It makes a patent absurdity of progressive income tax. Covenants in most cases are really nothing more than gifts. They are promises under seal to do a certain thing. No consideration need be given by the covenantee. Why should an individual be allowed to give away part of his income without first paying tax on it?

In Canada we preserve the integrity of progressive taxation by taxing income in the hands of the person who earns it. We then collect a tax on any gifts he makes out of that tax-paid income. This seems eminently more reasonable.

United States

Under growing pressures from community-of-property states in 1948 the United States introduced the split-income provision. Basically, the law provides for a computation which starts with the aggregate income of spouses, less applicable exemptions; the aggregate is then halved and tax is computed at current rates on this half. The result is multiplied by two to give the total tax payable. This system provides a reduction in taxes for middle and upper middle income classes.

The following illustration will serve to show how the United States provision works.

Assume husband's gross income is $10,000 and that of his wife is $2,000. They have two dependent children. The tax on a joint return would be computed as follows:

Gross income	$12,000
Adjusted gross income	$12,000
Optional standard deductions	1,000
Net income	$11,000
Exemptions	2,400
Taxable income	$ 8,600
50% of taxable income	4,300
Tax on $4,300 **/	918
Joint tax payable 2 x 918 =	$ 1,836

If each partner filed separate returns:

	Husband	Wife
Gross income	$10,000	$2,000
Adjusted gross income	10,000	2,000
Optional standard deduction */	500	200
Net income	$ 9,500	$1,800
Exemption	1,800	600
Taxable income	$ 7,700	$1,200
Tax	$ 1,870	$ 240 (combined tax $2,110)

Saving through filing a joint return $2,110 - $1,836 = $274 or 13%

*/ Where married taxpayers file separate returns optional standard deduction is restricted to $500 (Section 141 of the Internal Revenue Code).

**/ Rates do not reflect 1964 amendments.

As a general rule, it is not to the taxpayer's disadvantage to file a joint return. In the case of taxpayers in the lower income brackets, however, there is little or no tax saving. It has been demonstrated that income splitting yields small returns on incomes below $10,000. There are a few unusual situations where the taxpayer would pay more tax if a joint return is filed; for example, the tax on a joint return would be higher if combined capital losses exceed combined capital gains by more than $1,000.

The following is a table designed to show the percentage tax reduction accruing from the income-splitting device. It is assumed in each case that (1) the wife has no income, (2) there were three dependent children (3) it was to the taxpayer's advantage to claim the optional standard deduction, and (4) rates of tax used do not reflect 1964 amendments:

Income $	Tax on Single Return $	Tax on Joint Return $	Reduction %
4,000	120	120	-
5,000	300	300	-
6,000	510	480	5.9
8,000	970	844	13.0
10,000	1,510	1,240	17.9
15,000	3,210	2,460	23.4
25,000	8,100	5,660	30.1
50,000	24,300	17,940	26.2
100,000	64,275	50,760	21.0
200,000	153,670	131,160	14.6
400,000	336,535	310,040	7.9

The introduction of the income-splitting provision throughout the United States was a response to the blatant inequity created by income splitting which existed in those States which tax under community of property laws. Although the enactment in 1948 of statutory income-splitting abolished this inequity, it, however, created another in the form of discrimination between married taxpayers and single persons. It has been suggested that this discrimination arose out of the use of the same rate schedules for single and married persons. Joseph A. Pechman says, "The practical effect of this step was to double the width of the taxable income brackets for married couples; as a result, the tax on married couples was automatically set at twice the tax of a single person with half as much taxable income." 3/

The United States was forced to enact special provisions to counteract the inequitable effect as between single and married taxpayers. Notice, for example, the "head of the household" provisions of the Internal Revenue Code enacted in 1957 to soften the treatment accorded to widows, widowers and other single persons with dependants.

There are three possible alternatives which would avoid the problem which arose in the United States. The law could:

(1) grant full income splitting to all single taxpayers supporting children, grandchildren, parents or brothers and sisters;

(2) grant income splitting to all persons with dependants;

(3) enact similar provisions as in the United States but containing new rate schedule with narrower brackets for married taxpayers. 4/

Income splitting, such as is allowed in the United States, was unacceptable to the British. 5/ It was felt that the adoption of the U.S. income-splitting system would shift the tax burden to single persons to an excessive extent.

France

A quotient system was instituted in France in 1954.

Under the French system the income of the family is aggregated and divided into a number of parts. Progressive rates are applied to each part and total tax is calculated by multiplying by the number of parts. For this purpose, family includes husband, wife and children.

The number of parts into which income may be divided is set out in the French Code as follows:

Unmarried, divorced or widowed, no children	1
Married couple, no children	2
Unmarried or divorced, one child	2
Married or widowed, one child	2.5
Unmarried or divorced, two children	2.5
Married or widowed, two children	3
Unmarried or divorced, three children	3
Married or widowed, three children	3.5
Unmarried or divorced, four children	3.5

Under the system, the children who entitle the taxpayer to another half part are those for whom he is responsible. He is deemed responsible for the following children:

(1) under the age of 21;

(2) under the age of 25, if the child is a student;

(3) invalids, regardless of age;

(4) in compulsory military service regardless of age.

The benefits of the quotient system have also been extended to "heads of households".

The French system is really an extension of the U.S. split-income method except that a further division is made for each child. There is no maximum parts into which income may be divided. Each case rests on the number in the family unit.

The pertinent details of the French system have been stated as follows:

> Dependent children are all natural children and those for whom the taxpayer provides a home, who are: under 21; students under 25; invalids; or doing their national service. Invalid adult children usually count as one full unit.
>
> Where the taxpayer is a widow or widower with dependent children, the dividing factor is the same as if the other spouse were still living.
>
> The income of a single person (including a divorced person, widow or widower) may be divided by $1\frac{1}{2}$ in the following circumstances: where the person is a war widow or in receipt of a disablement pension; where the person has an adult child or a minor child who is separately assessable; where the person has had one or more children who have died, provided that at least one reached the age of 16 or died as a result of war; where the person has adopted or made a home for a child before it reached the age of 10.
>
> A single woman with an income of not more than Frs. 8,000 may treat her parents or invalid brothers or sisters living with her as though they were dependent children if the income of each does not exceed Frs. 2,000.
>
> The amount arrived at by the above means is the tax to be paid. This amount is increased by a 5% surcharge when the income of the taxpayer exceeds Frs. 8,000 for each "part" (see above).
>
> After application of the tax rates to total income, the resulting tax may be reduced by 5% of the net amount of wages, salaries and pensions included in total income.
>
> If the tax payable, before being multiplied by the appropriate number of parts (see above), does not exceed Frs. 70, it is not collected; marginal relief is given when the amount is between Frs. 70 and Frs. 210. 6/

It has been said that "the aim of the family quotient system, is to tax a married man not like a bachelor with the same income, but like a bachelor with the same standard of living." 7/

The French quotient system shows a far greater concern on the part of France for families than does any other European country. Although some comparative analyses have shown French income taxes to be far lower on the family than in many other European countries, the effect of the total tax system is to exact a higher levy.

Ceylon

(a) The taxable unit is the family with provision for compulsory aggregation of the income of husband, wife, children and dependent relatives.

(b) Personal exemptions are allowed.

(c) Rates are graduated according to a quotient system.

(d) In computing tax, personal exemptions are first deducted and then the rate is applied. The rate schedule is graduated by brackets or slabs of income which vary with the quotient. The quotient, in turn, varies with the size of the family unit. Income is divided as follows:

Single person (bachelor, spinster, widow and widower)	$1\frac{1}{2}$ units
Married man	$1\frac{1}{2}$ units
Wife	$\frac{1}{2}$ unit
Child	$\frac{1}{2}$ unit
Dependent relative	$\frac{1}{2}$ unit 8/

It has been said that in Ceylon:

> The procedure is to apply statutory brackets by the family quotient. For example, the statutory first bracket covers the first Rs 1500 of income and a family of 4 has a quotient of three. Such a family is taxable at the first bracket rate of 5 per cent on three times Rs 1500 or Rs 4500 of income in excess of personal exemptions. A family of two has a quotient of 2, and its first bracket covers the first Rs 3,000 of taxable income. The system is equivalent to dividing the aggregate income of the family unit by the quotient, computing tax on this amount according to the statutory brackets, and then multiplying by the quotient. 9/

(e) For the purposes of determining the quotient, a single taxpayer or married man counts as 1.5 units and wives, children and other dependants as 0.5 each. Four (4) is the maximum units allowed for any family. This represents a family of husband, wife and four children.

(f) Personal exemptions are from Rs 500 to 1,000 higher for married persons than unmarried persons.

(g) Under Ceylon law in some circumstances unmarried persons have some responsibility toward their relatives. In such cases, provision is made for an extra exemption.

(h) Brackets (in 1960) ranged from 5% to 60%. Top rate applies to income of Rs 31,500 for single persons and Rs 63,000 for families of four.

It is said that the quotient system is more effective in giving due weight to <u>family size</u> than is the personal exemption. Additional dependants under a quotient system may severely alter a taxpayer's liability, whereas under an exemption system it will have little effect, which will diminish with the increase in income.

Brazil

Joint returns are mandatory only where the husband and wife have chosen to act under non-tax laws as a unit.

Treatment of the family as a unit is reflected in personal exemptions: whether joint or separate returns are filed, married couples are entitled to only one household exemption (B.Cr$60,000) and to one wife's allowance (B.Cr$50,000).

Comparative Table

It is useful to compare treatment of the family in other countries, and the following table summarizes the treatment in 15 European countries and Australia. The main sources are Taxation in Western Europe, 1963, F.B.I. Taxation Studies, and the Harvard World Tax Series.

COUNTRY	COMPARATIVE TREATMENT OF SINGLE AND MARRIED TAXPAYERS	TREATMENT OF CHILDREN	COMPARATIVE TREATMENT OF MARRIED COUPLES WITH ONE AND TWO EARNED INCOMES
AUSTRALIA	One graduated rate applies to aggregated tax of a taxpayer. Husband and wife are separate taxpayers, the liability of each being determined independently. Personal allowance of a spouse is raised by about 40% for a dependent spouse with separate net income below a maximum. The allowance is reduced £ 2 for every £ 1 by which the dependent spouse's income exceeds the maximum.	Income of a minor is not included in parental income except where necessary to prevent tax avoidance through trusts. Daughter-housekeeper for widows or widowers are treated similarly to dependent spouses. Deductions for children over 16 are less for second and subsequent children than for the first. If a child's income exceeds a maximum, deductions are reduced £ 2 for every £1 by which the child's income exceeds the maximum. Reductions for students between 16 and 21 are similarly treated.	No provisions.
AUSTRIA	Class 1 rate schedule applies to single persons under 40. Class II rate schedules applies to married persons without children and single persons under 40, joint assessment being the general rule. Personal allowances are deductible, and the bottom bracket in each class is at nil per cent.	Class III is for taxpayers with dependent children. It is calculated by applying a percentage deduction on a regressive scale to the Class II rates. The percentage deductions vary for 1, and subsequent children.	Where a wife works in her husband's business there is a special deduction up to a maximum. Where both spouses have earned income, the joint earned income is reduced by the smaller one up to a maximum.
BELGIUM	Income of wife is jointly assessed with that of her husband, and one-tax rate schedule applied. Newly married taxpayers have a special deduction to a maximum. Exemptions vary as to the number of dependants.	Where parents have legal enjoyment of children's income, it is jointly assessed. Exemptions vary with the number of dependants.	If both spouses have earned income, that of the wife is reduced by 40% with maximum and minimum limits. If one spouse assists the other in business the deduction is from that part of income attributable to the assisting spouse if he or she has no other earned income.

COUNTRY	COMPARATIVE TREATMENT OF SINGLE AND MARRIED TAXPAYERS	TREATMENT OF CHILDREN	COMPARATIVE TREATMENT OF MARRIED COUPLES WITH ONE AND TWO EARNED INCOMES
DENMARK	The income of husband and wife is usually assessed jointly. Two rate schedules exist, one for a taxpayer with wife or children, the other for other individuals. Bottom brackets are at nil per cent, and there is a 10% deduction of earned income, including that of a wife and minor children, up to a maximum for each individual earning income.	Income of minor children is usually assessed jointly with that of the parents, with the 10% earned income deduction up to a maximum applying. The Government gives tax-free grants for children increasing in amounts for the fifth and subsequent children.	A deduction is allowed of one half of a wife's earned income, less that part of the husband's 10% deduction which applies to the wife's earned income. There is a maximum limit.
FINLAND	Income of spouses is assessed jointly. There are 3 classes each with a separate rate schedule, Class 1 being single persons over 24; Class 2 being persons married for over 3 years without children and single persons under 24; Class 3 being other individuals and partnerships. Classes 2 and 3 have bottom brackets at nil per cent. There is an earned-income allowance on a regressive scale up to a maximum. A cost-of-living allowance varying in different areas is given, which is 70% more for married couples than for single persons.	Unearned income of children under 16 is normally included in a parental joint income. The cost-of-living allowance, varying in different areas, allows about 70% of the single person's allowance for each dependent child. Also an education allowance is given to taxpayers supporting full-time students, increasing above 17 and up to 21, and increasing more if the child between 17 and 21 lives away from home. Tax payable in Class 3 is reduced by a lump sum tax credit for each child under 17.	If both spouses have earned or pension income, the lower one is tax free up to a certain figure, and half of income between that figure and a further figure is tax free.

COUNTRY	COMPARATIVE TREATMENT OF SINGLE AND MARRIED TAXPAYERS	TREATMENT OF CHILDREN	COMPARATIVE TREATMENT OF MARRIED COUPLES WITH ONE AND TWO EARNED INCOMES
FRANCE	One rate structure is fixed. For married taxpayers and those with dependants, a quotient system of income splitting is used. Income of the taxpayer, his wife and dependent children is aggregated and than split into parts on the basis of the following table. Married without children 2.0 Single or divorced, two dependent children 2.5 Married, two dependent children 3.0 Each dependent child counts for 0.5 The tax attributable to one part is multiplied by the total parts to find tax payable. A widow or widower with dependent children is treated as married. Detailed rules apply for single persons supporting dependants, etc.	Dependent children, that is, all natural children who are provided with a home and are under 21, or students under 25, or doing national service or invalid adults, are included in the quotient system.	There is a 10% expenses-of-employment deduction, and an earned-income allowance of 20% on income after the 10% is deducted.
GERMANY	Married taxpayers are usually assessed jointly and income splitting is applied. The basic rate schedule brackets are therefore twice as large for married taxpayers as for single taxpayers. Widows and widowers can split income for one year after the spouse's death, and also for any year he or she continues to support a dependent child of the marriage. There are personal allowances, which are not deducted before applying tax. Married taxpayers can elect to be assessed separately, in which case each takes half the personal allowance.	A child allowance, increasing with each child, is granted. Income of dependent children other than income from employment is normally assessed jointly with that of parents. If the parents elect to be assessed separately, each takes half the child allowance.	

COUNTRY	COMPARATIVE TREATMENT OF SINGLE AND MARRIED TAXPAYERS	TREATMENT OF CHILDREN	COMPARATIVE TREATMENT OF MARRIED COUPLES WITH ONE AND TWO EARNED INCOMES
GREECE	The husband is usually taxed on income of his own plus his wife's and that of children under 18. Some real property, business and employment income of a wife (up to certain maxima) is separately assessed. There is a personal allowance and dependent allowances of equal amounts for a wife, children and other dependants. The allowance for the wife is increased if taxable income includes wife's income from employment, business, etc. There is only one rate structure.	A child's earned income or inherited real property income is separately assessed. If income is aggregated, the dependent allowance to the father may be increased; otherwise they equal the allowance for a wife and other dependants.	
IRELAND	Similar to U.K. There is a standard rate and a surtax. Income is reduced by an earned-income allowance of 1/4 up to a maximum and by personal allowances for single persons, married persons, widows, children under 16 (in some cases over 16), and dependent relatives.	There is an allowance from the father's income for children under 16 (and in some cases, over 16).	The wife's earned-income allowance is 3/4 up to a maximum.
ITALY	There appears to be only one tax rate table. There is a personal allowance.	There is a dependent relative allowance and a large "family" allowance.	
NETHERLANDS	There are different rates for single and married taxpayers.	There are different rates applicable, depending on the number of children.	Earned income of a married woman is reduced by one third, with a minimum and maximum.

COUNTRY	COMPARATIVE TREATMENT OF SINGLE AND MARRIED TAXPAYERS	TREATMENT OF CHILDREN	COMPARATIVE TREATMENT OF MARRIED COUPLES WITH ONE AND TWO EARNED INCOMES.
NORWAY	Married couples are normally jointly assessed, but they can be separately assessed if both had income from employment, business or professional activity, and this was not from a business, etc., belonging to both spouses. The lower of such income is separately taxed, the aggregate of all other income being taxed in the hands of the other spouse.	Lump sum amounts are deducted on a progressive scale from tax for dependants.	Earned-income allowance is given to a single taxpayer with dependent children and to a wife who has earned income, which is aggregated with her husband's income. The amount varied with the number of children up to a maximum.
SPAIN	There is only one schedule of tax rates, but single men over 25 have a 30% surcharge. There is a basic allowance and tax-free exemptions of one third on small incomes and one fourth on slightly larger ones. There is also a progressive tax on professional earnings with a basic exemption.	There are allowable deductions for each child; as to the professional earnings tax there are exemptions for families with 4 to 7 children.	If both husband and wife receive professional income, and have children, the exemptions are increased.
SWEDEN	There is a dual-rate structure, one for married and one for single taxpayers, the rates coming together at 65%. There is a basic allowance for married persons and single persons supporting a child. There is a smaller basic allowance for other single persons. Married persons must live together for most of the year to apply the married rates.	There is no child allowance, but a tax-free subsidy is paid per child.	Married women with income from business or employment get an allowance up to a limit, and although it cannot exceed her net income, the excess unused can be applied against the husband's income. If the wife has children at home, the deduction can be increased by 10% of her net income from business and employment, subject to a maximum.

COUNTRY	COMPARATIVE TREATMENT OF SINGLE AND MARRIED TAXPAYERS	TREATMENT OF CHILDREN	COMPARATIVE TREATMENT OF MARRIED COUPLES WITH ONE AND TWO EARNED INCOMES
SWITZERLAND	There is one tax rate structure with a married allowance.	There is an allowance for each child and dependant.	
UNITED KINGDOM	The incomes of husband and wife are aggregated and assessed on the husband at the same rate as for single persons, both for standard income tax at 38.75% and surtax at progressive rates. There are personal allowances for single and married persons, and small incomes are charged at less than the standard rate.	If a child has income in its own right over a certain figure, the parent gets no allowance. Otherwise there are allowances for children under 11, more for those between 11 and 16, and more for those over 16 receiving full-time education.	There is a 2/9 earned-income allowance, up to a certain figure, above which the earned-income allowance is 1/9.

CAVEAT RE FOREIGN EXPERIENCE

Foreign experience is valuable for the purpose of extracting from it what seems useful but there is a certain danger in this procedure. We must bear in mind the underlying reasons for the foreign legislation. For instance, as we have previously noted, the U.S. split-income provision was almost an emotional response to the tax inequity which existed between common-law-property taxpayers and community-of-property taxpayers; at the time of its consideration, many of the vital questions relating to it were not raised, including such things as the treatment of income of minor children, the working wife, and the relative distribution of the tax burden. 10/ In Canada, on the other hand, the Supreme Court has held that Quebec community of property residents cannot split income to gain a tax advantage over common law province residents. Thus, we have a different basis from which to start in Canada.

In Britain compulsory aggregation came about because of the legal position of a married woman. She could not be sued without joining her husband. The aggregation rule circumvented this problem by making the husband responsible for the total tax. Although this same legal position existed in Canada years ago it is no longer true today.

These two points demonstrate that the United States and British systems are not based on any abstract and philosophical notions of the intrinsic value of the family in our society. They are the result of other factors, divorced from high-minded concepts, and represent practical responses to the "felt necessities" of the times.

Again in the United States the various difference in tax burden, resulting from the judicious handling of unearned-income splitting, between families of equal amount of unearned income, does not exist in Canada. Sections 21 and 22(1) have, in so far as they are not legally avoidable, prevented large-scale income splitting.

CONCLUSIONS FROM COMPARATIVE ANALYSIS OF TAXATION OF MARRIED PERSONS

There is no point in considering the family tax systems in the above countries unless we attempt to draw some conclusions and reach some decisions to some basic rationale. This has been done by Oldman and Temple, and the following excerpts are taken from their article entitled "Comparative Analysis of the Taxation of Married Persons". This article started as a report prepared by them at the request of the United Nations Secretariat for the Commission on the Status of Women, and appeared under the heading "Tax Legislation Applicable to Women" (U.N. Document No. E/CN.6/344). The present excerpts (to page 72) are taken from the article as it appeared in 12 Stanford Law Review 585 (1960).

> The appropriate progressive income tax unit has become the focal point of controversies over the broader problem of the allocation of tax burdens at various income levels among single persons, married couples with only one spouse receiving income, and dual income married couples.
>
> Separate taxation of each spouse is the system used in Argentina, Australia, Brazil, Canada, Dominican Republic, India, Israel, Japan, Mexico, Pakistan, Soviet Union, Spain, Venezuela, and Yugoslavia. Under some circumstances, however, the income of spouses is aggregated in these countries. ... The following countries aggregate the earned and unearned income of the spouses for application of progressive tax rates. Except in Germany and the United States, such aggregation is mandatory. Belgium, Ceylon, Republic of China, Columbia, Finland, Denmark, France, Germany, Ghana, Greece, Italy, Lebanon, Malta, Netherlands Antilles, New Zealand, Norway, Peru, Philippines, Sweden, Switzerland, Thailand, Turkey, Union of South Africa, United Kingdom, United States. All of these countries have some provisions which effect a reduction of the tax burden on married couples. In Ceylon ... France, Germany and the United States, the aggregate incomes are split, which results in lower rates. Reduced rates are applied directly to the aggregate incomes in several countries, including the Netherlands, Norway, and Sweden. Among those countries

in which allowances are permitted for the wife's earned income are Denmark, Finland, Norway, Switzerland, and the United Kingdom. Aggregation of the earned income of the wife with that of the husband is limited in scope in Belgium, Greece, Italy, and New Zealand.

In the following descriptive analysis of the relative burdens of progressive income taxation and single and married persons in several countries, the pendulum of discussion starts with the aggregation systems which impose relatively higher burdens on married than on single persons, swings through the separate taxation systems which are neutral in part or in whole, and ends with aggregation systems which place higher burdens on single than on married persons. With the exceptions noted below, the aggregation systems impose the same burden on all equal income groups, while the separate taxation systems differentiate among such couples but not among equal income individuals. For all the systems, at the lowest levels of income, there is little or no difference in tax burdens among married couples or between single or married persons because most of the income at such levels is taxed at the same beginning rate. At levels of incomes substantially beyond the beginning of the top bracket, there is also little differentiation made by the several systems because, except in the Netherlands, all taxpayers at such levels pay the same maximum rate on most of their income. At intermediate levels of income, however, the different methods of taxation produce wide variations in the allocation of tax burdens because at these levels the differing and increasing marginal rates of taxation operate on most of the income subjected to tax.

In the Philippines, married persons must file consolidated returns covering all the incomes of both spouses. ... When each spouse has income, aggregation pushes a combined income into brackets taxed at higher rates than would be applicable if each spouse were taxed separately. For any given amount of total income, the more nearly equal are the separate incomes of the spouses, the greater is the additional tax borne by the couple over what they would pay if taxed separately. Conversely, where one spouse receives all the income, the burden on the couple is identical to what it would be under separate taxation, except for the increase in personal allowance. ... At very high income levels, the total tax on the married couple with two incomes is always greater than it would be for two single persons with corresponding incomes despite the fact that in both cases all the income beyond two million pesos is taxed at the same marginal rate. However, the relative amount of extra tax on the married couple declines as the total income rises. ... The total tax on single and married persons never quite becomes equal because the aggregation of the incomes of the married couple gives them the benefit of the rates in the lower brackets only once, rather than twice, as would be the case if they were taxed as two single persons. This asymptotic relationship is an inherent characteristic of an aggregation system using a single progressive rate structure for all taxpayers. At the very lowest bracket of taxable income, the combined effect of aggregation and the differing exemptions for the single person (1800 pesos) and the married couple (3000 pesos) causes a heavier burden on married persons with two incomes than on single persons. The heavier tax burden would be eliminated or reversed in the lower bracket if the exemption for the married couple were exactly twice that of the single person, as it is in Norway and the United States.

Therefore, it may be said with only minor qualification that the aggregation system employed in the Philippines taxes the married couple with two incomes more heavily at all levels of income than two single persons with corresponding incomes, but that the additional burdens on the married couple at the very lowest and the very highest levels of income are relatively slight. With some modification, the same is true of Ceylon and Turkey, although their exemption patterns cause somewhat different relationships between single and married persons at the lowest income levels.

In the United Kingdom, although the spouses may elect to be assessed separately, their tax is computed on their aggregate income. With regard to earned income, however, the tendency of an aggregation system to place a heavier tax burden on married couples than on single persons is offset for the great majority of married taxpayers by various personal allowances. The first £360 of the earned income of each spouse is, in effect, taxed separately through the operation of provisions for reduced rate relief. Also, the personal allowance of up to £140 is granted to couples if both spouses have earned income. This allowance is over and above the £240 personal allowance granted to all married couples, as compared to £140 for single persons. In addition, the earned income allowance available to both spouses was increased in 1957, so that now a maximum earned income allowance of £1550 can be taken. The allowance is granted in the amount of two-ninths of the couple's earned income up to £4005 and one-ninth of the next £5940. Thus, in addition to reduced rate relief, the maximum allowance where both spouses work is £1930.

The effect of these allowances in the United Kingdom is that married taxpayers at the lowest levels of income are taxed less heavily than two corresponding single persons. From that point to the point where surtax levels are reached, the married couple bears virtually the same burden of tax on earned income as the two spouses would if separately taxed. The surtax level for the married couple is not reached until a minimum of £2100 of income is received. Most married taxpayers, however, do not reach the surtax level until a still higher level of actual income because of the various personal allowances available to them. It has been reported that surtax affects only 1.2% of the taxpayers. (See the Oldman and Temple report to the United Nations at p. 45.) Those married couples who are affected by the surtax are subject to the increased burden which aggregation usually tends to impose on married couples. With regard to earned income above the surtax level but below a total of £9945, however, the recently expanded earned-income allowance considerably modifies this increased burden in an absolute sense, but does not affect it relative to single persons to whom the same allowance is also available. The earned income allowance thus effects a reallocation of tax burdens between earned and unearned income, but not generally between single and married persons as such. With regard to unearned income, the effects of aggregation are unmitigated.

In Sweden, the spouses file separate returns but their incomes are aggregated in computing tax. The tax rate schedule applied to the married couple is different from that applied to single persons. The lower rate is 11% in both rate schedules, but it is applied to the first 8000 kroner of a married couple's income as compared to the first 4000 kroner of a single person's income. The next 2000 kroner in each case is taxed at 17%. From that point until 60,000 kroner is reached, the bracket widths remain the same, but the rates applicable to the married couple's aggregated income are slightly less than those applicable to single persons. From 60,000 kroner up, both the rates and bracket widths are the same. ... In addition to the lower rate schedule applicable to married persons, an earned income allowance of 300 kroner is given where both spouses received earned income independently of each other. This allowance is increased to 10% of the wife's earned income up to a maximum allowance of 1000 kroner if the couple has a child under 16 years of age living at home. The allowance is above the personal exemption, which varies with location within the country and which is twice as high for the married couple as it is for the single person not supporting children.

The relative burdens of taxation on single and married persons vary with the level of income. At the lowest brackets, spouses earning unequal amounts of income are taxed less heavily than if they were taxed as two single persons. If the spouses earn equal amounts of income, the tax is also less than if they were taxed separately because of the earned income allowance which is not available to single persons. If the earned income allowance is not considered, the effect of Sweden's dual rate system in the lowest bracket is the same as that of the United States system of splitting, with the result that where one spouse has all the income the couple is taxed less heavily than if the two spouses were taxed as single persons. In fact, couples in which only one spouse has income bear a lighter total tax at all income levels, though their marginal rates of tax are identical to those of single persons at income levels above 60,000 kroner. Where both spouses have equal incomes, they bear a tax at the lower income levels which is approximately the same as if they were singly taxed but, as their aggregate income increases, they bear a progressively greater tax burden than if singly taxed. Where one spouse's income is much smaller than the other's, there are some combinations of these incomes, even at brackets beyond the lowest ones where the total tax on the couple is less than if the two spouses were taxed separately. On marginal increments of income beyond 60,000 kroner, the extra burden of aggregation is analogous so that in the Philippines or that at surtax levels of income in the United Kingdom. At levels beyond 150,000 kroner, the extra burden of aggregation decreases asymptotically.

In Canada, the entire income of each spouse is taxed separately with the exception that the income of a spouse whose total income is less than $250 is not taxed at all. As a matter of convenience, a spouse with no more than $1250 of income aggregates it, in effect, with the income of the other spouse. The effect of aggregation is accomplished by reducing the spousal allowance, normally $1000, by the amount by which that income exceeds $250. With the exception of transactions coming within the purview of section 21, the tax burdens on single and married persons in Canada are virtually identical. However, unlike aggregation systems including those discussed below, but somewhat like the Israeli system, the separate taxation system substantially differantiates among married couples on the basis of varying distributions of income between the husband and wife. For example, at middle income levels in Canada, there is considerably greater total tax liability imposed on a married couple in which one spouse only receives income and on one in which the income is received in equal parts by each spouse, even though both couples have the same total income. The aggregation systems of the United Kingdom and Sweden, as already noted, obtain differentiation among married couples through the less pervasive device of allowances based on whether one or both spouses work.

Under separate taxation systems, a married couple with a dual income pays the same total tax as that paid by two single persons with corresponding incomes. Aggregation systems, in contrast, impose either a heavier or lighter tax on a dual income married couple than the total tax imposed on two single persons with corresponding incomes. The United Kingdom and the Philippines, each with a single rate schedule, and Sweden with dual rates, tend again to place a heavier tax burden on the married couple, although in these and in all other countries the married couple is never taxed more heavily than one single person with the same total income. On the other hand, as will be observed below, a general tendency to place the heavier burden on single persons is found in the Netherlands, and irrespective of the distribution of income between the spouses, in the United States.

In the United States prior to 1948, the method of taxing single and married persons was much the same as that of Canada, except that there was no provision quite like that in section 21 of the Canadian Income Tax Act. ... In 1948, the United States adopted the splitting system, which is similar to the quotient system of France, except that the income of children is not aggregated with that of the parents and the income is invariably divided into only two parts in computing the tax. In France the aggregate income is divided into one part for each spouse and one-half part for each child, with special "parts" for other relatives and widows. ...

In practice, virtually all married couples in the United States aggregate and split their incomes, although they are entitled under the law to be taxed separately. If the actual income of one spouse is in fact equal to that of the other, their total tax is always exactly the same, subject to minor exceptions due to certain deductions, whether they elect to be taxed separately or elect to aggregate the split. The advantage of splitting, as opposed to separate taxation, arises when one spouse has more income than the other; the larger the disparity in the income distribution between the spouses, the greater is the tax advantage. Where one spouse has all the income, splitting may still be elected and the advantage of splitting is at its maximum. However, because of the progressive rate scale, the amount of this advantage varies greatly according to the level of income, as described below.

In the United States, as in other aggregation systems, there is no difference in the tax burdens of married couples with the same total incomes. However, unlike those aggregation systems already discussed, which at some levels of income place a heavier burden on married couples than on single persons, the United States system reverses the positions and places the heavier burden on single persons. At lower levels of income, the extra burden on single persons is nil, except that the 20% rate */ in the lowest bracket could be lowered as a result of the revenue which would be gained if married couples with higher incomes were not permitted to split. The majority of married couples in the United States have taxable incomes not in excess of $4000, and splitting that amount merely removes the income over $2000 from the 22% rate bracket to the 20% bracket. Therefore, most married persons pay about the amount of tax as they would without splitting, irrespective of the actual distribution of income between the spouses. In the middle brackets, married couples realize an increasing tax advantage as the marginal rates rise to 50% and more. The relative burden on single persons rises with greater income, so that at about $25,000 of income they pay a tax bill that is more than 25% higher than that of a married couple with the same income. In the upper brackets, the married couple's advantage diminishes, but persists even beyond the 91% top rate */ applicable to income over $200,000 for single persons and, because of splitting, $400,000 for the couple. At $500,000 of income the single person pays about 6% more tax than the married couple.

The Netherlands is one of the few countries, other than the United States, which consistently taxes single persons more heavily than most married persons. This is done by aggregating the incomes of husband and wife and applying a separate rate schedule that is lower at all levels of income than one applicable to single persons. However, where both

---

*/ Pre-1964 rates.

spouses have equal incomes, there are some cases where the tax they pay on their aggregate income is higher than they would pay if each was separately taxed at the rates applicable to single persons. Thus, in the Netherlands, as in the United States, the relative advantage given to married couples decreases as the actual incomes of the two spouses become more nearly equal.

Countries other than the United States and the Netherlands which impose extra tax burdens on single persons are Bulgaria, Czecho-Slovakia, Poland, the Soviet Union, and Spain. These are the countries which also usually impose the same extra burden on married couples without children.

By what rationale, then, have many countries decided that married couples with the same taxable income should pay approximately the same total tax? The focus of taxation on close social units and specifically on the married couple is perhaps most rationally conceived in terms of a common pool of income or wealth, which constitutes the married couple as a spending or utilizing unit. The concept of a common pool of income does not necessarily mean that either spouse has complete access to the other's income. However, it assumes that in the vast majority of cases the spending habits and living standards of husband and wife are dependent on the same factors and that income is meaningful to each of them more on the basis of relative needs than according to which of them earned it. While there may not be agreement on just which principles of economics and equity are being pursued by progressive taxation, there is a widespread belief that, for the purposes of any reasonable policy of progressive taxation, the economic lives of a husband and wife are inseparable. ...

Continued higher taxation of married persons in the United Kingdom was recommended by Royal Commissions in 1920 and 1954, partly because it was believed that their taxable capacity was greater than that of single persons. However, the 1949 Shoup report on Japanese taxation stated that:

> "The aggregation of incomes pushes the combined income into brackets taxed at higher rates than are otherwise applied to taxpayers on the same general level of welfare and taxable property."

Japan now taxes earned incomes separately, as well as unearned income below a certain level. Other countries impose higher taxes on single persons, sometimes in the form of bachelor taxes, partly on the theory, contrary to the view of the Royal Commissions, that they have a greater taxable capacity than married persons. ...

For example, the cost of living is one important factor involved in theories of taxable capacity, ability to pay, sacrifice, and marginal utility. It is probable that two married persons living together spend less for food, shelter, and clothing, than two single persons living apart. Combined living quarters, bulk buying of food and home-cooking, and the wife's services in housekeeping, laundrying, and sewing, may effect sizeable economies in the cost of living. No country, however, taxes the married couple more heavily than one single person with the same total income. Some countries tax the married couple less heavily than one single person; and some, such as the United States and the Netherlands, go even further, and tax the dual income married couple less heavily than two single persons with corresponding incomes. These lighter burdens on married persons are in addition to the relief provided through personal and dependency allowances and may reflect a view that additional responsibilities incurred upon marriage are not adequately provided for by allowances.

Even most of those countries which place a heavier burden on the married couple recognize that the economic unities and advantages of the marriage relationship diminish when the wife earns income outside the home. This fact partially explains why several countries tax the spouses separately on earned income but jointly on unearned income. Countries which aggregate earned and unearned income consider the economic unity and advantage of joint living to be less seriously disturbed by the wife's earning activities outside the home than would justify separate taxation. These countries rely on a system of allowances, such as those for earned income, child care, and housekeeping expenses, to measure and provide for the differences. Such allowances, though they may vary with income, are generally not permitted to exceed a fairly low maximum, since additional costs due to the wife's earning activities are regarded as either not increasing proportionately with income or as ceasing at a fixed level. Allowances granted as constant percentages of the wife's earned income up to an amount established in a middle income bracket would offer greater differentiation among married couples.

Serious considerations of administration and enforcement also influence the choice between taxation of all persons as individuals and the taxation of some persons in units. ... Separate taxation of married persons poses the additional major problem of legal and fraudulent redistribution of income between the spouses. In several countries, separate taxation of the wife's income is restricted to income earned independently of the husband's earning activities. Such restrictions are probably designed to prevent abuse of the separate taxation rule by husbands who put their wives on the payroll or otherwise assign income to their wives in order to avoid tax. It is ordinarily quite difficult for tax authorities to determine which income distribution arrangements between spouses are legitimate and which are fraudulent or sham.

Those who oppose taxation of the married couple as a unit often assert that the system is based upon unjust and outmoded concepts of the legal incapacity of the married women. Certainly, such concepts should not serve as a basis for designing tax law. From a more understandable view, a country may feel that it is socially desirable for wives to tend house and raise children and thus to strengthen the home or family as a social unit. Even so, this behaviour should be a matter of personal choice and not the result of compulsion by taxation. ... While the working wife, like other taxpayers, must bear the disincentive effect always characteristic of progressive income taxation, a deliberate design to discourage her from earning money would be discriminatory and unjust. ...

Separate taxation based on the legal precept of the equality of the married woman is as ill-founded as aggregation based on the fictitious legal incapacity of the married women. Viewing each spouse as a separate spending unit is usually unrealistic. Most of the countries of the world treat the two spouses as a single unit. There is little basis for believing that they have done so on the basis of outmoded concepts and irrelevant social policies. The fact is that unit taxation of the married couple is consonant with economic, social and administrative realities.

Large relative differences in tax burdens exist principally within the intermediate income groups of the many countries. Equity in the allocation of tax burdens should be sought for taxpayers in these groups, even if they constitute a small proportion of all the taxpayers in a particular country. Consideration must also be given to whether or not greater differentiation of tax burdens should be made among the many taxpayers in the lowest income brackets, and among the few in the highest, in accordance with their varying individual circumstances. ...

Tax burdens should generally be allocated according to the following pattern. A married couple with only one spouse having income should pay a greater total tax than a married couple with both spouses working, assuming both couples have the same total income. The dual income couple should, in turn, pay a greater total tax on its two incomes than would be paid by two single persons with corresponding incomes. These allocations are based on the economic advantages of joint living, which are greatest when only one spouse works. To complete the pattern, one single person should pay the same or a greater tax than the married couple with one income, since the advantages of joint living are never so great that two can live more cheaply than one.

Aggregation with a single rate schedule and aggregation with splitting are imprecise systems of allocating tax burdens when unmodified by working wife allowances. In the middle income brackets, such systems produce extreme variations in the relative burdens of single and married persons; among married they effect little or no differentiation on the basis of whether one or both spouses work. While these systems have administrative simplicity, continued pressure can be expected from those taxpayers who bear unduly harsh relative burdens; for example, the dual income middle bracket married couples in the Philippines and the United Kingdom and single persons in France and the United States. Such complaints are more than the usual attempts of taxpayer groups to seek preferred treatment; they are indicative of a failure of tax policy to provide equitable tax burden allocations.

Aggregation with dual or multiple rate schedules can produce most of the desired allocations of burdens at every income level with a reasonable degree of accuracy. For example, the Income Tax law might provide two progressive rate schedules, one for single persons and one for married couples. The rate schedule applicable to single persons would in general be higher than that applicable to married couples. It could be only 2% of 3% higher in the lowest brackets, about 10% higher in the intermediate brackets, and from 2% to 10% higher in the highest bracket, depending upon the level of the rate for married couples in that bracket. Variations in bracket widths could provide for flexibility. To provide for differentiation among married couples, those couples with two earned incomes might be given special allowances which would make up rather fully for the additional costs incurred in household upkeep and child care. Such an aggregation system would tend to produce the burden pattern outlined above, with the burden allocations being determined more by deliberate forethought than by the arbitrary arithmetic of aggregation with or without splitting. An alternative to the special allowances for couples with both spouses working would be to permit separate taxation of such spouses at the higher rates applicable to a single person. Although this alternative is the less rational of the two, in that it will in many cases provide an unduly large amount of a differentiation among married couples it is likely to be more acceptable to those who demand provisions for the election of separate taxation.

A single progressive rate schedule with an intricate arrangement of absolute and percentage allowances would offer the most refined method of allocating burdens in accordance with the pattern outlined, and with a degree of accuracy consonant with the varying situations of different taxpayers. Such a system requires careful statistical and analytical studies of the personal, employment and dependency circumstances of the different groups of taxpayers at each level of income in order to determine for which circumstances allowances should be provided and of what type and amount they should be. ... New and more finely discriminating allowance systems necessarily involve new administrative problems. Advances in electronic data processing equipment and its application to tax administration offer new opportunities for the study of taxpayer circumstances and the refinement of tax systems. Finally, those countries accustomed to fine detail in their tax statutes face a special problem in the implementation of a system that makes refined differentiations among taxpayers. Further individualization of the income tax burden inevitably implies a shift of emphasis from the original legislative enactment to the continuing processes of administration and adjudication.

REFERENCES

1/ See Taxation in Western Europe, 1963, F.B.I. Taxation Studies, p.234.

2/ Royal Commission on Taxation of Profits & Income, Second Report, London; Her Majesty's Stationery Office, 1954, p.78.

3/ Stein, Hubert and Pechman, Joseph A., Essays in Federal Taxation, December 1959, p. 52.

4/ Ibid., pp. 60-61.

5/ See Second Report, Royal Commission on Taxation of Profits and Income, London, Her Majesty's Stationery Office, 1954, p. 37.

6/ See Taxation in Western Europe, 1963, F.B.I. Taxation Studies, pp.88-89.

7/ Harvard Law School, International Program in Taxation, Income Tax Policy and Legislation, 1962-63, p. 132.

8/ See Groves, Harold M., Federal Tax Treatment of the Family, p. 142.

9/ See Goode, R., "New System of Direct Taxation in Ceylon", 13 National Tax Journal, December 1960, (No. 4), pp. 329-340.

10/ See Young, Douglas Thorson, The Selection of a Tax Unit under the Income Tax, The Individual Unit versus the Family Unit, a thesis submitted to the Graduate School of the University of Wisconsin, 1962, pp. 242-244.

CHAPTER 3—CONSIDERATION OF SYSTEMS

PROBLEM STATED

The factor of family status must be considered in a system utilizing progressive rates which purports to be based on ability to pay. Not only does recognition of this problem reflect the admission that ability to pay is influenced by variations in economic obligations, but also it acknowledges a reality of our way of life in which families, or at least households, operate as economic units, and many facets of family law impose certain economic inter-family obligations.

Progressivity requires decisions regarding the treatment of the family unit, and how the rate schedules shall apply. Once this is determined, the refinements in the personal income tax are aimed at trying to recognize, in terms of the tax burden to be borne, the differing responsibilities of persons with equal incomes.

When deciding on an appropriate tax unit, it is noticeable that in the family, expenditures are made for the good of the whole, and not primarily or exclusively for the benefit of the member having legal title. 1/

Is then, the family or the person the logical tax unit? If the family acts as a unit, pooling its resources to develop its fortunes and meet its misfortunes, then possibly it should be treated as a tax unit also.

Although income tax is a tax on income it is exacted from persons. These persons form the tax-paying units of the tax system. Prima facie in an individualistic society one would expect that each person would bear some portion of the total tax burden. As we have seen, Canada has in a rough sort of way, to the present day, paid homage to this concept in that the basic tax-paying unit is the individual. Family differences are adjusted through exemptions. With the exception of section 21 and section 22(1) transactions, the tax burden in Canada, on single and married tax-payers with equal incomes is about identical. (This is apart from adjustments through exemptions.) Unlike split-income systems, greater total tax is imposed in Canada on a married couple in which one spouse receives all the income, than on one in which the income is received in part by each spouse, even though both couples have the same total income.

It is in the context of the principle of individualism that one may ask if there are valid and compelling reasons to search for some other tax unit. The present Canadian system is based on the assumption that the family as a unit has no combined tax-paying ability _per se_, that its tax-paying ability is the sum total of the ability of each member, and the tax-paying ability of each member is determined by his or her income. Is there justification for the view that there ought to be a family unit for taxation purposes? And if there is justification, who shall form the unit?

SOCIAL AND ECONOMIC CONSIDERATIONS

It is suggested that the basic fibre of western society is the family. We think in terms of the family for religious purposes, for welfare purposes, for political purposes and for status purposes. Christian thinking has lent itself to the development of a cohesive group called the family. Housing is being designed for the "family"—to the point where "family rooms" are now in vogue.

We think in terms of dad, mom and the kids. This development is not new. Anthropologists and sociologists have demonstrated that from time immemorial, the basic societal organism has been the family. It was only after the development of the family that clans and larger groups emerged.

On the economic side, however, the picture of the family as a unit does not reveal itself so distinctively. It is clear that the basic earner of the family is the husband although the trend toward the working wife increases yearly. We know very little about the contribution to family wealth made by its minor members. On the expenditure side the picture is more cloudy. For example, we know little about the decision-making process respecting family expenditures. Does the husband act as a pocket "Hitler" and "decree" what shall be spent, or are the husband's earnings dutifully carried home to the wife for disbursement? Notwithstanding this lack of information concerning the mechanics of spending in the family, we are certain that the economic life of all members of the family is interrelated and interwoven.

LEGAL CONSIDERATIONS

It must be noted at once that a very basic difference in viewpoint on the relationship of husband and wife exists in community-of-property-law countries as compared with common law countries. In the civil law, husband and wife are considered as one. Their property is aggregated and looked upon as a consummate whole. The common law, on the other hand, always treated the wife as subservient. She was afforded few legal rights and at one time could not sue nor own property and was under many other legal disabilities.

Industrialism brought with it a change in attitude toward married women so that the common law has now been much varied through statute. The 19th century saw the advent of the Married Women's Property Act and the 20th century has witnessed the complete emancipation of the wife. It is a fair summary to say that today women are in no way subservient in our society.

Legal liability to support children did not exist in the common law. Statutes have effectively changed this so that today a father may be made to pay for maintenance and support, and in some cases may be subject to a criminal charge for failure to do so.

TAX POLICY AND ABILITY TO PAY

Some of the above comments will raise a few of the problems and questions which must be worked out and answered before the family as a tax unit can be introduced. But, in addition, there are questions of pure tax policy which must be satisfied. It has been said that:

> In nearly all cases the income of the entire family, husband, wife and minor children is shared by all, especially if we consider both current consumption and current saving and planning for the future of family members. It is a proper tax goal to impose the same income tax burden on all similar family groups having the same total income. 2/

There is a powerful school of thought which holds that ability to pay as related to families depends upon the combined income of all members of the family. If this premise be true it is then suggested that tax laws must be geared to it and in a progressive rate system, we should tax the total income of the family as a "unit".

Others are opposed to this view and suggest that the family itself has no tax-paying ability as such but rather only has the combined ability of each of its members. The ability of each member is in turn measured by his or her income.

The present rationale of provisions like sections 21(1) and 22(1) is founded in the first of these two schools. Thus, although to some extent our tax law has been based on the paying ability of each individual, provisions like section 21(1) make it clear that this philosophy has not been adopted and carried through in a pure state. Basically section 21(1) is saying that the income from the property transferred is available to the family as a whole and thus taxes it to the husband as the head of the family, notwithstanding that the husband's ability to pay has been diminished to some extent since the transferee is legal owner of the income.

Progressive taxation is based in part on ability to pay. If we introduce into Canadian tax law the concept of the family unit, will this be consonant with the ability to pay theory? Does a married couple with two children, earning $10,000, have a lesser, equal, or greater ability to pay than a single person with the same income? A well-known result of income splitting in the United States was to shift the tax burden to single taxpayers. The tremendous shift which occurred caused such disruption and dismay in the tax structure that it was necessary to enact special legislation giving concessions to single taxpayers in special circumstances. In this regard, it may be noted that in England the U.S. split-income system, as well as the French quotient system were rejected because, although "each has its attractions... adoption of either would mean a shift in the distributions of the tax burden from married persons to single persons to an extent that seems... excessive". 3/

Thus, it is clear that there is a danger in adopting a system which aggregates all income in the family and taxes it as if it belonged to one unit. We shall see that the extent of inequity or inequality resulting from such a system depends in large measure on the tax computation plan used.

CHOICES AVAILABLE

There are at least four choices of a tax unit: (1) the individual, (2) husband and wife, (3) the family, (4) the household. A discussion of the choices available for a "tax unit" is really a discussion in disguise of equal treatment of families with the same income. At present in Canada where a husband earns $5,000 and the wife earns $5,000 giving a combined income of $10,000, they pay substantially less taxes ($1,400) than the family where the husband earns $10,000 and the wife earns $0 ($1,600).

THE EQUITY PROBLEM

In the main, the most difficult problem is to find a method of identifying the tax-paying unit which will be better fitted to the application of the doctrine that taxpayers equally situated as to income and size of family should pay equal taxes. Having determined this, there is still the problem of determining the tax-paying abilities of single persons and families of varying size, all with equal income.

Relative tax-paying abilities of families of different size cannot be determined merely with reference to their income. Although this statement is true, it is also true that our available information does not cast adequate light on the problem of the relative tax-paying abilities of families of varying size at all income levels. If we admit that in our society legal ownership of income is irrelevant so far as maintenance of the family and saving is concerned, then it is fair to ask whether there should be any difference in tax treatment between families with equal incomes, whether it is earned by both husband and wife or by the husband alone. And if one concedes there ought to be no difference, except to the extent of recognizing the imputed income, contributed by the wife who stays home and taxing it or recognizing the cost of earning the income, or lost-imputed income arising when the wife works, it becomes necessary to suggest a workable system to meet these views.

Virtually no information is available on the pooling of family resources in Canada. It has been said that in the United States, "... economists and tax students who have expressed views on this subject are in general agreement on the following points; first, that spouses in the normal case, pool and share their income; second, that the most frequent departures from this practice occur at upper income levels where there may be a desire to maintain separate fortunes; and third, that pooling and sharing also occur with minor children, but not in the same degree". 4/ It is conjecture but it seems fair to assume that the same general conclusions would apply to Canada. One thing is clear in Canada: there has been either implied or expressed general, judicial, legislative and social recognition of the family as an economic unit. Moreover, although statistics are not available the Estate Tax Administrator informs us that most estates contain some property held jointly between husband and wife. This is clear evidence of pooling but little indication as to its extent.

THE WORKING WIFE

In respect of the working wife, it is suggested that some percentage of her gross income be allowed as a deduction, but subject to a maximum dollar limitation. The percentage allowed and the dollar limitation could be worked out after careful study of the costs of child care and other expenses necessarily incurred by working wives. Any attempt to obtain equality in this area by taxing the imputed income of non-working wives is not administratively possible.

The following table has been prepared to show an analysis of working wives in Canada related to the incomes of their husbands.

MINOR CHILDREN

Incentive considerations must be taken into account in deciding on the tax unit. It is argued that the income of minor children ought not be taken into the pool and taxed on the grounds that often it does not in fact go into the pool and further, that because of the higher rate, there is a disincentive for the child to work. This argument does not seem very sound on either count. In upper income group families, money earned by children doubtless does not go into the pool but the family does gain substantially in that money which might otherwise be allocated to the child may now be used for other purposes. But this is not so in the lower income groups where it is most likely that we will find minor children who work. In this group, it seems logical to suggest that all earnings go into a common fund. Again the disincentive to minor children will not mean much in real terms because we are effectively dealing only with the lower income groups. Children in the higher income groups who are allowed to keep their money while it is nevertheless added to the family income for tax purposes, will never feel the tax—dad will pay it! Thus, there is in all likelihood little disincentive to these children.

Transfers of income-producing property should not be allowed to thwart the tax law. If the transfer is made to a child under 19 the income from the property should be brought into the family pool. Once the child leaves the unit, the income from the property should not be brought into the family pool. This rule concedes nothing in favour of the usefulness of property transfers before a minor severs his connection with the family—at least economically.

NUMBER OF WORKING WIVES BY INCOME BRACKETS RELATED TO INCOME CLASS OF HUSBANDS

INCOME OF HUSBAND	INCOME OF WIFE								
	$ 0-999	1,000-1,999	2,000-2,999	3,000-3,999	4,000-4,999	5,000-5,999	6,000-6,999	7,000-9,999	10,000+
$ 0- 999	-	40,178	158	7,273	4,033	2,553	941	577	102
1,000-1,999	196,673	16,681	5,508	3,219	974	243	64	34	39
2,000-2,999	107,705	21,865	25,936	5,955	1,539	355	93	82	21
3,000-3,999	177,313	43,541	55,320	26,884	4,255	955	307	156	30
4,000-4,999	389,813	37,499	47,255	33,713	8,036	1,517	438	219	33
5,000-5,999	327,496	17,423	18,861	18,559	5,701	1,856	494	222	30
6,000-6,999	188,709	7,023	8,159	8,132	3,094	1,090	495	198	16
7,000-9,999	184,513	4,722	4,328	5,694	2,724	1,263	1,874	487	45
10,000 +	87,430	867	840	943	642	412	625	235	94

SOURCE: Details of Wage earners from Census of Canada 1961; D.B.S. Section 2.1, Table 94-2. Partially adjusted to correspond to Table 6, Taxation Statistics 1963, for income distribution by all taxpayers. The figures shown for taxpayers with incomes over $10,000 are an understatement of the situation as they do not reflect the large proportion of non wage-earners in this group.

Note: Taxpayers with spouses earning over $1,000: less than 500,000.
Taxpayers with spouses earning over $3,000: less than 200,000.

TOTAL INCOME OF NON-FARM POPULATION, 15 YEARS OF AGE AND OVER, BY SIZE OF INCOME, SEX AND MARITAL STATUS, FOR CANADA, INCLUDING THE YUKON FOR THE YEAR ENDED MAY 31, 1961

INCOME GROUPS

	Without Income	Under $500	$500-999	$1,000-1,499	$1,500-1,999	$2,000-2,499	$2,500-2,999	$3,000-3,499	$3,500-3,999	$4,000-4,499	$4,500-4,999	$5,000-5,999	$6,000-9,999	$10,000+	Total */	Average */
MALE	369,252	266,038	392,170	276,685	255,441	309,174	319,115	445,275	412,032	431,437	319,172	479,902	521,468	180,135	4,608,044	$ 3,999
Single	332,655	182,474	150,598	107,948	81,276	93,529	76,773	90,513	59,093	46,441	26,973	31,229	24,725	7,236	978,808	2,158
Married	32,362	78,333	189,024	147,089	161,569	205,629	233,719	344,547	345,334	378,235	287,583	442,280	489,560	169,624	3,472,526	4,587
Widowed-Divorced	4,235	5,231	52,548	21,648	12,596	10,016	8,623	10,215	7,605	6,761	4,616	6,393	7,183	3,275	156,710	2,497
FEMALE	2,420,083	611,495	642,350	312,909	251,834	257,081	185,444	170,684	95,185	59,360	31,992	36,794	36,465	12,200	2,703,793	1,651
Single	339,369	144,322	111,180	80,589	82,347	94,401	68,771	66,780	37,278	23,354	12,383	13,536	13,044	2,537	750,522	1,942
Married	2,035,382	422,581	334,625	163,831	126,154	129,455	94,319	84,334	46,064	27,453	14,273	16,281	15,674	6,137	1,481,181	1,505
Widowed-Divorced	45,332	44,592	196,545	68,489	43,333	33,225	22,354	19,570	11,843	8,553	5,336	6,977	7,747	3,526	472,090	1,650
TOTAL	2,789,335	877,533	1,034,520	589,594	507,275	566,255	504,559	615,959	507,217	490,797	351,164	516,696	557,933	192,335	7,311,837	$ 3,131

Source: Census of Canada, 1961, Bulletin No. 5X - 2, Catalogue No. 98 - 516.

*/ Persons without income not included.

To the extent that it is thought or felt desirable to impose equal tax burdens on families with equal incomes, the inclusion of the income of minor children is a necessity. But this treatment depends entirely upon the validity of the premise that the income of minor children is pooled and shared with all the family. We have little or no statistics on this point.

It may be that the inclusion of the income of minor children could be made optional. If, for instance, a split-income plan were introduced and the spouses wished to use the split-income computation in arriving at tax payable, they would be bound to include the child's income with theirs.

In any event a provision similar to section 22(1) could be maintained so that "artificial" splits would be avoided.

Inclusion of the income of minor children would also necessitate a review of the problem of differentiating between equal-income couples with different numbers of children to allow for variations in ability to pay.

ADMINISTRATION

Administratively, the family tax unit offers a good deal. Property transfers designed to split income would vanish and other devices for splitting income, such as the use being made of personal corporations would be of no further benefit to taxpayers. The number of returns to be handled would be reduced substantially. In the short run, there would be some administrative frustrations and difficulties in preparing new forms to meet the system. However, these are short-run problems which eventually would disappear. The following is a list of administrative problems and advantages of a family unit using aggregation of (1) only husband and wife income, and (2) husband, wife and children income:

Husband and Wife Aggregation

(1) Husband and wife aggregation, eliminates administrative problems in trying to detect splitting of income between husband and wife under our present system. Thus, section 21 could be repealed. If the system also forced inclusion of children's income, the problems of detecting splitting with children would likewise disappear and section 22(1), in so far as it applies to father and son, could be eliminated.

(2) Separate returns would no longer be necessary and therefore the number of returns could be cut substantially with a concurrent reduction in the work entailed in processing returns. This advantage may not be too great with the new computer system in operation. But joint returns might tend to reduce the number of applications for tax refunds and thus reduce the work load.

(3) A change in withholding tables would probably be necessary to avoid large over-withholding in some cases.

(4) Obviously new tax return forms would need to be drafted.

(5) Liability for tax raises a problem. Should the liability be joint and several, when in most instances, all of the income will be owned by the husband? In this connection it is to be remembered that in the common law provinces the Married Women's Property Acts make married women separate as to property. It might be difficult to persuade the fairer sex of Canada that her property ought to be subject to a lien for taxes on income earned by her husband. Yet, if joint and several liability is not required, often returns will be signed by only one spouse and delays in obtaining information may arise.

(6) If splitting were extended to head of household status, obvious legal and administrative problems involving determination of that status would need to be worked out.

(7) Definitional problems relating to "who are spouses" would arise, but these could be worked out. What would be the position of the common law wife, for example?

Husband, Wife and Children Aggregation

(1) Attempts to split income with children would not arise and therefore the administrative problems of detection would be eliminated in this area.

(2) A definitional problem of which "children" are included in the plan would arise. Such problems, however, are not severe and are no different from other definitional issues all of which appear to be a natural concomitant of using the English language.

(3) Tax liability would present a difficult problem. Would a minor child be made liable for tax on his share of the family income? It would obviously be difficult to collect such taxes. And any attempts by the federal government in its tax law to make an infant liable in law might meet with a constitutional argument that it conflicts with property and civil rights. Whether this argument is valid is of little import in that, as a practical matter, it would be uttered throughout the realm and would create hardships in the implementation of the law.

DEFINITION OF FAMILY UNIT

There are a number of taxpayers who are, in fact, the head of a household although they are not married. A son may maintain a household for his mother or father who are dependent on him for support. Would such persons or households be treated as a family unit? Any tax plan based on a family unit which fails to provide for such cases will create gross inequity. Some adjustment would need to be made for these cases.

CORRELATION WITH GIFT AND ESTATE TAX LAW

Under the present income tax law, income from transferred property may, in some circumstances, be taxed to the transferor. In addition, although property is transferred, it may, nevertheless, under some circumstances, be taxed to the transferor's estate. In the study on transfer taxes as an alternative to estate and gift tax, a table showing the divergent tax results of various kinds of transfers has been set out. For convenience that table is reproduced here.

A personal tax system which would seek to tax first of all the income of a family and then to tax the capital transfers within or outside the family commends itself on a basis of simplicity and equity. In large measure, integration of such taxes would reduce avoidance and evasion immeasurably, and at the same time preserve or possibly raise the level of revenues. Personal taxes which are capable of achieving these ends must be reviewed with care and rejected only after intricate and detailed study.

TABLE SHOWING CORRELATION OF INCOME, ESTATE AND GIFT TAX UNDER PRESENT LAW

Type of Inter Vivos Disposition	Income Tax Treatment	Estate Tax	Gift Tax
1. Disposition subject to power to appoint or dispose solely in grantor.	Income is taxable to the grantor under s.22(2)(a)(ii).	Taxable unless power released within three years of death; and even then possibly taxed as a gift if the taxpayer dies in that period.	Not taxable. A taxable gift is made when the power is released.
2. Disposition subject to power to appoint or dispose in grantor and person having substantial adverse interest.	Income from the property is not taxable to grantor.	Not taxable if grantor is not valid object of power on the assumption s. 3(1)(a) of the E.T.A. would not apply. If grantor is valid object of power, s.3(1)(d) will apply regardless of when disposition made.	By departmental practice considered: (1) Not taxable, if there is a power to appoint to grantor, on assumption, gift is incomplete. (2) Taxable if power to appoint excludes grantor, as there has now been a complete divestment by grantor. On technical grounds it may be argued that both cases are either taxable or not taxable.

Note: If any of the dispositions referred to herein were made within 3 years of the death of grantor s. 3(1)(d) would apply to bring disposition into estate.

TABLE SHOWING CORRELATION OF INCOME, ESTATE AND GIFT TAX UNDER PRESENT LAW (Cont'd)

Type of Inter Vivos Disposition	Income Tax Treatment	Estate Tax	Gift Tax
3. Disposition subject to power to appoint or dispose in grantor and person lacking substantial adverse interest.	Interest from the property is not taxable except to the extent that the facts might enable the court to look through the power and say it really was vested in the disposer and thus work out a reversionary right capable of making s. 22(2) applicable.	Same as No. 2.	Same as No. 2.
4. Disposition subject to power to appoint or dispose solely in a person having substantial adverse interest.	Same as No. 2.	Same as No. 2.	Same as No. 2.
5. Disposition subject to power to appoint or dispose solely in a person lacking substantial adverse interest.	Same as No. 3.	Same as No. 2.	Same as No. 2.
6. Disposition subject to power to apportion income among named beneficiaries, exercisable by employee or certain relatives of grantor and lacking substantial adverse interest.	Income not taxable to grantor. The value of the incomes appointed is taxable when received by beneficiaries.	Not taxable.	Value of interest in the property disposed of is taxable as a gift.
7. Disposition subject to power to apportion income among named beneficiaries, exercisable by any person lacking a substantial adverse interest, other than wife, employee, or certain relatives of grantor.	Income not taxable to grantor but taxed in hands of beneficiaries among whom it was apportioned	Not taxable.	Value of interest disposed of is taxable as a gift.

TABLE SHOWING CORRELATION OF INCOME, ESTATE AND GIFT TAX UNDER PRESENT LAW (Cont'd)

Type of Inter Vivos Disposition	Income Tax Treatment	Estate Tax	Gift Tax
8. Disposition subject to power to invade corpus for current income beneficiary, exercisable by employee or certain relatives of grantor and lacking substantial adverse interest.	Income is not taxable to grantor but taxed in hands of income beneficiary.	Not taxable, unless income beneficiary was the grantor in which case there would be no gift tax due to s. 112(4) of <u>I.T.A.</u>	Taxable.
9. Disposition subject to power to invade corpus for current income beneficiary, exercisable by person lacking substantial adverse interest other than wife, employee or certain relatives of grantor.	Same as No. 8.	Same as No. 8.	Taxable.
10. Disposition subject to vested reversion in grantor (20-year term).	Income is taxable to grantor under s. 22(2).	Taxable on value of reversion unless reversionary right is assigned more than three years before grantor's death.	Taxable on value of property less value of reversion.
11. Disposition subject to vested reversion in grantor (3-year term).	Same as No. 10.	Taxable on value of property (1) if grantor dies within three years s. 3(1)(d) applies, (2) after three years the entire property has returned to him and is taxable.	Taxable on value of property less value of reversion.
12. Disposition to wife for life and on her death to grantor's children, provided that if wife predeceases grantor property to revert to grantor.	Income taxable to husband during life interest of wife under s. 21(1).	Taxable by s. 3(1)(j) and s. 3(4a) on full value of remainder interest.	Taxable on value of the income right plus value of remainder with possible reduction for reversion.

TABLE SHOWING CORRELATION OF INCOME, ESTATE AND GIFT TAX UNDER PRESENT LAW (Cont'd)

Type of Inter Vivos Disposition	Income Tax Treatment	Estate Tax	Gift Tax
13. Income to A for life of grantor; remainder over.	Income is not taxable to grantor.	Taxable on value of remainder interest passing on death of grantor by s. 3(1)(j) and s. 3(4a).	Taxable on the capitalized value of the income for the life of grantor plus remainder interest.
14. Income to A for life of grantor; remainder to X if living at grantor's death; if not, to grantor's estate.	Income from the property is taxable to grantor.	Taxable on property passing to remainderman under s. 3(1)(j) and s. 3(4a) or under s. 3(1)(a) if X has died.	Taxable on capitalized value of income right to A plus remainder to X less value of reversion to grantor's estate.
15. Disposition reserving life estate in grantor (ordinary income + capital gains).	Ordinary income is taxable to grantor but capital gains are not.	Taxable.	Not taxable due to s. 112 (4)(b).
16. Disposition subject to power to distribute or accumulate income for current income beneficiary, exercisable by grantor alone or in conjunction with another person.	Income is not taxable to grantor.	Not taxable.	Taxable on capitalized value of income rights and remainder interests.
17. Disposition subject to power to distribute or accumulate income for current income beneficiary, exercisable solely by another person.	Same as No. 16.	Not taxable.	Same as No. 16.
18. Disposition subject to power to invade for current income beneficiary, exercisable by grantor and limited by standard such as "need".	Not taxable to the grantor.	Not taxable.	Taxable on the entire value of the disposition.

TABLE SHOWING CORRELATION OF INCOME, ESTATE AND GIFT TAX UNDER PRESENT LAW (Cont'd)

Type of Inter Vivos Disposition	Income Tax Treatment	Estate Tax	Gift Tax
19. Disposition subject to power to revoke, exercisable solely by will by person lacking substantial adverse interest with grantor (alternative: gift over in event of revocation).	Income is not taxable to the grantor.	Not taxable on death of grantor.	Taxable because considered a complete gift subject to divestment.
20. Disposition subject to power to revoke, exercisable solely by will by person lacking substantial adverse interest with grantor (reversion to grantor in event of revocation).	Income is taxable to grantor under s. 22(2).	Taxable under s. 3(1)(d) on full value at date of grantor's death.	Taxable as a complete gift.
21. Disposition subject to power to amend, exercisable solely by will by person lacking substantial adverse interest to grantor (grantor not a valid object of power).	Not taxable. to grantor	Not taxable.	Taxable as a complete gift.
22. Disposition subject to power to pay over income to grantor, exercisable by grantor alone or in conjunction with person lacking a substantial adverse interest.	Income not taxable to grantor except to the extent of actual payment.	Taxable.	Value of property less contingent interest of grantor is taxable because s.112(4) would appear to be not applicable.
23. Disposition subject to power to pay over income to settlor, exercisable solely by person possessing substantial adverse interest.	Income not taxable to settlor except to the extent of actual payment.	Taxable under E.T.A. s.3(1)(d) regardless of when disposition made.	Taxable on value of property less value of contingent income right. (The income right would be virtually impossible to value.)

TABLE SHOWING CORRELATION OF INCOME, ESTATE AND GIFT TAX UNDER PRESENT LAW (Concl'd)

Type of Inter Vivos Disposition	Income Tax Treatment	Estate Tax	Gift Tax
24. Disposition subject to power to pay over income to grantor, exercisable solely by person lacking a substantial adverse interest.	Same as No. 23.	Same as No. 23.	Same as No. 23.
25. Disposition in trust to pay income to wife after death of husband and on death of husband and wife to divide among children; provided that during settlor's lifetime the trust to maintain certain insurance policies on life of settlor.	Income not taxable under s. 22(2) but is taxable under s. 65(1).	Taxable on full proceeds of the disposition including value of any insurance policies under s. 3(1)(j) and s. 3(4a).	Same as No. 23.

FOUR TAX TREATMENTS DISCUSSED

It appears that there are four available treatments here. 5/

(1) The tax system could ignore families and require each person with income to pay on a single rate schedule. This is the basis of the Canadian system.

(2) At the other extreme is the quotient system where income of all family members is aggregated and then divided among them, the rate set for the resulting figure being the rate at which the tax on all the income of the family is levied. This system is found in France and Ceylon, and favours large families. It was introduced in France as one of the methods of combatting the static population problem.

(3) A modified quotient system called income splitting, such as that used in the U.S. and Germany, might be used. Income of the husband and the wife is aggregated, and after splitting the income the applicable rate is applied to each part. Children are excluded from consideration here.

(4) Simple aggregation, used in the U.K. and Sweden, requires that the income of husbands and wives be aggregated and the rate applied to the whole. The burden on a couple is then more, relatively speaking, than on two people each with his own portion of the total income.

A negative approach is to say that system number (4) puts a premium on living in sin; a more positive attitude is to regard the systems which benefit a husband and wife both earning income as a calculated incentive to increase the number of working wives.

As an example of how different treatments of husband-and-wife taxable income can affect the tax burden borne by the family, see the following table where the Canadian rate schedule (not including old age security

COMPARISON OF PERSONAL INCOME TAX BURDENS UNDER THREE TREATMENTS OF MARRIED COUPLE INCOME USING PRESENT CANADIAN RATES

		Canada (Separate Taxation)		U. K. (Aggregation)		U. S. (Aggregation with Income Splitting)	
	Taxable Income $	Tax X/ $	Total Tax $	Tax $	Total Tax $	Tax $	Total Tax $
Husband	2,000	250				250	
Wife	2,000	250				250	
Total	4,000		500	610	610		500
Husband	10,000	2,170				1,050	
Wife	2,000	250				1,050	
Total	12,000		2,420	2,870	2,870		2,100
Husband	6,000	1,050				1,050	
Wife	6,000	1,050				1,050	
Total	12,000		2,100	2,870	2,870		2,100
Husband	15,000	4,070				1,720	
Wife	2,000	250				1,720	
Total	17,000		4,320	4,970	4,970		3,440
Husband	12,000	2,870				1,870	
Wife	6,000	1,050				1,870	
Total	18,000		3,920	5,420	5,420		3,740
Husband	23,000	7,670				3,070	
Wife	2,000	250				3,070	
Total	25,000		7,920	8,570	8,570		6,140
Husband	15,000	4,070				3,470	
Wife	12,000	2,870				3,470	
Total	27,000		6,940	9,570	9,570		6,940
Husband	90,000	45,070				19,370	
Wife	2,000	250				19,370	
Total	92,000		45,320	46,370	46,370		38,740
Husband	50,000	21,570				21,570	
Wife	50,000	21,570				21,570	
Total	100,000		43,140	51,570	51,570		43,140

X/ Exclusive of Old Age Security tax.

Source: Canadian Income Tax Act, s. 32.

tax) is assessed under the Canadian system, the U.K. system and the U.S. system. (Where there are no children, the U.S. and French systems are similar in effect.)

It is noted that the raw impact of the three systems is considerably mitigated in all cases. In Canada, a total exemption of $2,000 is available to a married couple whether they make one return or two. In the U.S., the harshness of including in the quotient system only the husband and wife is mitigated by the exemption for children. This is also the case in Canada. In the U.K. the aggregation system is mitigated by extensive allowances for earned income. In Sweden, where there is aggregation, a lower rate table is used for married couples. Thus, it must always be remembered that the treatment of the family cannot be considered out of the context of all aspects of the personal income tax system.

The four basic systems outlined above are reviewed in further detail.

The Individual as the Tax Unit

In Canada, where the progressive rates apply equally to single and married persons, differences in family circumstances are recognized by personal allowances. The $2,000 allowance for married taxpayers is, in fact, potentially $2,250, as a spouse earning up to $250 is not taxed. Above $250, the $1,000 exemption for the spouse is reduced by the amount by which the spouse's income exceeds $250. Over $1,250, the spouse must file a separate return. Apart from special treatment in section 21 dealing with husband-and-wife transactions, remunerations, and partnerships, the tax treatment of single and married people is similar. A result is, as shown by the above table, that if one spouse receives all or most of the income, the burden on the family is heavier than if both spouses receive approximately equal incomes. This leads to extensive expending of skill, time and energy to split incomes within a family. As a matter of historical interest, if the Canadian Supreme Court had recognized that the concept of community of property impinged on tax law, as was decided in the U.S., the Canadian provinces, by adopting the concept of community of property, as did several U.S. states, might have led to the development of income splitting in our personal income tax system, just as such a technique was forced on the U.S.

India is similar to Canada in that the tax liabilities of spouses are independently determined. However, the impact of the special tax treatment of the "Hindu undivided family" goes far to change the overall effect.

Australia also has a system of separate assessment.

Aggregation

In the U.K., because of the historical situation of the wife, who, at the inception of the income tax could not be sued without joinder of husband, and who had only restricted rights over property, aggregation of spouses' incomes was adopted. As the rate structure was originally proportional, it raised no problems with aggregation; it is now, however, progressive. Also, collecting from wives is no longer hindered by medieval concepts; nevertheless, aggregation for calculation of the total tax burden is still the rule, even though the burden of the tax may be allocated if the spouses wish. However, small incomes and earned incomes are given special treatment so that married taxpayers are treated more lightly than two single persons with corresponding incomes. It is to be noted that the effect of aggregation is unaffected in the case of unearned incomes.

In Israel, the same end result is achieved, in that earned income of spouses is not aggregated, whereas unearned income is. The earned income of each spouse is separately assessed, each being treated as a single person. In Brazil, contrary to what has been judicially decided in Canada and contrary to the practice in Argentina, joint returns taxing the husband and wife as a unit are only made where the husband and wife have chosen to hold their property in community of property. Income from property held by a spouse outside community is separately taxed. Separate filing, because of the progressive surtax over the flat-rate tax, reduces the total tax burden.

In Sweden, the basic principle is similar to the U.K. system, in that there is aggregation; however, a different rate schedule is used for married couples, the rates in lower brackets being lower for married couples so that there is achieved approximately the same end result as would be achieved by income splitting. The rates converge and meet at SKr 60,000, so that from a point below SKr 60,000, and more markedly above, a heavier burden is borne by a married couple than by two comparable single persons. Sweden does not have earned-income relief like the U.K. system, but its tax on net wealth achieves the same effect, as earned incomes receive comparably preferential treatment.

Several critics have described the U.K. and Swedish systems as a "tax on marriage", a "tax on virtue", a "direct tax...on marriage among the rather better off middle classes", etc. When the U.S. was considering adopting a similar system, Professor Dan Throop Smith said:

> It is hard to imagine a more inequitable, immoral and antisocial tax proposal. Its adoption would have imposed an annual progressive tax on the maintenance of the legal state of marriage. 6/

Sweden has recently attacked this problem in a manner different from what one would have expected; certain unmarried couples living together are in certain cases subject to aggregation.

In the English Royal Commission Second Report, it is submitted that under a progressive system, which would normally extract more tax from one income than from two incomes half the size, this principle of aggregation weighs heavily upon those married couples in which each partner is the owner of a substantial income.

Note also that the Netherlands, like Sweden, has two rate or bracket schedules for married and unmarried persons, with the tax for married persons somewhat different than for single persons. The Netherlands extends its rate differentiation to cover families which vary in size, and Sweden has certain refinements to cover earned incomes, a wife's earned income, and children under 16 living at home.

Income Splitting

Prior to 1948, the U.S. system was similar to the Canadian system, except that, in the absence of anything comparable to our section 21, income splitting could be achieved by transfers which were subject only to gift tax, or by forming partnerships. In 1948, an abridged form of the French quotient system was introduced, wherein, although income of children is not aggregated into the family income, the income of husband and wife is aggregated, then divided to find the applicable tax rate, at which the total taxable income is taxed. Community of property legislation in several states brought this about more than did any policy decision regarding realignment of tax burdens between married and unmarried taxpayers. In Sura v. M.N.R., 7/ a similar attempt in Canada to apply Quebec community-of-property laws to the personal income tax was rejected.

Most married couples in the U.S. split their income because it is usual for incomes of spouses to be extremely disproportionate. If incomes are the same or nearly the same, no advantage is to be gained from splitting as opposed to separate assessment, (an alternative which is available in the U.S.).

This system places a relatively heavier burden on single persons than on married persons, whereas it has been seen that aggregation systems do the opposite in a progressive tax structure system. All U.S. married couples now bear relatively identical burdens, the community of property distinction having been expunged. The tax on a married couple is then twice that of a single person with half the income. That is, the tax is exactly proportional as between these two tax units. Apart from thereby doubling the size of the progressive tax brackets for married couples and considerably reducing the progressive feature, there are theoretical difficulties in accepting a system which imposes, in one sense, a proportional tax. It seems to be the 20th century view that a proportional tax is not in accordance with modern concepts of the twin canons of ability to pay and equity. As a practical matter, also, the loss in revenue occasioned thereby brings with it an inevitable rate increase. This hits the single taxpayer hardest, and so aggravates the problem. The following table, taken from Surrey & Warren, 8/ reveals the tax treatment produced by income splitting:

Taxable Income before Exemptions $	Tax with Income Splitting $	Tax without Income Splitting (one spouse owning all income) $	Reduction in Tax: Amount $	Reduction in Tax: Per cent %
3,200	400	400	0	0
5,000	760	796	36	4.5
10,000	1,888	2,232	344	15.4
25,000	6,724	9,442	2,718	28.8
50,000	19,592	25,956	6,364	24.5
100,000	52,776	66,276	13,500	20.4
500,000	403,548	428,728	25,180	5.9

Surrey and Warren discuss the following alternatives that have been raised by other people:

(1) A married couple should pay the same tax as a single person with the same income, except for the effect of the additional exemption.

(2) A married couple should pay twice the tax of a single person with half the income.

(3) The solution is somewhere in between.

(4) Alternative (1) is suitable in lower brackets, alternative (2) is suitable in middle and upper brackets.

After reviewing several proposals, they show the proportion of tax payable by a single person, by a married couple, and by a married couple with one and two children at the taxable income level of $20,000 in the U.S. The following table compares these figures with the Canadian tax for taxpayers in similar circumstances.

Taxable Income Before Exemptions $20,000 */	Single	Married	Married with 1 child	Married with 2 children
U.S. Tax	6,942	4,872	4,668	4,464
Proportion	100	70	67	64
Canada Tax	5,940	5,540	5,405	5,270
Proportion	100	93	91	88

*/ Rates are pre-1964 amendments.

The U.S. figures show the considerable difference in tax burden between single and married persons, and the relatively minor difference between married persons and married persons with children. By comparison, the Canadian married couple is relatively heavily taxed, and the married couple with children even more so. The proportion of a single person to a married couple with one child is 100:91 in Canada as opposed to 100:67

in the U.S. It must, however, be recalled that the Canadian couple receives a non-taxable family allowance of at least $72 in respect of each child, and this to some extent offsets the discrepancy.

The U.S. system is further refined by the head-of-household rates which give to those who are not married but who support in their household a child, grandchild or qualified dependant, one half of the benefit of income splitting. This refinement is itself refined by allowing a surviving spouse full income splitting for two years after the death of his spouse.

The following table applies a splitting system to specified incomes, by way of comparison with the present system.

COMPARISON OF TAX BURDEN UNDER PRESENT CANADIAN SYSTEM AND UNDER AN INCOME-SPLITTING SYSTEM USING CANADIAN RATES

Income	Present Tax 1/	Tax under Income Splitting 2/	% Reduction
$ 4,000	$ 293	$ 266	9.2
6,000	681	603	11.5
12,000	2,230	1,818	18.5
18,000	4,565	3,294	27.8
24,000	7,265	5,185	28.6
50,000	20,505	16,375	20.1
100,000	50,295	42,165	16.2

1/ Assumes: wife has no income, and there are no exemptions or deductions other than married and standard deductions ($2,100 in total).

2/ Assumes: no exemptions or deductions other than married and standard deductions; income of the couple is aggregated, the appropriate allowances ($2,100) are deducted, balance is divided by two, tax is computed and multiplied by two to arrive at joint tax (similar to U.S. system).

The Quotient System

In France, a system similar to but more extensive than that of the U.S. is used. The family is treated as an economic unit, and any income of that unit, through whomsoever it comes, is aggregated, and the head of the family is assessed on the resulting total. The family income is divided into parts according to the following table:

Unmarried, divorced, widowed, no children	1
Married couple, no children	2
Unmarried, divorced, one child	2
Married, widowed, one child	2.5
Unmarried, divorced, two children	2.5
Married, widowed, two children	3
Unmarried, divorced, three children	3
Married, widowed, three children	3.5
etc.	

Tax is determined by dividing the total income by the appropriate figure from the above table, applying the progressive rate to the income of one part, and multiplying the tax on one part by the number of parts. Applying the quotient system to Canadian rates, the following is the tax payable by a widower with two children with taxable income of $12,000.

$\frac{12,000}{3} = 4,000$ Tax on \$4,000 = \$610.

\$610 x 3 = **\$1,830.** A Canadian widower with two children presently pays the following tax on taxable income before exemptions of $12,000.

\$12,000 - (\$1,000 + \$1,000 + \$300) = \$9,700. Tax on \$9,700 = **\$2,080.**
(Standard deduction omitted.)

The second system imposes a burden of about one third more than the first at this level.

There is no limit in France to the number of parts into which family income can be split, and each additional child adds an additional half part. The quotient system is compulsory for spouses living together, but with children, if a child has income of his own, the father can demand separate taxation of that child. This is only useful in high income brackets.

It is noted that the quotient system does not require each member of the family to contribute income to the aggregation. In most cases, of course, only the father has income. The United Nations Economic Bulletin for Europe, 1st quarter, 1952, pointed out in an article at page 42, that the system assumes that the increased financial burden created by the addition of a child to a family unit reduces the standard of living; the system seeks to tax at the same rate incomes which yield the same standard of living when family obligations are taken into account. Its aim is stated as being to tax a married man not like a bachelor with the same income, but like a bachelor with the same standard of living.

The system notably reduces the tax burden with increasing family size to a much greater degree than any other system. The loss of revenue is evidently replaced by value-added taxes and consumption taxes which make the overall French tax burden heavy. These are usually regarded as regressive taxes, and the addition of these to the quotient system of personal income taxes has the effect of inflicting a tax system approaching proportionality on the French taxpayer.

In Ceylon, in 1959, a similar system was adopted, but the table of parts is not so extreme as in France. The single or married man has 1.5 parts, and .5 is added for a wife and each child or dependant up to a maximum of 4.

In effect then, a married couple pays twice the tax paid by a single person with half their total income, while a married couple with two children pays three times the tax payable by a single person with one third their total income.

Aggregation of incomes of married couples is found in Belgium, Holland, Denmark, Norway and Sweden.

Summary

There seem to be the following possible treatments of family income:

(1) Separate taxation of spouses.

(2) Aggregation and splitting.

(3) Aggregation and separate rate schedules.

(4) Aggregation.

Our first problem is to decide whether or not to aggregate, and the second is to decide how to treat aggregated incomes.

Aggregation of Married Couple Incomes

Some of the basic questions raised by any progressive tax system are highlighted by the treatment accorded the family, for progressivity is horizontal as well as vertical. There is some indication that not even economists, let alone lawyers or sociologists, can agree on the ideologies of capacity, ability to pay, sacrifice, marginal utility, stability and redistribution. However, as a matter of social observation, it appears to be accepted that:

> ...for the purposes of any reasonable policy of progressive taxation, the economic lives of a husband and wife are inseparable. 9/

Although some countries tax by source, with varying rates, the concept of a unit is inherent in any reasonable explanation of progressive taxation. In countries where sociological customs lead to economic closeness and interdependence of large groups, these groups are regarded as appropriate tax units. See China and India as examples. In the west, however, economic associations of adult persons who are other than married are rare, and even married persons can be regarded as economically independent units in certain situations. However, "as long as a great degree of mutual economic activity continues to be a characteristic of the marital relationship, taxation of the married couple as a unit will be prevalent" 10/ and, we add, desirable.

From an administrative standpoint, it is, of course, more convenient to treat as a tax unit a group which is regarded in the country as a societal unit, as, in terms of economic benefit, it is not easy to evaluate the separate contributions of each individual to the group as a whole.

> In almost all countries the married couple is the most permanent social unit and the easiest to identify. 11/

Certainly in Canada separate taxation of married couples led to the enactment of section 21, and even in the face of this, there is constant inter-spousal redistribution of incomes, both legal, and fraudulent. In the United States, where there was no equivalent to section 21 before 1948, the practice of similar income redistribution became so prevalent that it became one of the prime factors in bringing about income splitting.

A further problem which is distinctively Canadian is the fact that one third of our population has available to it the community of property regime, whereas the other two thirds does not. The reasons for this have no bearing on tax policies, but the problem as to whether such a matrimonial property regime should impinge on tax law is not solved. In the U.S., community of property was allowed to do so, while in Canada, it has not. Oldman and Temple say of this problem.

> Others appear to have tortured consistency by attempting to adapt tax law to other law without regard to their sometimes unrelated purposes and to the differing forces, needs and conditions which led to their development. The factors, for example, which induce the adoption of varying matrimonial property regimes may bear little or no relationship to the policies which should control treatment of the married couple for income tax purposes.

However, this appears to try and place income tax law in a watertight compartment, unaffected by a social fact which in other ways has an economic effect on the way of life of a large segment of the community. It appears that there would be nothing more illogical in Canadian tax law recognizing community of property than in Indian tax law recognizing the social and economic fact of the undivided Hindu family.

The legal incapacity of the married woman is merely a historical anomaly, and should not be used by those in Canada who uphold the taxation of the individual and oppose the taxing of the married couple as a tax unit. Furthermore, even if it were considered socially desirable that the wife be persuaded to stay at home, this should be a matter of personal choice and not a matter to be subjected to the pressure of tax incentives. In any event, there appears to be an established need in Canada that wives with training be encouraged to employ those talents, and if the tax laws have any part to play in affecting family decisions, they should at least be formulated so as not to discourage working wives. The Canadian system of taxing, as a separate taxpayer, a working wife who makes over $1,250 thus giving no recognition whatsoever to the married status (the $2,000 married exemption still being, in total, only $2,000), appears to be a penalization of the working wife. Nor is there any reason for upholding the Canadian separate taxation system on grounds of equality of the sexes. This principle is hardly in issue when the married couple, in being taxed as a unit, taxes husband and wife alike. As a final quote from Oldman and Temple, the following is a conclusion in which we concur.

> Separate taxation based on the legal precept of the equality of the married woman is as ill-founded as aggregation based on the fictitious legal incapacity of the married woman. Viewing each spouse as a separate spending unit is usually unrealistic. Most of the countries of the world treat the two spouses as a single unit. There is little basis for believing that they have done so on the basis of outmoded concepts and irrelevant social policies. The fact is, unit taxation of the married couple is consonant with economic, social and administrative realities.

We are therefore of opinion that recognition in some form should be given to the married couple as a tax unit.

RELATIVE BURDENS OF SINGLE AND MARRIED UNITS

The next question to be faced is whether to place a heavier or lighter tax burden on two persons joined in marriage than on persons not so joined. Countries vary from placing a heavier burden on married couples (alleviated by earned-income allowances)—such as in the U.K.—to putting a 50% heavier burden on single persons—as in the Netherlands. Local conditions and the interpretation of principles underlying progressive taxation produce these variations. Certainly it is difficult to discern a consensus of opinion when enunciations of guiding policies are so varied as the following. The Second Report of the English Royal Commission on the Taxation of Profits and Income upholds the aggregation and consequential higher taxation of married couples on the ground, *inter alia*, that their taxable capacity is greater than that of single persons. Contrarily, in the Shoup Report on Japanese taxation (1949), it was said:

> The aggregation of incomes pushes the combined income into brackets taxed at higher rates than are otherwise applied to taxpayers on the same general level of welfare and taxable capacity.

As a result, Japan now treats earned incomes preferentially. Other countries impose bachelor taxes or higher rates for single persons, on the theory that they have a greater taxable capacity than married persons, since it costs a married couple less to live together than for the same two to live apart. The cost of living, in so far as it has a bearing on taxable capacity is influenced by two persons living together, as they spend less for food, and accommodation than two persons living apart. No country goes so far as to tax a married couple more heavily than a single person with the same total income, and some, such as the U.S. and Netherlands, go to the extreme of taxing the dual-income married couple less heavily than two single persons with corresponding incomes. When it is appreciated that this is done in addition to the reliefs provided in the reduction of taxable income by means of personal and dependent allowances, it appears that the U.S. at least takes the view that the personal allowances are not sufficiently graduated to provide for distinctions in economic burdens occasioned by marriage and children.

The distinction in treatment of earned income and unearned income in some countries appears to attempt a recognition of the diminution in the economic unity of the married couple when the wife earns income. Even those countries which aggregate both earned and unearned income offset the difference created by working wives by allowances for earned income, child care and housekeeping expenses. These allowances may vary with income, but they are usually subject to low maxima, as costs incurred by a working wife probably do not increase proportionally with income. Allowances at a percentage of a wife's earned income would differentiate between married couples.

It has been said that in the search for a new personal tax structure the problem of defining and arriving at a tax unit is not nearly so difficult or important as the tax computation plan to be used. In this regard it is instructive to note the conclusion of the British Royal Commission when, after its investigation, it reported:

> Our investigation has led to the view that the unit of taxation itself is less important than the method of treating the unit in the scheme of graduation. 12/

In the search for equality among equals we must not lose sight of the need to provide for adjustments between unequals. Thus, after choosing the tax unit as husband and wife, it is necessary to set out a tax computation plan which will treat single persons, childless married couples and married couples with children in a manner such that the tax burden is distributed equitably.

The real issue concerns the relative tax burden of single and family taxpayers. Should we encourage marriage through our tax law? Should the tax law be perfectly neutral between a man in a married position as opposed to a single position? Probably the answer to these questions is that tax policy cannot either encourage or discourage marriage. To quote The British Royal Commission on Taxation, "We are sceptical of the suggestion that men and women are dissuaded from marriage by any such nice calculation of the financial odds." 13/

Does the single taxpayer have a good case for arguing that the married taxpayer with the same income has a greater taxable capacity because of the imputed value of his wife's services upon which he is not taxed? Or conversely can he argue that this value should be included in the family income and taxed accordingly? This question is difficult because we have little or no information on the "economies of scale" that attend family living. This suggests an area where further research is required.

There is, at present, little information available on the relative tax-paying ability of families at all levels of income. We might impose relative tax burdens according to ratios of the relative incomes needed by families of different size to obtain the same standard of living. How much money does a single person need to maintain the same standard of living as a married couple without dependants? Or how much money does a married couple with two dependants need to maintain the same standard of living as a couple with no dependants or with four dependants?

Moreover, as savings increase with increasing income the information obtained from ratios showing relative tax burden might need to be discounted when dealing with high level income families.

The following examples show the relative personal tax burdens in Canada on an income of $15,000 under varying circumstances. It seems clear from these examples that single taxpayers fare very well.

CASE I

Single Taxpayer:

$ 15,000		
1,000	Exemption	Total Tax
14,000		$3,670.00

CASE II

Married (no dependants)

$ 15,000		
2,000	Exemptions	
13,000		$3,270.00

CASE III

$ 15,000		
2,600	Exemptions	Total Tax
12,400		$3,030.00

Relative Tax Burden between Families where Income is Earned in Part by Wife

CASE IV

Husband & Wife (no dependants)

Total Income	$15,000			Total tax
Husband earns	$10,000			
Wife earns	$ 5,000			
Husband's Tax		**Wife's Tax**		
	10,000		5,000	
Less	1,000	Less	1,000	
Taxable Income	$ 9,000	Taxable Income	4,000	
Tax	$ 1,870	Tax	$ 610	$2,480

CASE V

Husband, Wife & 2 Dependants

Total Income	$15,000			
Husband earns	10,000			
Wife earns	5,000			
Husband's Tax		**Wife's Tax**		
	10,000		5,000	
Less	1,600	Less	1,000	
Taxable Income	$8,400	Taxable Income	$4,000	
Tax	$1,690	Tax	$ 610	$2,300.00

Note 1: Difference in Tax between:

(1) Case IV and V is $180.00
(2) Case III and V is 730.00
(3) Case II and IV is 790.00
(4) Case I and IV is 1,190.00
(5) Case I and V is 1,370.00
(6) Case I and II is 400.00
(7) Case I and III is 640.00
(8) Case II and III is 240.00

Note 2: Standard deduction & old age security tax excluded.

FIVE PROPOSALS CONSIDERED

Before setting out our proposals (in Chapter 4), we must consider five other proposals. These are:

(1) Retain the present system.

(2) Retain the present system but with increased married exemptions.

(3) The Pechman proposal.

(4) The Vickrey proposal.

(5) The present U.S. system.

Retain the Present System

We feel that the present system of separate taxation of spouses can be criticized not only because it runs contrary to established socio-economic conditions in our country in respect of married persons, but also because it appears to have been rejected in so many other countries—a factor not without significance in an age where universal concepts of equitable tax treatment are sought after zealously. We note that our exemption system increases the benefit to married taxpayers as one rises through the tax brackets, the differentiation in tax paid between single and married taxpayers being $150 at $2,000 income less deductions, but before exemptions, and $800 at $400,000 income less deductions, but before exemptions. The benefit of the removal of a further $1,000 off the top of the income is greater, the higher the marginal rate. It is sometimes argued that this is the wrong way round, and that the lower brackets should receive the greater benefit of exemptions. However, we agree with the English Royal Commission, in its Second Report at p. 48, in paragraphs 156 and 157, where the fact that the lump sum allowance is of greater benefit to higher income groups is defended. Probably the matter should be looked at in an entirely different light, in that the difference in exemption between single and married taxpayers is intended to work a horizontal differentiation; when one looks at that horizontal differentiation, one finds the variation in differentiation is not only extreme, but of great hardship on the middle to upper income brackets.

In Canada, the only differentiation between a married couple and a single person with the same income is achieved by the additional $1,000 exemption for a wife, over and above the taxpayer's personal exemption of $1,000. The benefit of this varies from $150 to $800 in Canada, dependent on whether the net income is $2,000 or above $400,000. The value of the extra $1,000 as a percentage of income varies from 100% at $2,000, down to an asymptotic approach to 0% above $1,000,000. This is shown in columns 3 and 4 of the **Table** on page 117 where, for Canada, the income column equals net income before personal exemptions.

In the U.S., however, the tax benefit of marriage is not only obtained by an extra $600 exemption for a wife, making the married couple's personal exemptions twice that of a single person, but also, a further benefit is granted by aggregation and income splitting. This latter benefit varies from $0 at $2,000 taxable income (the income column in the **Table** is, for U.S. purposes, taxable income, not net income before personal exemptions) to $25,180 at $600,000 taxable income, and decreases thereafter to nil. The percentage benefit goes from nil to 28.7% at $26,000 taxable income, and back to nil at very high levels. This is shown in columns 1 and 3 of the **Table** where, for the U.S., the income column equals taxable income. The **Table** does <u>not</u> reflect the beneficial effect of the extra $600 exemption.

We do not say that the U.S. system or the Canadian system is wrong, but we are content at this point to reveal the differences in treatment.

Retain the Present System but With Increased Married Exemptions

Several submissions have advocated higher personal exemptions, not merely for married couples, but universally. Recommendations have been made to raise exemptions to $3,000 (Ralph E. Browne), to $2,000 and $3,000 (Communist Party of Canada), to $2,500 and $6,000 (United Electrical Radio and Machine Workers of America), to $1,500 and $3,000 (Julius M. Scharing, National Farmers Union and Yellowknife Board of Trade). Other recommendations have been made in respect of dependent exemptions. Also, Morris Neaman has suggested abolishing personal exemptions and the elimination of returns in respect of incomes under $6,000, and the Citizens Committee of Norman Wells—Northwest Territories and Inuvik and Western Arctic Development Association have advocated raising the exemptions for northern residents. J. Steiner wants exemptions to reflect the cost of living in specific areas, and he and the Montreal Chamber of Commerce want them related to minimum subsistence levels.

We are, at present, only concerned with the exemption as it affects the differential between single and married persons, but we should in passing recall that we have in our consideration of exemptions expressed our opinion that they do not, and need not, be related to a subsistence level, and it is not their function in the tax system to reflect changing costs of living over different areas or different times. Their effect, if not their purpose, has been to differentiate between single and married persons, and we believe that this can better be done by two rate schedules. Thus, the raison d'être of exemptions is eliminated. However, we did consider the alternative of raising exemptions as requested by several submissions, and we claculated the loss of revenue which would result therefrom. We note that estimates have been made in the U.S. that a $100 <u>per</u>

capita increase in the personal exemption there—from $600 to $700—would cost the Treasury some $2.5 billion. This is a further indication that the exemptions are, more than anything else, a revenue control and one of the most powerful ones in the tax machine. We have calculated that an increase of $100 in the single personal exemption in Canada would reduce the revenue by about $100 million or 5% on the basis of 1963 estimated figures obtained from the Department of National Revenue.

The submissions for higher exemptions do not affect the differentiation between single and married persons, since raising exemptions of both groups makes no difference to their interrelationship. We note that the United Electrical Radio and Machine Workers of America in its submission changes the ratio of the exemption from 1:2 to 5:12, but the figures it advocates are unprecedently high. Basically, however, we are concerned that the differentiation in dollar figures is not only insufficient, but it also contracts proportionally much too quickly as one goes up the income brackets. We have therefore sought to remedy both these points in the dual-rate schedule we have developed (see Chapter 4).

The Pechman Proposal

The approach adopted by Joseph A. Pechman is contained in "Income Splitting" Tax Revision Compendium, 1959, p. 473. He argued that income splitting remedied two forms of discrimination, (1) the difference in treatment between community and non-community states, and (2) the difference in treatment dependent on proportionality of incomes between spouses. However, income splitting in the U.S. has been criticized, first, for its effect on progressivity, and secondly, for its effect on relative tax burdens imposed on single and married persons. As to progressivity, income

RELATIVE TAX BURDEN OF MARRIED PERSONS (USING INCOME SPLITTING PROVISIONS IN U.S.) AND SINGLE PERSONS WITH EQUAL INCOMES IN THE U. S. A. AND CANADA

	Tax Differential Between Married & Single		Differential as a Percentage of Single Person's Tax	
	1	2	3	4
Taxable Income X/ $	U. S. $	Canada $	U. S. %	Canada %
2,000	0	150	0.0	0.0
4,000	40	210	4.8	38.9
6,000	120	220	8.8	23.2
8,000	280	260	14.3	18.2
10,000	440	300	16.7	15.1
12,000	680	350	20.0	13.2
14,000	940	400	22.1	11.8
16,000	1,280	400	24.7	9.5
18,000	1,600	450	25.8	8.8
20,000	1,980	450	27.3	7.5
22,000	2,340	450	27.9	6.5
26,000	3,080	450	28.7	5.2
32,000	4,060	500	28.1	4.3
38,000	4,900	500	26.7	3.4
44,000	5,740	550	25.6	3.1
50,000	6,520	550	24.3	2.6
60,000	7,880	550	23.0	2.0
70,000	9,300	600	22.1	1.8
80,000	10,740	600	21.4	1.6
90,000	12,180	600	20.8	1.3
100,000	13,680	650	20.3	1.3
150,000	19,480	700	17.4	0.8
200,000	22,180	700	14.1	0.6
400,000	25,180	750	7.4	0.3
600,000	25,180	800	4.8	0.2
1,000,000	10,360	800	1.2	0.1

X/ For Canada, read income less deductions but before exemptions.
Source: For U.S. figures—Groves, Tax Treatment of the Family, Brookings Institution, 1963, Table I, p. 47.

splitting benefits those in high income brackets relative to those in the lowest brackets. This is a method of relieving the steepness of the graduation without changing the rates and, though welcomed by some, is attacked by others. Even if all could agree on the relative burdens to be borne by the poor and the rich, we doubt whether tax treatment of the family is the proper mechanism for implementing the decision.

Insofar as income splitting has an impact on relative tax burdens, there is a legitimate reason for its existence, and we note that Pechman agrees that husband and wife should be regarded as one tax-paying unit. We conditionally concur with him in that the most practical way of allowing for differences in faculty amongst the married-couple units is to have deductions for working wives and allowances for children, rather than to have a series of rate schedules to cover each situation, but we prefer to differentiate between single and married couple units, not by way of deductions and exemptions, but by way of two rate schedules.

After pointing out that it is aggregation which enforces equality between married-couple units, Pechman shows the effect on progressivity, revenue and differentiation from single persons occasioned by income splitting. He continues; (p. 479)

> The classic argument in favour of the present 2:1 relationship between the tax liabilities of married couples and single persons is that husband and wife usually share their income equally.... Two conclusions follow if this view is accepted; first, married couples with the same combined income should pay the same tax, irrespective of the legal division of income among them; second, the tax liabilities of married couples should be computed as if their income is divided equally between the two spouses....With the distribution of tax liabilities among married couples already decided, the only remaining problem is whether the relationship between their tax liabilities and those of single persons is equitable.

In dealing with this problem, which is ours in this study, Pechman asks whether the justification for treating husband and wife as a tax unit is sufficient to justify taxing them as if they were two single persons with equal incomes. Probably married couples share their incomes equally, but (apart from the separate problem of working wives) the 2:1 relationship appears to be too extreme.

> The acquisition of a spouse by a single person would justify granting him an additional exemption, but it is hard to see why it would justify any other tax advantage.

As to this, we point out that the exemption system, although it provides a benefit to married persons which reduces in proportion to single incomes as one moves up through the tax brackets, it does increase in dollar value with each marginal rate increase. Thus, in after-tax income, the $1,000 exemption is worth $800 to the top bracket man, and only $150 to the bottom bracket man. The dual-rate table we subsequently recommend has the same general approach.

The arguments against a 2:1 relationship are that there are economies in marriage in the cost of housing and food, and, at present, no account is taken of the value of a housewife's service. Thus, married couples with one income have more ability to pay than two single persons with the same total income. Pechman criticizes this argument, saying that there are dis-economies in marriage, and that there is no way of measuring the net economies. Thirdly, a rate schedule could not be devised to adequately reflect these, even if they were measurable at the various income levels. Therefore, he concludes that the practical way is to make the necessary differentiation by adjusting personal exemptions. We think this is as much an argument against exemptions as it is against a rate schedule. Pechman admits the necessity for some differentiation, and as the exemption and rate schedule both achieve this, the rate schedule is as acceptable on this score as is the exemption, and more desirable for the reasons outlined above. There is no need for both, and we feel that exemptions, being less justifiable on other grounds, should be the one to go.

Pechman goes on to discuss the necessity for distinguishing between married couples with one income earner and those with both earning, and he reaches the conclusion we advocate, as follows: (p. 480-481).

> Aside from the fact that such a couple does not enjoy as much imputed income as it would enjoy if the wife remained at home, it incurs other money outlays that are directly attributable to the wife's employment. If the expenses necessary for the production of her gross income were measurable, the theory of income taxation would require that these be allowable as deductions in computing the amount of her net income. Since it is impossible to make such fine distinctions, the only practical remedy would be to permit working wives to deduct some arbitrary percentage of their gross income (with a maximum dollar limit).

Pechman's solution was to use two rate schedules, not for the purpose of differentiating between the tax burdens of single and married persons, (for it was his intention to eliminate that differentiation, and to compensate for the variation in ability to pay by way of exemptions), but for the purpose of differentiating between married couples, both of whom earn income, and married couples where only one earns income. This was done by permitting the married person to choose between joint or separate returns, those filing joint returns splitting income and using the married rate schedule, and those filing separate returns not splitting but still using the married rate schedule. The advantage would generally be with the former, but the latter would be of some advantage in certain cases.

We do not wish to use the dual-rate schedule for this purpose, being satisfied that the distinction between single- and double-income married couples can better be catered to by specific deductions rather than by a different rate-schedule treatment. However, we note that a general approving comment by Pechman as to a dual-rate system does apply to our recommendation, when he says:

> The rates in these schedules could be set to achieve any desired net revenue effect and any desired redistribution of tax burdens by income levels.

The Vickrey Proposal

The Vickrey proposal (Agenda for Progressive Taxation, 1947) commences with a justification of reducing tax on married couples on the ground that where two persons of unequal incomes live in a common household and share their resources, this sharing can be considered a redistribution of income similar to that which the income tax itself attempts to promote. Furthermore, from the approach of minimum or even proportional sacrifice, two who have unequal incomes and do not share resources should pay in total more taxes than two who have similar unequal incomes but do share resources equally. The only situation where sharing can, in practice, be accepted is that of marriage, as this is the only relationship where it can be presumed that there will be substantial pooling of resources. However, joint returns should not be compulsory for married couples, so that spouses who are in any way estranged can file separate returns if they are unwilling to reveal their income to each other.

> Where the parties are unable to co-operate in the filing of a split-income return, this fact in itself would be evidence that in this particular case the pooling of resources,...does not exist, and the higher taxes resulting from the filing of separate returns accordingly would be fully justified.

He points out that a simple aggregated joint return only differentiates between single persons and married couples generally, and does not differentiate between cases where the wife stays at home (where there are large amounts of imputed income from this source) and cases where the wife also works (where no additional burden on the married couple as compared to that on two single persons with the same money income is warranted on grounds of imputed income).

> If a really close adjustment of the tax to varying circumstances is required, it is better sought by modifying the split-income method either through an earned income relief, or a surtax on unearned income. Indeed, the split-income method, by such a credit, can be made to equalize the burdens on families where the wife works and those where she does not in a fairly simple and quite satisfactory manner. It can be presumed that as the total income of the family increases, the minimum amount of earnings that can be taken to represent full-time employment will increase likewise. ...at the same time, the value that can be placed on the wife's leisure, or her work in the home, as the case may be, tends to be the greater the family income, whether it be measured by the compensation necessary to persuade the wife to give up what she does with her "free" time, or by the amount which such a wife who does not actually go to work could earn if she did. On such a basis, then an appropriate earned income credit (is) suggested....

We are of the opinion that these comments are as applicable to an aggregation and dual-rate system as they are to a split-income system.

Revenue Implications of Adopting the U.S. System

It is not necessary to again review the U.S. system. However, it was felt useful to calculate the revenue implications of such a system if adopted in Canada, and this is done below.

The following statistics show the probably tax costs of income splitting in Canada between taxpayer and spouse. These statistics were prepared by the statistics Section of the Royal Commission on Taxation.

Before an estimate can be made, the form that income splitting will take must be decided. For purposes of this estimate we assume the following:

(1) In a joint return income of the husband and wife are summed.

(2) This sum is then reduced by the joint exemptions of husband and wife. ($1,000 each for husband and wife, charitable and medical exemptions $200, all other exemptions, the same as in 1962).

(3) The tax on half of the income in (2) is calculated and doubled.

The basic data used were Table 6, Taxation Statistics, 1963, (for 1961) and Table 94, Series 2.1, Households & Families, Bulletin 2.1 - 11, Census of Canada 1961, D.B.S. 1963. The census material is summarized in the table shown on p. 82.

To estimate the tax, an average exemption per income group was calculated from Table 6 of Taxation Statistics, 1963.

This calculated exemption was used to find the tax payable under income splitting.

A peculiar situation arises when the wife's income is between $250 and $1,250. In this range, the wife is permitted a $1,000 personal exemption. If the amount of her income is X dollars the amount of the exemption permitted to her is X dollars, her husband is permitted an exemption of $1,000 - (X - 250) = $1,250 - X. The total exemption permitted to both is therefore, $1,250 - X + X = $1,250. Under the income splitting scheme used in this study, the marital exemption permitted is $1,000 (in addition to the $1,000 basic exemption of the husband). Thus, taxable income (of both husband and wife) would be increased by $250. As a result, income splitting produces a higher tax in some cases.

Using these assumptions and approximations the revenue loss in 1959 at 1959 tax rates would have been about $150,000,000 in a total revenue of $1,580,041,000, or about 10% of revenue. The revenue loss in 1961 would also probably be about 10% of total tax, or about $190,000,000.

Pechman has estimated that the revenue loss caused by income splitting in the United States amounts to more than $4 billion a year, or a little over 10% of tax revenue. 14/

It has been estimated by the Statistical Section of the Commission that the application of the Pechman proposal in Canada would increase revenues by less than 5% and possibly only 2%. On the other hand, adoption of the present U.S. system by Canada in 1961 would have reduced revenues by something less than 12%, probably 10%.

Taxable Income	THORSON PLAN Bachelor	THORSON PLAN Married 0 Dependants	THORSON PLAN Standard Family */	FRENCH SYSTEM Bachelor	FRENCH SYSTEM Married 0 Dependants	FRENCH SYSTEM Standard Family	CEYLONESE SYSTEM Bachelor	CEYLONESE SYSTEM Married 0 Dependants	CEYLONESE SYSTEM Standard Family	PECHMAN Bachelor	PECHMAN Married 0 Dependants	PECHMAN Standard Family
	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)	Tax ($)
1,000	140	140	140	140	140	140	140	140	140	140	140	140
2,000	310	280	280	310	280	280	295	280	280	310	310	310
3,000	510	450	450	510	450	420	465	450	420	510	510	510
4,000	700	620	620	700	620	590	665	620	590	700	700	700
6,000	1,140	1,020	1,020	1,140	1,020	930	1,050	1,020	930	1,140	1,140	1,140
8,000	1,660	1,400	1,400	1,660	1,400	1,330	1,490	1,400	1,330	1,660	1,660	1,660
10,000	2,260	1,840	1,840	2,260	1,840	1,720	1,970	1,840	1,720	2,260	2,260	2,260
12,000	2,960	2,280	2,280	2,960	2,280	2,100	2,490	2,280	2,100	2,960	2,960	2,960
15,000	4,160	3,060	3,060	4,160	3,060	2,760	3,390	3,060	2,760	4,160	4,160	4,160
25,000	8,660	6,320	6,320	8,660	6,320	5,280	7,365	6,320	5,280	8,660	8,660	8,660
40,000	16,160	12,820	12,820	16,160	12,820	10,480	14,240	12,820	10,480	16,160	16,160	16,160
60,000	27,160	22,320	22,320	27,160	22,230	19,230	24,240	22,230	19,230	27,160	27,160	27,160
90,000	45,160	37,820	37,820	45,160	37,820	33,480	40,740	37,820	33,480	45,160	45,160	45,160
125,000	67,910	57,320	57,320	67,910	57,320	51,230	61,740	57,320	51,230	67,910	67,910	67,910
225,000	137,910	119,570	119,570	137,910	119,570	111,480	128,115	119,570	111,480	137,910	137,910	137,910
400,000	269,160	240,820	240,820	269,160	240,820	221,230	253,740	240,820	221,230	269,160	269,160	269,160

*/ A standard family is a married couple with two dependent children.

Pechman Plan - Combines incomes of husband and wife and halves present brackets for marital unit.

Thorson Plan - Same as Pechman plan but also includes tax credits to differentiate between single, married, and married-with-dependent-children units in the following ratio: 2 - 4 - 1.

	THORSON PLAN				FRENCH SYSTEM				CEYLONESE SYSTEM			
	Married 0 Dependants		Standard Family		Married 0 Dependants		Standard Family		Married 0 Dependants		Standard Family	
Taxable Income	Difference	% of Bachelor	Difference	% of Bachelor	Difference	% of Bachelor	Difference	% of Bachelor	Difference	% of Bachelor	Difference	% of Bachelor
0	0	.00	0	.00	0	.00	0	.00	0	.00	0	.00
1,000	0	.00	0	.00	0	.00	0	.00	0	.00	0	.00
2,000	30	9.68	30	9.68	30	9.68	30	9.68	15	5.09	15	5.09
3,000	60	11.76	60	11.76	60	11.76	90	17.65	15	3.23	45	9.68
4,000	80	11.43	80	11.43	80	11.43	110	15.71	45	6.77	75	11.28
6,000	120	10.53	120	10.53	120	10.53	210	18.42	30	2.86	120	11.43
8,000	260	15.66	260	15.66	260	15.66	330	19.88	90	6.04	160	10.74
10,000	420	18.58	420	18.58	420	18.58	540	23.89	130	6.60	250	12.69
12,000	680	22.97	680	22.97	680	22.97	860	29.05	210	8.43	390	15.66
15,000	1,100	26.44	1,100	26.44	1,100	26.44	1,400	33.65	330	9.73	630	18.58
25,000	2,340	27.02	2,340	27.02	2,340	27.02	3,380	39.03	1,045	14.19	2,085	28.31
40,000	3,340	20.67	3,340	20.67	3,340	20.67	5,680	35.15	1,420	9.97	3,760	26.40
60,000	4,840	17.82	4,840	17.82	4,840	17.82	7,930	29.20	1,920	7.92	5,010	20.67
90,000	7,340	16.25	7,340	16.25	7,340	16.25	11,680	25.86	2,920	7.17	7,260	17.82
125,000	10,590	15.59	10,590	15.59	10,590	15.59	16,680	24.56	4,420	7.16	10,510	17.02
225,000	18,340	13.30	18,340	13.30	18,340	13.30	26,430	19.16	8,545	6.67	16,635	12.98
400,000	28,340	10.53	28,340	10.53	28,340	10.53	47,930	17.81	12,920	5.09	32,510	12.81

Note: Pechman's plan is not included since the bachelor and married couple pay exactly the same tax.

	PECHMAN PLAN	THORSON PLAN		FRENCH AND CEYLONESE		CEYLONESE	
	All Taxpayers	Married		Standard Family		Single Taxpayer	
Taxable Income	Effective Rate	Effective Rate	Rate Difference	Effective Rate	Rate Difference	Effective Rate	Rate Difference
	%	%	%	%	%	%	%
0	0	0		0		0	
1,000	14.00	14.00	0.00	14.00	0.00	14.00	0.00
2,000	15.50	14.00	1.50	14.00	1.50	14.75	0.75
3,000	17.00	15.00	2.00	14.00	3.00	15.50	1.50
4,000	17.50	15.50	2.00	14.75	2.75	16.63	.87
6,000	19.00	17.00	2.00	15.50	3.50	17.50	1.50
8,000	20.75	17.50	3.25	16.62	4.13	18.62	2.13
10,000	22.60	18.40	4.20	17.20	5.40	19.70	2.90
12,000	24.67	19.00	5.67	17.50	7.17	20.75	3.92
15,000	27.73	20.40	7.33	18.40	9.33	22.60	5.13
25,000	34.64	25.28	9.36	21.12	13.52	29.46	5.18
40,000	40.40	32.05	8.35	26.20	14.20	35.60	4.80
60,000	45.27	37.20	8.07	32.05	13.22	40.40	4.87
90,000	50.18	42.02	8.16	37.20	12.98	45.27	4.91
125,000	54.33	45.86	8.47	40.98	14.35	49.39	4.94
225,000	61.29	53.14	8.15	49.55	11.74	56.94	4.35
400,000	67.29	60.21	7.08	55.31	11.98	63.44	3.85

Note: The percentages for the French and Ceylonese Systems for a married couple with no dependants will be the same as the Thorson plan for a married couple without dependants.

REFERENCES

1/ Vickrey, Agenda for Progressive Taxation, New York, Ronald Press Co., 1947, p. 275.

2/ See Surrey, S., Federal Taxation of the Family: the Revenue Act, 1948, 61 Harv. L. Rev. (1948) 1097 at 1114.

3/ See Royal Commission on the Taxation of Profits and Income, 2nd Report, Cmd 9105, para. 121, p. 37.

4/ See Young, Douglas Thorson, The Selection of the Tax Unit under Income Tax: The Individual Unit versus the Family Unit, a thesis submitted to the University of Wisconsin, 1962, p. 189.

5/ Prest, Public Finance, 1960, pp. 267-275.

6/ Smith, Dan Throop, Federal Tax Reform, 1961, p. 44.

7/ [1962] S.C.R. 65; 62 DTC 1005.

8/ Surrey and Warren, Federal Income Taxation, 1960, p. 1067.

9/ Oldman & Temple, Comparative Analysis of the Taxation of Married Persons, 12 Stanford Law Review (1960), 585 at p. 596.

10/ Oldman & Temple, op. cit.

11/ Oldman & Temple, op. cit.

12/ Supra, N. 9, para. 116, p. 35.

13/ Supra, N. 9, para. 118, p. 36.

14/ Joseph A. Pechman, "Income Splitting", 1959 Tax Revision Compendium, Vol. 1, p. 474.

CHAPTER 4— FORMULATION OF PRINCIPLES AND PROPOSALS BASED THEREON

CANONS

The tax system that is used in Canada at present can only be defended on the pragmatic ground that it is in some measure a solution to the problem of burden allocation. However, we feel that a properly organized aggregation system would achieve a more satisfactory solution. Recognition of the married couple as a tax unit should conform to certain canons.

All Married Couples of Comparable Taxable Income Should Be Treated Equally

Thus, whether the husband brings in all the income, or each spouse contributes half, the tax unit should pay a uniform tax. Certainly if the married couple is a tax unit because it has a certain ability to pay, then attention should not be paid to the proportionate contribution of those who make up the unit any more than attention is paid to the source of a taxpayer's income. This is not to deny that, as a separate problem, the taxable income of a married couple where both members' work should be computed only after deducting certain expenses, such as child-care and housekeeping expenses, which are not available to a married couple where only the husband works. However, once taxable income has been ascertained, all married couples as tax units with similar incomes should be similarly treated and should bear similar burdens.

Some countries provide differences in the treatment of dual-income couples and couples with only one income earner in their rate schedules. We feel it is more consistent with the Canadian concept of deductions, and also simpler, to treat this as a deduction problem. Once the married couple has been classified as a tax unit, there is then in our opinion no need to subcategorize into dual-income and single-income married units.

Groves (op. cit.) argues that the consensus of opinion, both lay and expert, is predominantly that two couples with equal taxable incomes should pay the same tax, regardless of the technical legal division of income. The concessions for working wives is either regarded as an exception or as a factor to be treated by a deduction and prior to reaching taxable income.

Married-Couple Units Should Pay Less Tax Than a Single Taxpayer With The Same Taxable Income

This is a self-evident proposition; the married-couple unit is supporting two people, not one, and therefore has less ability to pay. The problem, of course, is how much less. We emphasize that our conclusions in the study of the personal exemptions must be integrated with a tax structure which strikes a happy balance between single and married-couple units. The personal exemptions are, apart from a revenue-control provision, nothing more than machinery for controlling progressivity, not only vertically between income brackets, but horizontally between single and family units. We are of the opinion that there is no need to do this by the complicated interplay of personal exemptions and two sets of rates, as is done in the U.S. Income splitting produces in effect a second rate structure of brackets twice as wide as those for single taxpayers, and in addition, each taxpayer has a personal exemption of $600. As both these things aim to achieve the same thing— that is, a differentiation of treatment between single and married-couple tax units, we consider that the two can be combined into one by having two rate structures, one for single persons and the other for married-couple units, with no personal exemptions as they exist now. There is a lack of sound theoretical justification for the present exemption system, and the reduction of the married exemption of $2,000 because a working wife is earning income is illogical.

Married-Couple Units Should Pay More Tax Than Is Paid By Two Single Persons With The Same Total Income

This recognizes the economic advantages of joint living.

AGGREGATION ACCEPTED

The income of husband and wife, whether the ratio is 100:0 or 50:50, should be aggregated. We endorse the view of the English Royal Commission which, in its Second Report at p. 77, upheld the principle of aggregation of husband and wife incomes.

It is of interest to note that while we advocate the adoption of an aggregation system, the English Royal Commission received many representations to the effect that aggregation of income ought to be abolished and the income of each assessed as that of a separate individual. The Commission, in its Second Report in Chapter 6 dealt with this problem as follows:

> The unit of taxation itself is less important than the method of treating the unit in the scheme of graduation.
>
> Aggregation has never had any real connection with the "servile" status of a married woman in relation to her property. Aggregation was introduced because it afforded a convenient means of collecting the tax as the husband was a necessary party to any suit against his wife. So long as income tax remained a proportional tax, the principle of aggregation raised no issue of major importance. The historical argument on aggregation is of no weight either for or against the rule.

> Little weight should be given to the argument that aggregation tends to discourage marriage and to induce a man and woman with separate incomes not to marry. The statement that aggregation is a tax on marriage is only true if both spouses have incomes and above a certain range. Several forms of relief otherwise reduce the impact on married persons. At any rate, the tax treatment of income of married couples is not likely to lead people away from matrimony when the reasons that impel men and women to prefer marriage to more casual association are many and powerful.

In conclusion, the Report says at p. 36:

> We have come to the conclusion that the taxation of the combined incomes of husband and wife as one unit is to be preferred to their separate taxation as separate units because the aggregate income provides a unit of taxation that is fairer to those concerned. ... To tax the incomes of two married people living together as if each income were equivalent to the income of a single individual would give a less satisfactory distribution. ... Such a method of taxation ... [means] that one married couple bore a greater or less burden of tax than another according to what must surely be an irrelevant distinction for this purpose, namely, the proportion in which the combined income was divided between the partners. ... There would be natural tendency for husbands to try to arrange to transfer so much of their incomes to their wives as would produce an equal division.

(It is noted here that this is exactly the effect of the present Canadian system, and section 21 is in the Income Tax Act to stop the equal division of incomes.)

The Royal Commission Report continues:

> Our recommendation is therefore in favour of maintaining the general rule of aggregation for the incomes of husband and wife. An income upon which two people have to live as married persons has not the same taxable capacity as the income of a single individual. But in our view the right way to allow for the difference is to make an appropriate allowance for the fact of marriage in the assessment of the unit rather than by treating the two incomes as if they were the incomes of single individuals.

INCOME SPLITTING REJECTED

The following is a point-by-point exposition of how an income-splitting plan would be introduced in Canada.

(a) Retain the present concept of income.

(b) Abolish taxation of husband and wife as individuals and create the family unit.

(c) Define the family unit as husband and wife.

(d) Aggregate all income of this unit, including income accumulating in trust for husband and wife.

(e) Allow exemptions to husband and wife.

(f) Allow a deduction where the wife works based on a percentage of her income, but limited to say $500.

(g) Enact head-of-the-household provisions comparable to those of the U.S.

(h) Prevent splitting of income with minors and others by provisions comparable to the present sections 22(1) and 22(2).

(i) Enact provisions which correlate the income tax treatment of transferred property with that of the gift and estate tax (see Table commencing at page 88 in Chapter 3 which shows present treatment.)

(j) Aggregation would be limited to husband and wife.

(k) A new table of progressive rates would be enacted geared to defeating the possible tax shifting to single taxpayers which would result from this system.

(l) Apply the applicable rate to half the total income and multiply by two.

(m) Personal exemptions are a matter for further study.

The following comments can be made in respect of the effect of adopting an income-splitting scheme.

(a) The personal income tax is reduced to a single understandable system.

(b) The tax unit would conform with our general notions regarding the family.

(c) Some exemption provisions could be eliminated.

(d) Sections 21, 22 and similar provisions and the inequities resulting therefrom would be eliminated. In addition, administration would be simplified in that the need to review many complicated and involved income-splitting plans would be eliminated. Litigation would be decreased and thus the administration would be released for other more fruitful work.

(e) The tax revenues would be maintained without disruption and without gross inequities in tax burden, providing a new rate schedule is adopted.

(f) A general simplification of tax law, no longer dependent upon legal subtleties and denying the tax evader the luxury of casuistry, would result.

(g) It would be necessary or advisable under the split-income plan to make both spouses jointly and severally liable for tax.

(h) At present the 21% rate on corporate income below $35,000 is attractive to taxpayers with a business yielding more than $10,000 of income. Below this figure there is little or no saving through incorporation. The split-income plan, at present rate structures, would make the 21% rate of no value until income exceeded $20,000. Thus, the number of incorporations for tax purposes might be cut.

(i) Clearly, a split-income plan lightens the burden of high income taxpayers with almost no corresponding benefit to low income groups. To avoid this disproportionate distribution of benefits, it might be necessary to limit the amount of income which could be split or, alternatively, splitting might be limited to earned income. The first of these alternatives is based on the notion that in the high income brackets income is not shared between husband and wife in anything like the same proportions as it is shared in the lower income groups. However, we know very little about this question and the assumption may be completely unfounded. Introduction of a limitation of those who may split might therefore amount to rank and perverse discrimination.

Restriction of the split-income rule to earned income may stimulate incentive. The better "tax deal" available to earned income would cause many taxpayers to work harder and thereby earn more. But even this restriction would be of little value in that it applies only to persons receiving relatively large incomes, such as salaried business executives, proprietors and partners. It does not apply to the low income wage earner or single person since, in the main, they get little benefit from income splitting. In addition to these problems restriction of the split to earned income would be an incentive to avoidance in that persons would try to fall within the definition of earned rather than investment income. This, in turn, may give rise to some legal and administrative difficulties.

Brazer 1/ has the following comments to make on income splitting;

> This has had the effect of doubling the size of all tax brackets (of married couples) and of reducing very sharply the tax liabilities of those with taxable incomes substantially above $4,000. For those with taxable incomes below this amount the tax saving is either very small or zero. Income-splitting renders the fact of marriage a very important determinant of the individual's tax liability. Thus, for example, upon the death of his spouse (assuming there are no dependents living in the household), an individual whose tax liability was $13,500 on a $38,000 taxable income when the spouse was alive would find his tax liability to be $18,400 on the same taxable income after the spouse's death, an increase of more than 36 per cent. ... These provisions appear to offer far more in tax relief to married taxpayers relative to single persons ... than is warranted. ... The marital status of the taxpayer is properly recognized through the personal exemption allowed for the spouse. ...

We endorse the view that income splitting is extreme in its leniency, and we feel that the marital status of the taxpayer can either be recognized through the personal exemption or a different tax rate structure. For reasons outlined above, we prefer the latter. Brazer continues:

> The only other requirement would be some recognition of the fact that substantial unavoidable costs are incurred by the working wife, so that two couples with equal incomes are not in equal economic positions if in one case the wife is gainfully employed while in the other she is not. Broadening and liberalization of the present deductibility of so-called child-care expenses ... [and the inclusion] among deductible expenses any outlays made necessary for the fact that the wife works, would go far to solve this problem.

We also endorse this view.

We reject income splitting as too crude a system of differentiation between single and married-couple units. Aggregation with a single rate schedule is burdensome on the married-couple unit without extensive and complicated relief provisions. If these relief provisions are to differentiate between single and married-couple units, such differentiation is more logically found and more simply treated in the rate provisions themselves. Furthermore, the earned-income relief provisions in England, which are pointed to as mitigating the harsh effect of simple aggregation offend against our first canon, as married-couple units with similar incomes are not similarly treated if their income is not from a similar source. Differentiation of treatment of taxable incomes from different sources ignores a basic principle that in a progressive tax structure system the tax unit is what must bear the burden, and its ability to pay taxes is similar, whatever the source of its income. Differing treatment of incomes from different sources is more suitably to be found in the deductions area of our tax law where the problem of compromising between an accurate expression of net income and administrative feasibility has to be met.

On the other hand, aggregation followed by splitting income in half to establish the applicable tax rate offends against the third canon, as a married couple with $20,000 taxable income will, on the application of income splitting, pay the same tax as the total tax paid by two single persons, each with $10,000 taxable income.

Stern, in The Great Treasury Raid, has indicated this in the following table in respect of U.S. tax:

	Matrimony Brings This Tax Bliss	
To Those With Income of	Amount	Per Cent
$ 5,000	$ 38	4.7
$ 7,500	132	7.4
$ 10,000	312	14.9
$ 20,000	1,504	25.5
$ 50,000	5,792	25.5
$ 250,000	22,668	12.7
$ 500,000	25,180	6.6
$1,000,000	14,384	1.8

The advantages of income splitting taper off because of an upper limit on the tax, which can be no higher than 87% of taxable income.

Stern points out that even though income splitting is defended on the grounds that two cannot live as cheaply as one, this fact is not necessarily reflected in an income-splitting system.

> For if the purpose of this tax concession is to help married couples make financial ends meet why are those with the lowest incomes either wholly or virtually excluded from its benefits...?

The fact is that couples with incomes of under $2,889 get no benefit from income splitting, and in the U.S. this applies to about seven million persons.

Therefore, we do not recommend the quotient system or the U.S. income-splitting system as it involves a shift in tax burden distribution to single persons to such a marked degree that we feel it is excessive.

We are in favour, then, of developing a tax rate structure which is somewhere between the two extremes of income splitting and separate taxation of spouses. We note that in Ceylon, the ratio in the quotient system between a single and married-couple unit is 4:3. This we feel to be nearer to what in common sense is needed, the proportion narrowing in higher income brackets. However, we do not feel it necessary to develop a quotient table as in the French or Ceylonese systems, for, as will be seen, for various reasons we do not find we can extend the quotient system to deal with children or dependants. Thus, we favour instead the system used in some European countries, notably Sweden, of two rate schedules, one for the single and the other for the married-couple unit; we shall discuss it in more detail later.

AGGREGATION OF ALL FAMILY INCOME REJECTED

We have considered whether the aggregation system should be extended to cover the family as a unit as we have found it to be a satisfactory principle in the case of husband and wife. This is not a problem which involves a large percentage of taxpayers, but if a principle of aggregation is to ensure that all married couples with similar total incomes bear similar tax burdens, then possibly the same should be said of families. We have, however, rejected this view on the following grounds.

(1) In so far as we have recommended a two-rate system, one for single taxpayers and one for married couples, we could only introduce the family into the system if we were to have a separate rate schedule for each size of family. The complication involved in expansion or contraction of a family within a year with a consequent shifting from rate schedule to rate schedule, renders it impracticable to fit the family within the system we advocate. This is of itself an insufficient answer, as it is done in the Netherlands; also, some other system could be devised, but other considerations support this ground.

(2) We have elsewhere shown that the personal exemption, as it does no more than perform a function of progressivity, can be eliminated if the two rate schedules reflect the desired progressivity both vertically between income brackets and horizontally between single and married-couple units. As for children, progressivity is accentuated horizontally by exemptions in respect of each child, but it is then complicated by non-taxable family allowances. These two pieces of machinery achieve in the end a similar function, that is, the provision of more after-tax income for larger families. We have elsewhere expressed the view that one or the other of these could be removed. In keeping with our view that exemptions have no ideological rationale, in that they no longer realistically reflect any subsistence levels, we have recommended that of the two, the exemptions for children be done away with. We supported this view with the argument that we are persuaded that family allowances, however illogical, are here to stay for various reasons, social and political, and they should be retained, though changed somewhat so that they do the full job of equating the tax burden to the ability of the family to pay, whatever its size. Thus, we have recommended that they be increased in size, but be subject to tax, thus, again ensuring progressivity both horizontally and vertically.

(3) We feel that family units would not only be too various in size to permit of an unwieldy method of aggregation, but also that they vary too much in internal characteristics. Married couples vary little, in that either both have income, or only one does, and this distinction is reflected in suitable deduction provisions. But children can be infants or school children or part-time workers; they can be fully dependent or independent; they can bring in income or not; they can be using family funds at university or can be of economic benefit by acting as a housekeeper at home. We feel that the class is of too variegated a composition to permit of a straightforward solution. Individual problems such as these can be better treated by a comprehensive system of deductions and an adequate scale of family allowances, possibly with a "tapering" provision when the child is to some extent earning income to maintain himself.

(4) It would, in the words of the English Royal Commission, be "doubtful justice ... to attribute the whole of the child's income to the parent and leave him merely to such relief as the child allowance might afford him". The relief afforded to a parent by some reduction in tax may by no means be of the same magnitude as the expenditure made on a child.

(5) One of the reasons for advocating aggregation of children's income with that of the parent adopted by four members of the English Royal Commission in a Reservation to the Second Report, paragraph 72 at p. 78, was that transfers to children enabled spreading of income and avoidance of tax. This situation is in part met by section 22 of our Act, though the section is peculiarly ineffective in some ways.

(6) The income earned by children is usually regarded as pocket money and outside the family budget. Apart from enforcement problems, and the disincentive tendency which make a concomitant, we point out

that these amounts would be taxed at the married-couple unit's marginal rate.

DUAL-RATE PLAN RECOMMENDED

The dual-rate plan we recommend has received consideration in several forms in the U.S. as well as in Europe. Pechman 3/ and Vickrey 4/ have both advocated forms of the dual-rate plan, and the essentials of both are reviewed in Groves 5/ as follows:

> The Pechman plan would allow couples to split their income for tax purposes but would eliminate the advantage by halving the brackets for married persons. In terms of distribution of the tax load it is very similar to mandatory joint returns. Vickrey, who wrote on the subject before the passage of the 1948 legislation would disallow splitting on joint returns and would halve the brackets for married persons filing separate returns and single taxpayers. This would distribute the tax burden much like the split income plan but the effective rates of tax would be higher than under present law both for single persons and for married couples.

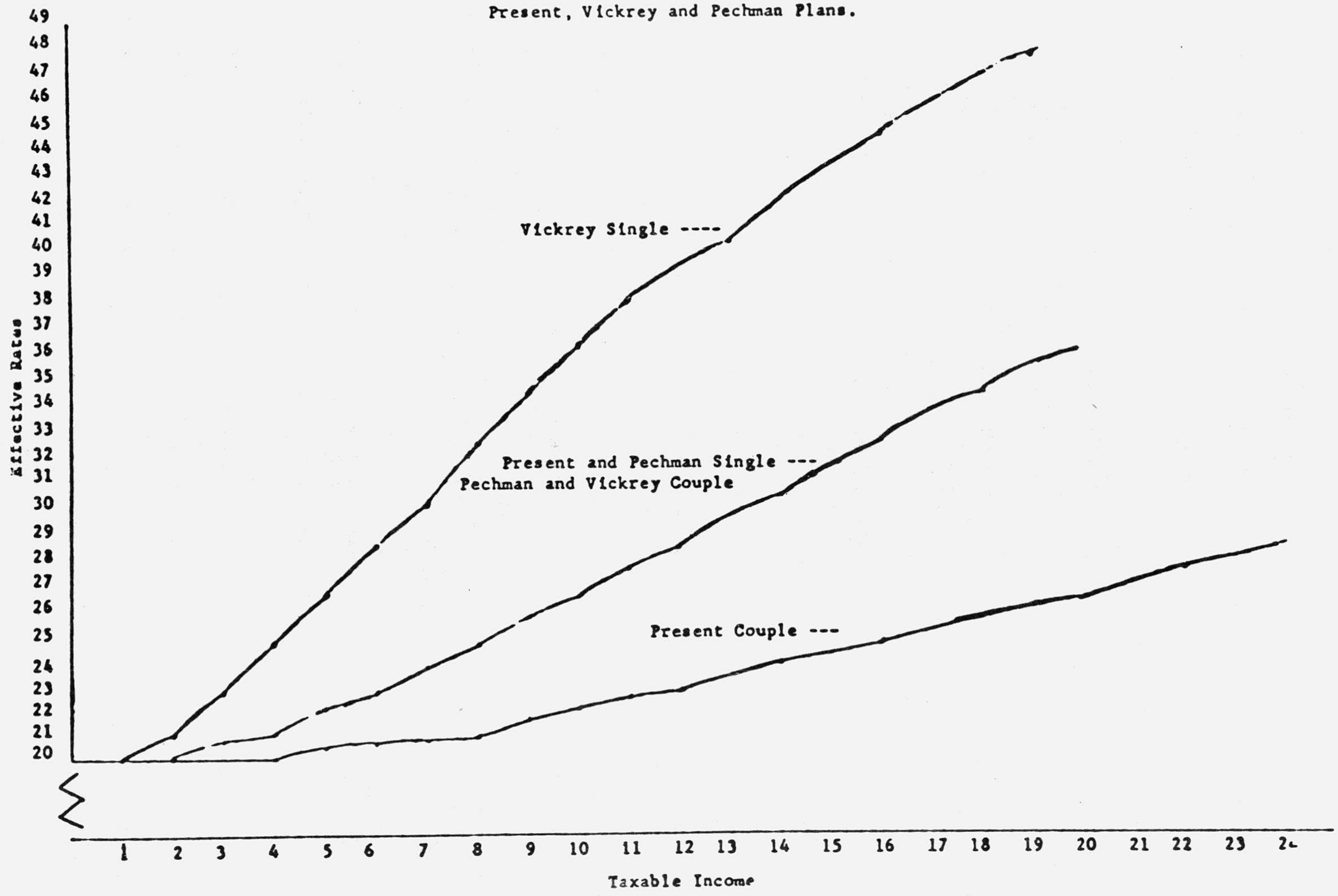
The following is a chart in Groves comparing the relative relationships of the burdens under the present U.S. system and the Pechman and Vickrey systems. (Chart II, page 142).

Certainly the income-splitting system in the U.S. has been found in certain cases to create too extreme a differentiation between single and married-couple units. As a result, the "head of household" rates had to be established as a halfway house, and this has been subject at various times to pressures for expansion to cover related situations. It is felt that the less extreme differentiations to be proposed herein will not lead so readily to halfway house legislation for hard cases.

We are aware that the decision as to the appropriate tax units still leaves collateral questions to be resolved, such as separated couples, where independent assessment may be of advantage to the taxpayer; this option should be available to him.

CHART II

Relative Burdens at Various Levels of Taxable Income.–
Present, Vickrey and Pechman Plans.



So far, the argument for two rate schedules has been on the basis of common sense and the attaining of a compromise between the extremes of simple aggregation and the quotient system. However, such a system does have some theoretical support as well. The classical theory of equal sacrifice as developed to apply to progressivity can be used to support it. Two have a greater sacrifice capacity than one. However, the logical extension of this <u>per capita</u> approach requires aggregation and a separate rate schedule, not only for married-couple units, but also for family units. But it is difficult to go as far in this area as has France, and some <u>per capita</u> allowance for children expressed as a constant percentage of income might equally satisfy the theory of equal sacrifice.

Others are concerned with subsistence levels at the bottom of the scale, and this is again a <u>per capita</u> problem. Actually, this has less to do with progressivity than with personal exemptions, and progressivity above the bottom of the scale is more concerned with avoiding extremes of distribution.

The sociological argument that society's morals are at stake whenever the family tax situation is discussed has largely been discounted, not only by the English Royal Commission's <u>Second Report</u>, but elsewhere. 6/ Aggregation and income splitting is of haphazard assistance to married couples, as its benefit varies from nothing upwards, in comparison to the separate taxation of spouses, depending on what the English Royal Commission has called an "irrelevant distinction"—the disproportionateness of the spouses' incomes; a dual-rate system does not. Certainly, the disincentive to married women to work, as is at present the Canadian experience, is removed; it would possibly be of some value in encouraging wives to work, but the English Royal Commission Report and Groves 7/ both advocate neutrality in this area.

It might here be suitable to note part of what is said by Groves 8/ on the system we recommend.

> The dual-rate scale plan is an especially flexible instrument and it permits almost an infinite number of compromises. Married couples could be given some advantage over single taxpayers with the same taxable income but less than our (U.S.) present law allows. ... Taking a leaf from the Swedish practice, the plan might confine the married-taxpayer concession to the lower brackets of the scale and gradually disappear. This would make a great deal of sense in terms of the welfare and power concerns of the socio-economic approach to progressive taxation. ... Dual rate schedules would complicate the statute and the tax return, but this could hardly be serious.

We have thus reached the conclusion that, since in any equitable progressive tax system variations in relative needs of different taxpaying units must be taken into account, it is not possible to treat single taxpayers and married couples similarly. Married people commingle their economic interests and affairs, and it is neither possible logically, or desirable equitably, to attempt to consider each spouse as an independent unit for tax purposes. With the vast majority of families the husband-wife relationship is akin to a partnership, sharing their pooled resources. The partnership concept is similar to what is generally thought of as the marriage relationship. Economists will agree with this lay point of view as the spending pattern of a married couple usually shows expenditures for their joint benefit rather than for the exclusive benefit of the spouse with legal control over income.

The present Canadian system links these considerations as the income of a married couple is divided between the spouses according to legal ownership of the income, with the exception of the spouse earning less than $1,250— an exception that is illogical within itself and whose rationale is expediency. The U.K. system requires married couples to file joint returns, the income of both spouses being aggregated and then taxed on the same rate schedule as is a single person, subject to larger exemptions. This resolves the inequity of disproportionate incomes, but does not recognize sufficiently the difference in ability to pay between single and married persons. The U.S. system aggregates income as does the U.K., but then splits them, giving benefits to married couples which are not only high, but which vary greatly, depending on one's income bracket.

ADVANTAGE OF THE DUAL-RATE PLAN

1. Disproportionate incomes. This is resolved by aggregating incomes so that the couple with incomes of $2,000 and $23,000 has the same tax to pay as the couple with incomes of $12,500 and $12,500.

2. Married couples with one income earner and married couples with two income earners. The problem of recognizing the added burdens when both spouses are working is resolved by providing suitable housekeeping expense deductions, probably a percentage of the wife's earned income up to a limit.

3. Married couples as compared to single taxpayers. This is resolved by taxing married couples on a different and lower rate schedule, with high percentages of differentiation in lower brackets, reducing as one moves up through the income brackets.

THREE ALTERNATIVE PROPOSALS

The following proposals are therefore presented.

1. Aggregate incomes of married couples; abolish the personal exemptions. Increase the family allowances but include them in income, thus reducing their benefit progressively. Apply a different rate schedule for married couples as opposed to single taxpayers, giving higher percentage differentiation to lower income brackets on the lines of the Table on page 147. Allow a percentage deduction to working wives.

It has been stated that there is little or no justification for personal exemptions other than to accentuate the progressivity of the rate structure in the lower income brackets. The size of the exemption seems to depend on the amount of revenue desired. If this is the case, it is suggested that personal exemptions be dispensed with completely. The extreme progressivity desirable at the bottom of the scale can be incorporated into the rate structure through rates ranging from zero. Separate rates are needed for married persons as opposed to single persons. The family allowance, being in its nature a form of tax credit, could be extended to reflect the need for tax reduction when there are children.

2. Aggregate incomes of married couples. Apply the present exemptions to reach taxable income. Allow a percentage deduction to working wives. Apply the rate structure.

3. Aggregate incomes of married couples. Abolish the personal exemptions but allow a percentage deduction to working wives. Apply a tax credit system.

RATE	SINGLE	MARRIED COUPLE
%	$	$
0		Up to 1,000 -
5	0 - 1,000 (Tax not to reduce taxpayer's income below $500)	above 1,000 - 2,000
10	above 1,000 - 1,500	above 2,000 - 3,000
15	above 1,500 - 2,500	above 3,000 - 4,000
20	above 2,500 - 5,000	above 4,000 - 7,000
25	above 5,000 - 10,000	above 7,000 - 12,000
30	above 10,000 - 15,000	above 12,000 - 17,000
35	above 15,000 - 20,000	above 17,000 - 22,000
40	above 20,000 - 25,000	above 22,000 - 27,000
45	above 25,000 - 30,000	above 27,000 - 32,000
50	above 30,000 - 40,000	above 32,000 - 42,000
55	above 40,000 - 50,000	above 42,000 - 52,000
60	above 50,000 - 100,000	above 52,000 - 101,000
65	above 100,000 - 200,000	above 101,000 - 200,000
70	above 200,000	above 200,000

DUAL-RATE TABLE EFFECT

Income 1/	Single Taxpayer Now	Single Taxpayer Suggested	Single Taxpayer Change	Married Taxpayer Now	Married Taxpayer Suggested	Married Taxpayer Change	Differential Now	Differential Suggested	Percentage of Suggested Differential
$ 500 2/	0	0	-	0	0	-	0	0	
1,000	0	50	+50	0	0	-	0	50	100%
1,500	75	100	+25	0	25	+25	75	75	75%
2,000	150	175	+25	0	50	+50	150	125	71%
2,500	240	250	+10	75	100	+25	165	150	60%
3,000	330	350	+20	150	150	-	180	200	57%
3,500	435	450	+15	240	225	-15	195	225	50%
4,000	540	550	+10	330	300	-30	210	250	45%
4,500	635	650	+15	435	400	-35	200	250	38%
5,000	730	750	+20	540	500	-40	190	250	33%
5,500	840	875	+35	635	600	-35	205	275	31%
6,000	950	1,000	+50	730	700	-30	220	300	30%
6,500	1,060	1,125	+65	840	800	-40	220	325	29%
7,000	1,170	1,250	+80	950	900	-50	220	350	25%
7,500	1,300	1,375	+70	1,060	1,025	-35	240	350	25%
8,000	1,430	1,500	+70	1,170	1,150	-20	260	350	23%
8,500	1,560	1,625	+65	1,300	1,275	-30	260	350	22%
9,000	1,690	1,750	+60	1,430	1,400	-30	260	350	20%
9,500	1,840	1,875	+35	1,560	1,525	-35	280	350	19%
10,000	1,990	2,000	+10	1,690	1,650	-40	300	350	18%
11,000	2,290	2,300	+10	1,990	1,900	-90	300	400	17%
12,000	2,640	2,600	-40	2,290	2,150	-140	350	450	17%
13,000	2,990	2,900	-90	2,640	2,450	-190	350	450	16%
14,000	3,390	3,200	-190	2,990	2,750	-240	400	450	14%
15,000	3,790	3,500	-290	3,390	3,050	-340	400	450	14%
16,000	4,190	3,850	-340	3,790	3,350	-440	400	500	13%
17,000	4,640	4,200	-440	4,190	3,650	-540	450	550	13%
18,000	5,090	4,550	-540	4,640	4,000	-640	450	550	12%
19,000	5,540	4,900	-640	5,090	4,350	-740	450	550	11%
20,000	5,990	5,250	-740	5,540	4,700	-840	450	550	10%
25,000	8,240	7,250	-990	7,790	6,600	-1,190	450	650	9%
30,000	10,690	9,500	-1,190	10,190	8,750	-1,290	500	750	8%
35,000	13,190	12,000	-1,190	12,690	11,150	-1,540	500	850	7%
40,000	15,690	14,500	-1,190	15,190	13,650	-1,540	500	850	6%
45,000	18,390	17,250	-1,140	17,840	16,300	-1,540	550	950	6%
50,000	21,140	20,000	-1,140	20,590	19,050	-1,540	550	950	5%
75,000	35,590	35,000	-590	34,990	33,950	-1,040	600	1,050	3%
100,000	51,040	50,000	-1,040	50,390	48,950	-1,440	650	1,050	2%
150,000	84,740	82,500	-2,240	84,040	81,400	-2,640	700	1,100	1%
200,000	119,740	115,000	-4,740	119,040	113,900	-5,140	700	1,100	1%
300,000	193,440	185,000	-8,440	192,690	183,900	-8,790	750	1,100	1%
400,000	268,440	255,000	-13,440	267,690	253,900	-13,790	750	1,100	0.4%
500,000	348,390	325,000	-23,390	347,590	323,900	-23,690	800	1,100	0.3%

1/ "Income" means income after deduction but before exemptions now, and income after deductions under the suggested table (there being no exemptions).

2/ Tax not to reduce single taxpayer's income below $500.

REFERENCES

1/ Brazer, A Program for Federal Tax Revision, Michigan Pamphlet No. 28, pp. 35-36.

2/ Stern, The Great Treasury Raid, New York: Random House, 1963.

3/ Pechman, Income Splitting, op.cit., pp. 473-486.

4/ Vickrey, Agenda for Progressive Taxation, op.cit., pp. 274-287.

5/ Groves, Tax Treatment of the Family, op.cit., pp. 25-27.

6/ Groves, op.cit., p. 52.

7/ Ibid., p. 53.

8/ Ibid., pp. 54-55.