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in Canada

Taxation of the Incomes of Married Women

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CHAPTER 1

INTRODUCTION

Thirty-nine briefs submitted to the Royal Commission on the Status of Women recommend one or more changes in the tax system. In these briefs it is asserted that the present system unfairly discriminates against women and deters them from working outside the home -- thereby reducing the economic well-being of all Canadians.

Twenty-six of the 39 briefs propose changes in the Income Tax Act only; three briefs propose changes in the Estate Tax Act only; 10 briefs propose changes in both pieces of legislation; approximately 12 briefs make explicit comments on the recommendations of the Royal Commission on Taxation (hereinafter called the Carter Report).

Income tax relief for working women is the change most frequently recommended. Indeed, 15 of the 39 briefs make no other tax proposals. In most briefs it is proposed that women who work should be allowed to deduct from their gross income the expenses of caring for children or aged relatives.

Many of the briefs raise the same objections to the present tax system and propose similar changes. This is shown by the following tabulation of the number of briefs that discuss particular questions.

Proposed Changes in Present Income Tax Act

a)	provide relief for working women with dependants	- 31 briefs
b)	increase personal exemptions (general)	- 7 briefs
c)	raise the ceiling or eliminate the reduction in a husband's personal exemption with respect to a wife who has income over $250	- 7 briefs
d)	eliminate the aggregation of the business income of husbands and wives working as partners	- 5 briefs
e)	allow the deduction of the tuition fees for children from the income of the mother	- 2 briefs
f)	liberalize the gift tax provision as it affects transfers between husbands and wives	- 1 brief
g)	exclude alimony from taxation	- 1 brief
h)	eliminate difference in the determination of taxable income of wives between Quebec (Civil Code) and the other provinces (Common Law)	- 1 brief

i) allow the deduction of the cost of occupational training for women with dependants - 1 brief

Proposed Changes in Estate Tax Act

a) eliminate estate taxes - 2 briefs
b) allow half of the property accumulated by a couple during marriage (excluding bequests from outside the family) to pass without tax to the widow - 2 briefs
c) impose no gift or death taxes on transfers of wealth between husband and wife - 9 briefs
d) raise estate tax exemptions on property passing to wives and dependent children - 4 briefs
e) change the tax treatment of widow's pensions and annuities to avoid "double" taxation, to eliminate difficulties now experienced in meeting tax liabilities in a short period of time, and to reduce the excess burden that can result when a widow dies prematurely - 6 briefs

Implicit and Explicit Comments on the Proposals of the Royal Commission on Taxation

i) approval of the proposed personal income tax credit for working wives with young children - 2 briefs
ii) approval of the proposed exemption of transfers of wealth between husband and wife - 9 briefs
iii) rejection of the proposal that the incomes of husbands and wives be aggregated for personal tax purposes - 6 briefs
iv) acceptance of this proposal - 2 briefs

Some of these views do not require examination in this paper because the proposals are not specifically related to the taxation of women. For example, the proposal that all personal exemptions be raised has no relevance, given the terms of reference of the Royal Commission on the Status of Women, and will simply be ignored. An across the board increase in personal exemptions would have to be financed through higher tax rates or by widening the tax base. Unless revenues were recouped by raising rates for those with large incomes or by broadening the base to increase the taxable incomes of these people, the effect of higher personal exemptions would be to increase the tax burden borne by those with low incomes -- without regard to their sex or marital status. It is doubtful that those who advanced the proposal that all personal exemptions

be raised had this result in mind.

The suggestion that death taxes be eliminated can be disregarded for the same reason. Specific death tax provisions can affect women particularly; to that extent the views expressed in the briefs should be considered in this study. But to discuss the recommended abolition of all death taxes on the grounds that they do not raise enough revenue to warrant their existence would take us too far afield.

Most of the other proposals given in the briefs concerning estate taxes do not require analysis for a different reason. The Government introduced certain tax resolutions in November of 1968. These resolutions, if enacted, would completely change the _Estate Tax Act_. Transfers of property between husbands and wives would be completely tax free, as recommended by the Carter Commission. Virtually all the objections to the present _Estate Tax Act_ raised in the briefs would be swept away -- since the proposed government changes in the _Estate Tax Act_ are precisely the changes demanded in the briefs. Indeed, the Government proposes to go further than some of the briefs dared to envisage. The exemption of transfers from husbands to wives would be infinitely large; the whole of the estate could pass tax free to them, not just half the estate as some of the briefs proposed. Pensions and annuities would not be "double" taxed to wives. There would be no need to be concerned about the time allowed to widows to pay death taxes, since they would not be levied.

Problems may be created as well as resolved by the adoption of the completely revised _Estate Tax Act_, but virtually all the problems that concerned the women who presented briefs to the Commission would be solved.

The major question raised by the briefs that is both relevant to the Commission and still unresolved is the appropriate taxation of the incomes of unmarried women and married women with dependants. As the complaints enumerated above suggest, the present income tax system poses problems of serious concern to women. The Carter Commission recommended changes that some women believe would be even more unfortunate than the present provisions. These are the issues that are examined in this paper.

But before we can begin to analyze the features of the present and proposed Carter income tax systems that are particularly important for women, we must first consider the

general objectives of taxation. The evaluation of specific provisions presupposes the existence of an agreed set of objectives. Only when we know what we are trying to achieve can we assess the adequacy of the present system and of proposed changes in that system.

CHAPTER 2

OBJECTIVES OF TAXATION

Some of the goods and services people want cannot be provided in adequate amounts by the private enterprise system or by a government acting like a private enterprise. Businesses cannot provide defence services, for example, because the suppliers would be unable to exclude from the enjoyment of the protection those residents who refused to pay. The majority may want more national defence: most citizens may be convinced that they would be better off if their private consumption were curtailed in order to release capital and labour for their common defence. But without a government that compels individuals to reduce their personal consumption the desired mixture of private and public consumption cannot be attained.

For essentially the same reason, increasing the purchasing power of the poor at the expense of the well-to-do requires compulsion, even if the majority of those adversely affected agree that more redistribution is desirable. Voluntary action does not suffice because each potential donor realizes that the greater his generosity the less the burden that has to be carried by others who are equally able to contribute.

Without the intervention of government, too much of some goods and services would be consumed, and too little of others. Some people would consume too much and others too little. Too much would be invested in plant and equipment; too little would be invested in roads and education. By reallocating resources, government can make people better off now and potentially better off in the future because the rate of increase of output can be raised.

To achieve these results governments have to perform two functions. Through their expenditures they must deliver public goods and services of the right kinds in the right places at the right times. The inescapable concomitant of this delivery function is the extraction function. Except where there are unemployed resources, governments cannot provide what they have not taken away. Ignoring technological improvements, if more resources are to be devoted to defence without reducing the other goods and services provided by government, resources must be extracted from the private sector of the economy. The tax system is one of the devices used to free resources from private uses.

Alternative Methods

Taxes are but one means of achieving the transfer of resources from private to public uses. The government could simply print more money and use it to outbid private citizens for available resources. It could conscript labour and capital. In a fully employed economy the former approach would raise prices and implicitly tax those whose incomes did not rise as rapidly as the price level. Confiscation is, in effect, equivalent to the imposition of a tax at a rate of 100 per cent on certain kinds of wealth that happen to be close at hand.

Systems of explicit taxes are imposed by government because, in a fully employed economy, there is no other way of achieving the desired allocation of resource that is potentially less disruptive to the economy, potentially more equitable, and potentially more consistent with the protection of the right of individuals.

Main Objectives

These potential advantages are realized when the tax system makes the greatest possible contribution to the achievement of the shared objectives of the nation's citizens. For the purposes of this paper it is assumed that most Canadians seek:

1) a fair allocation of the available goods and services;
2) the largest possible output of the goods and services that residents want consistent with their individual choices between work and leisure and between saving and current consumption;
3) maintenance of the rule of law;
4) full employment and price stability.

The first two objectives can be realized only through the provision of public goods and services and by transfer of purchasing power by government. But the method of obtaining the goods and services and purchasing power that are to be provided by government may be inconsistent with these objectives. The "ideal" tax system conflicts least with the simultaneous realization of all of these objectives.

Conflicts Among Objectives

If changing the tax system would result in the greater realization of one or more objectives, without sacrificing other objectives, the reform could be recommended without qualification. But if movement towards one objective necessarily means sacrificing another objective, a painful decision must be made. The "right" decision depends upon one's subjective values. All that can be done is to proceed on the basis of one's personal values or on the basis of predictions about the subjective values of others.

In designing a tax system two objectives are of overriding importance. One is the fairness with which the burden of reduced private consumption is allocated. The other is the effect on the volume and composition of output. Obviously, taking too much purchasing power away from some and too little from others can frustrate the realization of an equitable allocation of goods and services - the first objective specified above. The effects of the different tax systems on the output objective are less well understood.

Tax Neutrality

The extraction of purchasing power from the private sector of the economy induces individuals to change their work consumption and investment behaviour in order to minimize their tax liabilities. Unless these changes in behaviour rectify distortions resulting from imperfections in the market, or imperfections introduced by other government policies, they reduce economic welfare. In the absence of imperfections, changes in the composition of investment brought about by the imposition of taxes mean that resources are not allocated to their most productive uses and total output is diminished. Tax-induced changes in the level of investment result in too little or too much current consumption - given the rewards individuals require if they are to wait for future consumption. Changes in the composition of consumption brought about by the tax system mean that individuals consume more of some kinds of goods and services that they value less highly than others that could be supplied at no greater cost.

A tax system that has no effects on behaviour is defined as a "neutral" system. Departures from neutrality are only justified when there are:

a) imperfections elsewhere in the economy that should be offset by biases in the tax system;
b) conflicts among objectives that are resolved in favour of more of something else for less economic welfare;
c) administrative barriers that cannot be overcome except at inordinate cost.

To be concrete, imposition of a tax on income may induce individuals to consume more leisure and fewer goods and services that can be purchased only with after-tax income. Unless there is some market imperfection that would result in too little leisure being consumed in the absence of tax, the income tax reduces the welfare of individuals. However, an income tax may be the only tax that allocates the burden equitably. The lack of neutrality of an income tax may be accepted because the gain in equity achieved through such a tax is believed to be greater than the loss in welfare brought about by inducing the consumption of too much leisure.

Implicit Objectives of Those Presenting Briefs

Some of the briefs presented to the Commission emphasize that the present tax system discourages women from working outside the home and thus reduces the volume of output of goods and services relative to potential. It is argued, in other words, that the present tax system is inconsistent with the second objective specified above. The view is also expressed that the Carter proposals, if adopted, would make this situation even worse.

Most of the briefs argue that the present tax system unfairly discriminates against women. They claim it is inconsistent with an equitable allocation of the burden - the first of the objectives listed above. Some of the briefs also state that the adoption of the Carter proposals would not eliminate this inequitable treatment.

None of the briefs envisaged the possibility that the output and equity objectives might be in conflict -- that making the system more equitable as it affects women could reduce the volume of output. "Make the changes we propose," they said, "and Canadians can have a higher standard of living and women will be more justly treated." None of the briefs

appeared to recognize that adoption of the changes they proposed could create inequities between women in different circumstances.

Tax changes can, of course, result in the removal of one kind of discrimination, say between men and women, and thereby create other kinds of discrimination, say between women in different circumstances. In deciding whether such a change would constitute an improvement in the tax system a painful choice would have to be made.

In this paper, we wish to evaluate the extent to which changes in the provision of the present income tax system that particularly affect women - whether proposed in the briefs or in the Carter Report - would affect the realization of the output and equity goals. If a tax change would result in the greater realization of one or both of these two objectives, with no appreciable impact on other objectives, it can be recommended without qualification. If a tax change would result in the greater realization of one of the objectives, but only at the expense of one or more other objectives, or it would improve equity in one dimension but reduce it in another, the change can be recommended only if certain subjective judgments are made. The bases for these judgments must be clearly stated.

Before we attempt to appraise specific tax proposals in this way it is important that the full implications of the output and equity objectives be clearly understood. How could changes in the income tax provisions that particularly affect women bring about greater output and more equity? What do we mean by more equity? Indeed, what do we mean by equity? An attempt is made to provide this background in the next two sections of the paper. The discussion of the effects on output are relatively brief and straightforward. Unfortunately, the consideration of equity is both lengthy and complex.

CHAPTER 3

EFFECTS ON OUTPUT

The argument that the present tax system deters married women (and women with dependants) from working, and hence reduces the output of goods and services, can be simply stated. Women who have family responsibilities cannot deduct the costs of meeting those responsibilities from the income they earn when they work outside the home. Tax is levied not on the income that is left after paying a housekeeper, babysitter or nursery - expenses that must be incurred if the parent's responsibilities are to be met in the absence of the mother from the home - but on the gross income from employment. Second, this gross income is subject to substantial marginal rates of tax. Together, these two features of the tax system mean that a woman with family responsibilities who is considering re-entering the labour market finds that, after paying income taxes and necessary expenses, her net return from working outside the home is extremely low. As a result, it is claimed, many women remain at home who want to work outside it. It is further argued that such women could make a substantial contribution to the output of the economy if they were not inhibited by the tax system from joining the labour force.

There is little doubt that if the present provisions of the tax system induce women to consume more leisure than they would consume under alternative provisions, the Canadian labour force, and hence national output, is smaller than it could be. Remove these tax barriers and Canadians would be potentially better off in the sense that they could consume more goods and services and that they value these things more highly than they value the greater leisure they are induced to consume now.

Unfortunately the issue is more complex than it appears.

Offsetting Tax Changes

Allowing the deduction from employment income of the costs incurred by women in meeting family responsibilities, and reducing the marginal rates of tax on the net income from their employment, _might_ result in women consuming less leisure. This would increase output. However, if these changes reduced tax

revenues, as they probably would, other tax rates would have to be raised or the tax base would have to be broadened. If these compensating rate and base increases induced other members of the population to take more leisure the extra output produced by some women working more would be offset, in whole or in part, by other individuals working less. It is the net change in output that is significant.

The Effects of Income Taxes on the Work-Leisure Choice

It is often argued that all income tax systems deter labour effort because the relative attractiveness of leisure is increased by taxing the return from work. There is virtually no evidence to support this contention. While an income tax makes leisure more attractive, it also reduces after-tax income. To achieve a given standard of living under an income tax more effort has to be exerted. This "income effect" of taxes, as it is called, may have a positive impact on effort. It may outweigh the negative effect on labour effort of a tax that necessarily makes the consumption of leisure relatively more attractive than the consumption of goods and services that can be purchased only with the after-tax income obtained from work.

Even if income taxes did reduce labour effort it does not necessarily follow that income taxes should be abolished. Those who believe that income taxes are more equitable than other taxes may be willing to accept the reduction in output they entail as the inescapable price of achieving greater fairness. This potential conflict between more output and more equity applies, of course, both to men and to women. To suggest that income taxes should be abolished because of their presumed deterrent effects on the labour effort of women would be to miss the point that alternative tax systems are unlikely to treat women fairly relative to one another.

Net Versus Gross Changes in Labour Inputs

Many of the briefs seem to assume that the only alternative to working outside the home is the consumption of leisure by married women. The fact that most women who work in the home do not receive money wages does not mean that they make no contribution to national output. Much of the work women now perform in the home would have to be carried out by someone else if they entered the labour market. If, through a change in our tax laws, more women did work outside the home, the net addition to national output would be substantially less than

the gross addition. Obviously, if all married women with family responsibilities worked as housekeepers for one another, total wages and salaries and measured national output 1/ would be greater. But, unless they did more work for others than they do for themselves, real national output would be unchanged.

Effects on Children

Conceivably, children could be brought up better in nurseries than they are now brought up in the home. If this were the case, a large increase in national output of goods and services could be achieved by the establishment of large numbers of such nurseries. These institutions would more effectively employ some women and release many others so that they could work elsewhere. However, there is no objective method of measuring the merits of collective child rearing relative to child rearing by the mother. Such a scheme might well increase the immediate output of goods and services. But would this be achieved at the expense of the children? Until this imponderable can be answered it is impossible to say whether or not such a change would be desirable. Greater production of the goods and services that people want is one of our objectives. But if more material goods and services were obtained by one generation (parents) through imposing sacrifices (e.g. less attention and affection) on another generation (children) it is not clear that national welfare would be increased.

However, even if it were found that home care for children was superior to institutional care it would not necessarily follow that women should be induced to work in the home through discriminatory provisions in the tax system. Tradition and convention are so strong that it may be that those mothers who could rear their own children better than these institutions would continue to do so under a tax system that was completely neutral. Even if this were not a valid assumption, means could be devised to encourage women to raise their own children at home without penalizing those who wanted to work outside it. Carrots often work better than sticks! Favourable discrimination for those working in the home could be substituted for unfavourable discrimination for those working outside the home.

1/ The imputed value of the housekeeping services of wives is not included in our national income estimates because of the problems of measurement. There is no doubt that, in principle, the value of such services should be included.

Comparative Advantage

It is one of the cardinal principles of economics that, to achieve the greatest output, productive resources should be allocated in accordance with their relative advantages. The busy executive who is a better typist than anyone he can hire should not type his own letters. The value of the output forgone if he devotes his time to typing is greater than the cost of employing more typists. If this principle of comparative advantage were applied to household duties and child care it would frequently turn out that the wife and mother should be going out to work and the husband and father should be staying at home. For women, perhaps the most galling feature of the present social system is the implicit assumption that their comparative advantage is always within the home. But it is extremely doubtful that any changes in the tax system would achieve this improvement in the allocation of resources in the face of existing social conventions.

Summary

All of this is not to deny that the removal of tax discrimination against working wives and mothers might increase the national output without harmful effects on children. Rather, it is intended to emphasize that:

a) it is uncertain that tax barriers have had a significant deterrent effect on the labour force participation rates of married women;
b) a more efficient allocation of housekeeping and child rearing tasks between husbands and wives is prevented by social convention;
c) a dramatic increase in the net output of the nation through increased labour force participation by women would probably require the widespread introduction of institutions that specialized in raising children, at least during working hours. It is difficult to assess the advantages and disadvantages of such a change because little is known about the ultimate effects on the children.

In the light of this uncertainty, the main reason for seeking the removal of any unfavourable tax discrimination against married women, and women with dependants, is essentially to achieve equity - not more national output.

CHAPTER 4

BASIC ASSUMPTIONS

The analysis provided in this paper is based on assumptions identical with those given in the Carter *Report*. This section simply summarizes and explains the assumptions made in the Carter *Report* that are relevant to the present purpose.

Assumptions are not right or wrong. They are either acceptable or unacceptable or they are useful or useless. The author finds the assumptions given below both acceptable and useful. Those readers who find them unacceptable may still find them useful because they provide a conceptual scheme that helps to clarify the issues in dispute.

Simplifying Assumptions

In order to simplify the analysis it is assumed that:

1) government expenditures are predetermined;
2) these expenditures include transfers of purchasing power from the government to individuals and families allocated in such a way that the purchasing power of those with little income and heavy nondiscretionary expenses has been increased to the point where everyone can maintain a decent standard of living;
3) if the government obtains tax revenues equal to its expenditures full employment and stable prices will be maintained;
4) a personal income tax is the only form of taxation.

Under these assumptions the only question outstanding is how to achieve a fair allocation of the predetermined burden among the country's residents. It is important to note that, given that a fixed sum has to be raised, a tax reduction for one individual must, of necessity, be borne by someone else.

Horizontal and Vertical Equity

Two aspects of equity are often distinguished; horizontal equity that requires "equal treatment of equals" and vertical equity that calls for "appropriate" differences in tax treatment among those who are not equal. If we accept the proposition that men and women should be considered as equal in the contemplation of the law, it follows that the incomes of women

should be taxed in exactly the same way as the incomes of men who are in the same circumstances.

The rule that equity demands "equal treatment of equals" provides, unfortunately, little guidance in the development of specific tax proposals. What personal characteristics and circumstances are relevant in assessing equality? How different should the tax treatment be between two individuals who are unequal with respect to one characteristic but similar in all other relevant respects? It is not difficult to find agreement that two individuals with no dependants who are the same age, are in good health, have the same incomes (somehow defined), hold the same wealth, and have the same consumption expenditures should pay the same taxes whether they are male or female. But how should their taxes differ if one earns twice the income of the other? Should the total tax bill of the two increase if they marry? The "answers" to these questions are far from obvious.

Discretionary Income Concept

It is generally accepted that equity demands the allocation of the tax burden in accordance with ability to pay. 1/ More specifically, horizontal equity is achieved when the same taxes are levied against those with the same ability to pay taxes and vertical equity is achieved when differences in taxes fully reflect interpersonal difference in ability to pay. But what determines ability to pay?

The Carter Report stated that:

> The ability to pay of a tax unit should be assumed to be proportionate to its discretionary income.... The discretionary income of a tax unit should be assumed to be equal to the total income of the tax unit multiplied by the fraction of that income available for the discretionary use of the unit.... It should be assumed that, other things being equal, the greater the income of a tax unit the larger will be the fraction of that income available for discretionary use. 2/

1/ Taxes allocated in accordance with benefit received are irrelevant for the purposes of this discussion.

2/ Royal Commission on Taxation, Volume 3, p. 6.

The same assumptions are made in this paper. The discretionary income concept does not provide the ultimate answer to the question "What is the ability to pay taxes of each individual relative to every other individual?" That question cannot be answered in any absolute sense. But the concept has many methodological advantages. It does not eliminate the need for judgments but it provides a framework that makes explicit the judgments that cannot be avoided and helps to ensure that the judgments are mutually consistent.

Several features of the discretionary income concept require explanation.

1. Discretionary income is just another term for ability to pay taxes. It is assumed that if we agree on the relative discretionary incomes of two tax units, we also agree on their relative ability to pay taxes. Equity is achieved when their relative taxes are the same as their relative discretionary incomes.
2. Discretionary income is that part of a tax unit's total income that remains after the unit has made the expenditures necessary to maintain itself. The concept of maintenance is not synonomous with the concept of physiological subsistence but rather encompasses what is conventionally expected.
3. Income is defined as the change, over a period of time, in a tax unit's power to consume goods and services for personal use whether that power is exercised or not.
4. A tax unit is the unattached individual, or the married individual, or the family. It is the "person" liable for tax on discretionary income.

It may be helpful to illustrate these concepts through the use of a numerical example.

Consider three identical individuals, A, B, and C, who have incomes of $4,000, $8,000 and $12,000 respectively. Let us suppose that it is agreed that A has to spend 80 per cent of his income to maintain himself in the socially expected manner; B has to spend 60 per cent for this purpose; C is judged to have nondiscretionary expenditures that use up 50

per cent of his income. The discretionary incomes of the three are given in Table 4-1.

TABLE 4-1 Illustration - The Relationship Between Total Income and Discretionary Income

Tax Unit	Total Income	Percentage of total income required to meet nondiscretion-are expenses	Discretionary income (tax base)	Tax payable at a rate of 20 per cent on discretionary income base
A	4000	80	800	160
B	8000	60	3200	640
C	12000	50	6000	1200
Total	24000	-	10000	2000

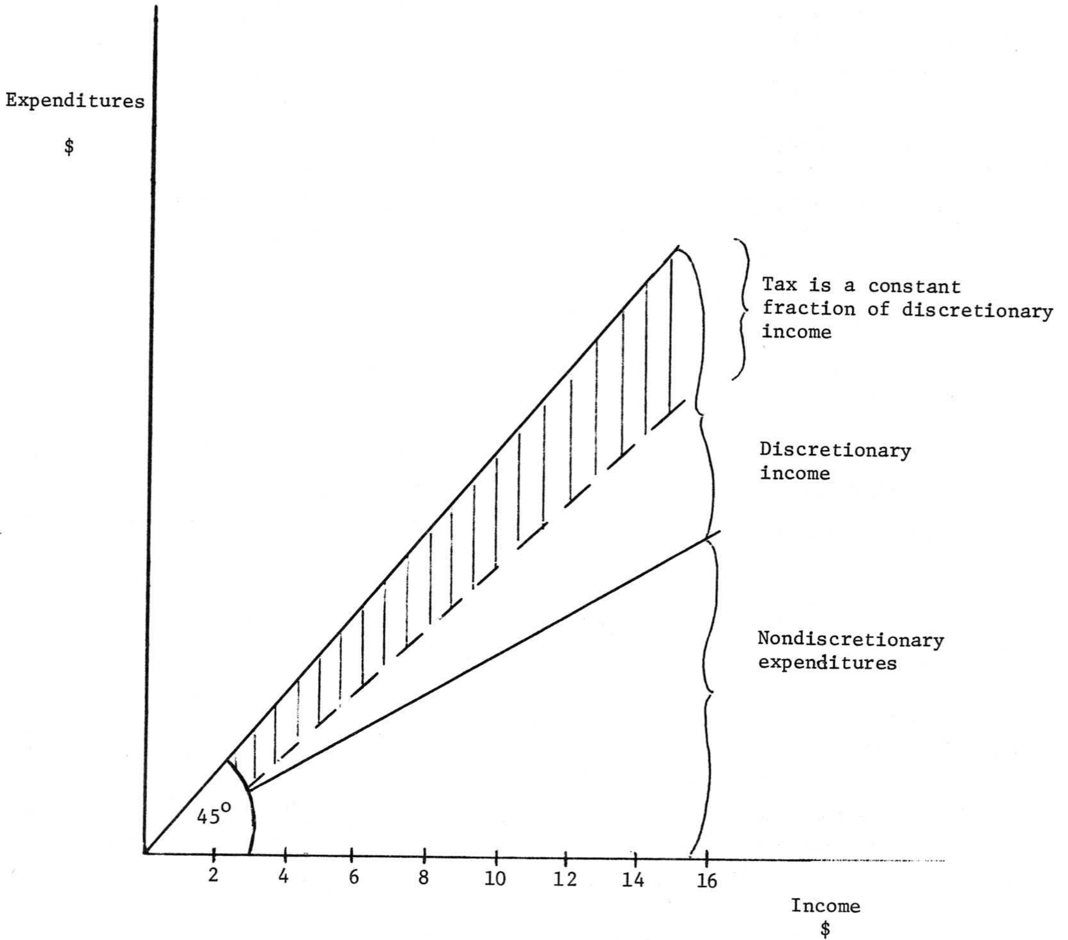
The ability to pay taxes of the three individuals is assumed to be proportionate to their discretionary incomes. If a total revenue of $2,000 were required the appropriate rate of tax on this base would be $2,000/10,000, or 20 per cent. The application of this flat rate of tax to the discretionary income of each of the three individuals would result in an allocation of the requisite tax burden that was proportionate to their discretionary incomes. This achieves, by definition, an allocation of the burden that is in accordance with their respective abilities to pay.

It is important to recognize that although a proportionate rate of tax has been applied to discretionary income, the burden is allocated progressively with respect to total income. That is to say, the tax burden rises relative to total income as total income rises. This result is attributable to our assumption that, over the income range $4,000 to $12,000, the nondiscretionary expenditures of individuals rise with total income but rise relatively less rapidly than total income rises. This relationship is shown in the following diagram (Chart 4-1). The 45-degree line drawn through the origin simply shows what expenditures would be if all income were spent.

As explained in some detail in the Carter Report, 1/ a proportionate rate of tax on discretionary income thus defined

1/ Royal Commission on Taxation, Volume 3, p. 11.

CHART 4-1 Illustration of the Discretionary Income Concept



is equivalent to marginal rates of tax on total income that rise from income bracket to income bracket. In other words, by making assumptions about the changes in the fraction of the total income that is available for discretionary use (or, what is the same thing, the fraction that is required to meet nondiscretionary expenditures), the degree of progression of the marginal rates of tax on additional income is determined. Because the fraction of total income that is available for discretionary use at different income levels is essentially a matter of judgment rather than of fact, and therefore can not be determined by investigation, the discretionary income concept does not determine what the rate of progression in a marginal rate schedule should be. But the concept makes it possible to make a judgment about something reasonably specific - the extent to which individuals (or other tax units) at different income levels are free to spend or save if they are to maintain a standard of living "appropriate" to their incomes.

There are, of course, an infinite number of judgments that can be made about the relationship between total income and discretionary income. But certain broad alternatives can be distinguished.

Assumed Relationships Between Discretionary Income and Total Income

In order to be reasonably concrete in the subsequent discussion, we have drawn up schedules of the assumed fractions of income that are available for discretionary use in each income bracket for unattached individuals, married individuals, and married couples who are taxed on their aggregate income. These schedules are given in Table 4-2.

These alternative assumptions are:

1) The level of nondiscretionary expenditures is fixed and independent of income. Every unattached individual has to spend, let us say, $2,500 to maintain himself. All income in excess of $2,500 is available for discretionary use.
2) Nondiscretionary expenditures rise less rapidly than income but continue to rise as income rises, without reaching a ceiling.

TABLE 4-2 Assumed Fractions of Total Income Available for Discretionary Use

Income Bracket	Unattached Individuals			Married Individuals			Married Couples (Aggregate Income)		
	Assumed fraction of income in bracket available for disc. use	Discretionary Income		Assumed fraction of income in bracket available for disc. use	Discretionary Income		Assumed fraction of income in bracket available for disc. use	Discretionary Income	
$		From bottom to top of bracket $	Cumulative total to top of bracket $		From bottom to top of bracket $	Cumulative total to top of bracket $		From bottom to top of bracket $	Cumulative total to top of bracket $
0-2000	0.1	200	200	0.11	220	220	0.11	220	220
2000-4000	0.2	400	600	0.23	460	680	0.11	220	440
4000-8000	0.3	1200	1800	0.36	1440	2120	0.23	920	1360
8000-16000	0.4	3200	5000	0.50	4000	6120	0.36	2880	4240
16000-32000	0.5	8000	11200	0.70	11200	17320	0.50	8000	12240

3) Nondiscretionary expenditures rise with income up to a ceiling, say an income of $100,000. All income above $100,000 is available for discretionary use.

Acceptance of the first assumption necessarily implies acceptance of increasing marginal rates on total income at the bottom of the income scale but virtually constant marginal rates of tax on all income above a fairly low level. Acceptance of the second assumption implies acceptance of marginal rates of tax on total income that continue to rise with the income of the individual - however great that income. The third assumption implies acceptance of marginal rates of tax that increase with total income up to a particular income level, say $100,000, and are constant thereafter.

For the purpose of this analysis it does not matter which of the three assumptions is made. Suffice it to say that acceptance of the discretionary income concept necessarily means some range over which marginal rates of tax on additional income rise. In this paper we assume that the marginal rates of tax on additional total income rise throughout the relevant range.

It cannot be emphasized too strongly that these schedules are hypothetical. They are used for expository purposes only and should not be considered as anything more than illustrative of the principles involved.

Marginal Rate Schedules and Progressivity

When applied to the income of each tax unit the data given in these schedules "determine" the size of that unit's discretionary income. By aggregating the discretionary incomes of all tax units resident in Canada, the total tax base of the nation is determined. Knowing the dollar value of government expenditures, the rate of tax on discretionary income that would finance these expenditures is readily ascertained: the ratio of these expenditures to the aggregate tax base. Knowing this rate of tax on discretionary income, rates of tax on the total income in each income bracket can then be determined. These are the marginal tax rates with which we are all familiar.

To illustrate, suppose that a rate of tax on aggregate discretionary income of 50 per cent would finance government expenditures. Given our schedules, this means that unattached individuals with incomes of $4,000 should pay taxes equal to 50 per cent of the assumed discretionary income of $200 on

their first $2,000 of income, they should pay taxes equal to 50 per cent of the assumed discretionary income of $400 on their second $2,000. The rate of tax on total income in the bracket is therefore determined as follows:

Marginal rate of tax on first $2000 of income $= \frac{0.50 \times \$200}{\$2000} = 0.05$ or 5 per cent.

Marginal rate of tax on second $2000 of income $= \frac{0.50 \times \$400}{\$2000} = 0.10$ or 10 per cent.

These are the marginal rates of tax on income in these two brackets implied by the schedule provided in Table 4-2.

By assuming that the fractions of income available for discretionary use rise more rapidly from bracket to bracket a more progressive marginal structure would be obtained; and conversely. For the purpose of this study the degree of progressivity is not at issue. That the system must have _some_ progressivity in this sense is taken for granted.

A comparison of the schedule for married individuals with the schedule for unattached individuals shows that we are assuming that married people have a larger fraction of their total incomes available for discretionary use than unattached individuals. It is also assumed that this benefit from marriage is greater the greater the income of the married individual. The rationale for these differences is discussed later.

The schedule for married couples is derived mechanically from the schedule for married individuals. If two individuals with identical incomes marry, their aggregate discretionary income can be determined either by using the schedule for married individuals and multiplying the result by two _or_ by calculating the aggregate discretionary income of the couple by the application of the rate schedule for married couples to the aggregate total income of the couple. The results are identical using either method.

However, if the incomes of the two married individuals that constitute the couple are not equal, the total tax on the couple is lower if the schedule for married couples is employed. The reason for this difference is also discussed later.

Treatment of Special Nondiscretionary Expenses

The use of three separate schedules for three different kinds of tax units implies that we are assuming:

a) different kinds of tax units have different discretionary incomes even if they have the same income;
b) tax units of the same kind have different discretionary incomes if they have different incomes.

Other differences in the characteristics of tax units are also relevant in the allocation of taxes.

In principle, any nondiscretionary expense reduces discretionary income and should be taken into account. Schedules of the type we have provided must be based on judgments about the nondiscretionary expenses of the "typical" married individual. The schedules provided earlier do not take into account special nondiscretionary expenses such as "unusual" medical expenses and the expenses of raising children. Those tax units that have these nondiscretionary expenses should be given special tax relief because their discretionary incomes are less than the schedules would assume.

To be faithful to our basic concept of discretionary income, equity would be achieved by providing each tax unit that has a special nondiscretionary expense not taken into account in the schedule with a tax credit equal to that expense multiplied by the proportionate rate of tax on discretionary income. This can be shown by the use of our earlier example. In accordance with this schedule given in Table 4-1, an individual with an income of $4,000 has a discretionary income of $600. If the rate of tax on discretionary income (the rate of tax that would give a balanced budget if applied to the aggregate discretionary incomes of all resident tax units) were 50 per cent, the appropriate tax liability would be $300. Let us suppose that this individual has an unusual nondiscretionary medical expense of $100. His "true" discretionary income is $500 rather than $600. His tax liability should be $250 rather than $300. This result can be obtained by first computing the tax liability of $300 on the basis of income and then reducing this liability by a credit of 50 per cent of the nondiscretionary medical expense of $100 (i.e. the provision of a tax credit of $50).

Determination of nondiscretionary medical expenses is relatively simple. What about the nondiscretionary expenses of raising a child? Some outlays are clearly inescapable. They are nondiscretionary in every sense of that term. But others may be entirely voluntary. A parent may enjoy providing the "best" for his or her child. Such expenditures are essentially gifts and no tax relief is appropriate. It is obvious that some arbitrary allowance must be made for these kinds of nondiscretionary expenses.

1. Provide a fixed credit against the tax liability of the tax unit that has the special nondiscretionary expense.
2. Allow the tax unit to deduct a fixed sum from total income before calculating discretionary income.
3. Provide a separate schedule for tax units with the special nondiscretionary expense (e.g., one schedule for married individuals with no dependants, another for married individuals with one dependant, another for married individuals with two dependants, and so on.)

Acceptance of the first is tantamount to assuming that the special nondiscretionary expenditure is independent of the total income of the tax unit. The nondiscretionary expenses of the poor man in raising his child are the same as those of the wealthy man. As illustrated in Table 4-3, acceptance of the second approach involves the implicit assumption that the nondiscretionary expenses of the tax unit with respect to child care not only rise with total income but rise as rapidly as we have assumed that the fraction of total income available for discretionary use rises from bracket to bracket (i.e. as rapidly as marginal rates of tax rise from bracket to bracket). Acceptance of the third approach allows for intermediate positions but, of course, is more administratively difficult.

The "ideal" treatment would require the use of method (3) in dealing with the nondiscretionary expenses arising from the support of children and dependants. However, this approach is ruled out for administrative reasons. It is assumed that method (1) is preferable to method (2) because it reflects the value judgment that upper-income parents should not be given more tax relief than lower-income parents if we are to achieve greater equality of opportunity.

We have frequently used the term "total income" in the preceding discussion. Income must be defined if we are to proceed with a minimum of confusion.

TABLE 4-2 Illustration of the Implicit Assumptions Underlying the Use of Standard Deductions for Special Non-discretionary Expenses

Rate Schedule[1] | Implicit Percentage Changes in Nondiscretionary Expenses

Income Bracket	Assumed fraction of total income in bracket available for discretionary income		Total Income	Total income less deduction of $2000	Discretionary Income		Implicit Nondiscretionary Expenses	
$	Ratio	Per cent change from previous bracket	$		Based on total income $	Based on total income less $2000 $	$	Per cent change from preceding row
0-2000	0.1	-	2000	0	200	0	200	-
2000-4000	0.2	100	4000	2000	600	200	400	100
4000-8000	0.3	50	8000	6000	1800	1200	600	50
8000-16000	0.4	33	16000	14000	5000	4200	800	33

1) Rate schedule is from Table 4-2

Concept of Income

Most of the heated discussion about the concept of income centres around two particular questions: Are capital gains income? Are gifts income? In this paper it is assumed that both answers are in the affirmative. Anything that increases an individual's command over goods and services for personal use is defined as income.

Gifts are not only income to the donee they are, by *definition*, discretionary expenses of the donor and therefore should not be deducted from the income of the donor. Gifts are, in a sense, a particular kind of personal consumption expenditure of the donor.

Income is *not* confined to money receipts. Wages in kind and gifts in kind are thus encompassed by the income concept we have adopted.

Working for oneself also generates income. Men who repair their own cars and women who make their own clothing have imputed incomes because saving the pocket is equivalent to adding to the pocket. Imputed incomes from providing services for oneself are valued at the cash income foregone by not devoting the same time and effort to a job.

Looked at in this way, every individual has an income. The food, clothing, shelter and care provided to an infant by his or her parents is income to the child - although the provision of these goods and services is not a discretionary expenditure of the parents until it exceeds the minimum maintenance required by social convention. Many housewives have no cash income. But, in terms of our concept, all have some income consisting at least of the food, clothing and shelter provided by their husbands and the imputed value of the household services they provide for themselves.

The room and board provided a housewife by her husband may be thought of as a "wage" paid for her household services or as a gift or as a nondiscretionary transfer required by law - or a mixture of all these.

Another aspect of our definition of income must be mentioned. Income is a net concept. From gross receipts must be deducted the expenses necessarily incurred to obtain them. Thus, if an individual obtains, say, $5,000 a year for the sale of personal services his income would be less than $5,000 if

he had to bear certain costs in order to generate the income. Expenses that would be incurred whether or not the income were generated are not deductible from gross income. Thus the "general expenses of living" are not deductible.

Having briefly stated our basic assumptions, we now proceed in Chapter 5 to examine the principles that underlie the income tax of married women and women with dependants.

CHAPTER 5

PRINCIPLES

Under our assumptions, individuals should be taxed in proportion to their discretionary incomes. To determine the appropriate taxation of married individuals relative to unattached individuals we must investigate the differences in their discretionary incomes. It will be recalled that the discretionary income of the individual is the sum that remains after deducting from gross income (whether in cash or kind or imputed) the expenses necessarily incurred to earn that income and maintain oneself. In the light of this rule, should married individuals pay more tax than single individuals with the same incomes?

The "Tax on Marriage"

Consider two unattached individuals, one male and one female, who in every other respect are alike. They have the same jobs, receive the same pay, have identical living accommodation, make the same expenditures, carry out the same household chores. Obviously they should pay the same taxes and we will suppose that they do. Assume now that they marry. Both continue to work, both continue to receive the same pay. They have no children or other dependants. Should their taxes rise, fall or remain unchanged?

It is generally agreed that two people living together as man and wife *can* live more cheaply than they can live apart. Two kinds of economies are possible. Nondiscretionary cash outlays *can* be reduced because the cost of providing accommodation and food for two living together is less than the cost of providing the same quality of accommodation and food for two living apart. Nondiscretionary outlays of effort also *can* be reduced for those living together as man and wife. Shopping and preparing meals for two *need* take little more than shopping and preparing meals for one. If, after marriage, both continue to spend the same amount of time doing household chores, and therefore have unchanged imputed incomes, they *can* provide themselves with better household services than they had before at the same labour cost. That is to say, a larger fraction of their imputed income derived from working for themselves is available for discretionary use.

To look at the situation from a slightly different point of view, after marriage one or both of the spouses can add to their financial assets or consume more leisure without any reduction in their standard of living. A larger fraction of the income of one or both of the spouses is available for discretionary use after marriage. One or both has a greater ability to pay taxes. This is the essential justification for imposing a "tax on marriage."

A "tax on marriage" is imposed not to penalize marriage but to achieve an equitable allocation of the tax burden between unattached individuals and married individuals who benefit from the economies of living together.

Interspouse Transfers

It is necessary to use the qualifying phrase "one or both spouses" when describing the effects of marriage on discretionary income because of the complex financial and work arrangements that can exist between spouses. Consider three of the infinite number of budgetary arrangements possible between working spouses with equal incomes.

a) A couple may have a "businesslike" agreement under which each spouse keeps his or her own income and assets. Living costs (labour costs as well as out of pocket costs are relevant) are shared on a fifty-fifty basis by the spouses. Under this kind of agreement the discretionary incomes of the spouses are increased by equal amounts by marriage - assuming that marriage does not affect the flow of gifts between the spouses.
b) A couple may have an agreement under which their individual incomes, assets and expenses are "pooled." Under this kind of arrangement it is virtually impossible for one spouse to make a gift to the other because neither has identifiable property to give. Each can spend the cash contributed by the other whether or not a gift is made. As with the businesslike arrangement, it is reasonable to suppose that marriage increases the discretionary incomes of both spouses to the same extent.
c) A couple may have a "traditional" agreement under which the husband supports his wife by the provision of all of the "necessitities." With this exception, each spouse keeps his or her own income, assets and expenses separately. The wife is free to save her

own income, spend her own income on herself or make gifts - including gifts to her husband. When this situation prevails, the sum of the discretionary incomes of the spouses may be substantially increased by marriage. This can arise because, under our assumptions, gifts add to the income of the recipient but are not deducted from the income of the giver.

An arithmetic example helps to explain what is involved in the "traditional relationship" case. As shown in Table 5-1, it is assumed 1/ that there are two individuals who, before marriage, had the same incomes ($7,100) and the same nondiscretionary expenses ($2,500). It is further assumed that their employment incomes and imputed incomes are not changed by marriage. Because of the economies of living together their nondiscretionary expenses fall from $2,500 to $2,000. If this were the only change, and the couple had a "businesslike" arrangement with no change in their gifts to one another, marriage would increase their individual discretionary incomes by $500 because of the reduction in their individual nondiscretionary expenses. However, in this hypothetical example of a "traditional arrangement" the husband is assumed to provide his wife with room and board valued to $1,500. This is treated as a nondiscretionary expense of the husband because he has a legal and moral responsibility to maintain his wife. The wife is assumed to transfer to her husband goods, services and cash also valued at $1,500. The latter transfer is a gift because the wife is under no legal or moral obligation to support her husband. Nor is the wife "buying" her room and board in exchange for this transfer because the husband would have to support his wife even if she transferred nothing to him. The net effect of these transfers, relative to the situation before marriage, is to increase the discretionary income of the husband by $400 (his net discretionary expenses increase by $1,000 but his net transfers received increase by $1,400). The wife's discretionary income rises from $4,600 to $6,500 because the transfers she receives rise by $1,400 and her nondiscretionary expenses fall by $500. The gift to her husband is not deductible because it is discretionary.

This means that unless interspouse transfers were explicitly excluded from the tax base, the taxation of married individuals separately would, in principle, increase the burden

1/ The amounts given in Table 5-1 are completely hypothetical. They are not derived from the schedules provided in Table 4-2.

TABLE 5-1 Hypothetical Changes in the Discretionary Income of Individuals Who Marry

	Before marriage			After marriage		
	Male	Female	Total	Male	Female	Total
Employment income	6000	6000	12000	6000	6000	12000
Imputed income from services	1000	1000	2000	1000	1000	2000
Transfers received from other party						
Nondiscretionary transfers	0	0	0	0	1500	1500
Discretionary transfers (gifts)	100	100	200	1500	0	1500
Total Income	7100	7100	14200	8500	8500	17000
Less assumed nondiscretionary exp.						
Nondiscretionary transfers (to other party)	-	-	-	1500	-	1500
Other nondiscretionary expenditures	2500	2500	5000	2000	2000	4000
TOTAL	2500	2500	5000	3500	2000	5500
Discretionary Income	4600	4600	9200	5000	6500	11500

borne by couples with "traditional" budgetary relationships relative to couples with "businesslike" or "pooling" arrangements. Needless to say, administrative difficulties would preclude the effective enforcement of this extra tax levy. It would be almost impossible to determine whether or not interspouse gifts were being made unless they were extremely large.

Aggregation of the incomes of husbands and wives and the taxation of the couple as a unit automatically achieves the exclusion of interspouse gifts because transfers and transactions within the unit are completely outside the purview of the tax system.

Aggregation of the Incomes of Husbands and Wives

Under a system that taxes married individuals separately and imposes marginal rates of tax that rise with the income of the individual, couples with the same aggregate income have different aggregate tax liabilities if the division of the income between the spouses differs. With progressive marginal rates and a separate tax unit for each spouse, the total tax on the couple is minimized when the incomes of the spouses are equal. With unequal incomes the total tax burden of the couple can be reduced by shifting a dollar of income from the high income spouse to the low income spouse. The increased tax borne by the latter is less than the tax reduction enjoyed by the former. As a consequence it is in the interest of the spouses to arrange their affairs, if they can, to equalize their incomes - while maintaining the same total income. With respect to the employment income, this leads to artificial arrangements whereby husbands who are self-employed "hire" their wives and provide them with a "salary" in order to equalize their individual incomes. The so-called "salary" paid to the wife may bear no relationship to the value of the work done by the wife for her husband's business.

To maintain the integrity of a system that seeks to impose progressive rates of tax on the individual tax unit, the law must preclude this kind of artificial averaging of the incomes of spouses. When husband and wife are partners in a business it is impossible to determine whether or not the payments to the wife are for value received or are simply a method of tax avoidance. These kinds of artificial averaging transactions must not be permitted. The employment income of the wife received from her husband must be treated as though it were the income of the husband.

The aggregation of the incomes of husbands and wives eliminates this problem but has certain disadvantages.

If the spouses do not have identical incomes, the taxation of the aggregate income of the couple confers an advantage compared to a system that provides for the separate taxation of the income of each spouse. In effect, aggregation automatically achieves the averaging of the spouses' incomes. This means that the magnitude of the tax on marriage is affected by the relative incomes of the spouses before marriage. The more unequal their individual incomes the less the tax on marriage, and conversely. Indeed, depending on the particular rate schedule adopted, aggregation of the incomes of individuals with extremely unequal incomes can confer a tax advantage on marriage even if the rates are higher for married couples than for unattached individuals. The tax reductions from income averaging achieved through aggregation can outweigh the tax increases from the imposition of higher rates of tax on the incomes of married couples. Furthermore, unless their incomes are identical, aggregation of the incomes of spouses raises the marginal rate of tax on the last dollar of income of the spouse with the lower income and lowers the marginal rate of tax on the last dollar income of the spouse with the higher income. As a result of aggregation, the spouse with the higher income finds the after-tax return from additional work raised; the spouse with the lower income finds the reverse. Bearing in mind the qualifications discussed in section 4, this may induce the higher income spouse to work more outside the home and the lower income spouse to work less outside the home.

Filing a joint return requires the full disclosure of the financial affairs of the spouses to one another. One or both may find this unacceptable. On the other hand, if the rates applicable to married individuals are higher than the rates applicable to unattached individuals, married individuals cannot be allowed to continue to use the schedule applicable to unattached individuals after their marriage. To do so would forgo the "tax on marriage" that is needed to reflect the increase in the discretionary income of the couple resulting from their marriage.

A separate filing option can be provided. It is possible to derive a rate schedule for married individuals that would allow the separate taxation of spouses without "giving away" the tax on marriage. The schedule for married individuals provided in Table 4-2 achieves this result. But if the incomes of the spouses were not identical, spouses who chose to be taxed

separately would necessarily pay higher taxes than couples who chose to file joint returns. In short, unless the spouses have equal incomes a penalty would be imposed on spouses who chose to be taxed separately. This penalty would be imposed on the spouse with the larger income.1/

Aggregation has also the disadvantage that, by automatically providing for the averaging of the incomes of husbands and wives, revenues are reduced relative to what they would be if separate taxation of spouses were effectively enforced. These revenue reductions must be recouped through higher rates of tax on discretionary income. This must raise the taxes borne by unattached individuals relative to married couples. It must also result in raising the tax on marriage for those couples whose incomes are approximately the same. This follows because under our assumption of equal revenues, the benefits from aggregation for couples with unequal incomes must be paid for by other taxpayers.

With the exception of the last consequence, which is ignored until later, these conclusions can be illustrated using the hypothetical rate schedules provided in Table 4-2.

As shown in Table 5-2, for individuals with the same incomes (e.g. couple A) the tax on marriage built into the schedules is effective. It would make no difference to their total tax liabilities if they decided to be taxed singly or in aggregate after marriage. For couple B, however, where the income of the man is ten times the income of the woman, if they agreed to be taxed on their aggregate income, a tax saving would be realized through marriage. Their discretionary income would decline from $2,300 to $2,080 and, it will be recalled, taxes are a constant percentage of discretionary income under this approach. If they insisted on separate taxation the tax on marriage would be greater than for Couple A. The tax on Couple

1/ As discussed before, this penalty could be avoided if the spouses entered into artificial arrangements that equalized their incomes. But there would be no reason to try to block such arrangements under a system that provided for aggregation. Averaging of the incomes of spouses would be available to all spouses who filed joint returns. In other words, by accepting aggregation as the "correct" result, artificial averaging by spouses who filed separately would not be objectionable. Whether they would be able to agree on artificial averaging arrangements if they are unable to agree to disclose their incomes to one another is another matter!

TABLE 5-2 Differences in Assumed Discretionary Income Before and After Marriage, With Aggregation or Separate Taxation of Spouses

Tax Unit	Income	Discretionary income		
		Before Marriage	after marriage	
			On aggregate income	On individual incomes
Couple A				
Man	5000	900	-	1040
Woman	5000	900	-	1040
Total	10000	1800	2080	2080
Average	5000	900	1040	1040
Couple B				
Man	9000	2200	-	2620
Woman	1000	100	-	110
Total	10000	2300	2080	2730
Average	5000	1150	1040	1365

A would rise from x percent of $1,800 before marriage to x percent of $2,080 after marriage. The tax on Couple B would rise from x percent of $2,300 before marriage to x percent of $2,730 after marriage if they chose to file separate returns.

The effect of aggregation on the incentive to work can be examined in terms of the fraction of an extra dollar of employment income that would be assumed to be discretionary before and after marriage. Using our hypothetical schedules and the same assumptions as in the previous table, these "marginal rates of tax" are shown in Table 5-3.

If we ignore the income effect discussed in the previous section extra work is less attractive to both spouses following marriage if they have identical incomes, like our Couple A. This is entirely the result of imposing a tax on marriage. For them it makes no difference whether they decide to be taxed on aggregate income or on their separate incomes. When the incomes of the man and woman differ, as in Couple B, the spouse with the higher income finds the tax disincentive to extra work reduced after marriage if the aggregate approach is used, but raised if each spouse's income is taxed separately. The spouse with the lower income is subject, after marriage under aggregation, to a severe disincentive to extra work. But the tax disincentive to the low income spouse would be only slightly greater after marriage if the separate taxation option were adopted. Assuming that a tax on marriage is required, the pros and cons of aggregation can be summarized as follows:

<u>Separate Taxation of Married Individuals Relative to Aggregation</u>

Pro:
- a) Slightly lower rates of tax are applied to discretionary incomes generally.
- b) Lower marginal rates of tax are applied to the extra employment income of the spouse with the lower income.
- c) The tax on marriage is consistent among couples even though spouses have unequal incomes.

Con:
- a) Transfers between spouses must be excluded.
- b) Arbitrary rules have to be introduced to prevent artificial income averaging by spouses.
- c) Couples with the same aggregate income pay widely divergent taxes unless the share of that income attributable to the two spouses is the same.

TABLE 5-3 Change in Assumed Discretionary Income Resulting from One Dollar of Extra Employment Income Before and After Marriage with Aggregation and Separate Taxation of the Spouses

Tax Unit	Income	Discretionary Income		
		Before Marriage	After Marriage	
			Taxed on Aggregate Income	Taxed on Individual Income
	$	$	$	$
Couple A				
Man	5000	0.30	0.36	0.36
Woman	5000	0.30	0.36	0.36
Total	10000	-	-	-
Couple B				
Man	9000	0.40	0.36	0.50
Woman	1000	0.10	0.36	0.11
Total	10000	-	-	-

Aggregate Taxation of Married Couples Relative to Separate Taxation

Pro: a) Arbitrary rules to prevent income averaging between spouses are unnecessary.
b) Transfers between spouses are irrelevant.
c) The marginal rates of tax on the extra employment income of the higher income spouse are probably reduced.
d) Couples with the same aggregate income pay the same taxes without regard to the division of the income between the spouses.

Con: a) Slightly higher rates of tax on discretionary incomes.
b) The tax on marriage is erratic. If the incomes of the spouses are very unequal the tax on marriage may be offset in whole or in part as a result of automatic averaging.
c) Higher marginal rates of tax are imposed on the extra employment income of the spouse with the lower income. This may discourage labour effort by that spouse.
d) Each spouse must disclose his or her income to the other spouse.

If the system made aggregation optional, in the sense that couples could choose between taxation of their aggregate income and submission of separate returns (with a tax on marriage being imposed in both cases), the situation would be altered. All the advantages of aggregation would be retained but objections (c) and (d) to aggregation could be avoided at the cost of imposing a penalty on couples who chose to file separately where the spouses had unequal incomes. 1/

It is apparent from this summary that if the incomes of the spouses were always equal aggregation would always be superior for it would resolve the problem of interspouse transfers and would have no other effects relative to separate taxation. But when the incomes of spouses differ there are advantages and disadvantags to each approach. It would appear that we are confronted with a conflict of objectives that can be resolved only through a painful compromise. As we will show, however, this conflict may be substantially reduced.

1/ To be precise, the penalty is imposed not on the couple but on the spouse with the larger income.

The issues can be set forth even more explicitly. If all wives had substantial incomes of their own so that they did not rely upon their husbands for support, and never were employed by their husbands, it would be possible to tax each spouse separately on his or her own income using a rate schedule that was slightly more stringent than the rate schedule for unattached individuals. Each spouse would be entirely self-supporting so that there would be no special exemptions or credits for married individuals. The gifts between husband and wife could be exempt, in whole or in part. With this approach there would be a tax on marriage that would make additional effort more unattractive to both spouses. But it would not hit the spouse with the lower income as heavily as the other spouse. Because the woman usually has the lower of the two incomes it would certainly be more favourable to her than would aggregation. The converse would be true for her husband.

The difficulty with this "solution" is that all wives do not have substantial incomes. Many do not work outside the home. Men who married women who never worked outside their homes, or who ceased working after marriage for one reason or another, would be faced with higher rates on their own incomes _and_ additional nondiscretionary expenses - the expenses of maintaining their wives. This decline in the discretionary income of the husband would not be reflected in a reduction in the taxes paid by the husband.

By the same token, if all wives worked at home there would be no great problem in taxing married individuals separately. A rate schedule could be devised for married individuals (husbands) that took into account the imputed income of their wives derived from their housework and the nondiscretionary expenses of the husband in maintaining a wife. This schedule would, presumably, reduce the tax on a man who married because his net nondiscretionary expenses would rise more than his income would rise by adding the value of the household services provided by his wife. As with the situation where both spouses were self-sufficient, interspouse gifts could be handled through an exemption.

This "solution" is, of course, also unacceptable. There are couples where the wives work in the home exclusively; there are couples where the wives work outside the home exclusively; there are couples where the wives divide their work between the home and the labour market. A tax system that pretended that there was only one possible arrangement would be hopelessly rigid.

Further, it must be recognized that there is no method of blending these two approaches that would not result in placing high rates of tax on the income a housewife might earn by entering the labour force. If we seek to lower taxes on marriage to one worker couples and to increase taxes on marriage for couples where both spouses are self-supporting, any income earned by a wife that moves her from the first status to the second would, perforce, be subject to high marginal tax rates.

The more generous the tax reduction given to a man upon his marriage to a woman who does not work outside the home (because of the assumed nondiscretionary expenses of maintaining a wife) the greater the tax barrier to women leaving the home to work.

Imputed Income of Housewives

A large part of the problem we have been discussing arises because neither the present tax system nor the proposed Carter system takes into account the imputed income of wives who work within the home. Wives who do not work outside the house usually work to a considerable extent in the house. They usually make a major contribution to the maintenance of the couple through the provision of housekeeping services. These housekeeping services are valuable. They save the pocket of the husband. In a world without income taxes we would assume that they are "worth" the income forgone by the woman in working inside the home rather than outside it either in the sense that the same quantity and quality of housekeeping services could not be purchased from others if the wife worked outside the home and used the proceeds to hire someone else, or in the sense that the extra cost of doing the work herself is a consumption expense (i.e. is more satisfying to the woman). She enjoys housework and is willing to "pay" for the opportunity of doing it. Just how valuable are the housekeeping services of wives is forcibly brought home to husbands who have to fend for themselves when their wives leave the home for a few weeks for some reason.

If the income of the couple included the imputed value of these housekeeping services, valued in terms of the income forgone by the woman working in the home rather than outside it, the aggregation of incomes would pose many fewer problems with respect to the rates of tax imposed on the income that wives could earn if they worked outside the homes.

To put the matter in a different way: the imputed income of the housewife now escapes tax altogether. As a result, if a woman is choosing between an hour of work in the home and an hour of work outside the home she is faced with a zero tax on the former and a significant tax on the latter, for part of her additional income is added to the income of her husband. If, however, the imputed income of the housewife were taxed on the family, there would be no tax consequences whatsoever when this substitution took place. The only change would be that the couple would substitute cash income for income in kind.

With the taxation of imputed income, only if the housewife wished to substitute work for leisure would she feel a significant tax barrier. But this barrier would exist whether she worked in the house or outside it. The same barrier would confront the husband who was deciding between work and leisure.

The same point may be made in still another way. The problem of aggregation from the point of view of most women who want to work outside the home is not primarily that their earnings from such work would be added to the incomes of their husbands and taxed at a high rate, but rather that the imputed earnings from work in the house are undertaxed so that there is a great tax bias in favour of working in the home.

The tax bias against working outside the home applies to men as well as to women. Other things being equal, the man who can earn an extra $3 an hour working outside his home is foolish to pay another man $3 an hour to paint his house - unless the professional painter can do more and better work in the same time. For the householder has to pay the painter with after-tax dollars. He has to work an hour and a quarter (we will suppose) in order to be able to pay the painter to perform an hour's work.

There are, of course, important differences that make the problem more serious for women than for men. Women tend to be less well-trained than their husbands for work outside the home and their rates of pay in the labour market tend to be lower even if they have the same training. Consequently, the income forgone by a woman working in the home tends to be lower and differential narrower between what she could earn outside the home and the cost of buying the same services from others.

Perhaps of greater importance, family self-sufficiency is now a thing of the past. The family needs cash income from outside the home to buy some goods and services. The husband may have to decide between working longer hours outside the home or doing his own house repairs. But unless he has investment income, only rarely does he decide between doing all his work in the home versus working outside the home exclusively. He can save by doing some things himself but he needs cash to buy most of what the family needs.

Convention seems to dictate that, except in rare instances, the husband invariably works outside the home. The wife's decision between working in the home and out of it then is concerned with substituting more goods and services purchased from others either for fewer housewife services, or for less leisure for the housewife. Because some goods and services purchased from others are essential, and the range of household work that most men can (or are willing to) perform is strictly limited, the husband's work outside the home is treated as both a necessity and, up to a point, costless. But more goods and services purchased from others in exchange for fewer housewife services or housewife leisure is a matter of preference. The husband thus decides how much work should be performed outside the house. His wife has to decide whether to work outside the home.

The tax bias against working outside the home therefore has much more material effect on wives than it does on husbands - even though the arithmetic effects may be the same.

The inclusion in the tax base of the "actual" value of the imputed income of housewives is straightforward in principle but virtually impossible to achieve in practice. Two facts would have to be determined for each housewife: what would she earn per hour if she worked outside the home? How many hours does she work inside the home each year? The answers to these questions are, to say the least, elusive!

A Theoretical Solution

While it is patently impossible to determine the imputed income for each individual, it is possible to achieve roughly the same result by:

1) requiring each physically and mentally able individual of working age to include in income an arbitrary value for imputed income (say $2,000) attributable to own services;

2) excluding from the tax base the actual employment income of each individual, up to the value of the imputed income arbitrarily included, on the grounds that this part of employment income is a substitute for imputed income and represents no addition to the tax base.

Ignoring for expository reasons all income other than employment income and imputed income, under this approach an individual with a cash employment income of $1,000 would be considered to have an adjusted income of $2,000: $1,000 of employment income and $1,000 of imputed income. The individual with an employment income of $2,000 would have an adjusted income of $2,000 - all employment income. The person with no employment income would have an adjusted income of $2,000 consisting solely of imputed income. In short, every healthy individual of working age would have at least an adjusted income of $2,000. Only employment income in excess of $2,000 would be considered a net addition to adjusted income.

The desired result could be achieved by requiring each individual to add $2,000 to total income and exempting the first $2,000 of employment income and using the usual rate schedules, such as those given in Table 4-2. Alternatively, these rate schedules could be altered so as to achieve the same result without the explicit addition of the assumed imputed income. Such a set of rate schedules are provided in Table 5-4. In either case the first $2,000 of employment income would be deductible for each individual. For want of a better term we have called the rate schedules that have a built-in tax on imputed income "Adjusted Income Rate Schedules." When using these schedules imputed income is ignored and only employment income in excess of $2,000 is added to the tax base. (Other kinds of income, such as investment income, would be brought into the adjusted income base without modification.)

The adoption of the adjusted income base has four important consequences.

1) By assuming that each individual of working age has an income of at least $2,000 the tax base is broadened. This permits lower rates of tax on discretionary income.
2) There is no change in tax liabilities if the individual's employment income varies between zero and $2,000. That is to say, between these limits the marginal rate of tax on extra employment income is zero and the system is neutral with respect to work inside or outside the home.

TABLE 5-4 Assumed Fractions of Adjusted Income Available for Discretionary Use

Income Bracket	Unattached Individuals			Married Individuals			Married Couples (aggregate income)		
	Assumed fraction of income in bracket available for disc. use	Discretionary Income		Assumed fraction of income in bracket available for disc. use	Discretionary Income		Assumed fraction	Discretionary Income	
$		From bottom to top of bracket $	Cumulative total to top of bracket $		From bottom to top of bracket $	Cumulative total to top of bracket $		From bottom to top of bracket $	Cumulative total to top of bracket $
0	-	200	200	-	220	220	-	440	440
0-2000	0.2	400	600	0.23	460	680	0.23	460	900
2000-4000	0.3	600	1200	0.36	720	1400	0.43	460	1360
4000-6000	0.3	600	1800	0.36	720	2120	0.36	720	2080
6000-8000	0.4	800	2600	0.50	1000	3120	0.36	720	2800
8000-10000	0.4	800	3400	0.50	1000	4120	0.36	720	3520
10000-12000	0.4	800	4200	0.50	1000	5120	0.36	720	4240
12000-14000	0.4	800	5000	0.70	1400	6520	0.50	1000	5240
14000-16000	0.5	1000	6000	0.70	1400	7920	0.50	1000	6240

3) Because every individual of working age is assumed to have some income, aggregation of the incomes of spouses achieves more consistent results. The tax on marriage is more stable because the averaging of incomes of husbands and wives achieved through aggregation is less important.
4) By assuming that all individuals of working age have an imputed income, the tax barrier to married women working outside the home is largely eliminated without "special" treatment for women, whether married or unmarried. Men and women are treated in exactly the same way.

Numerical Illustrations of the Effects

To show the implications of including an arbitrary value of imputed income in the base, and allowing the deduction of employment income, equal yield taxes were calculated using the discretionary income rate schedules given in Table 4-1 and 5-4 for unattached and married couples. The results are given in Table 5-5. The procedures followed to obtain these data are described below.

1) Tax liabilities were calculated for 16 pairs of individuals. Each of the pairs was assumed to have either a different income or a different division of income between its two constituent members.
2) Tax liabilities were calculated for each pair of individuals both before marriage and after marriage.
3) Discretionary incomes for each of the 16 pairs of individuals were calculated on the basis of "total income" (i.e. all imputed income excluded and all employment income included) and of "adjusted income." Each of these two incomes were subjected to the rate schedules for unattached individuals, married individuals taxed separately and married couples taxed on the basis of their aggregate incomes. In making these calculations the rates given in Table 4-2 were used with respect to total incomes and the rates given in Table 5-4 were used with respect to adjusted incomes.
4) To take into account the fact that total discretionary income is affected by the definition of income and by the adoption of aggregation, rates of tax on the aggregate discretionary income of the 16 pairs of individuals were determined such that a constant revenue ($25,000) would be raised from this population. The rates of tax on discretionary income were:

Total income approach:	
with no aggregation	0.51
with aggregation for married couples	0.54
Adjusted income approach:	
with no aggregation	0.48
with aggregation for married couples	0.50

The lower rates under the adjusted income approach reflect the broadening of the base through the inclusion of imputed income. The rates under aggregation are higher because couples in which the spouses have unequal incomes realize a tax saving through averaging that has to be recouped elsewhere.

The data provided in Table 5-5 for the pair of individuals designated D-3 can be interpreted in the manner described below.

1) It is assumed that individual number 1 has an employment income of $8,000 and individual number 2 has an employment income of $2,000.
2) Using the total income approach and no aggregation, the married couple would pay a total tax of $1,193 (individual 1, $1,081 and individual 2, $112). The unmarried pair would pay, in aggregate, $1,020 under these assumptions. A tax on marriage of $173 would be paid as shown in the second last column on the right.
3) Still using the total income approach but requiring aggregation would reduce the tax on the married couple to $1,123, a saving of $70. The tax on the unmarried pair would rise from $1,020 to $1,080. The net effect would be that the tax on marriage would fall from $173 to $43.
4) Using the adjusted income approach with no aggregation would result in a total tax on the couple of $1,124, a decline relative to the total income approach of $69 attributable solely to the lower rate of tax on the same discretionary income (from a rate of 0.51 to a rate of 0.48 on a discretionary income of $2,340). The unmarried pair would be required to pay $960, a decline of $60 in their tax liability relative to the total income approach. This decline also would result from the lower rate of tax imposed on a discretionary income of $2,000. The tax on marriage would be $164.

TABLE 5-5 Comparison of Equal Yield Income Tax Liabilities of Unattached Individuals and Married Couples Under Alternative Assumptions

Case	Employment Income						Tax Liabilities																			
	Indiv. No.1		Indiv. No.2		Total		Before Marriage									After Marriage									Tax on Marriage	
	Actual	Adj.	Actual	Adj.	Actual	Adj.	Without Aggregation				With Aggregation					Without Aggregation				With Aggregation						
							No. 1	No. 2	Total	Tax on Extra $1,000 Employ. Income for No.2	No. 1	No. 2	Total	Tax on Extra $1000 Employ. Income for No. 2	Col. (13) Col. (9)	No. 1	No. 2	Total	Tax on Extra $1000 Employ. Income for No.2	No. 1	No. 2	Total	Tax on Extra $1000 Employ. Income for No.2	Col. (22) minus Col. (18) (24)	Without Aggregation Col.(8) minus Col.(9)	With Aggregation Col.(22) minus Col.(13)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)
Total Income Approach																										
A	0	0	0	0	0	0	0	0	0	51	0	0	0	54	0	0	0	0	56	0	0	0	59	0	0	0
B-1	3000	1000	0	0	3000	1000	204	0	204	51	216	0	216	54	+12	230	0	230	56			178	59	-52	+26	-38
B-2	3000	1000	1000	0	4000	1000	204	51	255	51	216	54	270	54	+15	230	56	286	56			238	124	-48	+31	-32
B-3	3000	1000	2000	0	5000	1000	204	102	306	102	216	108	324	108	+18	230	112	342	117			362	124	+20	+36	+38
B-4	3000	1000	3000	1000	6000	2000	204	204	408	102	216	216	432	108	+24	230	229	459	117			486	124	+27	+51	+54
C-1	5000	3000	0	0	5000	3000	459	0	459	51	486	0	486	54	+27	530	0	530	56			362	124	-168	+71	-124
C-2	5000	3000	1000	0	6000	3000	459	51	510	51	486	54	540	54	+30	530	56	586	56			486	124	-100	+76	-54
C-3	5000	3000	2000	0	7000	3000	459	102	561	102	486	108	594	108	+33	530	112	642	117			610	124	-32	+81	+16
C-4	5000	3000	3000	1000	8000	4000	459	204	663	102	486	216	702	108	+39	530	229	759	117			734	194	-25	+96	+32
C-5	5000	3000	5000	3000	10000	6000	459	459	918	153	486	486	962	162	+44	530	530	1060	184			1123	194	+63	+142	+161
D-1	8000	6000	0	0	8000	6000	918	0	918	51	972	0	972	54	+54	1081	0	1081	56			734	194	-347	+163	-238
D-2	8000	6000	1000	0	9000	6000	918	51	969	51	972	54	1026	54	+59	1081	56	1137	56			929	194	-208	+168	-97
D-3	8000	6000	2000	0	10000	6000	918	102	1020	102	972	108	1080	108	+60	1081	112	1193	117			1123	194	-70	+173	+43
D-4	8000	6000	3000	1000	11000	7000	918	204	1122	102	972	216	1188	108	+66	1081	229	1310	117			1318	194	+8	+188	+130
D-5	8000	6000	5000	3000	13000	9000	918	459	1377	153	972	486	1458	162	+81	1081	530	1611	184			1706	194	+95	+234	+248
D-6	8000	6000	8000	6000	16000	12000	918	918	1836	204	972	972	1944	216	+108	1081	1081	2462	255			2290	270	+128	+326	-346
Adjusted Income Approach																										
A	0	0	0	0	0	0	96	96	182	0	100	100	200	0	+18	106	106	212	0			220	0	-8	+30	+20
B-1	3000	1000	0	0	3000	1000	192	96	288	0	200	100	300	0	+12	216	106	322	0			335	0	+13	+34	+35
B-2	3000	1000	1000	0	4000	1000	192	96	288	0	200	100	300	0	+12	216	106	322	0			335	0	+13	+34	+35
B-3	3000	1000	2000	0	5000	1000	192	96	288	96	200	100	300	100	+12	216	106	322	110			335	115	+13	+34	+35
B-4	3000	1000	3000	1000	6000	2000	192	192	384	96	200	200	400	100	+16	216	216	432	110			450	115	+18	+48	+50
C-1	5000	2000	0	0	5000	3000	432	96	528	0	450	100	550	0	+22	499	106	605	0			565	0	-40	+77	+15
C-2	5000	2000	1000	0	6000	3000	432	96	528	0	450	100	550	0	+22	499	106	605	0			565	0	-40	+77	+15
C-3	5000	2000	2000	0	7000	3000	432	96	528	96	450	100	550	100	+22	499	106	605	110			565	115	-40	+77	+15
C-4	5000	2000	3000	1000	8000	4000	432	192	624	96	450	200	650	100	+26	499	216	715	110			680	180	-35	+91	+30
C-5	5000	2000	5000	3000	10000	6000	432	432	864	144	450	450	900	150	+36	499	499	998	173			1040	180	+42	+134	+140
D-1	8000	6000	0	0	8000	6000	864	96	960	0	900	100	1000	0	+40	1018	106	1124	0			1040	0	-84	+164	+40
D-2	8000	6000	1000	0	9000	6000	864	96	960	0	900	100	1000	0	+40	1018	106	1124	0			1040	0	-84	+164	+40
D-3	8000	6000	2000	0	10000	6000	864	96	960	96	900	100	1000	100	+40	1018	106	1124	110			1040	180	-84	+164	+40
D-4	8000	6000	3000	1000	11000	7000	864	192	1056	96	900	200	1100	100	+44	1018	216	1234	110			1220	180	-14	+178	+120
D-5	8000	6000	5000	3000	13000	9000	864	432	1296	144	900	450	1350	150	+54	1018	499	1517	173			1580	180	+63	+221	+230
D-6	8000	6000	8000	6000	16000	12000	864	864	1728	192	900	900	1800	200	+72	1018	1018	2036	240			2120	250	+84	+308	+320

5) The adoption of the adjusted income approach and aggregation would give a tax on the couple of $1,040 - a reduction of $83 relative to the total income method - and a tax on the unmarried pair of $1,000 - a reduction of $80 relative to the total income method. The tax on marriage would be only $40.
6) If we suppose that the second individual is a woman, we can determine what would be the tax consequences of a decision to work outside the home at a job paying $2,000 compared with working in the home and earning nothing. From Table 5-5 we find:

	Tax borne by couple with husband earning $8000, wife $0	Tax borne by couple with husband earning $8000 & wife $2000	Difference
Total income approach	$	$	$
no aggregation	1081	1193	112
aggregation	734	1123	389
Adjusted income approach			
no aggregation	1124	1124	0
aggregation	1040	1040	0

7) If we suppose that the husband's income is $8,000 and the wife's income $2,000 we can ask what would be the extra tax if she earned an extra $1,000 under the various alternatives we are examining. The results are as follows:

	Tax on extra $1000 of income earned by wife.
Total income approach	$
no aggregation	117
aggregation	194
Adjusted income approach	
no aggregation	110
aggregation	180

Aggregation raises the tax on the extra $1000 of employment income under either approach, but the increase is less when income is adjusted to take into account imputed income. If it were desired to keep the tax on the extra $1,000 zero it would simply be necessary to raise the assumed imputed income from $2,000 to $3,000.

General Implications

To proceed from the particular to the general, the following conclusions emerge from the data given in Table 5-5.

If every individual of working age were assumed to have an imputed income of $2,000, and the first $2,000 of employment income were made deductible, it would be possible to adopt aggregation and achieve the following results relative to the taxation of married individuals without aggregation.

a) a more consistent tax on marriage
b) a reduced tax barrier to work outside the home for the spouse with the lower income
c) lower marginal rates of tax on employment income generally.

These results reinforce what was said earlier. The problem of aggregation is not, primarily, that it involves taxing the income of married women who work outside the home but rather is largely attributable to the failure to tax the imputed income of those who work in the home.

The adjusted income approach is not without potential difficulties, however. One set of problems would be reduced and another set of problems would be created. Fortunately, the problems would not be overwhelming.

If the adjusted income approach were adopted it would be necessary to provide a credit, equal to the tax on an adjusted income of zero, for individuals who were too young or too old or physically or mentally unable to work. This credit would just offset the tax on the imputed income of the individual. For married couples under aggregation this credit would offset half of the tax on zero income if one spouse were unable to work. Setting the age limits for these credits would be largely arbitrary. It would be difficult, undoubtedly, to validate the claims made by those who did not work outside the home that they were unable to work.

A man who married a woman who did not work outside the home would find that the tax liability that had to be met out of his cash income would rise if the aggregate adjusted income of the couple were used on the base. For example, consider a man earning $8,000 and a woman with no cash income. Under the adjusted income approach both would be subject to tax before marriage. He would have to pay $900. She would have to pay

$100 - the tax at a rate of 50 per cent on a discretionary income of $200 arising from an assumed imputed income of $2,000.

The total tax on the couple after marriage (assuming aggregation) would be $1,040. The extra $40 would be attributable to the net effect of the tax on marriage being offset to some extent by the automatic averaging of their incomes. The man would have additional nondiscretionary expenses as a result of his marriage but would have to pay more tax even though his cash income was unchanged. He would assume the tax liability of the woman - $100 _plus_ the tax on marriage.

The difficulty here is not essentially the tax on marriage but rather the assumed situation of the woman before marriage. To have survived without income before marriage (recall that gifts are income) the woman must have either been running down her capital or borrowing prior to marriage. She must have met her assumed tax liability of $100 in one of these ways. These alternatives would not be open to many individuals for protracted periods of time.

The point to be made is simply this. Under the adjusted income approach there would be a positive pressure on able-bodied individuals of working age to work outside the home to obtain the cash to meet their tax liabilities. This pressure would be intensified by marriage because the cash liabilities would rise as a result of the tax on marriage. It must be emphasized that, with one qualification, if the level of imputed income assumed were "correct," the adjusted income system would _not_ bias the decision to work inside or outside the home. The exception arises because the government accepts only cash in settlement of tax liabilities. Payments in kind (personal services) are not acceptable. Thus, if the present system is biassed in favour of providing oneself with goods and services in kind that escape tax, the adjusted income system would do just the opposite.

For those who want a bigger labour force, adoption of the adjusted income approach would be an effective instrument for achieving that objective.

The adjusted income system could have major effects on the allocation of the tax burden. Unless offset by a reduction in the rate of tax on discretionary income, middle income couples where the wife works at home exclusively would be required to bear a higher fraction of the total tax burden than they do now.

Treatment of Dependants

It is one thing to change the tax system to encourage women who have no children to work outside the home. It is another to apply the same approach to women who are fully occupied at home raising their children. Under the adjusted income method it would be essential to provide a system of tax credits for dependent children that more than offset the tax on imputed income for mothers. What would be required can be seen by looking at the treatment of a couple in which the husband earns $8,000 and the wife $3,000. Under the adjusted income - aggregation method the changes in the discretionary income of the couple following marriage and the birth of a child can be illustrated by the example given in Table 5-6.

When a child is born it is assumed that two things occur. The wife's employment income is lost, and this only partially replaced by her imputed income. The tax on the couple falls from $1,220 to $1,040 as a result. In addition it is assumed that the nondiscretionary expenditures of the family increase by $1,000 as a result of the child. At a rate of tax of 50 per cent on discretionary income, a tax reduction of $500 for the child would be appropriate. Such a credit would more than offset the tax on the imputed income of the wife, for if the income of the family were only $8,000 its discretionary income (ignoring the child) would be $1,360 and the tax would be $680 rather than $540.

An important feature of this approach should be noted. The tax credit of $500 for the child would be independent of whether or not the mother looked after the child herself.

After the birth of her child the mother would be faced with this alternative:

Labour force role

		$	$
Gross income for family		11000	
	$		
Less tax liability	1220		
credit	(500)	(720)	
Less child care expense		(1200)	
Net cash income			9080

TABLE 5-6 Illustration of Effect of Marriage and Birth of Child on Family Tax Liabilities

Situation	Income				Discret. Income	Tax on Discretionary Income at a Rate of 50 per cent
		Wife				
	Husband $	Employ. $	Imputed $	Total $	$	$
Before Marriage	8000	3000	0	11000	2200	1100
After Marriage						
a) wife working	8000	3000	0	11000	2440	1220
b) wife at home no child	8000	0	2000	10000	2080	1040
c) wife at home with child	8000	0	2000	10000	1080	540

Housewife role

		$	$
Gross income for family		8000	
	$		
Less tax liability	1040		
credit	500		
		(540)	
Net cash income			7460
Net cash gain from labour force role			1620

The numbers used in this example are obviously extreme, but they make the point that the adjusted income method need not pose any insoluble problems with respect to child care. However, providing tax credits of substantial size would, of course, require increases in the rate of tax on discretionary income that would offset some (or all) of the advantages that result from the broadening of the tax base to include imputed income.

Expenses of Working Women

As explained in Section 4, income is a net concept. From gross returns are deducted the expenses that are necessarily incurred to generate those returns. The use of income as a tax base implies, therefore, that certain expenses should be allowed as deductions.

The definition of the income of profit from the operation of a business clearly would permit the proprietor to deduct from his gross revenue the cost of materials and wages paid to his employees, rent and so on. For the employee the situation is much less straightforward. In order to be able to work an employee must be fed, clothed and housed. He must live. This suggests that at least some living expenses should be a deduction from employment income. But personal consumption is the ultimate reward for work as well as the necessary means to work. It follows that, in principle, each individual employee's consumption expenditures should be divided into two parts: the personal consumption that must take place if the individual is to be able to work and the personal consumption that is an end in itself.

It is obvious that this distinction is necessarily arbitrary. It is also obvious that these "necessary" living expenses could be deducted either from gross employment income to give net employment income or from total income in arriving at discretionary income.

While it is not difficult to obtain agreement that living is a necessary prerequisite to working, and that some personal consumption is a prerequisite to living, it is extremely difficult to determine what part of an individual's personal consumption is "essential" to the generation of employment income. About the only rule that can be used is that expenses that would have to be incurred whether or not the individual worked should not be allowed on a deduction.

Even if the division between living expenses and working expenses could be made for a particular individual another difficulty awaits us. Do these expenses differ with the amount of work or the kind of work performed? Should the individual who does not work, and lives entirely on the returns from owning property, be allowed no deduction? Does the individual who works one day a year have to consume as much as the person who works 10 hours a day 365 days of the year? Should there be distinctions between the deductible expenses of the labourer who must consume many calories and the sedentary office worker who needs fewer calories? What about the difference in expenses between the worker who can wear overalls to work and the worker who is expected to arrive at his place of work each day sartorially perfect? The mind boggles at the endless differences that could be taken into account.

Without pursuing the matter further it seems reasonably certain that: deduction of the necessary expenses of living cannot be denied to those who do not work. Every human being has a right to live whether he or she works or not. Secondly, it would be impracticable to attempt to determine, in each instance, the cost of the requisite food, clothing and shelter. To try to arrive at the "right" answer in each case would be intolerably burdensome from an administrative point of view and repugnant too: a great deal of information would have to be assembled about the personal circumstances of individuals and judgments would have to be made about matters that should remain strictly private.

The solution must be a compromise between what is correct in principle and what is feasible in practice. It is suggested that the following approach is not unreasonable.

1) Allow a deduction of nondiscretionary expenses for each individual regardless of the sources of income or the special cost of obtaining that income. This deduction is built into the rate schedules by the provision of zero rate brackets.

2) In addition, allow the deduction of an arbitrary fraction of employment income, up to a certain maximum, to reflect the fact that all those who work outside the home have some necessary expenses that those who remain at home do not have.
3) At the option of the employee, and as an alternative to 2), allow the deduction of actual expenses that have necessarily been incurred to earn the employment income, excluding those that are incurred by everyone in order to live (these are covered by item 1).

Certain expenses would have to be explicitly denied. The expenses of commuting from home to work would have to be denied in most circumstances because this cost depends upon the choice of residence. Those who chose to live a long way from their work should not be subsidized. Housekeeping services should not be allowed as a special deduction for those who work outside the home. By including in the tax base the imputed income of those who work within the home the position of those who work outside the home and those who work inside it would be put on all fours.

Dependent Children

Most parents derive immediate personal satisfaction from their children. To that extent the expenses incurred in raising them should be treated as a use of discretionary income. But children are also a responsibility. Having given birth to the child the parents are obligated, by law and by custom, to maintain the child adequately. These expenses are nondiscretionary. Finally, children are sometimes thought of as an investment. The child is expected to maintain the parents when they are old and he or she is capable of working.

It is not possible to determine the motivations of the parents in having the child (do they expect a return from their investment?) nor the degree of immediate satisfaction they derive from the child after it is born. This suggests that the tax structure must assume the relationship. The conservative approach would seem to be to treat certain outlays by the parents as nondiscretionary expenses. These are the expenses they must necessarily incur to meet their social responsibilities. Additional expenses incurred by the parents would be treated as gifts: they would be added to the income of the child but *not* deducted from the income of the parent.

Gifts could, of course, be made by either parent. Nondiscretionary expenses could be incurred by one only or shared between the parents. (Obviously the total deduction should be the same, however it is allocated between them).

Do the nondiscretionary expenses of raising a child depend upon the level of parental income? Is a parent with an income of $100,000 required to provide his or her child with more or better food, clothing, training and home than a parent with an income of $10,000? Or should the extra expenses of wealthy parents on behalf of their children be looked upon as gifts? The latter approach seems consistent with the notion that one of the goals of our society is to achieve greater equality of opportunity. This suggests that a tax credit should be provided to reflect the nondiscretionary expenses incurred by parents. Providing a deduction would provide more relief for upper income parents, as explained in Section 4.

One thing seems reasonably clear. The nondiscretionary expenses of parents are independent of their labour force status. Two-worker couples have the same obligations to their child as a couple with one parent staying at home or as a working parent with no spouse. The difference is that the mother who remains at home provides income in kind for her child in the form of child care services. The mother who works must buy those services.

By bringing into the tax base the imputed income of the housewife the system would become neutral with respect to working in the home and outside of it. By taking into account the imputed value of the services the mother provides her child when she works in the home the system would also become neutral with respect to the mother looking after her own child or employing someone else to do so.

For these reasons it seems preferable to deny the expenses of child care to working parents. It is more consistent to include the imputed income of housewives in the tax base and provide all parents with a tax credit with respect to each dependent child that would reflect the nondiscretionary expenses of child care and the rate of tax applicable to those expenditures.

Summary and Conclusions

In terms of our objectives and assumptions the "ideal" tax treatment of the income of married women and women with dependants would be as follows:

1. Three tax units would be distinguished:
   a) unattached individuals
   b) married individuals filing separately
   c) married individuals filing jointly with their spouses.
2. Separate rate schedules would be provided for each of these tax units. These schedules would differ in the following respects:
   a) To reflect the economies of living together the schedule of rates applicable to married individuals filing separately would be higher than the rates applicable to unattached individuals. This "tax on marriage" would increase with income in order to take into account the greater economies of living together for those who enjoy a relatively high standard of living.
   b) The schedule of rates applicable to married individuals filing jointly would be derived mechanically from the rate schedules applicable to married individuals filing separately. Under the joint filing schedule, two married individuals with identical incomes would pay, in aggregate, the same tax as they would pay if they filed separately. However, where the incomes of the spouses were not identical, they would pay more tax, in aggregate, if they filed separately for they would not benefit from the automatic averaging provided by joint filing.

3. Each individual who was physically and mentally fit and of working age would be assumed to have an imputed income derived from the provision of own services, and the tax base of the unit would be increased accordingly. Only the employment income of each individual in excess of this assumed imputed income would be brought into the tax base of the unit.

4. Parents or guardians of wholly dependent children would be entitled to a tax credit applicable against the tax liability of the unit that included the parent(s) or guardian(s). This credit would be designed to just offset the tax on the additional nondiscretionary expenses of the unit resulting from the care of the child. In the determination of the nondiscretionary expenses of caring for the child the imputed value of the services usually provided in the home by the mother would be taken into account. These credits would reflect the number of children and their ages.
5. Other dependants would be treated in the same way.
6. The expenses necessarily incurred in working outside the home would be allowed either through a percentage deduction from employment income with a ceiling or through the deduction of actual expenses. The expenses in looking after children would not be allowed as a deduction because they would be provided for in the credit described under (3).

Under this "ideal" treatment the results listed below would be obtained:

a) To achieve a fair allocation of the burden between married and unattached individuals a tax on marriage would be imposed that would mean that the total tax liabilities of married couples would be greater than those of unattached individuals with the same incomes. Only couples consisting of spouses with equal incomes would find that the tax on marriage would be the same whether they filed separately or jointly. This inconsistency in the impact of the tax on marriage is an inescapable consequence of aggregation. The imputation of income would reduce the variability in this extra tax.
b) It is often claimed that, where the incomes of husbands and wives differ substantially, aggregation of the incomes of husbands and wives deters women from working outside the home. If imputed income were added to income, and actual employment below the level of imputed income were exempt, this effect (if it exists) would be reduced because:
   i) there would be no tax consequences if the housewife's employment income did not exceed her imputed income;
   ii) marginal rates of tax on additional income probably would be somewhat lower generally;

iii) there would be pressure to earn cash income to meet the tax liability.

c) For couples that opted to file separate returns total taxes would be raised following marriage. Because the incomes of wives usually are lower than those of their husbands, most wives would face lower marginal rates on their extra earnings than would their husbands. Indeed, until the wife's income exceeded the exemption limit she would be subject to zero rates of tax on her employment income. The tax on marriage under these circumstances would likely increase the amount of work done outside the home by wives. To some extent wives would find it necessary to work outside the home just to pay their own tax liabilities.

d) There would be no provisions in the law that attempted to prevent husbands and wives from averaging their incomes through the payment of wages to each other.

e) Gifts between spouses would be tax free.

f) Tax credits for children would mean that a woman filing separately who chose to work outside the home would pay no tax on her employment income until it exceeded the sum of her imputed income _plus_ any additional employment income the tax on which would be offset by any unused tax credit with respect to the child. To put the matter the other way, if the credit for the child exceeded the tax on the imputed income of the mother, her employment income could exceed her imputed income before she would be subject to tax.

g) Couples with one or more children filing jointly would, presumably, more fully utilize their tax credits whether or not the mother worked outside the home. In these cases the mother would simply find that working outside the home was feasible because the family's tax liabilities would be low enough, by virtue of the credit, to allow her to buy the child care she needed and there would be no tax on her employment income below the exclusion.

h) There would be no personal exemptions in the system.

i) Childless couples where the wife worked within the home would be subject to substantial increases in their tax liabilities. Two-worker couples and unmarried individuals who work would bear less of the tax burden. Couples with children would be better off if the credit were large relative to the imputed income of the mother.

j) There can be little doubt that the "ideal" system would increase the number of women working outside the home. Certainly it would remove any tax biases against women.

k) The ideal system would be criticized because it would put pressure on women to work outside the home in order to raise the cash necessary to pay the tax on their assumed imputed income.

l) All provisions in the system would apply equally to men and women. There would be no special provisions for "women," "wives" or "mothers." Indeed, these terms probably could be deleted from the Act altogether.

CHAPTER 6

EVALUATION OF THE PRESENT SYSTEM

The briefs submitted to the Royal Commission on the Status of Women were highly critical of several basic features of the present tax system. In particular, they objected to the following features of that system:

a) A husband who wholly supports his wife is entitled to a personal deduction of $2,000. If his wife earns more than $250 his deduction is reduced dollar for dollar until his wife's income reaches $1,250. At that point the husband's deduction is $1,000 and his wife files a separate return and also has a deduction of $1,000. Spouses are taxed as single persons when each has an income in excess of $1,250. This means that the first $1,000 of the wife's earnings in excess of $250 are thus added to the income of the husband and taxed at his marginal rate. The greater his taxable income the higher the marginal rate of tax that applies to this income earned by the wife.

b) The Income Tax Act does not recognize wages paid by a husband to a wife when the husband operates an incorporated business.

c) There is no recognition of the expenses of child care that must necessarily be incurred by working mothers.

In this section each of these objections is examined in the light of the principles set forth in the previous section.

Fundamentally, the present Canadian system is based on the proposition that the individual is the appropriate unit for taxation. When individuals with substantial incomes marry there are no tax consequences (unless one spouse is the employee of the other in an unincorporated business). There is no tax on marriage. The system does recognize, however, that two cannot live as cheaply as one so that a man with income who marries a woman who has no income is given a tax reduction. This reduction is equal to the marginal rate of tax on the last $1,000 of the husband's income. In terms of our conceptual scheme, it is implicitly assumed that a husband's nondiscretionary expenses in looking after his wife rise with his income - indeed it is assumed that these expenses rise as rapidly as the marginal rates of tax rise with income.

Treatment of Dependent Wives

This assumption is difficult to justify. But what is more important for our purposes, providing the $1,000 deduction for a wholly dependent spouse means that when a wife who has been a housewife contemplates working outside the home the tax liability of the couple is raised not only by the tax on her income in excess of $1,250, but the extra tax her husband must pay as the result of the elimination of his deduction with respect to his wife.

To take an extreme example, let us suppose that the last dollars of a husband's income are subject to a marginal rate of tax of 80 per cent. Marriage to a wholly dependent woman would reduce his tax by $800. If she subsequently started to work and earned $1,250, she would pay a few dollars in tax ($18.50 in 1968), but his tax would rise by $800. The marginal rate of tax on her extra income would be in excess of 50 per cent.

The greater the taxable earnings of the husband and the lower the taxable income of the wife (in excess of $250) the higher the effective tax rate on her earnings.

It is important to recognize that the problem arises because of the tax reduction that is provided to a man who marries a woman with no income and is not the consequence of marriage as such. Consider the situation presented in Table 6-1 of the tax liabilities of two individuals before and after marriage (based on 1968 rates).

Marriage *per se* has no effect on the tax liabilities of the two-worker couple. But if they marry and she stops working a tax reduction of about $1,000 is obtained. Should she then contemplate returning to work at the same income there is obviously a tax increase of about $1,000 involved - an effective tax rate of about 20 per cent ($1,008/$5,000). Before marriage the effective tax rate on her income was about 13 per cent ($740/$5,000).

Unless the couple is under pressure to improve its standard of living this would tend to make the housewife choose leisure rather than work. Moreover, the tax reduction on marriage if a wife does not work also tends to encourage the woman to work in the home if the couple is content with a standard of living that can be attained with his larger after-tax income.

TABLE 6-1 Tax Liabilities (1968)
Two Individuals Who Marry
Assuming That Wife Continues
to Work and Wife Stops Working

Situation Before & After Marriage - Two Workers

	Man $	Woman $	Total $
Employment income	8000	5000	13000
Less: Personal deduction	(1000)	(1000)	(2000)
Less: Standard deduction	(100)	(100)	(200)
Taxable income	6900	3900	10800
Tax			
Federal	1176	572	1748
Provincial	359	165	524
Total	1535	737	2272

Situation After Marriage - One Worker

	Man $	Woman $	Total $
Employment income	8000	0	8000
Less: Personal deduction	(2000)	0	(2000)
Less: Standard deduction	(100)	0	(100)
Taxable income	5900	0	5900
Tax			
Federal	980	0	980
Provincial	288	0	288
Total	1268	0	1268

The briefs suggest several "solutions" to this problem.

a) Leave the personal exemption of the husband unchanged whatever the income of the wife;
b) increase from $250 to $950 the income a wife may earn before the personal exemption of a husband with a wholly dependent wife is reduced.

The first alternative would certainly remove the barrier created by the higher effective tax rate faced by married women who wanted to work. But it would be unsatisfactory because it would provide a tax saving on marriage - a tax saving that would be greater the higher the income of the husband. This is just the opposite result to that which would be appropriate. As we have argued above, when two individuals who both have significant incomes marry, they should pay more tax not less tax because of the economies of living together.

The second "solution" would certainly encourage married women to earn up to $950. It would not result in a tax saving on marriage for women who earned $950 or less before marriage because they would not have been taxable on this income. (Their personal deductions of $1,100 would more than offset this income). On the other hand, married women who earned more than $950 would be in about the same position as they are now. For each dollar they earned between $950 and $1,950 their husbands would have their taxes increased by 20, 30, 40 or 50 cents - depending on the marginal tax rate of the husband. If a wife's income were in excess of $1,950 the spouses would be taxed as single individuals as they are now when a wife's income exceeds $1,250. In short, raising the limit from $250 to $950 would remove only a small part of the basic difficulty. To raise this exemption beyond $1,100 would result in tax savings on marriage for couples in which the income of the woman before marriage does not exceed the exemption.

For example, suppose the law provided that a married man with a wholly dependent wife was entitled to a deduction of $2,000, as at present. But this deduction would be reduced if his wife's income exceeded $2,000. For each dollar of a wife's income in excess of $2,000 the husband's personal deduction would be reduced by one dollar until it reached $1,000. The wife would then be taxed as a single individual and would have a deduction of $1,000. The results, using 1968 rates, are given in Table 6-2.

TABLE 6-2 Tax Liabilities (1968) of a Couple, Before and After Marriage, Assuming $2000 of Wife's Income Exempt

Before Marriage

	Man $	Woman $	Total $
Employment income	8000	2500	10500
Less: personal deduction	(1000)	(1000)	(2000)
Less: standard deduction	(100)	(100)	(200)
Taxable income	6900	1400	8300
Tax			
Federal	1176	155	1331
Provincial	359	46	405
Total	1535	201	1736

After Marriage

	Man $	Woman $	Total $
Employment income	8000	2500	10500
Less: personal deduction			
self	(1000)	(1000)	(2000)
spouse	(500) 1/	-	(500)
Less: standard deduction	(100)	(100)	(200)
Taxable income	6400	1400	7800
Tax			
Federal	1079	155	1234
Provincial	323	46	369
Total	1402	201	1603

1/ $3000-$2500 = $500

If the woman stayed at home and did not work her husband's tax position would be:

Employment income	$8000
Less:	
Personal deduction	
Self	$1000
Spouse	$1000
Standard deduction	$ 100
	$5900
Tax	
Federal	$ 980
Provincial	$ 288
	$1268

The effective tax rate on her income before marriage would be:

$$\frac{\$201}{\$2500} = 8.04 \text{ per cent}$$

The effective tax rate on her income after marriage if she returned to work would be:

$$\frac{\$1602 - \$1268}{\$2500} = \frac{\$334}{\$2500} = 13.3 \text{ per cent}$$

The basic difficulty would not be corrected and there would be a tax saving on marriage under some circumstances. This result occurs because when the woman works after marriage her husband's personal exemption is reduced by $500. This increases his tax from $1268 to $1402 or $134. This must be added to his wife's tax liability of $201.

For reasons that are perfectly apparent, the simple solution to the problem posed by the briefs to the Commission was not proposed by them: remove the $1,000 personal deduction now provided for husbands with wholly dependent wives. This would mean that there would be no greater tax barrier facing married women who wanted to work than unattached women. There would be no tax saving on marriage. Of course, it would also result in the imposition of higher taxes on couples with one worker because there would be no recognition of the additional nondiscretionary expenses of a husband in supporting a wife who did not work. This approach would be satisfactory from our point of view if it were accepted that the nondiscretionary expenses in supporting a wife who did not work were exactly equal to the imputed income of the wife.

Employment of a Spouse

Several briefs took strong exception to the provisions of the present Act that are designed to prevent artificial averaging of the incomes of spouses through the payment of wages by one to another. They were particularly upset that these provisions apply only to proprietorships and partnerships but not to corporations with the result that those husbands who own businesses that cannot be incorporated are at a disadvantage relative to those who control incorporated businesses.

Some of the briefs seemed to reflect the incorrect view that husbands who were proprietors or partners could not pay their wives wages or salaries. They can pay them, of course. The law simply prohibits spouses from gaining any tax advantages through such payments.

As explained in Chapter 5 of this paper, these prohibitions are the inevitable consequence of a system that seeks to tax individuals rather than couples. If the "appropriate" unit is the individual then the distribution of income between husband and wife is material. Those couples where the spouses have unequal incomes should pay higher taxes than couples with equal incomes of the same aggregate amount.

The fact that these artificial averaging arrangements cannot be prevented when the husband controls a corporation is simply an unfortunate consequence arising from the legal fiction that the corporation is a "person" in the contemplation of the law so that the "corporation", not the husband who controls the corporation, pays the wife.

The solution to this problem is aggregation -- the use of the couple as a basic tax unit. Couples with the same income pay the same taxes under aggregation whatever the allocation of income between husband and wife. To reject aggregation and the restrictions on wage payments to spouses is completely inconsistent.

Child Care Expenses

The briefs submitted to the Commission were virtually unanimous in their demand for more generous treatment of the expenses of child care for working mothers. In the opinion of the author of this paper, they are on firm ground.

Under the present system, a taxpayer who maintains a wholly dependent child is entitled to an exemption of $300 if the child is qualified for Family Allowance or $550 if the child is not so qualified. A child is defined to include: "a son, daughter, grandchild, niece or nephew under age 21 or of any age if in full-time attendance at a school, a university, or infirm." Children with incomes greater than $950 are excluded, as are nieces and nephews under some circumstances. The labour force status of the taxpayer is not taken into account.

Consider a married man who has an income of $8,000 with a wife who works at home and one child. His situation under present law is as follows:

	Without provision for child	With provision for child
	$	$
Employment income	8000	8000
Less: personal deduction		
Self	1000	1000
Wife	1000	1000
Child	0	300
standard deduction	100	100
	5900	5600
Tax		
Federal	980	918
Provincial	288	269
	1268	1187
Less: family allowance of $8/ month	0	96
Net Tax	1268	1091

There is a net tax reduction of $177 provided because of the child.

Three points should be noted:

1) Because tax relief is provided through the use of a deduction, the relief is greater the greater the taxable income of the taxpayer. For example, if the taxpayer's income were $5,000 rather than $8,000, the tax reduction attributable to the child would be $161 rather than $177.

2) The reduction in the deduction from $550 to $300 for children qualified for family allowances is disadvantageous for high income taxpayers. If the family allowance payments amount to $96 per year, taxpayers with marginal rates in excess of 38% (taxable income of approximately $12,000), would be better off if the deduction were $550 and no family allowance were provided.
3) If both spouses have taxable income the child should be claimed by the spouse with the highest income if the tax liability of the couple is to be minimized.

Even if we ignore the problem of child care expenses of working mothers these provisions can be faulted because they provide less relief to low income taxpayers than for high income taxpayers. It would be preferable if the relief were entirely in the form of a tax credit, like the family allowance payments.

The level of tax relief provided is, of course, open to question too. It is doubtful that the out-of-pocket nondiscretionary expenses of maintaining a child are adequately reflected by a tax reduction of only $161 a year for a taxpayer with an income of $5,000 - but that is what the present law provides. However, the present concession is clearly much less inadequate for families in which the mother works at home. The largest expense in raising young children is the provision of "services" not "things." Because the imputed income of women who work in the home is not taxed under the present system, there is a substantial implicit tax concession provided to a husband who supports a wife who in turn raises his children. As we have shown in the previous section, in <u>principle</u> the imputed value of the services provided by a mother working in the home should be included in the tax base of the family. If this were done it would be necessary to provide much larger concessions for children - whether or not the mother worked outside the home.

To be more specific, the present system understates the income of one-worker couples and in part compensates for this defect by providing an inadequate tax reduction for the costs of raising children. For two-worker couples, income is usually overstated because some legitimate expenses of earning employment income are desired. The latter couples bear the full brunt of the inadequate tax concessions for the nondiscretionary expenses of raising children. For one-worker families two wrongs make a right; for two-worker families two wrongs add up to an extremely large wrong.

There are several methods of resolving this problem. In principle, what should be done is to:

a) include in the income of one-worker families the imputed value of the services of the spouse who works in the home;
b) provide a tax credit with respect to each child - a credit that would vary with the age of the child and the number of children;
c) this credit would not be dependent on the labour force status of the mother.

As explained in Chapter 5, under this approach the tax position of most families would be about the same whether the mother worked in the home or outside it. If the mother could earn more working outside the home than it would cost her to buy child care services, it would pay her to work outside the home. Only women who could earn less outside the home than they would have to pay to replace their services in the home, and those mothers who were willing to sacrifice cash income for the pleasure of looking after their own children, would work in the home.

It would be possible to move towards this result, while ignoring the imputed income of housewives, by replacing the present system of deductions for children with a system of tax credits for children. Larger credits would be provided to those families in which both spouses worked outside the home. These credits would offset the tax on the earnings of the mother below a certain dollar level.

The point to be made is not that the credit system would provide more relief than the deduction system for women earning $5,000 and $8,000. This results because of the particular assumptions made about the magnitude of the expense and the credit. What is important is the fact that the expense deduction system would reduce the tax of the $5,000 woman by $163 and the tax of the $8,000 woman by $189. The credit system would give approximately the same relief to both. This is a much more equitable result. The advantages of the credit approach relative to the deduction approach would be greater the greater the earnings of the mother.

It should be pointed out that with a nonrefundable credit of $400 and a family allowance of $96, a woman with a dependent child would pay no net tax on her employment income until that income exceeded about $3,900, at 1968 rates. Consequently, if

she earned $3,900 and paid a housekeeper $1,000 a year to look after her child, she would have a net gain from her work of $2,900. Smaller credits would lower the income the mother could earn without being subject to tax. A credit of $200 plus family allowances would exclude from tax a woman's employment income of about $2,900. A credit of $100 plus family allowance of $96 would exclude about $2,500.

Table 6-3 Implications of the Provision of Alternative Concessionary Allowances for Dependent Children, Based on 1968 Rates

Present System			
	$	$	$
Employment income of mother	2000	5000	8000
Less: Personal deduction			
Self	(1000)	(1000)	(1000)
Child	(300)	(300)	(300)
Standard deduction	(100)	(100)	(100)
Taxable income	600	3600	6600
Tax	$	$	$
Federal	58	518	1118
Provincial	18	149	337
Total	76	667	1455
Less: Family Allowance	(96)	(96)	(96)
Net Tax	(20)	571	1359

Deduction System

	$	$	$
Employment income	2000	5000	8000
Less:			
Child rearing expenses	(1000)	(1000)	(1000)
Personal deduction	(1000)	(1000)	(1000)
Standard deduction	(100)	(100)	(100)
Taxable income	(100)	2900	5900
Tax			
Federal	0	391	980
Provincial	0	113	288
Total	0	504	1268
Less: Family Allowance	(96)	(96)	(96)
Net Tax	(96)	408	1172

Credit System

	$	$	$
Employment income	2000	5000	8000
Less: Personal deduction	(1000)	(1000)	(1000)
Standard deduction	(100)	(100)	(100)
Taxable income	900	3900	6900
Tax			
Federal	87	572	1176
Provincial	28	165	359
Total	115	737	1535
Less: Family Allowance	(96)	(96)	(96)
credit for child	(400) 1/	(400)	(400)
	(96)	241	1039

1/ It is assumed here that this tax credit is not refundable. If it were refundable the taxpayer would receive from the government \$496-\$115=\$381.

These results are summarized in Table 6-4.

Table 6-4 Net Tax Position of a Working Mother with a Dependent Child under Alternative Concession Systems

Employment Income of Mother						
System	\$ 2000		\$ 5000		\$ 8000	
	Tax	Change from Present System	Tax	Change from Present System	Tax	Change from Present System
Present	(20)	-	571	-	1359	-
Expense System	(96)	(76) 1/	408	-163	1172	-187
Credit	(96)	(76) 1/	241	-330	1039	-320

1/ Indicates net funds received from government increased by \$76.

Conceivably the credit provided with respect to the children of working mothers could be made refundable. That is to say, if the income of the mother was not large enough to generate a tax liability as great as the tax credit, the excess credit could be refunded to the mother. This approach is not recommended because it would, in effect, subsidize women who worked outside the home. While it may not be desirable to create tax barriers that induce mothers to work at home, it is perhaps even more undesirable to reward women who work outside the home even if the income they earn in the labour market is less than the cost of replacing their services in the home. A refundable credit would have that result.

The use of a special credit for mothers working outside the home could be abused unless it were related to the time the woman devoted to work outside the home. Some kind of minimum period of time devoted to work outside the home would have to be stipulated.

Here too, these difficulties would not arise if the "ideal" system were implemented. If imputed income were taxed and a credit given to all tax units with children it would be unnecessary to worry about the extent to which the mother worked outside the home. The credit could be granted against the tax liabilities of the family, and not confined to those of the mother.

Summary and Conclusions

There can be no doubt that the present system imposes higher effective rates of tax on married women working outside the home than it does on single women who are choosing between work and leisure.

This difficulty arises because husbands are given an extra deduction of $1,000 if they support a wholly dependent wife. Should a wholly dependent wife decide to go to work and earn more than $250, this exemption is reduced. The higher the taxable income of the husband the greater his increased tax burden as a result of his wife's decision to work outside the home. While the couple cannot be worse off if a wife works (ignoring housekeeping expenses), for the effective rate of tax on her income cannot reach 100 per cent, the husband can be worse off.

The simple solution to this problem would be to withdraw the extra deduction of $1,000 to husbands with wholly dependent wives. This would raise the tax on one-worker families relative to two-worker families. It would certainly reduce the tax barrier that now confronts working wives.

To provide a personal deduction to the husband that was independent of the income of the wife would create a tax saving on marriage for couples with two earners. This is just the reverse of the appropriate treatment. Increasing the exempt income of a wife from $250 to $950 would provide a little relief to women who do a modest amount of work outside the home but would not remove the barrier for women who are likely to work outside the home to any considerable extent.

The disallowance of wages and salaries paid by one spouse to another is an intrinsic feature of a system that uses the individual as the basic tax unit. The solution to this problem is aggregation of the incomes of husbands and wives. To argue against disallowance <u>and</u> aggregation is inconsistent.

The child care expenses of working mothers are now ignored. This is a serious barrier to labour force participation by women. The problem is fundamental to the present system that ignores the value of the household services of women who work in the home.

The ideal solution would be to tax the imputed income of housewives and provide a tax credit for all families with children. Failing this, nonrefundable tax credit for mothers who work outside the home more than a stipulated period of time would be a decided improvement on the present system. The least desirable approach would be to allow women to deduct the expense of child care from their gross employment income. This would benefit women with substantial incomes more than it would benefit women who have lower incomes. Presumably it would be necessary to limit the maximum deduction.

The objections to the present system raised by the briefs to the Commission are <u>not</u> minor complaints that can be resolved by a little tinkering. Most of the solutions proposed in the briefs would certainly assist women who want or need to work outside the home. However, the briefs completely ignored the problem of treating equitably women in different circumstances. They were so anxious to help the woman who is "trapped" in the house that they were prepared - perhaps unwittingly - to give some women much greater tax advantages than others. They seemed

to be largely unconcerned about: the inequity involved in allowing tax savings to married women relative to single women; the unfairness of allowing women who worked for their husbands to obtain the advantages of income averaging that would be denied to women who worked for strangers; the injustice of giving larger tax reductions with respect to child care for women who had large incomes.

It is desirable to remove the unfair tax discrimination against women relative to men. It is equally important to treat women fairly relative to one another.

CHAPTER 7

EVALUATION OF THE CARTER SYSTEM

Rejection of the present system does not necessarily mean acceptance of the Carter system, as several of the briefs to the Royal Commission on the Status of Women attest. Brief Number 318 is a case in point. After criticizing the features of the present system discussed in the previous section of this paper, the brief stated:

> "We believe the Carter Commission on Taxation (1967) failed to come to terms with the position of women within the tax structure, neglected to appreciate the fundamental changes within the traditional family visualized by taxation authorities and underestimated the economic and social impact of the move into paid employment of married women.(p.141)"

In this Chapter certain criticisms of the Carter proposals advanced in some briefs to the Commission are evaluated. One principal objection concerned the proposed aggregation of the incomes of husbands and wives, on the grounds that this system would tax the married women's income at a rate higher than that of any other member of society, the rate being determined by the income of the husband. This effect occurs according to the briefs since in a case where both husband and wife are working, the husband's income is usually regarded as the primary income and the wife's is the secondary income.

It is argued in those briefs that this approach perhaps would be satisfactory if property laws were changed so that one half of the assets of the couple were automatically assigned to the wife and there was no tax on transfer between husband and wife.

Furthermore, it is also contended that the option of separate filing by married individuals is not a "true" option because it would impose tax penalties for separate filing under some circumstances. In the words of brief no. 318:

> "The penalty for exercising this option is so great as to make the suggestion that it is an alternative; a misconception. It offers not a choice as to the matter of filing , but a penalty for not filing together. To be valid, a choice must be just that, and not a penalty (p. 160)."

Some of those objecting conclude that the Carter Commission was in error in asserting that aggregation would not increase significantly the tax disincentive to the labour force participation of married women. Women married to men with large incomes it is argued, are also likely to be able to earn large incomes - and the tax barrier under Carter would be material under this circumstance.

The "Tax on Marriage"

These criticisms of the Carter Report undoubtedly have some validity. That Report proposed a tax on marriage. In principle this means that married individuals would face higher marginal rates of tax on extra income than unattached individuals. However, it should be borne in mind that adoption of the schedules proposed by Carter would result in: a) lower marginal rates for both married and unmarried individuals relative to those imposed under the present system; b) virtually no tax on marriage for couples with combined incomes of less than $40,000.

With the information available it is impossible to state categorically what effect the adoption of the tax on marriage would have on labour effort. Not only is there no evidence to support the contention that high marginal rates deter labour effort, the proposed tax on marriage is but one of many reforms recommended in the Carter Report. The impact of the tax on marriage should be evaluated in the context of the entire Carter system.

It is often contended that most Canadians are motivated by a desire to achieve and then maintain a target standard of living. If this is a valid assumption, adoption of the package proposed by Carter could reduce the labour effort of individuals with substantial employment and business incomes because they would be taxed much less heavily than under the present system. The lower marginal rates would tend to induce more work but the lower average rates of tax would have the opposite effect. Less work would have to be done to maintain current living standards.

Given the uncertainty about the incentive-disincentive effects of these dramatic tax changes that would affect both married and unmarried men and women, it is foolish to speculate about the possible impact of the proposed tax on marriage on the labour effort of married women since that tax would have an inconsequential impact except for a handful of Canadian women. The number of couples with combined incomes of $40,000 or more is so small that the effect on the economy of the decisions of these women to work or not to work is of no consequence.

To reject the tax on marriage proposed by Carter because of its disincentive effects would be to forgo the equitable taxation of upper-income couples relative to both lower-income couples and unattached individuals without any evidence that there would be an offsetting economic gain.

Aggregation

There can be no doubt that the marginal rate of tax on the income of married women would be higher under aggregation than under separate taxation. However, this proposition is equally valid with respect to married men. The marginal tax rate of either spouse would be determined by the aggregate income of the couple. His marginal rate would be raised by her income. Her marginal rate would be raised by his income. The greater the income of the one, the higher the marginal rate faced by the other.Both husband and wife would have the same marginal rate. Nevertheless, the claim that married women contemplating work outside the home would, under some circumstances, be subjected to higher marginal rates under aggregation than under separate taxation cannot be denied. As discussed at length in Chapter 6, this problem could be reduced, if not solved, by the appropriate treatment of the imputed income of housewives.

Property Laws

Critics of the Carter proposals are probably correct in asserting that aggregation implicitly assumes that the property of married couples is held jointly in the sense that the spouses share equally in the benefits of family expenditures and family saving. (The legal rights to property are relevant only in the case of divorce, separation, or death). Certainly it would be desirable if provincial property laws were consistent with this implicit assumption so that women who contributed to the accumulation of property during marriage were not cheated of their fair share of the property when the marriage ended. The Carter Commission went as far as it could when it recommended that property transferred between spouses should not be subject to tax.

At one end of the spectrum are couples who share everything. At the other end are couples in which each spouse carefully maintains his or her separate property. Indeed, these nonsharing spouses may not disclose their affairs to each other. How is the tax system to deal with these diverse relationships? If the system is suitable for couples with one kind of relationship it is unsuitable for the other. The Carter Commission assumed

that most couples have a sharing relationship and designed a system that would be appropriate for them. The option for separate filing was provided so that those at the other end of the spectrum would not be forced to fit into the majority pattern. The alternative would be to treat the nonsharing relationship as typical and provide options for the "sharers." That is the approach taken by the present system - the individual is the basic unit of the tax system. Modifying the present system to remove some defects inevitably creates other problems. It is in this context that the optional separate filing for married individuals proposed by Carter should be considered.

The Penalty Imposed on Those Filing Separately

To avoid forcing "nonsharing" spouses to disclose their affairs to each other, the Carter Report proposed that spouses could opt to file separately. Under the separate filing each spouse would make the following calculation:

a) double his or her taxable income;
b) determine his or her tax liability from the family unit rate schedule;
c) divide this tax liability by two to determine the liability of the individual.

This procedure (it sounds a great deal more complicated than it is) would ensure that couples who filed separately did not avoid the "tax on marriage." It would result in a greater tax than would be paid under joint filing if the spouses had unequal incomes because the advantages of implicit income averaging for spouses filing jointly would be lost. To see what is involved, the penalties involved in separate filing by married taxpayers under various income assumptions are shown in Table 7-1.

When the incomes of the spouses are both large and unequal the penalty would be substantial, as the data given in the Table show. But for the vast majority of taxpayers the penalty would be of no significance. Critics of the Carter Report failed to point out that the penalty would apply to the high income earner. If the woman's income were lower than her husband's income, her insistence on separate taxation would not subject her income to a penalty. She would be taxed as though she and her husband had an aggregate income equal to twice her income - and she would be liable for half the tax. If a husband's income were greater than his wife's income, and he did not wish to disclose

his income to his wife, his insistence on separate filing would impose the penalty on him.

TABLE 7-1 Penalty for Separate Filing by Married Individuals Under Carter Proposals.

Income			Tax Filing Jointly	Tax Filing Separately			Penalty on Separate Filing
Husband $	Wife $	Total $	$	Husband $	Wife $	Total $	
6000	2000	8000	1047	953	138	1091	44
4000	4000	8000	1047	524	524	1047	0
12000	8000	20000	3977	2608	1448	4056	79
10000	10000	20000	3977	1988	1988	3977	0
20000	10000	30000	7277	5538	1988	7526	249
15000	15000	30000	7277	3638	3638	7277	0
50000	10000	60000	19677	19338	1988	21326	1649
30000	30000	60000	19677	9838	9838	19677	0

Source, Calculated on the bases of rate schedule provided in Vol. 3 RCT, p. 174.

Under this system the penalties would usually be relatively small, they would usually be imposed on the husband, and they are necessary if the tax on marriage is not to be avoided by those who do not wish to aggregate. The disincentive effects of aggregation (if they exist) could, as we have demonstrated in Chapter 5, be substantially reduced if the imputed income of housewives were included in the tax base of the family unit and employment income were exempt up to the level of this assumed imputed income. This was not recommended by Carter, presumably on the grounds of administrative difficulty.

A "Tax Dividend" for Housewives

The thesis that women who work in the home should be paid a "tax dividend" to compensate them for their unpaid services to the state is sometimes advanced. It fails to recognize that the high rates of tax on the income of married women who are considering work outside the home arise precisely because the imputed value of the services they provide in the home escape taxation. To pay women a "tax dividend" if they worked in the home would serve to increase the barrier against working outside the home.

Summary and Conclusions

Some briefs presented to the Commission were strongly opposed to the Carter proposal that the family be adopted as a basic unit for tax purposes. They correctly pointed out that aggregation could increase the marginal rates of tax faced by married women returning to the labour force. This could deter women from working outside the home. These difficulties were acknowledged in the Carter Report. On the other hand, separate taxation of husbands and wives and the payment of a "tax dividend" to women who worked in the home would exacerbate the tax problem of women in the labour force. If the system is to be neutral towards the choice between working in the home and working outside the home, the imputed value of the services provided by housewives should be taxed, not subsidized.

CHAPTER 8

SUMMARY AND CONCLUSIONS

The present income tax system has three features that are particularly objectionable to women.

1) Married women who have been working in the home are confronted with higher effective tax rates on their employment income if they enter the labour market than are single men or women. Husbands find their taxable income increased by up to $1,000 if the income of their wives is greater than $250. The higher the income of the husband, the greater the tax on the husband.
2) The expenses of child care are not taken into account. Consequently, a woman with a dependent child has to pay child care services from tax-paid income. This means that a mother has to be able to earn substantially more than the cost of caring for her child in order to "break even" by working outside her home.
3) Wages and salaries paid to a wife by a husband who is a proprietor of a business are not deductible by the husband. This does not prevent the payment but precludes the averaging of the income of husbands and wives for tax purposes.

The immediate cause of the first of these three complaints arise from the concession of $1,000 given to husbands or wives who support wholly dependent spouses. The disincentive effect could be removed by withdrawing this concession and taxing one-worker families more heavily. This answer was not suggested in briefs. Rather it was proposed that married men should be granted a concession of $1,000 relative to single men without regard to the income of their wives. This would provide a tax saving on marriage for two-worker couples that would be completely inconsistent with the belief that two people living together can live more cheaply than two living apart.

The difficulty could be largely resolved by including in the tax base the imputed value of the "self" services of each individual. The provision of housekeeping services to oneself or to one's family adds to the tax capacity of the individual or family just as the sale of labour services for cash adds to taxable capacity. To use an old tax adage, "saving the pocket" is equivalent to "adding to the pocket."

Failure to tax the imputed value of self services means that one-worker families are generally undertaxed relative to two-worker families, since two-worker families often find it necessary to purchase services that one-worker families provide for themselves. Two-worker families have to purchase these services with tax-paid income. One-worker families can provide these services for themselves without tax cost.

If the imputed value of the services of housewives were taxed, women would pay the same taxes whether they worked in the house or outside it. The tax barrier against working outside the home would largely be removed. Indeed, because tax liabilities can be satisfied only with cash, adding the imputed value of the services of housewives to the tax base would create a positive pressure for them to work outside the home.

The fundamental problem with both the present system and the Carter system is not taxation of the income earned outside the home but failure to tax the imputed income of the housewife.

Taxing imputed income poses two difficulties. First, there is no administratively feasible way of determining imputed income in particular cases. It would be necessary to use arbitrary amounts, which would be inequitable in some cases. Second, one-worker families would need more cash to meet their tax liabilities.

These difficulties are not overwhelming but they are real. Taxing imputed income would materially alter the distribution of the tax burden. The typical middle-income, one-worker family would carry a heavier proportion of the tax burden.

The problem posed by child care expenses for working mothers is closely related to the problem of imputed income. If the value of the services provided their families by mothers who care for their own children were added to the income of those families, the position of mothers who worked in the home and those who worked outside it would be reconciled. To achieve vertical equity it would be necessary to provide a concession to families with children, since they clearly have nondiscretionary expenses that childless families do not have. A tax credit (related to the ages and number of children) that offsets the tax on the nondiscretionary expenses of rearing children for a family with an income of, say, $8,000, would be both simple to administer and equitable.

Because the imputed income of housewives would be included in the base, these credits would be made available to all families, not just to two-worker families. No special deductions or credits for working mothers would be necessary.

This approach, coupled with aggregation, would eliminate all three of the major objections stated in the briefs to the Royal Commission on the Status of Women. With aggregation it would be unnecessary to disallow the deduction of wages and salaries paid by husbands to their wives.

If it is accepted that there should be a "tax on marriage" because of the economies of living together, there is no escape from higher marginal rates for at least some married individuals than for single individuals. By the same token, if married individuals are to be given the option of filing separately there is no escape from a "tax on separate filing" if the tax on marriage is to be imposed. If the incomes of husband and wife are different, and it is impossible to determine the average of the two incomes without disclosing the affairs of the one to the other, then the benefits of family income averaging cannot be conferred on those couples that include a spouse who is unwilling to disclose his or her affairs to the other spouse.

To eliminate this unfortunate tax on separate filing it would be necessary to either forgo the tax on marriage or forgo aggregation. The former course would result in a disproportionate share of the tax burden being borne by unattached individuals. The latter course would result in problems arising from transfers between the spouses whether by way of gift or wage and salary payments. Given the relative insignificance of the tax on separate filing for the vast majority of taxpayers there seems no doubt that it is preferable to bear this cost rather than the costs of the alternatives.

Whether the public would be willing to accept the imputed income solution to the income tax problems of women it is not possible to say. It is technically feasible. It may not be socially acceptable to change the tax system in such a way that housewives would be induced to work outside the home rather than in it.

Economic output probably could be increased through the adoption of the imputed income approach. There could, however, be important social consequences arising from a dramatic change in the method of raising children. The author is not competent to judge the merits of this change.

If the imputed income approach were unacceptable, it would be possible to modify the present system slightly to mitigate greatly the unfavourable discrimination against women. Two steps would go a long way:

a) reduce (or eliminate) the personal deduction of $1,000 allowed a spouse who is the sole support of a husband or wife;
b) provide a tax credit for working mothers with young children to offset the tax on the employment income of a mother that, in the typical case, must be used to defray the costs of child care.

Under a system that taxes husbands and wives separately there seems no possibility of eliminating the provisions that disallow the deduction of wages and salaries paid by husbands to wives.

As explained in Chapter 6, most of the suggestions contained in the briefs for changes in the present system would reduce the unfavourable tax discrimination against married women but create inequities in the tax treatment of women in different circumstances.