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Claire F.L. Young

Allard School of Law at the University of British Columbia, young@allard.ubc.ca

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Tax and the Family: The Gendered Impact of Rules that Take Spousal Status into Account for Tax Purposes

Claire F. L. Young

The last 30 years in Canada have seen dramatic changes in the legal definition of “family” and “spouse” as well as our social understanding of these relationships. Today in Canada we recognize common law relationships¹ through ascription for many legal purposes. Based on a period of cohabitation many, but not all, of the rights and duties of marriage have been extended to common law cohabitants. Furthermore, common law relationships include both heterosexual and same-sex relationships. Most recently, in July 2005 the federal government legalized civil same sex marriage across Canada. Both opposite-sex and same-sex partners can now choose whether to marry or not; even if they do not, they may still be ascribed spousal status for various purposes, based on a period of cohabitation. In other countries such as the US and the UK we are seeing a move towards taking the rules that apply to married couples and extending them to common law cohabitants or allowing couples to register their partnerships so that they can avail themselves of the rights and responsibilities accorded to that status.

These changes, and in particular, the recognition of same-sex relationships for tax purposes have led me to re-examine how we treat spousal and common law relationships in tax law and policy.² It is important, however, to emphasise that I am not critiquing the inclusion of lesbians and gay men as common law partners. That change was an important part of the struggle for equality and indeed was a milestone in that quest. But, as I have discussed in other work, I argue that we need to rethink the broader issue of why we take marital or familial relationships into

1. “Common law” is the term used in Canada to describe two people living in a conjugal relationship that is recognized in law for some purposes.

2. Throughout this paper I refer to “spousal and common law relationships.” Section 248 of the Canadian *Income Tax Act* defines “spouse” as a married person and “common law partner” as an individual living in a conjugal relationship with the taxpayer for at least one year.

account at all for tax purposes.³ There are two points that should be made at this juncture. First, neo-conservative governments are increasingly using tax policies as they apply to married persons and common law spouses to reinforce the traditional family with a stay-at-home mother and the father as the breadwinner. Secondly, governments are increasingly using tax measures that take spousal status into account to shift economic responsibility for the welfare of citizens from the state to the private family.

My analysis is in three parts. First I trace some of the recent developments that led to the inclusion of same-sex couples as common law partners for tax purposes in Canada. I then turn to the political picture and consider the government's keen interest in taking familial or spousal relationships into account for tax purposes. Finally, I turn to some of the particular tax rules that take spousal status into account. In a nutshell my question is: can they continue to be justified or should we be looking to eliminate all reference to spousal and common law relationships from our tax legislation? My conclusion is that many of these provisions should be removed from the *Income Tax Act* (hereinafter the ITA). The reason that they are no longer valid varies from rule to rule. For example, some rules have a gendered impact, one that frequently discriminates without good reason against women and in favour of men. Others, including those that focus on dependency, are inherently flawed and poorly targeted so that they do not achieve their policy goals. Some rules can be critiqued on the basis that they are simply part of a neo-liberal privatization agenda that encourages individuals to rely on the private family for their economic security. These rules exclude those people not in spousal or common law relationships from a variety of very important benefits delivered by the tax system.

Changing Definitions of Spouse in Canada

In order to place the tax rules in the broader social context of changing definitions of family and spouse, it is important to trace some of these recent changes. Obviously marriage has been the primary relationship taken into account by law for a variety of purposes over the years. But since the 1970s Canada has increasingly recognized common law heterosexual relationships through ascription. As mentioned, the result is that many of the rights and responsibilities accorded to married couples are now accorded to common law couples. It is important to note that Canada is unusual in this regard. Very few other countries, including the US and the UK, give so many rights and place so many responsibilities on those in common law

3. Claire Young, "Taxing Times for Lesbians and Gay Men: Equality at What Cost?" *Dalhousie Law Journal* 17 (1994), 534-559.

relationships. In Canada those rights and responsibilities are based on an ascription of status as the parties to the relationship do not take that extra step of choosing to marry and therefore automatically have their relationships recognized by the state.

During the mid 1990s the *Charter of Rights and Freedoms*,⁴ and, in particular the equality provision section 15(1), was used with great success to challenge heterosexual definitions of spouse. The result is that since the mid 1990s, same-sex couples have increasingly, though unevenly across the provinces, been treated as common law couples. On the tax front, the Ontario Court of Appeal had held in 1998 in *Rosenberg v. Canada (Attorney General)*⁵ that the words “or same-sex” should be read into the definition of “spouse” in the ITA, for the purposes of registration of pension plans. The case was brought by two women who worked for one of Canada’s large unions, the Canadian Union of Public Employees (CUPE). CUPE had a standard employment pension plan which included a provision for survivor benefits. Pension plans in Canada are heavily subsidized by the tax system. They allow for deductions for contributions by employers and employees and shelter from tax of all income earned by the plan until the pension is received. In order to qualify for these subsidies the plan must accord with the requirements of the ITA and before *Rosenberg* that included a definition of spouse that was restricted to heterosexual couples. CUPE decided to extend its plan to its lesbian and gay employees on the same terms as it applied to its heterosexual employees, but the government refused to accept this amendment. By reading the words “or same-sex” into the definition of spouse in the ITA for the purpose of pension plans, the court effectively extended entitlement to survivor benefits under occupational pension plans to the partners of lesbians and gay men who die while covered by the plan.⁶ Interestingly, unlike other cases involving successful *Charter* challenges on the basis of sexual orientation, the federal government did not appeal this decision.

In 2000 the federal government enacted the *Modernization of Benefits and Obligations Act*⁷ which amended 68 pieces of legislation to include same-sex couples in an array of laws that assign rights and responsibilities based on spousal status. Sections 130–146 of the *Modernization of Benefits and Obligations Act* amended the ITA to redefine spouse to include married persons and to add a new definition of com-

4. *Charter of Rights and Freedoms*, Part I of the Constitution Act, being Schedule B to the Canada Act 1982 (UK) 1982, c 11 (hereinafter referred to as the *Charter*).

5. *Rosenberg v. Canada (Attorney General)*, (1998) 38 OR (3d) 577.

6. For an in depth analysis of this case, see Claire Young, “Spousal Status, Pension Benefits and Tax: *Rosenberg v. Canada (Attorney-General)*,” *Canadian Labour and Employment Law Journal* 6 (1998), 435–453.

7. *Modernization of Benefits and Obligations Act*, SC, C-23, ch. 12 (2000).

mon law partner which includes a person cohabiting in a conjugal relationship with the taxpayer for a period of at least one year.⁸ Meanwhile, the Law Commission of Canada (LCC) launched a major research project titled “Beyond Conjuality: Recognizing and Supporting Close Personal Adult Relationships” which entailed a “fundamental rethinking of the way in which governments regulate relationships.”⁹ In brief, the LCC concluded that governments rely too heavily on marital and common law relationships in accomplishing state objectives. The LCC suggested that the government re-evaluate the way in which it regulates relationships, and included in the legislation reviewed in this research paper was the ITA. Finally in 2005, Bill C-38, the *Civil Marriage Act*, received Royal Assent and was proclaimed into law, legalizing civil same sex marriage across Canada.

Progress at What Cost?

Without diminishing the struggle that lesbians and gay men have endured to secure legal recognition of their relationships, or its potential to challenge heterosexual norms and definitions of family, I argue that the recent tax changes in Canada to include same-sex couples as common law partners have done nothing to challenge the socio-economic and gender inequalities embedded in the tax rules that apply to spouses and common law partners. Expanding the definition of those who are treated as spouses for tax purposes has simply reinforced those inequalities. It is time to revisit and rethink why we take spousal and common law relationships into account for tax purposes. Other than the recent work of the Law Commission of Canada¹⁰ which was part of a larger project examining the numerous laws that take spousal status into account, no attention has been paid by legislators over the last four decades to the fundamental tax policy question of why we take spousal and

8. Section 248 provides that a “common law partner” with respect to a taxpayer at any time, means a person who cohabits at that time in a conjugal relationship with the taxpayer and: “(a) has so cohabited with the taxpayer for a continuous period of at least one year, or (b) would be the parent of a child of whom the taxpayer is a parent, if this Act were read without reference to paragraphs 252(1)(c) and (e) and subparagraph 252(2)(a)(iii), and for the purposes of this definition, where at any time the taxpayer and the person cohabit in a conjugal relationship, they are, at any particular time after that time, deemed to be cohabiting in a conjugal relationship unless they were not cohabiting at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship”.

9. Law Commission of Canada, *Beyond Conjuality: Recognizing and Supporting Close Personal and Adult Relationships* (Ottawa, 2001), ix.

10. *Ibid.*

common law relationships into account for certain tax purposes and whether such a policy can be justified.

While many see the federal government's decision to enact the *Modernization of Benefits and Obligations Act* and thus expand the group accorded common law status for tax purposes as progressive, we need to be cautious. There is an assumption by many that it is to their advantage to be treated as spouses and common law partners for tax purposes.¹¹ There is a sense that there are more tax breaks for couples and that the tax bill of a couple will be lower than it would be if they were taxed as individuals. As I have demonstrated in previous work, this is not necessarily true.¹² In fact, the impact of being treated as spouses or common law partners varies depending on three factors: the amount of income of each of the partners, the nature of that income, and the relative distribution of that income as between the partners. As I shall discuss in more detail later, generally speaking, in Canada the couple in which there are two low rate taxpayers pays more tax when they are treated as a couple rather than as individuals. The couple in which there are two high rate taxpayers and the couple in which one person is a high rate taxpayer and the other has little or no income both tend to benefit in terms of taxes saved when treated as a couple. It is also important to note that one cannot choose to be or not be a common law partner. If a person meets the statutory test of common law partner, that status is ascribed to that person and all the rules that apply to common law relationships apply to him or her. Thus it is vital that the rules that take spousal status into account operate in a fair and efficient manner.

In this paper I focus on two distinct aspects of these recent developments. First, I contend that the government's decision not to appeal *Rosenberg*, and its willingness to include same-sex couples as common law partners for tax purposes, was a pragmatic political decision, a decision that was not based on any analysis of the change from a tax policy perspective. As I shall discuss in more detail, such a change resulted in a tax windfall for the federal government in terms of the amount of tax collected. A large proportion of the windfall was due to a reduction in the amount of tax credits available to common law partners, a reduction that resulted from the aggregation of income when determining entitlement to those credits. At the same time, including same-sex couples as common law partners accords perfectly with the neo-liberal agenda of privatization of the economic security of citizens. This

11. The author spoke with several groups of lesbian and gay individuals about the impact on them of the changes to the definition of spouse and generally speaking most of those individuals believed they would benefit from the change even though in fact many of them would pay more tax as a result of the change.

12. Young, *supra* note 3.

neo-liberal agenda uses the tax system to encourage individual family members to care for each other, thereby relieving the state of its responsibility.

The Politics of It All

Tax Windfall

Income tax law is one of the most important political tools that a government has at its disposal. Tax laws are used to direct economic and social behavior in a myriad of different ways. Many of the most important measures we use to achieve social policy goals are tax expenditures. As mentioned above, inclusion of same-sex couples as common law partners for tax purposes resulted in a tax windfall for the government because some individuals lost entitlement to certain tax expenditures and thus were required to pay more taxes when treated as part of a couple than they previously paid as individuals. While the federal government has not published the amount of this windfall, it has been estimated to be approximately \$130 million.¹³ The primary reason for the increased tax revenues is attributable to the rules that require the combining of spouses' and common law partners' incomes for the purpose of computing entitlement to the refundable GST tax credit and the Canada Child Tax Benefit. Entitlement to both these tax credits depends on one's level of income and, as income increases, the amount of the credit is reduced and eventually phased out completely. Therefore, for example, two individuals with incomes of \$20,000 who are now included as common law partners will lose entitlement to either all or part of these refundable tax credits. The impact of this change is especially harsh on those with low incomes, the very group the tax credits are intended to benefit. There is also a gendered impact. Given that women tend to earn less than men and have lower incomes, it is likely that more women than men will lose these credits.¹⁴

The Privatization Agenda

One of the cornerstones of neo-liberalism and, more recently, neo-conservatism, is an increased reliance on the private sector, including the private family and the

13. See, Kathleen Lahey, *The Impact of Relationship Recognition on Lesbian Women in Canada: Still Separate and Only Somewhat "Equivalent"* (Ottawa, 2001), vi.

14. In Canada, women who work full-year, full-time earn on average \$41,331, whereas men who work full-year, full-time earn on average \$58,537 (latest figures available). See, Statistics Canada, "Presence of Employment Income (10), Age Groups (5A) and Sex (3) for the Population 15 Years and Over of Canada, Provinces, Territories, Census Metropolitan Areas and Census Agglomerations, 2005 - 20% Sample Data" (2005 Census statistics), <http://www12.statcan.gc.ca/english/census06/data/topics/RetrieveProductTable.cfm?>

private market, rather than the state, to provide for the welfare of citizens. As Lisa Philipps has said, “the drive towards privatization in Canada has at its heart one central claim: that private choice is better than public regulation as a mechanism for allocating resources and ordering social affairs.”¹⁵ In Canada, law, and in this context, tax law, is being used increasingly as a tool of privatization.¹⁶ Tax expenditures in particular are often used as a private mechanism to achieve social or economic goals. While we see the state as “public” in contrast to the private market or family, by using tax expenditures delivered to the private sector to reinforce private responsibilities the state is to a certain extent abdicating its public responsibility for that social or economic goal.

In this chapter, I focus on just one aspect of that privatization: the trend to place responsibility on individual family members to care for each other, thereby relieving the state of its responsibility in that regard. My contention is that by taking spousal and common law partner status into account with respect to entitlement to and allocation of a variety of tax expenditures, the tax system is one important tool in this privatization. For example, the Canadian government has made it clear that the future for Canadians in terms of their economic security in retirement is to contribute to private pension plans such as occupational pension plans (Registered Pensions Plans, RPP) and personal plans (Registered Retirement Pension Plans, RRSP), and not to rely on the more universal Old Age Security or the Canada Pension Plan.¹⁷ As a result, these private plans are heavily subsidized by tax expenditures, including tax deductions for contributions to the plans, and a sheltering of all income earned by the plan from tax until either the contributions are withdrawn or the plan matures. The value of these tax expenditures is a staggering \$38 billion for 2008, making tax expenditures for retirement savings the single largest tax expenditure in Canada.¹⁸

15. Lisa Philipps, “Tax Law and Social Reproduction: The Gender of Fiscal Policy in an Age of Privatization” in Brenda Cossman and Judy Fudge, eds., *Privatization, Law and the Challenge to Feminism* (Toronto, 2002), 41.

16. For a detailed discussion of the role of law in the drive towards privatization see *ibid.*, 30–36.

17. The Old Age Security is a non-contributory plan consisting of a flat rate monthly sum paid to those over 65, although as income increases there is a clawback through the income tax system of part of the pension. Nevertheless it is the most “universal” pension plan in Canada. The Canada Pension Plan is a contributory income replacement plan and benefits are based on labour force participation. Both these plans are described as “public” pensions in contrast to the private RPPs and RRSPs.

18. Canada, Department of Finance, *Tax Expenditures and Evaluations, 2008* (Ottawa, 2008), Table 1.

At a general level, the major problem for many is a lack of access to these plans. This is especially true for women whose lack of participation in the paid labour force in comparison to that of men means that many women are excluded from these plans.¹⁹ In Canada, women have consistently formed 70% of the part time labour force since the mid-1970s.²⁰ Similarly, in order to access RRSPs, one must have the discretionary income to make the contribution. Given that women earn less than men,²¹ it is not surprising that more men than women make these contributions and thereby benefit from the tax expenditure.

The government has recognized and attempted to remedy women's unequal access to private pension plans and the accompanying tax subsidies to a certain extent. Consequently, the ITA permits contributions to a "spousal" RRSP. A taxpayer may contribute to a plan in their spouse or common law partner's name and receive the same tax benefits that they would have received had they made the contribution to their own plan. Thus there is the opportunity to establish a pension plan for one's spouse or common law partner and to split income with that person by diverting future income to him or her. The advantages can be significant in situations where the spouse or common law partner has little or no other income when they retire.

While the Canadian "spousal" RRSP is a well-intentioned measure, it remains a highly private and limited response to the public issue of women's lack of access to pension and superannuation plans. This lack of access contributes to the fact that so many elderly women live in poverty.²² Essentially, the private family is encouraged to provide for its own economic security in retirement, albeit with a tax break to encourage them to do so. But many cannot take advantage of this opportunity. Low income taxpayers may not have the discretionary funds to contribute on their spouse's behalf. Additionally, single women have no access to this expenditure. Given that 43% of single women over 65 live below the poverty line compared to 5% of women over 65 who have a spouse, it appears that the subsidy is being misdirected.²³ By linking this tax expenditure to spousal status, the government is directing the benefit to a very limited group of people, a group that may not be the

19. In 2006 only 58% of women over 15 are employed in Canada, compared to 68% of men (latest figures available), see Marcia Almey, Family and Social Statistics Division, Statistics Canada, *Women in Canada: Work Chapter Updates* (Ottawa, 2006), <http://www.statcan.gc.ca/pub/89f0133x/89f0133x2006000-eng.htm#2>

20. Ibid.

21. Supra note 14.

22. In Canada in 2000, 72% of those over 65 living below the poverty line were women; see Statistics Canada, *Income in Canada, 2006* (Ottawa, 2008), http://dsp-psd.pwgsc.gc.ca/collection_2008/statcan/75-202-X/75-202-XIE2006000

23. Ibid.

neediest. Furthermore, in Canada at least, statistics show that fewer people than ever are living in a married or common law relationship.²⁴ As the Women and Taxation Working Group of the Ontario Fair Tax Commission stated, “the concept of a couple as a life-long economic unit with joint income, wealth, and expenses may no longer be appropriate given changing family structures, increasing divorce rates, and falling marriage rates.”²⁵

As I have demonstrated, reliance on the private sector for the economic security of individuals is problematic for a variety of reasons. At a general level such privatization policies tend to diminish the role that the state plays in ensuring a fair level of income for all its citizens. The state is delegating its responsibility to the private sector with virtually no strings attached. Encouraging the private family to fill the role previously taken by the state leaves gaps in the social security network, gaps that people without spouses or common law partners often fall through. As discussed in the pension context, the result is often a retirement lived in poverty. The current privileging of private pension plans also reduces the resources available for the more universal state pensions, pensions on which women in particular depend for their economic security in retirement.²⁶ Applying tax expenditure analysis to these provisions, one can conclude that they are not the best way to achieve the policy goal of ensuring that Canadians, and women in particular, are economically secure in their retirement. As I have discussed, they are too limited in scope and benefit some at the expense of others with no rational justification for that discrimination.

Other Tax Expenditures

I now turn to some of the other tax expenditures that take spousal status into account.

The Dependent Spouse and Common Law Partner Credit

The spousal and common law partner tax credit is available to a taxpayer who supports his or her spouse. Put simply, the taxpayer is entitled to a tax credit of just

24. Statistics Canada, “2006 Census: Families, marital status, households and dwelling characteristics,” *The Daily* (Ottawa, September 12, 2007).

25. Ontario Fair Tax Commission, Women and Tax Working Group, *Women and Taxation* (Toronto, 1992), 22.

26. During the past twenty years, 99% of the income gain of the 10% of elderly women living alone with the lowest incomes was from higher direct government payments. For the 20% of women in the middle of the income distribution, direct government transfers accounted for more than 80% of their gain, see Statistics Canada, *Analysing Family Income*, (last modified March 3, 2004). <http://www.12.statcan.ca/english/census01/products/analytic/companion/inc/canada.cfm#14>.

over \$1,000, which is reduced in amount if the spouse or common law partner's income exceeds approximately \$680, and with the credit eliminated once the spouse or common law partner's income exceeds approximately \$7,000. As the Law Commission of Canada has said, "the credit appears to be designed to promote economic dependency in conjugal relationships."²⁷

There have been many critiques of the spousal and common law partner tax credit.²⁸ First, because more women than men work in the home and not in the paid labour force, it is men who predominantly claim the spousal and common law partner tax credit. Several issues arise when one considers the impact on women of provisions such as the spouse and common law partner tax credit. Provisions based on dependency are a disincentive to women's participation in the paid labour force. When the tax costs such as the loss of the credit are taken into account, there is a real disincentive to women in spousal or common law relationships entering the paid labour force. This disincentive is exacerbated by other costs incurred by women who choose to work outside the home, such as childcare costs, travel costs, clothing, and the monetary and non-monetary costs associated with replacing the household labour. Furthermore, when one considers that many women are the secondary earners in their relationships, and that they work for relatively low wages, the combination of these factors and the loss of the tax credit have a particularly detrimental effect on women's choice to work outside the home. They create an unacceptable penalty.

Another important critique of dependency provisions is that rules like the spousal and common law partner tax credit affirm that a woman's dependency on a man deserves tax relief. Again, this undermines the autonomy of women and it results in a certain privatization of economic responsibility for dependent persons. Tax policy has responded to women's lack of economic power by leaving it to the family (the private sector) to assume responsibility for women's lack of resources. Furthermore, the tax subsidy is delivered to the economically dominant person in the relationship and not the "dependent" person who needs it. This manner of delivery assumes that income is pooled and wealth distributed equally within the relationship. However, research has shown that such pooling is not the norm in relationships, with one study demonstrating that it only occurs in one fifth of house-

27. Law Commission of Canada, *supra* note 9, 74.

28. See, e.g., Law Commission of Canada, *ibid.*, 77, which recommended that the spousal tax credit be repealed and replaced with "enhanced or new programs that more carefully target caregivers and children."

holds surveyed.²⁹ Many women do not have access to or control over income earned by their spouse; predicating tax policies on the assumption that they do is unfair.

The spousal and common law partner tax credit is a measure that can be viewed as one that gives public recognition to the work done by women in the home. It is the only measure (tax or otherwise) that places a “value” on household labour. But if it is intended to recognise the contribution made by those who work in the home then, as mentioned above, the tax credit should go to the person who performs that labour and not the person who benefits from it. Further, viewing the tax credit as a measure that values household labour is problematic because the “value” placed on the labour is so low. The measure can only be considered to reinforce the perception that household labour, including childcare, has little value. That in turn contributes to the under-valuation of work such as childcare, even when it is performed in the open market, as evidenced by the low salaries paid to childcare workers.

Another justification for the spousal or common law partner tax credit is that it recognizes that individuals who support their economically dependent spouse or common law partner have a reduced ability to pay tax. This argument is not persuasive. It ignores the benefit that accrues to the individual from work performed in the home, such as housework and childcare, by the person whom they support. Indeed, this home labour may well increase the employed partner’s ability to support the non-employed partner because there is no need to have recourse to the private market in order to obtain the services provided in the home by the non-employed spouse. This point was not lost on the Royal Commission on the Status of Women in 1970 when it rejected the Carter Commission recommendation that the family be the unit of taxation. At that time the Royal Commission on the Status of Women noted that “in most cases the wife who works at home as a housekeeper, far from being a dependent, performs essential services worth at least as much to her as to her husband as the cost of food, shelter and clothing that he provides for her.”³⁰ Given all these problems it is not surprising that various individuals and organizations have called for the repeal of the spousal or common law tax credit.³¹

29. Carolyn Vogler and Jan Pahl, “Money, Power and Inequality within Marriage,” *Sociological Review* 42 (1994), 285.

30. Royal Commission on the Status of Women in Canada, Report (Ottawa, 1970), 293–294.

31. See, e.g., Law Commission of Canada, *supra* note 9, 77; Maureen Maloney, “What is the Appropriate Tax Unit for the 1990s and Beyond?,” in Allan Maslove, ed., *Issues in the Taxation of Individuals* (Toronto, 1994), 146; and Claire Young, *What’s Sex Got To Do With It?: Tax and the Family* (Ottawa, 2000), 113.

The Tax-Free Transfer of Capital Property to a Spouse

As mentioned earlier in this paper, the impact of the rules that take spousal or common law status into account varies depending on the level of income of the spouses or common law partners and the distribution of income within the relationship. There is no question that those couples with high incomes and significant wealth can benefit tremendously from some of the tax rules. One example is the ability to transfer capital property to your spouse or common law partner on a tax-free basis, either *inter vivos* or on death. Canada's tax treatment of capital differs from that of most other jurisdictions. There are no estate taxes, succession duties, or gift taxes in Canada. Rather, when capital property is transferred from one person to another, either by way of a gift or bequest, the general rule is that the transferor is deemed to have disposed of the property at fair market value.³² The result is that if the fair market value of the property at the time of transfer is more than the cost of the property to the transferor, a capital gain arises and one half of the gain is included in the transferor's income. A significant exception to this rule exists. If the transfer is to a spouse or common law partner, a rollover of the property occurs. The taxpayer is deemed to dispose of the property for proceeds of disposition equal to their cost for the property and the spouse or common law partner acquiring the property at an amount equal to those proceeds of disposition. The result is a significant deferral of tax until the spouse or common law partner ultimately disposes of the property. The rollover is available both on an *inter vivos* basis and on death and is also available with respect to a transfer to a former spouse or former common law partner in settlement of rights arising from the marriage or common law partnership.³³

These rules serve a variety of purposes. From a practical perspective, if transfers between spouses were taxable events, the Canada Revenue Agency (CRA) would have to trace all such transactions in order to ensure that any tax owing was paid. Given the informal context in which these transactions occur, such a task would be difficult. Another problem is that because these transactions do not take place in the open market, there may be a liquidity problem with no cash available to pay the tax. The rollover rules are also intended to encourage the redistribution of property within the relationship, especially from men, who tend to own more capital property than women, to their spouse or common law partner. It is questionable, however, how effective they are in this regard. There are many reasons why an individual may choose not to transfer property to their spouse on an *inter vivos*

32. Section 69 of the ITA.

33. Section 70(6) of the ITA provides the rollover for transfers as a consequence of death to a spouse or common law partner or to a spouse trust and section 73(1) and (1.01) of the ITA provides the rollover for *inter vivos* transfers to a spouse or common law partner.

basis, including concern about transferring control of that property to the spouse or common law partner. These rules are also affected by the operation of the attribution rules. If capital property that is transferred to a spouse or common law partner at less than fair market value generates income, that income is attributed to the transferor and not taxed to the spouse or common law partner, thereby preventing income splitting with respect to income from property.³⁴ Given that most of these transfers are presumably gifts, the attribution of income may well operate to deter taxpayers from entering these transactions.³⁵ It is impossible to determine whether the rollover rules do encourage the redistribution of wealth on an *inter vivos* basis in spousal and common law relationships. While the CRA classifies these provisions as tax expenditures, they do not put a value on the expenditures because the data is not available to support a meaningful estimate or projection.³⁶

These rules can be critiqued on a variety of bases. First, they only benefit those couples with considerable wealth who own capital property. In the absence of gift taxes or estate taxes, these rules provide a huge benefit to those couples because there is no taxation of any appreciation in the value of the capital property owned by the couple so long as it is owned by either of the spouses or common law partners. Secondly, while it may be difficult to trace intra-spousal *inter vivos* transfers, the same cannot be said of transfers on death where the will or other documents relating to probate or intestacy will provide information about the transfer.

The rollover rules are predicated on an assumption of economic interdependence³⁷ and economic mutuality, that is, what is mine is yours and what is yours is mine. Yet not all spousal and common law relationships are founded on economic interdependence, nor is there an economic mutuality within the relationship with respect to property. Thus the rollover rules can be said to be over-inclusive. They are rules that apply in situations that do not reflect their underlying policy. This problem led the Law Commission of Canada to recommend the extension of the rules to all persons living in economically interdependent relationships.³⁸ I disagree with their recommendation and believe that the *inter vivos* rules at least should be repealed outright. First, as mentioned above, the application of the attribution rules

34. Section 74.1 of the ITA.

35. Section 74.2 of the ITA also provides that a transfer of capital property to a spouse or common law partner must be at fair market value in order to avoid the attribution of any capital gain arising from that transfer to the transferor when the spouse or common law partner disposes of the property.

36. Canada, Department of Finance, *supra* note 18.

37. The Law Commission of Canada described economic interdependence as the "raison d'être of the rollover rules," *supra* note 9, at 89.

38. *Ibid.*, Recommendation 25.

may deter taxpayers from entering into these transactions, thereby obviating the need for the rollover rules. Secondly, tracing problems are not unique to intra spousal or common law partner transfers. Transfers to adult children or close friends can be equally difficult to trace. Furthermore, the ITA provides for a self-assessing system in which taxpayers are required to declare a variety of transactions that cannot always be traced, including gifts to third parties. Finally, there is always the problem of defining “interdependence” if one goes down that road.

Provisions That Are Based on an Assumption of Economies of Scale in Relationships

Some of the provisions that apply to spousal and common law relationships take into account the economies of scale in terms of consumption and household production that are assumed to arise from spouses and common law partners living together. These economies of scale arise from sharing the cost of certain items, such as rent and household expenses, including durable consumer assets such as furniture and kitchen appliances, as well as the benefits from shared household work. The theory is that the savings from these shared expenses and labour increase a taxpayer’s ability to pay tax.

Some provisions take into account the assumed increased ability to pay that flows from economies of scale by aggregating the incomes of spouses and common law partners for the purposes of determining entitlement to tax credits. For example, the child tax credit is aimed at low income individuals and is intended to give them some financial support with respect to the costs of raising children. Because it is targeted at low income individuals, the tax credit is phased out by 5% of the individual’s income over approximately \$30,000. However, the income of spouses and common law partners is aggregated for the computing of entitlement to the Child tax credit, with the result that the amount they receive as a couple will be less than they received as two individuals.

The issue of aggregating the income of families or spouses when determining entitlement to tax credits is complex. To the extent that is based on an assumption of economies of scale, it is highly problematic. First, economies of scale arise in a variety of situations other than spousal or common law relationships. As the Law Commission of Canada noted, “even if consumption economies exist when individuals live together and share resources, and even if one takes the view that they should be taken into account in government transfers, conjugal cohabitation has become an increasingly poor proxy for the identification of such economies.”³⁹ Many other individuals, such as students or good friends share accommodation and the associated expenses. The tax system takes no account of their economies of scale

39. *Ibid.*, 80.

when determining entitlement to tax credits. In addition, individuals enter into all kinds of arrangements that produce economies of scale, such as car pooling, sharing a baby sitter for their children, recycling consumer durables by passing them on to a friend when new purchases are made. Again the tax system takes no account of these transactions. Given that it is virtually impossible to identify when household economies arise or to define the nature of the relationships in which they do arise, tax provisions should not be based on an assumption that such economies exist and enhance the ability to pay of spouses and common law partners.⁴⁰ I agree with the Law Commission of Canada which concluded that “income security programs should not assume that the benefits of individual income are always shared with others in conjugal relationships and that sharing never occurs in other relationships,”⁴¹ and share their view that entitlement to tax credits such as the child tax credit should be determined by reference to individual income and not spousal or family income.

It is interesting to note how arguments based on economies of scale are used (or not used). The example of the child tax credit indicates that those with relatively low and equal incomes lose a tax benefit because of assumed economies of scale. One does not, however, hear much talk of the advantages of economies of scale when looking at the tax treatment of the couple with one high income earner and a spouse or common law partner with little or no income. A recent development in Canada demonstrates this inconsistency in policy.

In 2007 the federal government introduced rules that permit the splitting of pension income between spouses or common law partners.⁴² Income splitting benefits the couple in which one partner has a high income and the other no income. The reason is that income that would be taxed at a high marginal rate of tax is taxed at a much lower rate because it is effectively taxed in the hands of the partner who had no income. Income splitting generates a huge tax saving for the couple, a savings of approximately \$8,000 for the couple in which one partner has an income of over \$120,000 and the other partner has no income. But of course the couple with relatively equal incomes (regardless of how high or low they are) will save nothing. I suggest that there are problems with the new rules. First, the income split is purely fictional; there is no requirement that the money ever be transferred to the low income spouse, usually the woman. Given that we tend to tax people on what they control, such a measure flies in the face of that principle. Secondly, the low income spouse’s marginal tax rate has increased from nil to a higher rate and she is liable to

40. *Ibid.*, 82.

41. *Ibid.*, 87.

42. See http://www.fin.gc.ca/drlcg/ITA-1_ftt1206e.html.

pay that tax, even though she has not received any funds and may not receive any benefit. The assumption appears to be that there is an economic mutuality in the relationship but that is not always the case and there is nothing to stop the high rate taxpayer from putting the tax savings into his own pocket.

Conclusion

In this paper I have demonstrated that it is high time that we reconsider taking spousal relationships into account for tax purposes. Some rules are simply inequitable and discriminate without good reason against those with low incomes and in favour of those with high incomes. Others, such as those based on dependency, are inherently flawed and poorly targeted so that they do not achieve their policy goals. Some rules can be critiqued because they are based on outmoded and incorrect assumptions including, for example, the assumption that there is a pooling of income in many relationships. At the end of the day I suggest that it is women, often by reason of their lower incomes, who pay a significant penalty when treated as spouses or common law partners for tax purposes.