Intimate Matters? An Evaluation of the Law Commission of Canada's Recommendations on the Tax Treatment of Close Personal Relationships

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INTRODUCTION

A recent report of the Law Commission of Canada, *Beyond Conjugality*,[1] is the first comprehensive study of the tax treatment of same-sex and other non-traditional types of relationships in Canada, and one of the few such studies in the world.[2] The report reaffirms some aspects of the personal income tax; for example, it recommends retaining the individual as the basic tax unit.[3] With respect to other aspects of the personal income tax, it suggests several fundamental changes: reforming the dependent relative tax credits to provide more flexible and more direct assistance to people with disabilities and people with caregiving responsibilities;[4] replacing the spouse and common law partner tax credit with direct income support to caregivers and children;[5] administering the goods and services tax (GST) credit on an individual basis;[6] and extending the provisions allowing tax-free transfers of capital property to all individuals living together in economically interdependent relationships.

In this paper, I answer some basic questions about the commission's recommendations: who would gain, who would lose, and how much would it cost? In particular, I take two of the proposals—elimination of the spousal tax credit and administration of the GST on an individual basis—and subject them to a detailed analysis, using the Social Policy Simulation Database/Model (SPSD/M), developed by Statistics

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Canada, to estimate the costs and distributional impacts of the proposed changes. I then use the dependent relative tax credits to examine the issue of dependency: who is considered dependent in our income tax system, and why? I conclude with policy suggestions.

Two of the recommendations identified above are not evaluated in this paper. The first is the recommendation to retain the individual as the basic tax unit. This recommendation is an endorsement of the status quo, and the commission's reasoning on the tax unit issue concurs with other recent studies on families and taxation, such as Krashinsky and Cleveland[7] and Vincent and Woolley.[8] I also do not consider the recommendation to extend the provisions allowing tax-free transfers of capital property to all individuals living together in economically interdependent relationships. SPSD/M does not contain the information necessary to estimate the cost of this proposal or its distributional impact.

REPLACEMENT OF THE SPOUSAL AMOUNT TAX CREDIT

> Recommendation 22: Parliament should replace the *Income Tax Act*'s spouse and common-law partner tax credit with enhanced or new programs that more carefully target caregivers and children for direct income support.[9]

The spousal amount tax credit (herein referred to as "the spousal tax credit" or "the spousal amount") can be claimed by a person whose spouse or common law partner (including a same-sex partner) has no taxable income of his or her own—that is, no employment or investment income, and no employment insurance, Canada Pension Plan, old age security, or other taxable income. The maximum credit for 2001 was $6,293; however, the credit is reduced by $1 for each dollar the spouse earns over $630. The credit reduces federal taxes owing by 16 percent (the base federal income tax rate) of the amount claimed, up to a maximum, in the 2001 taxation year, of $1,007. Every province also has a spousal amount tax credit.

The commission criticizes this tax credit on a number of grounds. First, it promotes economic dependency.[10] The reasoning behind this argument is straightforward: by taxing a second earner's income starting at $630 (the point where, in 2001, the spousal credit begins to be eliminated) rather than $7,412 (the amount of income sheltered from taxation by the basic personal amount), the spousal tax credit raises the effective marginal tax rate on the second earner.

The commission also argues that the tax credit is inequitable:

> In assessing the equity of the credit, it might also be noted that it is claimed disproportionately by relatively well-off individuals. This should not be surprising. Generally, middle- and high-income individuals are more able to afford to support an economically dependent spouse.[11]

The spousal amount is also seen as anomalous. The commission writes, "Tax provisions of this kind have been repealed in most countries."[12] It is true that some countries, most recently Australia and the United Kingdom, have reduced spousal benefits, directing funds, instead, to more generous child benefits.[13] However, a number of countries, including the United States, have provisions similar to the spousal amount.

The tax credit is sometimes justified as a measure to provide "income support to those families in which one spouse is looking after children in the home or acting as a caregiver for elderly parents."[14] However, the commission argues that, according to this justification, the credit is overinclusive: "Over one-half of the spouses who receive the credit are not supporting children."[15]

Replacing the spousal tax credit with programs targeted toward caregivers and children would clearly create winners and losers: people who lose the spousal amount, and people who gain from the new programs. But who are the losers? How much do they lose? How much do the winners gain?

In this study, I used SPSD/M to simulate the effects of removing the spousal tax credit at the federal level. (Provincial tax systems remained unchanged.)[16] The commission suggests, as one possible use of the savings from eliminating the spousal amount, enriching the Canada child tax benefit (CCTB);[17] however, it does not specify how this should be done. In this study, I simply used the savings to enrich the base CCTB by $306.85 per child, a revenue-neutral policy change.[18]

According to SPSD/M estimates, removing the spousal tax credit would generate additional federal tax revenue of $1,522 million in 2002. This estimate is somewhat higher than the Department of Finance's estimate of the cost of the spousal tax credit, which for the 2000 taxation year was $1,290 million.[19] The estimates differ because they are based on different populations (the SPSD/M is based on a statistical sample of Canada's population), because they are for different years, and because SPSD/M takes into account interactions between different elements of the tax system—for example, the change in GST revenue associated with a change in the personal income tax system. Despite these differences, the two estimates are comparable.

The strength of SPSD/M is in estimating distributional effects and in calculating gains and losses. However, it does have some limitations. Most significantly, it cannot estimate behavioural effects. Consequently, this study ignores any possible dynamic effects of eliminating the spousal tax credit—for example, increased labour force participation by secondary earners. However, evidence on the sensitivity of labour force participation to small changes in marginal tax rates suggests that these effects will not qualitatively change the results of the analysis.

Table 1 shows the effect of the proposed reform on federal tax paid. Most of the increase in federal taxes is due to the elimination of the spousal amount. However, there are also some secondary effects included here; for example, people receiving more CCTB will spend more and therefore pay more GST. (This explains the change in federal taxes for single parents.) The analysis is based on economic families—that is, any group of people living together who are related by blood or marriage (including common law marriage). A single parent with a 21-year-old child at home would be shown as a two-adult family; a childless same-sex couple would appear as two single-person households.[20] The households are shown by *total household* income, and the income categories are based on income before the policy change. The income concept used is "pre-tax, post-transfer." In other words, it includes income received by all household members from all sources, including both employment and transfer income, but does not take into account taxes paid.

Table 1 shows that the increase in federal taxes paid is concentrated in families containing two or more adults. The increase in federal taxes paid is highest for families with two or more adults and one or more children under 18 (an average increase of $258), second-highest for families without children under 18 ($180), and lowest for families containing a person over 65 ($94). However, if we look at all family units, including single individuals, the highest average tax increase is in the $50,000-$75,000 income range. This is where the married or cohabiting couples are. Eighty percent of family units with incomes between $50,000 and $75,000 contain two or more adults, compared with 15 percent of families with incomes under $20,000 (calculated from SPSD/M).

If we look at each family type in isolation, the increase in federal taxes resulting from a replacement of the spousal tax credit would be highest for those in the $30,000-$40,000 income range. People at lower income levels are less likely to claim the spousal amount because they are less likely to have taxable income and, possibly, because they are more likely to be non-spouse families—for example, a single parent with adult children. Spousal amount claims decrease as household income rises above $40,000 for two reasons. First, it is difficult to reach the higher income brackets without having both adults in the family in the labour force. Second, if the higher-income spouse shifts part of her income to the lower-income spouse, she will not be able to claim the spousal amount. Professionals and self-employed individuals can shift income by employing a spouse. Individuals over 65 can split Canada Pension Plan income or withdraw income from spousal registered retirement savings plans. Both strategies mean that the lower-income spouse claims the basic personal amount, rather than the higher-income spouse claiming the spousal amount.

This second form of income splitting is one factor that explains the lower level of spousal amounts claimed for households containing one person over 65. Another factor is that most individuals over 65 receive old age security and therefore have some taxable income; consequently, they claim the basic personal amount rather than the spousal amount.

It could be argued that consideration of family-level changes in income violates the spirit of the commission's recommendations for an income tax system based on the individual. Surely what matters is whether individuals gain or lose, not how much households gain and lose. Table 2 shows the change in federal tax paid by individuals, broken down according to whether or not the individual has a spouse present. Table 2 provides more support for the commission's argument that the spousal tax credit is inequitable. The average increase in federal tax from replacement of the tax credit increases sharply as individual incomes rise from $0 to $40,000. Low-income groups are dominated by women, secondary earners, and the elderly, all of whom

TABLE 1 Replacement of Spousal Tax Credit with Enhanced Canada Child Tax Benefit: Increase in Federal Income Tax Paid, 2002 Parameter Values

	Economic family type						
Base total income group	With kids, 1 adult	With kids, 2+ adults	With elderly, 1 adult	With elderly, 2+ adults	Other, 1 adult	Other, 2+ adults	All
Min.-$10,000	11	129	0	0	0	15	5
$10,001-$20,000	18	111	0	51	0	191	23
$20,001-$30,000	26	331	0	85	0	282	100
$30,001-$40,000	26	414	0	149	0	291	174
$40,001-$50,000	25	386	0	76	0	228	178
$50,001-$75,000	23	322	0	78	0	200	191
$75,001-$100,000	20	196	0	98	0	123	142
$100,001-Max.	4	123	0	88	0	119	114
All	23	258	0	94	0	180	123

Source: Calculated by Informetrica using SPSD/M.

are less likely to make a spousal amount claim. As we rise above the $40,000 income level, more and more of the sample are prime-age employed males, who are relatively more likely to claim the spousal amount. However, once we reach the $60,000 income level, the relationship between individual income and spousal amount claims is not particularly strong. Compare, for example, individuals in the $60,000-$65,000 income range and individuals in the $95,000-$100,000 income range. Both groups experience exactly the same average tax increase, $169, as a result of elimination of the spousal tax credit.

Table 3 shows the amount that various family types would gain if the savings from eliminating the spousal tax credit were used to increase the CCTB. The only families who gain are those with children. Except in the top two income groups, the gain per family depends entirely on the number of children per family, simply because of the mechanics of how the CCTB operates. If base benefits are increased by $306.85, all those currently receiving the CCTB will have their child benefits increased by the full amount, $306.85, per child.[21] In 2002, families receiving CCTB included all families with children and a taxable income of no more than $79,000,[22] as well as families with three or more children, or young children, at higher income levels.

In the top two income categories, the amount gained depends upon a family's income. If benefits were increased from the 2002 level by $306.85 per child, two-child families would receive CCTB up to a taxable income of $91,274. Because benefits are reduced by 5 cents for each dollar of income above $32,960 (in 2002), the higher the level of base benefits, the longer it takes for all of the base benefits to be taxed away.

These considerations can be used to interpret the results in table 3. In most income categories, single-parent families contain fewer children than two-adult families; consequently, for single-parent families, the average benefits received

TABLE 2 Increase in Federal Tax Payable Resulting from Replacement of Spousal Tax Credit, All Individuals, 2002 Parameter Values

Total income group	No spouse present	Spouse present	Both
Min.-$10,000	0	8	2
$10,001-$20,000	1	46	23
$20,001-$30,000	3	114	71
$30,001-$40,000	3	143	97
$40,001-$50,000	3	161	116
$50,001-$60,000	2	167	123
$60,001-$65,000	2	169	129
$65,001-$70,000	2	206	162
$70,001-$75,000	2	201	158
$75,001-$80,000	2	215	168
$80,001-$85,000	1	209	165
$85,001-$90,000	1	242	195
$90,001-$95,000	3	238	185
$95,001-$100,000	0	169	129
$100,001-Max.	0	222	188
All	1	105	51

Source: Calculated by Informetrica using SPSD/M.

TABLE 3 Replacement of Spousal Tax Credit with Enhanced Canada Child Tax Benefit: Increase in Transfer Payments, 2002 Parameter Values

	Economic family type						
Base total income group	With kids, 1 adult	With kids, 2+ adults	With elderly, 1 adult	With elderly, 2+ adults	Other, 1 adult	Other, 2+ adults	All
Min.-$10,000	238	524	0	0	0	0	16
$10,001-$20,000	360	423	0	0	−2	−2	27
$20,001-$30,000	523	494	−1	−1	−5	−9	90
$30,001-$40,000	521	534	0	−1	−1	−3	134
$40,001-$50,000	465	555	0	−2	0	−1	161
$50,001-$75,000	461	526	0	−2	0	−1	206
$75,001-$100,000	448	473	0	−1	0	−1	208
$100,001-Max.	62	185	0	−1	0	−1	83
All	458	432	0	−1	−2	−2	123

Source: Calculated by Informetrica using SPSD/M.

from a CCTB enhancement are lower. For example, in the $40,000-$50,000 income range, an average single-parent family would gain $465, compared with $555 for a two-adult family. However, on average, single-parent families would gain more than two-parent families ($458 compared with $432), because they are more likely to be concentrated in the lower income levels. As noted earlier, a family usually requires two wage earners to attain the higher household income brackets.

Table 4 shows the net gain or loss for each family type, taking into account changes in transfer payments, changes in federal taxes, and any changes in provincial taxes paid (owing to, for example, higher sales tax payments). Table 4 shows that the big winners from replacement of the spousal tax credit with direct support for children would be single-parent families: their level of taxes is unchanged, but they receive a substantially enhanced CCTB—an average net gain of $412 per family. The average gain for single-parent families is highest for those in the $20,000-$30,000 income range, $472, because this is where the average number of children per family is highest. Only single parents in the $100,000-plus income category (a small group) experience fairly small net gains, an average of $54 per family, because of the tax-back of CCTB income.

It is worth noting that the results for single-parent families would change significantly—and many single-parent families would lose—if the equivalent-to-married tax credit were eliminated. The commission does not recommend this reform; however, it seems somewhat inconsistent to eliminate the "married" tax credit while maintaining the equivalent-to-married tax credit in its present form.

Turning to two-adult families with children, it is striking that, for every income category, the average gain from an increase in CCTB outweighs the loss of the spousal tax credit. In fact, if we look at the net benefits from the replacement of the spousal amount with an enhanced base CCTB amount, we find a U-shaped pattern. The biggest beneficiaries are those at the bottom (under $20,000) and upper middle ($75,000-$100,000) of the income distribution. The households that gain the least on average are those in the $30,000-$40,000 income range—single-earner families with fewer children—and families at very high income levels, who do not see many gains from increased CCTB.

The people who would lose from the replacement of the spousal tax credit would be single-income, two-adult families without children under 18, since none of these would benefit from an enhanced CCTB. However, if some of the funds were used to provide support for people providing elder care, a suggestion mooted by the commission, these households would be much more likely to experience benefits. We cannot simulate such a proposal using SPSD/M because the model does not contain information about people's responsibilities for caring for others, except to the extent that people are living together. Yet it would be wise to explore this option, partly, as suggested by the commission, to recognize the value of caring work, and partly for purely pragmatic reasons, to cushion the losses experienced by the reduction in the spousal amount. Another way to cushion the loss of the spousal amount is through an expansion of the GST credit. It is to this option that I now turn.

ADMINISTRATION OF THE GST CREDIT ON AN INDIVIDUAL BASIS

> Recommendation 23. . . . Parliament should amend the *Income Tax Act* so that the amount of the Goods and Services Tax credit to which individuals are entitled is not reduced if they are married or cohabiting in a conjugal relationship.[23]

TABLE 4 Replacement of Spousal Tax Credit with Enhanced Canada Child Tax Benefit: Net Gain or Loss, 2002 Parameter Values

	Economic family type						
Base total income group	With kids, 1 adult	With kids, 2+ adults	With elderly, 1 adult	With elderly, 2+ adults	Other, 1 adult	Other, 2+ adults	All
Min.-$10,000	217	378	0	0	0	−15	10
$10,001-$20,000	325	293	0	−48	−2	−182	4
$20,001-$30,000	472	151	−1	−82	−5	−275	−10
$30,001-$40,000	468	108	0	−142	−1	−278	−39
$40,001-$50,000	415	154	0	−75	0	−217	−18
$50,001-$75,000	414	188	0	−77	0	−190	12
$75,001-$100,000	408	260	0	−94	0	−118	61
$100,001-Max.	54	58	0	−85	0	−114	−30
All	412	161	0	−91	−2	−172	−1

Source: Calculated by Informetrica using SPSD/M.

Marriage or cohabitation affects entitlement to the GST credit in two ways. First, the amount of the credit a person receives depends, for a married or cohabiting individual, on the combined income of both partners, not each person's individual income. (Same-sex partners are now treated as married if they self-declare on their income tax form.) Second, single individuals with earned income can qualify for an additional $107 credit not available to those in a conjugal relationship. Single parents receive the additional $107 automatically. For other single individuals (for example, students living with roommates and older singles living with extended family), the supplement is phased in at the rate of 2 cents for each dollar earned above the basic personal amount, up to a maximum of $107 in 2001.

This study used SPSD/M to simulate the effect of administering the GST credit on an individual basis. Essentially, every member of a cohabiting couple was treated as if he or she were a single individual, and the GST credit was calculated accordingly. The couples were then put back together to determine the effect on the total amount of GST received. GST credits received for children were held constant. The only difficult decision was how to treat the phase-in of the $107 GST supplement. Should single parents, like other individuals, receive the supplement only if they had earned income? Or should other individuals, like single parents, receive the supplement automatically? In the end, it was decided to leave the phase-in as is, giving single parents special automatic entitlement. Appendix table 1A presents the case where all individuals receive the $107 automatically.

Distributional Issues

The total cost of administering the GST credit on an individual basis would be $1.7 billion dollars, according to 2002 SPSD/M estimates, or $2.1 billion if all individuals with no income were entitled to the $107 additional supplement. Table 5 shows the distribution of gains and losses for the various economic families.[24] As the GST

TABLE 5 Administration of Goods and Services Tax Credit on an Individual Basis, Average Increase in Transfers Received, 2002 Parameter Values

	Economic family type						
Base total income group	With kids, 1 adult	With kids, 2+ adults	With elderly, 1 adult	With elderly, 2+ adults	Other, 1 adult	Other, 2+ adults	All
Min.-$10,000	0	231	0	1	0	12	7
$10,001-$20,000	0	208	0	62	0	72	15
$20,001-$30,000	0	208	0	139	0	103	70
$30,001-$40,000	0	263	0	300	0	247	164
$40,001-$50,000	0	378	0	310	0	324	238
$50,001-$75,000	0	349	0	257	0	283	246
$75,001-$100,000	0	271	0	233	0	207	219
$100,001-Max.	0	172	0	199	0	137	152
All	0	274	0	224	0	204	148

Source: Calculated by Informetrica using SPSD/M.

credit is currently administered, one person receives the GST cheque for the entire family. We have no information about the actual recipient of the cheque. It could be the lower or higher earner, the man or the woman. Therefore, we do not know whether any one person's GST credit would increase or decrease as a result of the reform. A woman receiving a cheque for the full amount of the credit for the couple, $410, might actually end up getting a smaller cheque, for $312, if the policy were administered on an individual basis. All we can determine is the change in the amount of the cheque received by the family as a whole.

It is particularly interesting to compare table 5 with table 1. Administration of the GST credit on an individual basis helps couples in which one partner has low income or no income. Every family who would lose from elimination of the spousal amount would gain from the change in administration of the GST credit. In table 5, as in table 1, those most affected are two-adult families with one primary earner in the middle income range. Two-adult families with children experience, on average, the greatest gains. Two-adult families containing someone over 65 gain relatively more from individual administration of the GST credit, compared with their loss from removal of the spousal amount.

Looking at each family type individually, the greatest gains are in the $40,000-$50,000 income ranges. Single parents and other one-adult households are, for the most part, unaffected by the change. If we look at all families, however, the greatest beneficiaries are in the $50,000-$75,000 income range. This apparently puzzling result arises because lower income ranges contain more single-adult families (either single individuals or single parents), and single-adult families do not gain from administration of the GST credit on an individual basis. Two-adult families in the $50,000-$75,000 income range gain less, on average, than two-adult families in lower income ranges. However, the $50,000-$75,000 income range contains more two-adult families and fewer other family types. Therefore, the average gains, taken over all family types, are higher in this income range. This reasoning explains a similar pattern in tables 1 to 4.

There are differences between the spousal amount and the GST credit, however. For a couple in which the lower earner had no income, an individually administered GST credit would be worth \$205 and the spousal amount \$1,007 (in 2000). For a couple in which the lower earner had \$15,000 of income, the GST credit would be \$312, because of the additional phased-in \$107 supplement. However, this two-income couple would not be able to claim the spousal amount. The fact that many more people would be eligible for an individually administered GST credit than currently claim the spousal amount explains why the average amounts in table 5 are higher, even though the GST credit is worth less than the spousal amount. It also explains why the cost of expanding the GST credit (\$1.7 billion) would exceed the additional tax revenue raised from elimination of the spousal amount (\$1.2 to \$1.5 billion).

The results in table 5 point to a viable way of implementing the commission's recommendations: offset elimination of the spousal amount with enhanced eligibility for the GST credit. This policy has several advantages. The GST credit could be implemented as a refundable credit going directly to the "dependent" spouse and would therefore be more empowering for the recipients. The "marriage penalty" or "togetherness tax" implicit in the current administration of the GST credit would be eliminated. Finally, depending upon how the enhanced GST credit would be designed, the disincentives for labour force participation implicit in the design of the spousal tax credit could be reduced or at least changed.

Further Issues

While a close examination of the GST credit suggests that individual administration is indeed feasible, the whole idea of administering the credit on an individual basis raises further, and fundamental, questions. Why should a person be allowed to qualify for a GST credit at the age of 18 years and not, say, 18 months? Although *Beyond Conjugality* argues for retaining the individual as the basic tax unit, in recognition of individual rights and autonomy, children's lack of autonomy remains unquestioned. Why should children not be entitled to a GST credit based on their own individual income? One might say that it is obvious that parents act in the best interests of their children, but 100 years ago such arguments were frequently made and accepted with respect to husbands acting in the interests of, and for, their wives. The most insidious constraints are those we cannot see, those we accept so unquestioningly that we forget to challenge them.

The focus on the GST credit raises another issue. Why should we choose to reform this credit, with a total program cost of \$2,805 million in 2000,[25] rather than the much larger CCTB (\$6,370 million)? The commission does, in fact, support individual administration of the CCTB,[26] but it shies away from spelling out the full implications of such a change. The reason, I suspect, has to do with differences between formal and substantive equality. In the case of the GST credit, individual administration could plausibly increase both formal and substantive equality. Because all individuals would be treated in the same way, formal equality would be increased. Because married and cohabiting individuals with little income of their own—often women, often the elderly—would have more income under their own control, substantive equality would be enhanced. But with the CCTB, the fit between formal and substantive equality is not so neat. Currently, the CCTB is paid to the primary caregiver, generally assumed to be the mother. Individual administration of the CCTB would likely mean giving half of the 2002 benefits, or $575.50, to each parent rather than $1,151 to the mother. This would mean less money in the hands of women. Formal equality—that is, equal treatment under the law—might suggest individual administration. But if individual administration took money out of the hands of women, it would, arguably, detract from substantive equality. How the commission envisaged dealing with this particular conflict is not obvious.

The GST credit is a fascinating case study because it raises the whole question of how best to design social policy initiatives—how to deliver government subsidies and transfer payments to individuals. The commission argues, quite convincingly, the case for individual administration of the GST credit. Yet the GST credit is not alone in penalizing individuals for forming households. Indeed, the penalty for living with others implicit in the GST credit is small change compared with disincentives for cohabitation implicit in other programs.

Table 6 looks at the situation of the hypothetical Long family. The Longs are typical of new immigrant families in that they are more likely than other Canadians to live as an extended family: the household contains two parents, aged 40 and 35; a grandmother, aged 63; and a son and daughter, aged 5 and 2. They are atypical in that the single earner in the family—the father—is highly successful, with a net income of $85,000 a year. Neither of the other adults in the family have earned income: age, language difficulties, and lack of recognition of foreign credentials make it hard for the grandmother to find work, and the mother has chosen to stay home with the children (a choice made easier by her present lack of qualifications for employment in a decent job in Canada).

Table 6 shows the "togetherness bonus" or "togetherness tax" implicit in various tax-transfer programs. There are a number of points worth noting about this table. First, the togetherness tax associated with the GST credit is one of the smallest in the tax-transfer system, partly because the GST credit is a relatively small program, and partly because the GST credit program allows people living in extended family situations to claim benefits; it is administered on a census family basis.

The largest penalty for living with others, a penalty estimated at $6,000, is contained in the social assistance system. This penalty is real. In 1998-99, one of the main categories of "welfare fraud" in Ontario, accounting for 15 percent of all cases, was the presence of an "undeclared spouse."[27] The second-largest penalty, estimated in this case at nearly $5,000, is due to the administration of the CCTB on a family income basis. The togetherness tax for the GST credit is only $549. If individual administration of the GST credit would cost $1.7 billion, how much would it cost to administer social assistance on an individual income basis? What would be the cost for child benefits?

TABLE 6 Entitlement to Selected Transfers and Benefits for the Hypothetical Long Family, Extended Family Versus Separate Units, 2002 Benefit Levels

	Father	Mother and two children under 7	Grandmother under 65	Total
Goods and services tax credit				
Extended family	nil	nil	$213	$213
Separate units	nil	$549	$213	$762
Togetherness bonus or tax	nil	($549)	nil	($549)
Spousal tax credit (federal)				
Extended family	$1,037	nil	nil	$1,037
Separate units	nil	nil	nil	nil
Togetherness bonus or tax	$1,037	nil	nil	$1,037
Dependent relative tax credits				
All cases	nil	nil	nil	nil
Canada child tax benefit				
Extended family	nil	$156	nil	$156
Separate units	nil	$5,138	nil	$5,138
Togetherness bonus or tax	nil	($4,982)	nil	($4,982)
Social assistance (estimate)[a]				
Extended family	nil	nil	nil	nil
Separate units	nil	nil	$6,000	$6,000
Togetherness bonus or tax	nil	nil	($6,000)	($6,000)

[a] Reliable estimates of social assistance rates are difficult to obtain. The numbers given here for social assistance income are based on 2002 BC rates: $185 monthly allowance for a single employable, plus up to $325 per month shelter allowance. A combined payment of $500 per month is assumed. Child support payments, calculated according to the Department of Justice child support guidelines, would likely be too high for the mother and children to qualify for social assistance payments.

Sources: All tax/benefit parameters are taken from 2002 figures given in Canada, Department of Finance, 2001 Budget, Budget Papers, December 10, 2001, table A2.6. Social assistance estimates are derived from British Columbia, Ministry of Human Resources, *Factsheet*, "BC Employment and Assistance: Shelter Allowance Changes Effective July 1, 2002," May 10, 2002 and *Factsheet*, "BC Employment and Assistance Initiatives Effective April 1, 2002," March 15, 2000 (both available online at http://www.mhr.gov.bc.ca/factsheets/Index.htm).

It is striking that there is only one "togetherness bonus" shown in table 6. Although Mr. Long's income supports four other people, the only substantial tax recognition he receives is the spousal tax credit. Tax benefits for children are income tested; tax credits are available for other dependants only if they qualify by reason of age (65 or older) or disability. Economic dependency in adults should not be promoted. But children's economic dependency is entrenched in our legal system: children are prohibited from working, and parents are legally obligated to support their children. Why, then, can an older adult be claimed as a dependant in situations where a child cannot? It seems that the treatment of dependency in our tax-benefit system needs serious reconsideration. The commission recommended changes in the tax treatment of dependants. It is to this issue that I now turn.

DEPENDENT RELATIVE TAX CREDITS

> Recommendation 20: Parliament should extend the tax credits for dependent relatives so that they can be claimed by any taxpayer who has provided financial or caregiving support to a person who is dependent by reason of age, disability or illness, without reference to relationship status.[28]

The dependent relative tax credits under the present tax system are here taken to include the equivalent-to-married tax credit (federal tax cost of $485 million in 2000),[29] the infirm dependant credit ($7 million), and the caregiver credit ($25 million).[30] The equivalent-to-married credit is available to taxpayers—generally single parents—who cannot claim the spousal tax credit but live with and support a wholly dependent (that is, under 18, over 65, or disabled) child, parent, grandparent, or infirm relative.[31] Caregiver and infirm dependant credits are available to those who live with and support elderly or infirm adult relatives.

The commission suggests modifying the dependent relative tax credits. However, it does not question, in a fundamental way, the notion of dependency underlying the existing tax provisions. The current system of credits is internally inconsistent. A single parent earning $100,000 can claim a child as a dependant using the equivalent-to-married amount. A married or cohabiting parent with the same income cannot. A person over 65 is automatically considered dependent by virtue of age. A person of sound mind and body under 65, no matter how remote his or her employment prospects, is not dependent. These inconsistencies create a horizontally inequitable tax system. In the Long family example above, the father pays almost exactly the same amount in taxes as would a single individual at the same income level. This does not seem fair.

The notion of dependency in the income tax system is also inconsistent with that underlying social assistance and other benefit programs. A person or household with no other source of income can qualify for social assistance, regardless of age or ability. If a person is in need, he or she is eligible for social assistance: need is equated with dependency. For income tax purposes, however, the test for dependency is demographic. An adult is considered a dependant only if he or she is 65 or over, or disabled. A person who is dependent on other family members by virtue of inability to find work because of age, language, or other barriers in the workplace is not classed as a dependant and is given no recognition. In the example of the Long family, this means that the mother and grandmother are ineligible for employment programs, such as language training or job placement assistance, tied to the receipt of social assistance.

Implicitly underlying these inconsistent notions of dependency are different assumptions about how income is shared within families. The benefit system presumes that income is shared within the family. Consequently, members of a family—spouses, children under 18—are not eligible for benefits if their family's income exceeds a specified threshold. The tax system, with the exception of the spousal tax credit, makes no allowance for such sharing. While non-earning family members are denied benefits, family members who are employed receive no tax relief.

Yet the tax system and the benefit system cannot be separated. What matters for people's behaviour, and for people's economic well-being, is the net impact of the tax-benefit system on how much money they have in their purse or their pocket. The real issue is how taxes and benefits together penalize and reward people for their particular choice of living arrangements. In an attempt to focus benefits on the most needy, we have created a tax-benefit system that gives minimal or no help to people who try to provide for each other as an extended family. Given the huge potential savings in benefit payments, such as child benefits and social assistance, that are experienced when family members support each other, it seems prudent to encourage such support in a modest way through the income tax system.

There is, however, a real danger here of wasting time tinkering with a system that is fundamentally flawed. It seems doubtful that we will be able to reform the dependent relative tax credit provisions in a way that does not presume dependency or that encourages autonomy. Perhaps instead of fiddling, we should try a radical reform ("think outside the box"). It is to this alternative idea that I turn in my concluding section.

CONCLUSION: ALTERNATIVE DIRECTIONS FOR POLICY REFORM

Beyond Conjugality examines various components of the tax-transfer system and argues, often convincingly, for moving toward a more individual-based system of entitlement. Yet even if we were to adopt all of the Law Commission's recommendations, individuals would still find themselves penalized or rewarded for entering into various forms of relationships. Social assistance alone contains "togetherness taxes" amounting to thousands or tens of thousands of dollars.

There is one policy reform that would allow for a truly individual-based tax-benefit system: a guaranteed basic income or negative income tax. Under such a program, social assistance and income taxes would be integrated into a single, flat-rate system. François Blais and Jean-Yves Duclos have simulated the effect of a guaranteed income scheme in Quebec.[32] They estimate that it would be possible to guarantee a basic income of $6,500 to each adult, $9,000 to single parents, and $2,730 to each child. The basic guarantee would be received by all individuals, regardless of income or economic status, and would replace social assistance, personal income tax credits, and a variety of other programs. It would be financed by taxing all income earned at a flat rate of 60 percent. While this rate may seem high, it is lower than the effective marginal tax rates currently faced by low-income Canadians struggling to get off social assistance—rates that often reach 80 to 100 percent, or possibly higher. Blais and Duclos estimate that, given an economic growth rate of

APPENDIX

TABLE A1 Administration of Goods and Services Tax (GST) Credit on an Individual Basis, Average Increase in Transfers Received, 2002 Parameter Values, Elimination of GST Credit Phase-In

	Economic family type						
Base total income group	With kids, 1 adult	With kids, 2+ adults	With elderly, 1 adult	With elderly, 2+ adults	Other, 1 adult	Other, 2+ adults	All
Min.-$10,000	0	231	103	243	93	214	111
$10,001-$20,000	0	211	3	170	16	201	38
$20,001-$30,000	0	209	0	221	4	195	104
$30,001-$40,000	0	267	1	362	2	318	193
$40,001-$50,000	0	382	0	351	0	378	261
$50,001-$75,000	0	353	0	293	0	324	264
$75,001-$100,000	0	274	0	262	0	233	234
$100,001-Max.	0	176	0	231	0	157	165
All	0	278	3	281	20	254	173

Source: Calculated by Informetrica using SPSD/M.

around 2.5 percent per year, the tax rate needed to finance this guaranteed basic income system would fall to 45 percent in less than 10 years.

The guaranteed basic income system would be completely individual-based. No adult would be presumed to be dependent on anyone else; there would be no special allowances for spouses, and no taxes or bonuses associated with forming a family. The system would allow all individuals autonomy and be completely neutral with respect to people's choices of personal living arrangements. If we can think about what is wrong with the idea of a guaranteed basic income, we may gain some insights into why we have created the present system—and what are the real obstacles to change.

NOTES

1 Law Commission of Canada, *Beyond Conjugality: Recognizing and Supporting Close Personal Adult Relationships* (Ottawa: Public Works and Government Services, 2001).

2 For other work in this area, see Kathleen A. Lahey, *The Benefit/Penalty Unit in Income Tax Policy: Diversity and Reform* (Ottawa: Law Commission of Canada, September 2000), and Claire Young, *What's Sex Got To Do with It? Tax and the "Family"* (Ottawa: Law Commission of Canada, May 2000).

3 Supra note 1, at 71.

4 Ibid., at 73-74.

5 Ibid., at 77.

6 Ibid., at 82 and 87.

7 Michael Krashinsky and Gordon Cleveland, *Tax Fairness for One-Earner and Two-Earner Families: An Examination of the Issues*, CPRN Discussion Paper no. F07 (Ottawa: Canadian Policy Research Networks, 1999).

8 Carole Vincent and Frances Woolley, "Taxing Canadian Families: What's Fair, What's Not" (2000) vol. 6, no. 5 *Choices* 3-42.

9 Supra note 1, at 77.

10 Ibid., at 74.

11 Ibid., at 75.

12 Ibid., at 77.

13 See Ken Battle and Michael Mendelson, eds., *Benefits for Children: A Four Country Study* (Ottawa: Caledon Institute of Social Policy, January 2001).

14 Supra note 1, at 76.

15 Ibid., at 76-77.

16 SPSD/M calculates provincial taxes using the "tax-on-base" method, with separate spousal amount parameters for each province. This study made no adjustment of provincial tax parameters.

17 Supra note 1, at 77.

18 This amount was calculated on a trial-and-error basis, by varying the base CCTB parameter in SPSD/M (FCBBAS) until revenue balance (to the nearest $100,000) was obtained.

19 Canada, Department of Finance, *Tax Expenditures and Evaluations 2001* (Ottawa: Department of Finance, 2001).

20 Same-sex couples are not identified as such in the SPSD/M database. It is possible to identify probable same-sex couples by using demographic profiling, as described in Lahey, supra note 2. Once 2001 income tax records are added to the database, however, it will be possible to identify same-sex couples who self-declare as common law married.

21 It is not obvious why one-adult families with children gain, on average, less than $306.

22 The calculation assumes a base benefit of $1,151, the actual 2002 number (Canada, Department of Finance, 2001 Budget, Budget Plan, December 10, 2001); a 5 percent tax-back rate for a two-child family; and a threshold for tax-backs of $32,960. It is also assumed that the family is not eligible for the supplement for children under the age of seven.

23 Supra note 1, at 82.

24 The results on a census family basis are very similar and are available on request.

25 See *Tax Expenditures and Evaluations 2001*, supra note 19.

26 Supra note 1, at 79.

27 Ontario, Ministry of Community and Social Services, *Making Welfare Work: Report to Taxpayers on Welfare Reform* (Toronto: Queen's Printer for Ontario, 2000) (available online at http://www.gov.on.ca/CSS/page/brochure/makingwelfarework.html#We're_Cracking). The single largest reason for termination of welfare payments, accounting for 34 percent of cases, was incarceration.

28 Supra note 1, at 73.

29 See *Tax Expenditures and Evaluations 2001*, supra note 19.

30 Supra note 1, at 72.

31 Ibid.

32 François Blais and Jean-Yves Duclos, *Le Revenu de Citoyenneté : Revue des écrits et consultation des experts* (Québec: Remis au Fonds Québécois de la Recherche sur la Société et la Culture, septembre 2001) (available online at http://www.fqrsc.gouv.qc.ca/programmes/pdf/rapcitoyen.pdf).