
Policy Forum: Liability Without Control—The Curious Case of Pension Income Splitting

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ABSTRACT

Canadian pensioners are now allowed to split income from an employer pension and, in the case of people 65 and older, income from a registered retirement income fund, a registered retirement savings plan (RRSP) annuity, and some other forms of annuity. In this commentary, I argue that pension income splitting has no efficiency benefits and involves significant revenue sacrifices. From an equity perspective, pension income splitting benefits some of the least needy taxpayers in Canadian society and inhibits equality between men and women. Administratively, pension income splitting under the current rules is inferior to a number of other methods of achieving the same distributional outcomes; in particular, it imposes tax liabilities on the lower-income spouse, who may lack the means to pay those liabilities. There are better ways of achieving the government's goals, such as allowing for retroactive conversion of personal to spousal RRSPs or transferring basic rate tax room as opposed to tax liabilities. There are also better ways of spending money on older Canadians—for example, expanding the reach of the guaranteed income supplement.

KEYWORDS: PENSIONS ■ TAX POLICY ■ FAMILY

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INTRODUCTION

Recent tax changes have been generous to Canadians 65 and older. On October 31, 2006, the Harper government announced that couples would be allowed to “split” pension income.¹ Specifically, income from an employer pension and, for people 65 and older, income from a registered retirement income fund (RRIF), a registered retirement savings plan (RRSP) annuity, and some other forms of annuity could be transferred, for tax purposes, between spouses. At the same time, the “age amount” tax credit would be increased by \$1,000. The 2007 budget reiterated these announcements and also proposed to increase the registered pension plan (RPP) and RRSP age limit from 69 to 71.² Legislation implementing these proposals was enacted in June 2007, applicable to the 2007 and subsequent taxation years.³

This is, in some respects, a puzzling set of initiatives. In a country where mandatory retirement and other age-based tests are being challenged in the courts, and in many cases phased out, why add new age-based tax provisions? In a world where individual taxation is increasingly the norm, why permit the division of pension income? The measures were justified on the grounds of need and deservedness: “[S]eniors on a fixed income are often forced to make choices to get by”; Canadian seniors “earned and deserve every penny.”⁴ Yet there are many other ways to help seniors—for example, increasing home-care services for those who are elderly and living alone. Why this particular set of initiatives?

1 Canada, Department of Finance, “Canada’s New Government Announces Tax Fairness Plan,” *News Release* 2006-061, October 31, 2006, and accompanying Backgrounder.

2 Canada, Department of Finance, 2007 Budget, Budget Speech, March 19, 2007, 14.

3 SC 2007, c. 29; given royal assent June 22, 2007; amending the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”).

4 *Supra* note 2, at 14.

Pension income splitting was introduced as part of a package of policies that included the taxation of income trusts. Taxing trusts broke the Conservatives' campaign promise to "[s]top the Liberal attack on retirement savings and preserve income trusts by not imposing any new taxes on them."⁵ When the erosion of tax revenues induced the government to act on income trusts, it needed to compensate voters—particularly retirees—who could be hurt by that decision. Pension income splitting was the outcome of a political calculus—a calculus no doubt influenced by persistent and effective seniors' lobby groups such as CARP (Canada's association for the 50-plus) and the Common Front for Pension Splitting (now renamed the Common Front for Retirement Security).

Income splitting is also a personal priority of many in the Conservative Party. For example, in 1999 Jason Kenney, while in Opposition, moved in the House of Commons that "the federal tax system should be reformed to end discrimination against single income families with children."⁶ The Liberal government responded to the motion by striking a subcommittee of the Standing Committee on Finance to report on tax equity for families with children. The subcommittee examined the option of income splitting and rejected it for a number of reasons: the revenue cost, the failure of income splitting to recognize the value of unpaid work, and the work disincentives that joint taxation creates for second earners.⁷ Pension income splitting may be a test of the political, economic, and administrative feasibility of splitting other forms of income, the first step toward adoption of the cohabiting couple as the tax unit.

In this commentary, I will describe the age-related tax measures introduced by the new legislation and explore their rationale. I will then examine the arguments for and against income splitting, challenge the age threshold, and set out a number of alternative policy options. I will argue that, on the basis of what is known about joint taxation and about Canadians' savings behaviour, pension income splitting has no efficiency benefits and involves significant revenue sacrifices. From an equity perspective, pension income splitting benefits some of the least needy individuals in Canadian society and inhibits equality between men and women. Moreover, pension income splitting under the current rules could create serious administrative problems. A significant concern is the transfer of tax liabilities to the lower-income spouse, but not the income to pay the taxes. I will argue that there were, and are, better ways of achieving the government's goals, such as allowing for retroactive conversion of personal to spousal RRSPs or transferring tax room as opposed to tax liabilities. There are also better ways of spending money on older Canadians, such

5 Conservative Party of Canada, *Stand Up for Canada: Conservative Party of Canada Federal Election Platform 2006* (Ottawa: Conservative Party of Canada, 2006), 32.

6 Canada, House of Commons, *Debates*, March 4, 1999, 12, 404.

7 Canada, House of Commons, Standing Committee on Finance, *For the Benefit of Our Children: Improving Tax Fairness*, Nineteenth Report of the Standing Committee on Finance, Subcommittee on Tax Equity for Canadian Families with Dependent Children, 36th Parl., 1st sess., June 1999.

as expanding the reach of the guaranteed income supplement (GIS), rethinking the clawback of old age security (OAS), targeting resources to the “old-old” (say, those over 80), or introducing tax-prepaid savings plans.

AGE-RELATED TAX MEASURES IN THE 2007 FEDERAL BUDGET

Pensioners often pay high effective marginal tax rates. As well as paying the same income taxes as employed individuals, people 65 and older often face additional “stealth taxes” in the form of loss of income-tested benefits.⁸ Taxbacks of the age amount tax credit, OAS, and GTS can add between 3 and 50 percentage points to the standard marginal tax rates.

Income splitting is a way of reducing tax liabilities when one spouse pays a higher marginal tax rate than the other—for example, because of the taxback of OAS. Some of the higher-rate spouse’s income can be taxed at the lower-rate spouse’s marginal tax rate, thus saving taxes. It is useful to distinguish here between income splitting and joint taxation. Joint taxation aggregates incomes (of spouses or an entire family) and taxes the aggregate as one unit. Joint taxation does not necessarily result in tax savings for families or households. Whether or not joint taxation is advantageous depends upon the joint taxation schedule. Where a family faces the same tax schedule as a single individual, joint taxation will generally result in higher tax liabilities. A couple who earn \$50,000 each will generally pay more taxes if they are taxed as a single unit with income of \$100,000 than they will pay if they are taxed individually. Only if the joint rate schedule is generous, allowing some measure of income splitting, will couples save from being taxed as a single unit. There are elements of joint taxation within the current income tax system, such as the calculation of child tax benefits on the basis of family income.

Limited income splitting has been available to Canadians for some time through spousal RRSPs, registered education savings plans (RESPs), employment of a spouse or child in a family business, or the sharing of Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) income. But there is a fundamental difference between the income-splitting measures introduced in 2007 and other, established measures. Every one of the established measures requires some sort of monetary transfer. With the new income-splitting provisions, the higher-income spouse is not required to transfer control over income or assets to the lower-income spouse. The transfer is a purely nominal or notional transfer for income tax purposes only:

Canadian residents who receive income that qualifies for the existing pension income tax credit will be permitted to allocate to their resident spouse (or common-law partner) up to one-half of that income.⁹

8 See Alan Macnaughton, Thomas Matthews, and Jeffrey Pittman, “‘Stealth Tax Rates’: Effective Versus Statutory Personal Marginal Tax Rates” (1998) vol. 46, no. 5 *Canadian Tax Journal* 1029-66.

9 Canada, Department of Finance, “Tax Relief for Canadian Seniors” (online: http://www.fin.gc.ca/pensioncalc/factsheet_e.html).

These “phantom transfers” create real tax liabilities for the lower-income spouse. What happens if the lower-income spouse does not have the wherewithal to pay an increased tax liability? The legislation relies upon the ability of couples to negotiate some agreement:

For income tax purposes, the amount allocated will be deducted in determining the income of the person who actually received the pension income and included in computing the income of the person to whom some or all of the pension income is allocated. Since it will in many cases increase the transferee’s tax payable, both persons must agree to the allocation in their tax returns for the year in question.¹⁰

To the extent that pension income splitting changes the way that taxable income is calculated, it will have a knock-on effect on provincial tax liabilities, since the federal-provincial tax collection agreements require provinces to use the federal definition of taxable income.¹¹

The reaction to the pension income-splitting announcements was broadly positive. But any form of tax reduction would likely have generated positive reaction. The need and worthiness of seniors has to be set against the merits of other options. Finance Minister Jim Flaherty expressed it nicely in the budget speech:

There were many personal tax relief options we could have pursued in this budget. We made a choice.¹²

But was pension income splitting the right choice to make?

THE EFFICIENCY CASE AGAINST INCOME SPLITTING

Income splitting is generally agreed to be inefficient; however, almost all of the studies of income splitting to date have only considered the taxation of earnings or labour income. The argument against income splitting is straightforward. Taxes distort economic choices, and the more responsive that people’s choices are to economic incentives—that is, the greater the elasticity of supply or demand—the greater will be the distortion associated with any set of taxes. Since female labour supply is more elastic than male labour supply, efficiency requires that women’s earnings should be taxed at a lower rate. With income splitting, the first dollar that a married (or cohabiting) woman earns is taxed at her husband’s (usually higher) marginal tax rate, given that social norms dictate that men are generally seen as “primary” wage earners and women as “secondary” wage earners. By raising marginal tax rates on relatively elastic forms of labour supply, income splitting distorts

10 Ibid.

11 Canada, Department of Finance, “Federal Administration of Provincial Taxes” (online: <http://www.fin.gc.ca/fapt/fapt1e.html>).

12 *Supra* note 2, at 13.

and discourages female labour supply.¹³ For example, Crossley and Jeon found a significant increase in female labour force participation when the 1988 tax reforms reduced the “jointness” of the Canadian tax system.¹⁴

More recent research has recognized that taxes distort both labour supply and household production decisions.¹⁵ The optimal policy response is to balance these two distortions by a system that blends elements of joint and individual taxation.¹⁶ For example, Kleven, Kreiner, and Saez find that optimality requires a combination

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- 13 Michael J. Boskin and Eytan Sheshinski, “Optimal Tax Treatment of the Family: Married Couples” (1983) vol. 20, no. 3 *Journal of Public Economics* 281-97. At various times, there has also been concern with “marriage taxes” and the neutrality of the tax system with respect to marriage; see, for example, Alicia H. Munnell, “The Couple Versus the Individual Under the Federal Personal Income Tax,” in Henry J. Aaron and Michael J. Boskin, eds., *The Economics of Taxation* (Washington, DC: Brookings Institution, 1980), 247-78. In Canada, such considerations are relevant primarily in the design of programs such as the child tax benefit, where the decision to cohabit can result in a loss of benefits that are a significant fraction of (sometimes very low) household income.
- 14 Thomas F. Crossley and Sung-Hee Jeon, *Joint Taxation and the Labour Supply of Married Women: Evidence from the Canadian Tax Reform of 1988*, Social and Economic Dimensions of an Aging Population Research Paper 149 (Hamilton, ON: McMaster University, 2006). A wide range of studies have confirmed the negative effect of income splitting on female labour supply: Viktor Steiner and Katharina Wrohlich, “Household Taxation, Income Splitting and Labor Supply Incentives—A Microsimulation Study for Germany” (2004) vol. 50, no. 3 *CESifo Economic Studies* 541-68; S. Gustafsson, “Separate Taxation and Married Women’s Labor Supply: A Comparison of West Germany and Sweden” (1992) vol. 5 *Journal of Population Economics* 61-85; Jan Dirk Vlasblom, Peter De Gijssel, and Jacques Siegers, “Taxes, Female Labour Supply and Household Income: Differences Between the Netherlands and the Federal Republic of Germany” (2001) vol. 33, no. 6 *Applied Economics* 735-44; Jane Leuthold, “Income Splitting and Women’s Labor-Force Participation” (1984) vol. 38, no. 1 *Industrial and Labor Relations Review* 98-105; Sara LaLumia, *The Effects of Joint Taxation of Married Couples on Labor Supply and Non-Wage Income*, College of William and Mary, Department of Economics Working Paper 28 (Williamsburg, VA: College of William and Mary, March 2006) (online: http://www.wm.edu/economics/wp/cwm_wp28.pdf); and Nina Smith, Shirley Dex, Jan Dirk Vlasblom, and Tim Callan, “The Effects of Taxation on Married Women’s Labour Supply Across Four Countries” (2003) vol. 55, no. 3 *Oxford Economic Papers* 417-39. Very few studies find opposing conclusions, although Irene Dingeldey, “European Tax Systems and Their Impact on Family Employment Patterns” (2001) vol. 30, no. 4 *Journal of Social Policy* 653-72, argues that other factors, such as availability of child care, are relatively more important than income taxation in determining female labour supply, and Steiner and Wrohlich, *supra*, note that some studies have ignored the negative effects of separate taxation on male labour supply.
- 15 John Piggott and John Whalley, “The Tax Unit and Household Production” (1996) vol. 104, no. 2 *Journal of Political Economy* 398-418; and Patricia F. Apps and Ray Rees, “Individual Versus Joint Taxation in Models with Household Production” (1999) vol. 107, no. 2 *Journal of Political Economy* 393-403.
- 16 See also Craig Brett, “Optimal Nonlinear Taxes for Families” (2007) vol. 14, no. 3 *International Tax and Public Finance* 225-61; and Patricia Apps and Ray Rees, *The Taxation of Couples*, Institute for the Study of Labour Discussion Paper no. 2910 (Bonn: Institute for the Study of Labour, July 2007).

of joint and separate taxation, such as family-based transfers combined with individual income taxation, which is essentially what Canada has at present.¹⁷

The various studies on the effects of income splitting on labour supply have some relevance to the efficiency of splitting pension income, in that pensions are in some sense a deferred salary payment. However, the more direct efficiency impacts of pension income splitting would be on savings. Very little is known about the efficiency impacts of joint taxation of capital or investment income, despite the vast literature on the effects of taxation and social security on savings.¹⁸ (One exception is Stephens and Ward-Batts, who found that, when the United Kingdom moved from a joint to an individual tax system in the 1990s, there was a transfer in asset ownership from husbands to wives.¹⁹ However, changes in asset ownership can be viewed as distributional impacts rather than efficiency impacts.)

At least conceptually, the arguments against joint taxation of labour income carry over to joint taxation of capital income. Unfortunately, there are no data. Almost all studies of wealth and asset holding are carried out at a household level and do not distinguish between men's and women's savings. There is some evidence that households in which women's earnings constitute a greater portion of the household income save less,²⁰ but this may be explained by the higher costs of running a household when both spouses work outside the home. My own work and other research finds that households in which women control the family finances save less; however, it could be that women are more likely to have financial control in households with low net worth.²¹ Lundberg and Ward-Batts find a positive relationship between net worth and wives' relative education and age, and conclude that "long-term relative bargaining power of wives [has] a positive effect on the household's wealth."²² However, given that they also find a negative relationship between wives' share of earnings and savings rates, this conclusion seems stronger than is supported by the data.

17 Henrik Jacobsen Kleven, Claus Thustrup Kreiner, and Emmanuel Saez, *The Optimal Income Taxation of Couples*, CEPR Discussion Paper no. 5978 (London: Centre for Economic Policy Research, December 2006).

18 B. Douglas Bernheim, "Taxation and Saving," in Alan J. Auerbach and Martin Feldstein, eds., *Handbook of Public Economics*, vol. 3 (Amsterdam: Elsevier, 2002), 1173-1249.

19 Melvin Stephens Jr. and Jennifer Ward-Batts, "The Impact of Separate Taxation on the Intra-Household Allocation of Assets: Evidence from the UK" (2004) vol. 88, nos. 9-10 *Journal of Public Economics* 1989-2007.

20 Martin Browning, "Saving and the Intra-Household Distribution of Income: An Empirical Investigation" (1995) vol. 49, no. 3 *Ricerche Economiche* 277-92; and Shelly J. Lundberg and Jennifer Ward-Batts, *Saving for Retirement: Household Bargaining and Household Net Worth*, Discussion Papers in Economics at the University of Washington no. 0026 (Seattle: University of Washington, January 2000) (online: <http://ideas.repec.org/p/fth/washer/0026.html>).

21 Shelley Phipps and Frances Woolley, "Control Over Money and the Savings Decisions of Canadian Households," *The Journal of Socio-Economics* (forthcoming); and John Gibson, Trinh Le, and Grant Scobie, "Household Bargaining Over Wealth and the Adequacy of Women's Retirement Incomes in New Zealand" (2006) vol. 12, nos. 1-2 *Feminist Economics* 221-46.

22 Lundberg and Ward-Batts, *supra* note 20, abstract.

From the perspective of economic efficiency, what matters is the relative *responsiveness* of men and women to savings incentives, and this we just don't know. However, from what we do know about the sensitivity of RRSP savings to tax rates in general, it is probably safe to conclude that pension income splitting will have minimal effects on savings. Canadian studies suggest that tax-assisted retirement savings plans in general have had little effect on overall savings, and changes in tax rates have only a small effect on RRSP savings.²³ The average person's lifetime earnings are simply not high enough to provide the basis for substantial capital investments. In 2004, for example, the average 65-plus male taxfiler had less than \$10,000 in "other pension or superannuation" income, and the average female less than \$4,000.²⁴ At these income levels, income splitting doesn't matter.

One reading of the literature brings us to a positive conclusion: since marginal tax rates have little effect on RRSP savings, pension income splitting will not have large efficiency costs. However, pension income splitting is unlikely to create any efficiency gains. And it will be expensive, involving revenue losses of \$675 million in 2007-8 and higher amounts in subsequent years.²⁵ This revenue loss requires some justification. If not efficiency, then perhaps equity?

PENSION INCOME SPLITTING IS INEQUITABLE

When the pension income-splitting provisions were first announced, they were justified as a reasonable recognition of income transfers and sharing within families:

Canada's income tax system generally requires each individual taxpayer to report and pay tax on all of the income they earn. This is the case even if the individual, like many Canadians, actually uses much of their income to support other family members.²⁶

There has been a long and extensive debate in Canada on the best way of recognizing family ties in income tax legislation, dating back to the introduction of the original Income War Tax Act.²⁷

23 John Burbidge, Deborah Fretz, and Michael R. Veall, "Canadian and American Saving Rates and the Role of RRSPs" (1998) vol. 24, no. 2 *Canadian Public Policy* 259-63; John Sabelhaus, "Public Policy and Saving in the United States and Canada" (1997) vol. 30, no. 2 *Canadian Journal of Economics* 253-75; Michael R. Veall, "Did Tax Flattening Affect RRSP Contributions?" (2001) vol. 34, no. 1 *Canadian Journal of Economics* 120-31; and Kevin Milligan, "Tax-Preferred Savings Accounts and Marginal Tax Rates: Evidence on RRSP Participation" (2002) vol. 35, no. 3 *Canadian Journal of Economics* 436-56.

24 See table 1 in the section "Alternative Policy Options" below.

25 See Backgrounder, *supra* note 1, at 6.

26 *Ibid.*, at 5.

27 For a good survey and overview of the literature, see Pooja Samtani, "Facts and Fallacies of Conjugality: The Attribution Rules Revisited" (University of Waterloo, 2006) (online: http://accounting.uwaterloo.ca/mtax/SamtaniP_ResearchPaper.pdf).

I have set out in an earlier article the horizontal equity grounds against income splitting in general.²⁸ First, income splitting between husbands and wives is an ineffective way of recognizing family ties because it does not target people with caregiving responsibilities. The new, non-refundable \$2,000 child tax credit announced in the 2007 budget is a much better way of recognizing caregiving, since it is a benefit explicitly tied to the presence of children. Second, because work done by at-home spouses is valuable and contributes greatly to a family's well-being, a family with one person earning \$100,000 and an at-home spouse has a higher standard of living than a family where two people work full-time to each earn \$50,000. Fairness dictates that the single-earner household, being better off, should pay more taxes. This is accomplished with individual taxation, but not with joint taxation. However, as is the case for efficiency, the arguments against splitting labour income do not obviously apply to pension income splitting. So, for example, Kesselman, in a paper that is otherwise largely critical of income splitting, makes a horizontal equity case for allowing some pension income splitting.²⁹ In this section, I will discuss the equity of Canada's new pension income-splitting provisions.

Income Splitting Is Regressive

The first equity argument against income splitting is based on vertical equity: high-income people benefit the most. David Dodge made this point in 1988 (when he was senior assistant deputy minister of finance) in defence of the Mulroney government's decision to introduce more stringent attribution rules:

It is true that there are relatively few Canadian taxpayers who have sufficient liquid assets at their disposal to enable them to divert substantial amounts of income to members of their families. It is true that only the most wealthy Canadian taxpayers can benefit substantially from income splitting. But these few are precisely the ones for whom the attribution rules have been designed—in order to ensure that they bear their fair share of the tax burden, in accordance with our rules of progressive income taxation. And let us not be naive; clearly this group is not so small as to be insignificant.³⁰

The tax savings from pension income splitting plateau when one spouse has eligible pension income of around \$125,000 and the other has no pension income. In this case, if each spouse pays tax on half of the income, they can entirely avoid any claw-back of OAS. Additional savings are generated by shifting income from the highest

28 Carole Vincent and Frances Woolley, "Taxing Canadian Families: What's Fair, What's Not" (2000) vol. 6, no. 5 *Choices* 1-44.

29 Jonathan Kesselman, "Taxing Couples: Is Income Splitting Fair?" prepared for the Institute for Research on Public Policy, Montreal, preliminary draft June 22, 2007.

30 William J. Strain, David A. Dodge, and Victor Peters, "Tax Simplification: The Elusive Goal," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 4:1-63, at 4:39.

(29 percent) or second-highest (26 percent) federal tax brackets to the lowest (15.25 and 22 percent),³¹ faced by the lower-income spouse. The Department of Finance estimates that the total tax savings from pension income splitting are \$7,280 in 2007 for a couple where one spouse has \$100,000 in pension income and the other none.³² Kesselman computes a maximum \$9,017 gain from complete income splitting received by households with income over \$242,000 per year, all of which is received by one spouse.³³

Yet it is hard to make an equity case for transferring income between pensioners with incomes above \$100,000, or between pensioners at all. The claim that “seniors on a fixed income are often forced to make choices to get by”³⁴ reflects a stereotype that does not stand up to sustained scrutiny. The percentage of Canadians 65 and over with low income is just 6.1 percent, or almost half the 11.7 percent rate of low income experienced by children under 18.³⁵ Senior couples are less likely to have low incomes than any other demographic group, with a low income rate of 1 to 2 percent. Pendakur shows that when the value of owner-occupied housing is taken into account, the relative position of the elderly is further enhanced.³⁶ If our equity goals are to reduce poverty or income inequality, there are better ways to spend money than on pension income splitting.

Single Versus Married Pensioners

One possible equity argument for income splitting is that couples share. It is presumably appropriate when “the individual, like many Canadians, actually uses much of their income to support other family members.”³⁷ Indeed, treating married couples as a single tax unit seems, on the surface, to be consistent with modern norms of sharing and economic partnership within marriage, as well as with provincial family laws that require equal division of marital assets when couples divorce. Quebec, with its civil-law tradition, has always taken the view that marital property is owned jointly by both spouses. In the rest of Canada, the doctrine of constructive trust has been used to establish a right to marital property among common-law, as well as

31 These are the basic rates set out in schedule 1 of the Canada Revenue Agency's 2006 T1 tax return.

32 Canada, Department of Finance, “Senior's Tax Savings Calculator” (online: http://www.fin.gc.ca/pensioncalc/sentaxcal_e.html).

33 *Supra* note 29.

34 *Supra* note 2, at 14.

35 Data for 2005, taken from Statistics Canada, *Income in Canada*, catalogue no. 75-202-X: “Persons in Low Income After Tax, by Prevalence in Percent.”

36 Krishna Pendakur, “Consumption Poverty in Canada, 1969 to 1998” (2001) vol. 27, no. 2 *Canadian Public Policy* 125-49.

37 *Supra* note 26.

same-sex, couples.³⁸ If the basis of our family law is the presumption that all assets are joint, then logically we should tax couples jointly on the basis of their total assets.

However, joint taxation is not the same as income splitting. “Equivalence scales” are a way of comparing the cost of achieving a given standard of living for different types of households. Income splitting assumes an equivalence scale of 2.0; that is, a single person with an income of \$30,000 pays the same tax rate as a couple with an income of $2.0 \times \$30,000$, or \$60,000. However, studies of consumption patterns find that a Canadian childless couple needs about \$1.34 to every dollar of income for a single person in order to achieve the same standard of living.³⁹ Even if we take a more conservative estimate, such as a 1.4 equivalence scale, this means that a couple with an income of \$42,000 has the same standard of living as a single person on \$30,000.

If we take the position that a married or common-law couple is a unit, fairness dictates that, because a couple with pension income of \$60,000 is better off than two single people with an income of \$30,000 each, the couple should pay more taxes—not the same taxes, as occurs with income splitting. The fact that, with income splitting, cohabiting couples are taxed advantageously relative to comparably situated other households—parent-child households, sibling households, or single individuals—is inequitable.

But taxing married couples more than singles would create a cohabitation penalty—or, in more politically persuasive rhetoric, a marriage penalty.⁴⁰ Two people with equal incomes would find their tax liabilities increased upon marriage, much as two individuals can lose goods and services tax credits when forming a household. Increasing the marriage penalty is unlikely to be politically acceptable.

The pensioners most at risk of poverty are single women: 20 percent of single women over 65 are in low-income situations. While the poverty rate for single elderly women is much lower than that for single women under the age of 65 (37 percent) or female single parents (33 percent),⁴¹ it is still high enough to be of policy concern. When couples are allowed to split pension income, the neediest pensioners—single women—gain nothing.

Nominal Transfers Discourage Real Equality

Nominal or *notional* splitting of pension income (the form introduced in the new legislation) discourages real transfers of ownership and control. Philipps has surveyed the literature and set out the arguments for recognizing transfers of property

38 Nicholas Bala, “Controversy over Couples in Canada: The Evolution of Marriage and Other Adult Interdependent Relationships” (2003) vol. 29, no. 1 *Queen’s Law Journal* 41-102.

39 Pendakur, *supra* note 36.

40 See, for example, “Tax Relief for Families and Businesses,” pamphlet released with the 2007 federal budget, *supra* note 2.

41 Statistics Canada data for 2005, *supra* note 35.

between spouses: “promoting the autonomy of individuals, encouraging the redistribution of property within relationships, taxing individuals only on income they earn or control, and valuing care work.”⁴²

Historical evidence suggests that tax regimes do affect women’s access to marital property. When the United States introduced notional income splitting at the federal level in 1948, a number of jurisdictions that had adopted community property family-law regimes—regimes that had tax advantages but also gave women a claim on marital assets—reverted to the common-law tradition, under which men controlled the bulk of marital property. As McCaffery described the changes, “[a]ll income was now *deemed* to be split between spouses, for tax purposes, without the unpleasant pressure to *actually* split it, for non-tax purposes.”⁴³

Evidence also suggests that, even if some income is shared within the family, women’s control over income matters. Burton, Phipps, and Woolley⁴⁴ examine spending patterns of retired couples where the wife is under 65, and thus not eligible for OAS, and retired couples where the wife is 65 to 69, and hence receives OAS. We find that there is a real change in household spending patterns when women are entitled to OAS income, even controlling for work status and household income; in particular, more is spent on gifts and charitable donations. Having income of one’s own has a real and measurable impact.

One case for pension income splitting is that, since CPP income can be split and RRSPs can be split (through spousal RRSPs), it is only fair to allow the splitting of other forms of pension income. Yet the form of pension income splitting that the government has chosen to introduce is fundamentally different from CPP income splitting or spousal RRSPs. *Tax liabilities are transferred, but not control over assets.* Splitting eligible pension income does not have any effect on how or to whom the pension income is paid. The only additional funds that may flow directly to pension transferees as a result of pension income splitting are, possibly, some income tax refunds, since income tax that is withheld at source will have to be allocated in the same proportions as pension income.⁴⁵

As I will argue below, there is a case for moving closer to a truly individual-based tax system, relaxing the attribution rules, and permitting or encouraging more real transfers of property. By discouraging real transfers, nominal income splitting reinforces inequalities within the household. In addition, as discussed below, phantom transfers with the potential to create real tax liabilities give rise to a number of administrative problems.

42 Lisa Philipps, “Cracking the Conjugal Myths: What Does It Mean for the Attribution Rules?” (2002) vol. 50, no. 3 *Canadian Tax Journal* 1031-39, at 1034.

43 Edward J. McCaffery, *Taxing Women* (Chicago: University of Chicago Press, 1997), 54.

44 Peter Burton, Shelley Phipps, and Frances Woolley, “Inequality Within the Household Reconsidered,” in John Micklewright and Stephen Jenkins, eds., *Inequality and Poverty Re-Examined* (Oxford: Oxford University Press, forthcoming).

45 Canada Revenue Agency, “Pension Income Splitting” (online: <http://www.cra-arc.gc.ca/agency/budget/2007/pension-e.html>).

ADMINISTRATIVE PROBLEMS

Generally, the pension income-splitting provisions apply where a pensioner and a pension transferee jointly elect to split pension income.⁴⁶ The rules also establish the liability for taxes payable on the transferred amount.⁴⁷ There are several concerns about the application and administration of these provisions in their present form.

Liability for Payment of Taxes

The new rules make Canada's system more like that of the United States in providing that spouses are jointly and severally liable for tax owing on amounts notionally transferred under the pension income-splitting provisions. When couples are jointly liable for taxes, what happens if one spouse fails to report income or claims fraudulent deductions and then becomes "difficult to locate"? In the United States, spouses can avoid liability for the taxes owing in such cases by making an "innocent spouse" claim. About 50,000 innocent spouse claims are made to the Internal Revenue Service each year, "making the IS [innocent spouse] relief under section 6015 arguably the most frequently litigated issue in the Code."⁴⁸

Canada's pension income-splitting legislation provides that "[a] joint election is invalid if the Minister establishes that a pensioner or a pension transferee has knowingly or under circumstances amounting to gross negligence made a false declaration in the joint election."⁴⁹ As in the United States, understating income or overstating deductions would be grounds for revoking pension income splitting.

There are, however, significant gaps in the protection of pension transferees under the existing provisions. Given the joint and several liability requirements, if the tax owing is not paid, presumably the Canada Revenue Agency (CRA) will first attempt to recover the funds from the pension transferee, who may have few or no assets of her own. There do not appear to be any provisions allowing the transferee to revoke a joint declaration if the transferor does not pay taxes owing. It is unfortunate that more consideration was not given to other models of income splitting, such as transferring basic rate tax room or allowing, as for CPP/QPP, real (as opposed to phantom) income transfers. Either of these measures would have avoided the innocent spouse administrative problem.

Takeup

If the grounds for income splitting are that couples generally share their income, it is not clear why couples must apply for income splitting, or why they are allowed to

46 Section 60.03.

47 Subsection 160(1.3).

48 Richard C.E. Beck, "The Failure of Innocent Spouse Reform" (2006/7) vol. 51 *New York Law School Law Review* 930-55, at 931. See also Gary Fleischman and Sean Valentine, "Professionals' Tax Liability Assessments and Ethical Evaluations in an Equitable Relief Innocent Spouse Case" (2003) vol. 42, no. 1 *Journal of Business Ethics* 27-44.

49 Subsection 60.03(4).

choose how much income to split. Kesselman discusses this issue and points out that determining the optimal income split can be complex: in some cases, it may be optimal for a lower-income spouse to shift income to a higher-income spouse in order to reduce the couple's total OAS clawback.⁵⁰ If pension income splitting is in fact a desirable goal, why would the government design and administer the provision in a way that runs the risk that infirm or ill-informed individuals may not utilize it, or may not use it in the most advantageous way?

Takeup is not a trivial issue. A study of GIS income assistance using 2000 data found that at most 86 percent of those eligible for the GIS actually applied for and received it.⁵¹ And the GIS is a generous, well-known, and well-established program with a simple application procedure. Given that, to split pension income, a joint election must be made every year, and that there is no provision for late filing (the parties must file the election "on or before their respective filing-due dates for the taxation year),"⁵² takeup is likely to be a similar concern for pension income splitting.

There are a number of simple administrative steps that could—and, I believe, should—be taken to ensure that all eligible couples benefit equally from the pension income-splitting provisions. The most straightforward is to have the CRA determine the most advantageous split of pension income for couples, and calculate tax liabilities accordingly. A slightly more cumbersome way of ensuring a high takeup rate would be for the CRA to mail letters to eligible pensioners informing them of the benefits of income splitting. A similar letter-writing campaign for the GIS has succeeded in increasing takeup rates significantly.⁵³ At minimum, provision should be made for late filing of the joint election.⁵⁴

Death

A transfer of pension income is permitted where the transferee is resident in Canada, is married to or in a common-law partnership with the pensioner at any time in the

50 *Supra* note 29.

51 Preston Poon, "Who's Missing Out on the GIS?" (2005) vol. 6, no. 10 *Perspectives on Labour and Income* 5-14. Taking into account individuals who fail to file tax returns, the takeup rate may be lower.

52 Subsection 60.03(1), definition of "joint election."

53 Canada, *Report of the Auditor General of Canada to the House of Commons 2006* (Ottawa: Office of the Auditor General of Canada, November 2006), chapter 6. For more information on initiatives to increase GIS takeup, see Richard Shillington, "GIS Saga," July 21, 2002 (online: http://www.shillington.ca/benefits/gis_saga.htm).

54 It is possible that late filing of elections will be permitted by the CRA under its fairness package (see subsection 230(3.1) of the Act), even though this is not specifically mentioned in the rules for pension income splitting: see *Information Circular* 07-1, "Taxpayer Relief Provisions," May 31, 2007. Also see M. Gerard Tompkins, "Emerging Tax Issues: Fixing Income Tax Elections and Designations, US Limited Liability Companies and the Use of Nova Scotia Unlimited Liability Companies, Deductibility of Capital Losses and BILs Relating to Shareholder Loans and Guarantees," in *Report of Proceedings of the Forty-Seventh Tax Conference, 1995 Conference Report* (Toronto: Canadian Tax Foundation, 1996), 9:1-26.

taxation year, and is not living separate and apart from the pensioner (because of a breakdown of their relationship) at the end of the taxation year and for a period of 90 days or more commencing in the taxation year.”⁵⁵ In the year of death, prorated pension splitting is available: a pensioner can transfer up to 4.17 percent of his or her income for each month of marriage to or cohabitation with the transferee during the year, for a maximum of 50 percent for a couple married or cohabiting throughout the year. Bereavement brings not only the loss of a partner and (frequently) diminution of income, but also an increase in the average tax rate that an individual faces, although the costs of maintaining a household may have changed little (if at all).

There may be an administrative problem with (possibly inadvertent) non-compliance after the death of a spouse. OAS, like income splitting, relies upon individuals to promptly report the death of a spouse. The auditor general has flagged “late notification of death” as a common cause of OAS overpayment.⁵⁶ It does not provide any indication of the number of such cases, but as of March 31, 2005, the total amount outstanding in overpayments of OAS benefits was about \$82 million. Kopczuk and Slemrod have found that the death rate is responsive to changes in estate taxes, and they “cannot rule out . . . ex post doctoring of the reported date of death.”⁵⁷

Formation of New Relationships

After the death of a spouse, many people begin new relationships. Administratively, when do such new relationships become eligible for income splitting? Is cohabitation an appropriate test? Given that remarriage complicates inheritance issues, and could jeopardize one partner’s capital gains exemption on owner-occupied housing, it is not clear that encouraging remarriage is a desirable policy goal. However, research by Baker, Hanna, and Kantarevic suggests that the rate of marriage among older Canadians is sensitive to tax and benefit policy,⁵⁸ so the incentive effects created by income splitting are a genuine policy issue.

Ageism

In Canada, we have had little experience with splitting of family income. It is hard to know which of the administrative issues highlighted above will indeed be serious problems. What we do know is that the number of people over 65 is growing rapidly, both in absolute numbers and relative to the so-called working age population.

55 Subsection 60.03(1), definition of “pension transferee.”

56 *Report of the Auditor General*, supra note 53.

57 Wojciech Kopczuk and Joel Slemrod, “Dying To Save Taxes: Evidence from Estate-Tax Returns on the Death Elasticity” (2003) vol. 85, no. 2 *The Review of Economics and Statistics* 256-65, at 256 (abstract).

58 Michael Baker, Emily Hanna, and Jasmin Kantarevic, *The Married Widow: Marriage Penalties Matter!* NBER Working Paper no. W9782 (Cambridge, MA: National Bureau of Economic Research, June 2003).

This growth raises an additional administrative—as well as equity and human rights—issue. What’s so special about 65?

The 2007 budget reinforced the dividing line between taxpayers over and under 65. The age amount tax credit, available only to people 65 and over, has been increased by \$1,000, reducing recipients’ federal taxes owing by up to \$158.⁵⁹ Moreover, pension income splitting is, in part, age-tested: income from a RRIF, an RRSP annuity, and certain other annuities can only be split by pensioners who are 65 and older.

Most Canadians live in provinces without mandatory retirement legislation. Our society is gradually rejecting the notion that age alone can be used as a test of competence. The Ontario Human Rights Commission, for example, has promoted examination of “age-based stereotypes.”⁶⁰

Yet age discrimination has been the basis of one of Canada’s greatest successes in fighting poverty. Broad-based age-tested government transfer programs such as GIS, CPP/QPP, and OAS have largely eliminated poverty for elderly couples, and have greatly reduced it for single individuals over 65.⁶¹ Reducing employment rights for people over 65 and at the same time providing generous age-tested benefits was part of a social contract that saw major reductions in poverty among the elderly. But it is a social contract that is breaking apart. People who are 65 and over are demanding employment rights, while those who have not yet reached 65 are wondering why they cannot benefit from the income assistance programs available to older Canadians. If age-based stereotypes are no longer permissible, what are the grounds for limiting programs such as annuity income splitting to those 65 and over? Why enhance the age credit, or even provide one at all?

It is true that seniors are more likely than younger taxpayers to experience disability or incur significant health-care expenses. However, the tax system already provides deductions for these things. It is illogical to reject, for the purposes of employment, the notion that age can be used as an indicator of disability or ill health, and accept the same premise for the purpose of defending the age credit.

I hope that calls to end age discrimination will lead to a re-examination of the age amount tax credit. Unfortunately, I think it more likely that we will find ourselves on a slippery slope, where the introduction of pension income splitting will lead to the adoption of broad-based income-splitting provisions. This article has presented arguments against such an approach, on the grounds that it would be inefficient, inequitable, and administratively complex. In the remaining pages, I will argue that there are better policy options—alternatives that can achieve real gains in efficiency, equity, and administrative simplification.

59 Subsection 118(2), as amended. The estimated tax saving is taken from “Senior’s Tax Savings Calculator,” *supra* note 32.

60 Ontario Human Rights Commission, *Time for Action: Advancing Human Rights for Older Ontarians* (Toronto: Ontario Human Rights Commission, June 2001).

61 Kevin Milligan, *The Evolution of Elderly Poverty in Canada*, Social and Economic Dimensions of an Aging Population Research Paper 170 (Hamilton, ON: McMaster University, 2007).

ALTERNATIVE POLICY OPTIONS

Option 1: Do Nothing—Income Splitting Is Becoming Irrelevant

The advantages of income splitting stem almost entirely from differences between men's and women's private pension income, as shown in table 1. This table is calculated from the CRA's *Income Statistics* for the 2004 tax year, and includes all married and single taxfilers. Women receive fractionally higher OAS payments than men. Women's annuity income is 72 percent of men's—not enough to offer significant income-splitting opportunities. The female to male ratio of CPP/QPP income is 69 percent. The real difference is found in pension incomes. The average man aged 65 and over receives \$9,369 in pension income; the average woman (including widows receiving survivor benefits) receives \$3,934.

The reason for the gap in private pension income is shown in figure 1, which provides historical data on the ratio of women's total deductions for RPP and RRSP contributions to men's total deductions for taxation years between 1967 and 2002. For simplicity, two age groups are shown, the peak child-rearing years (35-39), which reflect large increases in female labour force participation over the period, and the peak saving years (50-54). The data are based on the CRA's *Taxation Statistics* and are for tax-deductible employee contributions only. When today's 70-year-olds were 35, in 1972, women aged 35 to 39 deducted 19 cents for each dollar that men deducted for RPP contributions; the corresponding figure in 2002 was 90 cents.⁶² Women have always contributed less to RRSPs, relatively, but here too there has been a dramatic increase.

Today the majority of women work, and many have access to well-paid, unionized jobs in health care, government, and other service sector jobs. As shown in figure 2 (also based on the CRA's *Income Statistics* for 2004), female taxfilers between the ages of 20 and 60 are more likely than males to belong to an RPP.⁶³ Male taxfilers of all ages are more likely than females to claim an RRSP deduction, perhaps in part because of the difference in RPP coverage. My own calculations from the data indicate that RRSP deductions claimed as a fraction of income are approximately the same for both male and female taxfilers, ranging from 3.3 percent of income for men aged 25 to 29 and 3.2 percent for women, to 4.6 percent of income for men aged 50 to 54 and 4.9 percent for women.

The point of this analysis is that, given women's present access to employer pension plans, income splitting will do relatively little to benefit tomorrow's seniors. Hence, one policy option is simply to do nothing: the need for income splitting will disappear in time. However, if one is concerned about today's seniors, and if one is

62 Canada, Department of National Revenue, *Taxation Statistics*, 1972 tax year (Ottawa: Supply and Services, 1974); and Canada Revenue Agency, *Income Statistics*, 2002 tax year (Ottawa: CRA, 2004).

63 Strictly speaking, female taxfilers are more likely than males to claim an RPP deduction.

TABLE 1 Average Amount Received, All Taxfilers Aged 65 and Over, 2004

	Male	Female	Female:male ratio
	<i>dollars</i>		
Old age security	4,968	5,012	1.01
Annuity income	2,954	2,138	0.72
CPP/QPP	6,324	4,344	0.69
Pension income	9,369	3,934	0.42

Source: Calculated by the author from Canada Revenue Agency, *Income Statistics: 2006 Edition*, 2004 tax year (Ottawa: CRA, 2006)

convinced—despite the efficiency and equity arguments above—that income splitting is a good idea, there are more equitable and administratively superior means of accomplishing the same goal.

Option 2: Real (Not Phantom) Transfers

Advocates of pension income splitting were campaigning for real transfers of pension income. They argued that “government rules are contradictory, actively promoting CPP income splitting as a tax-saving strategy while denying the right to split private pension benefits.”⁶⁴ With CPP, the pensions that the spouses earned during marriage are combined, and the total payment is divided between—and paid equally to—both spouses.⁶⁵ The focus of the campaign was to extend the CPP provisions to other forms of pension income.⁶⁶

There are a number of reasons why it would have been better to adopt the CPP method of income splitting rather than phantom transfers. First, the CPP approach would avoid the innocent spouse problem mentioned above, whereby a real tax liability can be created by a phantom transfer. Second, given women’s longer life expectancy and the tendency of women to marry men older than themselves, most married women over 65 will eventually become widows and may then (if not before) be entirely responsible for managing their own finances. It will be easier for a surviving spouse to adjust to the death of the partner if she (or he) has already shared in handling the household’s income. Third, if a couple share their pension income during retirement, both of their names will be on record as income recipients, and widows and widowers will be certain to receive CPP survivor benefits.⁶⁷

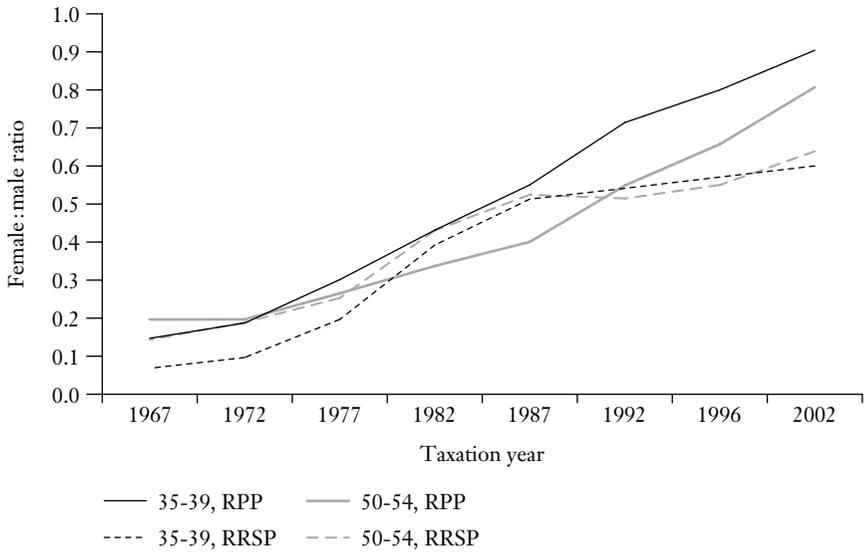
64 June Yee, “Financial Policies Reflect Ageism” (online: <http://en.50plus.com/display.cfm?documentID=7307&CabinetID=329&LibraryID=104>).

65 Service Canada, “Fact Sheet: Sharing Your Pension for Possible Tax Savings,” March 2006 (online: <http://www1.servicecanada-gc.ca/en/isp/pub/factsheets/sharing.shtml>).

66 E-mail sent by Dan Braniff to the author, September 12, 2007.

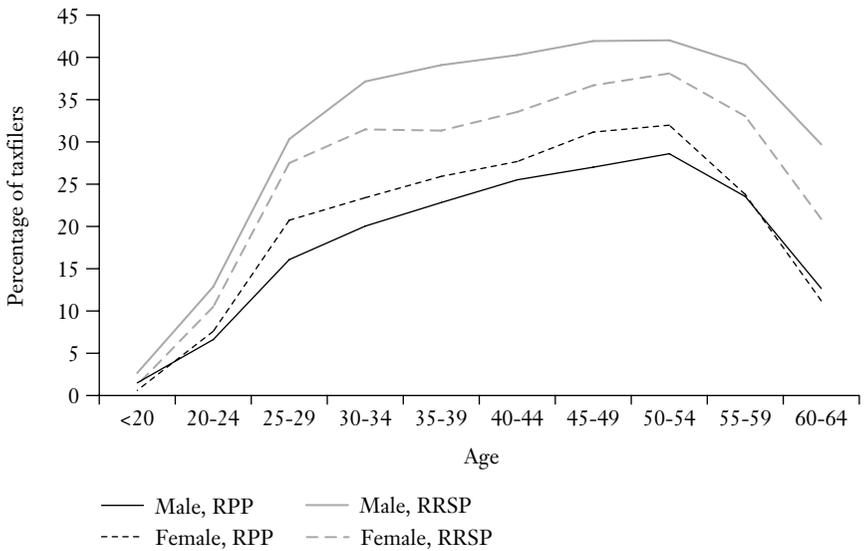
67 The actual takeup rate for the CPP survivor benefit appears to be unknown. See, for example, Human Resources and Social Development Canada, *Phase III Evaluation of Survivor Benefits and Other Features of Canada Pension Plan: Final Report* (Ottawa: HRSDC, May 1997) (online: <http://www.hrsdc.gc.ca/en/cs/sp/sdc/evaluation/sp-ah010e.pdf>).

FIGURE 1 Ratio of Total Female to Total Male Pension Deductions, 1967-2002



Source: Canada Revenue Agency, *Taxation Statistics*, 1967 to 2002 tax years (Ottawa: CRA, various years).

FIGURE 2 Percentage of Taxfilers Claiming RPP and RRSP Deductions by Age and Sex, 2004



Source: Canada Revenue Agency, *Taxation Statistics: 2006 Edition*, 2004 tax year (Ottawa: CRA, 2006).

Real transfers do not need to be overly cumbersome. If we take the position that joint ownership gives each individual a claim on half of the marital assets, why not permit the sort of asset division during marriage that occurs after divorce? Couples can already split pension income by taking advantage of spousal RRSP provisions, concentrating RRSP contributions in the name of the lower-income spouse, or allocating CPP income. I have not been able to find any information on the take-up rates for CPP pension-sharing provisions or for the use of spousal RRSP provisions. The real gap in the legislation, before the introduction of the new pension income-splitting rules, was with respect to employer pensions. Yet it would have been better to address the deficiencies of employer pensions directly, rather than adopt an administratively problematic form of income splitting.

Option 3: Transferable Tax Room

The Act contains a number of provisions that allow families to save taxes by transferring unused tax credits between family members. For example, students can transfer unused tuition fee tax credits to parents—apparently on the basis that parents are among the “many Canadians” who “actually [use] much of their income to support other family members.”⁶⁸ The Act also provides a transferable pension amount credit on the first \$2,000 of eligible pension or annuity income received by the pensioner or annuitant in the year (income from an RRSP, RRIF, or other eligible pension amount).

The idea of transferring tax credits could be extended to transfers of basic rate tax room. In 2006, individuals paid federal tax of 15.25 percent on the first \$36,378 of taxable income and 22 percent on the second \$36,378. To make the entire amount of basic rate tax room transferable, schedule 2 of the T1 return could be modified as shown below (using calculations based on the 2006 tax schedule).

Pension basic rate tax room transferred from spouse

Other pensions or superannuation (line 115 of your return)	_____
Subtract: \$36,378	_____
Subtract: pension income claimed by spouse (line 115 of his or her return) (maximum \$36,378)	_____
Net amount	_____
Multiply by: 6.75 percent	_____
Tax reduction: enter on line _____ on Schedule 1	

Essentially, this would mean that a single-earner couple with pension income under \$72,756 would pay tax at the basic rate on their entire pension income. There are three reasons why transferring basic rate tax room would be better than making nominal income transfers. First, it would avoid the innocent spouse problem. Second,

⁶⁸ See *supra* footnote 26 and the accompanying text.

there would be no need to file a separate joint election; instead, standard schedules could easily be modified. Third, because the maximum benefits would be capped (using the 2006 amount) at \$2,456 per couple, a transfer of basic rate tax room would be less regressive than full pension income splitting. It would help people who could use a little extra help—retired couples living on the savings from one earner’s moderate or middle income. In addition, this option is feasible. In Ireland, for example, married couples can choose to allocate the “standard rate cut-off points” in any way between the two spouses.⁶⁹ The cut-off point for Canadian taxpayers (using the 2006 income threshold and rate) would be \$36,378, the point at which the 15.25 percent rate ceased to apply.

Option 4: Income Splitting for Other Types of Families

The benefits of income splitting need not be limited to senior couples but could be extended to other household formations—an elderly person living with, and being cared for by, an adult child; parents caring for a disabled adult child; or siblings sharing a home and providing mutual support. The French model of the “quotient familial” provides a model of how income splitting could be used to benefit families, as opposed to couples. The Law Commission of Canada’s report *Beyond Conjuality* makes a strong case for extending legal recognition to a wider variety of close personal relationships, in order to provide individuals with more choice in accessing benefits available under the law.⁷⁰

Option 5: Address the Source of the Need for Income Splitting

The rationale for pension income splitting advanced by its advocates was a perception that seniors were paying too much in taxes. Indeed, many seniors do face very high effective marginal tax rates. The age amount taxback adds about 2.3 percentage points to the effective marginal tax rate faced by seniors with income over \$30,270.⁷¹ The taxback of OAS adds 9 to 10 percentage points to the effective marginal tax rate of any senior with a net income between \$63,511 and \$103,101 (as of July 2007).⁷² A retired couple with income of not more than \$19,680 over and above OAS will have their GIS taxed back at the rate of 50 cents for every dollar of pension or other

69 Irish Revenue Commissioners, “Assessable Spouse Election Form” (online: http://www.revenue.ie/forms/ass_spouse.pdf).

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

71 Income tax information for 2006 taken from schedule 1 of the CRA’s T1 tax return. Clawback rates are calculated by the author from the T1 schedule and T1 worksheet (online: <http://www.cra-arc.gc.ca/E/pbg/tf/5000-d1/5000-d1-06e.pdf>).

72 The taxback rate is 15 percent; however, since OAS is taxable income, the effective marginal tax rate is closer to 9 or 10 percent: Service Canada, “Old Age Security (OAS) Payment Rates” (online: <http://www1.servicecanada.gc.ca/en/isp/oas/oasrates.shtml>).

income.⁷³ Since approximately one-third of seniors receive GIS payments,⁷⁴ GIS tax-backs affect many people. Macnaughton, Matthews, and Pittman identify GIS income testing as having the single largest impact on effective marginal tax rates of any clawback: it is estimated to increase the effective marginal tax rates of 1.4 million individuals by 50 percentage points and the tax rates of another 132,000 individuals by 25 percentage points.⁷⁵

The underlying source of the need for pension income splitting could have been addressed by revisiting these various clawback provisions. Many of today's older Canadians paid the former old age security tax, which was earmarked to fund a universal old age security pension.⁷⁶ These seniors can, with some justification, argue that they should not have to repay what was promised as a universal entitlement. Eliminating or raising the threshold for the OAS clawback would have relieved the dissatisfaction of some of these seniors with Canada's retirement income system.

The GIS clawback means that many Canadians over 65 face higher effective marginal tax rates than those under 65. Investing in RRSPs may leave taxpayers worse off after retirement, because funds withdrawn from an RRSP trigger reductions in GIS benefits. Moreover, despite the end of legislated mandatory retirement, clawbacks mean that GIS recipients have minimal scope for raising their income through employment. Tax-prepaid savings plans (TPSPs), similar to RESPs or American "Roth IRAs" (individual retirement accounts), could, if implemented appropriately, offer low-income individuals a means to save without facing the loss of GIS.⁷⁷ Contributions to a TPSP are not tax-deductible, but withdrawals are not included in taxable income, making TPSP investment income free from tax and also from the clawback of benefits.

Generally speaking, the greatest efficiency gains result from reducing the highest marginal tax rates. Reducing the rate at which benefits are clawed back therefore has the potential for achieving real efficiency gains. Moreover—especially with policies that reduce the scope of the GIS clawback—there is a chance to help the neediest older Canadians.

Option 6: Enhance Supports for the Neediest Older Canadians

There are a number of groups who are vulnerable under Canada's present pension system: the "not-old-enough," the "old-old," and new Canadians.

73 Based on 2007 eligibility and taxback rates calculated from Service Canada, "Tables of Rates for Old Age Security, Guaranteed Income Supplement and the Allowance" (online: <http://www1.servicecanada.gc.ca/en/isp/oas/tabrates/tab2-23.shtml#above>).

74 Poon, *supra* note 51.

75 Macnaughton et al., *supra* note 8.

76 Kenneth Bryden, *Old Age Pensions and Policy-Making in Canada* (Montreal: McGill-Queen's University Press, 1974), 105.

77 Richard Shillington, *New Poverty Traps: Means-Testing and Modest-Income Seniors*, C.D. Howe Institute Background no. 65 (Toronto: C.D. Howe Institute, April 2003); and Jonathan R. Kesselman, "Tax Design for a Northern Tiger" (2004) vol. 10, no. 1 *Choices* 1-48.

- The “not-old-enough” are displaced workers in their 50s and early 60s. Since mandatory retirement at 65 is being phased out, is it equitable to provide benefits to Canadians under 65 that are so much less generous than those available under OAS and GIS? The government has recently struck an Expert Panel on Older Workers to examine precisely this issue.⁷⁸
- The “old-old” are seniors of advanced age; many are female, single, perhaps in need of assistance with everyday living, and sometimes facing depleted financial resources as inflation erodes the value of their savings. Unlike married couples, single seniors do face a substantial risk of poverty. If provisions such as the age amount are intended to recognize the special needs of the elderly, it would be better to target those provisions to older and more vulnerable seniors.
- Elderly recent immigrants are another group who face a high risk of poverty, especially if they do not satisfy the residency requirements for OAS. Because many elderly immigrants live with extended family, recognition of a greater variety of family ties, as mentioned above, would help people in this situation.

CONCLUSIONS

The decision to introduce pension income splitting was made quickly and without extensive consultation. Just one week before the announcement, the finance minister was quoted as saying, “I wouldn’t call it a priority. . . . But it is worthy of study and we are reviewing it.”⁷⁹ It is unfortunate that there was so little discussion, or consideration, of alternative methods of income splitting or otherwise helping seniors. As I have argued in this article, there are ways of achieving income splitting that are more equitable than, and administratively superior to, the approach that the government has chosen. And there are better ways of spending money on current or future pensioners. More research is necessary to compare the distributional and efficiency impacts of the various policy options described here. However, the main point is simple: there is a range of alternatives that would have provided greater benefits for many older Canadians than the new pension income-splitting provisions.

The Common Front for Pension Splitting (now the Common Front for Retirement Security) is continuing its lobbying efforts. It is thinking of “[expanding] our campaign from pension income splitting to income splitting for couples of all ages.”⁸⁰ Given what is known about the efficiency and equity impacts of income splitting, one can only hope that this campaign will be less successful than the previous one.

78 See the Web site of the Expert Panel on Older Workers at <http://www.ow-ta-sec.org/>.

79 Carol Goar, “Senior Savours Unexpected Win,” *Toronto Star*, November 8, 2006.

80 Canadian Activists for Pension Splitting, *Newsletter*, June 29, 2007 (online: http://www.pensionsplitting.ca/Copy_of_June29_2007_newsletter.doc).