AN EXAMINATION OF THE INCOME TAX CONSEQUENCES OF A NEW MATRIMONIAL PROPERTY REGIME FOR ALBERTA.

by WALTER K. MIS, LL.M.

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A. The Provisions of Section 74

1. Historical Development

The Income Tax Act, R.S.A. 1952, c. 148, as amended by S.A. 1970-71, c. 63 and subsequent amendments, (hereinafter referred to as the "Act"), taxes the income of each spouse separately.[1] However, since the first Income War Tax was promulgated in 1917, taxing authorities have recognized the special relationship that exists between members of a family and have included income attribution rules in the income tax legislation so as to prevent the splitting of income among family members by the transfer of property between members of this unit.

The historical development of these statutory provisions is outlined in Appendix A and culminates in section 74 of the present Act which reads as follows:

> "74. (1) Where a person has, on or after August 1, 1917, transferred property either directly or indirectly, by means of a trust or by any other means whatever to his spouse, or to a person who has since become his spouse,[2] the income for a taxation year from the property or from property substituted therefor shall, during the lifetime of the transferor while he is resident in Canada and the transferee is his spouse, be deemed to be income of the transferor and not of the transferee.

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[1]This method of treating the income of a family is by no means universally accepted and in Part III, infra, for comparative purposes, different modes of taxing family income will be examined.

[2]In Connell v. M.N.R., [1946] Ex.C.R. 562, it was held that a transfer before marriage was not subject to the attribution rules and as a result, The Income War Tax, S.C. 1948, c. 52, s. 21(1) contained a new provision for premarital transfers.

" (2) Where a person has, after 1971, transferred property either directly or indirectly, by means of a trust or by any other means whatever to his spouse, or to a person who has since become his spouse (which property is referred to in this subsection as "transferred property"), in computing the transferor's income for any taxation year the amount, if any, by which

(a) the aggregate of

(i) the transferee's taxable capital gains for the year from dispositions of transferred property other than listed personal property and from dispositions of property (other than listed personal property) substituted for transferred property, and

(ii) the amount that the transferee's taxable net gain for the year from disposition of listed personal property would be if the transferee had at no time owned listed personal property other than listed personal property that was transferred property or property substituted therefor,

exceeds

(b) the aggregate of the transferee's allowable capital losses for the year from dispositions of transferred property other than listed personal property and from dispositions of property (other than listed personal property) substituted for transferred property, "shall during the lifetime of the transferor while the transferor is resident in Canada and the transferee is his spouse, be deemed to be a taxable capital gain of the transferor for the year from the disposition of property other than listed personal property, and any gain or loss taken into account in computing the aggregate described in paragraph (2) of the aggregate described in paragraph (b) shall, for the purposes of computing the income of the transferee for a taxation year, be deemed not to have been a gain or loss of the transferee.

(3) Where a person has received remuneration as an employee of his spouse, the amount thereof shall not be deducted in computing the spouse's income and shall not be included in computing the employee's income.

(4) Where, in a taxation year, a person has received remuneration as the employee of a partnership in which his spouse was a partner, the proportion of the remuneration that the spouse's interest in the partnership business was of the interest of all the partners shall be deemed to have been received by the spouse as part of the income from the business for the year and not to have been received by the employee.

(5) Where a husband and wife were partners in a business, the income of one spouse from the business for a taxation year may, in the discretion of the Minister, be deemed to belong to the other spouse."

2. Requirements of the Section

a. Conditions Precedent

In order for the section to be applicable, certain conditions must exist in the particular taxation year, namely:

(a) the transferor must be living;

(b) the transferor must be resident in Canada; and

(c) the transferee must still be the spouse of the transferor.

If any of these conditions is not fulfilled, the income will be the transferees rather than the transferors.

b. Transfer of Property

The word "transfer" is interpreted very broadly and in the case of Fasken v. M.N.R., 49 D.T.C. 491, the Exchequer Court dealing with a transfer between a husband and wife which took place in 1924 stated at p. 497 that,

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

In German v. M.N.R., 57 D.T.C. 1216, the appellant husband entered into an agreement with his wife by which she agreed to give her consent to the sale of the homestead as required under The Dower Act of Alberta in consideration of the sum of $5,000 to be received by the wife directly from the purchaser. The $5,000 received by the wife when the sale was completed was invested by her and subsequently the income from this investment was treated by the Minister as income of the appellant husband. The husband contended that he had not transferred any property to the wife since she had a dower interest by virtue of The Dower Act and this was valued at $5,000 and the purchaser when purchasing the property was paying for her dower interest and paying the husband for the balance of the property. The Minister contended that the income in question was income from property substituted for property transferred by the appellant to his wife within the meaning of section 21 (1) of The Income Tax Act of 1948.

The Exchequer Court reviewed the matter and upheld the position of the Minister in deciding that the income in issue was taxable as income of the husband. The Court stated that the question to be decided was whether or not the husband ever had title to the $5,000 or to any right in it which, in the course of the transaction, was transferred to his wife. If he had divested himself of the $5,000 and it vested in his wife, he had transferred the $5,000 to her and regardless of whether or not anything capable of constituting a consideration was given by the wife for the property so transferred, the provisions of section 21 (1) would apply. The Court found that in spite of the wife's dower rights, the entire present right and possession in the enjoyment of the property at the time of disposition belonged to the husband. In order to make the sale of the property possible, the appellant bargained for his wife's consent and it was the purchaser to whom the consent was given. When the husband sold and conveyed to the purchaser, he was conveying the entire property and by the covenant that he had made with his wife, he had divested himself of his right to $5,000 of the consideration to be paid for what had been his property and vested it in his wife. Regardless of the consideration moving to the appellant from his wife, he had transferred the $5,000 to her within the meaning of section 21 (1).

The Court in effect decided that whether or not the wife had anything to sell, this was immaterial since at best, if she did have something to sell, namely her dower interest, then such a sale itself constituted a transfer and therefore if the wife received consideration for her dower interest, then this consideration would be property transferred to her by the husband and income therefrom would be the husband's.

Notwithstanding the doubts expressed by the Court[3] the question may still be open in the case of a third party purchaser who approaches the wife directly. For instance, if a purchaser should contact the husband to purchase the property and the wife refuses to release her dower interest and the purchaser approaches the wife directly and for a further consideration payable directly to the wife, obtains her consent, such a transaction might result in a Court saying that this additional consideration paid to the wife directly by the purchaser was not property transferred by the husband. If this is the case then the dower interest given to the spouse under The Dower Act would differ from the interest given to a spouse under most community of property legislation since in the latter instance, the spouse having title, has the right to deal with the property and the proceeds are substituted for the original property.

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[3]At page 1219, Thurlow, J. states, "The consent, in my opinion, operates by way of a waiver of the right of the spouse to prevent the proposed disposition and as a bar or waiver of her possible claim to a life estate. I doubt very much that it can be said that the spouse's rights in the property by virtue of a consent are transferred to anyone, but if they are so transferred, I think it is even more doubtful that they can, by a consent, be transferred to anyone other than the married person who owns the property."

The way the Court dealt with this question is of interest since any matrimonial regime will be faced with a similar problem, viz., is there a present interest in the property or only an expectancy.

B. Attribution of "Income"

1. Duration of Attribution

Any redistribution of matrimonial property prior to the date upon which the divorce becomes final would result in the income being attributed to the transferor. The position of the Department of National Revenue on this point is confirmed in Interpretation Bulletin IT-136 which is reproduced as Appendix B and which serves as a summary of the Department's views in this area. In effect, once property is transferred from one spouse to another, the income is attributed to the transferor until the marriage is either terminated by death or by divorce.

2. Alimony and Maintenance

To the extent that any matrimonial regime provides that a division of matrimonial property would be a substitute for alimony and maintenance payments under The Income Tax Act, then as long as both spouses were still married, they would be in a less flexible position than under the present scheme. Presently, alimony and maintenance payments complying with the requirements of section 56 (1) (b) and (c) are included in the income of the recipient spouse and are deductible by virtue of section 60 (b) and (c) by the paying spouse. To the extent that these provisions permit a limited amount of income splitting between spouses, a tax saving is achieved and therefore as an overall position, the two spouses are better off from a tax point of view since they pay less taxes and therefore have more aftertax income. If property were transferred between spouses so as to equalize income, then no income splitting would be possible until the marriage actually terminated.

Therefore, any termination of the matrimonial regime by formal agreement or court order prior to an actual dissolution of the marriage could leave the spouses in a less advantageous position than at present if, as a result of the redistribution of the property, maintenance and alimony payments would be decreased, and presumably this would be the case if the assets would be equalized.

3. Transfers to Children

From the outline of the proposed matrimonial regime, it is not certain if transfers to children would be treated as fraudulent gifts intended to defeat the donor's spouse. In other words, if one spouse with large after-acquired assets could foresee the breakdown of the marriage and transferred substantially all the accretion in wealth to the children of the marriage, would this in itself amount to a fraudulent preference. If it would not, then the provisions of section 75, which are very broad in that they tax the income on property transferred to any infants, could be used to avoid the intent of the regime since the income on transfers to anyone, including children 18 years of age or over, will not be attributed to the transferor. If this were not a fraudulent preference then it would be to the advantage of a parent to transfer outright assets to any adult children or in the alternative, to set up a trust for the benefit of these children with the parent retaining some control over the trust. In this way the spouse with the larger accretion in property would avoid paying any amount to the other spouse. What this really comes down to is whether or not there would be any transfers for less than bona fide consideration that would be excepted from the traceability of transfers made for inadequate or for no consideration.

4. Business and Property Income

Although the word "property" is defined very broadly in section 248 (1) of the Act and

> "means property of any kind whatever, whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes
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> (a) a right of any kind whatever, a share or a choice action, and
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> (b) unless a contrary intention is evident, money."

When applying the income attribution rules, it is necessary to distinguish between "business income" and "property income" as is done in sections 3 and 9 of the Act. The necessity for so doing arises out of the fact that property income and not business income is attributed to the transferor's spouse.

In the case of Robins v. M.N.R., 63 D.T.C. 1012, the Exchequer Court held that the profits of a wife derived from her share of an interest in a partnership formed for the purpose of investing in real estate were not taxable to the husband even though the monies used by the wife came from the husband. The court found that the husband had repaid an obligation to the wife under a marriage contract entered into under the laws of Quebec, but stated that whether or not it was considered a reimbursement of a loan or a loan in itself by the husband to the wife, it would in both cases be excluded under the attribution rules as a loan is not a transfer of property.[4] In dealing with the scope of section 24, Noel, J. stated:

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[4] At page 1022.

> "Section 21 [now section 74] as well as sections 22 [now section 75] and 23 [now section 56 (4)] are designed to prevent avoidance of tax by transfer of income producing property to persons who are normally in close relationship with the transferor. But what is deemed to be the income of the transferor, and this is clearly stated, is income from property only. Indeed there is no mention of income from a business such as we have here and therefore, this section can be of no assistance in determining whether the business profit resulting from the real estate transactions is taxable as income of the Appellant or of his wife."

The Department of National Revenue acknowledges this distinction and does not attempt to attribute business income to the transferor even if the business operates with some or all of the property obtained originally from the transferor.[5]

A rather anomalous situation was arrived at in Goodman v. M.N.R., 51 D.T.C. 50 where the wife on marriage transferred her business to herself and her husband, each receiving an equal share of the profits. In addition, the husband received $50.00 per week for managing the business. The Minister relying on the provisions of what is now section 74, added the husband's income to the wife's income and assessed her accordingly. The Tax Appeal Board was of the opinion that the transfer fell within the meaning of now subsection 74 (1) and that the wife remained liable to be taxed on the income derived from the property transferred, however the Court held that income referred to net income and there-

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[5] Interpretation Bulletin IT-136, paragraph 7.

fore the salary of the husband had to be treated separately. The Court reasoned that,

> "While it is true that, because of the provisions of section 32 (2) [now section 74 (1)], the income derived from property transferred by a husband to his wife, or vice versa, is to be considered as income of one transferor, this section does not nullify the transfer itself, and I am satisfied that the Appellant's husband was, in 1947 and 1948, the owner of one half of a business which had been owned in full by the Appellant before the sale on June 17th, 1947."[6]

The Court went on to say that,

> "Whether the Appellant and her husband were partners as she claimed they were, or whether the Appellant and her husband were co-owners in equal proportions of a business, which I think they were, it is clear to me that the husband was at the time working for himself and for his wife, in the proportion of their respective interests in the business, to wit, one half. In the circumstances, I am of the opinion that one half only of the salary received by the Appellant's husband in the years 1947 and 1948 was received by him as an employee of his wife and that, to that extent, the provisions of 31 (2) apply."

The case is open to criticism since partners are normally not entitled to deduct a salary when computing the income of the partnership.[7] In this case the dis-

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[6]At page 53.

[7]cf. The Partnership Act, R.S.A. 1970, s. 27 (f).

tinction between business and property was not raised since it was the case of a partnership between a husband and wife and under section 74 (5) where a husband and wife are partners in a business, the Minister may in his discretion deem the income from the partnership to be solely the income of one partner or the other.

However, the mere fact that the wife engages in a business does not preclude the Minister from attributing a portion of the business income to the husband if it is found that the husband advances funds to the wife in her business and takes an active part in its management. In such circumstances without adequate proof that the advance of funds was actually a loan, the court will find a joint venture between the husband and wife and apportion the profits in accordance with their capital contributions.[8]

5. Avoiding the Income Attribution Rules

Taxing legislation is frequently criticized as being inequitable in that it perpetuates the disparities that exist between those with high incomes and those with low incomes. The income attribution rules of section 74 are open to criticism on this account since the various provisions discussed above can be circumvented to a greater or lesser degree depending upon the source of income.

If one examines the three main sources of income, namely office or employment income, business income and property income, the reason for the criticism becomes apparent. Those in the low income brackets normally have little or no property income and generally do not carry on a business. They are for the most part employees and there is little scope for tax saving through income splitting with respect to employment income because of the attribution rules found in section 74. To put the proposition conversely, it is easier for those with

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[8] M.N.R. v. Minden, 63 D.T.C. 1231.

property income and some forms of business income to defeat the purpose of section 74 through income splitting than it is for those with employment income to effect the same end. Because it is usually the higher income groups that have business and property income, this means that tax saving can be achieved by those in the higher income groups whereas a corresponding opportunity is not given to those in the lower income groups.

To illustrate the foregoing proposition, two generally accepted forms of income splitting can be examined for a moment.

a. Loans

The first method of income splitting between husband and wife is by way of a loan. In Dunkelman v. M.N.R., 59 D.T.C. 1242, the taxpayer set up a trust for his children and lent the trust sufficient funds so that it could purchase a building. The income from the trust was attributed to the taxpayer by the Minister and the taxpayer challenged this attribution. Thurlow, J. speaking for the Exchequer Court held that the loan of monies to the trustees did not amount to a transfer of property within the meaning of the section since it would require an unusual and unnatural use to arrive at this interpretation. At page 1246, Thurlow, J. states:

> "I do not think it can be denied that, by loaning money to the trustees, the Appellant, in the technical sense, transferred money to them, even though he acquired in return a right to repayment of a like sum with interest and a mortgage on the Butterfield Block as security, or even though he had since then been repaid with interest. But, in my opinion, it requires an unusual and unnatural use of the words 'has transferred property' to include the making of this loan. For

> "who, having borrowed money and knowing he must repay it, would use such an expression to describe what the lender has done? Or what lender thinks or speakers of having transferred his property, when what he has done is to lend it? Or again, what casual observer would say that the lender, by lending, 'has transferred property'? And, more particularly, who would so describe the lending where, as in this case, the transaction is such that the only purpose to which the money loaned could be turned was in acquiring a property to be immediately mortgaged to the lender? ... I also think that, if parliament had intended to include a loan transaction such as the present one, the words necessary to make that intention clear would have been added, and it would not have been left to an expression which, in its usual and natural meaning, does not clearly include such a transaction."[9]

The Dunkelman decision was applied in Oelbaum v. M.N.R., 68 D.T.C. 5176, wherein a wealthy taxpayer lent his wife $150,000 and the wife executed three promissory notes each for $50,000 payable on demand in favour of the taxpayer without interest. The wife invested the money and the income from this invest-

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[9]The reference to the change of wording to make the intention clear to cover a loan it is submitted would not be satisfied by the change in the definition of "property" which resulted after the substantial amendments to the Income Tax Act in 1970-71-72. The definition of property presently found in section 248 (1) is extended to include money unless the contrary intention is evidence and this phrase was not found in section 139 (1) (ag) of the Act which was in force at the time of the Dunkelman decision.

ment was attributed to the husband by the Minister. The husband challenged the attribution and succeeded in the Exchequer Court of Canada which followed the Dunkelman decision.

The Department of National Revenue has now acknowledged that a properly executed loan transaction will effect the above purpose.[10]

It is evident therefore that married taxpayers in Canada can achieve income splitting with respect to property income by utilizing the above procedure.

b. Incorporation

A second method of achieving income splitting is through the medium of a corporation and there are two variations of this, both of which however are dependent upon the spouses having a business as opposed to an office or employment income. The first variation deals with a situation where the spouses carry on a business in partnership but are faced with the difficulty that section 74 provides that the Minister can attribute all the partnership income to either one or the other of the partners.

In Klamzuski v. M.N.R., 52 D.T.C. 51, a husband and wife were partners in a farming operation and it was acknowledged that the wife with her own funds purchased all the lands involved and certain of the assets and furthermore that the wife probably had the "larger stake in the partnership assets"[11], nevertheless all the income from the farming operation was attributed to the husband and taxed in his hands and this assessment was upheld by the Tax Appeal Board. Recent cases have reiterated the propriety of this assessment and in Funk v. M.N.R., 61 D.T.C.

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[10] Interpretation Bulletin IT-136, paragraph 6.

[11] At page 52.

590 at 591, the Tax Appeal Board said that the section is descretionary and the Board has no authority to interfere in the matter unless there is proof that the Minister in exercising his discretion, did not act fairly and impartially.

To overcome this all that is needed is the interposition of a corporate entity between the business and the spouses so that the company owns the business and the spouses are shareholders and employees of the company. The spouses can then split the income of the business through the salaries paid to them by the company and the income attribution rules will not apply.[12] The aforementioned technique is not available to employees, however unless there is a special arrangement between an employee and the employer whereby the employer retains both spouses. This is relatively rare and if it is done at all, it is usually at the executive level where the executive is so valuable to his employer that the employer is willing to make special arrangements in order to retain his services.

So long as both spouses actually perform services in the business and the remuneration paid is not unreasonable, the above method of splitting income between spouses is a proper and recommended tax planning technique.

A variation of the above is utilized in those situations where incorporation is not possible, for example, in the medical or legal professions. In these circumstances, if one spouse is in professional practice, say the husband, then it is possible for the wife to incorporate a company and perform services for her husband through the medium of the company. The company is paid for these services by the husband and in turn the wife is compensated by the company for her services. This technique is on the borderline as can be seen from the

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[12]cf. Ward, Current Tax Planning, 1972, Vol. 2, page 19-52, paragraph 192.6 [c] (3).

decisions in Murphy v. M.N.R. 68 D.T.C. 5178 and Edwards v. M.N.R., 69 D.T.C. 738.

In the Murphy case, a Toronto doctor whose wife worked as a receptionist, arranged for the incorporation of a company which was controlled by an accountant whom he knew. This company was employed to provide receptionist, accounting, office management and stenographic services for the doctor at a monthly rate. The company in turn hired the doctor's wife to perform the services which she had performed previously and almost 95% of the management fees paid to the company by the doctor were paid out by the company to the wife for her services. In this instance the Court found that the procedure was a sham and attributed the salary of the wife received from the company to the doctor.

However, in the subsequent Edwards case, a dentist whose wife incorporated a management company and worked in his office was successful in deducting the fees paid to her company from his income. In the case, R.S.W. Fordham, Q.C., Assisant Chairman of the Tax Appeal Board at page 740 stated:

> "In the present instances there were, in my opinion, all the earmarks of a genuine corporate enterprise begun primarily for the benefit of the Appellant and not in order to overcome any particular facet of the Income Tax Act. The Appellant testified that the new administrative arrangements have been of considerable benefit to him and that since the inception of Quinte, he has been able to give more individual attention than had theretofore been possible in treating patients."

It should be emphasized that the foregoing suggestions with regard to splitting of income are raised not in the context of an artificial reduction of income, but to illustrate where the tax results will differ in circumstances where the spouses both contribute to the profitability of a business. These results follow in the present Income Tax Act because spouses are taxed individually except in those circumstances such as section 74 where income is attributed entirely to one or the other spouse.

6. Possible Inequities in Income Taxation of Spouses

The possible inequity of the position is borne out in a short story entitled "Marriage and Equity in Taxation" written by Gwyneth McGregor in 10 Canadian Tax Journal 369, pp. 376-377, an exerpt from which reads as follows:

> " 'The point is that whereas all taxpayers are treated alike in the matters of their private lives - and wives - taxpayers who are married couples in business are not treated like other taxpayers in business; that is where the inequity comes in.'
>
> 'That's quite true', granted the director handsomely. 'So a couple living in sin, as you put it, is better off in many sets of circumstances than a married couple - for tax purposes, of course', he added hastily forestalling the improper retort he saw trembling on the editor's lips.
>
> 'Only', said the editor, 'where the wife doesn't go out to work. Now if you send your wife out to work, she will be assessed as a single person and so will you; and you will be in the same position - for tax purposes - as though you were living in sin.'
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> 'I'd have to pay a housekeeper to look after the kids', said the director ruefully, 'and I couldn't deduct her wages either.'[13]

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[13] This has been changed in the present Act.

" 'That', said the editor pompously, 'is what the Act calls 'personal living expenses of the taxpayer' - prohibited by section 11 (1) (h) as a deduction; and prohibited, mark you, to all taxpayers.'

'Oh, all right', said the director resignedly, 'I was only trailing a red herring. But I still say that it isn't as simple to achieve equity for married couples as you seem to think. Even if you achieve it for married couples in partnership and for husbands employing their wives, I can't see it being achieved for couples where the wife's share in the partnership is running the home.'

'If you can't achieve equity for all married couples', snapped the editor, 'is that any reason for not trying to achieve it for some of them? Two wrongs don't make a right.' "

It should perhaps be noted in passing that although section 74 attributes income to the transferor's spouse, there is no certainty that any losses can be taken by the transferor. In Martens v. M.N.R., 64 D.T.C. 191, and Stratton v. M.N.R., 66 D.T.C. 5422, the Tax Appeal Board and the Exchequer Court respectively refused to allow the transferor husband to deduct losses which were incurred by his wife in utilizing the funds to carry on a business. The Department of National Revenue takes the position that the transferor can deduct property losses but not business losses.[14] It is difficult however to visualize a property which would not be either a business loss or a capital loss.

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[14]Interpretation Bulletin IT-136, paragraph 11.

Similar sentiments relating to the inequitable treatment of the family in tax law were indicated by those doing the background studies for the Royal Commission on Taxation (Carter Commission).

> "There has been, of recent years, much public clamor for more equitable treatment of the family in tax law. Those involved in this outcry hark back to the religious and social view of marriage which characterizes the man and wife as one. The argument is further advanced in declaring the family an 'economic' unit. In this connection, reference is made to the words of the British Royal Commission on Marriage and Divorce when it said:
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> > 'In the first place, we fully endorse the view that marriage should be regarded as a partnership in which husband and wife work together as equals and that the wife's contribution to the joint undertaking and running the home and looking after the children is just as valuable as that of the husband providing the home and supporting the family. We think that the importance of the wife's contribution is not always sufficiently recognized.'
>
> If this view is acceptable to Canadians, or if it, in fact, expresses the opinion of Canadians, then our tax laws have lost contact with that opinion and cry out for revision."[15]

At this point it might be asked why should those considering a new matrimonial property regime in Alberta concern themselves with the foregoing pro-

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[15] Studies of the Royal Commission On Taxation, No. 10, "Taxation of the Family" by E. J. Mockler, John G. Smith and Claude Frenette, June, 1964, page 2.

visions of the Income Tax Act in such detail? The answer is that a matrimonial property regime will form one of the cornerstones of the marriage contract and it is necessary to analyze the various other forces that affect this contract and here we are examining the effects of income tax on the marriage contract. We see that the Income Tax Act recognizes the separate entity of the spouses for tax purposes, however this equality is illusory only in the majority of matrimonial householders where there in only one spouse working and the other one is looking after the home and children.

Yet it is precisely in this marriage relationships where one spouse is working and the other is not where some of the more serious injustices occur when there is a breakup of the marriage and the property is divided. In these circumstances, the spouse that has been working and generally has all the assets, does not have to divest himself or herself of one half the assets in favour of the other spouse, but usually is required to transfer substantially less. The main thrust of the new matrimonial regime would be to try and avoid some of the inequities in property distribution upon dissolution through the medium of a statutory rule giving the spouse with fewer after-acquiried assets an interest which is not now recognized.

It would seem that the proposed approach only goes half way to solving the problem since one of the main reasons for bringing such legislation into effect is to deal with those marriages where only one spouse is employed. In those circumstances it is proposed that upon dissolution the assets would be divided equally between the spouses and in addition, the matrimonial home would be divided. However, it overlooks the fact that if one waits until the property is obtained, then this is the most unfavourable position to be in from an income tax point of view. It would be far more preferable to have the income of each spouse declared by law to be equally the property of each spouse. If this was done, then both spouses would be taxed separately on this income and by virtue of this income splitting, a tax saving would arise. In this way there would be more property available for both spouses and the object of the property regime would also be achieved.

The proposed matrimonial property regime is similar to the community of property legislation in other jurisdictions and these will be examined later for comparative purposes. It will suffice to say at this point that if only one spouse works and the other spouse remains at home, the Canadian system of taxing such a couple is among the few in the world where such a married couple is not specially recognized for income tax purposes.[16] If the purpose of the community of property regime is to better the lot of the spouses upon dissolution, then it would seem logical to start at the source, that is, the income receipts, rather than at the product of the labours, namely the property that is available on dissolution.

The necessity for dealing with the division of income as opposed to property in the Canadian context arises out of the fact that in many respects the Canadian matrimonial and tax laws in combination are somewhat unique. In the United States, income splitting is specifically permitted under their income tax legislation and therefore whether or not a person lives in a community of property state, the income tax consequences are the same. In France the tax legislation recognizes the marriage relationship and this, is taxed on a different basis than are single taxpayers.[17]

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[16]It might be argued that the spousal deduction is a recognition but the comparison here is in broader terms and it refers to jurisdictions such as the United States or France which in their own way give income tax advantages to married people.

[17]This will be dealt with in greater detail later on in Part III.

7. Constitutional Considerations

Whether or not Alberta would have the jurisdiction to pass legislation purporting to attribute income equally between the spouses is a constitutional question. There is authority for the proposition that section 74 cannot give parliament the power to legislate with respect to property and civil rights and if Alberta should pass legislation to the effect that income is the property of the husband and wife equally, then the Income Tax Act must tax them accordingly and cannot purport to say that notwithstanding that a provincial statute makes certain property that of one spouse that for tax purposes it is the property of the other spouse. This problem was discussed at some length in Study No. 10, "Taxation of the Family" (supra) at pages 12-19 where the authors refer to the case of Romero v. Reed, (1932) 48 C.L.R. 649, an Australian decision dealing with the interpretation of a section in the Australian Income Tax (Management) Act, 1928 (NSW). In the Romero case,

> "Under a deed of separation and supplemental deed, the late Lebbeus Horderon covenanted to pay his wife (the Appellant) during her lifetime the clear annual sum of £10,000.00 free from all State income tax, the intention being that he should pay all income tax assessed against or payable by her in respect of the annuity, and, in the event of any such income tax being paid by her, that he should refund and repay the same, the obligation imposed upon him being limited to the amount of tax which would be assessable against his wife if the amount paid to her by him were only income....
>
> The Appellant was assessed to income tax under the provisions of the Income Tax (Management) Act, No. 35 of 1928, and amending Acts, and also to unemployment relief tax under the provisions of the Prevention and Relief of Unemployment Act, No.

"34 of 1930, and amending Acts. These assessments were levied on the annuity and were paid by the Appellant. In a case stated to the Supreme Court of New South Wales a question was asked whether the Respondents, who were the Executors and Trustees of the Will of the late Lebbeus Horderon, are liable to pay the Appellant the sums or either of them so paid by her. The Supreme Court answered the question in the negative, affirming the contention of the Respondents that they were relieved from the liability under sec. 83 of the Income Tax Management Act, 1928 which provides that every contract, agreement or arrangement shall, so far as it has or purports to have the purpose or effect of in any way, directly or indirectly, altering the incidents of any income tax, be absolutely void, but without prejudice to its validity in any other respect or for any other purpose.

The main contention on the part of the Appellant was that sec. 83 was exclusively concerned with the Crown's sources of revenue and had no other purpose than the protection of the Crown from avoidance and evasion of the tax.

... I think that it is impossible to escape the conclusion that sec. 83 (a) was intended to make void any contract, agreement or arrangement having the purpose or effect of removing the burden from the person indicated by the statute as the proper subject of the charge and placing it upon some other person wholly or in part."[18]

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[18] Rich, J., pp. 656-658.

Applying the Romero case to the Canadian situation, it is argued that property and civil rights are within the purview of the provinces under the British North America Act and section 74 (1) purports to divest the transferee's spouse from the income from the property so long as the conditions in this section are met. In effect, the property rights of the transferee's spouse are being effected.

Although the Royal Commission's study goes on to examine a number of arguments that would be put forth if the issue of ultra vires was raised and provides a rebuttal to these, it does not deal with the effect of provincial Income Tax Acts such as The Alberta Income Tax Act, R.S.A. 1970, c. 182, wherein the Province of Alberta has adopted the federal basis for computing taxable income. For example, section 4 (4) (c) (iii) of the Alberta Act (as amended by S.A. 1972, c. 53) provides that "income for the year" means "in the case of any other individual" his income for the year as determined in accordance with and for the purposes of the federal Act. It would probably be impossible to argue from the point of view of the provincial portion of income taxes that these were not properly levied but the question with respect to the federal portion still remains open.

In any event, the answer to the above question is immaterial for if the constitutional question has merit, it would mean that the provincial legislature could specifically deal with the "ownership" of "income" and therefore if a matrimonial property regime passed by Alberta provided that an undivided one half of the income of one spouse belonged to the other and vice versa, then there would be a strong argument to the effect that the Province was altering the property rights of the spouses in income and the specific legislation would override.

8. Sections 6 (8) and 82 (2)

The Income Tax Act avoids double taxation of attributed income by virtue of section 6 (8) and if dividend income is attributed to a transferor, then section 82 (2) deems the dividend to have been received by the transferor.

C. Attribution of Capital Gains

1. Postponement of Realization of Capital Gains or Transfers

To this point the discussion has centered around "income" as opposed to "capital" as defined in the Act. With the implementation of capital gains tax, new rules have been promulgated for capital gains purposes and these differ from the rules dealing with "income". Capital property is defined to mean[19]

> "(i) Any depreciable property of the taxpayer, and
>
> (ii) Any property (other than depreciable property), any gain or loss from the disposition of which would if the property were disposed of, be a capital gain or a capital loss, as the case may be, of the taxpayer."

Section 73 provides for a tax free rollover of capital property from one spouse to another in the following circumstances:

> "73.
> (1) For the purposes of this Part, where at any time after 1971 any particular capital property has been transferred by a taxpayer to his spouse, or to a trust created by him under which
>
> (a) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and
>
> (b) no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the

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[19] Section 54 (b).

" income or capital of the trust.

and both the taxpayer and the spouse or trust, as the case may be, were resident in Canada at that time, the particular property shall be deemed to have been disposed of at that time by the taxpayer for proceeds equal to,

(c) where the particular property is depreciable property of a prescribed class, that proportion of the undepreciated capital cost to the taxpayer immediately before that time of all property of that class that the fair market value immediately before that time of the particular property is of the fair market value immediately before that time of all that property of that class, and

(d) in any other case, the adjusted cost base to the taxpayer of the particular property immediately before that time,

and to have been acquired at that time by the spouse or trust, as the case may be, for any amount equal to those proceeds.

(2) Capital cost and amount deemed allowed to spouse or trust. Where a spouse or trust, as the case may be, is deemed by subsection (1) to have acquired any particular depreciable property of a prescribed class of a taxpayer for an amount determined under paragraph (1) (c) and the capital cost to the taxpayer of the particular property exceeds the amount determined under that paragraph, for the purposes of sections 13 and 20 and any regulations made under paragraph 20 (1) (a)

"(a) the capital cost to the spouse or trust, as the case may be, of the particular property shall be deemed to be the amount that was the capital cost to the taxpayer thereof, and

(b) the excess shall be deemed to have been allowed to the spouse or trust, as the case may be, in respect of the particular property under regulations made under paragraph 20 (1) (a) in computing income for taxation years before the acquisition thereof."

The effect of these provisions is to postpone the payment of capital gains tax until such time as ownership of the property passes from the spouses. Any income earned on the transferred property by the transferee however is attributed to the transferor in accordance with the provisions dealing with transfers of income, however if there is a capital loss when the transferee disposes of the capital property, then the transferor may take the benefit of the loss for tax purposes to the extent that the transferee is unable to use the losses.[20] The ability of the transferor to take advantage of the transferee's losses is lost if the transferor is dead, is no longer resident in Canada, or is no longer the transferee's spouse.

In many ways the rules dealing with interspousal transfers in the capital property area are the converse of those dealing with the income transfers between the spouses. If capital property is transferred while the spouses are still married, then there is a tax free rollover to the transferee. If the parties subsequently are divorced and the transferee sells the property, then the capital gain is taxed in the hands of the transferee with no attribution of income back to the transferor.

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[20] Section 74 (2).

From the point of view of a matrimonial property regime, the time at which the transfer of properties takes place will therefore be of crucial importance since a transferee may be taking property which will be subject to a large capital gains tax once it is disposed of and yet on the face of it, both spouses may seem to be receiving an equal share of the after-acquired assets if computed upon market value. To illustrate, let us assume the spouses own two buildings, one of which was acquired for $50,000 and now has a market value of $100,000 and the other which was purchased for $100,000 and is presently valued at this amount. Assuming all the other assets have been equalized between the spouses, then a simple division of assets would say that one spouse should take one building and the other spouse the other building and each would have a $100,000 asset. In fact, the spouse that received the building that was purchased for $50,000 would be subject to tax on the gain from $50,000 to $100,000 as soon as it was disposed of, and assuming a tax rate of 50 percent, then there would be a tax payable on the disposition of 50 percent of $50,000 divided by two (since capital gains tax is payable on one half of the capital gain) or $12,500. Therefore, it is obvious that a simple division of assets would not leave the spouses in an equal position as one spouse would in fact only have $87,500 and the other would have $100,000.

The computations become even more involved when it is considered that the realization of a capital gain may be postponed during the owner's lifetime and therefore let us assume that the building, having an adjusted cost base at $50,000 is transferred to the spouse with no income and a computation is made on the basis that if the spouse at that point disposed of the building, then the tax rates would be relatively low. On this basis, the spouse with a taxable income consisting of approximately $25,000 which would be comprised of the capital gain on disposition, would be taxed in the amount of approximately $9,500. This would be a total tax of approximately 35 percent rather than the 50 percent assumed in the first set of facts. However, if the distribution of property was based on the 35 percent tax rate, should any consideration be given to the fact that the owner might hold the property for a number of years and at a later time would be in a higher tax bracket. Furthermore, should any consideration be given to a holding period if it is known that the property will be held for a number of years, for example, land adjacent to a principal residence.

If on the other hand, capital property is not transferred until after the marriage is dissolved, then there will be a disposition for income tax purposes. If this realization is required by law under the terms of the regime, then there would be little leeway for the spouses to determine when any capital gains would be taxed. In this context, it is not certain if the reference to termination of the regime"by formal agreement between the spouses at any time, possibly on judicial separation and on the application of either spouse by court order where termination is 'just and equitable' " would embody agreements which would provide for a disposition subsequent to the termination of marriage or if agreements prior to formal termination are the only ones contemplated.

To illustrate the problem let us assume that the facts of the foregoing illustration, that is, two properties each worth $100,000 and one having an original cost of $50,000, are owned by the spouses. Assume the spouses obtain a divorce in February of a calendar year and the wife decides to take up residence in the United States and moves there in June of the same year. If the matrimonial property regime provides no leeway for the date of transfer, then if the wife takes title to the property having an original cost of $50,000 subsequent to the marriage, there will be a capital gain of $50,000 which will be taxed in her hands in Canada. If however the transfer can be postponed until after she leaves Canada and takes up residence in the United States, then no capital gains tax would be payable in Canada.[21] In these circumstances it is obvious that flexibility could be of

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[21] Canada-United States of America Tax Convention Act, S.C. 1943, c. 21,

assistance to separating spouses since it would be possible to avoid the payment of Canadian tax entirely on the capital gain assuming the disposition took place while the owner was a resident of the United States. In order to determine the total tax picture, it would be necessary to ascertain the transferee's United States tax position, however, for the present purposes the illustration will suffice to illustrate that flexibility in the transfer times could be of assistance to the parties from a tax point of view.

2. Categories of Property

The Act puts assets into a number of categories and the following are a few of the general categories:

(1) "capital property" defined in section 54 (b) above;

(2) "eligible capital property" is defined in section 54 (d) and "means any property, 1/2 of any amount payable to the taxpayer as consideration for the disposition of which would, if you disposed of the property, be an eligible capital amount in respect of a business within the meaning given that expression in subsection 14 (1)."

Section 14 reads as follows:

"14. (1) Where, as a result of a transaction occurring after 1971, an amount has become payable to a taxpayer in a taxation year in respect of a business carried on or formerly carried on by him and the consideration given by the taxpayer therefor was such that, if any payment had been made by the taxpayer after 1971 for that consideration, the payment would have been an eligible capital expenditure of the taxpayer in respect of the business, there shall be included in computing the taxpayer's income for the year from the business the amount, if "any, by which 1/2 of the amount so payable (which 1/2 is hereafter in this section referred to as an "eligible capital amount" in respect of the business) exceeds the taxpayer's cumulative eligible capital in respect of the business immediately before the amount so payable became payable to the taxpayer.."

This category refers to goodwill and other "nothings" which have been given recognition under the present Act and for which limited write-offs are available.

(3) "Listed personal property" is defined in section 54 (e):

"listed personal property" of a taxpayer means his personal-use property that is all or any portion of, or any interest in or right to, any

(i) print, etching, drawing, painting, sculpture, or other similar work of art,

(ii) jewellery,

(iii) rare folio, rare manuscript, or rare book,

(iv) stamp, or

(v) coin. "

Section 41 deals with the taxation of listed personal property and provides that in computing the net gain for a taxation year from dispositions of a listed personal property, the aggregate gains for the year are first offset by aggregate losses for the year. If a gain results any losses from listed personal property for the five years immediately preceding and the year immediately following the taxation year are deducted. The significance of this category is that losses from listed personal property are deductible only to the extent of gains from such property, and they may not be used to offset gains from dispositions of any other kinds of property and they may not be applied against any other income. Furthermore, there is only a five year carry-over for listed personal property losses and therefore such losses may be lost for tax purposes if they cannot be utilized within the five year period.

(4) "personal-use property" is defined in section 54 (f):

"personal-use property" of a taxpayer includes

(i) property owned by him that is used primarily for the personal use or enjoyment of the taxpayer or the personal use or enjoyment of one or more individuals each of whom is

(A) the taxpayer,

(B) a person related to the taxpayer, or

(C) where the taxpayer is a trust, a beneficiary under the trust or any person related to the beneficiary,

(ii) any debt owing to him in respect of the disposition of property that was his personal-use property, and

(iii) any property of the taxpayer that is an option to acquire property that would, if he acquired it, be personal-use property of the taxpayer.

any "personal-use property" of a partnership includes any partnership property that is used primarily for the personal use or enjoyment of any member of the partnership or for the personal use or enjoyment of one or more individuals each of whom is a member of the partnership or a person related to such a member."

Personal-use property is governed by another special set of rules and in particular, any losses from the disposition of any personal-use property are only deductible from gains made on listed personal property[22] and where personal-use property is bought for less than \$1,000, its cost is deemed to be \$1,000 and where it is sold for a price less than \$1,000, its selling price is deemed to be \$1,000[23]. The effect of this is to eliminate the necessity for keeping detailed records of the cost and selling price of chattels for personal use.

In looking at the four general categories listed above, it can be seen that the mix of assets becomes important in determining the after-tax picture, since losses on certain assets can only be offset against gains on other assets within specified categories. If a matrimonial property regime is to take cognizance of the net asset position of the spouses at the time of dissolution, then it will be necessary to compute the market value of all these various categories of assets and then determine the various options available to the parties and it may well be that the assets which one spouse might want would leave the total tax picture in a relatively poor position. For example, if the spouses have purchased an item of furniture such as a dining room suite for say \$4,000 and it has deteriorated to the point where it is only worth \$1,000, then there is a \$3,000 loss on this personal-use property. To take advantage of this however, it would be necessary to have a gain from the disposition of another item of personal-use property or a gain from listed personal property. Let us assume that the spouses have also purchased a painting for \$1,000 but its value has now increased to \$4,000. If these two assets were disposed of by the same party, then the gain and loss would offset each other and there would be no tax. However, if the parties in dividing

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[22] Section 40 (2) (g) (iii).

[23] Section 46 (1).

the ass could not agree that one spouse would take both assets but would maintain that the painting should go to one spouse and the furniture to the other, then from a tax point of view, the painting would not be worth $4,000 since capital gains tax would have to be paid on the $3,000 gain.

In effect, any proposed matrimonial property regime must come to grips with a number of questions:

(a) Who is to decide what assets are to be transferred between spouses?

(b) What basis is going to be used for valuing the assets for the purpose of determining the assets of each spouse? The Act provides that dispositions are to take place at "fair market value"[24] and if any other method is employed, this could have adverse tax consequences.

(c) At what time is the actual disposition between the spouses to take place, before or after the actual dissolution of the marriage?

(d) Is there going to be any leeway on the part of the spouses in determining when disposition takes place?

(e) If on a tally of the assets, one spouse has a substantial unrealized capital gain, will the asset need to be sold if there is no other source of funds to equalize assets?

(f) If the post-marriage increment in value of an excluded asset is to be included in the after-acquired property, is there to be any cost of living or inflationary adjustment factor?

(g) If the pension funds are to be included in the balancing, are they included on a discounted basis considering that the funds are only payable at sometime in the future, or on the present value on the assumption that the spouse concerned terminates his or her employment and presently takes benefits out? If pension benefits have not vested as is the case

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[24] Section 69 (1) (a).

in the first years with most pension plans, will the pension valuation include such funds which have not vested?

3. Principal Residence

The matrimonial home which is singled out in the proposed matrimonial regime as possibly being dealt with separately, is also treated separately for capital gains purposes under the Act. Section 54 (g) defines principal residence as follows:

> "54. (g) "Principal residence of a taxpayer for a taxation year means a housing unit, a leasehold interest therein, or a share of the capital stock of a co-operative housing corporation, owned, whether jointly with another person or otherwise, in the year by the taxpayer, if the housing unit was, or if the share was acquired for the sole purpose of acquiring the right to inhabit a housing unit owned by the corporation that was,
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> (i) ordinarily inhabited by the taxpayer in the year, or
>
> (ii) the property in respect of which the taxpayer has made an election for the year in accordance with subsection 45 (2),
>
> except that in no case shall any such housing unit, interest or share, as the case may be, be considered to be a taxpayer's principal residence for a year
>
> (iii) unless it has been designated by him in prescribed manner to be his principal residence for that year and no other property has been so designated by him for that year, or

(iv) by virtue of subparagraph (ii), if by virtue of that subparagraph the property would, but for this subparagraph, have been his principal residence for 4 or more previous taxation years,

and for the purposes of this paragraph the "principal residence" of a taxpayer for a taxation year shall be deemed to include, except where the property consists of a share of the capital stock of a co-operative housing corporation, the land subjacent to the housing unit and such portion of any immediately contiguous land as may reasonably be regarded as contributing to the taxpayer's use and enjoyment of the housing unit as a residence, except that where the total area of the subjacent land and of that portion exceeds one acre, the excess shall be deemed not to have contributed to the individual's use and enjoyment of the housing unit as a residence unless the taxpayer establishes that it was necessary to such use and enjoyment."

Section 40 (2) (b) provides that the gain from the disposition of a principal residence is not subject to tax so long as the principal residence is designated as such by the owners and is owned for no longer than one year more than the number of years for which it has been designated as a principal residence. Section 40 (1) (c) provides a similar exemption in the case of farm land that is used as a principal residence. Because the principal residence is one of the few areas in the Act where capital gains may be realized and escape income taxation entirely, it is necessary to look at this provision closely to see how it would be affected by a common ownership provision of the proposed regime.

It appears that the term "matrimonial home" is used to describe the residence of the spouses and it is not certain if the definition of matrimonial home is synonymous with principal residence under the Act. Initially, it would appear that the two are not identical since under the matrimonial regime, once there is a marriage and one spouse owns a home, then this would be the matrimonial home. It is presumed that there would be some requirement of habitation by the parties similar to The Dower Act and furthermore, it would be possible to have a number of homes that would fall within the matrimonial home classification if the spouses moved from one home to another. Under the Act an election must be filed specifying the principal residence and it is uncertain how an election under the Act would effect the designation of a matrimonial home. For example, if the husband purchased a home in 1972 and the parties lived in it until 1973 and in 1974 the spouses purchased a second home, this time in the wife's name, and lived in it until the end of 1974 when they were divorced, then under the Act the husband could return to the home that he owned and reside in it and the wife could remain in her home and there would be no adverse tax consequences since both parties could elect to treat their respective homes as principal residences, assuming they resided in them until they were sold. However, if under the matrimonial regime "the matrimonial home be deemed by operation of law to be owned in common", then the exact nature of the non-owner spouse's interest in the matrimonial home would need to be ascertained. If the "non-owner" spouse would be deemed to have an actual interest in the property so that for income tax purposes both would be owners, then it would be necessary for both spouses in 1974 to elect on the same residence or if each elected on his or her own residence, then the other half might be taxed.[25] If therefore the matrimonial property regime was to give each spouse an immediate vested interest in each matrimonial home, then the spouses would be at a disadvantage for income tax purposes since they may lose the exemption for principal residence

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[25]The provisions of Interpretation Bulletin IT-120 dated September 14, 1973, paragraph 4.

which might otherwise be available to them. If, on the other hand, the interest of a non-owner spouse would be contingent, then although this might remove this spouse from the category of owner under the Act, it would not appear that this would satisfy the requirements of the proposed matrimonial regime. Such contingent interest would amount to little more than an extension of the present dower interest from a life interest in the matrimonial home to a half interest in the equity.

Another problem could present itself if the spouses did not contribute equally toward the purchase of the home and subsequently the matrimonial regime was terminated before the termination of the marriage. If the home continues to be a principal residence for income tax purposes there would appear to be no problem however, if a part of the house is rented then the income attribution rules would apply.

To illustrate the point let us assume the husband has made all the payments toward the home and the wife has used her funds for other purposes. In such circumstances, a number of alternatives present themselves:

(1) The husband moves out of the matrimonial home and leaves it for the wife and she continues to reside in it. If the wife has funds of her own and purchases the husband's interest in the matrimonial home, then any income received by the husband from the proceeds of the sale would be attributed to the wife since a transfer includes a sale of property.

(2) Another possibility would be the husband's remaining in the matrimonial home and the wife to leaving. In these circumstances if the husband purchased the wife's interest and took title to the home free and clear of any claim of the wife under the regime, then again monies paid to the wife would be a transfer of property, the

income therefrom would be taxed back to the husband.

(3) The third alternative would be the parties to selling the matrimonial home, then splitting the proceeds. Here the money paid to the wife would probably constitute a transfer of property from the husband and any income earned on these funds thereafter by the wife would be taxed back to the husband.

Although these three illustrations are predicated upon the assumption that the husband would be making all the contributions towards the matrimonial home, the result would be the same if the wife would be making all the contributions or if there was a joint contribution by both spouses but in unequal amounts.

One hesitates to suggest that the definition of the "matrimonial home" should be made the same as "principal residence" for income tax purposes, since the Alberta law would then be tied into a definition in the federal Act, however this is already done in the income tax field with the Alberta income tax, and it would avoid the possibility of conflicts between these two areas.

Even though a sale in the above discussion is considered to be a transfer within the meaning of the Act, it is the position of the Department of National Revenue not to attribute the income or loss from transferred property to the transferor if the sale was made at fair market value prior to 1972.[26]

D. Potential Income Tax Liability of Transferee Spouse

In dealing with the transfer of property between spouses, the potential tax liability of a transferee should be kept in mind. The provisions of section 160

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[26] Interpretation Bulletin IT-136, paragraph 5.

of the Income Tax Act read as follows:

"160. (1) Where a person has, on or after the 1st day of May, 1951, transferred property, either directly or indirectly by means of a trust or by any other means whatever,

(a) to his spouse or to a person who has since become his spouse, or

(b) to a person who was under 18 years of age,

the following rules are applicable:

(c) the transferee and transferor are jointly and severally liable to pay a part of the transferor's tax under this Part for each taxation year equal to the amount by which the tax for the year is greater than it would have been if it were not for the operation of section 74 or section 75, as the case may be, in respect of income from the property so transferred or from property substituted therefor; and

(d) the transferee and transferor are jointly and severally liable to pay the lesser of

(i) any amount that the transferor was liable to pay under this Act on the day of the transfer, and

(ii) a part of any amount that the transferor was so liable to pay equal to the value of the property so transferred;

but nothing in this subsection shall be deemed to limit the liability of the transferor under any other provision of this Act.

"(2) The Minister may at any time assess a transferee in respect of any amount payable by virtue of this section and the provisions of this Division are applicable *mutatis mutandis* in respect of an assessment made under this section as though it had been made under section 152.

(3) Where a transferor and transferee have, by virtue of subsection (1), become jointly and severally liable in respect of part or all of a liability of the transferor under this Act, the following rules are applicable:

(a) a payment by the transferee on account of his liability shall to the extent thereof discharge the joint liability; but

(b) a payment by the transferor on account of his liability only discharges the transferee's liability to the extent that the payment operates to reduce the transferor's liability to an amount less than the amount in respect of which the transferee was, by subsection (1), made jointly and severally liable."

If after a transfer of property between spouses it is found that the transferor was liable for taxes at the time of the transfer, then if the transferor cannot pay the taxes, the transferee will be subject to payment of the taxes as to the lesser of the amount that the transferor was liable to pay under the Act on the day of the transfer and the value of the property so transferred. If therefore the proposed matrimonial regime contemplates a transfer of property prior to the actual dissolution of marriage, this contingent tax liability would remain with the transferee until such time as it was certain that the transferor was not liable to pay any further taxes. The limitation period for reassessment is four years from the day of the mailing of a notice or original assessment or of a notification that no tax is payable for a taxation year except in the case where there is a misrepresentation that is attributable to neglect, carelessness or wilfull default or where there has been a fraud in the filing of a return or supplying any information under the Act, and in the latter instance there is no limitation period.[27]

Therefore, in weighing whether or not a transfer of property should take place before or after the actual dissolution of marriage it is necessary to consider whether or not the advantage of a postponement of realization for capital gains purposes prior to dissolution is outweighed by the potential tax liability which will linger with the transferee. If there is a mandatory disposition of property required between spouses, then it could be disadvantageous for the parties for income tax purposes since at the present the settlement of property is a matter of mutual agreement and can be carried out either before or after dissolution. Furthermore, the wife may elect to take periodic maintenance payments which can be secured by the property owned by the husband and in this way she will receive funds and yet avoid the potential tax liability that the husband may have. It would appear that the provision of periodic maintenance payments equal to the value of the property and secured by a charge on the property would give the wife priority over the Minister of National Revenue, should the Minister try to collect taxes by selling the husband's property.

Section 160 would not apply if the property was transferred after dissolution of the marriage.

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[27] Section 152 (4).

II. TAXATION AND COMMUNITY OF PROPERTY

A. Treatment of Community of Property in Canada

1. Quebec Community

a. Income Tax

i. Earned income

In the Province of Quebec there presently exists a "partnership of acquests" which was introduced in that Province in 1969. This new matrimonial property regime replaced the community of property regime which had been in effect in the Province of Quebec since its inception.

The leading Canadian case on the taxation of income of spouses living under community of property is Sura v. M.N.R., 62 D.T.C. 1005. In that case the husband and wife were resident and domiciled in the Province of Quebec and the husband claimed that one-half of his income belonged to his wife under Quebec community of property and therefore in effect, the income should be split for tax purposes and each spouse taxed on one-half the total. At first instance, the Income Tax Appeal Board[28] found in favour of the taxpayer on the basis that community of property exists from the inception of marriage[29] and that the community includes all income[30]. W. S. Fisher, Q.C. in giving the judgement of the Income Tax Appeal Board stated:

> "As already indicated, I am of the opinion that the wife has a vested interest at all times in her one-half of the community property, whether income or capital; that the legal community

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[28] 57 D.T.C. 478.

[29] Article 1260 of Title IV of Book 3 of the Civil Code.

[30] Article 1272, subparagraph 2, of Title IV of Book 3 of the Civil Code.

"of property under the Quebec Civil Code is not a separate and distinct 'person' such as is envisaged in the definitions in the Civil Code and in the various income tax acts; that the husband is only the agent for himself and his wife in respect of the community of property; and that there is no provision in the Income Tax Acts which tax can be legally assessed against the husband on the full amount of the income arising from the community property, since the husband is not the owner of all the property but only the owner of one-half thereof."[31]

There is no doubt that at that time the rights of a wife under the provisions of the Quebec Civil Code were very restricted. For instance, the wife could not appear in judicial proceedings without her husband or his authorization even if she was a public trader or not common as to property nor could se do so even if she was separate as to property except in limited circumstances.[32]

The Exchequer Court of Canada reversed the Income Tax Appeal Board[33] on the basis that the wife had no interest in the community until the community was dissolved.

On appeal to the Supreme Court of Canada[34], the Supreme Court upheld the Exchequer Court decision but disagreed with the Exchequer Court's interpretation of the basis for taxation. The Supreme Court held that community of property existed from the inception of the marriage. The Court acknowledged that "the

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[31]P. 489.

[32]Article 176 of Chapter IV of Book 1 of the Civil Code.

[33]59 D.T.C. 1280.

[34]62 D.T.C. 1005.

husband and wife are co-owners of the property"[35] however by virtue of the provisions of the Code giving the husband almost exclusive rights to deal with the community property, the Court was of the opinion that any income received by the community was received by the husband since the wife had no power to deal with it. At page 1007, Taschereau, J. stated:

> "It is thus apparent that, without being 'the lord and master of the community' as the ancient authors used to call him, the husband is the only administrator of the community, and has very broad powers. The husband administers the three portions and collects the income from the portions which are used to increase the common assets. He also can dispose of this income, he alone has the unrestricted enjoyment of this income, and nothing can leave the common fund unless it results from the expression of his wish. He receives on his own account, and not at all as agent or fiduciary for the benefit of his wife. The latter withdraws no income and her benefit consists of the increase of the community of property of which she is co-proprietor and in which she has a contingent right to share in a future division."

Then he goes on:

> "... Thus, if it is true, as I believe it to be, that the wife is co-owner of the community property, it is also true that she does not have the exercise of the plenitude of the rights which ownership normally confers (406 C.C.). Her right is formless, dismembered, inferior even to the right of one who has bare ownership of property in which another has a life-interest. Her right is stagnant, nearly sterile,

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[35] At p. 1008.

"because it is unproductive for the duration of the life of the husband. It is only at the dissolution of the community that the wife will be vested with the plenitude of her rights of ownership, which brings with it the *jus utendi, fruendi et abutendi,* of which her married status has temporarily deprived her.

Thus she withdraws no income from the property of the community, of which the husband is the sole administrator (1292 C.C.), without being required, as a general rule, to obtain the concurrence of the wife. All income is his, he may dispose of it, he may alienate it, even gratuitously, except for the restrictions imposed by the law (1292 C.C.). The result is that the wife receives no income from community property, that she has 'no salary, wages and remuneration', that she 'receives nothing from businesses, property, offices and employments.' Now, this is precisely what is taxable.

As I have pointed out earlier, the Act does not address itself to capital or ownership of property. It addresses itself to the person and the amount of the tax is determined by the benefits the person receives. Since the wife withdraws no benefit derived from the community property, it follows that the Department of Revenue cannot claim anything from her."[36]

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[36]Pages 1008-1009.

The present Quebec position is substantially different in that both spouses are equal and the acquests of each spouse are "held in undivided ownership each for one-half"[37]. Each spouse has the administration, enjoyment and free disposal of all his private property and acquests but cannot without the concurrence of the other spouse, dispose of his acquests by gratuitous title inter vivos with the exception of modest sums and customary presents.[38]

No cases have been decided under the new provisions, however in Leduc v. M.N.R., 67 D.T.C. 501, Maurice Boisvert, Esq., Q.C., speaking for the Tax Appeal Board in an obiter remark directed at the Sura decision, stated at p. 504 that:

> "All that discussion appears to me to be quite academic. Since 1964 the Civil Code has undergone several important amendments in respect of the status of husbands and wives in the Province of Quebec and in respect of the rights of a married woman with regard to property common to consorts under the community of property system."

It is possible that under the present provisions a different decision might be arrived at by the Courts. On the other hand when one examines the provisions of the present Quebec Civil Code, it is apparent that neither spouse has the right to deal with the other spouse's acquests and although each spouse holds his acquests one-half for each spouse, the other spouse has no right to deal with this one-half. For example, if a husband holds $1,000 that is an acquest, although $500 of this is deemed to be the property of the wife, the wife still has no power to deal with this except to withhold consent in the case of

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[37]Article 1266 (n), section I, chapter first A.

[38]Article 1266 (o), section II, chapter first A.

gratuitous dispositions inter vivos. When looked at from this point of view, then it is still possible to apply the Supreme Court's reasoning in the Sura case to the acquests of each spouse and therefore tax the income in the hands of the spouse that has title to the acquest, even though one-half of the acquest is actually the property of the other spouse.

The decision in the Sura case was followed within a month in No. 738 v. M.N.R., 62 D.T.C. 32, where the obiter remarks of R.S.W. Fordham, Esq., Q.C. regarding uniformity of tax legislation throughout Canada are interesting. He stated:

> "... in writing the judgment of the Supreme Court of Canada in the Sura appeal, Taschereau, J., made on reference to Minister of Finance v. Cecil R. Smith, (1927) A.C. 193 [1 D.T.C. 92], a Canadian income tax case, wherein Viscount Haldane said, at page 197:
>
> > Moreover, it is natural that the intention was to tax on the same principle throughout the whole of Canada, rather than to make the incidence of taxation depend on the varying and divergent laws of the particular provinces.
>
> It seems to me that this significant statement has marked applicability in the instant appeal also."

It would appear therefore that there is some basis for the claim that the decision of the Supreme Court in the Sura case was founded upon practical grounds as much as on legal grounds.

If one considers that in the case of gift tax and estate tax, both of which are primarily provincial taxes, the community of property has been held to effectively give each spouse a one-half interest in the community without the necessity of any transfer, then the Supreme Court's decision in the Sura case is open to further question. If it is acknowledged that the existence of a community of property regime per se is sufficient to give the wife a one-half interest in the community without the necessity of a transfer from the husband, then it is difficult to see why this same reasoning cannot be applied to income as opposed to capital since in both instances one is faced with the difficulty of accounting for the division of assets between spouses when the customary transfer documents are not employed.

If one looks at the Sura decision as promoting uniformity of the incidence of income tax throughout Canada, a number of developments have taken place within the last decade since the Sura decision which would indicate a definite erosion in this principle: firstly, the various provinces all levy personal and corporate taxes but these vary from 30.5% of the federal tax in British Columbia and Ontario to 42.5% of the federal tax in Manitoba; secondly, Alberta and the Maritime Provinces have abolished death and gift taxes with the intention of attracting private investment capital by making these jurisdictions tax havens; thirdly, Quebec recently passed legislation providing for the effective elimination of provincial corporate tax on investment income earned by companies that qualify as Quebec investment corporations.

ii. Property Income

Although there is no transfer for estate or gift tax purposes of community of property with respect to the spouses' share in Ade v. M.N.R., 63 D.T.C. 27, the Tax Appeal Board attributed the royalty income from community property entirely to the husband since the royalties came from properties originally owned by the husband. In that case, the Tax Appeal Board acknowledged that the original property would not fall within the community but the royalties did and all royalty income had to be attributed to the husband. This decision is less than a page in length and no reasons were given for the Board's finding as it did. However it is difficult to reconcile the decision with the Sura case, since in Sura the Court held that it was the husband who was actually earning the income and had full control over it. In the Ade case, if one assumes that both spouses have an equal interest in the royalties, then no active act is necessary by either spouse and the income accrues from the property which is owned equally. If this is so, then it is difficult to understand how the income from the wife's portion can be attributed to the husband.

b. Gift Tax

In Leduc v. M.N.R. (supra), the spouses made gifts valued at some $186,000 out of community property and each declared half the value of the gifts and paid tax thereon. The Minister of National Revenue returned the wife's payment and assessed the husband on the entire amount. The Tax Appeal Board held that although in 1963 the Quebec Civil Code granted to the wife neither administration nor possession of community property, she nevertheless had a right to the ownership of one-half of that property. Since the wife had to concur in the making of the gifts, she became a taxpayer and as such was personally taxable in respect of the aggregate value of the rights she gave. The Board stated:[39]

> "It is my opinion that the Minister committed an error of law by having the appellant alone bear the burden of the tax connected with the gifts. The appellant could not, alone, give inter vivos the property of the community, he could not therefore be assessed, alone, on gifts made by himself and his wife."

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[39]At page 405.

c. Estate Tax

For purposes of estate tax, it has generally been accepted that one-half of the community property belongs to each spouse and in the case of death, only one-half of the community is taxed as part of the estate of the deceased.[40] This was acknowledged even in the Sura case where the Supreme Court said:

> "... As Mignault again points out, the law states positively that the community begins with the marriage (art. 1269), and that it ends with the marriage.
>
> If it were not so, and if the wife were not co-owner of the community property she would, when the community is dissolved, have to pay succession duties, for it would then be a matter of a trasmission of property from her husband to her. But, this is not the case, for there is no transmission, but a partition in which she takes the portion which is returned to her and which belonged to her since the marriage. What she receives does not come from the patrimony of her husband."

It is acknowledged that this method of dealing with community property for estate tax purposes has worked a great benefit to taxpayers in Quebec who are subject to community of property.[41] The question is academic in Alberta since there are no estate or gift taxes.

d. Renunciation of Community

Although the wife has a one-half interest in the community property upon marriage, if the wife should release her community rights prior to marriage,

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[40] Bernier-Fregeau v. M.N.R., 57 D.T.C. 1005 at page 1009.

[41] cf. Studies of the Royal Commission on Taxation, No. 10, "Taxation of the Family", June, 1964, page 39.

there is no good and valuable asset which she is giving up in return for any consideration she might give for this renunciation.[42] In this respect the treatment of the community interest is analogous to the treatment afforded the dower interest.[43]

2. Foreign Communities in Canadian Jurisdictions

a. Income Taxes

i. Common Law Provinces

The first case to deal with the tax position of spouses living under community of property in the common law provinces of Canada was Reese v. M.N.R., 55 D.T.C. 488, where a United States citizen domiciled and married in California but employed in Alberta, attempted to split his royalty income from a company in California between himself and his spouse. The Income Tax Appeal Board held that the husband had not transferred one-half the royalty income to his wife since this was always hers under the community of property regime and therefore the attribution rules found in the Income Tax Act did not attribute the income she received to him. It is interesting to note that W. S. Fisher, Esq., Q.C. wrote the judgment of the Board in this case and was also the one who wrote the judgment of the Income Tax Appeal Board in the Sura case at first instance. The Reese case was not appealed by the Minister of National Revenue, however on appeal in the Sura case, W. S. Fisher, Esq., Q.C.'s judgment was reversed.

The Reese decision was not followed in Skelton v. M.N.R., 56 D.T.C. 147, where the Income Tax Appeal Board would not allow the United States citizen who became the part owner of a ranch in British Columbia to apportion his income

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[42] The Royal Trust Co. et al v. M.N.R., [1948] Ex.C.R. 34 and 3 D.T.C. 1084.

[43] cf. German v. M.N.R., 57 D.T.C. 1216.

equally between himself and his wife. Although in Idaho the community of property legislation made the income equally the property of each spouse, this was not the basis for taxation in Canada and the community was not recognized. Both No. 676 v. M.N.R., 60 D.T.C. 42 and Pope v. M.N.R., 60 D.T.C. 456 dealing with community of property in Washington and Belgium respectively followed the Skelton case and it has been generally accepted in common law jurisdictions that the community of property under which spouses are married will not be effective to split income for income tax purposes in a common law province.

(ii) Quebec

Bedford v. M.N.R., 64 D.T.C. 419 involved spouses domiciled in California but resident in Quebec and the Tax Appeal Board stated the current position as follows:[44]

> "It is my finding that the Civil Code of California, U.S.A., with respect to the matrimonial regime of the appellant and his wife, living together in Canada, bears no weight at all on the application of the Income Tax Act of Canada. It makes no difference whatsoever if the regime is alike or different from the regime of community of property as it exists in the Province of Quebec. The Income Tax Act of Canada considers solely the residence and the relationship between the resident and his revenue. For the Canadian Act, no consideration is given to any matrimonial separation of property. It applies only to persons and the residence is the determining factor."

(iii) Transfers Prior to Coming to Canada

Although Canadian jurisdictions therefore have not recognized foreign community of property relationships between spouses, they have had to deal with

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[44] Page 423.

instances where parties under community of property have transferred assets pursuant to the community regime prior to coming to Canada. In Wertman v. M.N.R., 64 D.T.C. 5158, the spouses were married in Poland and entered into a community of property arrangement in accordance with the custom prevailing in that country. They came to Canada and brought with them certain funds, invested these and subsequently, the income from this investment, an apartment house, was taxed entirely to the husband. The Court held that the attribution section of the Income Tax Act (now section 74) applied so that it was necessary to trace the origin of the wife's portion of the monies and when this was done it was found that the monies coming to the husband from Switzerland although they were part of the community and therefore owned equally by the spouses, actually came from the husband's assets and therefore for income tax purposes, the income had to be attributed to the husband.

The decision in the Wertman case was given a very narrow meaning in Duplessis v. M.N.R., 71 D.T.C. 153, wherein the Court found that monies brought to Canada by spouses from South Africa were the property of the spouses in accordance with the antenuptial contract entered into in South Africa prior to their marriage in 1949. The husband had transferred certain assets to the wife pursuant to this contract and the wife deposited these monies in South Africa prior to immigration from that country; the husband also had deposited certain monies in South Africa prior to immigration. The Court held that the attribution rules did not operate to tax income arising from property transferred by an individual to a spouse before such individual became a resident of Canada and stated that:[45]

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[45]Page 156.

"The correct principle which strikes me as governing the crucial question in this matter is that, while the Act clearly reaches out its tentacles all over the world to gather in every bit of income to which a taxpayer is entitled, it does not purport to use those selfsame tentacles to explore for possible transfers of property which an immigrant taxpayer may have made to his wife before stepping on to our Canadian shores for the purpose of carving out a home for himself and his family in a new land. In other words, it is my view that, while the Act clearly exerts its sway over individuals born in this country from the cradle to the grave so long as they remain residents of Canada, it only assumes the right to wield such power over other individuals in the world from the time they take up residence in Canada, and that it would be fundamentally unsound to hold otherwise."

Statements in the Wertman case to the contrary were indicated to be obiter and not binding on the Board.

b. Estate Tax

The treatment of community of property assets upon the death of one of the spouses has had a varying history also. The Ontario Court of Appeal in Beaudoin v. Trudel, [1937] 1 D.L.R. 216, recognized the Quebec community of property regime for the purpose of ascertaining the assets of the wife on her death even though the spouses were resident and domiciled in Ontario at the time of her death. The Court however would not apply the entire community of property regime so as to determine who was to succeed to the wife's portion of the assets, but for that purpose stated that the Ontario law dealing with intestate succession applied.

In Pinkus v. M.N.R., 69 D.T.C. 787, the Tax Appeal Board acknowledged that the community of property regime which applied to the spouses, originally married in Poland but residing in Quebec at the time of the husband's death, resulted in an equal division of the community assets on his death.

The more interesting case however is M.N.R. v. Faure, 73 D.T.C. 5236, wherein the deceased was married in Belgium under a matrimonial regime of community of acquests which was sanctioned by the Quebec Civil Code. Under the marriage contract the spouses stipulated that the whole of the community should belong with full right of ownership to the surviving spouse. When the deceased died in Quebec, his spouse inherited his property under his will and the Minister of National Revenue sought to tax the deceased's share of the community arguing that prior to his death, the deceased was capable of disposing of half the assets of the community of acquests and consequently that this was property passing to his widow on his death which should be included in the list of assets transmitted. The Federal Court of Canada Trial Division held that the surviving spouse was at the time of the deceased spouse's death, deemed to have been the owner of the assets in the community from the date of their purchase and this being the case, no part of the community could be taxed by the Minister.

The case is significant for a number of reasons. Firstly, it recognizes that a surviving spouse may be deemed to have the entire interest at the moment of death even though during the lifetime it is unkown whether the spouse has all or none of the interest since this can only be determined by the death of one of the spouses. Secondly, there is a clear indication here that provincial law governing the property rights of the spouses is recognized for federal tax purposes and in this case, estate tax. Admittedly, this was expressly recognized by the statute since section 71 (e) of the Estate Tax Act, S.C. 1958, c. 29, provided:

"(2) For the purposes of this section,

(e) notwithstanding anything in this section the expression in paragraph (a) of subsection (1) 'property of which the deceased was, immediately prior to his death, competent to dispose' does not include the share of the spouse of the deceased in any community of property that existed between the deceased and such spouse immediately prior to his death."

3. Summary

From an examination of the tax treatment of community of property regimes in Canada, it is evident that their treatment for tax purposes is not completely clear. Therefore, in drafting any matrimonial property regime for Alberta, thought should be given to how the interest of the spouses is described and in particular, the amount of control each spouse has over any community asset. If it is felt that the income as well as other property is to be divided with the maximum income tax saving then very explicit provisions must be inserted in the legislation since the courts have been reluctant to sanction income splitting for income tax purposes.

B. <u>The United States Experience</u>

1. History

a. Origin

The origin of the community property system has never been satisfactorily determined, however it is acknowledged that it was not developed by the common law[46]

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[46]Jackson, J.P., "Community Property and Federal Taxes", (1958) 12 S.W.L.J. 1.

nor was it derived from the Roman law.[47] One writer suggests that the system had its origins in the laws of the Visigoths.[48] After a victory in battle, the women and men together gathered spoils of victory and shared the loot equally. In their conquest of Spain, they are supposed to have brought into the Spanish Civil Law this concept of equal sharing between man and wife of the accumulations of the marriage.

Intermediately, the system has been traced to the laws of France and of Spain and it is from these jurisdictions that it was transplanted into certain of the states of the United States.

b. States Having Community of Property

There are eight community of property states - Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington - and while the laws of these eight states have some basic concept of marital partnership, they do have different histories and do vary in substantial detail. For example, Louisiana derived its system from the civil law of France and from the Napoleonic Code whereas Texas derived its system from the Spanish law via Mexico. The common law training of most American lawyers has influenced the community of property concepts in the States and as a result by legislation and judicial decision, the laws of several community property states differ in important detail. In California and Washington income derived from separate property is the separate income of the separate owner, however in Texas and Louisiana such income is community. In the case of New Mexico its system is a hybrid and perhaps not a true community of property system at all since the wife, while entitled to a vested half interest in the marriage accumulations upon her husband's death, is not given any power of testamentary disposition

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[47] C.J.S., § 462 b.

[48] Jackson, <u>op</u>. <u>cit</u>., page 1, note 2.

over her half of the community in the event of her prior death. In this respect the New Mexico law differs from civil law and from the law of other community property states.

There are four principal theories as to what the community of husband and wife is:

(1) The earlier California theory of single ownership in the husband with an expectancy given to the wife;

(2) The entity theory applied to the Washington division under which the entity of husband and wife is the owner of the property. In this entity the members are equal in right and interest although the husband in constituted by the statute the managing agent of the entity;

(3) The trust theory which is espoused in Texas and which holds that the interests of the spouses are beneficially equal but that the legal title is in the husband, the wife's interest being vested but equitable;

(4) The dual ownership theory followed in Idaho, Arizona, Nevada and New Mexico under which each spouse owns an undivided indivisible legal title to one half.[49]

2. Legal Nature of Wife's Interest

The general principle underlying the system of community property is that all property acquired during marriage by the industry and labor of either the husband or the wife together with the produce and increase thereof, belongs beneficially to both during the continuance of the marriage. Therefore although the community property laws in different states differ, they are all in agreement in providing that property acquired by the spouse during marriage is community

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[49] Oliver, C.J., "Community Property and the Taxation of Family Income", (1941-42) 20 Texas Law Review, 532 at 541.

property. (Ariz. Rev. Stat. Ann. §25-211; Cal. Civ. Code §§687, 5110; Idaho Code Ann. §32-906; La. Civ. Code Ann., art. 2334; Nev. Rev. Stat. §123.220; N. Mex. Stat. Ann. §57-4-1; Vernon's Tex. Stat. Ann., art. 5619; Wash. Rev. Code §26.16.030.)

The precise nature of the community of property has never been satisfactorily defined and although it is not a legal entity separate from the spouses, it has been suggested that the marital community is essentially a "business concern" but is in no sense a corporation.[50]

In dealing with this problem, certain writers have attributed the difficulties to the fact that the community property concept is alien to the common law.

> "The precise nature of the wife's interest under the community system of shared ownership and unitary control has been a source of considerable speculation, some fruitful and some otherwise. Lawyers, like others, must work with categories. It is not strange, therefore, that the community has been compared to a partnership, a trust, an estate by the entirety, an inchoate dower right, and an heir's expectancy. It has been frankly concluded that the wife's interest is sui generis, defying common law criteria. When confronted with something alien to their way of thinking, lawyers and judges, raised on common law terminology, have, as a way out of their difficulties, seized upon the concepts of 'vested interest' and 'expectancy' in order to deal with the wife's property right. It would appear to have made little difference which of these two concepts was employed in describing the wife's interest.

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[50] 41 C.J.S., §462 a, page 986.

> "It is not surprising that this dichotomy, which has prevailed in the private law of community property, has been carried over into the federal law of estate and gift tax, as well as the income tax. These revenue measures were constructed entirely upon a common law system of ownership, and no consideration was given to the community property system."[51]

3. The Tax Treatment of Community Property

a. Initial Position

The initial position of the U.S. Treasury was to consent to a husband and wife dividing community income and making separate returns thereof. This position was confirmed in 1920 by the Treasury for all community of property states except California where under the then law, the interest of the wife was considered to be in the expectancy of inheriting from the husband. The right to divide the income was first written into regulations in 1921.[52]

b. Development of the Control Doctrine

i. Income Tax

In order to clarify the tax position the Treasury brought a test case, United States v. Robbins, (1925) 269 U.S. 315, to determine if the husband in California could split his income with his wife for tax purposes. The Supreme Court of the United States found that the wife had a mere expectancy, however stated that even if they were wrong as to the law of California and assuming that the wife had an interest in the community income "that Congress could tax if it so minded, it does not follow that Congress could not tax the husband for the whole."[53]

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[51] Hammonds, O.W. and Ray, G.E., "Federal Tax Problems in Community Property" (1954) 8 S.W.L.J. 127 at page 131-132.

[52] Oliver, C.J., "Community Property and the Taxation of Family Income" (1941-42) 20 Tex. L.R. page 534.

[53] Page 327.

> "Although restricted in the matter of gifts, etc., he alone has the disposition of the fund. He may spend it substantially as he chooses and if he wastes it in debauchery, the wife has no redress.... His liability for his wife's support comes from a different source and exists whether there is community property or not. That he may be taxed for such a fund seems to us to need no argument. The same and further considerations lead to the conclusion that it was intended to tax him for the whole. For not only should he who has all the power bear the burden, and not only is the husband the most obvious target for the shaft, but the fund taxed, while liable to be taken for his debts, is not liable to be taken for the wife's, Civil Code, § 167, so that the remedy for her failure to pay might be hard to find. The reasons for holding him are at least as strong as those for holding trustees in the cases where they are liable under the law."

It will be noticed that the control argument although obiter to the decision since the Court had already found the wife having no present interest, was stated to be the criteria in determining taxability for federal tax purposes. In comparing this decision to the Sura case in the Supreme Court of Canada, it will be seen that the same reasoning was applied by the Supreme Court of Canada when it disallowed the husband's claim to split his income with his wife.

The decision in the Robbins case resulted in the husband even having to include his wife's earnings in his return because of his management and control over them as part of the community, although this was not the case in any of the other states. The effect of this was mollified to a certain extent in Helvering v. Hickman, 70 F, (2d) 985, (1934) which held that the husband and wife in California could contract that her salary should be separate property.

In order to overcome the decision in the Robbins case, California in 1927 added a provision to its Civil Code declaring that the interests of husband and wife in the community property to be present, existing and equal.[54]

ii. Estate Tax

In the estate tax field the case of Tyler v. United States, (1929) 281 U.S. 497 held that there was a taxable death transfer at the death of a tenant by entireties despite the common law principle that husband and wife are one and that the surviving tenants by entireties takes the whole as if he owned it from the beginning. The applicable portion of the Revenue Act provided

> "Sec. 202. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated:
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> (c) To the extent of the interest therein held jointly or as tenants in [by] the entirety by the decedent and any other person, or deposited in banks or other institutions in their joint names and payable to either or the survivor, except such part thereof as may be shown to have originally belonged to such other person and never to have belonged to the decedent."[55]

In dealing with the case the Court went on to say:

> "Death duties rest upon the principle that death is the 'generating source' from which the authority to impose such taxes takes its being, and 'it is the power to

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[54] Cal. Civ. Code (1941) §161.a.

[55] Pages 500-501.

"transmit or the transmission or receipt of property by death which is the subject levied upon all death duties.' ... If the event is death and the result which is made for the occasion of the tax is the bringing into being or the enlargement of property rights, and Congress chooses to treat the tax imposed upon that result as a death duty, even though, strictly, in the absence of an expression of the legislative will, it might not thus be denominated, there is nothing in the Constitution which stands in the way."

. . .

"Taxation, as it many times has been said, is eminently practical, and a practical mind, considering results, would have some difficulty in accepting the conclusion that the death of one of the tenants in each of these cases did not have the effect of passing to the survivor substantial rights, in respect of the property, theretofore never enjoyed by such survivor. Before the death of the husband, ... the wife had the right to possess and use the whole property, but so, also, had her husband; she could not dispose of the property except with her husband's concurrence; her rights were hedged about at all points by the equal rights of her husband. At his death, however, and because of it, she, for the first time, became entitled to exclusive possession, use and enjoyment; she ceased to hold the property subject to qualifications imposed by the law relating to tenancy by the entirety, and became entitled to hold and enjoy it absolutely as her own; and then, and then only, she acquired the power, not there-

> "tofore possessed, of disposing of the property by an exercise of her sole will. Thus the death of one of the parties to the tenancy became the 'generating source' of important and definite accessions to the property rights of the other. These circumstances, together with the fact, the existence of which the statute requires, that no part of the property orginally had belonged to the wife, are sufficient, in our opinion, to make valid the inclusion of the property in the gross estate which forms the primary base for the measurement of the tax. And in that view the resulting tax attributable to such property is plainly indirect."

The Tyler case dealt with tenancies held by residents of Maryland and Pennsylvania and although the Court affirmed that a taxing power did exist in the Federal Government, in fact prior to 1942, the federal tax structure took into account the division of ownership in community property and on the death of one of the spouses, subjected to an estate tax only that spouse's one half of the community property.[56]

After the California amendment in 1927, the Supreme Court affirmed in United States v. Malcolm, (1930) 282 U.S. 792, that the husband and wife could split their income in the State of California.

c. The Ownership Test

Flushed with the success in Robbins, the revenue authorities brought test cases to determine the income tax status of community property income in the States of Washington, Arizona, Louisiana and Texas. The decision in Poe v.

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[56] Hammonds and Ray, "Federal Tax Problems in Community Property" (1954) 8 S.W.L.J. 127 at page 145-156.

"tofore possessed, of disposing of the property by an exercise of her sole will. Thus the death of one of the parties to the tenancy became the 'generating source' of important and definite accessions to the property rights of the other. These circumstances, together with the fact, the existence of which the statute requires, that no part of the property orginally had belonged to the wife, are sufficient, in our opinion, to make valid the inclusion of the property in the gross estate which forms the primary base for the measurement of the tax. And in that view the resulting tax attributable to such property is plainly indirect."

The Tyler case dealt with tenancies held by residents of Maryland and Pennsylvania and although the Court affirmed that a taxing power did exist in the Federal Government, in fact prior to 1942, the federal tax structure took into account the division of ownership in community property and on the death of one of the spouses, subjected to an estate tax only that spouse's one half of the community property.[56]

After the California amendment in 1927, the Supreme Court affirmed in United States v. Malcolm, (1930) 282 U.S. 792, that the husband and wife could split their income in the State of California.

c. The Ownership Test

Flushed with the success in Robbins, the revenue authorities brought test cases to determine the income tax status of community property income in the States of Washington, Arizona, Louisiana and Texas. The decision in Poe v.

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[56] Hammonds and Ray, "Federal Tax Problems in Community Property" (1954) 8 S.W.L.J. 127 at page 145-156.

Seaborn, (1930) 282 U.S. 101, dealt with the Washington position and the Court found that the income from communities should be taxed equally to the husband and wife. In coming to its decision, the Court found that in Washington the wife has "a vested property right in the community property, equal with that of her husband; and in the income of the community, including salaries or wages or either husband or wife, or both."[57]

In dealing with the control argument, the Court said:[58]

> "The Commissioner contends, however, that we are here concerned not with mere names, or even with mere technical legal titles; that calling the wife's interest vested is nothing to the purpose, because the husband has such broad powers of control and alienation, that while the community lasts, he is essentially the owner of the whole community property, and ought so to be considered for the purposes of Sections 210 and 211. He points out that as to personal property the husband may convey it, may make contracts affecting it, may do anything with it short of committing a fraud on his wife's rights. And though the wife must join in any sale of real estate, he asserts that the same is true, by virtue of statutes, in most states which do not have the community system. He asserts that control without accountability is indistinguishable from ownership, and that since the husband has this, quoad community property and income, the income is that 'of' the husband under Sections 210-211 of the income tax law.

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[57] Page 111.

[58] Page 111-112.

"We think, in view of the law of Washington above stated, this connection is unsound. The community must act through an agent. This Court has said with respect to the community property system (Warburton v. White, 1 6 U.S. 494) that 'property acquired during marriage with community funds became an acquest of the community and not the sole property of the one in whose name the property was bought, although by the law existing at the time the husband was given the management, control and power of sale of such property. This right being vested in him, not because he was the exclusive owner, but because by law he was created the agent of the community.'

In that case, it was held that such agency of the husband was neither a contract nor a property right vested in him, and that it was competent to the legislature which created the relation to alter it, to confer the agency on the wife alone, or to confer a joint agency on both spouses, if it saw fit, -- all without infringing any property right of the husband. See also, Arnett v. Read, 220 U.S. 311 at 319.

The reasons for conferring such sweeping powers of management on the husband are not far to seek. Public policy demands that in all ordinary circumstances, litigation between wife and husband during the life of the community should be discouraged. Law-suits between them would tend to subvert the marital relation. The same policy dictates that third parties who deal with the husband respecting community property shall be assured that the wife shall not be permitted to nullify his transactions. The powers of "partners, or of trustees of a spendthrift trust, furnish apt analogies."

The Seaborn decision was followed in the companion cases of Goodell v. Koch, 282 U.S. 118, with respect to Arizona, and Hopkins v. Bacon, 282 U.S. 122, with respect to Texas, and Bender v. Pfaff, 282 U.S. 127, with respect to Louisiana. Since ownership of the community was the determining factor and since laws dealing with ownership were within the purview of the States, the decisions in effect acknowledged that the States could if they wished, effect tax consequences by virtue of the manner in which they dealt with the ownership of marital property.

d. 1942 Estate Tax Amendments

In order to remove the estate tax advantages of the residents of community property states, the United States Congress in 1942 in the Revenue Act of that year passed amendments that provided that on the death of the spouse first to die, all of the community property should be subject to estate tax except to the extent that it could be shown that the community property was derived from the separate property of or from personal services actually rendered by the surviving spouse. It was also provided that in any event there would be included in the taxable estate the one half of the community property over which the deceased spouse had the power of testamentary disposition.[59] However, it soon became evident to the residents of community property states that these amendments did not put them on an equal position with non-community states but in a worse position since they resulted in double taxation in some instances and required tracing which was almost impossible.

The provisions however were upheld by the United States Supreme Court in Fernandez v. Wiener, (1945) 326 U.S. 340, where the Court held that notwithstanding the way the community property was divided upon the death of the husband, according to the laws of Louisiana, the federal estate tax provisions were valid and could

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[59] Hammonds and Ray, "Federal Tax Problems in Community Property", 127 at page 146.

tax community property in a different fashion and in particular, could include in the husband's estate, certain of the property which according to Louisiana law would belong to the wife upon his death. At page 352 the Court stated:

> "It is true that the estate tax as originally devised and constitutionally supported was a tax upon transfers.... But the power of Congress to impose death taxes is not limited to the taxation of transfers at death. It extends to the creation, exercise, acquisition, or relinquishment of any power or legal privilege which is incident to the ownership of property, and when any of these is occasioned by death, it may as readily be the subject of the federal tax as the transfer of the property at death....
>
> Congress may tax real estate or chattels if the tax is apportioned, and without apportionment it may lay an exise upon a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property.... The power to tax the whole necessarily embraces the power to tax any of its incidents or the use or enjoyment of them. If the property itself may constitutionally be taxed, obviously it is competent to tax the use of it, ... or the sale of it, ... or the gift of it. It may tax the exercise, non-exercise, or relinquishment of a power of disposition of property, where other important indicia of ownership are lacking ....
>
> If the gift of property may be taxed, we cannot say that there is any want of constitutional power to tax the receipt of it, whether as the result of inheritance, ... or otherwise,

> "whatever name may be given to the tax, and even though the right to receive it, as distinguished from its actual receipt and possession at a future date, antedated the statute. Receipt in possession and enjoyment is as much a taxable occasion within the reach of the federal taxing power as the enjoyment of any other incident of property. The taking of possession of inherited property is one of the most ancient subjects of taxation known to the law. Such taxes existed on the European Continent and in England prior to the adoption of our Constitution.
>
> It is upon these principles that this Court has consistently sustained the application of estate taxes upon the death of one of the joint owners to property held in joint ownership, measured by the full value of the property so held."

In the income tax field in the case of Commissioner of Internal Revenue v. Harmon, (1944) 323 U.S. 44, the Supreme Court found that a husband and wife under Oklahoma law that elected to have community of property apply were not entitled to split their incomes.

e. Non-Community States Turn to Community for Tax Reasons

The heavy tax burden of the war years brought into the forefront the discrepancy between community and non-community states for income tax purposes and non-community states seriously began to consider the passage of community of property laws to obtain the income tax advantages concomitant therewith.[60] Michigan passed a community of property statute in 1947[61] as did Nebraska.[62]

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[60] Trigg, Paul R., "Some Income Tax Aspects of Community Property Law" (1947) 46 Mich. L. Rev. 1.

[61] P.A. 1947 no. 31 effective July 1, 1947.

[62] Laws 1947, c. 156.

f. 1948 Income Tax Amendments

However, before more states passed similar legislation, the 1948 Congress passed comprehensive amendments to the Revenue Code changing the income, gift and estate tax laws so as to equalize all these taxes as between common law and community property states.[63] The result for income tax purposes was that spouses in the United States could split their income for tax purposes.

In dealing with the United States development in this area it is interesting to note that as early as 1933 suggestions were made to tax the husband and wife as a unit and in 1941 this recommendation failed passage in the House.[64] One of the concerns at that time was the constitutional problem and whether one spouse could be liable to pay the taxes for another spouse. The case of Hoeper v. Tax Commission of Wisconsin, (1931) U.S. 206, had held that Wisconsin State income tax laws providing that the income of husband and wife and of the children under 18 years should be assessed to the husband as head of the family were unconstitutional.

It is interesting to note that in Canada the Carter Commission on Taxation recommended changing the basis for taxing spouses to that of a family unit however this recommendation was not embodied in the recent revisions to the Act. The recommendations of the Carter Commission were not primarily concerned with the tax discrepancies between community provinces and non-community provinces but were based on equity and equality as between various taxpayers in our society.

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[63] Revenue Act of 1948, §§301, 302, 303, 351, 361, and 363 amending Int. Rev. Code of 1939, §§12, 23 (aa), 51 (b), 811 (d), (§811 (c) (2) repealed), 812, 813 and 936 (b).

[64] Oliver, C.T., "Community Property in the Taxation of Family Income", (1941-42) 20 Tex. L. Rev. 532 at p. 556-55 .

4. Some Current Problems

One of the problems presently besetting U.S. taxpayers in community of property states is the problem of capital gains on dispositions between spouses.[65] Fortunately in Canada there is a tax free rollover between spouses and the problem only arises if disposition takes place subsequent to the dissolution of marriage.

Another problem which is inextricably intertwined with any community of property legislation is the tracing problem and the requirement that scrupulous records be kept to enable the parties to determine what is and what is not community property. Most taxpayers are only becoming cognizant of the recordkeeping obligations as a result of the recent imposition of capital gains tax in Canada, however any matrimonial property legislation will require still further recordkeeping since the cost of the property is only one factor and must be considered in conjunction with the source of the proceeds.

An executor of the estate of a spouse in a community of property jurisdiction has special problems since the community assets may have to be apportioned between the deceased and the surviving spouse and in effect the executor must perform a two-fold function, that of an executor of an estate and that of a trustee for the surviving spouse.[66]

Although the initial interest in community of property legislation was a result of its supposed advantages to the spouses and in particular the wife, it must not be forgotten that all rights have concurrent obligations and many of these obligations are only now becoming obvious. The case of United States v. Mitchell (1970) 403 U.S. 190 is a good example of unforeseen consequences which may rise out of legislation which generally may be beneficial. In that case it was held

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[65] For example, Schwartaz, H.E., "Divorces and Taxes: New Aspects of the Davis Denouement", 1967-68, 15 U.CL.L.A. L. Rev. 176.

[66] This problem is discussed in Jackson, J.P., "Community Property and Federal Taxes", (1958) 12 S.W.L.J. 1, pages 33-40.

that a married woman domiciled in Louisiana, where under state law the wife has a present invested interest in community property equal to that of her husband is personally liable for federal income taxes on her one half interest in community income realized during the existence of the community, notwithstanding her subsequent renunciation under state law of her community rights since federal not state law governs what is exempt from federal taxation.

Under the proposed Alberta regime a spouse could renounce his right to the balancing payment even if this would mean the defeat of creditors. Since bankruptcy and insolvency are one of the specific heads of the Federal Parliament, there may be a strong constitutional argument against the validity of such a provision in any Alberta matrimonial property regime.

III. INCOME TAXATION OF SPOUSES IN OTHER JURISDICTIONS AND THE TREND IN CANADA

A. Alternative Methods of Taxing

In commenting on the tax consequences of any matrimonial property regime for Alberta it is necessary to take into account income tax system in other jurisdictions and the trend in Canada. In looking at the possible alternatives available, the authors of Studies of the Royal Commission on Taxation, No. 10 "Taxation of the Family", June, 1964, outlined four possible methods of taxation:

(1) The tax system could ignore families and require each person with income to pay on a single rate schedule and this is basically what is done in Canada at present;

(2) An income splitting system could be used such as that in the United States and Germany where the income of the husband and wife is aggregated and after splitting the income the applicable rate is applied to each. In this system, children are excluded from consideration.

(3) A simple aggregation system as used in the United Kingdom and Sweden where the income of husbands and wives is aggregated and the rate is applied to the whole. The burden on the married couple is then more relatively speaking than on two people, each with his own portion of the total income;

(4) At the other end there is the quotient system where the income of all family members is aggregated and then divided among them, the rate set for the resulting figure being at a rate at which the tax on all the income of the family is levied. This system is found in France.

The detailed examination of the pros and cons of the various systems is beyond the scope of this paper, however one of the more important recent articles[67] on this topic is reproduced as Appendix C to this paper.

B. <u>The Carter Commission</u>

The Carter Commission recommended that the basis for taxing families should be changed from the individual members of the family to the "family unit".[68] The basis for their finding on this point was, firstly, the inequity that is present in our present system of taxation where a couple with one income recipient often pays substantially more tax than another couple with the same aggregate income earned by both spouses.[69]

Secondly, that income splitting is not available to all under the present system and therefore there is inequality as to the burden of tax.[70] Thirdly, that

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[67] Oldman, O. and Temple, R., "Comparative Analysis of the Taxation of Married Persons", (1959-60) 12 Stanford L. Rev. 585.

[68] cf. Report of the Royal Commission On Taxation, Vol. 3, Taxation of Income, Part A - Taxation of Individuals and Families, 1966, pages 142-149.

[69] cf. Report of the Royal Commission on Taxation, Vol. 1, 1966, page 17; Report of the Royal Commission on Taxation, Vol. 2, 1966, page 12; and Report of the Royal Commission on Taxation, Vol. 3, 1966, page 128.

[70] Vol. 1, page 18, Vol. 2, page 12, Vol. 3, page 121.

the family is the basic economic unit of society. In this connection the report states:[71]

> "Our first responsibility is to establish clearly our grounds for recommending the family as the basic tax unit. In a sense, we have already made the case by establishing the inadequacies of taxing the members of a family as individual tax units, the inference being that only by taxing the total family income can these shortcomings be removed. But the case is much stronger than that. We believe firmly that the family is today, as it has been for many centuries, the basic economic unit in society. Although few marriages are entered into for purely financial reasons, as soon as a marriage is contracted it is the continued income and financial position of the family which is ordinarily of primary concern, not the income and financial position of the individual members. Thus, the married couple itself adopts the economic concept of the family as the income unit from the outset. In western society, the wife's direct financial contribution to the family income through employment is frequently substantial. It is probably even more true that the newly formed family acts as a financial unit in making its expenditures. Family income is normally budgeted between current and capital outlays, and major decisions involving the latter are usually made jointly by the spouses. Budget decisions indirectly influence family saving and provisions for retirement, although these are frequently determined on a contractual basis through insurance and pension arrangements, both of which have implications for the family rather than for the individual directly involved."

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[71] Vol. 3, page 123.

Fourthly, that Canada is conspicuous among the major countries of the world in its absence of aggregation with respect to taxation of the family.[72] Fifthly, that in order to try to attain equity, one must recognize that a married couple living together can effect savings in joint accommodation and other expenditures that cannot be effected by two single people living separately. Therefore, it is necessary to recognize that the total income of two spouses should be taxed at a higher rate than the total income of two single individuals assuming both totals are equal, however there should not be a distinction between spouses on the basis of whether or not one spouse earns all the income or whether it is earned equally.[73]

In the light of the Carter Commission findings it is suggested that the comments of Sheppard, A.F. in "The Taxation of Imputed Income and the Rule in Sharkey v. Wernher", (1973) 51 Can. Bar. Rev., page 637, must be discounted. In that article the author stated:

> "Where both spouses are gainfully employed in market activities, they will have greater taxable income than a married couple in which only one spouse is gainfully employed outside the home (assuming that both couples are otherwise identical). The second couple's economic capacity is said to be understated by the value of the spouse's full-time services in the house. And, the exclusion of this form of imputed income is unneutral for it tends to encourage the wife to remain at home rather than to undertake outside employment. Thus the tax system creates a 'barrier' to married women who wish to

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[72] Vol. 3, page 124.

[73] Vol. 1, pages 22-23.

> "work. Even if one subscribes to the view that married women should stay at home anyway, this form of tax discrimination is an inefficient and undesirable means of effecting that social policy. On the other hand, it does encourage marriage: that is, of the male householder to his housekeeper, or of the single woman to her chauffeur!"

Although many of the recommendations of the Carter Commission were accepted and formed the basis for the extensive revision of the Act within the last five years, the taxation of the family as a unit was not accepted. If it should turn out that provincial legislation would result in substantial income tax advantages to residents of certain provinces as opposed to those of other provinces, then it is quite conceivable that the recommendations of the Carter Commission would be re-examined and strong representations made to have a "family unit" system of tax to overcome any possible differentiation for tax purposes between taxpayers in provinces of Canada where income may be split as opposed to those provinces where income may not be split. This movement would be reminiscent of the United States experience in the 1930's and early 40's in trying to overcome the disparity between community and non-community states.

APPENDIX "A"

Income War Tax Act, S.C. 1917, c. 28, s. 4 (4).

(4) A person who, after the first day of August, 1917, has reduced his income by the transfer or assignment of any real or personal, movable or immovable property, to such person's wife or husband, as the case may be, or to any member of the family of such person, shall, nevertheless, be liable to be taxed as if such transfer or assignment had not been made, unless the Minister is satisfied that such transfer or assignment was not made for the purpose of evading the taxes imposed under this Act or any part thereof.

Income War Tax Act, S.C. 1919, c. 55, s. 4 (2).

(2) Subsection three of section four of the said Act is repealed and the following is substituted therefor:—

"(3) Any persons carrying on business in partnership shall be liable for the income tax only in their individual capacity; provided, however, that a husband and wife carrying on business together shall not be deemed to be partners for any purpose under this Act. A member of a partnership or the proprietor of a business whose fiscal year is other than the calendar year shall make a return of his income from the business, for the fiscal period ending within the calendar year for which the return is being made, but his return of income derived from sources other than his business shall be made for the calendar year."

Income War Tax Act, S.C. 1920, c. 49, s. 8.

8. Subsection three of section four of the said Act, as amended by subsection two of section three of chapter fifty-five of the statutes of 1919, is hereby amended by striking out the words "of his" in the seventh line thereof and inserting in lieu thereof the following:—

"and have the tax computed upon the"

Income War Tax Act, S.C. 1924, c. 46, s. 6.

6. Subsection three of section four of the said Act, as enacted by subsection two of section three of chapter fifty-five of the statutes of 1919 and amended by section eight of chapter forty-nine of the statutes of 1920, is repealed and the following is substituted therefor:—

"(3) *(a)* Where two or more persons are carrying on business in partnership the partnership as such shall not be liable to taxation but the shares of the partners in the income of the partnership, whether withdrawn or not during the taxation year shall, in addition to all other income, be income of the partners and taxed accordingly.

(b) A member of a partnership or the proprietor of a business whose fiscal period or periods is other than the calendar year shall make a return of his income and have the tax payable computed upon the income from the business for the fiscal period or periods ending within the calendar year for which the return is being made, but his return of income derived from sources other than his business shall be made for the calendar year.

(c) Where a husband and wife are partners in any business the total income from the business may in the discretion of the Minister be treated as income of the husband or the wife and taxed accordingly.

(d) Where a husband derives income as an employee of his wife or *vice versa* any remuneration paid to the husband or wife shall not be chargeable as an expense of the business in determining the net profit thereof.

(e) Where the husband of a partner in any business receives any salary or other remuneration therefrom, then the portion of the remuneration paid that bears a similar proportion to the interest of the wife in the partnership business shall be added to the income of the wife and taxed accordingly, or *vice versa* if a wife is employed by a partnership of which her husband is a member."

Income War Tax Act, S.C. 1926, c. 10, s. 7.

7. Subsection four of section four of the said Act is hereby repealed and the following substituted therefor:—

"(4) For the purposes of this Act,—

(a) Where a person transfers property to his children such person shall nevertheless be liable to be taxed on the income derived from such property or from property substituted therefor as if such transfer had not been made, unless the Minister is satisfied that such transfer was not made for the purpose of evading the taxes imposed under this Act.

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

Income War Tax Act, R.S.C. 1927, c. 97, ss. 31,32.

31. Where a husband and wife are partners in any business the total income from the business may in the discretion of the Minister be treated as income of the husband or the wife and taxed accordingly.

2. Where a husband derives income as an employee of his wife or *vice versa* any remuneration paid to the husband or wife shall not be chargeable as an expense of the business in determining the net profit thereof.

3. Where the husband or wife of a partner in any business receives any salary or any other remuneration there-

from, the portion of the remuneration paid that bears a similar proportion to the interest of the wife or husband, as the case may be, in the partnership business shall be added to the income of the said wife or husband and taxed accordingly. 1924, c. 46, s. 6.

Transfers to Evade Taxation.

32. Where a person transfers property to his children such person shall nevertheless be liable to be taxed on the income derived from such property or from property substituted therefor as if such transfer had not been made, unless the Minister is satisfied that such transfer was not made for the purpose of evading the taxes imposed under this Act.

2. Where a husband transfers property to his wife, or *vice versa,* the husband or the wife, as the case may be, shall nevertheless be liable to be taxed on the income derived from such property or from property substituted therefor as if such transfer had not been made. 1926, **c. 10, s. 7.**

Income War Tax Act, S.C. 1936, c. 38, s. 13.

13. Section thirty-two of the said Act is amended by adding thereto the following subsection:—

"(3) Where a person transfers property in trust and provides that the corpus of the trust shall revert either to the donor or to such persons as he might determine at a future date or where a trust provides that during the lifetime of the donor no disposition or other dealing with the trust property shall be made without the consent, written or otherwise, of the donor, such person shall nevertheless be liable to be taxed on the income derived from the property transferred in trust or from property substituted therefor as if such transfer had not been made."

Income War Tax Act, S.C. 1939, c. 46, s. 14.

14. Section thirty-two of the said Act is amended by adding thereto the following subsection:—

"(4) Where a person has transferred the right to income to any person connected with him by blood relationship, marriage or adoption, or to a trust for his or their benefit, without transferring the ownership of the property producing such income, he shall nevertheless be taxed on the said income as if the transfer had not been made."

Income Tax Act, S.C. 1948, c. 52, ss. 21, 23.

21. (1) Where a person has, on or after the first day of August, 1917, transferred property, either directly or indirectly, by means of a trust or by any other means whatsoever, to his spouse, or to a person who has since become his spouse, the income for a taxation year from the property or from property substituted therefor shall be deemed to be income of the transferor and not of the transferee.

(2) Where a person has received remuneration as the employee of his spouse, the amount thereof shall not be deducted in computing income from the spouse's business and shall not be included in computing the employee's income.

(3) Where, in a taxation year, a person has received remuneration as the employee of a partnership in which his spouse was a partner, the proportion of the remuneration that the spouse's interest in the partnership business was of the interest of all the partners shall be deemed to have been received by the spouse as part of the income from the business for the year and not to have been received by the employee.

(4) Where a husband and wife were partners in a business, the income of one spouse from the business for a taxation year may, in the discretion of the Minister, be deemed to belong to the other spouse.

23. Where a taxpayer has, at any time before the end of a taxation year, whether before or after the commencement of this Act, transferred the right to income from property to a person connected with him by blood relationship, marriage or adoption or to a trust for such a person's benefit, without transferring the property, the income therefrom for the year shall be deemed to be income of the taxpayer.

Income Tax Act, R.S.C. 1952, c. 148, s. 21.

21. (1) Where a person has, on or after the 1st day of August, 1917, transferred property, either directly or indirectly, by means of a trust or by any other means whatsoever, to his spouse, or to a person who has since become his spouse, the income for a taxation year from the property or from property substituted therefor shall be deemed to be income of the transferor and not of the transferee.

(2) Where a person has received remuneration as the employee of his spouse, the amount thereof shall not be deducted in computing income from the spouse's business and shall not be included in computing the employee's income.

(3) Where, in a taxation year, a person has received remuneration as the employee of a partnership in which his spouse was a partner, the proportion of the remuneration that the spouse's interest in the partnership business was of the interest of all the partners shall be deemed to have been received by the spouse as part of the income from the business for the year and not to have been received by the employee.

(4) Where a husband and wife were partners in a business, the income of one spouse from the business for a taxation year may, in the discretion of the Minister, be deemed to belong to the other spouse. 1948, c. 52, s. 21.

APPENDIX "B"

INTERPRETATION BULLETIN IT-136

SUBJECT: INCOME TAX ACT
Transfers of Property to a Spouse, Child or Minor

SERIAL NO: IT–136 DATE: December 10, 1973
REFERENCE: Section 73, subsection 74(1) and (2), sections 75 and 75.1

1. Subsection 74(1) provides that the income from property transferred to the transferor's spouse or a person who has since became his spouse (whether transferred directly or indirectly by any means whatever including trusts and provisions in marriage contracts) is taxable as income of the transferor and not the transferee while the former is a resident of Canada. Income from property substituted for the transferred property continues to be so taxed. Sales at fair market value made prior to 1972 as described in paragraph 5 below are excepted.

2. Subsections 73(1) and (2) provide in effect, that where capital property is transferred after 1971 to a spouse or to an exclusive lifetime trust for the spouse at a time when the spouse or trust, as the case may be, and the transferor were both resident in Canada, any recapture of capital cost allowance on depreciable property and any capital gains or losses on the disposition of the capital property are deferred until the property is actually disposed of, or deemed to be disposed of, by the spouse or trust. Depreciable property is deemed to be disposed of by the transferor for proceeds equal to its undepreciated capital cost and to have been acquired by the transferee for the same amount. The capital cost allowance already claimed by the transferor is deemed to have been allowed to the transferee. Other capital property is deemed to have been disposed of for proceeds equal to the adjusted cost base of the transferor and acquired by the transferee at the same figure.

3. Subsection 73(3) provides, in effect, that farm land or depreciable property of a prescribed class used in a farming business may be transferred by a taxpayer, either by sale or gift, to his child during the taxpayer's lifetime without the taxpayer realizing either a capital gain or a recapture of capital cost allowance on depreciable property at the time of transfer. The subsection applies only if, immediately before the transfer, the child was a resident of Canada and the property was used by the taxpayer, his spouse or any of his children in the business of farming. For the purpose of the above subsection a child of a taxpayer is defined to include a grandchild or great-grandchild.

4. Subsection 75(1) provides that where a taxpayer has transferred property to a person under 18 years of age (a minor), the income from that property or property substituted therefor is deemed to be income of the taxpayer (the transferor) unless the minor (the transferee) has attained the age of 18 years before the end of the taxation year. The minor need not be a relative of the transferor for subsection 75(1) to apply. Sales at fair market value made prior to 1972 as described in paragraph 5 below are again excepted.

5. For purposes of sections 73, 74, 75, and 75.1, a transfer is considered to include a sale to a spouse, minor or child at fair market value. However, where a sale was made prior to 1972 to a spouse or minor at fair market value and the sale price was fully paid by the transferee in cash or kind and not from funds furnished by the transferor, it is the Department's policy not to attribute the income or loss from the transferred property or property substituted therefore to the transferor. So-called "payment" in services or by means of a note or other promise to pay is not regarded as payment.

6. A transfer does not include a genuine loan made by a person to his spouse. No all-inclusive statement can be made as to when a loan can be considered to be "genuine", but a written and signed acknowledgment of the loan by the borrower and his agreement to repay it within a reasonable time ordinarily is acceptable evidence that it was so. If, in addition, there is evidence that the borrower has given security for the loan, that interest on the loan has been paid, or that actual repayments have been made, it is accepted that the loan was genuine. The fact no interest is required to be paid does not mean, in itself, that a genuine loan has not been made.

Attribution of Income

7. It is necessary to distinguish between income from property and income from a business. Subsections 74(1) and 75(1) do not apply to attribute business income even if the business operates with some or all of the property obtained originally from the transferor.

8. Income derived from the investment or other use of the earnings from the transferred property is considered to be income of the transferee. Interest on any interest allowed to accumulate is also considered to be income of the transferee, but the interest being allowed to accumulate is income of the transferor.

9. Subsection 74(1) also does not apply to attribute income to a spouse (the transferor):

(a) from the date of death of the transferor or transferee;

(b) from the date the transferor ceases to be resident in Canada until the date, if any, when he again takes up residence in Canada; or

(c) from the date the transferee ceases to be his spouse.

In the case of (c), the date the transferee ceases to be his spouse is the date a divorce becomes final. Separated spouses are still considered to be married.

10. Subsection 75(1) does not apply to attribute income to a transferor:

(a) where the property is transferred to a trust for the benefit of a person under 18 years old so that it does not vest in him before he attains the age of 18 and none of the property or the income therefrom is available to or disposable by him, or can be used by the trustee for his benefit, until he attains 18 years or some stated greater age;

(b) from the date of death of the transferor or transferee; or

(c) from the date the transferor ceases to be resident in Canada until the date, if any, when he again takes up residence in Canada.

11. There is some uncertainty in the Act about the proper tax treatment where transferred property or property substituted therefor has produced a loss instead of income. The Department's view is that the transferee may claim all or part of the loss, and any part of the loss not so claimed is deductible by the transferor provided that the loss is not a business loss.

Attribution of Capital Gains and Losses

12. Pursuant to subsection 74(2), where property is transferred by a taxpayer after 1971 by any means to his spouse or a person who has since become his spouse, capital gains net of capital losses in a taxation year from the disposition of the property or property substituted therefor are deemed to be those of the transferor. Likewise, taxable net gains for the year from disposition of transferred listed personal property are deemed to be gains of the transferor. Where however, in a taxation year, capital losses from the disposition of transferred property or property substituted therefor exceed capital gains from the disposition of such property, the Department's view on the allocation of the losses between the transferee and the transferor is the same as expressed in paragraph 11. Subsection 74(2) does not apply if, at the time of disposition, any of the following conditions exist:

(a) the transferor is dead;

(b) the transferor is no longer resident in Canada;

(c) the transferee is no longer his spouse.

13. Subsection 75.1(1) provides that where property described in paragraph 3 above is transferred by a taxpayer pursuant to subsection 73(3) to his child, grandchild or great-grandchild who is under the age of 18 years, capital gains net of capital losses from the disposition of the property by the transferee in a taxation year are deemed to be those of the transferor. This subsection does not apply if, at the time of the disposition, any of the following conditions exist:

(a) the transferor is dead;

(b) the transferor is no longer resident in Canada;

(c) the transferee attains the age of 18 years before the end of the taxation year in which the disposition takes place;

(d) the transfer was made at the fair market value of the property immediately before the transfer.

14. Where a capital gain realized on disposition of transferred property by the transferee has been attributed to the transferor and a substituted property has been acquired by the transferee, the funds representing the portion of the capital gain which accrued after the property was transferred to the transferee are not considered as part of the substituted property. For example, assume that husband transferred to his wife capital property having a cost to him of $20,000 and a fair market value of $50,000. His wife later disposed of the property for $80,000 and the capital gain of $60,000 was attributed to the husband. If the wife then acquired a substituted property with the $80,000 realized by her on the disposition of the transferred property, only 5/8 of any income or capital gain realized from such property would be attributed to the husband.

15. Capital gains arising on the disposition of property transferred before 1972 to a spouse or a person who has since become his spouse, or to a child who has not attained the age of 18 years before the end of the taxation year in which the disposition takes place, cannot be attributed to the transferor under either subsection 74(2) or 75.1(1). While such capital gains are those of the transferee, it should be noted that, subject to the comments in paragraph 5 above, income from such property remains the income of the transferor.

16. Except for the provisions of subsection 73(3), there are no provisions in the Act to defer capital gains or losses on the transfer of property to a minor. Consequently, the transferor may be deemed to have disposed of the property at fair market value at the time of transfer and a capital gain or loss, as well as a recapture of capital cost allowances in the case of depreciable property, may arise at that time. When property that has been transferred to a minor in circumstances where subsection 73(3) did not apply is subsequently disposed of by the minor, resulting capital gains and losses are relevant in calculating the income of the minor only.

Dividend Tax Credit

17. Subsection 83(2) provides, in effect, that where the transferor of property includes in his income a dividend received or deemed to be received by the transferee from a corporation resident in Canada, the transferor is required to gross-up the dividend by one-third and is entitled to the dividend tax credit.

Non-Resident Transferee

18. Where an amount paid or credited to a non-resident of Canada is included in another taxpayer's income by virtue of sections 74 or 75 and is subject to tax under Part I of the Act, subsection 212(12) provides that non-resident withholding tax is not exigible on such amount.

Liability for Payment of Tax.

19. Section 160 provides that the transferee and the transferor are jointly and severally liable for the tax of the transferor that arises through the operation of sections 74 and 75.

APPENDIX "C"

Comparative Analysis of the Taxation of Married Persons*

OLIVER OLDMAN† AND RALPH TEMPLE‡

[T]axation of the combined incomes of husband and wife as one unit . . . provides a unit of taxation that is fairer to those concerned.

ROYAL COMMISSION ON TAXATION,
SECOND REPORT[1]

It is in effect a tax upon marriage and a tax upon virtue.

A. P. HERBERT,
THE UNCOMMON LAW[2]

Fairer unit or tax on virtue? This perennial battle over whether the income of husband and wife should be taxed aggregately or separately is only a part of our theme. The appropriate progressive income tax unit, however, has become the focal point of controversies over the broader problem of the allocation of tax burdens at various income levels among single persons, married couples with only one spouse receiving income, and dual-income married couples.

Tax systems the world over reflect the differing views of nations on these tax burden allocations, as well as on the question whether the aggregation of married couples' incomes is taxation based on fairness or is taxation of virtue itself.[3] A comparative study of these

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* An earlier version of the present Article appeared in 51 REVUE DE SCIENCE FINANCIERE 551 (1959). A substantial part of the information on which this Article is based was developed in connection with a report prepared by the present writers, at the request of the United Nations Secretariat, for the Commission on the Status of Women. Oldman & Temple, *Tax Legislation Applicable to Women* (U.N. Doc. No. E/CN.6/344) (1959) [hereinafter cited as *U.N. Report*].

† S.B. 1942, LL.B. 1953, Harvard University; Assistant Professor of Law and Director of Training of the International Program in Taxation, Harvard University.

‡ B.B.A. 1953, University of Miami; LL.B. 1956, Harvard University; Assistant Professor of Law, George Washington University.

1. Royal Commission on the Taxation of Profits and Income, *Second Report*, CMD. No. 9105, at 36 (1954).

2. HERBERT, THE UNCOMMON LAW 401 (1935).

3. Separate taxation of each spouse is the system used in Argentina, Australia, Brazil, Canada, Dominican Republic, India, Israel, Japan, Mexico, Pakistan, Soviet Union, Spain, Venezuela, and Yugoslavia. Under some circumstances, however, the income of spouses is aggregated in these countries. Some countries aggregate income if the spouses are associated in business. India aggregates the income of a Hindu undivided family; Yugoslavia aggregates the household income of an agricultural commune; and Argentina, Brazil, Dominican Republic, and Spain aggregate community property income. In the Dominican Republic and Spain, aggregation extends to earned income if the spouses were married under a community property regime. Israel, Japan, and Venezuela aggregate the unearned income of husband and wife.

The following countries aggregate the earned and unearned income of the spouses systems offer possibilities of broader perspective, greater insight, and identification of universal principles. Rational allocation of the burdens of progressive income taxation among individual taxpayers, insofar as marital status is concerned, can to a substantial degree be achieved. Some of the approaches in operation in the world today provide better guidelines than others for such achievement.

We begin with a detailed description of the systems now in operation in the Philippines, United Kingdom, Sweden, Canada, United States, and the Netherlands, with references to other countries in illustration of variations on these six basic approaches to the taxing of married persons. After describing the several basic systems, we attempt to analyze the guiding policies and to find workable techniques for their implementation.

Systems

In the following descriptive analysis of the relative burdens of progressive income taxation on single and married persons in several countries, the pendulum of discussion starts with the aggregation systems which impose relatively higher burdens on married than on single persons, swings through the separate taxation systems which are neutral in part or in whole, and ends with aggregation systems which place higher burdens on single than on married persons. With exceptions noted below, the aggregation systems impose the same burden on all equal-income couples, while the separate taxation systems differentiate among such cou-

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for application of progressive tax rates. Except in Germany and the United States such aggregation is mandatory:

Belgium	Greece	Philippines
Ceylon	Italy	Sweden
China (Republic of)	Lebanon	Switzerland
Colombia	Malta	Thailand
Denmark	Netherlands	Turkey
Finland	Netherlands Antilles	Union of South Africa
France	New Zealand	United Kingdom
Germany	Norway	United States
Ghana	Peru	

All of these countries have some provisions which effect a reduction of the tax burden on married couples. In Ceylon, see note 22 *infra*, Colombia, Draft Law No. 462, 4 Dec. 1958, art. 13, Anales del Congreso (expected to be in effect in 1960), France, Germany, and the United States, the aggregate incomes are split, which results in lower rates. Reduced rates are applied directly to the aggregate incomes in several countries, including the Netherlands, Norway, and Sweden. Among those countries in which allowances are permitted for the wife's earned income are Denmark, Finland, Norway, Switzerland, and the United Kingdom. Aggregation of the earned income of the wife with that of the husband is limited in scope in Belgium, Greece, Italy, and New Zealand.

ples but not among equal-income individuals. For all the systems, at the lowest levels of income, there is little or no difference in tax burdens among married couples or between single and married persons because most of the income at such levels is taxed at the same beginning rate. At levels of income substantially beyond the beginning of the top bracket, there is also little differentiation made by the several systems because, except in the Netherlands, all taxpayers at such levels pay the same maximum rate on most of their income. At intermediate levels of income, however, the different methods of taxation produce wide variations in the allocation of tax burdens because at these levels the differing and increasing marginal rates of taxation operate on most of the income subject to tax.[4]

In the Philippines,[5] married persons must file consolidated returns covering all the incomes of both spouses. The personal exemption of single persons is 1,800 pesos, while that for married couples is 3,000. Rates are three per cent on the first 2,000 pesos, six per cent on the next 2,000, nine per cent on the next 2,000, thirteen per cent on the next 4,000, and continue up to a maximum of sixty per cent on amounts over 2,000,000. Quite clearly, when each spouse has income, aggregation pushes the combined income into brackets taxed at higher rates than would be applicable if each spouse were taxed separately. For any given amount of total income, the more nearly equal are the separate incomes of the spouses, the greater is the additional tax borne by the couple over what they would pay if taxed separately. Conversely, where one spouse receives all the income, the burden on the couple is identical to what it would be under separate taxation, except for the increase in personal allowance from 1,800 to 3,000 pesos. At very high income levels, the total tax on the married couple with two incomes is always greater than it would be for two single persons with corresponding incomes, despite the fact that in both cases all the income beyond 2,000,000 pesos is taxed at the same marginal rate.

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4. Our concern is with variations based solely on marital status. Detailed analysis of differing burden allocations necessitated by differences in *dependency* situations among married couples, and between married and single persons, is beyond the scope of the present Article. Such differentiations are almost universally effected by various allowances, not by applying different systems, such as aggregation and separate taxation. However, it is to be noted that different systems are employed in the United States, through the head of the household provisions, and Finland, through a triple rate structure, to effect further dependency differentiations among single persons. See *U.N. Report* paras. 33, 35–41.

5. Information on the Philippines is taken from the Philippine government's reply to the Secretary General's request for information. This reply was published as an addendum to the *U.N. Report*, U.N. Doc. E/CN.6/344/Add. 2 (1959). See also Philippine Internal Revenue Code §§ 21, 23, 45.

However, the relative amount of extra tax on the married couple declines as the total income rises. The total tax on the two single persons thus approaches asymptotically the always greater total tax on the married couple with two incomes. The total tax on single and married persons never quite becomes equal because the aggregation of the incomes of the married couple gives them the benefit of the rates in the lower brackets only once, rather than twice, as would be the case if they were taxed as two single persons. This asymptotic relationship is an inherent characteristic of an aggregation system using a single progressive rate structure for all taxpayers. At the very lowest bracket of taxable income, the combined effect of aggregation and the differing exemptions for the single person (1,800 pesos) and the married couple (3,000 pesos) causes a heavier burden on married persons with two incomes than on single persons. The heavier tax burden would be eliminated or reversed in the lowest bracket if the exemption for the married couple were exactly twice that of the single person, as it is in Norway and the United States.

Therefore, it may be said with only minor qualification that the aggregation system employed in the Philippines taxes the married couple with two incomes more heavily at all levels of income than two single persons with corresponding incomes, but that the additional burdens on the married couple at the very lowest and the very highest levels of income are relatively slight. With some modification, the same is true of Ceylon (prior to 1959)[6] and Turkey,[7] although their exemption patterns cause somewhat different relationships between single and married persons at the lowest income levels.

In the United Kingdom,[8] although the spouses may elect to be assessed separately, their tax is computed on their aggregate income. With regard to earned income, however, the tendency of an aggregation system to place a heavier tax burden on married couples than on single persons is offset for the great majority of married taxpayers by various personal allowances. The first 360

6. *U.N. Report*, paras. 25, 26; CEYLON SESSIONAL PAPER XVII—1955—REPORT OF THE TAXATION COMMISSION 206–10 (1955).

7. See Law No. 5421 of June 3, 1949, as amended by Law No. 6908, 1958, §§ 32, 78 (Personal Income Tax Law of Turkey).

8. Information on the United Kingdom was obtained in part from the *U.N. Report*; in part from Royal Commission on the Taxation of Profits and Income, *Second Report*, CMD. No. 9105 (1954); and in part from HARVARD LAW SCHOOL INTERNATIONAL PROGRAM IN TAXATION, WORLD TAX SERIES: TAXATION IN THE UNITED KINGDOM ch. 12 (1957, Supp. 1958).

pounds of the earned income of each spouse is, in effect, taxed separately through the operation of provisions for reduced rate relief. Also, a personal allowance of up to 140 pounds is granted to couples if both spouses have earned income. This allowance is over and above the 240 pounds personal allowance granted to all married couples, as compared to 140 pounds for single persons. In addition, the earned income allowance available to both spouses was increased in 1957 so that now a maximum earned income allowance of 1,550 pounds can be taken. The allowance is granted in the amount of two-ninths of the couples' earned income up to 4,005 pounds and one-ninth on the next 5,940 pounds.[9] Thus, in addition to reduced rate relief, the maximum allowance where both spouses work is 1,930 pounds (140 + 240 + 1,550).

The effect of these allowances in the United Kingdom is that married taxpayers at the lowest levels of income are taxed less heavily than two corresponding single persons. From that point to the point where surtax levels are reached, the married couple bears virtually the same burden of tax on earned income as the two spouses would if separately taxed. The surtax level for the married couple is not reached until a minimum of 2,100 pounds of income is received. Most married taxpayers, however, do not reach the surtax level until a still higher level of actual income because of the various personal allowances available to them. It has been reported that surtax affects only one and two-tenths per cent of the taxpayers.[10] Those married couples who are affected by the surtax are subject to the increased burden which aggregation usually tends to impose on married couples. With regard to earned income above the surtax level but below a total of 9,945 pounds, however, the recently expanded earned income allowance considerably modifies this increased burden in an absolute sense, but does not affect it relative to single persons to whom the same allowance is also available. The earned income allowance thus effects a reallocation of tax burdens between earned and unearned income but not generally between single and married persons as such. With regard to unearned income, the effects of aggregation are unmitigated.

9. Finance Act, 1957, 5 & 6 Eliz. 2, c. 49, § 12(1) (United Kingdom). The British earned income allowance is analogous to the earned income credit that was a feature of United States tax law in the years 1924–1931 and 1934–1943. U.S. Treas. Dep't, The Tax Treatment of Earned Income (Press Service No. S-530, 1947), reprinted in part in Surrey & Warren, Federal Income Taxation 265 (1955).

10. *U.N. Report*, para. 45.

In Sweden,[11] the spouses file separate returns, but their incomes are aggregated in computing tax. The tax rate schedule applied to the married couple is different from that applied to single persons. The lowest rate is eleven per cent in both rate schedules, but it is applied to the first 8,000 kroner of a married couple's income as compared to the first 4,000 kroner of a single person's income. The next 2,000 kroner in each case is taxed at seventeen per cent. From that point until 60,000 kroner is reached, the bracket widths remain the same, but the rates applicable to the married couple's aggregated income are slightly less than those applicable to single persons. From 60,000 kroner up, both the rates and bracket widths are the same: fifty-four per cent from 60,000 kroner to 100,000 kroner; fifty-nine per cent to 150,000 kroner, and sixty-five per cent on the excess. In addition to the lower rate schedule applicable to married persons, an earned income allowance of 300 kroner is given where both spouses receive earned income independently of each other. This allowance is increased to ten per cent of the wife's earned income up to a maximum allowance of 1,000 kroner if the couple has a child under sixteen years of age living at home. The allowance is above the personal exemption, which varies with location within the country and which is twice as high for the married couple as it is for the single person not supporting children.

The relative burdens of taxation on single and married persons vary with the level of income. At the lowest brackets spouses earning unequal amounts of income are taxed less heavily than if they were taxed as two single persons. If the spouses earn equal amounts of income, the tax is also less than if they were taxed separately because of the earned income allowance which is not available to single persons. If the earned income allowance is not considered, the effect of Sweden's dual rate system in the lowest bracket is the same as that of the United States system of splitting, with the result that where one spouse has all the income, the couple is taxed less heavily than if the two spouses were taxed as single persons. In fact, couples in which only one spouse has income bear a lighter total tax at all income levels, though their marginal rates of tax are identical to those of single persons at income levels above 60,000 kroner. Where both spouses have equal incomes, they bear a tax at the lower income levels which is approximately the same

11. The information on Sweden was obtained from HARVARD LAW SCHOOL INTERNATIONAL PROGRAM IN TAXATION, WORLD TAX SERIES: TAXATION IN SWEDEN ch. 12 (1959).

as if they were singly taxed, but, as their aggregate income increases, they bear a progressively greater tax burden than if singly taxed. Where one spouse's income is much smaller than the other's, there are some combinations of these incomes, even at brackets beyond the lowest ones, where the total tax on the couple is less than if the two spouses were taxed separately. On marginal increments of income beyond 60,000 kroner, the extra burden of aggregation is analogous to that in the Philippines or that at surtax levels of income in the United Kingdom. At levels beyond 150,000 kroner the extra burden of aggregation decreases asymptotically.

In Canada,[12] the entire income of each spouse is taxed separately with the exception that the income of a spouse whose total income is less than 250 dollars is not taxed at all.[13] As a matter of convenience, a spouse with no more than 1,250 dollars of income aggregates it, in effect, with the income of the other spouse. The effect of aggregation is accomplished by reducing the spousal allowance, normally 1,000 dollars, by the amount by which that income exceeds 250 dollars. Separate returns may be filed by the spouses in any event and are required where each spouse has income of more than 1,250 dollars. Section 21 of the Canadian Income Tax Act[14] taxes to the transferor the income from any property transferred by one spouse to the other as long as they are married and the transferor is alive. In addition, this section does not permit the separate taxation of the remuneration of a spouse who is directly or indirectly employed by the other spouse. With the exception of transactions coming within the purview of section 21, the tax burdens on single and married persons in Canada are virtually identical. However, unlike aggregation systems including those discussed below, but somewhat like the Israeli system,[15] the separate taxation system substantially differentiates among married

12. Income Tax Act (Office Consolidation) §§ 2, 21, 26 (1958) (Canada).

13. McGurran, *Principles of Income Tax: 1. Introduction to the Federal Income Tax*, 6 CAN. TAX J. 372, 378 (1958).

14. See note 12 *supra*.

15. In Israel, only the incomes of the spouses earned independently of each other are taxed separately under the single rate schedule applicable to all individual taxpayers. At all income levels, therefore, married couples in Israel bear the same tax burdens on their earned incomes as do single persons except for some variations caused by different personal and dependency allowances. Unearned income is aggregated, however, and married couples with two such incomes are taxed more heavily than are two single persons with corresponding incomes. Israel Income Tax Law, Sept. 1, 1958, § 23, as published in English by Israel Business Books Ltd., Haifa, Israel. See also ISRAEL MINISTRY OF FINANCE, A SHORT GUIDE TO TAXATION IN ISRAEL (1959). The general scheme of taxation provided in the statute calls for compulsory joint returns, following the United Kingdom pattern, but § 23 produces the characterization described in this footnote.

couples on the basis of varying distributions of income between the husband and wife. For example, at middle income levels in Canada, there is considerably greater total tax liability imposed on a married couple in which one spouse receives all the income, than on one in which the income is received in equal parts by each spouse, even though both couples have the same total income. The aggregation systems of the United Kingdom and Sweden, as already noted, obtain differentiation among married couples through the less pervasive device of allowances based on whether one or both spouses work.

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

In the United States prior to 1948, the method of taxing single and married persons was much the same as that of Canada, except that there was no provision quite like that in section 21 of the Canadian Income Tax Act.[16] Thus, in the United States, it was common for spouses to transfer property (subject to gift tax where applicable) to each other in order to minimize total income tax burdens.[17] It was also common for spouses to form partnerships in order to attempt to divide earned income.[18] Such partnerships were a great source of disputed tax liabilities, since often one of the spouses rendered little or no services to the partnership and provided little or no capital.[19] In 1948, the United States adopted the splitting system,[20] which is similar to the quotient system of

16. See note 12 *supra*.
17. Pechman, *Income Splitting*, in 1 Tax Revision Compendium 473 (1959).
18. See Surrey, *Federal Taxation of the Family—The Revenue Act of 1948*, 61 Harv. L. Rev. 1097, 1111-12 (1948).
19. See, *e.g.*, Commissioner v. Tower, 327 U.S. 280 (1946).
20. Revenue Act of 1948, § 301, 62 Stat. 114.

France, except that the income of children is not aggregated with that of the parents and the income is invariably divided into only two parts in computing the tax.[21] In France the aggregate income is divided into one part for each spouse and one-half part for each child, with special "parts" for other relatives and widows.[22]

The adoption of income splitting in the United States was probably not the result of a conscious policy of attempting to reallocate tax burdens between single and married persons. Splitting was introduced at a time when several converging pressures made it politically expedient to adopt this method. First, there was the growing problem of the discrimination in tax burdens between married persons living in states of the United States which had community property regimes and married persons living in other states. Under the community property laws, the income earned by each spouse was treated as owned equally by husband and wife. Federal income tax law permitted the wife in such states to be taxed separately on her half of her husband's earned income.[23] After World War II, some of the noncommunity property states began to change their property laws in order to provide lower federal tax burdens on married couples resident there.[24] Some federal action was needed on this problem.

Second, 1948 was a year in which a Republican Congress was determined to obtain a twenty per cent tax reduction in the face

21. In New York State the earned income of unemancipated children is taxed to the parents (who may elect separate taxation as between themselves). This rule of taxation seems to be based on the parents' legal right to the personal services of the child. See N.Y. Tax Reg., art. 525, in CCH STATE TAX CAS. REP. (N.Y.) ¶ 18-309 (1958). The rule is anomalous in that the earned, but not the unearned, income is aggregated. Moreover, the rule, which has recently been the subject of political controversy, see New York Times, March 1, 1960, p. 1, col. 5 ("State Prods Parents to Declare Children's Pay as Babysitters"), seems to be founded on administrative interpretation rather than on explicit statutory language.

22. Code General des Impôts, arts. 193–97 (France 1959). The new system introduced into Ceylon in 1959 is a quotient system similar to that of France, but with less extreme differential tax burdens between single and married persons. In Ceylon single persons and married *men* are each entitled to one and one-half parts; one-half part is then added for a wife, each child, and each dependent relative, up to a maximum of four parts for any one family. CEYLON DEP'T OF INLAND REVENUE, THE NEW TAX SYSTEM 13–22 (1959).

23. The same problem is now before the Canadian courts. The Canadian Department of National Revenue has not been permitting the separate taxation that the United States allowed in community property states. Thus, a taxpayer in the Province of Quebec, which has community property laws, challenged the Department's practice. The Income Tax Appeal Board held that the income must be split in two parts. No. 445 v. Minister of Nat'l Revenue, 57 D.T.C. 478 (1957) (in camera), *rev'd sub nom.* Minister of Nat'l Revenue v. Sura, 59 D.T.C. 1280 (Can. Ex. Ct. 1959). The case is now pending before the Supreme Court of Canada.

24. Oklahoma's 1939 community property law was unsuccessful for tax purposes, Commissioner v. Harmon, 323 U.S. 44 (1944), but its 1945 law succeeded. Weisbard, *Michigan's Community Property Tax Problems*, 25 TAXES 773 (1947).

of a threatened veto by a Democratic President. In 1947, the same Congress had unsuccessfully attempted to muster enough votes to override a veto of a general twenty per cent tax reduction bill.[25] In 1948, however, Congress' tax reduction bill combined splitting for all states with a lesser reduction in rates than previously sought. Largely because the splitting device equalized the tax treatment of married persons in all states, the Republicans were able in 1948 to obtain enough votes to override the presidential veto that followed the first passage of the bill through Congress.[26] About two years later the rates were again raised, at the time of the Korean conflict, but splitting remained.[27]

In practice, virtually all married couples in the United States aggregate and split their incomes,[28] although they are entitled under the law to be taxed separately. If the actual income of one spouse is in fact equal to that of the other, their total tax is always exactly the same, subject to minor exceptions due to certain deductions,[29] whether they elect to be taxed separately or elect to aggregate the split. The advantage of splitting, as opposed to separate taxation, arises when one spouse has more income than the other; the larger the disparity in the income distribution between the spouses, the greater is the tax advantage. Where one spouse has all the income, splitting may still be elected and the advantage of splitting is at its maximum. However, because of the progressive rate scale, the amount of this advantage varies greatly according to the level of income, as described below.

In the United States, as in other aggregation systems, there is no difference in the tax burdens of married couples with the same total incomes. However, unlike those aggregation systems already discussed, which at some levels of income place a heavier burden on married couples than on single persons, the United States system reverses the positions and places the heavier burden on single persons. At lower levels of income, the extra burden on single

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25. See Surrey, *supra* note 18, at 1097.

26. For a discussion of the background of splitting in the United States and of various proposals for modifying the present system, see SURREY & WARREN, FEDERAL INCOME TAXATION 889–906 (1955).

27. For rate increases see Revenue Act of 1950, § 101, 64 Stat. 910, and Revenue Act of 1951, § 101, 65 Stat. 459.

28. U.S. TREAS. DEP'T, STATISTICS OF INCOME—INDIVIDUAL INCOME TAX RETURNS FOR 1954, table C, at 11 (1957).

29. For example, where the income of each spouse is the same and each of them has excess capital losses, then by filing separately each can deduct up to $1,000 of capital loss from other income, while by filing jointly they would have to share a single $1,000 capital loss deduction. Treas. Reg. § 1.1211-1(d) (1957).

persons is nil, except that the twenty per cent rate in the lowest bracket could be lowered as a result of the revenue which would be gained if married couples with higher incomes were not permitted to split. The majority of married couples in the United States have taxable incomes not in excess of 4,000 dollars,[30] and splitting that amount merely removes the income over 2,000 dollars from the twenty-two per cent rate bracket to the twenty per cent bracket. Therefore, most married persons pay about the same amount of tax as they would without splitting, irrespective of the actual distribution of income between the spouses. In the middle brackets, married couples realize an increasing tax advantage as the marginal rates rise to fifty per cent and more. The relative burden on single persons rises with greater income, so that at about 25,000 dollars of income they pay a tax bill that is more than twenty-five per cent higher than that of a married couple with the same income. In the upper brackets, the married couple's advantage diminishes, but persists even beyond the ninety-one per cent top rate applicable to income over 200,000 dollars for single persons and, because of splitting, 400,000 dollars for the couple. At 500,000 dollars of income the single person pays about six per cent more tax than the married couple.

The Netherlands[31] is one of the few countries other than the United States which consistently taxes single persons more heavily than most married persons. It is reported that at some levels of income single persons in the Netherlands pay fifty per cent more tax than married persons.[32] This is done by aggregating the incomes of husband and wife and applying a separate rate schedule that is lower at all levels of income than the one applicable to single persons. However, where both spouses have equal incomes, there are some cases where the tax they pay on their aggregate income is higher than they would pay if each were separately taxed at the rates applicable to single persons. Thus, in the Netherlands, as in the United States, the relative advantage given to married couples decreases as the actual incomes of the two spouses become more nearly equal.

Countries other than the United States and the Netherlands

30. U.S. TREAS. DEP'T, *op. cit. supra* note 28, chart 1, at 7, table 1, at 33.

31. *U.N. Report*, para. 32; FEDERATION OF BRITISH INDUSTRIES, TAXATION IN WESTERN EUROPE 102 (1959); VAN HOORN & VAN WAARDENBURG, 13 INTERNATIONALE STEUERN: NIEDERLANDE (Eiche ed. 1959).

32. *U.N. Report*, para. 32.

which impose extra tax burdens on single persons are Bulgaria, Czechoslovakia, Poland, the Soviet Union, and Spain.[33] These other countries also usually impose the same extra burden on married couples without children.

Rationales

The various approaches to the problems of allocating tax burdens among married couples and between married and single persons are largely dependent on complex economic theories, as well as the conflicting political and social interests unique to each country. Generalization is therefore difficult, but some understanding can be gained by a discussion of the economic, administrative, social, and other policy considerations that are operative in the different approaches taken.

Economic

(1) *Units.* The initial question countries have had to answer in approaching the allocation of tax burdens is whether or not the characteristics of the marriage relationship are such that all married couples with the same total incomes should pay approximately the same total tax.[34] Logically, the context of tax policy in which these characteristics might or might not have significance should first be defined. However, economists, sociologists, and lawyers can reach little agreement on notions of taxable capacity, ability to pay, sacrifice, marginal utility, economic stability, and redistribution of income and wealth.[35] Such questions go beyond the problem of the married couple; they are basic to all systems of progressive taxation. Even if one or more of these theories were agreed upon by the experts, it is difficult to imagine its acceptance by the electorate without modifications conforming to the conflicting political and social interests within the particular country. These factors make difficult an evaluation of the tax significance of similarities and dissimilarities among married couples.

By what rationale, then, have many countries decided that married couples with the same taxable income should pay approxi-

33. See *U.N. Report*, paras. 16, 40; *e.g.*, Act No. 76/1952 Concerning the Wage Tax (Czechoslovakia), which imposes a 60% higher tax on unmarried taxpayers or those who are married but have no children.

34. See note 4 *supra*.

35. See generally Blum & Kalven, The Uneasy Case for Progressive Taxation (1953).

mately the same total tax? The focus of taxation on close social units and, specifically, on the married couple, is perhaps most rationally conceived in terms of a common pool of income or wealth, which constitutes the married couple as a spending or utilizing unit. The concept of a common pool of income does not necessarily mean that either spouse has complete access to the other's income. However, it assumes that in the vast majority of cases the spending habits and living standards of husband and wife are dependent on the same factors and that income is meaningful to each of them more on the basis of relative needs than according to which of them earned it. While there may not be agreement on just which principles of economics and equity are being pursued by progressive taxation, there is a widespread belief that, for the purposes of any reasonable policy of progressive taxation, the economic lives of a husband and wife are inseparable.[36] It is conceivable that some countries base their progressive taxation on theories of economics and equity which place no significance on the spending unit, but are directed solely to the sources of income. Such countries would naturally tax income according to source units, rather than according to utility or spending units. A person with two or more sources of income would be taxed progressively on each source as a separate unit.[37] Husband and wife would be taxed separately and pay less total tax than another married couple in which one spouse received the same total income, because they received it in separate smaller quantities. It is most likely, however, that the concept of a spending or utilizing unit is inherent in any reasonable explanation of progressive taxation.

In countries where clannishness of families, patriarchal control, or other socio-economic habits result in economic closeness and interdependence of the members of the societal groups, those groups have been viewed as appropriate taxable units.[38] In most countries, however, the economic lives of persons in associations other than marriage are rarely as interrelated as in the marriage relationship. Possibly the emancipation of the married woman

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36. See DUE, GOVERNMENT FINANCE 155 (1959).

37. Mexico has a system of schedular income taxes with progressive rates in each schedule. See HARVARD LAW SCHOOL INTERNATIONAL PROGRAM IN TAXATION, WORLD TAX SERIES: TAXATION IN MEXICO ch. 12 (1957).

38. For example, China aggregates the income of all the taxpayer's dependent relatives. Income Tax Law of China, art. 15 (1955). And India aggregates the income of the members of a Hindu family. HARVARD LAW SCHOOL INTERNATIONAL PROGRAM IN TAXATION, WORLD TAX SERIES: TAXATION IN INDIA 12/3.2 (1960).

in many societies and her increasing economic independence will modify older views. If husbands and wives conduct economic activities so completely independent of each other that they may be regarded as independent income and expenditure units, it may be reasonable to tax them separately.[39] Undoubtedly, there are some such married persons in most countries, but these persons are neither numerous nor easy to identify for tax purposes. As long as a great degree of mutual economic activity continues to be a characteristic of the marital relationship, taxation of the married couple as a unit will be prevalent.

(2) *Burdens.* Countries which aggregate part or all of the incomes of husband and wife must determine whether to place a heavier or lighter tax burden on the married couple than that placed upon two single persons with corresponding incomes. The earlier description of systems indicates that countries run the gamut from placing on married couples a heavier burden unalleviated by earned income allowances (Philippines) to placing as much as a fifty per cent heavier burden on single persons (Netherlands). This range is partially the result of varying conditions among the countries, but is also attributable to their varying conceptions of the principles basic to all systems of progressive taxation. Here the difficulties of determining and defining guiding policies particularly hamper efforts to reach sound decisions. When such specific implements as tax rates are based upon vague and indefinite principles, inequities are likely to result. However, efforts can be, and are, exerted to reduce these inequities to a minimum and to achieve a maximum of rationality in the allocation of tax burdens.

Continued higher taxation of married persons in the United Kingdom was recommended by Royal Commissions in 1920 and 1954, partly because it was believed that their taxable capacity was greater than that of single persons.[40] However, the 1949 Shoup report on Japanese taxation stated that: "The aggregation of incomes pushes the combined income into brackets taxed at higher rates than are otherwise applied to taxpayers on the same general level of welfare and taxable capacity."[41] Japan now taxes earned

39. Many aggregation countries recognize that, for tax purposes, the marital status ceases to exist on *de facto* separation of the spouses. *U.N. Report*, para. 20.

40. Colwyn Committee, *Report of the Royal Commission on the Income Tax*, Cmd. No. 615 (1920); Royal Commission on the Taxation of Profits and Income, *Second Report*, Cmd. No. 9105, at 37 (1954).

41. Shoup Mission, 1 Report on Japanese Taxation 73 (1949).

income separately, as well as unearned income below a certain level. Other countries impose higher taxes on single persons, sometimes in the form of bachelor taxes,[42] partly on the theory, contrary to the view of the Royal Commissions, that they have a greater taxable capacity than married persons.

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

Even most of those countries which place the heavier burden on the married couple recognize that the economic unities and advantages of the marriage relationship diminish when the wife earns income outside the home. This fact partially explains why several countries[43] tax the spouses separately on earned income but jointly on unearned income.[44] Countries which aggregate earned and unearned income consider the economic unity and advantage

42. For example, Bulgaria, Czechoslovakia, Poland, the Soviet Union, and Spain. See note 33 *supra*.

43. For example, Argentina, Austria (prior to 1959), Brazil, Israel, Japan, and Venezuela. See *U.N. Report*, para. 22; Shoup, Due, Fitch, MacDougall, Oldman & Surrey, The Fiscal System of Venezuela: A Report 95 (1955); note 15 *supra*.

44. Other factors explaining the aggregate taxation of only unearned income are the administrative problems, discussed below, a basic policy dictating the heavier taxation of unearned income, and a desire to prevent couples with large unearned incomes from having an advantage over other couples through the device of shifting property income between the spouses.

of joint living to be less seriously disturbed by the wife's earning activities outside the home than would justify separate taxation. These countries rely on a system of allowances, such as those for earned income, child care, and housekeeping expenses, to measure and provide for the differences.[45] Such allowances, though they may vary with income, are generally not permitted to exceed a fairly low maximum, since additional costs due to the wife's earning activities are regarded either as not increasing proportionately with income or as ceasing at a fixed level. Allowances granted as constant percentages of the wife's earned income up to an amount established in a middle income bracket would offer greater differentiation among married couples.[46]

Administrative

Serious considerations of administration and enforcement also influence the choice between taxation of all persons as individuals and the taxation of some persons in units. Such considerations may dictate unit taxation of certain societal groups because of the close relationships within them. If the group activities are directed at the production of income, the administrative facility of treating the group as a taxable unit is clear, for it would be almost impossible to separate and evaluate the contribution of each individual in the group.[47] Moreover, a particular country may be greatly handicapped by an insufficient supply of skilled administrative and investigative personnel and therefore may find it necessary to simplify administration by the designation of certain groups as taxable units. Normal societal groups are easily identifiable and accessible for purposes of tax reporting, assessing, and collection. The performance of these functions is also facilitated by the relative permanency of these associations, with the result, among others, of giving greater predictive value to revenue estimates. In almost all countries, the married couple is the most permanent social unit and the easiest to identify.

However, even if there are solutions for the administrative difficulties just discussed, separate taxation of married persons

45. See *U.N. Report*, paras. 42–47.

46. Compare, for example, the 6% sliding allowance in the minority recommendations of the Royal Commission on the Taxation of Profits and Income, *Second Report*, CMD. No. 9105, at 77 (1954).

47. For example, for tax purposes, India aggregates the income of a Hindu undivided family, and Yugoslavia aggregates that of the agricultural communal household. *U.N. Report*, para. 21; see note 38 *supra*.

poses the additional major problem of legal and fraudulent redistribution of income between the spouses. In several countries,[48] separate taxation of the wife's income is restricted to income earned independently of the husband's earning activities. Such restrictions are probably designed to prevent abuse of the separate taxation rule by husbands who put their wives on the payroll or otherwise assign income to their wives in order to avoid tax. It is ordinarily quite difficult for tax authorities to determine which income distribution arrangements between spouses are legitimate and which are fraudulent or sham.

Social and Other Policies

Several irrational factors have influenced the development of various tax systems. Tax laws in some countries have evolved in response to short term political and revenue pressures, without any consistent scheme; other countries have imported parts of foreign tax systems, without evaluating their suitability to local conditions and needs. Still others appear to have tortured consistency by attempting to adapt tax law to other law without regard to their sometimes unrelated purposes and to the differing forces, needs, and conditions which led to their development. The factors, for example, which induce the adoption of varying matrimonial property regimes may bear little or no relationship to the policies which should control treatment of the married couple for income tax purposes.

Those who oppose taxation of the married couple as a unit[49] often assert that the system is based upon unjust and outmoded concepts of the legal incapacity of the married woman. Certainly, such concepts should not serve as a basis for designing tax law. From a more understandable view, a country may feel that it is socially desirable for wives to tend house and raise children and thus to strengthen the home or family as a social unit.[50] Even so, this behavior should be a matter of personal choice and not the

48. *E.g.*, Canada and Israel.

49. See, *e.g.*, H.R. REP. No. 1040, 77th Cong., 1st Sess. 69 (1941).

50. It is sometimes asserted that the opposite effect results from aggregation systems which cause the married couple to pay more tax than the two spouses would pay if taxed separately, since these systems weaken the marriage institution by encouraging cohabitation without marriage. While there is little merit to the argument, a bizarre instance was recently described by a British MP during a debate in the House of Commons. A man and a woman, by not marrying, and through contractual and trust arrangements, have calculated a tax saving of £20,000 by the time their children reach the age of twenty-one, whereupon they plan to marry and settle the money on the children. See 7 CAN. TAX J. 59 (1959).

result of compulsion by taxation. There may be social policies which should be implemented by a government through its tax system, or other quasi-compulsory devices, but decisions as to marriage and children should be left to the widest range of individual choice that is consonant with the mores and with the economic and sociological needs of a given society.[51] Furthermore, tax considerations are with rare exceptions of minor importance in the making of decisions to marry or bear children. Thus, even if it were government policy to affect certain family decisions, tax laws do not appear to be an effective implementing device. While the working wife, like other taxpayers, must bear the disincentive effect always characteristic of progressive income taxation, a deliberate design to discourage her from earning money would be discriminatory and unjust. The justice of those heavy bachelor and barren taxes that sometimes appear to be penalties for failure to marry and bear children is as questionable as that of deliberate penalization of the wife who wishes to work.

Support for separate taxation is often founded on the notion of equality before the law regardless of sex. Almost all countries today assert recognition of the woman's right to such equality, and few would challenge the clear justice of such a principle. But this principle is not at issue here, since husband and wife are treated the same for the purpose of calculating the tax on the married couple as a unit.[52] Separate taxation based on the legal precept of the equality of the married woman is as ill-founded as aggregation based on the fictitious legal incapacity of the married woman. Viewing each spouse as a separate spending unit is usually unrealistic. Most of the countries of the world treat the two spouses as a single unit. There is little basis for believing that they have done so on the basis of outmoded concepts and irrelevant social policies. The fact is, unit taxation of the married couple is consonant with economic, social, and administrative realities.

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51. Thus, for example, we leave open the question whether or not the economic and sociological needs of a country could become so great as to justify a government policy of birth control. However, it is doubtful to us that the countries which presently impose taxes on bachelors and childless married couples, see note 42 *supra*, are in sufficiently dire economic straits, or can point to strong enough sociological needs, to justify their policy.

52. The United States permits separate taxation; yet almost all wives file with their husbands and there is no apparent feeling of loss of equality. However, the procedural provisions of the tax laws of some countries occasionally reflect a carry-over of fallacious medieval attitudes. In Denmark and Switzerland, for example, the wife cannot herself appear before the tax authorities, but is represented by the husband. For a discussion of the alleged inequities of the United States system of assessing liability for taxes, see Ritz, *The Married Woman and the Federal Income Tax*, 14 Tax L. Rev. 437 (1959).

Conclusions

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

The formulation of universally applicable principles to guide in the allocation of tax burdens will be a difficult task until a rational theory of progressive taxation is developed and demonstrated. Even then, it is likely that the basic decisions in the application of progressive taxation will continue to involve value judgments of a character that only the electorate can make, albeit after the economists, lawyers, and administrators have presented the facts, the logic, and the techniques. Nevertheless, some guide lines emerge from comparative analysis.

Taxation of the married couple as a unit is more reasonable, in terms of economic realities and administrative facility, than separate taxation of the spouses. Separate taxation, if based upon the alleged economic independence of husband and wife, flouts the facts of their interdependence. In a system of progressive taxation of each source of income, separate taxation makes sense; but such a system is itself irrational. Finally, the argument for separate taxation cannot be based upon the equality of taxpayers regardless of sex, for such reasoning is circular and avoids the task of seeking fair tax treatment in accordance with economic circumstances. The one plausible justification for the separate taxation system is the pragmatic one that such a system is a compromise solution to the difficult problems of burden allocation, a solution which could result in fewer inequities than might exist under a poorly constructed aggregation system.

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

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

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

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

In the final analysis, a tax system should pursue a reasonable allocation of burdens. Through factual studies of the differences among married couples and of the differences between them and single persons, a country can attempt to reach conclusions as to what differentiations should be made among taxpayers. An attempt to modify an existing system in the light of such conclusions, with due consideration to the ramifications of each change throughout the entire tax system, would appear to be the reasoned approach to reform. Responsible and rational development of tax law demands that problems of policy, administration, and law be faced rather than avoided or ignored.