# The Family and the Income Tax Act in Canada

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One of the four fundamental objectives which the Report of the Royal Commission on Taxation envisaged was that the tax system ensure that the flow of goods and services be distributed equitably among individuals and groups of Canadians.[1] To achieve this object the *Report* suggested that the tax system must be consistent with the following purposes:

> 1. Most of the time most government expenditures should be financed through taxes that are allocated in proportion to ability to pay. This means, in effect, that the government must seek to impose progressive marginal tax rates on all additions to personal economic power, without regard to the source of those increments in power. Wages, salaries, business profits, gifts and capital gains all increase the economic power of the recipients and should be treated on exactly the same basis for tax purposes.
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> 2. In most families incomes are pooled, consumption is collective, and responsibilities are shared. It should be an objective of the tax system to reflect this fact, by considering families as taxable units. The ability to pay of the family, as distinct from the individual members of the family, must be recognized.
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> 3. The tax system must also recognize that the special responsibilities and non-discretionary expenditures of unattached individuals and families affect their ability to pay. Unusually heavy medical expenses, certain education costs and the number of dependent children, for example, should be taken into account in allocating tax liabilities.
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> 4. It should also be a goal of the tax system to avoid tax concessions to particular industries and to particular kinds of income. While the efficacy of special treatment can be judged only in the light of the particular circumstances, such tax concessions are always inequitable, are frequently inefficient, tend to distort the allocation of resources, and erode the tax base. If such special concessions are to be given, they should be provided in a form that makes it possible to assess their costs, that is, revenue forgone, so that the concessions can be appraised at periodic intervals. Therefore, generally speaking, subsidies should be used rather than tax concessions.[2]

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[1] *Report of the Royal Commission on Taxation*, Queen's Printer, (Ottawa, 1967), Vol. 2, at p. 7.

[2] *Ibid.*, Vol. 2, at pp. 10-11.

Perhaps the most curious aspects of the *Report of the Royal Commission on Taxation* is that despite this dissertation concerning equity in taxation and the use of progressive income taxes to achieve this, the *Report* never dealt with the inequities which result when a government which has the power to control both the rate of progression in its income taxes and the national rate of inflation (and hence the nominal gains of income and capital to those whom it taxes) uses these powers to increase the real weight of taxation on taxpayers in the community. The failure of the Royal Commission to deal with this problem is particularly disconcerting when the inequities which arise from the combination of progressive taxes and inflation are examined.

The *Report* assigned a higher priority to the object of equity than to any other of its objectives. The feeling among the commissioners was that unless the tax system is generally accepted as fair, the fundamental purpose of taxation is lost because once the public believes the tax system to be unfair the social and political system under which it operates is likely to collapse.[3] In order to achieve equity, the Commission recommended reorganization of the rates of income taxes, the taxation of the family or individuals as a unit, the integration of corporate and personal income taxes, the inclusion of all gains in the tax base, and the elimination of separate taxes on gifts and bequests. The *Income Tax Act* which came into force January 1, 1972[4] combined with the repeal of the *Estate Tax Act*, included legislation which moved at least part way towards each of the Commission's major recommendations except that it did not change the treatment of the family unit for tax purposes.

The "family unit" recommended by the Royal Commission would have consisted of a resident husband and his wife and family, an unmarried woman with a child, an unmarried individual who has adopted a child, or a divorced or separated spouse with one or more dependent children. The family unit was to be granted a special rate schedule and would be taxed on the aggregate family income which would be filed as a single return. Under the schedule, to be known as a "family unit rate schedule" family units would pay less tax than individuals with the same income. Individuals were granted a basic exemption of $1,000.00 and family units a basic exemption of $2,100.00.[5] In addition, tax credits were allowed in the amount of $100.00 for the first child and $60.00 for each additional child where

[3] *Ibid.*, Vol. 2, at p. 17.
[4] S.C. 1970-71, c. 63.
[5] *Report of the Royal Commission on Taxation, op. cit.*, n. 1, Vol. 3, at p. 173.

two parents exist in the family unit; if the family unit had a working mother the tax credit for school age children was $80.00 each and for pre-school children it was $200.00 each.[6] The Royal Commission described the difference between tax credits and exemptions succinctly:

> The difference between tax credits and exemptions is simple. A tax credit involves a reduction in taxes of a given amount, while an exemption grants a reduction in taxable income. The latter results in a tax reduction that increases with income. Because an exemption excludes from tax the last dollars of income received by a taxpayer, the value of an exemption depends upon the marginal rate applicable to the taxpayer. A tax credit, on the other hand, in effect exempts a given amount of the first dollars of a taxpayer's income. A tax credit thus affects all taxpayers in the same amount, while an exemption provides an allowance which increases in value as income increases. To put this in other terms, the revenue loss resulting from the use of exemptions is higher than from the use of credits, where credits and deductions achieve the same result for low income families.[7]

The Royal Commission attempted to reduce the regression in the Canadian tax load which derives in large measure from the fact that the Canadian sales tax is roughly double the United States rate and is among the highest in the world; with this in view the Royal Commission aimed to establish a rate schedule that would result in roughly equal income taxes for middle income tax payers in Canada and the United States so as to narrow the unfavourable income tax differential between Canada and the United States and prevent an exodus of middle income Canadians to the United States. The Royal Commission also decided that the maximum rate of tax on any form of income should be no greater than 50% so as to minimize disincentive effects.[8]

The first federal income tax statute, *The Income War Tax Act, 1917* [9] provided an exemption for the first $1,500.00 of income of an unmarried person, widow or widower without dependent children. Any other person was granted an exemption of the first $3,000.00. A flat 4% income tax rate was levied on all amounts in excess of these sums in addition to which a super tax was charged on a progressive basis.[10] The $3,000.00 marital exemption was reduced to $2,400.00 in 1932,[11] in 1933 it was reduced to $2,000.00,[12] and in 1940

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[6] *Ibid.*, Vol. 3, at p. 181 and p. 193.
[7] *Ibid.*, Vol. 3, at p. 180.
[8] *Ibid.*, Vol. 3, at pp. 154-162.
[9] 7-8 Geo. V, S.C. 1917, c. 28.
[10] *Ibid.*, s. 4.
[11] S.C. 1932, c. 43, s. 4.
[12] S.C. 1932-33, c. 41, s. 4.

it was reduced to $1,500.00 [13]. The marital exemption was once again increased to the sum of $2,000.00 in 1948 [14]. In 1927 a taxpayer was granted $500.00 exemption for each dependent child under 21 [15]. In 1932 this was changed to a $400.00 exemption for each child and in 1946 this was further amended as a result of *The Family Allowances Act, 1944*, to provide an exemption of $100.00 for each dependent child who might have been registered under *The Family Allowances Act, 1944*, and an amount not exceeding $300.00 expended by the taxpayer during the taxation year to support any other dependent child.[16] In 1952 this was amended to provide dependent child exemptions in the amount of $150.00 for those in receipt of family allowances and $400.00 for others. By 1971 the *Income Tax Act* provided a deduction of $2,000.00 to a married taxpayer who supported his spouse and, in addition thereto, deductions of $300.00 for each dependent child under the age of 16 and $550.00 for each normal, dependent child over the age of 16 but under 21 [17]. Throughout this period the rates of income tax were also varied.

The "Proposals for Tax Reform" prepared by the Minister of Finance, and tabled in the House of Commons on November 7, 1969 suggested that the personal exemptions be increased by $400.00 to $1,400.00 for single taxpayers and by $800.00 to $2,800.00 for married taxpayers; the exemptions for dependent children were to remain the same as they were at December 31, 1971. In making this recommendation the Minister of Finance specifically compared the United States exemption provisions with the Canadian exemptions. He stated:

> ...However, they are now much lower than formerly in relation to the general level of earnings in Canada. Moreover, provincial and federal sales taxes and municipal property taxes have increased substantially, falling heavily on income just above exemption levels. And the present exemptions will no longer compare as favorably with those in the United States if proposals now before Congress are approved.[18]

These recommendations were accepted, virtually without comment, by the House of Commons Report on Taxation.[19] The Standing Senate Committee on Banking, Trade and Commerce recommended that the increased personal exemptions be granted only to single

[13] S.C. 1940, c. 34, s. 11.
[14] S.C. 1948, c. 52, s. 25.
[15] S.C. 1927, c. 97, s. 5(e).
[16] S.C. 1946, c. 55, s. 4(2)(e).
[17] R.S.C. 1952, c. 148, s. 26, as amended.
[18] Queen's Printer, (Ottawa, 1969), at p. 14.
[19] Queen's Printer, (Ottawa, 1970), at pp. 13 and 14.

individuals whose income did not exceed $3,000.00 and married persons whose income did not exceed $8,500.00 with a notch provision for calculating the taxes of those with income in excess of these amounts.[20]

In the Proposals for Tax Reform the Minister of Finance recommended taxation of the total amount of capital gains, the full integration of income from closely-held Canadian corporations, and permitted credit for one-half the income tax paid by widely-held Canadian corporations on their profits. The House of Commons report recommended half integration for Canadian residents with respect to all Canadian corporations resident in Canada and full integration for closely-held Canadian corporations with taxable incomes of $50,000.00 or less annually. The Standing Senate Committee recommended a capital gains tax to be virtually identical with the system used in the United States and rejected the proposal of the Minister of Finance for integration of corporate and shareholder taxes. Both the House of Commons committee and the Senate committee made these recommendations with a careful eye on the tax provisions in existence or proposed in the United States. Both the House of Commons and the Senate are considered to be somewhat representative of the people of Canada, yet neither compared the practical effect of the proposed individual rates and exemptions with those in effect in the United States as did the Royal Commission on Taxation; nor did they refer to the problem of taxing the individual and the family in terms of the relative tax burden borne by similar people in the United States, although both the Minister of Finance and the Royal Commission on Taxation considered this term of reference to be sufficiently important to require substantial review and discussion. Despite this cavalier attitude towards the individual and the family, both Committees examined the problems associated with business income and large capital accumulations extremely carefully and sympathetically, perhaps because these areas of study represented the chief concern of briefs submitted to them.

The discrepancy between the amount of income tax levied in Canada and in the United States on a married couple derives largely from the fact that in the United States a joint income tax return is permitted to a married couple. The joint income tax return in the United States came about as a result of litigation concerning community property there. In the *Sura* cases[21] the Canadian courts

[20] *Report on The White Paper Proposals for Tax Reform* presented to the Senate of Canada, (September, 1970), at p. 53.

[21] 57 D.T.C., 478; 59 D.T.C., 1280; (Ex. Ct.) and 62 D.T.C., 1005 (Supreme Ct.).

examined the right of a husband to file the equivalent of a joint income tax return on income from community property. The Tax Appeal Board, which was chaired in that instance by a member educated in the common law, decided that there was a right to divide income from community property between the husband and wife. Both the Exchequer Court and the Supreme Court of Canada decided that the income from community property is solely that of the husband. Taschereau, J., speaking for the Supreme Court of Canada, described the Supreme Court's view of the matter in the following words:

> ...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, 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.
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> 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 business, property, offices and employments". Now this is precisely what is taxable.[23]

During the hearings of the *Sura* cases reference was made by counsel to the fact that the American Courts had already decided that in the eight states of the United States where there is legal community, co-ownership of property had been determined as between the husband and wife and that two income tax returns were required. However, Taschereau, J. pointed out that various authorities in American law admit that the civil law existent in the United States has been infiltrated with common law. In his view the American authorities did not reflect the position of the law in Quebec.[23]

As a result of the decisions concerning the taxation of income from community property, the United States government enacted legislation in 1948 to enable all married couples to file a joint return.

[22] 62 D.T.C., 1005, at pp. 1008-1009.

[23] *Ibid.*, at pp. 1009-1010.

The effect of the United States system is to allow each married couple to total its income, deduct the exemptions, halve its income and calculate at individual rates on the half so computed; the result of this calculation is multiplied by two in order to determine the total tax payable. The consequence of United States legislation permitting a family to file a joint return has been a dramatic discrepancy in taxes paid by a couple in Canada and the United States on the same income. The Royal Commission on Taxation illustrated this in its *Report* as is shown in the following table:

INCOME TAXES PAYABLE BY A FAMILY WITH TWO CHILDREN FILING AVERAGE ITEMIZED DEDUCTIONS UNDER 1966 RATE SCHEDULES IN CANADA AND THE UNITED STATES AND RATES RECOMMENDED BY THE ROYAL COMMISSION

| | Income Taxes Payable | | |
|---|---|---|---|
| Income | Canada | United States | Recommended Rates |
| $ 1,500 | $ — | $ 3 | $ — |
| 2,500 | — | 23 | — |
| 3,500 | 67 | 76 | 1 |
| 5,000 | 294 | 268 | 235 |
| 6,500 | 586 | 478 | 505 |
| 8,000 | 865 | 715 | 777 |
| 10,000 | 1,316 | 1,065 | 1,177 |
| 12,000 | 1,827 | 1,409 | 1,586 |
| 15,000 | 2,744 | 1,996 | 2,251 |
| 25,000 | 6,758 | 4,284 | 4,900 |
| 40,000 | 13,666 | 8,886 | 10,056 |
| 70,000 | 29,362 | 21,117 | 22,460 |
| 100,000 | 46,571 | 34,145 | 36,018 |

Note: Itemized deductions under the 1966 Canadian and United States tax laws are average deductions shown in Appendix H, Volume 3, Report of the Royal Commission on Taxation. United States taxes include average and local income taxes. Canadian taxes include the provincial tax. In all cases, it is assumed that the taxpayer claims only standard and the old age security tax.[24]

[24] *Report of the Royal Commission on Taxation, op. cit.*, n. 1, Vol. 3, at p. 188, Table 11-14.

The Royal Commission on Taxation also examined the effective income taxes payable by individuals in Canada and in the United States in 1966. An American filing as an individual paid slightly less in effective taxes than did a Canadian. The rates recommended by the Royal Commission on Taxation would have resulted in the individual Canadian taxpayer paying substantially less income tax had the recommendations been put into effect. The following table, as taken from the Report of the Royal Commission, describes the Commission's findings:

INCOME TAXES PAYABLE BY AN UNATTACHED INDIVIDUAL CLAIMING STANDARD DEDUCTIONS UNDER THE 1966 RATE SCHEDULES IN CANADA AND THE UNITED STATES, AND RATES RECOMMENDED BY THE ROYAL COMMISSION

| | Income Taxes Payable | | |
|---|---|---|---|
| Income | Canada | United States | Recommended Rates |
| $ 1,500 | $ 51 | $ 88 | $ 54 |
| 2,500 | 202 | 265 | 211 |
| 3,500 | 394 | 454 | 395 |
| 5,000 | 691 | 727 | 714 |
| 6,500 | 1,018 | 1,033 | 1,063 |
| 8,000 | 1,384 | 1,366 | 1,423 |
| 10,000 | 1,940 | 1,849 | 1,942 |
| 12,000 | 2,585 | 2,441 | 2,501 |
| 15,000 | 3,730 | 3,488 | 3,400 |
| 25,000 | 8,175 | 7,977 | 6,747 |
| 40,000 | 15,620 | 16,130 | 12,495 |
| 70,000 | 32,510 | 34,842 | 25,692 |
| 100,000 | 50,955 | 55,298 | 40,090 |

Note: United States taxes include state and local income taxes of an average state; Canadian taxes include the provincial tax abatement but not provincial taxes in excess of the abatement, and the old age security tax. In all cases, it is assumed that the taxpayer claims only standard deductions. Under the Royal Commission's recommendations, the standard deduction of $50.00 is used.[25]

[25] *Ibid.*, at p. 172.

The percentage differences between United States and Canadian income taxes in 1966 were described by the Royal Commission in the following table:

PERCENTAGE DIFFERENCES BETWEEN
UNITED STATES AND CANADIAN INCOME TAXES
1966

| Assessable Income | Percentage Difference for Single Persons, No Dependants, Using Standard Deduction | Percentage Difference for Married Couples, No Dependants, Using Standard Deduction | Percentage Difference for Family With Two Children Itemizing Deductions |
|---|---|---|---|
| $ 1,500 | 76.5 | — | — |
| 2,500 | 34.8 | 249.0 | — |
| 3,500 | 16.2 | 55.4 | 13.4 |
| 5,000 | 5.2 | 11.6 | 18.4 |
| 6,500 | 1.5 | 1.8 | —18.4 |
| 8,000 | — 1.3 | — 3.7 | —17.3 |
| 10,000 | — 4.7 | —11.9 | —19.1 |
| 12,000 | — 5.6 | —15.2 | —22.9 |
| 15,000 | — 6.5 | —21.5 | —27.3 |
| 25,000 | — 2.4 | —28.5 | —36.6 |
| 40,000 | 4.5 | —23.7 | —35.0 |
| 70,000 | 7.2 | —14.8 | —28.1 |
| 100,000 | 8.5 | —10.9 | —26.7 |
| 200,000 | 5.3 | — 6.6 | —24.3 |

Note: The percentages shown in this table are calculated so that a "plus" figure shows United States income taxes being higher than Canadian income taxes; a "minus" figure shows United States taxes being lower. In all cases the base of the comparison is the Canadian income tax payable on that income. United States taxes include average state income tax; Canadian taxes include only the lowest provincial income tax. Old age security taxes are included in Canadian tax figures. Compulsory contributions to government pension plans are not included in either United States or Canadian tax figures.[26]

[26] *Ibid.*, at p. 161.

However, the foregoing tabels do not adequately describe the extent of the discrepancy between United States and Canadian income taxes on individuals and married couples. The Royal Commission stated that:

> ... Including average state income taxes, the United States middle income taxpayer pays roughly 10% less tax than does a Canadian taxpayer with the same amount of taxable income. However, because taxable income is, on the average, a lower fraction of gross income for the United States taxpayer, the middle income United States taxpayer in fact pays almost 30 per cent less tax.
>
> The lower United States taxes result largely from a lower ratio of taxable income to gross income. This lower ratio, in turn, results from the deductibility of items such as mortgage interest, property taxes, state and local sales taxes and state income taxes, as well as from a more liberal definition of what can be claimed as charitable deductions, expenses of earning employment income and other deductions.[27]

In his Proposals for Tax Reform, the Minister of Finance suggested that the top rate of income tax be 82.4% of taxable income in excess of $400,000.00 per year on the basis that the provinces levy an income tax 28% of the federal tax. Over the first five years it was proposed that the rates in the top brackets be reduced until the maximum combined provincial and federal rate would be 51.2 per cent (the provinces to tax at 28 per cent of the federal tax). On January 1, 1972, the *Income Tax Act,* came into force. Personal exemptions were set at $1,500.00 for an unmarried individual and $2,850.00 for a married taxpayer. Dependant's exemptions were $300.00 for those under the age of 16 and $550.00 for those 16 years of age and over.[28] Individual rates for 1972 range from a low of 17 per cent to a high of 61.1 per cent. The following table compares the tax levy for a married taxpayer with two dependent children at 1971 rates, at the rates proposed in the White Paper and at the rates proposed under the new *Income Tax Act* for 1972:

[27] *Ibid.,* at pp. 619-620.
[28] S.C. 1970-71, c. 63, s. 109(1)(d)(iv) and s. 109(1)(d)(v).

MARRIED TAXPAYER — TWO DEPENDENT CHILDREN UNDER AGE 16

| Income | 1971 Income Tax Rates | White Paper Rates | 1972 Income Tax Rates |
|---|---|---|---|
| $ 2,800 | $ 15 | $ — | $ — |
| 3,000 | 44 | — | — |
| 3,500 | 118 | — | — |
| 4,000 | 210 | 83 | 73 |
| 5,000 | 422 | 309 | 302 |
| 6,000 | 663 | 568 | 553 |
| 7,000 | 928 | 841 | 816 |
| 8,000 | 1,215 | 1,132 | 1,089 |
| 9,000 | 1,496 | 1,448 | 1,370 |
| 10,000 | 1,764 | 1,780 | 1,669 |
| 11,000 | 2,044 | 2,122 | 1,976 |
| 12,000 | 2,353 | 2,481 | 2,301 |
| 13,000 | 2,677 | 2,839 | 2,634 |
| 14,000 | 3,038 | 3,206 | 2,985 |
| 15,000 | 3,414 | 3,590 | 3,351 |
| 20,000 | 5,592 | 5,652 | 5,486 |
| 25,000 | 7,910 | 7,956 | 7,761 |
| 30,000 | 10,346 | 10,381 | 10,156 |
| 50,000 | 21,022 | 20,621 | 20,156 |
| 75,000 | 35,818 | 33,421 | 35,238 |
| 100,000 | 51,643 | 46,221 | 50,513 |

Note: The 1971 tax is the current tax including old age security tax, social development tax, and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax. White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper. 1972 tax is federal tax for 1972 using the new rate schedule and the basic exemption for married taxpayers of $2,850.00 plus provincial tax at 30 per cent of federal tax. In calculating tax under the new Act, taxpayer received the employment expense deduction of 3 per cent, maximum $150.00. No account has been taken of other proposed adjustments to income such as taxation of capital gains. In all cases it is assumed that taxpayers take the optional standard deduction of $100.00. Taxpayers are assumed to be under age 65.[29]

[29] Summary of 1971 Tax Reform Legislation, Hon. E. J. Benson, Minister of Finance, at p. 20.

The effective rates for a single taxpayer without dependants at 1971 rates, at rates proposed in the White Paper, and at the rates proposed in the *Income Tax Act*, effective 1972 are set forth in the following table:

SINGLE TAXPAYER WITHOUT DEPENDANTS

| Income | 1971 Income Tax Rates | White Paper Rates | 1972 Income Tax Rates |
|---|---|---|---|
| $ 1,200 | $ 15 | $ — | $ — |
| 1,400 | 44 | — | — |
| 1,600 | 74 | 11 | — |
| 1,800 | 104 | 54 | 32 |
| 2,000 | 133 | 96 | 75 |
| 2,500 | 230 | 207 | 187 |
| 3,000 | 331 | 324 | 304 |
| 4,000 | 563 | 576 | 547 |
| 5,000 | 817 | 841 | 803 |
| 6,000 | 1,100 | 1,132 | 1,076 |
| 7,000 | 1,387 | 1,448 | 1,355 |
| 8,000 | 1,657 | 1,780 | 1,654 |
| 9,000 | 1,924 | 2,122 | 1,960 |
| 10,000 | 2,229 | 2,481 | 2,285 |
| 11,000 | 2,538 | 2,839 | 2,616 |
| 12,000 | 2,894 | 3,206 | 2,967 |
| 13,000 | 3,254 | 3,590 | 3,331 |
| 14,000 | 3,661 | 3,974 | 3,734 |
| 15,000 | 4,073 | 4,372 | 4,137 |
| 20,000 | 6,334 | 6,574 | 6,373 |
| 25,000 | 8,651 | 8,878 | 8,648 |
| 30,000 | 11,170 | 11,405 | 11,144 |
| 50,000 | 21,928 | 21,645 | 21,765 |
| 75,000 | 36,806 | 34,445 | 36,429 |
| 100,000 | 52,715 | 47,245 | 51,704 |

Note: The 1971 tax is the current tax including old age security tax, social development tax, and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax. White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper. 1972 tax is federal tax for 1972 using the new rate schedule and the basic exemption

for single taxpayers of $1,500.00 plus provincial tax at 30 per cent of federal tax. In calculating txa under the new Act, taxpayers received the employment expense deduction of 3 per cent, maximum $150.00. No account has been taken of other proposed adjustments to income such as taxation of capital gains. In all cases it is assumed that taxpayers take the optional standard deduction of $100.00. Taxpayers are assumed to be under age 65.[30]

It will be noted that there are severe discrepancies between the rates recommended by the Royal Commission on Taxation and those put into effect by the *Income Tax Act*, 1971, especially for the married taxpayer. The Royal Commission on Taxation had as part of its task the problem of fixing rates which would yield an income equivalent to that already received by the government from income tax and this affected the selection of a rate schedule.[31] In large measure the discrepancies result from the attempt of the Royal Commission on Taxation to bring Canadian income taxes into some measure of alignment with United States income taxes. In addition, between 1966 and 1971, the income taxes imposed on the middle income taxpayer have risen by very substantial amounts in Canada. Even the fact that only one-half of capital gains are taxed under the *Income Tax Act*, 1971, whereas all capital gains are taxed under the recommendations of the Royal Commission, does not account for the volume of discrepancy contained in the following table:

EFFECTIVE AMOUNTS OF INCOME TAX

| | MARRIED TAXPAYER WITH TWO DEPENDENT CHILDREN UNDER 16 | | SINGLE TAXPAYER WITHOUT DEPENDANTS | |
|---|---|---|---|---|
| Income | Royal Commission | Act 1972 | Royal Commission | Act 1972 |
| $ 5,000 | $ 235 | $ 302 | $ 714 | $ 803 |
| 8,000 | 779 | 1,089 | 1,423 | 1,654 |
| 10,000 | 1,185 | 1,669 | 1,942 | 2,285 |
| 12,000 | 1,586 | 2,301 | 2,501 | 2,967 |
| 15,000 | 2,251 | 3,351 | 3,400 | 4,137 |
| 25,000 | 4,900 | 7,761 | 6,747 | 8,648 |
| 100,000 | 36,018 | 50,513 | 40,090 | 51,704 |

[30] *Ibid.*, at p. 18.

[31] *Report of the Royal Commission on Taxation*, *op. cit.*, n. 1, Vol. 3, *op. cit.*, n. 24, at p. 154.

The *Income Tax Act* does not follow the proposal of the White Paper or the Report of the Royal Commission on Taxation for the purpose of taxing capital gains. The *Act* taxes one-half the value of capital gains in a fashion similar to the United States tax system. Modifications were also made to the recommendations that Royal Commission insofar as corporations and shareholders are taxed; generally speaking a system like that in use in the United States is contained in the *Act*. The *Income Tax Act* deals with mining and petroleum income and expenses in a manner which is also analogous to the system used in the United States. However, no major change was made in the system by which the single or married taxpayer is dealt with under the *Act*. In particular, the new *Act* has not adopted either the joint return which is in effect in the United States or the family unit concept which was recommended by the Royal Commission. As has been noted, the exemptions were merely raised somewhat in order to comply more or less with the exemption allowed in the United States. The reason for the minute concession granted to the married taxpayer, as compared to the changes recommended by the Royal Commission or in effect in the United States may be found in study paper No. 10 *Taxation of the Family* prepared for the Royal Commission on Taxation. This paper estimated that the United States Government suffers a revenue loss of a little over 10 per cent of tax revenue by virtue of the income spliting provisions created by the joint income tax return. It also estimated that the adoption of a joint income tax by Canada in 1961 would have reduced revenues between 10 and 12 per cent or $190,000,000.00.[32]

The failure of the Canadian Government to recognize the responsibilities associated with the family unit and the family's consequent real ability to pay, as described in the purposes of an equitable tax system by the Royal Commission on Taxation and set forth in the introduction to this article, is especially glaring in view of the concessions which are granted to married taxpayers in the United States by the joint income tax return. Although gross, this failure exceeded by the failure of both the Royal Commission on Taxation and the Federal government to recommend and enact an adjusting factor which would remove the inequities which result from a combination of progressive rates of income tax and an inflationary economy. From 1939 until May of 1972,

[32] E. J. Mockler, John G. Smith and Claude Frenette, Studies of the Royal Commission on Taxation, No. 10, *Taxation of the Family*, Queen's Printer, (Ottawa, 1966), at pp. 123-124.

the Canadian Consumer Price Index has risen to 282.7 using 1939 as 100.[33] At the same time the Canadian General Wholesale Index has moved up to 305.3 [34] (using 1935 - 1939 as 100). It will be recalled that in 1939 (before the *Family Allowances Act*, 1944, came into effect) the tax exemption granted for a married couple was $2,000.00; two dependent children resulted in further exemptions of $400.00 each, being a total of $2,800.00.

In real terms an income of $10,000.00 in 1972 would have amounted to $3,537.00 in 1939. In 1939 the income tax payable by a married man with two dependent children under 16 on $3,537.00 would have amounted to $26.53, using the deductions that were then available to him; prorating the 1939 income tax of $26.53 to 1972 on the basis of an increase in the cost of living index in the same period of 282.7, would result in a similar taxpayer earning a 1972 income of $10,000.00 paying a 1972 income tax of $75.00. Similarly, the real value of $25,000.00 in 1939 amounted to $8,843.00, upon which a married man with two dependent children under the age of 16 would have paid $400.64 income tax; prorated forward, the 1972 income tax would amount to $1,132.61 if the income tax on $25,000.00 in 1972 funds were determined on an identical basis with that available to its real income equivalent in 1939. Instead of paying $75:00 income tax the Canadian recipient of $10,000.00 pays $1,669.00 income tax in 1972; and the $25,000.00 income earner doesn't pay $1,132.61. Rather, in 1972 income tax he pays $7,761.00.

It should be remembered when reviewing these figures that the Canada Pension Plan, health and welfare schemes, better roads, better national parks, and a dramatically changed way of life have transpired in the interval between 1939 and 1972; however, it remains to be determined whether a man earning $10,000.00 a year is receiving more than 22 times the amount of benefit from the government than his peer would have received in 1939, since he is paying more than 22 times the amount of income tax; and whether the $25,000.00 per year income earner is obtaining almost 7 times as much in benefits for his increased taxes.

The destructive effects of an inflationary economy on the taxpayer faced with a "progressive tax" system can only be alleviated if Parliament enacts income tax legislation which fixes the value of the dollar as of a base year for the purposes of tax calculations.

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[33] Statistics Canada, Catalogue 62002, Prices and Price Indexes, (May, 1972), p. v., and calculations based thereon.

[34] *Ibid.*, at p. vii.

In the examples used, the base year is 1939. To fix the dollar value for that year legislation necessitating the following before determining income adjustments or tax calculations would be required for the year 1972:

Assume 1972 income is $10,000.00.

Assume 1939 is the base year.

Assume that the cost of living index is used as the adjustment index.

$$\$10{,}000.00 \times \frac{100}{282.7} = \$3{,}537.00$$ (Cents rounded to the nearest dollar)

Thereupon the tax could be calculated on the basis of rates and exemptions created for 1972, which would yield no tax in the example used. If the same procedure were adopted for a man with a wife and two dependent children under 16, and an income of $25,000.00 in 1972, using the 1972 rates and exemptions his real income tax in 1939 dollars would be $1,323.26. Such a procedure would enable rates to be adjusted in accordance with social policy so as to permit change and would simultaneously remove the insidious expropriation of the citizen's income which is permitted by the present system. It would require careful attention to the index used for calculation in order that the index will not ultimately be weighted or adjusted against the taxpayer with results similar to the present system; this will mean that both the administrators adjusting the index must be as independent as is, for instance, the Auditor General of Canada, and the factors contained in the index must be flexible so as to allow for changes in social habits and development of new goods and services.

As was suggested by the Royal Commission on Taxation and admitted by the Minister of Finance, the heaviest burden of income taxation and non discretionary expenditure falls on the family. It is the most poorly treated tax unit under our present policy both in principle and competitively. It is also the tax unit which is the most adversely affected by an inflationary fiscal policy since it cannot pass the effects of inflation on to any other unit. It was in recognition of the weight of the progressive income tax system on family earners in relation to the expenditures which are required of them that the Royal Commission recommend that a "family unit" be created for income tax purposes and given a reduced rate schedule. In discussing this and the concept of a joint income tax return, the Minister of Finance stated in the White Paper:

> After the basic reforms proposed in the present paper are in effect, it would be possible to reconsider separately a family unit basis, or a more complicated system similar to some of those used in other countries, as a further instalment of reform.[35]

In compliance with the recommendations of the Royal Commission on Taxation and the undertaking of the Minister of Finance contained in the Proposals for Tax Reform, it is appropriate that Parliament enact income tax legislation to create a more equitable tax policy by alleviating the income tax burden on the family. When doing so it would also be appropriate for Parliament to pass legislation to stop the erosion of earnings which has been created by consistent government policies of "progressive" taxation and inflation to the detriment of the Canadian taxpayer.

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[35] *Proposals for Tax Reform*, Hon. E. J. Benson, Minister of Finance, (1969), at p. 15.