



**FAFIA Submission to Standing Committee of Finance,
Pre-Budget Consultations
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(Canadian Feminist Alliance for International Action)**

The Canadian Feminist Alliance for International Action (FAFIA) has launched a gender budgeting initiative in collaboration with some of our over 80 member organizations. As part of this initiative FAFIA proposes that the Department of Finance, during budget development, ensure that all tax policy proposals undergo gender analysis to better meet the needs of the women of Canada in their capacities as paid workers, unpaid caregivers and citizens.

The Department of Finance has claimed that it does carry out a gender budget analysis. However it has yet to release many details or documents regarding the kind of analysis the department is using. Meanwhile many recent tax policy measures have been poorly designed from the perspective of women's equality.

One of the priority areas we have identified as having the greatest potential impact on women in Budget 2008 is income splitting.

The income tax code contains anti-avoidance provisions that place strict limits on income splitting. Effective 2007, however, individuals will be allowed to split income by allocating up to 50% of any private pension income to a spouse's tax return (private pensions include employment based pensions as well as RRSPs and RRIFs). This is a relatively small change but it has opened the door to a much larger discussion about extending the new income splitting rules to apply generally to all couples, and all kinds of income. FAFIA is opposed to any expansion of pension income splitting and would instead like to see these rules repealed. Before introducing any further rules on income splitting the Government should conduct a thorough study of their impact on women.

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The 5 key facts behind FAFIA's position that income splitting is bad tax policy detrimental to women's equality are as follows:

(All figures based on the latest available data as of November 2007.)

1. Unpaid caregivers get no direct benefit from income splitting, and in fact will suffer additional burdens.

The new pension splitting rules do not require any income or assets to be transferred to the lower income spouse. It is a purely fictional reallocation of income from one spouse's tax return to the other's, on paper only. As economics professor Dr. Frances Woolley of Carleton University has explained, "tax liabilities are transferred, but not control over assets."¹

One of the most misleading arguments offered by those who favour more income splitting is that it will value unpaid caregiving work. This supposed valuation is purely symbolic at best, since the caregiver herself need not receive a cent of additional resources. This model of income splitting relies on the discredited notion that women will be "looked after" by male breadwinners, so have no need of their own money.

This fictional form of income splitting is new to Canada. Until recently, tax law has permitted couples to split income only in limited cases where there is a real transfer of assets from one member to the other. For example couples can choose to split their CPP or QPP for tax purposes, but this requires an actual division of the pension so that each partner receives his or her own cheque. Likewise it is possible to split income using a spousal RRSP, if the main breadwinner is willing to put money into a separate plan that belongs to the spouse as her own asset. The new pension splitting rules are the first of their kind, in that spouses can acquire tax liability for income which they never receive.

It is important for women to understand that the Canada Revenue Agency is entitled to collect the tax owing on pension income reported on their returns, even if they never got a share of the pension. There is a serious concern that dependant spouses will agree to have a share of pension income placed on their tax returns without knowing all of the implications. This has been a huge problem in the U.S. where thousands of spouses are pursued by the IRS each year for tax owing on their husbands' earnings, even after divorce or separation.²

¹ Frances Woolley, "Liability without control: The curious case of pension income splitting" (2007) (forthcoming in the *Canadian Tax Journal*), at p.13.

Online at <http://www.carleton.ca/economics/cep/cep07-06.pdf> (accessed November 21, 2007).

² Richard E.C. Beck, "The Failure of Innocent Spouse Reform", (2006/2007) 51:4 *New York Law School Law Review* 929-55.

To make matters worse, a spouse may lose other benefits as a result of pension splitting. This is because the pension income that appears on her tax return will make her look richer than she really is. Benefits like Old Age Security, the Guaranteed Income Supplement, and the over age-65 tax credit are income-tested, meaning they must be repaid or are simply denied once a person's income (as reported on their tax return) exceeds a certain level. This is another reason why pension splitting can leave a poorer spouse worse off in financial terms, while the richer spouse gets a tax break.

2. The benefits go mainly to higher income men.

Income splitting is only available to those in higher tax brackets who can shift income onto the tax return of a spouse in a lower bracket. In effect, this skews the tax savings heavily toward men with higher incomes.

The federal tax brackets are as follows (figures are rounded):

Lowest bracket	income up to \$37,000	15%
Second bracket	income from \$37,000 - 74,000	22%
Third bracket	income from \$74,000 - 121,000	26%
Top bracket	income above \$121,000	29%

Income splitting is only beneficial for taxpayers in the second (22%) bracket or higher, so anyone earning less than \$37,000 is left out. This excludes the majority of Canadians, and especially women whose average income in 2004 was only \$26,065 (compared to \$43,070 for men).

In 2004 only 29% of individuals who filed tax returns reported income above \$40,000, and within this group men were in the clear majority (65% men, 35% women).

By far the greatest rewards from income splitting go to those in the top bracket. Less than 4% of individuals earned over \$100,000 in 2004, and this group was even more male dominated (77% men, 23% women).³

The class and gender bias of income splitting can be illustrated by a simple table comparing the impact on three different one-earner couples. As income on the left side of the table rises, the breadwinner is less and less likely to be a woman.

³ All data on income level and sex of taxfilers is derived from Canada Customs and Revenue Agency, *Income Statistics 2006 (2004 tax year)*, Basic Tables 2 and 4. Online at <http://www.cra-arc.gc.ca/agency/stats/gb04/pst/final/menu-e.html> (accessed November 22, 2007).

Table 1: Tax Savings from Income Splitting for a One-Earner Couple

Breadwinner's Salary	Maximum Tax Savings from Income Splitting
\$35,000 or less	none
\$40,000	\$198
\$80,000	\$2,828
\$200,000	\$7,950

3. Income splitting discourages women's paid workforce participation.

It does so by increasing the tax rate on any money earned by a lower-paid spouse in her own job. Her wages will be added on top of whatever income has already been shifted to her tax return through income splitting, pushing her into a higher tax bracket more quickly. For example a woman who is deciding whether to re-enter paid work after a parental leave could face a higher tax on any earnings, if she is already reporting a portion of her spouse's salary.

Many economic studies have confirmed that women's attachment to the labour market is more fragile than men's.⁴ The reasons are complex but include women's lower pay and heavier caregiving responsibilities. The consequence is that women's choices about entering or staying in the labour market are more strongly affected by changes in their net take home pay. If taxes or child care costs go up, for example, women are likely to drop out of paid work before men do. This disincentive to women's labour market participation is often cited by economists as the main reason why we should tax people on their individual earnings and should not allow income splitting.

4. Income splitting biases the tax code in favour of traditional family structures.

Putting all the above facts together, what we have is a measure that singles out one type of family structure for special recognition and rewards: couples in which one member earns more than \$37,000, and earns significantly more than his or her spouse. Though the law does not say the higher income spouse must be a man, or that the lower earning spouse must be a woman with primary responsibility for unpaid work in the home, in practice this would almost always be the case.

⁴ This literature is summarized clearly in Kathleen A. Lahey, *Women and Employment: Removing Fiscal Barriers to Women's Labour Force Participation* (Ottawa: Status of Women Canada, November 2005), at 11-12. Online at http://www.swc-cfc.gc.ca/pubs/pubspr/0662416759/200511_0662416759_e.pdf (accessed November 23, 2007).

The majority of Canadian households would be left out of income splitting. Groups who would receive **no benefit** include:

- Single parents
- Any individual who does not reside with a spouse or common law partner
- Two-earner couples where both members are already in the same tax bracket
- Couples in which each member has less than \$37,000 income

Groups that favour income splitting sometimes argue that one-earner couples are disadvantaged by the current tax system. This view is generally based on a simplistic comparison between a couple with one \$80,000 earner, for example, and another in which both spouses are in paid work earning \$40,000 each. It is true that the first couple will pay more tax because the earner is in a higher tax bracket. Income splitting proponents argue this is unfair because the two couples have the same total earnings. However this argument ignores other advantages that give the one-earner couple a higher standard of living.

Having one spouse working full-time in the home means she (or he) can provide many valuable goods and services for the family, which the two-earner couple must pay for in cash or do without. In addition, the two \$40,000 earners must bear additional expenses for things like EI and other payroll taxes, commuting costs, work-related clothing, child care that is only partly deductible for tax purposes, and other incidentals.

It is also important to note that several recent budget measures have benefited one-earner couples. These include an increase in the tax credit for supporting a dependant spouse, a new child tax credit, and the *Universal Child Care Benefit*, a monthly transfer payment to parents of young children that replaced funding for a national child care program.

5. Income splitting would be so costly as to preclude more effective and equitable programs to support families and caregivers.

Various media reports suggest that income splitting has been actively considered by the federal government but has not yet been implemented, perhaps in part due to its high cost. More recently, researchers with the Library of Parliament have estimated that extending income splitting to all couples would reduce federal revenues by almost \$5 billion per year.⁵ If only couples with children were included, the cost would be about \$2.2 billion. These are enormous sums and the total cost would be substantially higher if

⁵ Andre Laurin, *Income Splitting: A Brief Overview* (Ottawa: Library of Parliament, January 2007). Online at <http://www.parl.gc.ca/information/library/PRBpubs/prb0636-e.pdf> (accessed November 21, 2007). The estimated cost of extending income splitting to all couples for all sources of income was \$4.894 billion: Table 1, p.5.

provincial revenue losses were added. To put these figures in perspective, here are the estimated costs of some other tax cuts and spending programs introduced or proposed in recent years⁶:

Reducing the GST from 6% to 5%:	\$6 billion (2008/9)
Reducing the lowest tax rate from 15.5% to 15%	\$1.3 billion (2008/9)
Universal Child Care Benefit	\$2 billion (2006/7)

If there is fiscal room for new tax or spending measures in Budget 2008 the Government should not use it to expand income splitting, but should instead use it wisely for programs that promote gender equality.

On the revenue (tax) side of the budget, the Government and the Department of Finance should avoid any further cuts in the general rates of taxation, or further cuts to capital gains taxes. Recent research indicates that these tax cuts have contributed to the growing income gap in Canada.⁷ Women make up a disproportionate share of low income earners in Canada, and tax cuts have not enhanced their economic security or independence. FAFIA joins other organizations in calling for increased rates of tax at the high end of the income scale, to finance measures that will improve economic security for the most at risk citizens.

In addition, the Department of Finance should examine any new tax expenditure proposals carefully to ensure they have a positive impact on women's equality. Recent budgets have added a host of new tax expenditures, many of which are poorly designed to address women's needs as individuals or members of families. For example the use of non-refundable tax credits as an economic and social policy lever means that large numbers of lower income individuals, mainly women but also men, cannot access them. Refundable credits such as the Working Income Tax Benefit are more positive for low wage earners, but its amount is currently far too modest. FAFIA joins anti-poverty organizations in calling for an increase in the Working Income Tax Benefit.

On the spending side of the budget, childcare is still of concern to many Canadian families. Where the Universal Child Care Benefit has offered funding to Canadian families, FAFIA and our member organizations propose that the current government fund

⁶ Cost estimates are drawn from Department of Finance, *Budget Plan 2007* (tax cuts); and Department of Finance, *Annual Financial Report of the Government of Canada Fiscal Year 2006-07* (UCCB).

⁷ See Marc Lee, *Eroding Tax Fairness: Tax Incidence in Canada, 1990-2005* (Ottawa: Canadian Centre for Policy Alternatives, November 2007). Online at http://www.policyalternatives.ca/documents/National_Office_Pubs/2007/Eroding_Tax_Fairness_web.pdf (accessed November 23, 2007).

a national childcare program to better meet the needs of all Canada's families. The rising cost of childcare and the lack of quality spaces have been identified as a clear disincentive for women to re-enter the paid work force. A national publicly funded childcare system would greatly contribute to women's economic security and to the wellbeing of children and families in Canada.