INCOME SPLITTING

What is the background to this debate?

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 measure was designed to quell negative reaction to the Government's decision to impose a tax on income trusts, a popular form of retirement savings investment. It is a relatively small change but 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. Since pension splitting was announced, social conservative groups inside and outside government have seized the opportunity to campaign for broader income splitting rules. (See for example this website: http://sharingincome.tripod.com/id8.html)

Here are the 5 key facts behind FAFIA's position that income splitting is bad tax policy that is detrimental to women's equality.

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

1. The benefits go mainly to higher income men.

The income splitting model promoted by the Harper Conservatives is only available to those in higher tax brackets who can shift income onto the tax return of a spouse in a lower bracket.

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 30% 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).

The class and gender bias of income splitting can be illustrated by a simple table comparing the impact on three different one-earner couples.

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 (59% are women)	none
$40,000 (35% are women)	$198
$80,000	$2,828
$200,000 (<23% are women)	$7,950

2.Unpaid caregivers do not get any 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."

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 each year by the IRS for tax owing on their husbands' earnings, even after divorce or separation.

To make matters worse, a spouse may lose certain other benefits. 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.

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. 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 would single 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.

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 the Harper Government has already delivered several other programs that benefit one-earner couples. These include an increase in the tax credit for supporting a dependant spouse, a new child tax credit for all parents, 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.

FAFIA believes the Government seriously considered an announcement of full income splitting in 2006 but was ultimately deterred by the 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. This is an enormous sum and the total cost would be substantially higher if provincial revenue losses are 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 years:

Reducing the GST from 6% to 5%:	$6 billion (2008-09)
Reducing the lowest tax rate from 15.5% to 15%	$1.3 billion (2008-09)
Universal Child Care Benefit	$2 billion (2006/7)