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TAX EQUITY AND HOMELESSNESS:
A TAX POLICY ANALYSIS OF THE GOLDEN REPORT

GRAHAM WEBB*

When you drive around and you see homeless people lying on the street, sleeping in bus shelters, it just turns your stomach that this is happening in this rich city. We need to find solutions. —Mayor Mel Lastman

RéSUMÉ

Un groupe de travail sur les sans-abri a été formé par la Ville de Toronto en réponse à une crise du logement perçue par la population. Une enquête approfondie sur les causes du problème des sans-abri et les moyens d’y remédier a été menée, et on a conclu que la situation est surtout attributable à un écart de revenu toujours plus grand entre riches et pauvres, le coût élevé du logement et le manque d’habitations sociales subventionnées où le loyer est fonction du revenu. Les membres du groupe de travail ont recommandé la création d’un nouveau programme d’allocation pour le logement financé par la province et le rétablissement du financement par le gouvernement fédéral des coûts d’immobilisation liés aux habitations sociales.

Une analyse de la politique fiscale révèle que des avantages fiscaux importants sont consentis à l’égard des logements occupés par leur propriétaire, ce qui entraîne des inégalités entre les propriétaires et les locataires. Le système d’imposition devrait éliminer ces inégalités en taxant les propriétaires sur les gains en capital provenant de la vente d’une résidence principale et en imposant une taxe sur les revenus de location tirés des immeubles résidentiels occupés par leur propriétaire. Idéalement, une mesure d’imposition permettant de compenser pour le manque à gagner qui résulte de l’absence d’impôt sur ces revenus apporterait une réponse générale plus adéquate au problème grandissant de la pauvreté, dont la crise du logement n’est qu’un symptôme.

Une réforme de la fiscalité aussi radicale est quasi impossible sur le plan politique, mais les effets des recommandations contenues dans le Golden Report se rapprocheraient de ceux que produirait le minimum de modifications fiscales nécessaire pour éliminer les inégalités entre propriétaires et locataires et représenter une solution fiscale très valable en vue d’améliorer le régime actuel.

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I. THE COMPELLING OBLIGATION OF HUMANITY

A. A New Responsibility in a New Millennium

In January 1999 the Report of the Mayor’s Homelessness Action Task Force (hereafter called the Golden Report) was issued, recommending significant direct-spending programs through provincial shelter allowances, and federal funding for the capital costs of social housing.

In March 1999 the Government of Canada announced the appointment of the Minister of Labour Claudette Bradshaw to a new and additional cabinet responsibility as Co-ordinator on Homelessness. The Minister has a long record of public service for the poor and disadvantaged, and some expertise in the social policy issues related to homelessness. Her credentials allow no doubt about her experience and good intentions, yet her new responsibility has not yet restored federal funding of new social housing for young low-income families, nor the creation of any other long-term policy instrument that would reduce or eliminate homelessness.

One hopes that this appointment signals the focus of attention of the Government of Canada, and the Province of Ontario, on the plight of the homeless to the extent that the type of long-term direct-spending programs advocated by the Golden Report will soon be delivered. From a tax-policy perspective, the housing subsidies recommended by the Golden Report have considerable merit and are worth serious attention from both senior levels of government.

B. The Case for Housing Subsidies

There is no greater need than from shelter, especially for the young, the old, the infirm, and the vulnerable in Canada. Our very climate transforms the need for adequate housing from an abstraction to a concrete reality. The Québécois songwriter Gilles Vigneault aptly wrote, “Mon pays, ce n’est pas un pays, c’est l’hiver,” last modified 2001. and in fact our ability to cope with cold, harsh, and unforgiving winters does help define us all as Canadians. The general importance of good housing to Canadians was highlighted by Elmer McKay, then federal minister of public works, who said in debate on 1992 amendments to the Canada Mortgage and Housing Corporation Act and the National Housing Act, “[T]here is nothing more important to Canadians in general than the state of their housing,” and it is hard to disagree.

Homelessness is a tear in the social fabric. There can be no greater tear in the fabric of our nation than when large numbers of Canadians—our children, our elders, our neighbours—find themselves homeless. Should we fail to repair the fabric we will

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2. Ibid. at 77-85.
3. Ibid. at 152-53.
4. Gilles Vigneault, “Mon Pays” in Gilles Vigneault (sound recording) (Don Mills, Ont.: Sony Music Canada Inc., 1972 [vinyl], re-released 1991 [C.D.]). This may be translated as “My country, it is not a country, it is the winter.” See AltaVista World Translations, online: <http://babelfish.altavista.com/translate.dyn
inescapably be rent apart, divided in proportions as “haves” and “have nots.” Such profound social division is inconsistent with the vision of an egalitarian democracy. To echo the words of Henry Simons, who considered the prevailing distribution of wealth to be intrinsically evil and esthetically displeasing, homelessness in Canada is also “distinctly evil or unlovely.” On a purely ethical and esthetic basis, homelessness is simply a phenomenon that most Canadians would prefer not to have in our own nation, much less in our own communities.

The economic case for housing subsidies is not the focus of the present enquiry, but it is briefly necessary as a foundation for the tax analysis to follow. Jurists and economists have turned their minds to housing as one aspect of poverty and considered whether the best social policy would be to direct subsidies to affordable housing as a discrete commodity, or rather to address the underlying issue of income distribution in general. Greg Mason presented a paper on housing access and affordability to a 1995 Canada Mortgage and Housing Corporation (CMHC) symposium on housing affordability, and captured the debate as follows:

> Analysts can be divided into two general groups... First there are neo-classical economists who argue that housing should be treated like any other commodity. In this view consumer preferences are constrained by a budget. The outcome of this decision-making framework results in an optimum combination of housing and all other goods. This perspective has much to recommend it. Housing affordability is not an issue; income adequacy is. Rather than creating housing, poor people should get money, or better yet, the skills to earn higher incomes. The resolution to any problem is through income re-distribution and not through direct intervention into a specific market... Few economists subscribe to this view. For most, housing is a merit good and the state has an obligation to intervene in the market...  

In the same vein, Michael Schill, in a review of American public-housing policy queried why governments should make direct interventions in the housing market rather than addressing the underlying problem of poverty where “elementary welfare economics would indicate that an unrestricted income supplement such as a negative income tax [that would generally alleviate poverty with respect to all commodities] would be the most efficient policy.” However, Schill supported the opposite view, that there should be direct intervention in housing markets. He pointed out that although “housing markets are generally competitive,” and therefore ought to respond with adequate supply if the demand for low-income housing were increased, there are significant market imperfections that call for direct market intervention.

6. Henry C. Simons, *Personal Income Taxation* (Chicago: University of Chicago Press, 1938) at 18-19, as follows: “The case for drastic progression in taxation must be rested on the case against inequality—on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely.”


There can be an imbalance between long-term and short-term market equilibriums that may leave renters homeless in the short term, even where long-term market equilibrium is predicted.\textsuperscript{10} Schill also stated that "government regulation impedes the supply of housing, especially for low-income households."\textsuperscript{11} Quoting James Tobin, he noted that "although most Americans typically accept inequality in most aspects of life, there is a rough consensus that 'certain scarce commodities should be distributed less unequally than the ability to pay for them.'"\textsuperscript{12} On the distribution of housing for children living in poverty, which is particularly salient to the present housing crisis in Toronto, he noted that "efforts to provide a minimum level of housing consumption may be justified as necessary to protect those who do not themselves have the power to make expenditure housing decisions."\textsuperscript{13}

Early in the twentieth century, the economist A.C. Pigou also considered the problem of low-income housing "as one aspect of the general problem of poverty"\textsuperscript{14} and, casting aside the veil of welfare economics, he succinctly held that

\begin{quote}
  everywhere . . . some system of standards should be set up, and the lapse below any one of them should be made the occasion of intervention by the public authorities. For this position a good defence can, in many instances, be made upon economy . . . but even where this ground fails, the policy that I have sketched is amply maintained: for it is not more than the acceptance in fact of the compelling obligation of humanity.\textsuperscript{15}
\end{quote}

Pigou considered, in the context of his time, whether low-income housing should receive subsidies, like education, or be left to the marketplace, like food and clothing. He did not reach a conclusion, but tended to favour housing subsidies and was "convinced that carefully drawn schemes of state assistance toward the housing of the poor ought not to be condemned out of hand upon grounds of principle. They deserve, if not support, at least sympathetic consideration."\textsuperscript{16}

Much water has passed under the bridge of social policy since Pigou's time. However, universal access to adequate housing remains a timeless human obligation. The social structures that have come to pass in Canada, particularly in income taxation and corresponding public expenditures on housing, cause this author to think that the social-policy issues that left Pigou sympathetic but undecided now mitigate unequiv-
ocally in favour of increased program spending on social housing along the lines suggested by the recently released Golden Report.

II. THE GOLDEN REPORT ON HOMELESSNESS

A. The Mayor's Homelessness Action Task Force

Mayor Mel Lastman of Toronto commissioned the Mayor's Homelessness Action Task Force in January 1998, "in response to public concern about the growth of homelessness and its increasing visibility on the streets of Toronto." The task force conducted an intensive and comprehensive study of issues surrounding homelessness, and released its report in January 1999. The Golden Report recommends concrete, cost-evaluated measures to combat homelessness in Toronto that are needed from the federal, provincial, and municipal governments to bring immediate relief.

The main task force recommendations on tax policy call for significant direct-spending programs by the provincial and federal governments in the area of social housing. The scope and purpose of this paper is to consider the tax-policy implications of the spending recommendations of the report.

B. The Causes of Homelessness

1. The Rich Are Getting Richer, and the Poor Are Getting Poorer

Poverty strikes at the heart of the distributional function that ought to be adequately addressed in a well-designed income tax system. Yet the evidence is that in the City of Toronto there is greater and more profound poverty than in the recent past. The Mayor's Homelessness Action Task Force commissioned a study on trends in poverty in the new City of Toronto, and the findings were remarkable.

Poverty is increasing, even during a time of economic growth, which is a departure from earlier opposite trends that indicated poverty should recede in a growing economy. Using the Statistics Canada "Low-Income Cut-Offs" (LICOs) as a proxy for poverty lines, most low-income Canadians have fallen even further below the poverty line in the past decade. The study found that "in 1995, the percentage of households earning less than $20,000 in Toronto was 24.3% compared to 20.6% in 1990." When one considers the cost of housing in Toronto, this alone is an astonishing statistic.

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17. Supra note 1 at 13.
18. Ibid. at 14-17 (on the task force's methodology).
19. See ibid. at 189-202 for a complete list of the report's 105 recommendations.
21. Supra note 1 at 254 (Appendix H).
22. Ibid. at 255.
23. Ibid.
Young families are more often poor. Since 1980 there has been a dramatic shift in the incidence of poverty by age. In that time, poverty among families headed by someone aged 65 or older has fallen from 21% to 9.2%. In the same time, poverty for families headed by someone under age 25 has risen from 20.9% to 42.0%. The study concluded that "young families have gotten poorer, families headed by someone middle-aged have stayed about the same, and the situation for older families has improved. There has been a similar shift by age group for unattached individuals."²⁴

The most profound effects are on families headed by single mothers, who are at extreme risk of poverty. "In 1995, the poverty rate for families headed by a single mother under 25 years of age was 83% . . . between 25 and 44, the poverty rate was 57.4% . . . between 45 and 64 the rate was 38%."²⁵ These findings on poverty among families headed by single mothers are impossible to ignore, particularly in view of the arguments for the inclusion of imputed income together with a negative income tax, which will follow.

Renters are losing ground relative to homeowners. "Poverty rates [for families who rent] have reached a new high of 36.2% in 1996, at a time of economic growth. The incidence of poverty among homeowners was 7.2% in 1996."²⁶

Recent changes to income-security programs have exacerbated poverty. Federal employment insurance adopted more restrictive eligibility criteria in 1996, forcing more of the unemployed onto provincial social-assistance programs. In 1995 Ontario also restricted eligibility criteria and cut benefits to social assistance programs by 21.6%. Thus the poorest of the poor, drawing on the income security programs of last resort, have suffered a significant loss of income.²⁷

2. The High Cost of Homeownership

The perception of the high cost of homeownership is one shared by rich and poor alike. Residential housing in Canada has a high capital cost, particularly in relation to the earnings of young families. One tax planner introduced a discussion on how to assist children in purchasing a home at the 1996 Canadian Tax Foundation annual conference with the following observations:

One of our persistent concerns is that our children will not be able to enjoy the material things that we have enjoyed. We see university graduates working at subsistence-level jobs; we hear of the stiff competition for acceptance in programs to provide skills that command reasonable earnings; we perceive a replacement of high-paying jobs with more menial employment and the replacement of middle management with technology. At the same time we consider unbelievable the cost of capital items such as cars and homes. We value the positive social elements we perceive to come with homeownership and desire that our children enjoy these also.

²⁴. Ibid. at 256.
²⁵. Ibid. at 256-57.
²⁶. Ibid. at 257-58.
²⁷. Ibid. at 259-60.
As well, we look at homes as good investments and believe that increases in their values will keep pace with, and probably exceed, the rate of inflation. With house prices increasing and our perception of a weak job market, how will our children ever be able to put aside the funds needed for a down payment?28

If the accumulation of a down payment is perceived to be so difficult for the children of the middle-class and the well-to-do, one might wonder how much more difficult and impractical will that be for the disabled, the unemployed, the underemployed, and the working poor. Without an intergenerational wealth transfer, or some other family support, a substantial income would be required to make a home purchase possible. The practical effect may be to exclude the working poor from the owner-occupied housing market, and that conclusion would be consistent with the evidence revealed in the Golden Report.

3. The Unmet Demand for Social Housing

The Golden Report found that in June 1998 there was a huge unmet demand of “more than 37,000 households, representing about 100,000 people ... waiting for social housing in Toronto.”29 In hindsight, this should hardly be surprising. In 1992, Joe Fontana, then Opposition housing critic, said in debate on amendments to the Canada Mortgage and Housing Corporation Act and the National Housing Act, currently only 6 percent of Canadians are served by social housing programs. There are 15 percent or more, over one million Canadians,30 who are still in core housing need. Despite such overwhelming need, the federal government has consistently cut social housing programs in consecutive budgets.

The most recent budget will amount to a 50 percent reduction in the construction of new social housing units within three years.31

Those facts were not disputed by the Minister, who was then in the House, and any abatement of the unmet demand for social housing in that context would be virtually unimaginable.

The profile of those on the waiting list for social housing has also changed, to include more families and more children. In Toronto “there are more than 16,000 applicants for social housing who have children. In all, more than 31,000 children are waiting for social housing.”32 Families with children are at a high risk of homelessness and are one of the fastest-growing groups in the use of hostels.33 Because of their need for larger accommodations, families are also the most difficult to house.34

29. Supra note 1 at 27.
30. Fontana did not state the source of his statistics, but based on the percentage he gave and census data at the time in question, it seems that the figure of 1 million Canadians in core housing need may be a significant understatement.
32. Supra note 1 at 28.
33. Ibid. at 49-51.
34. Ibid. at 53-54.
4. Cancellation of Funding to Build Social Housing
Prior to 1993, the Government of Canada funded capital costs for the construction of social housing. In 1993 the federal government abruptly withdrew from funding new social housing except for the elderly, the disabled, and members of First Nations. Most provinces, including the province of Ontario, did not take up additional program spending on new social housing, to the detriment of young poverty-stricken families and all low-income renters.

C. The Golden Report Recommendations
The Golden Report found that the problem of homelessness is not insoluble, but does require immediate action by all levels of government to achieve a resolution. The Golden Report made 105 recommendations.\(^{35}\) Recommendations that require additional government spending are evaluated on cost. Those under consideration here are: (1) a new provincial shelter allowance for all working poor families at an annual cost of $91 million, which, if feasible, should be extended to all working adults at an estimated cost of $178 million;\(^{36}\) and (2) new federal funding of the capital cost of social housing, to the extent of $200 to $300 million nationwide, or $40 to $60 million for Toronto.\(^{37}\)

1. Provincial Shelter Allowances
The program design recommended by the Golden Report is a shelter allowance that would be given to low-income families, aimed at reducing the percentage of family income devoted to rent to a target of 35%.\(^{38}\) Up to 90% of the difference between 35% of income and the actual percentage of income devoted to rent would be subsidized on a sliding scale. This “35/90 formula” would operate as follows:

The “contribution rate” would be 35 percent, meaning that the tenant pays at least 35 percent of income on rent. The percentage of the affordability gap covered by the benefit would range from a high of 90 percent (the allowance covers 90 percent of the difference between 35 percent of income and the actual rent for households with incomes of $10,000) to a low of 70 percent (for households with incomes of $30,000).\(^{39}\)

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35. Ibid. at 189-202.
36. Ibid. at 82-85, and recommendation 38 at 84, as follows: “A new shelter allowance program should be created, targeted to working poor families as a first priority, and to working adults if feasible. The aim of this program, which would require annual re-application, is to reduce the risk of homelessness and to ensure that the transition from welfare to employment does not increase the risk of homelessness. The shelter allowance program should reduce the share of income that low-income people spend on housing to between 35 and 40 per cent.”
37. Ibid. at 145-55, and recommendation 84 at 154.
38. Compare Peter W. Salsich, Jr., “Welfare Reform: Is Self Sufficiency Feasible without Affordable Housing?” (1997) 2 Mich. L. & Policy Rev. 43 at 56, stating that “the affordability definition of the Section 8 and public housing programs [is] that a person should not have to pay more than 30% of his/her income for housing, including utilities.” By comparison, the 35% ratio adopted by the Golden Report is less generous to renters than comparable federal American program criteria.
39. Supra note 1 at 83.
The recommended program design is intended to encourage tenants to seek lower-cost housing by reimbursing less than the full differential between 35% of income and actual housing costs. The graduated scale would target the program at those most in need, while preventing "an abrupt loss of benefits or an inequity between those just over and those just under the line."40 It also recommends a maximum benefit based on "median or average market rent for a unit of an appropriate size for each type of household,"41 and annual reapplication to ensure continuing housing needs and income eligibility.42

The report recommends the shelter-allowance program be delivered by the provincial government, since it is an income transfer similar to other provincial social-assistance programs. Shelter allowances are now delivered by four other Canadian provinces, and are said to "fit within the declared priorities of the [Ontario] government."43

Not mentioned by the report, but mitigating in favour of provincial spending of this type, is that a high portion of provincial revenue is collected from personal income taxes,44 which are highly biased in favour of homeowners as opposed to renters. Rent subsidies would to some degree help correct tax inequities between homeowners and renters.

2. Federal Capital Funding of Social Housing
The Golden Report recommends that "the federal government should provide up to $300 million in capital support for new low-income housing" and "should also reinvest in housing each year the savings to be realized from devolution to the provinces."45 These recommendations are consistent with the historical role of the federal government in the area of social housing.

Federal housing policy is delivered primarily under the National Housing Act through a Crown corporation, the Canada Mortgage and Housing Corporation. The Golden Report notes the declining federal commitment to social housing:

CMHC currently spends $1.9 billion a year on social housing, which is offset by about $900 million in capital and interest payments for old loans the government made to CMHC. This results in a net federal treasury cost of $1 billion. A rising share of CMHC spending is the recycling of old loans as borrowers repay...46

Grants or interest-free loans to new housing in the range of $20,000 to $50,000 a unit (depending on the size of the unit) are needed. This type of federal support is consistent with the current devolution to the provinces of program administration
for social housing. The federal government would not be administering programs but would be reinvesting savings it realized during the 1990's and the savings that will accrue after devolution to the provinces.

Under the housing agreements being signed between CMHC and the provinces, the federal subsidy will gradually decline to zero over the next 30 to 40 years as existing project agreements expire. This means the federal government will save a total of $600 million in Ontario by the end of that period.47

Restored federal program spending on social housing is necessary to offset huge tax preferences to taxpayers who own and occupy their own homes, and to restore some semblance of tax equity to the income tax system.

III. WHAT'S TAX GOT TO DO WITH IT?

A. The Owner-Occupied Home: A "Great Canadian Tax Shelter"

The Income Tax Act48 affords an overwhelming tax preference for owner-occupied housing. Investment in a home is well recognized by tax planners as one of the most widely used and effective tax-free savings vehicles available to Canadian taxpayers. At the 1992 national conference of the Canadian Tax Foundation, Rodney Bergen said,

The longstanding exemption from income tax of the gain on the sale of a principal residence is one of the linchpins of the Canadian tax system. Along with the registered retirement savings plan (RRSP), the principal residence stands as one of the great Canadian tax shelters. 49

The value of the home as a tax shelter is twofold. First, "the return on investment, in the form of a shelter is not taxable." Second, "and most significantly, the capital gains realized upon disposition of the home is exempt from taxation by virtue of the existing provision governing the capital gains exemption on principal residence."50

47. Ibid. at 154.
A tax-policy analysis will show that the tax preferences for owner-occupied housing are grossly inequitable, to the advantage of homeowners and disadvantage of renters. If the existing tax preferences are to remain, then the fundamental objectives of the tax system, and the usual criteria for evaluating pure-tax provisions and tax expenditures would call for compensating policy instruments along the lines of the direct expenditure programs recommended by the Golden Report.

B. The Fundamental Objectives of the Tax System
The underlying objective of taxation is to raise revenue. However, the objectives any system of taxation should serve and the principles it should follow in the course of raising revenue have been the subject of much scholarly debate.

The Royal Commission on Taxation (commonly known as the “Carter Commission”) was completed in 1966, and its report is the seminal work on tax policy for Canada. It has always been widely acknowledged for its depth of analysis. For example, shortly after the Report was issued, Boris Bittker, even in criticizing it, noted that the Report “has few peers among modern proposals for tax reform,” and belongs in “select company.” He also said,

for the foreseeable future, the Report will be a starting point for any responsible program of income tax reform in an industrialized country, as well as a prod to the re-examination of many issues, theoretical and practical, in the taxation of income.

It has already evoked the attention of many commentators who, whatever their separate orientation and reservation, have paid tribute to the Report’s importance.

The Royal Commission found that

four fundamental objectives [of the tax system] on which the Canadian people agree are: (1) to maximize the current and future output of goods and services desired by Canadians; (2) to ensure that this flow of goods and services is distributed equitably

51. See, for example, Hogg and Magee, supra note 44 at 35, as follows: “The purpose of the income tax is to raise revenue to finance government spending,” and at 36, as follows: “Given that the main purpose of the income tax is to raise revenue, the question arises what subsidiary objectives should be served by the tax system” [emphasis added]. While these statements are undoubtedly correct at present in Canada, given the financial obligations of the federal and provincial governments and the vital importance of income-tax revenue, it is not apparent to this author whether on first principles this must always be so. Robin Hood, for example, implemented what might be thought of as a rudimentary tax system that was entirely revenue-neutral but intended to achieve a more just distribution of wealth. Robin Hood’s “tax” was admittedly a bit arbitrary in its application (although left long enough, perhaps every fictional upper-quintile taxpayer could have been reached) and undoubtedly lead to some horizontal inequity, but it probably improved the overall distribution of wealth systemwide. While this facetious example is indeed quite spurious, it would not be hard to conceive a more revenue-neutral tax system designed primarily to redress the growing inequality of income distribution, with overall positive effects.


54. Ibid. at 638.
among individuals or groups; (3) to protect the liberties and rights of individuals . . .; and, (4) to maintain and strengthen the Canadian federation.\textsuperscript{55}

This view of the underlying role of taxation is consistent with legal and economic scholarship that both preceded and followed it to date. For example, Neil Brooks wrote in 1993 that a wide range of international studies suggest that

the tax system is seen as basically a policy instrument with which the government pursues its ultimate economic objectives of: (1) reallocating resources, primarily by providing goods and services that the market cannot provide efficiently, (2) redistributing income in a way that is more socially acceptable than that which results solely from market forces, (3) stabilizing the economy near full employment and a zero rate of inflation, and (4) encouraging economic growth.\textsuperscript{56}

Similarly, Professors Boadway and Kitchen held that:

the tax system is designed to fulfil two main functions. First, taxes are levied to finance public sector expenditures on goods and services at all levels of government. Second, taxes are used to facilitate the transfer of purchasing power among individuals in society and among levels of government with a view towards improving the distribution of income and wealth,\textsuperscript{57}

and then stated widely accepted tax criteria of “equity, efficiency, economic growth, stabilizing ability, effect on economic growth, and ease of administration and collection for taxpayers and governments.”\textsuperscript{58} Of interest to this discussion is that virtually every description of the fundamental underlying objectives of the tax system includes significant reference to a just and equitable distribution of wealth.

C. The Priority of Tax Equity

Simons noted in prefacing his classic text, \textit{Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy},

Taxation is the proper means for mitigating inequality; and, confining attention to this field of economic policy, one naturally places more emphasis upon that objective than would be appropriate in a less restricted discussion.\textsuperscript{59}

The Royal Commission weighed the competing objectives of the tax system, and on a general basis attached the highest priority to that of tax equity:

We assign a higher priority to the objective of equity than to all the others . . . We are convinced that unless this objective is achieved to a high degree all other

\textsuperscript{55} Supra note 52 at vol. 1, 17.


\textsuperscript{58} Ibid. at 7.

\textsuperscript{59} Simons, supra note 6, at Part V.
achievements are of little account. Thus the need for an equitable tax system has been our major concern and has guided us in all our deliberations.  

Recently, Professors Hogg and Magee concurred with this finding, stating that "the Carter Commission took the view, which is still widely shared, that equity (or fairness) should be the major subsidiary objective of the income tax system."  

Recalling Pigou’s comments about housing at the 1914 Warburton Lecture, on the need everywhere for “some system of standards,” one would think that in Canada everyone should have the means to meet basic needs such as food, shelter, clothing, transportation, and education. The systemic failure of large sections of our population to meet any of these needs is an indictment of our use of the policy instruments that could address the distribution of wealth.

Income tax is the main policy instrument that could address the distribution of wealth and must come under special scrutiny for its present effects on poverty and homelessness and for the role it could fulfill.


The fundamental objectives of a tax system articulated in the report of the Royal Commission are expressed in widely accepted criteria for evaluating pure-tax provisions. The sole purpose of pure-tax provisions is to raise revenue according to the fundamental objectives of the tax system. The usual criteria in evaluating pure-tax provisions are equity, neutrality, and simplicity.

It should be noted that many provisions of the Income Tax Act have no relation to the commonly accepted policy principles of equity, neutrality, and simplicity that should direct the shape of an income tax system. They are indirect spending provisions usually known as “tax expenditures” that are not connected to the fundamental objectives of the income tax system. They are the equivalent of direct-spending programs, which do not bear examination according to the usual criteria of evaluating pure-tax provisions. Rather, tax expenditures should be evaluated by the same criteria that would be appropriate for a corresponding direct-spending program.

However, tax issues related to the measurement of income are pure-tax provisions that do require some understanding of the tax concepts of equity, neutrality, and simplicity.

1. Equity

The concept of equity in tax law is no less elusive than in other areas of endeavour. Nevertheless, excruciatingly simplistic definitions of tax equity are generally accepted among tax authors. Contemporary definitions of tax equity resemble the Aristotelian

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60. Supra note 52.


62. Neutrality here refers to the lack of tax-induced behaviour between economically identical alternatives. It does not refer to the concept of revenue-neutrality in the revenue-raising ability of comparative tax measures. 
principle of **formal equality** (which was rejected by the Supreme Court of Canada in the interpretation of *Canadian Charter of Rights and Freedoms*), which is that “things that are alike should be treated alike, while things that are unalike should be treated unalike in proportion to their unalikeness.” This principle finds expression in the concepts of horizontal and vertical equity.

**Horizontal equity** is taken to mean that similarly situated taxpayers should pay similar amounts of tax. **Vertical equity** means that “persons in different circumstances bear ‘appropriately different’ taxes.”

### 2. Neutrality

A neutral tax measure is one that will not influence individual behaviour. With a perfectly neutral tax, no one would change his or her behaviour with the tax or without it. An example of the most neutral tax is a poll tax, since it does not depend on any individual behaviour and there is no opportunity for avoidance (short of leaving the taxing jurisdiction). A non-neutral tax is one in which taxpayers have ample opportunity to plan their affairs to avoid paying tax and alter individual behaviour for the express purpose of avoiding tax liabilities.

### 3. Simplicity

Tax simplicity refers to ease of administration. This criterion includes concepts of convenience, certainty, and economy in the administration of a tax advocated by Adam Smith in the *Wealth of Nations*. A simple tax is one that can be conveniently administered, with certainty in the incidence and calculation of the tax, and low administration cost.

Simplicity may be the most complex of the pure-tax criteria, because it squarely addresses sometimes irreconcilable divergence of theory and practice in the implementation of a tax. In the measurement of income, for example, it is often

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63. *Andrews v. Law Society of British Columbia*, [1989] 1 S.C.R. 143 at 166, per McIntyre, J., citing Joseph T. Tussman and Jacobus tenBroek, “The Equal Protection of the Laws” (1949) 37 Cal. L Rev. 341, and *Ethica Nichomacea*, trans. W. Ross (1925) book V-3 at 1131a-6. Incidentally, one might wonder whether the contemporary concept of tax equity is durable enough to withstand a Charter challenge in any given situation. In adopting a purposive approach to the similar concept of “equality” under the Charter, McIntyre, J. noted in the passage next following (at 166), with reference to the Aristotelian principle of formal equality, as follows: “[T]he test as stated, however, is seriously deficient in that it excludes any consideration of the nature of the law. If it were to be applied literally, it could be used to justify the Nuremberg laws of Adolf Hitler. Similar treatment was contemplated for all Jews. The similarly situated test would have justified the formalistic separate but equal doctrine . . . that incidentally was still the law in the United States at the time that Professor Tussman and J. tenBroek wrote their much cited article . . . .” Within the context of the grossly unequal treatment of homeowners and renters under the *Income Tax Act*, a separate enquiry might be made into the viability of a Charter challenge of tax provisions that disadvantage renters as a discrete and perhaps already disadvantaged group, if poverty were accepted (which it is not) as a prohibited analogous ground of discrimination.

64. Hogg and Magee, *supra* note 44 at 38, with reference to the *Report of the Royal Commission on Taxation*, *supra* note 52 at vol. 1, 4-5. See also Grover and Iacobucci, *supra* note 61 at 153.

necessary to adopt a simple proxy as a substitute for an aspect of the true measure of income, where the true measure is by definition or in practice immeasurable.\textsuperscript{66} Ease of administration may dictate that approximations be made with the least possible distortion to the other criteria of equity and neutrality.

IV. THE NON-TAXATION OF IMPUTED RENTAL INCOME

Imputed income generally refers to the inclusion as income for tax purposes of amounts that a taxpayer does not actually receive as money, but instead receives as goods or services, including self-performed services and the use of durable goods already owned. Imputed rental income, for an owner-occupied home, generally means the amount that the owner would have received if the home had been rented out in an arm's-length transaction.

The case for inclusion of imputed rental income can at first blush be somewhat counter-intuitive, but is strongly supported on economic and tax-policy grounds. The failure to include imputed rental income in the income tax base skews residential housing markets with an inflated housing demand driven by tax preferences for owner-occupied housing. It seriously disadvantages renters in comparison to homeowners, to the point that it helps create an insurmountable barrier for entry into the housing market by many low-income renters. The non-inclusion of imputed rental income cannot be supported on a pure-tax policy basis, as the following analysis will show.

A. The Definition of Income

1. \textit{The Fallacy of the Transplanted Principle}

The term \textit{income} has many definitions and yet has been left largely undefined in income-tax statutes. The lack of a comprehensive statutory definition left courts to define income, and in doing so they drew on a pre-existing body of law in trusts and estates that laid down principles to differentiate ownership of trust receipts and disbursements as "income" or "capital." Those principles are necessary for the operation of a trust, since ownership of the income and capital of an estate may belong to different parties, and it is necessary to differentiate ownership of funds on a principled basis. However, the same principles have little to do with income-tax concepts.

Trust principles were eventually transplanted into tax theory. One author noted,

\begin{quote}

an early and persistent theory identified income as the amount that the individual could periodically spend without encroaching upon her capital. Using this approach, British theorists became preoccupied with formulations that would tax \([\text{as income}]\) only the permanent yield from capital, but not the capital itself.\textsuperscript{67}
\end{quote}

\textsuperscript{66} A proxy is something substituted as a reasonable approximation of an underlying characteristic that may be difficult or impossible to measure directly. For example, English landowners were once taxed on the number of windows in the buildings they owned as an approximation of, or "proxy" for, land value. (Unfortunately, that proxy did not meet the tax policy criterion of economic neutrality, and many buildings that still stand were built with too few windows, to avoid the payment of the window tax.)

\textsuperscript{67} Chancellor, \textit{infra} note 74 at 576.
The definition of *income* is best provided with reference to the purpose that the term serves. The purpose of defining *income* in relation to income tax is to measure economic power. Principles necessary to differentiate ownership of trust property where the trust capital was left to one person and income to another are irrelevant to the measurement of economic power germane to income taxation, but were nonetheless applied to income-tax cases by British and American courts. This caused economists such as R.M. Haig to conclude that the legal definition of income was "so narrow and artificial as to bring about results which from the economic point of view are certainly eccentric and in certain cases little less than absurd," and to seek other definitions of income more broadly consistent with economics and equity.69

2. The Haig-Simons Definition of Income

Henry Simons defined *income* as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." This is an economic definition often referred to as the "Haig-Simons," or the "comprehensive," "use," or "accretion" theory of income. It is widely accepted as the point of departure in most discussions of the appropriate income tax base. For example, William Andrews opened his own famous article proposing an alternative consumption tax base by remarking that serious thought about personal income tax has come to be dominated by an ideal in which taxable income is set equal to total personal gain or accretion, without distinctions as to source or use. It will be useful to call this ideal an accretion-type personal income tax.71

The Haig-Simons economic definition of *income* is a benchmark that the legal definition of an income tax base should ideally seek to achieve. However, there are several administrative difficulties in the practical application of an income tax. One discrete set of problems in the application of the economic definition of *income* is the measurement of "the value of property rights exercised in consumption," of which imputed rental income and the value of self-performed labour are significant components.

B. The Nature of Imputed Income

According to the Haig-Simons definition of income, all forms of consumption should be taxable. There is considerable debate over whether income should include only market-based transactions, or imputed income as well.

70. *Supra* note 6 at 50.
Simons discussed the problems associated with imputed income under the heading of "income in kind." Donald Marsh followed Simons's definition of *income* with an article supporting the theoretical basis for inclusion of imputed income, which he defined as follows:

Imputed income may be provisionally defined as a flow of satisfactions from durable goods owned and used by the taxpayer, or from goods and services arising out of the personal exertions of the taxpayer on his own behalf . . . Imputed income is non-cash income or income in kind . . . and its distinguishing characteristic is that it arises outside the ordinary processes of the market.

Thomas Chancellor correctly pointed out that *income in kind* is a broad term that can include bilateral exchange transactions in which taxable benefits are exchanged but no cash changes hands. Chancellor noted that this form of imputed income should be taxable in the ordinary sense, and that "bilateral transactions can be properly characterized (as producing income or not) under general income tax principles." The more limited term *imputed income* is "a species of in-kind income . . . [and] is limited to hypothetical benefits from self-performed services, leisure, or the use of personal assets."

Imputed income can arise from either (1) self-performed labour or services that, if obtained on the open market, would have a discernible market value; or (2) the use of durable goods that could otherwise be leased or rented, also with some market value, free of charge to their owner. The imputed rental income of owner-occupied housing falls squarely in the second category. The neat issue is whether imputed income should be included in an ideal income tax base. The policy rationales on the inclusion of these two types of imputed income are widely divergent and suggest that while imputed income from self-performed labour need not be included, the failure to include imputed income from the use of durable goods is highly inequitable and distorts the income tax base. Even though the present discussion will centre on the imputed income from durable goods, the differences between the two forms of imputed income and the fundamental nature of each should be briefly acknowledged.

1. **Self-Performed Labour**

Self-performed labour includes tasks that, if purchased on the open market, would have some market value. These things could include, for example, painting one's own house, fixing a car, or growing one's own vegetables. The value of self-performed

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72. *Supra* note 6, c. V, "Income in Kind."


75. Economists, and presumably tax theorists, would also include leisure as an activity that has an intrinsic market value that can be measured and theoretically could be imputed to each taxpayer as an element of taxable income. Issues concerning the measurement of imputed income of leisure and all other self-performed services are somewhat complex and far beyond the scope of the present discussion. However, they could be of vital importance to devising a more equitable measure of income for the elderly and disabled, who are often economically disadvantaged because of an inability to carry
labour is difficult to measure, and the administration of an income tax base that includes such amounts would be highly intrusive and cumbersome, to say the least. With respect to self-performed labour, Simons noted,

"[The] measurement of consumption presents insuperable difficulties to achievement of a rigorous conception of personal income . . . from the point of view of equity in taxation, the consumption of goods and services produced within the household or individual economy presents real imponderables. Clearly inequitable results arise whether such items are consistently included or ignored."

As for the desirability of including this form of imputed income, Simons noted that there is a high degree of horizontal equity in the use of self-performed labour, which is more highly concentrated in the lower-income classes. This tends to reduce inequities within income classes, and to the extent that the exclusion from income favours lower- over higher-income classes it promotes progressivity, which he held to be a desirable end. Simons concluded that the non-inclusion of imputed income from self-performed labour would cause no serious distortion of tax criteria.

2. Income from Durable Goods

It might not at first be obvious why the use of durable goods should be considered a special case in the definition of income. Perhaps the best point of departure is to recall that the economic definition of personal income is "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question." The problem at hand focuses on the measurement of consumption. Usually, the purchase price of goods is a reasonably accurate proxy for the measurement of consumption. However, where the goods purchased are not fully consumed within a single taxation year, the proxy breaks down, because the value of such durable goods continues to be consumed in subsequent taxation periods. Unlike perishable goods, whose value is used up and entirely disposed of within a single taxation period, durable goods may even appreciate in value (and never be used up), thereby increasing the flow of benefits to their owners in each passing year.

As for the measurement of consumption, Simons wrote that "consumption, presumably, should be measured in terms of values at the time of consumption; but to ignore changes in values between the time of purchase and the time of use will ordinarily make very little difference." He acknowledged that while the purchase price of perishable goods is usually a suitable proxy for the value of consumption, there is an inherent error in this approximation concerning the use of durable goods, as follows:

"[T]he error involved in ignoring consumption from property varies directly with the durability or service life of the property in question; with most foods, to take an out many self-performed tasks that other taxpayers take for granted.

76. Supra note 6 at 110.
77. Ibid. at 50.
78. Ibid. at 119.
extreme case, the difference is simply negligible. In general, the disregard of income in kind from the less durable forms of personal tangibles will occasion no serious inequities in relative tax burdens.\textsuperscript{79}

However, Simons also held that “serious inequity” arises from the non-inclusion of imputed income from the consumer use of durable goods.\textsuperscript{80}

Perhaps the horizontal inequity that Simons had in mind can be demonstrated by a taxpayer who spends, for example, a certain sum of money (in cash) on the purchase of an expensive seaside resort exclusively for personal vacation use over the next 40 years. Had the taxpayer invested the same money in bonds, the return on the investment would be fully taxable. However, the return on the seaside resort is its annual use as a vacation property, and is fully sheltered from tax. Therefore, the entire present value of the seaside resort is available for consumption on vacations, without any payment of tax on the benefits that flow from the property.

Had the same taxpayer taken the identical sum of money and, instead of spending it at once on a capital asset that gives a return “in kind,” meted out the entire amount year by year over the next 40 years on annual vacations abroad, tax would be paid on the income earned on the amount saved for future vacations. The traveller would then have to divide the present value of the money between the payment of income taxes and future consumption on vacations, and would be disadvantaged in comparison to the seaside resort owner, whose annual return on investment is entirely tax-free. There are unequal tax burdens borne by taxpayers who buy a capital asset that gives benefits “in kind” in comparison to other taxpayers with different consumption tastes and preferences. Presumably, an equitable and neutral income tax base should be indifferent between the two forms of consumption, and should not for tax-avoidance reasons induce the purchase of capital assets as a less expensive method of similar consumption.

Simons noted that the same considerations that tend towards exclusion of self-performed labour support the inclusion of imputed income from durable goods, as follows:

Income from consumers’ capital is often a large part of total income for individuals in the upper brackets. To exclude it is to introduce a bias inconsistent with progression and to differentiate flagrantly among persons of really similar financial circumstances. Furthermore, where such income is excluded, an attractive and easy means of evasion is made available . . .

Serious inequity arises, furthermore, from the fact that the opportunity for evasion is open to different income classes, on very different terms. If consumers’ capital provided a relatively uniform percentage of true income among persons of the same income class, and if the amount or percentage of such property income increased in fairly continuous manner from one income class to the next above, then adjustment for the exemption might be worked out merely in the scale of rates. But even the first of these conditions is certainly not fulfilled; nor can continued exploitation of

\textsuperscript{79} Ibid. at 118-19.

\textsuperscript{80} Ibid. at 113-14.
the opportunities for tax avoidance be expected to bring it about. The direct employment of capital is far from equally feasible for different kinds of consumption or for different people with similar consumption tastes . . . 81

In contrast to his conclusion that imputed income from self-performed labour need not be taxed, Simons held that

when property is employed directly in consumption uses, there is the strongest case for recognizing an addition to taxable income. This is widely recognized in criticism of our federal tax for its egregious discrimination between renters and homeowners . . . 82

C. Imputed Rental Income

1. Conceptual Definitions of Imputed Rental Income

A common conception of imputed rental income is the notional value that an owner-occupied home would produce if let out to a third party in a market transaction. A better way to describe it may be the market value of the use and occupancy of a home for any period of time. This latter concept focuses better on the true nature of use and occupancy, which is the consumption of the right of exclusive or quiet possession of real estate for any period of time. Occupancy measured over time is a true consumer good in the classic sense, because once it is consumed for the time in question it has been forever lost and for that time period cannot be consumed again. Further occupancy for some other period of time is another product that could be used by another consumer.

The question here is whether imputed rental income from owner-occupied housing should be included in the tax base. Imputed income is not included in the income tax base in either Canada or the United States. Whether it should be included in the tax base is a pure-tax issue entirely concerned with the measurement of income, and should be evaluated on the criteria of equity, neutrality, and simplicity.

Distortions of both equity and neutrality from the non-taxation of imputed rental income are concisely demonstrated by the following example given by Marsh:

A taxpayer who has acquired the sum of $20,000 (after payment of income tax) has the choice (among other, but similar, alternatives) of (1) investing the sum in, say five per cent bonds, collecting $1,000 and spending the interest income left, after payment of income tax, on house rent; or, (2) investing the $20,000 in a house, in which case he receives his rental services directly. If the tax is flat 20 per cent with no exemptions, the first alternative leaves $800 for rent. The second alternative would yield rental services to the full value of $1,000 yearly, since the homeowner pays, under our statute, no tax upon his imputed income.83

81. Ibid.
82. Ibid. at 112.
83. Supra note 73 at 140-41. See also Harry Kitchen, “Imputed Rent on Owner-Occupied Dwellings” (1967) 15 Can. Tax J. 482 at 483-84; and Fulton, supra note at 79-80, for similar but more detailed examples of horizontal inequity.
2. **Net Imputed Rental Income**

Ideally, tax consequences should be completely indifferent to the use of a home as an owner-occupied dwelling, or as rental accommodation. It is already the case that residential landlords are taxed only on the net profit (or loss) of investment property. If the full value of imputed rental income were included as income for owner-occupied homes, it would then be necessary to treat owner-occupied housing identically to rental housing with respect to the deductibility of expenses, in order to maintain equity and neutrality. All of the expenses that a landlord presently deducts in calculating net rental income should also be available to owners occupying their own homes, since as Patricia Fulton points out, "imputed net rental income is the gross rental value of an owner-occupied dwelling, less the homeownership expenses of mortgage interest, property taxes, maintenance and repairs."\(^{84}\) Omitted from this list is a capital cost allowance, which should also be afforded to maintain neutrality.

It also follows that net investment losses incurred from owner-occupied housing should also be deductible as they are incurred, provided only that the proxy used for measuring the market value of occupancy is fair and reasonable, and that the losses are therefore not artificial. This too would be comparable to rental housing, which may well incur a loss while there is little equity in the property.

D. Issues Concerning the Inclusion of Imputed Rental Income

1. **Double Taxation**

One argument against the inclusion of imputed rental income is that it represents double taxation. In an article challenging the theoretical basis of the inclusion of imputed income of all types, Chancellor argues that under the "consumption is income" formulation the purchase of the consumer durable should be included in the tax base as consumption either when purchased or as it is used up over its useful life. Thus, the purchase price of a house, for example, could be taxed as consumption in the year purchased or over the period that it is used in consumption, *but not both*. If the asserted justification for taxing imputed rent is that consumption is income, then including in income any amount in addition to the cost of the house would be a second tax on the same consumption. Thus, the "consumption is income" thesis does not justify taxing imputed rent if the funds used to buy the house were included in the tax base.\(^{85}\)

The double-taxation argument ignores the fact that accumulated capital for all other forms of investment may come from the use of after-tax funds. In Marsh's example, it would be highly unexpected that the taxpayer who invested $20,000 after-tax dollars should not have to pay tax on the interest earned from a bond, because tax was paid on the income earned to buy the bond itself.

The double-taxation argument also ignores the possibility that capital invested in any way may derive from an untaxed source, such as an inheritance or windfall. To

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84. Fulton, *ibid.* at 74.

85. *Supra* note 74 at 603-4.
maintain consistency, it would then become necessary to inquire into the source of invested capital to determine whether tax on the return on investment is double taxation or not. This type of inquiry would predictably lead to absurd and completely unadministrable results, in that objectively identical investments would be taxable or not, depending on the individual source of invested capital. The only theoretically consistent principle possible is that the return on investments of any kind is included in income, regardless of whether or not the source of the accumulated capital was taxed.

Further, Chancellor's argument rests on an unfounded assumption that the acquisition of a home derives from a market transaction where "the funds used to buy the house were included in the tax base." Chancellor incorrectly refers to this as an implicit assumption of those advocating for the inclusion of imputed income, when in fact no such assumption can be made. A home itself, or part or the entire purchase price, may derive from an inheritance or another untaxed source. Even if the concept of double taxation were otherwise sound (which it is not), the assumption that a first tax was paid is not consistently justified. In cases where untaxed sources were used to acquire a home, the argument of double taxation must completely fail.

2. Simultaneous Consumption and Investment
Another argument against the inclusion of imputed rental income is that it is artificial and inconsistent to characterize homeowners as both investor and consumer in relation to the same asset. Chancellor noted that characterizing

the purchase of owner-occupied housing, and other consumer durables, as an investment rather than consumption . . . leads to an artificial construct—the homeowner as a landlord renting the property to herself as a tenant . . . Through this artifice, the asset is shifted from the category of consumption to the category of investment to create additional imputed investment income. To simultaneously treat a consumer asset as both consumption and investment is inappropriate.87

In a footnote to this passage, Chancellor correctly noted that in examining other definitions of income and their limitations, Simons had earlier found that

the whole distinction between consumption and saving may well be expressed in terms not of individual purpose but rather of social consequences of different employments of purchasing power. One tends to conserve and augment productive capacity; the other involves loss and destruction of economic goods.88

The root of this objection is expressed in a question: "Can the use of a home be both consumption and investment at once?"

In reality, people do think of homes as investments. Certainly a home has considerable value that often increases over time (although, as with many investments, its value admittedly may also decrease). The essential characteristic of an investment is that it returns something of value to the owner, and the owner-occupied housing does this

86. Ibid.
87. Ibid. at 604.
88. Supra note 6 at 96.
both in the form of shelter and in the form of appreciable capital property. At the same
time, there is, in reality, a consumption element to housing.

Homeownership has many features, and to understand how the dual reality of invest-
ment and consumption from homeownership may arise, it is useful here to examine
the smaller components of both the physical assets and the property rights (including
the right to convey and to enjoy quiet possession) involved in homeownership. The
physical assets consist of land and buildings. There are many property rights bound
up in the fee simple to real estate, which include the right to convey (or to sell the
property), and the right to enjoy quiet possession (or to have the use and occupancy
of the property). The use of these different property rights may not be evaluated along
a single dimension.

The value of land on which a home is built is a property right not capable of consumption
in the ordinary sense of being used up to the extent that it is not capable of any further
use. Consumption, with respect to land, can mean the right of use and occupancy over
time. In this sense, it is not the least inconsistent to characterize a land owner
occupying his own land as both consumer of the temporal value of occupation and
investor in the capital value of the land, at once.

Buildings resemble land in that they too have a consumption value in the right of use
and occupancy over time, but are different in that the building may well depreciate
and be consumed even to the point of expiry. If both investment and consumption
aspects on homes were taxed, any losses due to capital depreciation of the building
would be entirely accommodated by allowing a capital cost allowance, and a deduction
for capital losses on the sale of a principal residence. The temporal right of use and
occupancy is a separate and distinct "right exercised in consumption," which is also
completely consistent to include in the tax base, despite any possible depreciation in
the capital value of the asset.

Therefore, treatment of a homeowner as both consumer and investor is not an artificial
construct, but rather is both appropriate and necessary to reflect different aspects of
investment and consumption. It is entirely mistaken and incorrect to reduce a multi-
faceted property right to a single dimension, as Chancellor attempts to do.

3. Taxing Potential Income

Chancellor held that the inclusion of imputed rental income would amount to taxing
"potential rental income," and that
taxing economic potential rather than actual economic outcomes . . . is objection-
able in a democratic society. The taxation of potential earning power would do
violence to our cherished notion of personal autonomy. Individuals should be free to
decide how much they will work and how much income they will have. Therefore,
any definition of income which permits taxing potential income should not be
permitted. 89

89. Supra note 74 at 604-5.
This argument is specious, since it fails to recognize the "actual economic outcomes" of homeownership. The right to use and occupy a home is a property right "exercised in consumption," and is separate and distinct from ownership of the home. Should a taxpayer obtain the right of occupancy by purchasing it for a fixed period of time, it would be called a lease, and there is no question that the market value of that transaction would be taxed. Should a taxpayer alternatively obtain the right to use and occupy a home by an outright purchase of title to the property, the actual economic outcome is also that there is identical consumption of the right to use and occupy, which should also be taxed. It would be illogical that consumption of the right to use and occupy a home over any period of time (since it is a temporal right) should be sheltered from tax merely because the occupier also enjoys other property rights in the same home, such as the right to convey, which are investments not capable of consumption.

4. Liquidity

Liquidity refers to the fact that in any individual case, a taxpayer may be asset rich and cash poor. With many assets, it would not be at all distressing to suggest that a taxpayer who cannot meet the carrying costs of the asset should sell it and liquidate his or her investment. However, this is not true for a principal residence. Homeownership is generally perceived to be a societal good, and the notion that a taxpayer should be forced to sell his or her home to meet tax liabilities from imputed rental income would generally be thought to be unacceptable. This issue may in fact be the greatest single deterrent to the taxation of imputed rental income.

The liquidity problem has special importance for the elderly and the disabled, who already face the same issue in payment of municipal property taxes. The additional burden of paying income tax on the occupancy value of the home would be well beyond the means of many low-income groups. However, this aspect might bring into focus that the problem with liquidity is not a pure-tax issue, but an income-distribution issue. The problem with liquidity does not in any way diminish the tax equity or neutrality of taxing imputed rental income. Rather, it identifies and highlights the fact that large segments of our society do not have enough income to pay the true market value of home occupancy costs. Those who own homes or have access to social housing are to some degree sheltered from this adverse effect of inadequate income distribution. Those who can neither afford market occupancy costs nor have non-market access to shelter are at present completely marginalized. The very problem is that this marginalized group is growing at an unacceptable rate.

In the view of this author, the correct answer to the liquidity problem is to squarely address the general question of poverty and income distribution, or to create some proxy that will practically alleviate the need for additional income specifically in the area of shelter. The first approach would be achieved by use of a negative income tax, discussed below. The second approach is reflected in the recommendations of the

90. See Lawrence B. Smith, "Comment [on Fulton]" in Thirsk and Whalley, supra note 50 at 97.
Golden Report, which are also discussed below for their suitability as minimally acceptable proxies for a more equitable, neutral, and simple income tax system.

In any case, the incorrect answer to the problem of liquidity would to continue the present distortions to the tax base caused by the non-taxation of imputed rental income. This is the very cause of the "egregious discrimination between renters and homeowners" noted by Simons. The violations of equity and neutrality, as well as the deterioration of the income tax base here occasioned may well be a significant causative factor in the present housing crisis, and it is illogical to treat the symptoms without at least acknowledging (if not correcting) the cause.

5. Capitalized Tax Advantages
Chancellor noted that the markets for rental and owner-occupied residential housing "cannot be isolated," and that

because imputed rent from homeownership is not taxed, an owner-occupier will pay more for a given house than a taxpayer who will be an owner-landlord. Owner-occupiers will bid up the price of new and existing single-family housing well beyond the level that could be justified as an investment. Over time, single family residences would be owned by owner-occupiers rather than owner-landlords.92

This anticipated effect is commonly known as a capitalized tax advantage.

The extent to which capitalized tax advantages for owner-occupied housing (deriving from both the non-taxation of imputed rental income, and the capital-gains principal-residence exemption) may have affected housing costs is a purely empirical question, the analysis of which is beyond the scope of the present enquiry.93 For the sake of the present argument, it is enough to know that an upward effect on housing costs would be anticipated from the tax advantage of non-taxation of imputed rental income.

The adage that "an old tax is a good tax" holds where the repeal of tax advantages would disadvantage taxpayers who have ordered their affairs in the open market according to then-existing tax rules. In the case of owner-occupied housing, the taxation of imputed rental income would have the anticipated effect of deflating house prices and adversely affecting the value of the single largest investment owned my many middle- and lower-middle-class taxpayers.

However, that one-time adjustment might also be compared to the social cost of continuing tax incentives, which predictably inflate housing costs, in turn deepening divisions between the economically advantaged and disadvantaged in our society. Perhaps at some time a demarcation must be drawn between the interests of homeowners and renters, and the economic classes that largely populate those groups. The present housing crisis tends to favour restoring tax equity and neutrality between homeowners and renters, even at the cost of disadvantaging the investment interests

91. Loc. cit. note 82.
92. Supra note 74 at 607.
93. This author has not been able to find any statistical data on this issue, whether through faulty research or by virtue of the possibility that no widely available published data exists.
of homeowners. Should house prices fall if imputed rental income were taxed, that in itself would be a social good, which would not only be more consistent with basic tax theory, but would help overcome the present housing crisis.

E. Evaluating the Non-Inclusion of Imputed Rental Income on Pure-Tax Criteria

1. Equity

The present non-taxation of imputed rental income is both horizontally and vertically inequitable, and is the cause of "egregious discrimination between renters and homeowners" noted by Simons.94

The resulting horizontal inequity is unacceptable, because it discriminates against those who for reasons of transience (perhaps even for employment purposes) or other personal circumstances prefer to rent rather than own their homes for any period of time.

The vertical equity occasioned is worse yet, because of the high degree of homeownership among all income classes, except for those in the bottom quintile of income earners (such as single mothers under age 25 with an incidence of poverty of 83% in Toronto) who are excluded from the housing market for lack of financial resources. While this tax preference probably does help the majority of Canadian taxpayers, it certainly marginalizes the poorest of the poor, who are the group now most likely to find themselves homeless. A rising tide raises all boats, so the saying goes. The caveat is that the tide raises only boats that still float. Boats that have already sunk stay at the bottom, no matter how high the tide gets, and in fact the rising tide only puts them farther under water. Such is the case of the "have nots" in Toronto, who cannot buy into the tax preferences given to homeowners, and this lack of tax equity may in large measure explain why they are now in increasing numbers living in hostels and on the streets.

Theoretically, inclusion of both the full market value of the occupancy cost of owner-occupied housing and the deductibility of expenses identically with owner landlords would somewhat widen the tax base, and achieve both horizontal and vertical equity. A new homeowner with little equity would likely have little change in tax liability if purchasing a home similar to that previously rented, with carrying costs (not including the principal component of monthly mortgage payments, which would be a non-deductible savings or investment contribution) similar to rent. Homeowners with encumbered homes, who enjoy more wealth, would pay more tax. This result closely resembles Simons's definition of income, in that the growth of equity in the asset is a "change in value of the store of property rights," and should yield gradually increased income in kind (in the form of shelter) as equity is accumulated. The result is extraordinarily simple in this respect, since the declining amount of mortgage interest actually paid in a year is directly proportional to the growth of equity in the home, and is not susceptible to evasion. It captures the return on paid capital in the home, while not taxing what is not intended to be taxed.

94. Loc. cit. note 82.
2. Neutrality
Fulton persuasively noted that the lack of neutrality in the non-taxation of imputed income leads to allocative inefficiency:

The exemption of imputed net rental income amounts to a price subsidy in the form of a tax saving to homeowners. The non-taxation of homeowner capital gains further reduces the cost of housing services. The direct economic effect is to reduce the relative price of housing services to homeowners. This increases the demand for homeownership relative to rental housing; it also increases the overall demand for housing by encouraging investment in more valuable homes and the consumption of a higher level of housing services. The result is a high and rising incidence of homeownership among all Canadians...

To a certain extent, the incidence of homeownership and the associated level of consumption of housing services may be viewed as over-investment in housing induced by homeowner preferences in the tax structure. The level of consumption is inefficient...

Chancellor also noted that "the failure to tax imputed rent changes the equilibrium that would otherwise exist between consumer assets and investment assets in a non-tax world," but dismisses this criterion as irrelevant once an income tax base has been chosen, since "an acknowledged feature of an income tax it that it encourages consumption over investment."

To the contrary, allocative efficiency is entirely relevant. It is synonymous with the generally accepted criteria of tax neutrality, which was expressly adopted as one of the fundamental objectives of the tax system by the Royal Commission on Taxation. Acknowledgement that income tax encourages consumption over investment is to merely notice that the current law does not adequately define the income tax base. If better proxies for Simons' definition of income as "the market value of rights exercised in consumption, and the change in the value of the store of property rights" were adopted, then ideally an income tax would be neutral between consumption and investment. Chancellor posed the rhetorical question, "Does this [lack of allocative efficiency] justify taxing imputed rent?" The answer given here is that it does. This is particularly so because each of the other arguments made against imputed rental income inclusion is completely without merit. Maintaining allocative efficiency would at least promote one of the basic tenets of tax theory: neutrality.

3. Simplicity
Simons anticipated some administrative difficulties in the taxation of imputed rental income, but nothing of the sort that would make it at all impractical or inadvisable.

Other authors, such as Kitchen, anticipate that the inclusion of imputed rental income "presents a more formidable barrier to its inclusion in the income tax base" in relation...
to the calculation of deductible expenses, and the "determination of gross rental
value," which problems they present in far greater detail than that disclosed here.99

In the view of this author, far too much is made of the complexities associated with
taxing imputed rental income. The essential task is to attribute a fair market value to
the use and occupancy of land, which is tied to land value. The material fact, from an
administrative standpoint, is that throughout Canada we already use the assessed value
of real estate as a municipal property tax base, and now at least in Ontario for
provincial tax purposes as well.

Conceptually, in order to estimate the market value of the use and occupancy of land,
all that need be done is to assess the fair market value of land, and then attribute a
fixed uniform percentage of that value as an approximation of the market value of its
use and occupation. This amount would be included by default as a minimum amount
in the absence of any other greater income inclusion.100 Taxpayers would then deduct
actual expenses, whether owner-occupier or owner-landlord, on an identical basis as
is already the case without undue administrative burdens for landlords.

The complexities of assessing property values cannot be underestimated. Despite that,
in Ontario we presently have a province-wide property tax base with enough consistency
between municipalities to fund education costs province-wide. The task, although diffi-
cult and complex, is certainly administratively feasible. Having already assembled a
property tax base that is currently assessed based on fair market values (or "current
value assessment") in Ontario for other purposes, it would take minimal administration
cost to fix a percentage of the assessed value of property as an imputed occupancy
value for inclusion in income, in the absence of any other revenue stream from that
property.

Admittedly, no enquiry is made here into the strengths and weaknesses of the existing
assessed property tax bases in other provinces. Municipal property taxes are collected
in every province, and it may well be that substantial improvements must be made to
methods of assessment in some provinces to adequately assess income-tax liabilities.
The fact remains that in all parts of Canada we already venture into the area of
assessing tax liabilities based on the value of real property, and to use that existing tax
base for an additional purpose would not be a radical departure. Rather, the use of the
same tax base for more than one purpose may have the desirable effect of efficiently
pooling resources to do a better job of property assessment for all tax purposes, to the
benefit of all taxpayers.101 Simons considered this possibility, and found that

99. Supra note 83 at 484-85.

100. Using a percentage of property value as a minimum inclusion is a simple anti-avoidance mechanism,
which averts inquiries into whether transactions are arm's length or not. A similar device is presently
used on the collection of retail sales tax and G.S.T. on the sales of used automobiles at the time of
registration in Ontario, for example.

101. It should also be noted here that using the same property tax base twice will not place additional
taxes on all taxpayers. Owners of investment real estate would not pay any additional tax, since their
actual rent receipts are already included in income. The dual use of the same tax base would only
increase equity and neutrality throughout by fairly estimating the consumption value of the use and
to be sure, the property must be valued; but assessments must be made in any event for purposes of other levies. If this work is badly done under the property taxes, we need not be reconciled to indefinite continuance of present conditions of administration; and the general program of co-operation between the tax-administering agencies of the federal, state, and local governments has much to commend it. If federal officials had need of good assessments on residence properties, income-tax collection might become more costly for a time. But their activities might contribute greatly toward improvement of state and local administration.

F. Negative Income Taxes and Refundable Tax Credits

The particular virtue of a negative income tax, or more limited programs of refundable tax credits, is that it could overcome the problems of liquidity inherent in the taxation of imputed rental income, and at the same time provide a more adequate general response to poverty. The use of a negative income tax is suggested here as a superior integrated approach to accommodating the taxation of imputed rental income, and income redistribution to the point that other more specific housing interventions might be averted. At the same time, the use of this type of policy instrument would enhance the fundamental tax criteria of equity, neutrality, and simplicity.

1. A Universal Response to the Inequitable Distribution of Income

At this juncture, it is useful to recall the case for housing subsidies as a remedy for one aspect of poverty, and the divergence of approach referred to by Mason. Policy makers may address the issue of housing through policy instruments directed to the relief of poverty in general, or by direct interventions into the housing market.

It is here suggested that in considering the ideal or best possible results, the universal relief of poverty is a superior response to housing affordability than other interventions that leave grossly inequitable distributions of income and high levels of poverty in place. This approach appears to be consistent with the thoughts of Claudette Bradshaw, federal Co-ordinator on Homelessness, who in private correspondence to this author said, “The Government of Canada is working on a variety of fronts to address the longer-term issue of poverty so that homelessness does not become a consideration for Canadians. For example, we are doing everything we possibly can to help Canadians find stable jobs so that they no longer have to live in poverty.”

In the context of generally addressing an inequitable distribution of wealth, the use of a negative income tax (as suggested by Mason and Schill) also comes immediately to mind.

2. Development of Negative Income Tax Programs

A comprehensive review of the negative income tax is well beyond the scope of the present enquiry. For the purposes of this discussion, it may be enough to say that it is

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occupancy of owner-occupied real estate, and even within that latter group it is those with the most equity who have more tax burdens. The net effect would be to put all taxpayers on a more even footing.

102. Supra note 6 at 117-18.

103. Letter from Claudette Bradshaw, Minister of Labour, to Graham Webb (6 May 1999).
an administratively convenient device that—more than any other policy instrument—might bring about an effective redistribution of income. Certainly, the Canadian experience with a negative income tax for seniors in the form of the Guaranteed Income Supplement\(^{104}\) has been highly popular and effective. Criticism of the Guaranteed Income Supplement is virtually unheard of and, more important, the supplement is likely a significant factor in reducing the poverty rate among the elderly from 21% to 9.2% since 1980. Administration of the supplement is remarkably smooth, and by every measure the program has been an unqualified success. Similarly, the province of Manitoba experimented with the “Mincom” negative income tax for a limited duration, without serious adverse results. The next question might be whether a universal negative income tax could be a practical response to poverty throughout all age groups in Canada.

A brief review of literature suggests that support for a negative income tax seems to have ripened on the vine. Milton Friedman prominently advanced the concept more than 30 years ago,\(^{105}\) and the number of proposed program designs and the amount of academic literature that followed within the next decade suggest that it may have been viewed as a serious possibility.\(^{106}\) More recent literature on a negative income tax per se is less common, consistent with the general competition for government spending among different program areas in Western economies. Boadway and Kitchen seem to have captured the present mood of policy makers towards a negative income tax by noting in their 1984 tax paper that

> while the case for [a negative income tax] is probably well accepted by economists, there is apparently still some unease among political decision-makers about it. The federal government's white paper on income security recommended against a universal [negative income tax] scheme to replace existing income transfers. Also, it is certainly the case that [a negative income tax] scheme would not fulfil the social insurance function as it would the income maintenance one . . .\(^{107}\)

The same authors noted in a paper delivered at the Canadian Tax Foundation 1999 tax policy conference that “what is surprising about the system of redistribution is that,

\(^{104}\) The Guaranteed Income Supplement is an income-security program administered under the *Old Age Security Act* by Human Resources Development Canada, based on age (minimum age 65), immigration status (Canadian citizen or other legal immigration status), and residence (at least 10 years' residence in Canada after the age of 18). It guarantees an annual income (for the first quarter of 1999 in the amount of $977.44 for a single person, or $1,388.67 for a married couple), and benefits are reduced by $1 for every $2 of other income. Therefore, it comprises a negative income tax for seniors with a 50% marginal rate.


\(^{107}\) *Supra* note 57 at 346.
despite the widespread view among economists and other public policy specialists in favour of negative income tax-type systems, transfers delivered through the tax system have not been widely used in Canada.”¹⁰⁸ Regardless of the merits, it certainly appears for the present time that any sweeping income redistribution through the income-tax system is not practically foreseeable, even though it might yield a more effective and adequate response to poverty in general. This result tends to move the debate on responses to housing issues from the general relief of poverty, to housing programs of the type suggested by the Golden Report.

3. **Refundable Tax Credits**

While negative income taxes appear to be presently out of favour among policy makers, the related concept of refundable tax credits that disappear as taxable income rises to a given threshold are very much in vogue.¹⁰⁹ The two instruments resemble one another to the point that it is difficult to distinguish between them, except on the criteria that disappearing refundable tax credits serve more limited purposes and are not generally available. The refundable tax credit is a limited application of the negative income tax with great potential practical application.

An interesting recent development tying imputed income and negative income tax together is the proposal by Nancy Staudt for a non-refundable household income tax credit (HITC) resembling the American refundable employment income tax credit (EITC),¹¹⁰ which itself resembles a negative income tax. What is perhaps most unexpected about this proposal is that it derives from a feminist perspective and is intended to incorporate the value of women’s household labour into the tax base, which previously had not been advocated as an equality-seeking measure for women. Under Staudt’s proposal, the imputed value of household labour would be included in income, and a corresponding tax credit would be applied to overcome the problem of liquidity in taxing that income. Unlike the EITC, the HITC under Staudt’s proposal would be non-refundable. Further details of the proposal are not important here, except to note that the general objective of the scheme would be to include the value of household labour in the tax base for the express purpose of generating more equitable earning of social security benefits for homemakers, and to generally acknowledge the high societal value of women’s work in the home.

Staudt’s work is not unique and was preceded by the work of Charles O’Kelley who, for quite different reasons, advocated a similar proposal for the taxation of the imputed income of household services with an offsetting credit for the tax.¹¹¹ Unlike Staudt, O’Kelley was concerned with overcoming what he perceived to be a tax penalty in

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¹⁰⁹ In Canada, the Child Tax Benefit and the G.S.T. credit enjoy the endorsement of authors such as Boadway and Kitchen (1999) ibid. at 11. The American EITC has prompted other authors to propose similar programs for other purposes.


traditional parenting relationships. The use of the same type of policy instrument for such widely divergent purposes might incidentally demonstrate the flexibility of this type of measure.

4. Negative Income Taxes and Refundable Tax Credits in the Taxation of Imputed Incomes

The generic conclusion drawn here is that refundable tax credits and negative income taxes have considerable potential for bringing more comprehensive resolutions of the "imponderables" Simons referred to in the taxation of imputed income.

With some ingenuity, all aspects of imputed income might well be taxed in a negative income-tax system that makes corresponding refundable tax credits available, based on objective criteria. Such a system would yield consumer indifference between cash expenditures and self-performed labour, since the former would be paid directly and the latter taxed as in-kind income. This type of program would reduce the penalty against specialization lamented by Simons, and overcome many "insuperable difficulties" for taxing a broad range of activities that have market equivalents. The benefit of such a system, in short, is that those unable to take advantage of income in kind, such as the infirm or disabled (with respect to housework and the activities of daily living), working parents (with respect to child care), and renters (with respect to accommodation) would retain the tax credits (thus forming a type of negative income tax) but be relieved of tax liability for imputed incomes not present in the individual case. Greater equity in the taxation of all forms of income would be achieved. Certainly, beyond the skeletal conceptual framework here mentioned, a specific program design would have its own considerations well beyond the scope of the present discussion.

5. Resemblance to the Golden Report Recommendation on Provincial Shelter Allowances

The relevance of this discussion to the Golden Report is that recommendation 38 suggesting a provincial shelter allowance has elements that resemble a refundable tax credit or a negative income-tax design suggested above. The credit is targeted exclusively at renters, so that taxation of imputed rental income is not an issue. On the opposite side, it offers a disappearing credit based on income, which would be delivered by the provincial government rather than through the income-tax system. Yet, the net effect for the targeted group would be similar to taxing imputed rental income with an offsetting refundable tax credit for reasonable housing costs. The recommended program is if anything less generous than a universal negative income tax might be, since it addresses only the "affordability gap" between actual rent and

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112. Supra note 6 at 110. The nature of the penalty against specialization is that taxpayers that funnel all of their productive activity into a single specialty that is sold or traded in exchange for other services that the taxpayer could have less productively performed herself, pays tax on her full economic output and is penalized in comparison to a taxpayer who foregoes marketable production in favour of self-performed services. For example, if an automobile mechanic fixes more cars, and hires a painter to paint her house, she will pay more tax than a mechanic who fixes fewer cars and paints her own house, because self-performed labour is not included in the income tax base.
35% of income, and 90% of the difference at that. Yet for the most marginalized group of housing consumers, the shelter allowance conceptually resembles the net results of what a general response to the existing tax preference for the non-taxation of imputed income might take.

V. THE PRINCIPAL RESIDENCE EXEMPTION

A. The Principal-Residence Exemption as a Tax Expenditure

The second aspect of the tax preference for owner-occupied housing is the non-taxation of capital gains from the sale of a principal residence. This preference is far less complex than the non-taxation of imputed income, since it is a tax expenditure and not a taxing provision at all. It is indisputable that according to the strict application of pure-tax criteria, the capital gains on the sale of a home would be taxed in a benchmark tax base, and that the non-taxation of that income does form a tax preference.

B. Criteria for Evaluating Tax Expenditures

Tax expenditures are the equivalent of direct-spending programs, and should be evaluated as such. One difficulty in evaluating tax expenditures is that, unlike direct-spending programs, the merits are rarely articulated and debated. In the case of the principal-residence exemption, for example, the provision was last before the House in the context of the 1981 federal budget, which eliminated the availability of separate exemptions for a home and cottage owned and jointly occupied by spouses. The issue then concerned the inequity of allowing double exemptions, without directly addressing the validity of the first exemption at all. It is inconceivable that a direct-spending program would similarly escape the scrutiny of Parliament.

The merits of the principal-residence exemption are not the central focus of the present enquiry. Of central importance is that the exemption does form a tax preference for homeowners that serves non-tax objectives. In that sense, it distorts the pure-tax criteria of equity, neutrality, and perhaps simplicity. Here we need only briefly examine the policy objectives served, with particular attention to the comparative situation of renters.

C. Purposes and Results of the Principal-Residence Exemption

In the absence of vigorous Parliamentary debate, it is useful to briefly articulate the goals of the principal-residence exemption, and then to compare those goals to the results of the expenditure on the same basis as would be appropriate in a direct-spending program.

The major articulated goal of the principal-residence exemption is to “encourage and assist homeownership by Canadians.” For renters, that broad purpose might be

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113. See, for example, Canada, Department of Finance, 1981 Budget: The Budget in More Detail (Ottawa: Dept. of Finance, November 12, 1981) at 38, for a brief discussion of the policy implications of the principal residence exemption under the heading "Secondary Residential Properties," as follows:
examined in relation to (1) how it assists renters to enter the housing market, and (2) the degree of preference given to homeowners.

1. Assisting Renters to Enter the Housing Market
The sad fact for renters is that the principal-residence exemption offers no assistance in entering the housing market. It is the equivalent of a direct-spending program, in which the only qualifying criteria are that a taxpayer should buy a home of his or her choosing (without necessary reference to housing needs), live in it, and claim no other principal residence exemption for the same period of time, and then at the time of sale receive a grant equal to the tax liability that would otherwise have accrued on the capital gain. The program offers no cash assistance to first-time buyers at the time of purchase, and may in fact form a barrier to entry to the extent that it inflates demand for residential housing and inflates housing prices. With respect to this objective, it would be difficult to conceive of a more inept program design.

2. The Degree of Preference Given to Homeowners
a. Larger Preferences for Larger Homes
The other remarkable feature for renters is that the principal-residence exemption rewards opulence and penalizes frugality. Homeowners in the same tax bracket enjoy greater tax savings in direct proportion to the value of their principal residence. If one assumes a reasonably consistent capital gain expressed as a percentage of property value within a single housing market for a defined period of time, the taxpayer owning the more expensive home will realize the largest gain and thereby shelter the most income. This penalizes a similarly situated taxpayer who buys a less valuable home and invests the price difference in a taxable form of investment. Of course, the renter is completely disadvantaged in relation to both, since he or she has no gain at all to shelter.

b. Vertical Inequity
One hardly expects a tax expenditure to be perfectly equitable in the purest sense, since it does by definition apply non-tax criteria and distort the fundamental principles of the tax system. Despite that, the Royal Commission on Taxation directly commented on the equity of tax expenditures:

In our opinion, there is a consensus that the tax-expenditure mechanism (including transfers) is equitable when it increases the flow of goods and services to those who, because they have little economic power relative to others, or because they have particularly heavy responsibilities or obligations, would otherwise not be able to maintain a decent standard of living... our principal concern is that the allocation of taxes, given the existing transfer mechanism and public expenditures, should be such as to achieve an equitable distribution of the flow of goods and services among Canadians.\footnote{\textsuperscript{114}}

\footnote{Supra note 52 at V-I, 10.}
Of particular interest to the homeless is the glaring vertical inequity of the principal-residence deduction. There is a high incidence of homeownership across all income classes, save and except the bottom quintile of income earners in Canada. It would be unexpected to say the least for the federal government to propose a direct-spending program that subsidizes housing, but gives the greatest benefits to most wealthy participants who can afford the largest homes, and completely excludes those in the lowest-income groups who cannot afford to buy into the housing market. The policy considerations that would support such a program would be rather elusive.

Exacerbating the vertical inequity of the principal-residence exemption is the upside-down effect common to all income deductions. Assuming identical gains for taxpayers in different tax brackets, those taxpayers in the highest tax brackets will enjoy the greatest tax savings, and this too is a rather unsupportable result. Fulton ably expressed the significant problems with vertical equity, as follows:

> The substantial benefits to homeownership are distributed among homeowners in accordance with the level of housing services consumed and homeowner marginal tax rates. The value of the benefit an individual homeowner receives depends on the homeowner's marginal tax rate and the amount by which his housing consumption is subsidized (that is, imputed net rental income plus capital gains as a proportion of gross housing cost). Fulton and Smith have both examined the distributive consequences of homeowner tax preferences. The results indicate that benefits as measured by tax savings increase with income. Higher-income homeowners derive a greater benefit than lower-income homeowners do; and because renters are excluded, the distortion between renters and homeowners increases with income.\(^{115}\)

There can be no mistaking that the application of the principal-residence exemption is a marked departure from the principles of tax equity laid down by the Royal Commission on Taxation.

c. Aggregate Value of the Principal-Residence Exemption

The aggregate value of the principal residence exemption for 1999 is projected to be $1.450 billion compared to a 75% inclusion of capital gains, and $1.930 billion compared to a full income inclusion of capital gains. The latter sum would seem to give a fairer reflection of the principal-residence exemption, since the partial inclusion of capital-gains income is itself a tax expenditure, and only the latter gives a true comparison to a truly equitable and neutral tax base.

VI. THE USE OF COMPENSATING POLICY INSTRUMENTS

A. The Need for Compensating Policy Instruments

The Royal Commission recommended against the use of tax preferences in general, but where (as in the case of the principal-residence exemption) they are to continue, it also recommended the use of other compensating policy instruments. In Canada, tax

\(^{115}\) Supra note 50 at 84.
preferences for owner-occupied housing are somewhat offset by direct-spending programs in other areas.

B. Federal Housing Policy

Federal housing policy is delivered primarily through CMHC under the National Housing Act. Except in relation to First Nations, the elderly, and the disabled, the federal government has stopped funding of new social-housing units since 1993. Prior to that change in policy, CMHC had funded a social-housing stock of more than 645,000 units under 40-year project agreements. CMHC continues to honour those pre-existing agreements, and by doing so is no more than meeting its contractual obligations. To enable CMHC to meet its contractual obligations, the federal government continues to fund CMHC in the nominal amount of $1.9 billion annually, which the Golden Report maintains “is offset by about $900 million in capital and interest payments for old loans the government made to CMHC. This results in a net federal treasury cost of about $1 billion. A rising share of CMHC spending is the recycling of old loans as borrowers repay . . .”

Now, administration of the social-housing stock is being transferred from CMHC to the provinces as funding agreements are reached, in which the existing contract obligations continue to be funded by the federal government. In the end, the present federal commitment to social housing is a historical obligation involving no new program spending, nor the construction of new social-housing units except in the limited circumstances mentioned above.

In June 2000, the Government of Canada laid the cornerstone of its “action plan on homelessness” in the form of the Supporting Communities Partnership Initiative (SCPI). SCPI is a three-year program with a total budget of $305 million to “enable communities to bring together various partners to develop local solutions to their homeless problems. The initiative will help communities put in place a seamless web of supports for their homeless population.” Under SCPI, local governments are left to devise their own homelessness action plans, and then seek funding (of up to 50% for priority initiatives) from the federal government and other partners that may include municipal and provincial government, the private sector, community agencies, and charities. To date, homelessness action plans have been developed for the cities

116. Supra note 1 at 154, n. 28. See also Canada, Department of Finance, Public Accounts of Canada, 1997-98 (Ottawa: Supply and Services Canada, 1998) at 20.6 (showing total program budgetary spending for CMHC in current year of $1,863,052,805) and at 20.13 (showing total non-tax revenues for CMHC in the current year of $620,883,626, including “return on investments—loans, investments and advances—Canada Mortgage and Housing Corporation of $609,998,938).

117. See, for example, CMHC, Annual Report, 1996 (Ottawa: Canada Mortgage and Housing Corporation, 1997) at 4-5, reporting that “the orderly transfer of federal management responsibilities in social housing” to the provinces had begun with a 1996 agreement with Saskatchewan, and the expectation of several more provinces in 1997.


119. Ibid.
of Toronto, Calgary, Edmonton, Ottawa, Halifax and Hamilton. Vancouver has an interim plan, and one is in development for Winnipeg.120 (last modified: 8 March 2001). These cities are the urban areas in which homelessness is most acute.

SCPI is part of the federal government’s Homelessness Initiative, first announced in December 1999, which has a stated total budget of $753 million over three years.121 (last modified: 15 June 2001). Beyond SCPI, other aspects of the federal government’s Homelessness Initiative include (over three years) $59 million for youth programs under the Youth Employment Strategy; $59 million for homelessness-related projects under the Urban Aboriginal Strategy; $268 million for the renovation or conversion of shelters and affordable housing units under the Residential Rehabilitation Assistance Program (RRAP); $43 million to expand the Shelter Enhancement Program for shelter and second-stage housing for survivors of family violence; and $10 million worth of surplus federal properties to alleviate homelessness.122

The Homelessness Initiative does not fund the re-entry of the federal government into the continual construction of new social housing for young low-income families.123 However, this special one-time effort is miniscule in comparison to the unmet demand for social housing. The measures undertaken in the Homelessness Initiative are much needed to alleviate the grave social ills that were caused by the federal government’s withdrawal from the construction of new social housing (except for the elderly, disabled, and First Nations) in 1993. The Homelessness Initiative is structurally deficient and practically ineffective, because it does not address the underlying problem of the lack of affordable housing. The City of Toronto published a Report Card on Homelessness 2000 that aptly summarized the efforts of the federal and provincial governments in the area of homelessness, as follows:

The provincial and federal governments have each taken some action in response to the Task Force recommendations. However, much of the response involves targeting funds to homelessness services. A service strategy on its own cannot solve the problem. People need access to an adequate income, to a range of employment opportunities, skills training and education so they can provide for themselves and their families. And, of course, people need access to supportive and affordable housing.124

123. Special one-time funding under the RRAP program is reported by the City of Toronto, for example, to upgrade several hundred rooms and apartment suites for low-income renters, of which “74 rooms and 80 apartment suites were either newly created or restored”: City of Toronto, “An Action Plan for Homelessness (2001), online: <http://www.city.toronto.on.ca/homelessness/action.htm#2
In the view of this author, the federal Homelessness Initiative is nothing more than the food bank of social housing. It accepts and perpetuates the economic and social conditions (including a federal income-tax policy that egregiously discriminates against low-income renters) that overwhelmingly contribute to the condition of homelessness, and does nothing to correct the underlying problem of the lack of affordable low-income housing. It attempts to alleviate and remove from public view the most visible and worrisome symptoms of homelessness, without any reconsideration for the major policy instruments that create and perpetuate homelessness. It soothes and comforts the homeless with temporary shelter, but does not radically change the social conditions that make them homeless in the first place.

C. Tax Policy and Homelessness
Even though the federal government has begun the retirement of its single major spending program that assists the homeless and in part compensates for grossly inequitable tax advantages given to homeowners, it has never disclosed any intention of curbing or ending those tax advantages itself. These facts are capable of supporting only one set of conclusions: that the present intention of the federal government is to continue with highly inequitable tax advantages in favour of homeowners (which additionally favour upper-income earners more than lower-income earners), without the benefit of any compensating policy instrument specifically designed to redress those inequities beyond what it is now retiring.

Attribution of blame for the present housing crisis is not the purpose of this discussion, but the facts stated suggest inescapable conclusions. Every objective standard of tax policy casts a damning indictment of the federal tax base, and of the failure of any level of government to implement any type of compensating policy instrument to restore the barest notion of tax equity.

VII. A SYNTHESIS OF TAX POLICIES
A. An Equitable, Neutral, and Simple Tax Policy
Applying pure-tax criteria, the most equitable, neutral, and simple method of addressing the present housing crisis would call for:

1. The taxation of net imputed rental income of owner-occupied housing, using a reasonable estimation of the market value of occupancy rights (perhaps with reference to the assessed property tax base), and the deduction of expenses on a basis identical to that presently afforded to residential landlords

2. The implementation of a negative income tax system, or in the alternative a refundable tax credit, to address the general issues of inequitable income distribution, poverty, and housing affordability, and also to overcome problems with liquidity in the payment of tax liabilities deriving from imputed rental income

3. The repeal of the exemption for inclusion in income of capital gains on the sale of a principal residence
B. The *Golden Report* Recommendations as Suitable Proxies for a More Fundamentally Sound Tax Policy on Housing

Since there is no suggestion from any level of government that tax inequities that egregiously discriminate against renters and significantly contribute to homelessness will be fundamentally remedied any time soon, it is here appropriate to turn attention to the suitability of the *Golden Report* recommendations under consideration as a suitable proxy for a more fundamentally sound tax policy on housing.

The *Golden Report* recommends provincially funded shelter allowances, and increased federal government program spending for the construction of new social housing. From a tax policy perspective, both recommendations have considerable merit.

Housing allowances on the program design recommended tend to offset the non-taxation of imputed rental income, and resemble a negative income tax or refundable tax-credit system which would be minimally necessary to overcome problems of income distribution, housing affordability, and liquidity with respect to payment of tax obligations arising from imputed rental income if a more fundamentally sound tax base were implemented.

Federal capital spending on social housing in the amounts suggested is more than offset by the principal-residence exemption, which is a significant tax preference paid disproportionately to high-income earners, in direct contradiction to the principles of tax equity laid down by the Royal Commission on Taxation.

Both programs are sound in program design from a tax policy standpoint. They are remarkably modest in amount in comparison to tax advantages inequitably afforded to higher-income groups, and fairly represent the least possible interventions available to both senior levels of government in the rental housing market. To do less would ignore every generally accepted principal of tax policy, and would fail to carry out a compelling obligation of humanity.