Support Payments and the Personal Income Tax

Richard Krever

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SUPPORT PAYMENTS AND THE PERSONAL INCOME TAX

By RICHARD KREVER*

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I. SUPPORT PAYMENTS AND THE COMPREHENSIVE TAX BASE

A continuing controversy in the area of tax policy is the correct categorization of a number of alleged tax expenditures. The issue being debated is whether certain provisions in the Canadian Income Tax Act\(^1\) are deviations from a neutral concept of income or are, in fact, essential refinements necessary to calculate a taxpayer's true income. Some of the more interesting and conceptually difficult provisions in the Act are those allowing a taxpayer to deduct amounts paid as support\(^2\) and, consequently, forcing the recipient to include the same amounts in his or her income.\(^3\)

For over forty years Canadian taxpayers have been able to shift tax liability for amounts paid as maintenance or alimony to the recipient spouse or ex-spouse. Practitioners strive to structure divorce or separation settlements that will meet the requirements of the provisions which permit the payor to deduct these amounts from income and which require the recipient to include the same amounts in his or her income. The types of support payments eligible for the tax liability transfers have grown over the years as notions of spousal obligations and appropriate responsibilities have changed. The expanded application of the support payments tax transfer provisions has meshed well with the structure and operation of the earlier provisions. There is little evidence, however, that the original rationale for the provisions has been considered when subsequent amendments and additions to these support payments sections have been enacted. Moreover, in many respects the provisions appear inconsistent with the application of the general principles upon which the Act is based.

A proper evaluation of the support payments provisions necessarily begins with an inquiry into the concept of "income", the cornerstone of any income tax system. As with many similar statutes in other countries, the Canadian Act makes no attempt to define the concept on which it is based.\(^4\) Only after it is determined what exactly an income tax seeks to tax can one turn to support payments and ask whether they are or are not part of the payor's, or transferer's, income. If they are, the provisions transferring tax liability on such amounts are equivalent to a government subsidy of certain support obligations; if they are not part of his or her income, a deduction to provide relief from tax liability on these amounts is clearly called for.

This paper consists of two sections. The first part examines the concept of income as used in the Act. While the study begins with the Haig-Simons\(^5\) for-

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\(^1\) S.C. 1970-71-72, c. 63, as amended [hereinafter Act].
\(^2\) Subsections 56(1)(b) and (c).
\(^3\) Subsections 60(b) and (c).
\(^4\) The main charging section, s. 2(1), simply states, "An income tax shall be paid as hereinafter required upon the taxable income for each taxation year . . . .", a provision not clarified by the next subsection, s. 2(2), which provides, "The taxable income of a taxpayer . . . is his income for the year minus the deductions permitted [elsewhere in the Act]."

The U.S. Internal Revenue Code provides a partial list of items that are to be included in income in §61, but the general definition found in the same section states that "gross income means all income from whatever source derived . . . ."\(^6\)


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mula, namely income equals consumption plus increase in net worth, a number of considerations will be resorted to to give meaning to that definition. It is useless to try to define income without at the same time asking why we use the concept as a tax base and, more importantly, as a tax base to which a graduated rate schedule is applied. An obvious purpose of the income tax system is to divert a portion of the nation's potential private consumption and accumulation to public purposes. There remains the question of why an income tax system with graduated tax rates is used to achieve this end. The answer lies in a goal quite distinct from the purely fiscal concerns of the government — a desire to appropriate to the state progressively larger portions of taxpayers' incomes. This non-proportional tax burden might be used to accomplish redistributive functions if coupled with a progressive government expenditure programme, or to achieve a relative neutrality of government intervention in the market if coupled with a regressive expenditure programme. Neither explanation for the graduated tax rates leads inexorably to a particular definition of income. Ultimately the choice of tax base rests on one's understanding of the non-fiscal goals of the income tax system. The history of progressive income taxation in Canada, as well as the basic structure of the original and replacement acts, suggest that the appropriate definition of income for the purposes of the Act is one that encompasses a taxpayer's ability to distribute income, not merely to consume with it.

In the second half of this paper the principles of income and control are applied to the support transfer provisions. A brief review of the development of support obligations shows that support has a nebulous character, providing no clues in its inherent nature as to its appropriate treatment in an ideal personal income tax.

An examination of the history of our tax treatment of support payments similarly shows that the present treatment has not evolved from a deliberate application of income tax principles to this particular type of taxpayer expenditure and receipt. Support payments were originally treated as a non-deductible personal expense of the payor and a non-taxable receipt to the recipient. In the United States, during the Second World War, provision was made for the transfer of tax liability on such amounts for two reasons. First, there was concern over the effect of rising tax rates on taxpayers who had settled their alimony obligations on the basis of their after-tax incomes as calculated at the pre-war rates. Second, Congress sought to end the inconsistent treatment of taxpayers who had attempted to satisfy their alimony obligations by establishing alimony trusts only to find the tax consequences of the settlements turned on the peculiarities of applicable state law. Canada quickly adopted the changes initiated in the United States despite the fact that the second rationale for the change in the United States, the desire to achieve a uniform tax treatment of alimony trusts throughout the country, had no application north of the border. The soundness of that original decision has not been questioned despite the detailed examination of other areas of income tax theory and practice that has been undertaken since that time.

An application of the principles of income and control to the provisions governing the treatment of support payments leads to the conclusion that in a comprehensive tax base system support should be considered part of the payor's income and not deserving of relief from tax liability. The effect of the deduction is to act as a government subsidy for certain transfer payments.
There is one way in which the transfer of tax liability on support payments might be justified on tax principle grounds, namely if it were considered a form of property income — the recipient's return on his or her investment in the human capital of the payor. This analysis, however, will not stand up to careful scrutiny in light of the historical justifications for and present nature of support obligations. On the other hand, applying those same principles to the treatment of support payments from the recipient's perspective would lead to the conclusion that such payments should be taxed as income in the hands of the recipient even though ideally no deduction would be allowed to the payor. Practical considerations preclude any attempt to tax persons in a family on the support they receive, however, and equity dictates that support payments should receive like treatment in the case of recipients who are no longer part of the payor's household.

Applying a tax expenditure analysis to the provisions shows that the deduction and re-inclusion provisions are a particularly inappropriate way to provide public assistance for certain private income transfers or to accomplish whatever other ends that might be sought through the application of the present treatment. The government might well wish to subsidize these income transfers, and it might seek to do so through the income tax system. It is important, however, to recognize that in essence it is dealing with a subsidy, not a refinement of the tax base within the context of a normative tax system. The provisions adopted to distribute the benefit should take into account its nature as a subsidy if it is to be equitably distributed. Many models are possible; one is sketched briefly to illustrate the concerns that should be addressed when drafting provisions to accomplish an equitable distribution.\footnote{See text accompanying notes 223, 224, infra.}

Political realities and not tax theory must often govern the reform of our income tax law and, realistically, the fact that the support transfer provisions are firmly imbedded in our income tax system must be recognized. There is little likelihood that we shall return to the pre-1942 treatment of such payments and it is therefore time to acknowledge the tax expenditure nature of the provisions and ask how they should be modified to best accomplish the non-tax goals the government seeks to achieve through these tax provisions.

II. INCOME AS A TAX BASE

A. The Elements of Income

The question of which deductions from gross income are appropriate to calculate taxable income, on which it is fair to base tax liability, has generated much debate. It is clear that income is not synonymous with receipts — unquestionably a taxpayer should be permitted to subtract the expenses incurred to earn gross receipts in arriving at his or her profits; income from a business cannot exceed net profits. Less clear, however, is the appropriate treatment of amounts spent on involuntary purchases such as medical expenses, or amounts transferred to others for their own consumption, such as charitable donations or support payments.

Resolution of these issues will turn on their evaluation in light of the operative definition of income used in our income tax; that definition, in turn, must be based upon the application for which it is intended. When we speak of
income we are referring to its potential, that is, its social utility or ability to command goods or services in the marketplace. We are not, however, concerned with that ability in a vacuum. It has a quality that we not only wish to tax, but which we wish to tax at increasingly steeper rates. In addition, we seek to measure in the hands of certain taxing units that ability to which the progressive tax rates are applied. Thus, the choice of unit is as integral as the rate structure to the meaning of "income", the base being taxed. The definition which results from the consideration of the economic ability of income as measured in the hands of pre-determined taxing units, in light of our desire to tax it at progressive rates, is likely to be very different from the meaning a layperson would ascribe to it outside of a tax context.

Take, for example, the taxpayer who gives half of her receipts to a charity. She would most likely be quite surprised to learn that some persons did not consider the money she gave away to be her "income". She earned the money; she made the decision to give it away; she chose the recipient — in almost all non-tax contexts we would agree with her that this was her income. If income measures her economic potential to either consume or to give the money to others to consume, such amounts should also be considered her income for tax purposes. On the other hand, she might agree with those who assert that it is inappropriate for her to pay tax on that part of the money she gave away for others to use. Members of this school would suggest that income for tax purposes means income actually available for the personal consumption of the taxpayer at the end of the tax period and taxpayers should be relieved of tax liability on amounts that are earned and then given away so they will not be used by the initial earner.\(^7\)

Once we define the quality of utility that we seek to tax (potential to consume or actual ability to consume after income transfers), it is equally important to determine who should be taxed on it. If a charitable donor, support payor, assignor of income or gift giver belongs to the same taxable unit as the recipient, it matters little whether the money is taxed in the hands of the giver or the receiver.

Most important to the proper definition of income is the question of why we seek to tax it at the progressive rates we do. If income is diverted from one intended recipient to another, and it would be taxed at the same flat rate in either party's hands, it is unimportant whether we consider the payment to be the income of the divertor or divertee. The purpose one attributes to the progressive rate structure of the income tax system will determine the quality of utility we wish to tax. The debate might take the form of asking whether charitable donations or support payments are part of the payor's taxable income. The real question being answered is whether it is appropriate to tax such amounts at the marginal rates of the payor, or the recipient, or both.

1. Progressive Taxation

Proponents of progressive taxation have long sought to base the arguments in favour of such a system on rational grounds tied to some in-

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\(^7\) Professor William Andrews is one of the leading proponents of this view. He develops the point in his article, *Personal Deductions in an Ideal Income Tax* (1972), 86 Harv. L. Rev. 309 at 312.
herent nature of income itself. This approach was designed to preclude non-fiscal arguments in favour of such a regime. It has long been evident that taking increasing portions of money from taxpayers as their incomes grew would necessarily result in a transfer of amounts to the government and then on to society as a whole, or that part of society thought to be deserving of the redistribution. Critics were quick to emphasize the redistributory aspects of progressive taxation. Its supporters, however, were reluctant to admit that its effect could also be its aim. Thus, they sought to show that inherent in Adam Smith's first canon of taxation — each taxpayer should contribute to the government according to his or her ability — was a notion that ability rose geometrically and not arithmetically with income. The thrust of the theories presented by early supporters of progressive taxation was to demonstrate that increasing rates were necessary if all taxpayers were to be treated equally. They sought to prove that a progressive tax system was actually neutral so that the use of graduated tax rates did not involve differential treatment but, in fact, subjected all taxpayers to a similar liability.

The superficial attractiveness of a rationale that purported to treat all taxpayers alike while taxing them at increasingly higher rates proved to be transitory as critics easily refuted the assumptions upon which each argument was based. Much more persuasive is the rationale based upon the effect of pro-

8 A more cynical commentator might suggest that the rationale for increasing marginal rates is to divert attention from the large loopholes which enable the rich to effectively avoid a large portion of their tax burden and so appease taxpayers in lower brackets with the illusion that the rich will be taxed at progressively higher rates. See, e.g., Whitman and Wheatcroft, Income Tax and Surtax (London: Sweet & Maxwell, 1971) at 9.

9 It is, therefore, no surprise that Marx and Engels made progressive income taxation an essential platform of the Communist Manifesto. (Marx and Engels, "Manifesto of the Communist Party," in Marx and Engels, Collected Works (New York: International Publishers, 1976) 476 at 505.) The English editions of the Manifesto called for "a heavy progressive or graduated income tax" while the German editions wrote only "a heavy progressive tax."

10 Seligman, for example, suggested that those who supported progressive taxation as a tool for redistribution were advocating a path of socialism or communism. (Seligman, Progressives and the Taxation in Theory and Practice (2d ed. American Economic Assoc., 1908) at 132.) He supported the idea of progressive taxation on other utilitarian grounds, however, based on the decreasing real cost of production of income, described infra this section. Other critics were less willing to accept alternative grounds for a progressive rate structure. See, e.g., Blum and Kalven, The Uneasy Case for Progressive Taxation (1952), 19 U. Chi. L. Rev. 417 at 489, 180n.

11 Smith, 2 An Inquiry into the Nature and Causes of the Wealth of Nations, ed. Campbell and Skinner (Oxford: Clarendon Press, 1976) at 825: "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state."

12 The seminal work that most effectively dismantles the equal treatment theories remains Blum and Kalven's The Uneasy Case for Progressive Taxation, supra note 10. This article was reprinted as a monograph by the University of Chicago in 1953 and as a book in 1963, the latter containing an introduction to update the work. All references in this paper are to pages in the original article. For earlier works, see Fagan, Recent and Contemporary Theories of Progressive Taxation (1938), 46 J. Pol. Econ. 457; Simons, Personal Income Taxation (Chicago: The U. of Chicago Press, 1938) at 3-16; Kendrick, The Ability-to-pay Theory of Taxation (1939), 29 Am. Econ. Rev. 92, and for a later discussion see, "The Troubled Creed of Ability" in Eisenstein, 2 The Ideologies of Taxation (New York: Ronald Press, 1961).
ggressiveness. It is obvious that progressive taxation takes more from the rich than the poor. If the redistributory effect of progressive taxation is also our goal, the tax's consequences provide the very justification for its use.

Taxes are designed to appropriate to the state (and through the operation of its government to the citizenry) a portion of each taxpayer's income. The common purpose of all tax systems is to transfer economic resources from individuals to the state so they can be used for public purposes. This could easily be accomplished by imposing a flat rate of tax. It only makes sense to take increasingly higher proportions from the rich than from the poor if we are seeking to alter the distribution of income while diverting it to the public purse. The strongest rationale for progressive income taxation is the assertion by its advocates that it "is the proper means for mitigating inequality." This is the level on which the progressive tax concept must be debated; not how should we collect revenue for the state but rather how should we as a society seek to distribute income and the attributes it possesses.

The proponents of redistribution present a strong case if one accepts their premise that economic control and political power accompany wealth. If we believe that the optimum social organization requires the greatest participation possible by all citizens so that society generally can enjoy the fruits of its labours, participate in the democratic decision-making process, and achieve a more equal distribution of economic control over its members, it is obvious that measures must be enacted to help distribute the bases of economic and political power. The optimal distribution of society's resources is one that promotes the growth of our democratic political structures and the system of free enterprise they engender.

It is not so clear, however, why we should resort to income taxation if our goal is more equal wealth distribution. Other bases, or a combination of

13 Simons, supra note 12, at v.
14 As Simons explained, supra note 12, at 18-19:
Taxation must affect the distribution of income, whether we will it or not; and it is only sensible to face the question as to what kinds of effects are desirable. To do this is to reduce the discussion frankly to the level of ethics or aesthetics. Such procedure, however, is certainly preferable to the traditional one of "describing" the attributes of the good life in terms which simply are not descriptive.

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.

Richard Goode maintains, however, that progressive rates are appropriate for allocating taxes according to ability to pay and this objective should remain the primary objective of a progressive income tax. He admits "the reduction of economic inequality is a valid objective," but asserts "it is secondary to the objective of allocating taxes according to ability to pay." Goode, The Individual Income Tax (rev. ed., Washington: The Brookings Institution, 1976) at 20.

15 See Blum and Kalven, supra note 10, at 493-501; Goode, supra note 14, at 22; Potts, The Relation of the Income Tax to Democracy in the United States (1957), 10 W. Pol. Q. 911.
bases, would be more effective if that was our sole objective. Political pragmatism has tempered that aim however, and, inadequate as it may seem to some, we have enacted a system that, instead of taxing wealth directly, taxes the increase in the ability to command goods and services over a given period. And it does so not merely to redistribute the goods and services that can be purchased with the income, but to redistribute the potential economic power the holder of income wields. The concept of income must embrace the quality that we wish to tax, determined by the motivation for taxing it at progressive rates.

2. The Taxable Unit

When Canada first imposed federal income taxation in 1917, it chose to follow the United States income tax system of individual taxation, rather than the British system of marital aggregation. Thirteen years later, the United States Supreme Court reached a decision which set that country on the road to marital unit taxation. In the case of Poe v. Seaborn, the Supreme Court decided that the community property laws of Washington treated married persons as one unit and gave both partners a vested right to half the community income and property, allowing them to split their incomes for tax purposes. Persons living in community property states used the decision to lower their tax liability, an option unavailable to those living in separate marital property states. Only eight states had community property systems, so the different tax treatment resulting from the decision was tolerable at first. But as rates rose shortly before and during the Second World War, a number of states adopted, or contemplated adopting, community property systems to secure the tax advantages for their citizens. To achieve uniformity in tax burdens across the country, Congress adopted a marital schedule in 1948 that permitted all married persons to split their incomes, regardless of the family property regime under which they lived. This system remained in effect until 1969 when a separate higher schedule was adopted for married persons.

The American changes had no effect on the system of individual taxation used in Canada. The Supreme Court of Canada was not faced with the same

17 An income tax alone cannot accomplish a redistribution of economic power. The nature and pattern of government expenditures is the second half of the redistribution equation and can either negate or achieve the redistribution begun by the tax system. See Coleman, Redistributive Equity in Canada: Taxation and Government Expenditures (1978), 16 Osgoode Hall L. J. 193.


19 As Simons explained, supra note 12, at 41, "Income taxation is broadly an instrument of economic control, a means of mitigating economic inequality . . . We shall assume that moderation of inequality is an important objective of policy and proceed to consider income taxes as devices for effecting it."


21 For a comprehensive discussion of the background to the Poe decision and its immediate consequences, see Burton, The Taxation of Family Income (1932), 41 Yale L.J. 1172.

22 For a brief synopsis of the legislative response to the problem, see Bittker, Federal Income Taxation and the Family (1975), 27 Stanford L. Rev. 1389 at 1404-14.
issue its American counterpart had in *Poe* until 1962 when a taxpayer attempted to split his income with his wife by utilizing Quebec’s community property law. In *Frank Sura v. M.N.R.*, the Supreme Court of Canada differentiated the Quebec community property system from those in the United States and held that the Quebec system did not entitle citizens of that province to split income for federal tax purposes. Quebec was the only province with a community property system and the issue that had led to a fundamental change in the United States income tax law quietly faded away in Canada.

Since rates reflect directly on the amount collected by a unit, it is essential that an appropriate unit for taxation be adopted. Conversely, the choice of unit should reflect the ability of that unit to enjoy the attributes of the income it receives. Thus, it is generally conceded that income as defined in a graduated system of taxation is meaningless without reference to the appropriate taxable unit. However, the goal of progressive taxation using a comprehensive tax base to reflect the economic ability of income earners will not in itself help one define the appropriate tax unit. While certain economic units are able to recognize economies of scale, the choice of the unit in which income is to be

23 Taxpayers in Quebec had tried to use the community property laws as a device to split income shortly after the introduction of income taxation. However, revenue officials assessed all income earned by the community in the hands of the husband, as head of the community. (See Bourassa in *Can. H. of C. Deb.* June 10, 1926, at 4306). It was common practice in Quebec for upper income taxpayers to enter into marriage contracts that set aside the community. This practice, as well as the real differences between the Quebec and American community systems, likely accounts for the fact that it took forty-five years for the issue to reach the Supreme Court of Canada.


25 As Blum and Kalven explain, *supra* note 10, at 431-32:
With a flat tax it is a matter of indifference what the taxable unit is. But under a progressive system this issue poses an almost insuperably difficult problem of equity among taxpayers. The unit selected by the tax system for comparing incomes will determine the size of income aggregates subject to tax, and the size of the income aggregates will determine the effective rates of tax. Different solutions to the unit problem will produce marked differences in the allocation of the tax burden.

26 Professor Bittker claims, “The concept of a comprehensive tax base is of no assistance in selecting the taxpaying unit.” He says, “I find nothing in the CTB concept that leads inexcusably, or even points vaguely, to the conclusion that the income of individuals should be taxed, rather than the income of married couples, families, or households, or that tells us anything about the extent to which tax rates should take account of marriage bonds or family responsibilities.” Bittker, *A Comprehensive Tax Base as a Goal of Income Tax Reform* (1967), 80 Harv. L. Rev. 925 at 974, 976-77.

This observation prompted a reply by Professor Musgrave in which he pointed out that while the concept might not spell out the appropriate unit, it would help establish the guidelines for choosing that unit. Musgrave, *In Defense of an Income Concept* (1967), 81 Harv. L. Rev. 44 at 60-61. Both Bittker’s and Musgrave’s articles were reprinted in Bittker et al., *A Comprehensive Tax Base? A Debate* (Branford, Conn.: Federal Tax Press, 1968).

Professors McIntyre and Oldman claimed to have arrived at the proper tax unit through an application of the Haig-Simons comprehensive tax base income concept. (McIntyre and Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax* (1977), 90 Harv. L. Rev. 1573 at 1576.) To do so, however, they chose a narrow definition of income in which the consumption element of income is restricted to actual beneficial enjoyment of the goods or services acquired. As this paper will show, such a definition is quite inappropriate when considered in light of the purpose for which we tax income progressively.
measured is a political one, and in Canada it has been decided that each tax-paying unit should consist of separate individuals. The Canadian income tax system is not entirely consistent in applying its choice of the taxpaying unit since in a number of instances it takes into account a taxpayer's family or marital status when determining tax liability. These are exceptions to the general rule, however, designed to achieve particular non-tax social goals, and a taxpayer's status as a separate unit for tax purposes is not altered by family or social ties.

The necessary corollary to the adoption of an individual unit for the purpose of measuring the earning of income is the retention of the same unit for measuring the use of that income. If the tax system does not make an allowance for every individual's ability to realize certain economies of scale, it must similarly ignore the loss of economy if the taxpayer chooses to support more or fewer persons on his or her individual income. Taken to its logical conclusion, this proposition would imply that no recognition should be given to the taxpayer's obligation to support dependents. The Act deviates from this principle and provides an explicit tax expenditure to taxpayers supporting families through the adoption of a fixed deduction for dependents. At the same time, it prohibits income splitting between a taxpayer and his or her dependents. A taxpayer might pass on income to dependents to divide physical consumption between the taxpayer and dependents, but this will not lower his or her income and there are no provisions to similarly divide the amount for tax purposes. Income should be defined in such a manner that its use or distribution will not affect its measurement in the hands of the original owner. The concept of income employed in the Act serves to reinforce the choice of an

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27 Our goal of taxing comprehensive income bases at progressive rates will help us understand why the appropriate unit should be chosen. But it is our external social and political mores that will decide what social units we consider to be economic units. More importantly, the balancing of income measurement goals with neutrality as between different economic units and the need for neutrality vis-à-vis individual entry and exit from the work force must be done by reference to standards outside the realm of pure tax theory. As Professor Surrey has explained:

[T]he questions involved in determining the units to be taxed must initially be determined by policy makers and not technicians. As to individuals, for example, is the family to be taxed as one unit and if so who are members of the family, or are individuals to be taxed separately, or is some other approach to be chosen? There are no normative answers to these questions. Instead the response depends on a country's attitudes toward women, marriage, the sexual makeup of the work force, property ownership, the care of children, and so on.


Roger Smith has similarly suggested that "the Haig-Simons definition which has proved so helpful in defining the tax expenditure concept offers little or no guidance in determining the appropriate taxable unit. . . . That which is appropriate is very much a sociological, administrative, and political question as well as an economic question." Smith, *Tax Expenditures: An Examination of Tax Preferences in the Canadian Federal Income Tax System* (Toronto: Canadian Tax Foundation, 1979) at 31, 34. Pechman, too, believes the comprehensive tax base is neutral vis-à-vis the appropriate tax unit. See Pechman, *Comprehensive Income Taxation: A Comment* (1968), 81 Harv. L. Rev. 63 at 65, also reproduced in Bittker et al., *supra* note 26.

individual as a tax unit by preventing income splitting between separate tax units.

B. The Quality of Income

1. The Definition of Income: Consumption as Control

   a) Income Transfers

   While there appears to be a consensus among scholars that the Haig-Simons definition of income is a good starting point for determining the application of an income tax, there is an equal lack of agreement as to what the definition means.

   That definition encompasses two distinct halves, each of which can be examined separately. Henry Simons said, "Personal income may be defined 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." Both elements accruing to the taxpayer embody economic power, that is, the utility of income or its ability to exercise dominion over goods and services in the marketplace. This accretion in utility or market rights is measured in the hands of a tax unit over a period of time, the tax period. At the end of the tax period the taxpayer has either added to his or her capital or consumed with the income not saved.

   The extent to which the taxpayer did not draw upon the utility of his or her income but instead banked it is relatively easy to recognize. Much more ambiguous is the meaning of consumption. Income, for tax purposes, does not literally measure all that "comes in." It is unquestionably a net concept: the actual increase in economic power accruing to the taxpayer at the end of the period. Expenditures incurred to earn income do not comprise an element of income. Thus, even the broadest view of consumption would include only net increases in economic power not saved, that is, all applications of income aside from those incurred to earn the net income. A much narrower view of consumption starts with the same net economic power not saved (that is, after expenses) and then proceeds to exclude certain applications of that power. The economic rights of the taxpayer excluded from this view of consumption are those that were not exercised in the marketplace by the taxpayer for his or her benefit directly, but which were instead transferred to others to exercise for their benefit. This narrow version of consumption encompasses the concept of direct benefit.

   Proponents of the narrow view of consumption seek to utilize the concept as "an index of relative material well-being." In other words, they would use an income tax as a progressive tax on one's standard of living. But on what

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29 Simons, supra note 12, at 50.
30 David Bradford labels the former view an "ability to pay consumption" as opposed to outlays for the taxpayer's direct benefit, which he calls a "standard-of-living consumption." Bradford's terminology is useful for illustrating the different concepts the two views seek to measure. Bradford, The Choice Between Income and Consumption Taxes (1982), 16 Tax Notes 715 at 723.
31 Andrews, supra note 7, at 335.
32 Professor Warren has offered a definition of consumption that would achieve the same results as that of Professor Andrews, were it literally applied. Professor War-
grounds might we seek to redistribute physical consumption, the appropriation of real goods and services? This redistribution lessens one type of inequality and gives everyone a more equal share of the pie of available goods and services. It redistributes the ultimate exercise of economic power. However, it does not redistribute true economic power. True economic power does not belong to those who only physically consume. Rather, it belongs to those who hold the rights to appropriate from the social pool of available goods and services and who can decide to utilize those rights or forgo their use by passing them on to others to exercise.

Were a progressive rate structure designed to redistribute only the use of income (the power of income in its final application), it would be appropriate to consider only physical consumption as the consumption element of income. But progressive income tax does not seek to redistribute physical consumption. If it is to accomplish its social and economic aims, it must redistribute the economic and social power of income, not simply its marketplace utility. The true economic power of income which we seek to redistribute with our tax system is not its application but rather the right it confers on the holder to potentially exercise dominion over goods or services.\(^3\)

Different definitions of income follow directly from different perceptions of the purpose of an income tax. If we sought to redistribute real goods and services, the total income available for redistribution would equal the sum of all income put into savings, and thus made unavailable for consumption, and all income actually used for consumption. Thus, as income is transferred from one taxpayer to another by way of donation, alimony, gift or any means by which the transferor is not "really" consuming, it would only be included in taxable income once because it will only be used once to appropriate actual goods and services. But if our concern were to redistribute potential economic power, income could be taxed once or twice or an infinite number of times as it

\(^3\) George Schanz, the German theoritician to whom Simons often referred, explains the concept in a passage quoted by Simons: "We want to know to what extent a person is an independent economic unit in a specific period and what means they had for their disposition during this period without having to use their own assets or means or the assets of others (debts)." Simons, supra note 12, at 61 (translated by the author). The resources the taxpayer had for his or her disposition are not just savings accumulated at the end of the period but total resources available during the period.
accords power to the holder, despite the fact that it will only be used once in the market.\textsuperscript{34}

One reason proponents of the narrow view of consumption would use an income tax only to "reduce disparities in standards of living" by redistributing actual consumption of economic resources by a taxpayer is their belief that an income tax is an inappropriate vehicle for equalizing the distribution of one type of economic power given its inability to tax all forms of power equally.\textsuperscript{35} It is quite true that an income tax cannot alter the distribution of power bases that it was never intended to affect; this observation should be of little consequence when adopting a progressive income tax to mitigate inequalities in the distribution of a particular form of economic power.

An income tax system that defined income as actual real consumption and accumulation might be established with either a flat or graduated structure. The choice will turn on whether the tax is designed to provide revenue for the government or to redistribute consumption as it does so. However, if the concept of income is expanded to include potential command as well as actual utilization by the taxpayer in the market, it is only logical to adopt a progressive rate structure, for the only explanation for the broader definition is a desire to redistribute something greater than actual consumption. Assuming that income transfers such as gifts or support payments are to be taxed only once, under a flat rate income tax the transferor and the recipient end up in the same net positions regardless of in whose hands the amount is taxed. Under a flat rate income (broadly defined) tax, a donor would not be permitted a deduction for an income transfer and the recipient would receive only the after-tax portion of the amount available for transfer. The result is identical to that which would ensue if a flat rate of tax were imposed on real consumption, and the donor given a complete deduction for the transferred amount and that sum taxed in the hands of the recipient, thus making the definition of income irrelevant. This is not the case in a progressive income (broadly defined) tax system. When a graduated rate structure is applied to these transfers, higher marginal rates are imposed on the transferor and the recipient ends up with a smaller net amount, while the government has more for its distribution purposes as the donor's income rises. As the donor's income rises, the effect is an

\textsuperscript{34}Simons stated that the notion that income should only be taxed once when it is only used once for actual appropriation of goods or services makes sense only if it is believed that the total of all personal income will add up to a separate measurable whole which can then be distributed, an idea he called a "disastrous misconception." See Simons, \textit{supra} note 12, at 58. See also text accompanying note 181, \textit{infra}, for a discussion of why it is appropriate to include gifts in the tax base of both donor and recipient.

Addressing the question of individuals' incomes as compared to social income, Musgrave explained, "[T]he sum of individual incomes as defined under accretion exceeds national income in the economist's sense. National income excludes transfers, but gifts are accretion to the donee without reducing the income of the donor. The defense for the accretion plus consumption concept as an index of equality must rest on its superiority as an equity concept, not as a tool of economic theory." Musgrave, \textit{supra} note 26, at 48.

\textsuperscript{35}As Professor Andrews points out, "One might wish also to reduce inequalities in power or pleasure more generally, but those wishes are beyond what it is practical to expect an income tax to accomplish." Andrews, \textit{supra} note 7, at 356.
increasing transfer from the donor to the state of the ability to shift consumption and choose recipients of income transfers.

b) Assignments of Income

Income must be defined so that persons will be taxed on the economic potential they command and not on their potential to acquire the economic rights that will grant them access to the market. Once a taxpayer acquires this power, the income tax system is indifferent to the use to which it is put. Whether a person consumes wisely or poorly, underpays or overpays for purchases, or retains all of his or her income or gives it all away should have no effect on his or her tax liability.

It is also true that the income tax system is indifferent as to the time at which a taxpayer incurred an obligation to transfer income to another person. This principle is firmly imbedded in the structure of the Act. Subsections 56(2) and 56(4) provide that income transfers or assignments will be ignored for tax purposes. The Act provides no deduction for gifts and only a limited deduction is available for charitable donations to certain registered charities and charitable foundations. Taxpayers are, of course, free to utilize their income or to legally obligate themselves to give it to others for the recipients’ consumption. They are similarly free to transfer income after it is received or commit themselves to transfer it before it is earned. In all of these cases, they will be taxed to the extent that they acquired rights that enable the holder to exercise command over economic resources, rather than the degree to which they exercised those rights.

2. The Question of Property Income

The most important concept in defining income thus far has been that of control. We wish to tax the economic potential of income and are not concerned with its actual use — the taxpayer might transfer the ability to consume to someone else but the initial power to make that decision is the quality that income taxation seeks to tax and redistribute.

A number of new issues arise when we turn to the question of income from property. Until it is actually consumed, property always retains the power to create income either directly or through conversion to an income producing asset. And unlike income from services, the entity actually producing the income can be transferred to another taxpayer, either partially or absolutely, permanently or temporarily. These unique features of property give rise to a number of concerns that must be addressed when determining who should bear the tax liability on transferred property income.

In the Canadian income tax system, under almost all circumstances, income from property in which the transferor retains an interest is taxed in the transferor’s hands and income from property from which the transferor has

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36 The incorporation of this rule into the Act at an early date left little room for the courts or legislature to expound the rationale on which it was based. In the United States, however, it was largely left to the courts to establish a definition of income that would achieve Congress’ intention in introducing a progressive income tax. This led to the development in the United States of a well-articulated assignment of income doctrine, whose effect was similar to that of the Canadian provisions.
severed all ties is taxed in the hands of the recipient, even where inadequate or no consideration was paid for the property.  

This result, not taxing the person who retains no interest in transferred property on subsequently generated income, seems intuitively correct. It accords with the Haig-Simons income definition and the broad view of consumption that has been suggested is preferable given the purposes attributed to our progressive income tax system. It will be recalled that the Haig-Simons definition of income states that income during the tax period equals the sum of consumption plus change in net value over that period. Consumption is composed of two elements, actual physical consumption and economic potential within the control of the taxpayer, i.e. money that would have gone to the taxpayer if not for an assignment or other transfer on his or her part. Property income follows its source and in the absence of a transfer or assignment accrues to the benefit of the person holding the beneficial (and often also legal) interest in the property. Since property income does not flow to a former owner, the taxpayer who transfers property has no "control" over the subsequently generated income. Once property passes to a new owner, the former owner is never in a position to exercise the economic power of the income produced by either consuming with it or redirecting it for others to consume with. It follows that income from property should be taxed in the hands of the new owner following a transfer of the property, even where no or less than adequate consideration has been paid.

III. APPLYING THE INCOME TAX BASE TO SUPPORT PAYMENTS

A. What are Support Payments?

The obligation to pay support to a spouse or ex-spouse has its roots in the common law doctrine euphemistically labelled unity of married persons. At common law, upon marriage a woman ceased to have a separate identity — her personality merged with that of her husband. A number of prin-

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37 The important exceptions to these general rules are the attribution provisions covering property transfers to spouses and children. These provisions attribute income generated by property that has been transferred by the taxpayer to a spouse or child. See Income Tax Act, s. 74(1) and 75(1).

38 Technically, support provided to a spouse following separation and prior to divorce is called alimony. After divorce payments to an ex-spouse are known as maintenance. Terminology usage has become very relaxed in recent times. While the Divorce Act, R.S.C. 1970, c. D-8, still speaks of alimony and maintenance using their historic meanings (ss. 10 and 11), the terms are now generally interchangeable. Provincial legislation such as the Family Law Reform Act, R.S.O. 1980, c. 152, uses the term "support" for payments made before or after a divorce. The Income Tax Act actually uses the terms in the opposite contexts to their traditional usage (s. 56(1)(b) and (c)). For a discussion of the relationship between alimony's etymological roots and historical rationale, see Ryan and Granfield, Domestic Relations — Civil and Canon Law (Brooklyn: Foundation Press, 1963) at 363.


By marriage the husband and wife are one person in law: that is, the very being or legal existence of the woman is suspended during the marriage, or at least is incorporated or consolidated into that of the husband: under whose wings, protection, and cover she performs everything.... Upon this principle, of an union of person in husband and wife, depend almost all the legal rights, duties and liabilities, that either of them acquired by the marriage.
inciples flowed from this subordination and merger process, the most im-
portant of which was the transfer of a woman’s property rights to her husband as her separate legal personality vanished. As a woman’s personal and property rights passed to her husband, a corresponding obligation arose for her hus-
band to support his wife.

Prior to the Reformation, the solemnization of marriage was solely a church function. Marriage was a sacrament and hence indissoluble; the only way to undo a marriage was to have it declared a nullity, a form of divorce vincula matrimonii (a divorce dissolving the marriage tie), or, at a later date, to petition Parliament for a divorce, an alternative open only to the very wealthy. A divorce vincula matrimonii based on nullity grounds meant that the putative marriage was void ab initio. A wife’s property was returned to her and there was no continuing duty of the “husband” to support his “wife” — they had never been married.

In the vast majority of cases there were no grounds for a nullity finding and the sole relief available was a judicial separation granted by the ecclesiastical courts, a divorce a mensa et thoro (from table and bed), available only when one partner had committed adultery. The decree granted only a separation and the marriage was not dissolved; in theory the partners were merely separate while awaiting reconciliation. Because the marriage remained intact, the husband retained his spouse’s property and his common law duty to support her. The ecclesiastical courts therefore made alimony awards ancillary to the divorce a mensa et thoro decree. Adultery being the only grounds for separation, alimony acquired some elements of punishment as not only the amount of the property the husband had received but also the degree of his guilt were taken into account when determining the amount of the alimony award.

A husband’s support obligation applied only to a wife who remained with him or who could excuse her absence due to her husband’s misconduct; no alimony was awarded to a “guilty” wife. Parliamentary divorce, however, often made continued support to a “guilty” wife a condition to the granting of a decree.

Following the American Revolution, jurisdiction to grant absolute divorces was conferred by statutes on the regular courts in the United States, no system of ecclesiastical courts having been established on this side of the Atlantic. Since the marriage was now ended by the divorce decree, the existing rationale for alimony was no longer applicable. The courts nevertheless con-

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40 For example, the doctrine of inter-spousal immunity (a man could not sue himself) and the legal incapacity of a woman to contract, sue or be sued without joining her husband all flowed from the unity concept.

41 A married woman did retain some minor property rights. See McCaughan, The Legal Status of Married Women in Canada (Toronto: Carswell, 1977) at 3.


43 Blackstone, supra note 39, at 441: “In the case of divorce a mensa et thoro, the law allows alimony to the wife; which is that allowance, which is made to a woman for her support out of her husband’s estate.”

44 MacQueen, Divorce and Matrimonial Jurisdiction (London: Maxwell, Sweet and Stevens & Norton, 1858) at 55-56.
continued to grant alimony as an incident of divorce where so authorized by statute and the struggle to characterize the obligation began.

In England divorce jurisdiction did not pass to the common law courts until 1857, at which time absolute divorces became possible without resort to Parliament. In Canada the federal government had apparent jurisdiction over divorce. However, in the absence of comprehensive federal legislation courts relied on provincial law, supplemented by some federal modifications, for divorce authority. The divorce laws of five provinces were based on the English Act of 1857 and those of the Maritime provinces were based on similar pre-Confederation local statutes. The courts in two provinces, Newfoundland and Quebec, had no authority to grant divorces.

Pressure for reform eventually led to the adoption of a federal Divorce Act, which pre-empted all existing provincial divorce legislation and laid down a uniform law for the entire country. The Divorce Act provided authority for alimony awards following the commencement of a divorce action and prior to a judgment and maintenance orders ancilliary to a final decree. While conduct remains a factor in awarding alimony or maintenance, the provisions have shifted the emphasis from fault to need, and from a husband’s duty to support his wife to a mutual support obligation. While the view that alimony flows from a right to support inherent in the nature of marriage itself still surfaces on very rare occasions, current legal thought has largely rejected the idea of a right to support and the courts have tended to agree with this view.

The Divorce Act applied to divorce actions only, while provincial law,
often archaic, continued to govern separations where no divorce action was initiated, as well as void or voidable marriages. Provincial governments also continued to retain exclusive jurisdiction over property divisions between spouses or ex-spouses. In the mid-1970s, pressure for a change in the law of matrimonial property led to the enactment of reform legislation in most provinces. In addition to altering the law of property division, the provincial laws extended and altered the nature of support obligations. In response to suggestions that the law of alimony or support should recognize the obligation of each partner to support him- or herself, the new legislation generally adopted the premise that the primary purpose of support payments was to help a spouse or ex-spouse attain self-sufficiency. The most important criteria for fixing alimony levels are the recipient's need and the payor's ability to support. But despite strong criticism of the procedure, conduct remains a factor in both divorce and non-divorce separations.

The most significant development in the alimony concept has been the extension of the support obligation to marriage-like situations in the provincial reform legislation. This obligation no longer flows from the marriage, whence it originated, but now arises as a result of a certain type of relationship having existed. Thus, many Canadian jurisdictions now extend a support obligation to persons deemed to be "spouses" by virtue of their cohabitation with the party seeking support or their parenting a child resulting from the relationship.

Attempts to devise an independent rationale for support obligations have been made by those unhappy with the intellectual framework and social implications of the traditional alimony theory. The theory that has gained considerable support suggests that the division of family labour and the subsequent support obligation arising from that division should be thought of as arising from an implied contract. Under the implied contract theory of support obligations, partners to a marriage or family-like relationship are assum-

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58 See, e.g., Family Law Reform Act, R.S.O. 1980, c. 152, s. 15.
59 Payne, Maintenance Rights and Obligations: A Search for Uniformity (1978), 1 Fam. L. Rev. 2 at 10-12; University of Alberta, Institute of Law Research and Reform, Matrimonial Support, Report No. 27 (Edmonton, 1978) at 23-27 canvasses prevailing opinion. The authors of this report favoured retention of conduct as a criterion when determining support awards.
60 For divorce see, supra note 53; in non-divorce cases see, e.g., Family Law Reform Act, R.S.O. 1980, c. 152, s. 18(6).
61 Ontario, British Columbia, New Brunswick, Manitoba, Newfoundland, Nova Scotia and the Yukon have such provisions.
62 See e.g., supra note 54, at 23-25.
A division of function between marriage partners, where one is a wage earner and the other remains at home will almost invariably create an economic need in one spouse during marriage. The spouse who stops working in order to care for children and manage a household usually requires financial provision from the other. On divorce, the law should ascertain the extent to which the withdrawal from the labour force by the dependent spouse during marriage (including loss of skills, seniority, work experience, continuity and so on) has adversely affected that spouse's ability to maintain himself or herself. The need upon which the right to maintenance is based therefore follows from the loss incurred by the maintained spouse in contributing to the marriage partnership.
ed to expect that they will face a support obligation if the division of labour in that relationship were such that their gain in wage earning ability was offset by an equal decline in the other partner's income earning ability due to the assumption of household responsibilities outside the labour force.63

The implied contract theory of support responsibilities suggests that alimony and maintenance obligations have evolved from a personal duty of a husband to support his "other half" to a responsibility to supplement the income of a person whose inability to be self-sufficient following the termination of a relationship can be traced in some way to the relationship. As intellectually attractive as the rationale may be, however, it fails to fully explain the support obligation. The statutes authorize, and the courts readily impose, support obligations in cases where the recipient is unable to care for him- or herself because of factors completely extraneous to the relationship, such as financial mismanagement, mental illness or physical incapacity.64 One might wonder why a former spouse and not the state or society at large should be responsible for another person's support in such cases. The desire of the government to pass the costs of support on to persons whose only connection to the recipient's need for support was participation in a now defunct relationship not connected to the present inability to be self-sufficient might make fiscal sense for the state but is hard to comprehend from a policy perspective unless one returns once again to the belief that the support obligation is inherent in a relationship.65

We should point out that this approach to maintenance necessarily means that as far as the law is concerned, each spouse has an equal responsibility for the three essential functions characteristic of the marriage partnership: financial provision, household management and child care. . . . We propose that a right to maintenance may arise from "the express or tacit understanding of the spouses that one will maintain the other" so long as such an arrangement, made either before or during marriage, results in a reasonable need for financial provision for the maintained spouse at the time of divorce.

63 The theory is strengthened by the fact that spouses or persons who are cohabiting are able to expressly contract out of support obligations. See, e.g., Family Law Reform Act, R.S.O. 1980, c. 152, s. 51(1)(b), 52(1)(b), 53(1)(b).

64 See, e.g., Coupland v. Coupland (1981), 25 R.F.L. (2d) 230, 12 A.C.W.S. (2d) 136 (Ont. H.C.) where a wife awarded nominal maintenance of $1 per year at the time of divorce because of her inheritance of over half a million dollars successfully applied for an increase to $500 a month seven years later after she had squandered the inheritance, the only alternative available to her being welfare; Bates v. Bates (1971), 7 R.F.L. 344 (N.B. S.C.) where a wife who was capable of supporting herself but for her mental illness was given a lump sum support award; Upson v. Upson (1970), 2 R.F.L. 405 (Sask. Q.B.) where a wife unable to seek employment because of bleeding ulcers was awarded support as long as her medical problem persisted.

65 An extreme example of the inherent right doctrine is that of Astor v. Astor, 89 So. 2d 645 at 648 (Fla. S.Ct. 1956) where the court accepted the chancellor's finding that the wife had been "motivated and dominated by greed for money," yet granted her a weekly alimony of $250 per week despite the fact that her maximum income before marriage had been $65 per week and the marriage had been of only six weeks' duration. To do otherwise, the court declared, "would fail to recognize the fundamental nature of the marriage relationship and the rights and obligations it imposes upon each of the parties."

Canadian courts generally no longer contend a person has a "right" to support. See, e.g., Schartner, supra note 55. Nevertheless, the ties between sought-for support and any aspect of the marital relationship aside from the relationship itself remain tenuous in many cases. For example, a plaintiff in Davis v. Davis (1971), 4 R.F.L. 160 (Ont. S.C.) sought support from a husband with whom she had cohabited for just over one month.
The character and treatment of support obligations has greatly changed during their evolution from their common law alimony origins. What was once a logical consequence of the doctrine of unity is now a much broader general obligation faced by all parties to certain types of relationships. The principles behind the obligation are no longer easy to discern.

B. The Tax Treatment of Support Payments

Prior to 1942, Canadian courts relied on American precedent to hold that alimony payments were neither deductible to the payor nor taxable income to the recipient. The American position evolved from precedents predating the permanent adoption of income taxation in that country. The need to characterize the payment had arisen most often in adjudications in bankruptcy where the issue confronted was whether a discharge from debts in bankruptcy extended to an alimony obligation. When the issue reached the Supreme Court of the United States it accorded alimony a unique character; it was neither a gift from payor to recipient nor an obligation founded on contract. As a personal obligation of the payor arising out of a marriage relationship and a husband's duty to support his wife, it could not be considered a debt. Thus, neither alimony in arrears at the time of bankruptcy nor alimony accruing after that date could be discharged by an order in bankruptcy adjudication.66

The appropriate treatment of alimony for tax purposes was first considered by the same court in the 1917 case of Gould v. Gould,67 which was heard shortly after the passage of the first Canadian income tax act and prior to its implementation. In that case the taxpayer was an alimony recipient who sought to dispute an assessment that had included her alimony receipts in her taxable income. The Supreme Court found that alimony was not "income" within the meaning of the predecessor to the present charging section68 but the rationale is not easily perceived in the short two and a half page judgment. Two factors are mentioned. The first is the personal nature of the obligation, flowing from the institution of marriage, as articulated by the Court in the earlier bankruptcy case to which reference was made. Second, the Court pointed out that the payment was not deductible by the payor and quickly jumped to the conclusion that the "sum received by the wife on account thereof [as alimony] cannot be regarded as income arising or accruing to her within the enactment."69 Commentators have suggested it was this latter ground, that the sums were not deductible by the payor, that was the real ra-

66 Audubon v. Shufeldt, 181 U.S. 575 at 577-78, 21 S. Ct. 735 at 736 (1901). The Court said:
Alimony does not arise from any business transaction, but from the relation of marriage. It is not founded on contract, express or implied but on the natural and legal duty of the husband to support the wife. . . . Permanent alimony is regarded rather as a portion of the husband's estate to which the wife is equitably entitled, than as strictly a debt; alimony from time to time may be regarded as a portion of his current income or earnings.
68 Now I.R.C. §61.
69 Gould, supra note 67, at 154 (U.S.), 53 (S.Ct.).
The income tax assessors would have taxed the payments twice, initially in the hands of the payor and again in those of the recipient. The Supreme Court of the United States felt the transferred amounts could only be "income" to one party.

Sir Thomas White, the Canadian Finance Minister who introduced income taxation to Canada, believed his Act permitted taxpayers to deduct amounts paid as alimony when calculating taxable income and that these amounts would be assessed as income to the recipient. By the time the tax was in place, however, the American precedent of Gould had been established and it was soon cited in Canada as authority for the inability of payors to deduct such amounts, and recipients to exclude such amounts, from their taxable income.

Taxpayers on both sides of the border looked for a vehicle with which they could skirt the Gould precedent. Those with sufficient property could seek a property settlement in satisfaction of their alimony obligation. This alternative was not feasible, however, in those forums where the courts claimed ongoing jurisdiction over spousal support obligations so they could modify an alimony award or property settlement in lieu of alimony at any future time. The taxpayer who transferred property in satisfaction of his alimony obligation

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70 See, e.g., Note (1918), 31 Harv. L. Rev. 494: "It is not an allowable deduction in the husband's return and hence is taxed with his general income.... To tax it again, in the form of alimony, would be double taxation of the most obvious sort. It is undoubtedly this consideration which led the court to the present conclusion." See also Gornick, Alimony and the Income Tax (1943), 29 Cornell L. Q. 28 at 29; Chommie, The Law of Federal Income Taxation (2d ed., St. Paul, Minn.: West, 1973) at 482; Lagomarcino, Federal Tax Consequences of Alimony and Separate Maintenance Payments (1954), 3 Buffalo L. Rev. 179.

Over thirty years later the Court of Claims responded to a taxpayer's argument that alimony was not income, based on Gould, supra note 67, by noting:

The [Gould] court used language which indicated it thought alimony was not income. The court did not purport to be deciding a constitutional question [that is, whether the amounts were "income" which the Sixteenth Amendment permitted Congress to tax] but only a question of the interpretation of the Income Tax Act of 1913. It would have been hard to believe that Congress intended to tax the receipt of alimony by the divorced wife, when the law had already taxed the husband upon his receipt of the income from which he paid the alimony.... Mahana v. U.S., 88 F. Supp. 285 at 288 (Ct. Cl.), cert. denied 339 U.S. 978, rehearing denied 340 U.S. 847 (1950).

71 In response to a question posed during the debate on the income tax bill, he replied, "I think it would be held that the husband would be liable to taxation on his net income, that is to say his income less the amount he was obliged to pay to his wife." Quoted in Pontifex, Canadian Income Tax (Toronto: Carswell, 1917) at 2.

72 White said, "If the wife had an income under a marriage settlement in excess of the exemption provided for by this Act, whether it is called alimony or not, it is the intention that she should be assessed." Quoted in Pontifex, id. at 3.

73 E.g., Plaxton and Varcoe, Dominion Income Tax Law (Toronto: Carswell, 1921) at 150-51: "Alimony paid to a wife is not income, but is regarded rather as a portion of the husband's income to which the wife is equitably entitled, than as strictly a debt." This is the result of an American decision based upon the definition of income in the United States, which for the purpose of this question may be regarded as similar to the Dominion Act. See also Plaxton and Varcoe at 196 and Plaxton, The Law Relating to Income Tax (Toronto: Carswell, 1939) at 107.
tion ran the risk that the recipient might squander the property and leave him liable to a new alimony award, notwithstanding the fact that the original settlement had been intended to end any ongoing obligation. Thus, rather than transferring the property outright, taxpayers sought to retain some control through the trust mechanism while disposing of the property sufficiently to transfer the income to the recipient spouse for tax purposes.

In the United States, however, characterization of the alimony obligation as a personal domestic expense continued to plague taxpayers/settlers and offered the courts a rationale for taxing the donor on income generated by property that had been sufficiently alienated to avoid any attribution back to the donor if the money had been used for any other purpose.

The problem was first confronted by the United States Supreme Court in the case of Douglas v. Willcuts,74 in which the Court found a husband taxable on income received by his wife and generated by property he had transferred to a trust "in lieu of, and in full settlement of alimony."75 The settlor's continuing interest in the property was so obvious (amounts exceeding the agreed upon support were to be paid to him and the property reverted to his control upon the wife's death) it would have been easy to justify attribution of the trust income to the settlor on the basis of his continuing control over the trust and beneficial interest in its capital and income. The United States Supreme Court, however, explained that the settlor would be taxed on the trust income because it was paid to his wife in satisfaction of the taxpayer's personal obligation to support her. But in a series of cases that arose five years later, the Supreme Court decided that in some cases payments from alimony trusts should be taxed in the recipient's hands and not attributed to the settlor. The Court distinguished and reconciled the various cases by making them turn on whether the transfer of assets to the trust was in satisfaction and complete discharge of the husband's obligation of support under state law. In other words, the question of attribution was based not on the extent to which the settlor had severed himself from the trust property, as it did in non-alimony cases, but on whether the husband might have a potential continuing obligation under state law, notwithstanding the transfer, because the courts in that jurisdiction claimed the ability to alter alimony awards at any time.76

An interesting result of the alimony trust cases was a gradual shift in the manner in which the courts perceived the alimony obligation. In Helvering v. Leonard,77 the United States Supreme Court found that the taxpayer was

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74 296 U.S. 1, 56 S.Ct. 59 (1935).
75 Id. at 3 (U.S.), 60 (S.Ct.).
76 In Helvering v. Fuller, 310 U.S. 69, 60 S.Ct. 784 (1940) the Court held that the transfer of property to a trust in favour of the taxpayer's spouse extinguished his personal obligation to support his wife and the income she received from the trust was therefore taxable in her hands. The crucial difference between Douglas, supra note 74, and Helvering was emphasized in two cases heard before and after Fuller. Helvering v. Fitch, 309 U.S. 149 at 156, 60 S.Ct. 427 at 430 (1940) held attribution would follow unless the transferor demonstrated that "local law and the alimony trust have given the divorced husband a full discharge and leave no continuing obligation however contingent." Helvering v. Leonard, 310 U.S. 80 at 87, 60 S.Ct. 780 at 784 (1940) confirmed that the taxpayer must establish "by 'clear and convincing proof' that local law and the alimony trust have given him a full discharge."
77 Helvering v. Leonard, id.
unable to prove his obligation had been fully discharged by a transfer of property to an alimony trust. Holding him taxable on trust income paid to his ex-wife, the Court noted, "The case in substance is the same as those where pursuant to contract or arrangement an obligation is discharged by another for the taxpayer's benefit; ... or where the taxpayer creates a trust, the income of which is applied to the discharge of his debt." Alimony remained a personal obligation of the taxpayer, but it acquired debt-like properties. As a result, lower courts began to construe lump sum settlements in lieu of alimony as realization events in the nature of a sale or exchange, leaving the transferor liable for taxes on all gains accrued until the time of transfer. The Supreme Court declined to disturb these decisions.

Canadian taxpayers never faced the inconsistent treatment to which Americans domiciled in different states had resigned themselves. As long as the settlor did not establish an imperfect trust in which he retained an interest in the income or corpus, he would not be assessed on trust income regardless of whether or not the income from the trust was used to satisfy an alimony obligation. No tax consequences followed the transfer of capital property in a property settlement because Canada had no capital gains taxation at the time.

With the advent of World War Two, tax rates began to climb in Canada as it became a belligerent and in the United States as it rearmed. In the United States the rise in marginal tax rates exacerbated the disparity in treatment between taxpayers in community property states and those in states with separate property regimes for married persons. In light of the proposed rate increases in the 1941 Revenue Bill, Treasury officials pressured Congress to place married taxpayers in non-community property states on a parity with those in community property states by adopting a system of marital unit taxation, a proposal accepted by the House Ways and Means Committee. The Senate's response to the problem was a plan that would have taxed income to the spouse who earned it regardless of marital property regimes. The Senate also proposed changes in the tax treatment of separated or divorced spouses. The Senate Report noted that some taxpayers making alimony payments faced "substantial hardship" in light of the fact that they were taxable on their entire income even though a portion was payable to their separated spouse or ex-

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78 Id. at 85 (U.S.), 783 (S.Ct).
80 Subsection 32(3) of the Income War Tax Act, S.C. 1917, c. 28, as am. by S.C. 1936, c. 38, s. 13, attributed trust income to the grantor where the trust could revert to the settlor or where the settlor retained a power to choose recipients of income or to otherwise deal with trust property.
81 A gift tax was payable on the transfer of certain types of assets to a spouse but the tax provided a large exemption for spousal transfers.
82 H.R. 1040, 77th Cong., 1st Sess. at 10-13 (1941).
spouse. It was proposed that periodic payments in the form of alimony should be included in the income of the recipient and deductible to the payor.\textsuperscript{84} Neither the need for joint filing nor the transfer of tax liability on alimony payments was seen to be of overwhelming importance\textsuperscript{85} and both proposals failed to survive the legislative process.\textsuperscript{86}

American entry into the war in December of 1941 was followed a few months later by the first war-time budget. Significantly higher marginal rates had been proposed and once again the Treasury urged Congress to enact a measure adopting a joint filing system for married persons.\textsuperscript{87} It also endorsed the Senate recommendation of the previous year that recipients, and not payors, bear the burden of taxes on alimony payments.\textsuperscript{88} It was suggested that "rising tax rates [had] in some cases absorbed the entire income of the husband required to pay the tax on his income and that of his divorced wife."\textsuperscript{89} Moreover, it was felt that alimony recipients were unfairly avoiding their fair share of tax liability by receiving tax-free support payments.\textsuperscript{90} Both the House\textsuperscript{91} and Senate\textsuperscript{92} adopted the alimony proposal and it was incorporated into the 1942 Revenue Bill, which was enacted into law that year. The motivation for the change was two-fold: to relieve taxpayers of the possible hardship of paying tax on money that went to a spouse or ex-spouse as alimony or maintenance payments\textsuperscript{93} and to "produce uniformity in the treatment of amounts paid in the nature of or in lieu of alimony regardless of variance in the laws of different States concerning the existence and continuance of an obligation to pay alimony."\textsuperscript{94} However, filing did not become law. So, while separated or divorced spouses were able to achieve a measure of income split-

\textsuperscript{84} \textit{Id.}; Sen. Fin. Comm. Bill §117 (a-c) (1941); remarks of Senator George in 103 Cong. Rec. 7267 (1941).
\textsuperscript{85} It appeared that less than one percent of the total returns filed in the country represented community-property returns. See s. 673, \textit{supra} note 83, at 11.
\textsuperscript{86} H.R. 1203, 77th Cong., 1st Sess. at 10 (1941).
\textsuperscript{87} Statement by Hon. H. Morgenthau, Jr., Secretary of the Treasury, Revenue Revision of 1942, Hearings Before House of Representatives, Committee on Ways and Means, 77th Cong., 2d Sess., Vol. 1 at 9-10 (1942).
\textsuperscript{88} Statement of Randolph Paul, tax advisor to the Secretary of the Treasury, Revenue Revision of 1942, Hearings Before the House of Representatives, Committee on Ways and Means, 77th Cong., 2d Sess., Vol. 1 at 92 (1942).
\textsuperscript{89} There were many classes of persons who had incurred obligations that had been negotiated on the assumption that tax rates would remain fairly constant. For example, many taxpayers had incurred mortgage liabilities based on their after-tax income. Aside from those paying alimony, no relief was proposed for all the other taxpayers who suddenly found that their fixed liabilities and new tax burdens left them with little or no disposable income.
\textsuperscript{90} Paul, \textit{supra} note 88.
\textsuperscript{92} S. 1631, 77th Cong., 2d Sess., at 83 (1942), reprinted in 2 C.B. 504 at 568-70.
\textsuperscript{93} H.R., \textit{supra} note 91.
\textsuperscript{94} \textit{Id.} at 72.
Tax rates in Canada had risen rapidly following the outbreak of war. Taxpayers who had enjoyed a relatively low burden of income taxation prior to the war found themselves paying high marginal rates on low levels of income. The point at which over half their income went to taxes had dropped from $300,000 to $15,000 in less than three years, and the minimum rate on their first taxable dollar had tripled in the same period. The government proposed further increases in its 1942 budget, although a portion of the increased taxes were designed to be a form of compulsory savings, refundable after the war. There was no indication in the budget speech that the government was considering any changes to the tax treatment of alimony payments, though it is likely that Finance Department officials were considering the matter.

It was almost by accident that the issue entered the budget debate. The question of divorced persons was raised in the context of dependents’ deductions and a few opposition members commented that it seemed unfair for taxpayers making alimony payments to shoulder the tax burden on the transferred income, especially if they were now supporting a second family. It was suggested that the tax burden might be a factor behind alimony payment defaults. The Finance Minister agreed it was unjust in many cases and indicated that changes had been proposed in the United States and that his department had looked at the problem. The discussion was brief and aroused little interest outside the House. But a few weeks later the government added a resolution to its proposed legislation to tax alimony in the hands of the

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96 In 1931 tax rates extended from two percent to fifty percent, with the fifty percent level applying to incomes over $500,000 (R.S.C. 1927, c. 97, Schedule 1, as am. by S.C. 1932, c. 43, s. 11). In 1933 rates varied between three percent and fifty-six percent and the point at which the fifty percent rate applied had dropped to $300,000 (S.C. 1932-33, c. 41, s. 1). An investment income surtax was added in 1934 and remained in effect until 1942. In 1939 a war surtax of twenty percent of tax payable and a further five percent of tax for incomes over $5,000 was added to the 1933 rates still in effect (S.C. 1939, c. 6, s. 2). By 1940 rates had risen to a range from six percent to seventy-eight percent and the fifty percent rate was imposed at the $50,000 level (S.C. 1940-41, c. 18, s. 1). The next year the rates climbed to a range from fifteen percent to eighty-five percent and the fifty percent level was reached at $15,000 (S.C. 1940-41, c. 18, s. 1).


98 Less than a month later the Finance Minister responded to an inquiry about alimony, noting, “much consideration has been given some method by which the law might be changed. However, I am not in a position at the moment to say whether or not an amendment to meet the situation will be proposed. The matter is still under consideration.” Ilsley, in Debates, July 14, 1942, at 4361.

99 Debates, July 14, 1942, at 4360-61.

100 See Bence in Debates, id. at 4360.

101 Ilsley in Debates, id. at 4360-61.

102 The Toronto Globe and Mail devoted only two lines to the matter (July 18, 1942 at 1) and the Toronto Daily Star gave it little more coverage (July 18, 1942 at 9).
recipient.\textsuperscript{103} Such amounts were to continue to be taxable in the hands of the payor. However, the payor was to be allowed a tax credit equal to the amount of tax that would be payable on the alimony amount in the hands of the recipient if it were the recipient's only income for the year. Opposition members were quick to point out that the effect of the proposals was to transfer to the recipient only a small part of the total tax liability on the portion of the payor's income turned over to the recipient as alimony and they would not provide relief from the effects of high marginal rates imposed on the amounts in the payor's hands, as would the changes proposed in the United States. But the government indicated that it was unwilling to move towards the deduction and inclusion provisions being considered in Congress. While it was willing to shift a part of the tax burden, it believed the total taxes paid on the portion of the taxpayer's income transferred as alimony should remain the same. The measures finally enacted into law were substantially the same as those first proposed by the government.\textsuperscript{104}

The 1942 provisions provided only modest relief to high income taxpayers' while those in the lower brackets making smaller alimony payments received almost no benefit from the changes.\textsuperscript{105} In many cases the recipient would pay little or no tax and no credit would be available to the payor. The government recognized the problem and two years later proposed a change to a full deduction for the payor while continuing a full inclusion of such amounts in the recipient's income.\textsuperscript{106} The resulting provisions were similar to the American enactments of two years earlier and permitted taxpayers to deduct support

\textsuperscript{103}Debates, July 22, 1942, at 4532.

\textsuperscript{104}S.C. 1942-43, c. 28, s. 7(1) specified for the first time that income included amounts paid as alimony. Subsection 3(2) also included alimony received in income. Section 11 provided the credit.

\textsuperscript{105}If an amount paid and received as alimony is to be taxed in the hands of only the payor or recipient, any change to the method of taxation will create a windfall for one party and an unanticipated burden for the other. The same is true of changes in the tax rates.

Take, for example, the taxpayer who negotiated an alimony obligation prior to the Second World War on the basis of his after-tax income. As taxes rose his fixed alimony obligation would comprise an increasing portion of his after-tax income. The 1942 changes, to the extent that they shifted some of the tax burden on the alimony payment, would help to restore the balance of the payor's after-tax income. But the recipient who had agreed to a lower alimony payment than would otherwise be the case on the understanding that it would be tax-free suddenly faced a drop in after-tax income. As tax rates rose during the War, all taxpayers who were unable to increase their incomes faced decreases in their after-tax income. The issue was how to distribute fairly the burden of reduced personal consumption due to increased taxation. Both the American and Canadian proposals accomplished a redistribution of the tax burden. To the extent that the American provisions provided the payor with a higher after-tax income than the Canadian, they helped return the taxpayer to the position he was in before the tax rates rose. If too much relief were provided, the result might have been that his after-tax, after-alimony income was not substantially different from what it was before the tax increase combined with his alimony obligation to reduce his available income. In this case, the burden of war-time taxation has been shifted only to the recipient, which is clearly unfair.

There is no easy solution to the allocation of burdens of reduced consumption due to high war-time taxation. Measures designed to affect taxpayers who had negotiated alimony obligations before taxes rose would have an unfair effect on those whose obligations arose after the taxes started increasing. In these latter cases the alimony amounts would likely reflect the reduced after-tax income due to war-time conditions and the amount agreed upon would apportion the burden of higher taxes between the two parties.

\textsuperscript{106}Debates, June 22, 1944, at 4178.
payments made pursuant to an order accompanying a divorce decree, judicial separation or pursuant to a written separation agreement.\textsuperscript{107}

In 1948 a periodic requirement was added to the deduction provision to prevent the deduction of lump sum payments.\textsuperscript{108} No further changes were made until 1957 when the sections were modified to include payments made pursuant to a written agreement (such as a marriage contract) in addition to those made pursuant to a written separation agreement.\textsuperscript{109} At this time the transfer of tax liability on support payments was only available to persons whose marriage was dissolved or who were separated pursuant to a judicial order or a separation agreement. A change was made in 1958 to extend the operation of the transfer provisions to all orders of competent tribunals so that other maintenance payments similarly qualified for the preferential treatment.\textsuperscript{110}

The tax “reform” debate in Canada that followed publication of the \textit{Report of the Royal Commission on Taxation} in 1966 devoted almost no attention to the question of support payments. While the \textit{Report} proposed sweeping changes in many areas of income tax law, it suggested the tax treatment of support payments “be treated substantially as at present.”\textsuperscript{111} The only change recommended was the elimination of the periodic requirement so lump sum payments could receive like treatment.\textsuperscript{112} Most of the Royal Commission’s recommendations concerning family taxation dealt with the proper tax unit, which the commissioners felt should be composed of married persons and their dependent children. The family unit, the \textit{Report} suggested, should be taxed at a separate rate than individuals. The levels proposed, relative to those applicable to individuals, were similar to those utilized in the United States since 1969 for the marital tax unit integral to American income tax law. The conclusion of the Royal Commission, therefore, was that the transfer of tax liability on support payments was consistent with the adoption of a family tax unit whose tax liability was calculated by reference to a separate rate schedule.\textsuperscript{113} The government’s response to the \textit{Report of the Royal Commis-

\textsuperscript{107}The credit was repealed and S.C. 1944-45, c. 43, s. 4(8) added a deduction for the alimony payments. There were some important differences from the American provisions. Amounts specified for child support were deductible under the Canadian law but not the American. In addition, to qualify for a deduction under the American provisions payments had to be “periodic”. In the absence of the same wording in Canada lump sum payments could qualify for the deduction.

\textsuperscript{108}S.C. 1948, c. 52, s. 11(1)(j).

\textsuperscript{109}S.C. 1957, c. 29, s. 4(2).

\textsuperscript{109}S.C. 1958, c. 32, s. 3(2). Court ordered maintenance payments were common in a number of situations not covered by the provisions. For example, Family Courts often made support orders based on provincial deserted wives legislation.

\textsuperscript{110}Can., 3 \textit{Report of the Royal Commission on Taxation (Carter Report) (Ottawa: Queen’s Printer, 1966) at 130.}

\textsuperscript{111}\textit{Id.}

\textsuperscript{112}There is a reference to the alimony and maintenance provisions at one point in the \textit{Carter Report} discussing deductions generally that might be interpreted as a suggestion by the Commissioners that the support payments deduction was appropriate in any case. The \textit{Carter Report} says, “Under our proposals most expenditures reasonably related to the production of income would be deductible at some time. We anticipate that a significant number of the detailed provisions in the Act relating to specific deductions would cease to be required. However, some provisions for specific deductions would continue to be necessary because some types of expenditures are not related to the earning of income, as in the case of alimony and maintenance payments.” Supra note 111, at 88.
tion on Taxation, Proposals for Tax Reform,\textsuperscript{114} rejected the proposal for a family tax unit and ignored the question of alimony, as did the later reports of the Senate\textsuperscript{115} and House\textsuperscript{116} committees studying tax reform.

The next changes to the alimony provisions occurred in 1974 when, in response to judicial decisions denying deductions for payments made to third parties, sections were added authorizing the deduction of these amounts as long as they remained an allowance in nature.\textsuperscript{117}

It had been held that the alimony and maintenance transfer sections applied only to persons who were or had been legally married.\textsuperscript{118} With the reform of provincial family laws in the last half of the 1970s, pressure grew for a modification of the income tax treatment of support payments so that persons deemed spouses for the purpose of support obligations imposed by provincial law could receive treatment similar to that accorded those whose support obligation arose out of an existing or dissolved marriage.\textsuperscript{119} The Act was amended in 1980 to achieve the sought-after parity.\textsuperscript{120} In 1981 the provisions dealing with payments to third parties were amended to ensure that only payments in the nature of an allowance would qualify for a deduction.\textsuperscript{121} There have been no further changes to the support provisions since that time.\textsuperscript{122}

C. The Ideal Tax Treatment of Support Payments

1. Consequences to the Payor when Traditional Support Doctrines are Applied

The nebulous character of support payments offers little guidance to the appropriate tax treatment of the amounts in the payor's hands. Some explanations for the obligation are analogous to expenditures about which there is general agreement as to the correct tax treatment. But other reasons have no counterparts in the transactions with which the income tax system usually deals, which could be used as models for determining the suitable tax treatment of these transfers. In the end, the ideal treatment of support payments will not rest on some inherent quality of the payment itself. Instead it will be necessary to recognize that, whatever the rationale for the obligation, it is an incident of certain relationships and the tax treatment should not turn on why the obligation exists but on how it is incurred.

\textsuperscript{114} Can., Dept. of Finance, Proposals for Tax Reform (Ottawa: Queen's Printer, 1969) at 14-15. (The report was popularly known as "The White Paper on Taxation" and is often referred to by this title.)


\textsuperscript{117} S.C. 1974-75-76, c. 26, ss. 28, 31.


\textsuperscript{119} See, e.g., Suzuki, Recommendations of the Family Law Section Committee on Income Tax and the Family (Toronto: Canadian Bar Association — Ontario, 1979) at 5.

\textsuperscript{120} S.C. 1980-81, c. 48, s. 25(3), 29(2).

\textsuperscript{121} Id. s. 30. See text accompanying note 206, infra.

\textsuperscript{122} For a more detailed look at the income tax transfer provisions and their treatment by the courts, see the sources cited in notes 212 to 220, infra.
There are a number of explanations for the support obligation that have been offered in the past which, were they still applicable, would leave little room for a proposition that such amounts should not be taxed in the payor’s hands. For example, if alimony “merely continues the support which the wife was entitled to receive while the marriage existed,” there would be no reason to permit a deduction of payments made at the end of a marriage where none was allowed before. Similarly, if alimony was seen as “furnishing damages for the husband’s wrongful breach of the marriage contract,” or if it were “a penalty imposed on the guilty husband”, it would be difficult to view the payments as anything but consumption expenses of the payor. However, as explained earlier, the extension of the right to support to both sexes, its application to relationships other than legal marriages, and the growing unimportance of conduct as a factor in setting the quantity and initial qualification for support awards all serve to demonstrate that these explanations are no longer viable rationale for the obligation.

A more contemporary explanation for the support obligation, the implied contract theory, would, if valid, offer one of the clearest cases for concluding that the payments represent consumption expenditures of the payor for which no deduction should be permitted. The implied contract theory of support suggests that spousal relationships involve an implicit understanding that if family responsibilities are divided so that one spouse assumes the income earning responsibility and the other attends to household responsibilities such as caring for children, the spouse working outside of the home will support the one remaining in the home. A further feature of the implied contract is an understanding that if the relationship should end, the working spouse will support the other spouse, or at least compensate him or her for the loss of economic potential he or she suffered by spending time with household responsibilities instead of participating in the labour force and accruing skills, experience and seniority. The emphasis in recent legislation on the obligation to be self-sufficient, the possibility to contract out of a support obligation, and the use of support payments as a bridge to re-entry into the workforce all add strength to the implied contract view of the support responsibility. At the same time, however, the obligation has been extended to many situations where the need of the party seeking support is attributable to circumstances that have little or nothing to do with the relationship that gave rise to the claim for support. The imposition of a duty to support in instances that were clearly beyond the contemplation of the parties at the time the relationship began tends to undermine the implied contract theory and show that it is inapplicable to many support cases. If support payments were, in fact, made pursuant to an express or implied contract, they could be treated similarly to any personal expenses of the payor made under contract. The income tax system does not generally inquire whether or not the beneficiary of a contract has struck a good bargain and

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124 Id. at 421-33.
125 Id. at 422; Horne, Tax Pitfalls in Alimony and Separation Payments (1957), 35 Taxes 751.
126 “We believe that a woman does not become economically dependent by virtue of her marriage. If she is in fact dependent, it is the couple’s personal choice.” Can., Report of the Royal Commission on the Status of Women (Ottawa: Information Canada, 1970) at 299.
received full value in exchange for the consideration offered, but taxes all con-
sumption expenditures in the hands of the payor. Given its inapplicability in so
many situations, however, this theory of support is an inadequate explanation
for the obligation and should not serve as the basis for developing rules to
govern the taxation of support payments.

It is apparent that no one rationale adequately explains the support
obligation in its many forms and situations. If we turn to the initial step that a
person must take to become potentially liable for a support obligation,
however, it is possible to discover the thread running through the many in-
stances in which the obligation arises. The common denominator for all sup-
port obligations is the underlying relationship from which they flow. They are
imposed only on persons who are legally spouses or are deemed to be spouses
by virtue of a marital-like relationship. While we may be at a loss to under-
stand why the obligation arose, we can see how it came about. For the persons
on either side of a support obligation it really does not matter whether it is bas-
ed on any of the explanations discussed earlier or is simply a desire by the state
to utilize the relationship as an excuse to pass along an obligation that would
otherwise fall on the public purse. The legislatures have decided that an obliga-
tion should attach to all relationships meeting certain criteria, an obligation
that will not ripen until the relationship ends, at which time it will crystallize
only if certain criteria relied upon by the courts (or individuals reaching an
out-of-court settlement) are present. Persons entering into marital or marital-
like relationships are actually, or are deemed to be, aware that one of the
potential consequences of the relationship is a support obligation.127 If cir-
cumstances evolve so that a taxpayer is later required to make support
payments, they might be treated as transfers made pursuant to a personal
undertaking agreed to implicitly at the time the relationship commenced. The
initial control of the transferor permits us to consider the amount he or she
earns and then transfers to others the consumption of the taxpayer.128

While the simple way to resolve the appropriate tax treatment of support
payments is to assert that they are consumption expenses of the payor and,
therefore, part of the payor's taxable income, there are many aspects of the

127 The analysis does not turn on whether or not the parties are actually aware of
the potential obligation. They are expected to understand the legal consequences of the
actions they contemplate or to learn about them before commencing the act that might
give rise to an obligation. This principle is firmly established in almost all areas of law.
For example, tort law imposes liability on the person who is aware of her negligence or
who should have been aware of the potential consequences of her actions.

128 Of course this conclusion is based on the assumption outlined earlier that a pro-
gressive income tax system seeks to redistribute economic potential. If the goal were a
redistribution of consumption, a lower tax burden for the transferor is reasonable. For
example, Vickrey believes that a degree of income splitting for marital units with only
one earner might be appropriate. He suggests a case "can be made for reducing the tax
where two persons of unequal incomes live in a common household and share their
resources: this sharing of resources can be considered a redistribution of income similar
to that which the income tax is attempting to bring about." Vickrey, Agenda for Pro-
gressive Taxation (New York: Roland Press, 1947) at 280.

Similarly, the conclusion relies on a definition of income that equates consumption
with economic command, not actual physical consumption or benefit. As McIntyre
points out, "the alimony deduction is a necessary corollary of the benefit rule." McIntyre,
Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion
support obligation that make it a rather unusual alienation of income. It is possible to treat the payments as we would any other income transfer but in many respects the doctrine of control normally applicable to these transfers provides an awkward mold into which support payments should fit. Support payments may result from an initial consumption choice of the payor, but it might be asked whether they continue to remain acts of consumption forever. And even if they do represent the consumption of the payor, there may be features of support payments that make it appropriate to treat them differently from other consumption expenditures that take the form of income assignments. Income assignments usually occur within a family and transfers outside the family are likely to be for short periods of time. Support payments, however, are long-term assignments occurring outside family. All these factors make support a harder case than some other income transfers. However, on close analysis, they fail to establish a convincing case for not including these amounts in the tax base of the payor.

a) *For How Long are Support Payments the Payor’s Consumption?*

While lump sum support payments or support obligations lasting for a fixed period of time are not uncommon, most support orders and agreements extend for an indefinite period of time, although they may be terminable upon the passing of specified events such as remarriage of the recipient. Taxpayers might wonder how far down the line these financial consequences are deemed to be their consumption because they flow from an original consumption choice.

A similar long-term expense whose nature is often discussed is that of child-care costs. The issue debated is whether all subsequent child-rearing expenses should be considered consumption of the person who originally committed the act that led to the conception of the child. Many commentators believe this is the case.\(^\text{129}\) The child-care expense issue can be resolved, however, by pointing out that whatever consumption element there is in the expenditure, there might also be a business purpose if the expenses are incurred to enable someone to work. Unlike other personal expenses such as food and clothing that must be incurred whether or not the taxpayer is working, child-care expenses are incurred only when the person caring for the child seeks to return to the workforce.\(^\text{130}\) In the case of child-care expenses it might still be debated what effect this factor should have on the original characterization of the expenses as a personal consumption expenditure of the payor.\(^\text{131}\) In any

\(^{129}\)See, e.g., Klein, *Tax Deductions for Family Care Expenses* (1973), 14 Boston College Ind. and Comm. L. Rev. 917 at 941: “[T]he cost of caring for children can be thought of as a voluntary outlay — as a matter of consumption, if you will.”

\(^{130}\)The Canadian Royal Commission on Taxation concluded that child care expenses were nondiscretionary outlays of the taxpayer where both parents were working. *Supra* note 111, at 34, 193.

\(^{131}\)It should have no effect on that characterization according to some. See, e.g., McIntyre, *Evaluating the New Tax Credit for Child Care and Maid Services* (1977), 5 Tax Notes 7 at 8:

No one would suggest that the costs of caring for a pet elephant are deductible, simply because it is impossible to go to work and leave the elephant alone. What made child care expenses different was that a parent, after making the quintessential personal choice to have a child, could not undo that decision by giving the child to the local zoo. This difference, however, is not sufficient to convert child care into a business deduction within the meaning of the Internal Revenue Code.
event, no business purpose can be imputed to support payments\textsuperscript{132} and a case for deductability of these expenses cannot be based on a dual-purpose type of analysis.\textsuperscript{133}

If support payments do not acquire a secondary purpose along the route that would help shift them from pure consumption expenses of the payor, there remains one further possibility that might be utilized to move the expenditures from a taxable to a non-taxable consumption category. While the broadest understanding of the Haig-Simons income definition recognizes no expenses as necessary deductions from taxable income other than those incurred to earn further income,\textsuperscript{134} another view of the optimal comprehensive tax base would permit taxpayers to deduct non-discretionary expenses over which they had no control.\textsuperscript{135} If it could be shown that support payments cease to be discretionary at some point, then a deduction for the payments would be appropriate under this view of the ideal tax base.

The argument in favour of narrowing a person’s tax base from potential economic power to “discretionary economic power” is based on a belief that it would not be fair to tax a person on income that was used to pay certain expenses which were not incurred as a result of a voluntary consumption choice. Unanticipated, costly medical expenses are perhaps the best example of expenses that are considered to be non-discretionary by advocates of this narrower tax base.\textsuperscript{136} Leaving aside for the moment the merits of an exemption from taxable income for non-discretionary outlays, it is clear that in any case an unexpected illness or accident is quite different from a support obligation resulting from a personal arrangement into which the payor deliberately entered. A discretionary economic power tax base only becomes relevant to the

\textsuperscript{132} However, the Canadian deduction provision and, since 1976, its American counterpart both operate as deductions from gross income similar to business expenses, unlike personal deductions which are subtracted at a later stage to calculate taxable income. See Bashinsky, \textit{Income Taxation: The Tax Reform Act of 1976 Changes in the Treatment of Individual Taxpayer’s Alimony and Child Care Payments} (1978), 9 Cumberland L. Rev. 177 at 179.

Goode, \textit{supra} note 14, at 148, includes support payments in a list of deductions, the “dominant reason” for which is “an allowance of costs of obtaining income.” It is not clear to what extent he attributes this purpose to all the items in his list.

\textsuperscript{133} An additional innovative and theoretical justification for the child care deduction (which operates as a credit in the United States) is that of McIntyre and Oldman, who claim a deduction is called for “to equalize the tax treatment of purchased child-care services and self-performed services by in effect making both kinds of services exempt from tax.” McIntyre and Oldman, “Treatment of the Family,” in Pechman, ed., \textit{Comprehensive Income Taxation} (Washington: The Brookings Institution, 1977) 205 at 225. Equalizing the treatment of extra-family support with intra-family support would, of course, require taxing both or neither.

\textsuperscript{134} This is the view Professor Surrey uses as the base for establishing his tax expenditure budget. Beginning with Simons’ definition, he says, “Consumption in this approach is thus all funds spent except where spent in the earning or production of income — since the tax is on net income.” Surrey, \textit{Pathways to Tax Reform, supra} note 27, at 21.


\textsuperscript{136} See, e.g., \textit{supra} note 111, at 213-19.
issue of support payments if it can be demonstrated that at some point such payments are no longer attributable to a voluntary commitment of the payor. To support such a contention is not an easy task. Ultimately, of course, the expense can be traced to an intentional consumption choice of the payor. But is it fair to continue labelling support payments consumption of the payor years after that original commitment? To do so implies that the only way a taxpayer can avoid the possibility of an obligation that might require payments which will be considered to be voluntary consumption outlays for the rest of her or his life is to live a solitary existence and avoid any acts that might make one an actual or deemed spouse.

There is no demarcation point set out in tax theory or practice that can be utilized to help resolve the dilemma. Family law, which imposed the obligation in the first place, similarly fails to establish criteria that could be used to distinguish discretionary from non-discretionary payments. A potential support obligation has been made an incident of certain relationships and may crystallize after the relationship ends once certain factors are considered. The form of the obligation can range from one lump sum payment through to an indefinite commitment that may be modified or terminated as the conditions under which it was originally imposed alter. The evolution of support from a discretionary to non-discretionary obligation is not one of the factors considered when the amount and duration of the payments is determined.

The only analogous situation confronted by family and tax law is that of support payments in a family that has not dissolved. At the time a person enters into a family relationship he or she assumes a support obligation that is treated as a consumption choice of the payor throughout the life of the relationship. While one could distinguish support in an existing family from similar payments between persons who no longer live in one household, it is hard to conceive of a basis for distinction that would justify differing tax treatment of the two types of transfers. For example, if it were assumed that every

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137 As Klein said of child care expenses, "The expense is necessary at a given point in time only because the couple had previously made a decision to have children." Klein, supra note 129, at 938.

138 Bittker’s argument in favour of a recognition of child support expenses as non-discretionary may be equally applicable to support payments to a spouse or ex-spouse. As to children, Bittker said, supra note 22, at 1448:

To be sure, nobody forced the taxpayer to procreate, but this does not mean that the cost of supporting children is no more entitled to legal recognition than the cost of maintaining a yacht. For one thing, the decision to have children is irreversible; they cannot be abandoned, like a hobby that has become burdensome or boring. Moreover, society feels an obligation to support the children — but not the hobby — if the taxpayer is unable to do so. No one but a tax theorist, it might be asserted, could fail to see the difference. For these reasons, it is argued, the taxpayer’s taxpaying capacity is reduced by parenthood (and, in most circumstances, by the support of other dependents) to a degree that should be reflected in his tax liability.

139 The taxpayer can also contract out of a potential obligation before committing those acts.

140 The common law duty is now codified. See, e.g., Family Law Reform Act, R.S.O. 1980, c. 145, s. 15; Criminal Code, R.S.C. 1970, c. C-34, s. 197. Of course action to enforce the obligation is rare when parties cohabit, unlike the situation where persons seek to enforce an obligation to support a separated or divorced spouse.
year in which a couple does not separate the person supporting the unit has made an implicit affirmation of his or her original consumption choice, then from the taxpayer's perspective intra-family support is a discretionary expense, while payments made after separation are no longer voluntary, given the payor's renunciation of the original consumption choice. However, the income tax system does not permit each taxpayer to choose the point at which expenses should be considered non-discretionary. If the payments were considered personal consumption of the payor until separation, repudiation of the relationship that gave rise to the obligation cannot make subsequent payments involuntary outlays. We do not draw such a line with any other consumption choice — neither the taxpayer who buys a yacht and changes her mind after a year nor the taxpayer who pledges a gift under seal and who no longer wishes to make the donation is permitted to treat payments subsequent to the change of heart as involuntary outlays that should be deducted from income. While support obligations tend to last longer than many other consumption choices, no convincing reason can be offered for treating the expenditures differently from those incurred for a short-term responsibility. "Involuntary" and "non-discretionary" are terms that are defined for tax purposes by criteria other than the motivation of the taxpayer.

Many persons believe that a fair comprehensive tax base should measure only a taxpayer's discretionary economic power. An income tax system using this base would allow a taxpayer to exclude from taxable income a number of involuntary payments. Involuntary does not mean the taxpayer did not want to make the payment — a taxpayer might not "want" to make a payment on her mortgage or car — but that they result from an obligation which was not voluntarily incurred by the taxpayer. Support payments clearly are not involuntary in that sense of the word and should be taxable in the payor's hands regardless of whether a broad or a narrow comprehensive tax base is utilized.

b) Do Support Payments Merit Special Treatment Not Accorded Other Consumption Expenditures?

The conclusion that support payments should be considered taxable income of the payor was supported in part by caselaw and statutory provisions which established a definition of income that ignored the effect of income assignments for tax purposes. The treatment of income assignments helped to illustrate the doctrine that equated consumption with initial control over income. If it can be demonstrated that the goals of the income assignment principles would not be endangered by failing to strictly apply the rules that were developed to deal with these earlier concerns to support payments, there may be no need to tax these amounts as we would all other consumption expenses of the taxpayer. The reason we might seek to differentiate support payments from other income transfers is the fact that they are made out of the family and, at the same time, are based on an obligation that may last as long as intra-family commitments.

Both the American income assignment doctrines and the Canadian statutory provisions, which ignore income assignments when computing tax liability, are directed at intra-family transfers. It is possible that the doctrine which equates consumption with control over income evolved as it did because the courts and legislators were addressing concerns that only apply to intra-
family transfers. Neither the United States nor Canada used a spousal tax unit at the time the income assignment doctrines were developed, although the United States subsequently adopted such a unit, and implicit in the court decisions and legislation may be an unarticulated belief that notwithstanding the decision to treat each individual as a separate tax unit, families act as one economic unit and the transferor will always continue to benefit from any transfer within a family, even if the recipient constitutes a separate unit for tax purposes. If this was the real motivation for the broad definition of income, there is no reason for the doctrine to continue to apply to support payments made only after the family has dissolved.

The obvious way to determine the appropriate treatment of transfers made outside the family is to consider a payment to someone with no present or past connections to the payor. If the payor should not be relieved of tax on the transferred amount in this case, surely it should be treated as the payor’s income where it arises out of a family obligation. This type of transfer was briefly discussed earlier. It was pointed out that apart from a limited deduction for certain charitable contributions designed to encourage such donations, the general structure of the tax system ignores any effect on the payor’s taxable income even where the payor and recipient were completely unconnected. However, the extent to which the donor controls income that is transferred as a charitable contribution is not difficult to observe — the assignment is usually a short-term, one shot occurrence (although it may be repeated in later years). Is the argument in favour of imputing transferred income to the transferor for tax purposes as convincing in the case of a long-term transfer, which is not made within a family context, where the original commitment was entirely gratuitous?

The situation in which this type of transfer would be most likely to occur outside of a family is in the case of a member of a religious order who has assigned her income to the order to which she belongs pursuant to a vow of perpetual poverty. Like many support obligations, these assignments are of an indefinite duration. However, aside from the length of time involved, these transfers do not differ greatly from other charitable donations and a longer duration of an obligation is not in itself a sufficient reason to consider amounts that are usually taxable to be non-taxable. And yet, the legislature has responded to the case of the person transferring all her income pursuant to a vow of perpetual poverty and relieved these persons of tax liability on the transferred amounts.

The subject was first addressed by the United States Congress in 1924 when the deduction for charitable donations was amended to permit an unlimited deduction for persons regularly giving away substantially all of their incomes to charity. The change was apparently introduced for the benefit of

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141 In Helvering v. Clifford, 309 U.S. 331 (1940), a taxpayer established an irrevocable trust for his wife, in which he retained significant power over the trust property in his role as trustee. In a decision that helped establish the American attribution rules with regard to transfers to trusts, the American Supreme Court held the grantor/trustee taxable on income received by his wife, the beneficiary of the trust. Douglas J. noted, at 335, that the arrangement was “at best a temporary reallocation of income within an intimate family group.”

an order of nuns whose vows required them to turn over their incomes to their church.\textsuperscript{143} The provision was designed to accommodate persons who habitually donated almost all their incomes\textsuperscript{144} and it is clear that a major concern of Congress was to provide relief to the person who, after turning over her income to the charity, had nothing left with which to pay taxes. A taxpayer could have easily found herself in this predicament prior to the Second World War when there was no withholding of taxes at the source.

A Canadian provision designed to provide the same relief was introduced in 1949.\textsuperscript{145} While the Canadian provision remains in the Act, its counterpart in the United States has since been repealed. The Canadian provision is tightly drafted — it applies only to members of a religious order who have taken a vow of perpetual poverty.\textsuperscript{146} The American deduction, however, was available to all taxpayers for all charitable donations and became the source of widespread abuse as wealthy taxpayers were able to donate untaxed income to charities and shelter all taxable income with the resulting deduction.\textsuperscript{147}

Is the perpetual vow deduction a tax expenditure or is it instead an application of an income refinement concept, not encountered previously, which might be applicable to support payments? Leaving aside for the present other possible arguments in favour of a deduction not directly related to our concern (for example, the proposition that a duty to one’s Lord is not voluntary in the usual sense of that word), the issue confronted is whether the income assignment doctrine should apply even in the case of the taxpayer who transfers all of her income. In other words, is there a quantitative point after which assignments should no longer be considered consumption of the payor? Applying the analysis developed earlier, one would conclude that the income of the donor does not vary whether five percent or ninety-five percent of her earnings are given away. The economic command is the same in both cases and the only factor that differentiates these two situations is the extent to which the taxpayers personally consumed or passed on to others to consume. The effect of Parliament’s decision to grant a larger deduction for the taxpayer transferring a larger portion of income is not to more accurately measure the taxpayers’ incomes, but rather to grant a larger subsidy to one taxpayer than the other (which, in the case of the perpetual vow donor, is passed on to the ultimate consumer, the religious order that will actually use the amount in the market).\textsuperscript{148}

In some ways the provisions in the Act dealing with support transfers parallel those for charitable contributions. Parliament has concluded that

\textsuperscript{143} See Rudick and Gray, \textit{Bounty Twice Blessed: Tax Consequences of Gifts of Property to or in Trust for Charity} (1961), 16 Tax L. Rev. 273 at 274, n. 4; Merten (rev. by Doheny and Calvert), \textit{Mertens Law of Federal Income Tax} (Wilmette, Ill.: Callaghan & Co.) at §31.03b, n. 3.

\textsuperscript{144} S. 398, 68th Cong., 1st Sess., at 24 (1924).

\textsuperscript{145} S.C. 1949, c. 25, s. 11(6).

\textsuperscript{146} Subsection 110(2) in the Act.

\textsuperscript{147} See Rudick and Gray, \textit{supra} note 143; statement by Stanley S. Surrey before House of Representatives Committee on Ways and Means, 91st Cong., 1st Sess., at 1612 (1969).

\textsuperscript{148} The Canadian Royal Commission on Taxation recommended that the provision be abolished. \textit{Supra} note 111, at 226.
there is something unique about income transfers for these purposes too and, accordingly, has stipulated the relief it thinks is appropriate. The resulting legislation permits taxpayers a fixed deduction of $1,400 for support provided to a spouse, a provision that is often less generous than that provided for charitable donations which allows a deduction of up to twenty percent of income. For some Canadian families the deduction might equal the actual amount of support received by the non-working spouse. For many, however, the deduction is a small percentage of the support amount. This can be contrasted with support payments to persons living separately from the payor where, under the present system, the entire amount is deductible, as is the case with perpetual vow donations.

It might be argued that Parliament has addressed the issue of support payments twice — once in the case of support within a family and once in the case of payments made after the dissolution of the family. However, the question of the appropriate treatment of support has really only been looked at once. The provisions applicable to support payments outside of a contemporary family were not designed to achieve a legislative goal with regard to support. Instead, they were intended to provide relief to a specific group of taxpayers, whose support and tax liabilities had combined with high wartime marginal rates to leave them with little or no after-tax income, and to distribute the burden of reduced personal consumption due to war taxation between the giving and receiving parties. There is no evidence whatsoever that the retention of these provisions after the war was designed to achieve a different legislative goal. It was simply a case of inertia where the status quo was maintained long after the rationale for the rule was no longer valid. Thus, we should consider the rules regarding support payments within a family as the only time at which Parliament specifically addressed the need for exceptions to the usual tax rules for the case of income transferred in the form of support. Parliament's response, a $1,400 deduction for support payments, is deliberately limited, in contrast to the present rule which allows taxpayers an unlimited deduction for amounts used to support former mates, an expenditure that is essentially the same type of transfer in both cases.

In some respects support payments appear to sit on the margin of "consumption". Even if they sit on the taxable side of that line, as has been suggested, they do represent a somewhat unique situation. Although these facts combine to make the choice of appropriate tax treatment of support more difficult than might otherwise be the case, amounts paid pursuant to a support obligation remain the consumption of the payor and a deduction for these payments is not desirable in a normative income tax. The government might want to take the factors mentioned above, along with any others it feels to be important, and decide to help subsidize these income transfers. And although the motivation for the original alimony deduction is no longer applicable, the

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149 Subsection 109(1)(a)(ii) provides for a $1,400 deduction for a dependent spouse. This figure has been indexed to a cost of living formula since 1974. In September 1982, the government announced that the indexing factor for the next two years would be six and five percent respectively, regardless of actual rises in the cost of living above those amounts, as part of an anti-inflation programme.

150 But not all payments to persons receiving support are deductible — just those that go to spouses or ex-spouses. In the case of other blood relatives supported by the taxpayer a deduction ranging from $300 to $1,400 applies. See s. 109(b)-(h) of the Act.
government may wish to provide a greater level of subsidy for taxpayers providing support to a person with whom he or she is not cohabiting. The subsidy nature of these measures should be recognized, however, so that equitable results can be achieved.

2. Consequences to the Parties Applying the Support as a Return on an Investment in Human Capital Doctrine

Thus far, it has been suggested that two principles should govern the treatment of various income and property transfers between spouses or ex-spouses. To review, the paper began with the proposition that earned income or property income should be taxed in the hands of the person who labours or who controls property, whether he or she consumes with the income or assigns it to another person. Second, it was suggested that income should follow beneficial ownership of property. When property is transferred, subsequently generated income should be taxed in the hands of the new owner whether the property was purchased or received as a gift.

The different treatment of income earned by one who labours or owns property and transfers the income and income generated by property that has itself been transferred raises an interesting problem — how should support payments be treated if they are considered income from property belonging to the recipient, that property being a share of the human capital of the payor? If a support award is actually a return on an investment in the earning capacity of the working spouse, it might be argued that it should be taxed as income to the recipient and at the same time be excluded from the income of the transferor.

There are many instances in which a court hearing a matrimonial dispute that involves conflicting claims to a particular property may conclude it is preferable not to sell the property and divide the proceeds. Such is the case, for example, where the asset consists of an on-going business that would not survive were a portion of its capital taken out of the operation. An alternative example is that of a property earning a healthy return but whose value is based on a large accrued and unrealized gain where it is desirable to defer recognition of the gain as long as possible. In these cases a court will usually transfer legal title to a portion of the asset and permit the present legal owner to continue to operate the business or manage the property, as the case may be. That person must forward to the new co-owner a portion of the profits generated by the property equal to the share of ownership held by the recipient partner.

It is not possible, of course, to vest legal title to a portion of human capital in another person. Although such an order cannot be made in form, it is possible to achieve the practical consequences such an order would accomplish, were it technically possible. A support order based on a portion of the payor’s earnings might be seen as a substitute for an order that transferred ownership of a portion of property but permitted the former owner the right to continue to manage the property. In both cases the owner or manager transfers that part of the income that is equal to the share of the new owner in the property. While legal title to property that takes the form of human capital cannot be transferred, perhaps a beneficial interest in the property can be. This could be

151 In the case of spousal transfers, if the amount transferred is property income, it will be taxed in the hands of the recipient who now owns the property that generated it because the attribution rules that normally apply to spousal transfers (supra note 37) cease to operate after the end of a relationship.
accomplished through a support order. It is arguable that the beneficial “owner” of the property should be taxed on the income generated by the “property” and the nominal owner should not be taxed on the income generated by the “property” and the nominal owner should not be taxed on income over which he or she had no control, but instead should be treated like a conduit or the vehicle for operating another taxpayer’s property. If support is a return on an investment in human capital, the inability to transfer legal title because of the peculiar nature of the property should not alter its tax status as property income. But despite its apparent validity as a logical and consistent application of the principles governing the taxation of “property” income, this conclusion is based on a flawed reasoning process. It is a fine example of the process once referred to as the “fallacy of the transplanted category,” or the error of applying concepts suitable in one area of law to another with different objectives.

To explain this assertion, the following part of the paper will first explore the theory of human capital and its role in family relationships, then review briefly the extent to which it is a factor in family dissolution proceedings, and finally show that the application of the principles upon which the human capital theory is premised to family law concerns is not important to those seeking to categorize these income transfers for income tax purposes.

a) The Economic Theory of Human Capital

The theory that suggests support may be a return to the recipient on an investment in property (human capital) held by the payor for the benefit of the recipient is based on a view of a family as a rational economic unit. It commences with the individual participants in that unit who are each presumed to expect to be better off following an exchange of services and a division of labour. Thus economists presume that the division of labour and responsibilities in a household is designed to maximize the return to the household and both parties expect to enjoy increased future consumption from the arrangement. As a result of the divided family functions, one or both parties

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152 When the Canadian Income War Tax Act, S.C. 1917, c. 28 imposed a surcharge on investment income, support payments received were considered investment income. They are now defined as “earned income” for the purpose of calculating contribution limits to a Registered Retirement Savings Plan (see s. 146(1)(c) of the Act). The United Kingdom continues to consider maintenance payments exceeding a fixed amount of investment income for the purpose of an investment income surcharge. See Tiley, Revenue Law (London: Butterworths, 1978) at 142. For a brief discussion of the arguments for and against considering these amounts investment income see Willis and Hardwick, Tax Expenditures in the United Kingdom (London: Heinemann Educational Books, 1978) at 72.


154 Most economic theory is based on an assumption that this is the case with any exchange of property rights, obligations or responsibilities. See Pejovich, Towards a General Theory of Property Rights (1971), 31 Zeitschrift für Nationalökonomie (Heft 1-2) 141, reprinted in Furubotn and Pejovich, The Economics of Property Rights (Cambridge: Ballinger, 1974) 341 at 344.

may be able to acquire one or more of three types of assets: tangible assets, intangible but marketable assets, and property personal to the holder that can be used in the future to generate a stream of income, that is, human capital. Almost all of the common law separate property regimes in North America have incorporated sharing into their divorce laws, but the extent to which courts in these jurisdictions have recognized a right of the non-owning spouse to the three different forms of property varies.

Canadian courts have definitely recognized two ways in which a non-owning spouse might acquire an interest in the tangible assets owned by the other spouse, as a result of which they may order a transfer of assets or other compensation. First, the non-owning spouse may have contributed money or money’s worth directly to the acquisition or growth of the transferred property or a predecessor property. Second, the transferee might have freed the other spouse from household responsibilities which allowed the working spouse more time to devote to the acquisition of assets. In the latter case the spouse who remained in the home will have contributed nothing to the disputed assets. However, when household and child rearing responsibilities are assumed by one person, that person must forego the opportunity to acquire non-family assets at the same time the spouse who is working outside of the home is able to accumulate these assets. This division of family functions will leave both parties with equal responsibilities but unequal opportunities and this fact is recognized by the courts. As a result, the non-working spouse is often awarded a portion of the other spouse’s assets based on this shifting of opportunities.

While a court can divide the assets of one spouse who was able to acquire the property because the other spouse undertook those responsibilities that af-


157 See, e.g., Boardman v. Boardman (1977), 2 R.F.L. (2d) 156 at 162 (Sask. Q.B.): "Much of what the doctor has today in a material sense is attributable as much to his wife’s help and assistance, as it is to his own industry and initiative. She has contributed considerably in caring for the home, and has, both prior and subsequent to separation, cared for the children." Another example is Bregman v. Bregman (1978), 21 O.R. (2d) 722 at 739, 91 D.L.R. (3d) 470 at 487, 7 R.F.L. (2d) 201 at 218 (Ont. H.C.), aff’d without written reasons (1979), 25 O.R. (2d) 254, 104 D.L.R. (3d) 703 (C.A.): "[S]he was, as I find, the marriage partner who took the main burden of responsibility of household management and child care. I am in no doubt that this left her husband physically, intellectually and mentally free to concentrate as much as he required to earning and acquiring and managing his non-family assets." It is interesting to note that Mrs. Bregman had the assistance of housekeepers and “charwomen” in carrying out those household responsibilities.

The distinctive nature of the two types of contributions a non-working spouse can make is well illustrated by the decision in Silverstein v. Silverstein (1978), 20 O.R. (2d) 185, 87 D.L.R. (3d) 116, 1 R.F.L. (2d) 239 (Ont. H.C.). Mrs. Silverstein was awarded a twenty-five percent interest in a rental property owned by her husband in recognition of her indirect contribution towards the acquisition of the property. She had worked in her husband’s store without a salary and had provided money for the purchase of another property. The proceeds of the sale of that property were invested into the rental property that was divided. Mrs. Silverstein also undertook the bulk of household responsibilities which permitted her husband to acquire assets that were traced to the rental property. In recognition of this she was granted a further twenty-five percent interest in the property.
forded no opportunity to acquire property, it is much more difficult to divide the intangibles that the working spouse also acquired over the same time. Nevertheless, this property can be valued and taken into account when the assets of the two parties are compared. The opportunity to acquire tangible assets is not the only benefit realized by the working spouse as a result of the assumption of the income earning part of the family duties. Whether that spouse runs a business, develops a professional practice or builds a career, the same time and effort that permit the acquisition of assets also permit the building up of business, finding new clients, establishing goodwill, accumulating experience, seniority and tenure; in short, as the working spouse earns and saves income, he or she also builds the base for future income. If the assumption of household responsibilities entitles a spouse to a portion of the real assets acquired by the working spouse, it should similarly entitle that person to a claim on these intangible assets. This will not prove a problem in common law sharing jurisdictions where a court can estimate the value of this property and take it into account when dividing property unevenly.\textsuperscript{158} In community property jurisdictions, however, the accumulation of this property must be divided equally and it must therefore be accurately valued. It is not surprising, therefore, that jurisdictions such as California consider goodwill, the amount by which a person's business or professional practice exceeds the tangible assets invested therein, a community property that must be divided upon matrimonial dissolution,\textsuperscript{159} notwithstanding the problems that may be encountered in valuing the asset.\textsuperscript{160}

Canadian courts have not yet explicitly recognized a spouse's interest in the human capital property of the other spouse that has not produced income at the time of the dissolution. American courts have explored the respective rights of parties to share in this property, however, and their decisions provide a useful introduction to the concepts involved. It is possible that the Canadian courts do consider the rights of both parties to share in developed human capital and take this into account when dividing accumulated assets. The only time the issue is clearly confronted is where one spouse has directly contributed to the other spouse's education and the parties separate before any assets are acquired that might be transferred to satisfy the interest.

\textsuperscript{158} See Bregman, \textit{supra} note 157. See also Peterson v. Peterson (1979), 12 R.F.L. (2d) 319 (Ont. H.C.) where the wife was awarded a lump sum payment in recognition of her contributions that helped establish the initial momentum which permitted her husband, a neurosurgeon, to later accumulate assets; and Weir v. Weir (1978), 96 D.L.R. (3d) 725, 6 R.F.L. (2d) 189 (Ont. H.C.) where the wife acquired an interest in her husband's non-family assets by enhancing his professional image and reputation by refraining from working herself.


\textsuperscript{160} As the court said in Lopez, \textit{id.} at 110:

While "market value" and the value for marital dissolution purposes of "professional goodwill" may be synonymous, in our view such value should be determined with considerable care and caution, since it is a unique situation in which the continuing practitioner is judicially forced to buy an intangible asset at a judicially determined value and compelled to pay a former spouse her share in tangible assets.
Human capital can take many forms, including improved health, on-the-job training, study programmes and higher education. Of these benefits, education, especially college education, is recognized to be the investment most likely to pay measurable economic returns to the holder. This is particularly true of a professional degree where the value of the education can actually be ascertained on a group-wide basis if not in each individual case. Unlike many property rights a taxpayer can acquire, higher education may have many personal consumption attributes. Economists generally consider all the costs of attaining a degree to be investment and ignore any consumption element when calculating the return on this type of investment. The magnitude of the value of such a degree is shown by the fact that even using this calculation, which increases the cost of the investment to its maximum possible, the rate of return is estimated to be similar to investment in non-human capital.

Some United States jurisdictions that have been asked to compensate one spouse for her interest in the human capital of the other, as represented by a professional degree, have simply asserted that education acquisitions are simply not property because they exhibit none of the attributes normally associated with property such as “being susceptible of ownership in common, of transfer and survival.” Others have conceded that the claim may be for a legitimate property right but it is property that the court has no jurisdiction to divide and, even if the court could divide it in theory, in practice it could not do so given the difficulties in valuing the asset. Those jurisdictions that have recognized education as a property right in which the non-owning spouse may have an interest have done so on the basis of an economic theory almost identical to that used to justify a division of assets acquired during the course of the relationship. The theory is best illustrated in those cases in which one spouse supported the other while he or she attained a professional degree and paid for the tuition of the student spouse. It is a situation where “one spouse has foregone the immediate enjoyment of earned income to enable the other to pursue an advanced education on a full-time basis. Typically, this sacrifice is

162 See Krauskopf, supra note 155, at 382-84; Becker, Human Capital (2d ed. New York: Columbia Univ. Press, 1975), esp. c. IV, “Rates of Return from College Education.”
When calculating the value of this future income stream, account must be taken of the higher risk and uncertainty attached to this type of investment when compared to more common investments. See Thurow, Investment in Human Capital (Belmont, Cal.: Wadsworth, 1970) at 22.
163 See Schultz, supra note 161, at 35ff for a look at the problems involved in separating consumption elements from investments.
164 Id. at 42.
165 In Re Marriage of Sullivan, 134 Cal. App. 3d 634, 184 Cal. Rptr. 796 at 800 (C.A. 4th Dist. 1982).
166 See, e.g., Sullivan, id. at 801-802. The Sullivan case was decided on a rehearing. On first hearing (Civ. 23634, Cal. App. 4th Dist., Jan. 8, 1982) the court decided that an education was a property right capable of division, which prompted a number of commentators to discuss the appropriate measurement of the value of the right, as well as the preferable way to determine the portion of that value to which the spouse seeking compensation should be entitled. See Note (1982), 9 Comm. Prop. J. 64; Parks, Cost as the Measure of the Community’s Interest in a Spouse’s Education (1982), 9 Comm. Prop. J. 110.
made with the expectation that the parties will enjoy a higher standard of living in the future.\textsuperscript{167} If the relationship ends long after one spouse has attained the education, the other spouse’s interest may be satisfied by a division of available assets. However, if the couple separates shortly afterwards, there may not be other assets to transfer. The courts realize there is a need to prevent the supporting spouse from suffering an injustice and the spouse who received the higher education from receiving a windfall and have ordered the newly educated spouse to compensate his or her former partner. Given the lack of present resources, the order will usually specify that the awarded amount is to be paid on an installment basis.\textsuperscript{168} The award is not one of support — indeed, there may be no need for support because the spouse who helped the other party attain an education is usually working and most likely suffers no drop in living standard after separation if he or she were formerly supporting the other spouse.\textsuperscript{169} Thus, many courts have specified they are transferring capital property, and not making a support order.\textsuperscript{170} On other occasions, however, the courts have made similar property awards and labelled the payments “alimony”.\textsuperscript{171} Often support awards have been treated as compensatory in nature\textsuperscript{172} and have been limited to the value of support and tuition paid for by the supporting spouse.\textsuperscript{173} But while many courts reject the idea of human

\textsuperscript{167} DeLa Rosa v. DeLa Rosa, 309 N.W. 2d 755 at 758 (Minn. S.Ct. 1981). Other courts have used similar language to describe this situation. See, e.g., \textit{In Re Marriage of Horstmann}, 263 N.W. 2d 885 at 887 (Iowa S.Ct. 1978) quoting the trial court decision:

Had [the husband who attended law school] been working at a full-time job, it is likely that their joint income would be higher with an attendant increase in living standards. . . . However, all of their assets substantially contributed to making up deficiencies in income and educational expenses due to the fact that [the husband] was a full-time student rather than a full-time employee during the marriage. . . . These sacrifices would be acceptable if [the wife] could reap the future benefits of these sacrifices in the way of increased income and a satisfying life style as a result of [the husband’s] education and legal training.

See also \textit{Inman v. Inman}, 578 S.W. 2d 266 at 268 (Kentucky C.A. 1979) where the court noted the wife had “devoted much of the product of several years of labor to an ‘investment in’ future family prosperity.”

\textsuperscript{168} See, e.g., \textit{In Re Marriage of Horstmann}, supra note 167, at 888; DeLa Rosa, supra note 167, at 757; \textit{Daniels v. Daniels}, 185 N.E. 3d 773 at 774 (Ohio C.A. 1961).

\textsuperscript{169} See, e.g., DeLa Rosa, supra note 167.

\textsuperscript{170} For example, the Iowa Supreme Court in \textit{In Re Marriage of Horstmann}, supra note 167, awarded the wife $18,000 to be paid in installments in recognition of her interest in her husband’s legal education and an additional $1 per year alimony. The Minnesota Supreme Court in \textit{DeLa Rosa}, supra note 167, awarded Mrs. DeLa Rosa $11,400 for her contributions towards her husband’s education while pointing out she was not entitled to alimony.

\textsuperscript{171} See, e.g., \textit{Daniels}, supra note 168.

\textsuperscript{172} For example, the Supreme Court of New Jersey uses the concept of “reimbursement alimony” which covers “all financial contributions he or she [the support recipient] made to the spouse’s successful professional training. Such reimbursement alimony should cover all financial contributions towards the former spouse’s education, including household expenses, educational costs, school travel expenses and any other contributions used by the supported spouse in obtaining his or her degree or license.” See \textit{Mahoney v. Mahoney}, 453 A. 2d 527 at 534 (N.J. S.Ct. 1982).

\textsuperscript{173} See, e.g., \textit{DeLa Rosa}, supra note 167, where the court used an elaborate formula to arrive at an amount equal to the working spouse’s contribution to joint living expenses, after taking into account the student spouse’s contributions; \textit{Daniels}, supra note 168, where the working wife was awarded $24,000 to reimburse her for her contribution to household expenses and to repay funds her father had contributed to the family.
capital giving rise to divisible property, it is not unusual for the same courts to suggest that "even though the enhanced earning potential provided by a degree or license is not 'property' for the purposes of division . . . , it clearly should be a factor considered by the trial judge in determining a proper amount of alimony," in effect awarding a portion of the income attributable to the human capital of the payor.

b) Choosing the Appropriate Taxpayer

It is not implausible to suggest that a person can "earn" an interest in the human capital, as represented by education, of a spouse. The value of the property can be calculated, as can the interest of the non-owning spouse. What tax consequences should follow if the family law courts hearing marital separation or divorce cases see their support awards as "property" income based on an investment in human capital theory? Given our tax system's different treatment of income that has been assigned and income from transferred property, one might suggest that if support is really a return on an investment in human capital, it falls onto the income from transferred property side of the line and should be taxed in the hands of the new beneficial owner of the property that produces the income.

A number of responses to this line of reasoning are possible. The easiest is simply to point out that support orders do not appear to be based on any such considerations. Indeed, the factors that the courts do take into account when making support awards reinforce the conclusion that the payments have no attributes of property income. For example, as mentioned earlier, courts may take into account factors such as remarriage or a new relationship on the part of the recipient to lower support payments. Similarly, external conditions unrelated to the former contributions or division of family responsibilities by the parties are often used to justify an increase in support. A return on capital clearly would not vary according to factors like these.

174 Mahoney, supra note 172, at 536.

175 The working spouse's share will be less than half most likely — while she did contribute cash, the student spouse had to contribute substantial amounts of intellectual work to pursue the degree. See, e.g., O'Brien v. O'Brien, 114 Misc. 2d 233, 452 N.Y.S. 2d 801 (Supp. Ct. Westchester County 1982) where Mrs. O'Brien was awarded forty per cent of the present value of Dr. O'Brien's medical licence. The decision and formula used to arrive at that figure, as well as an alternative formula, are discussed in Shuman, Equitable Distribution of Degrees and Licenses: Two theories Toward Computing Spousal Contributions (1983), 49 Brooklyn L. Rev. 301. Recent cases and trends across the United States are discussed in Rush, The Supporting Spouse's Rights in the Other's Professional Degree Upon Divorce (1983), 35 Univ. Fla. L. Rev. 130.

176 See, e.g., Neal v. Neal (1972), 89 D.L.R. (3d) 254, 8 R.F.L. 194 (B.C.S.C.); Morrow v. Morrow (1980), 18 R.F.L. (2d) 374 (B.C.S.C.) where an ex-wife cohabiting with another man was still held to be entitled to maintenance, though the payments were reduced from $300 per month to $1 per year. Brower v. Brower (1981), 18 R.F.L. 348 at 356 (Ont. S.C.): "[Payment] shall continue until the petitioner remarries or until she establishes a relationship with a man whereby she is being supported by him or ought to be supported by him."

177 One common concern of many courts is to protect the public purse. See, e.g., Hall v. Hall (1979), 13 R.F.L. (2d) 77 at 79 (B.C.S.C.): "Maintenance is not only for the benefit of the wife but also for the benefit of the general public in the sense that it may relieve the public from supporting a divorced spouse."; Collins v. Collins (1978), 2 R.F.L. (2d) 385 at 392, 10 A.R. 214 at 221 (Alta. S.C.): "The public has an interest in
One could further argue that the nature of the payments themselves render them quite distinct from property income. The obligation to pay support often lasts for an indefinite and unknown period and may increase, decrease, or cease as circumstances change or contingencies occur. If the income stream is considered to emanate from a property right, it is a property inseparable from its original holder, incapable of legal transfer.

It is nevertheless possible that courts in this country do use a human capital type of analysis when determining the nature and quantity of a support obligation. While the problems just mentioned are undeniable, the present value of a support obligation can be estimated once contingencies such as remarriage and death are taken into account, just as the present value of the human capital asset can be determined. And while it may be difficult to find a case in which a court has specified that the support amount chosen was based on a portion of the present value of the expected return on another person's education, the theory that support payments represent a return on an investment in human capital may be used by family law courts to determine support obligations so that in their eyes the awards are a form of property income.

While a property income analysis may prove an invaluable tool for family law courts seeking an equitable resolution to the conflicting interests of parties seeking a dissolution of economic ties on the one hand and a continuing support obligation on the other, there is no reason to assume that it might also play a role in the income tax analysis of such payments. Viewing support as a form of property income may be desirable and even essential to a court called upon to determine an appropriate support award. However, the payment does not thereby acquire any of the qualities of property income that explain the tax treatment of that type of income, particularly the lack of attribution following a transfer of property. Whether family courts choose to categorize the support payments as an inherent feature of marital or marital-like relationships, as the consequence of an implied contractual obligation between persons entering certain relationships or as a form of property income resulting from a division of labour between spouses, the character of the payments does not alter from an income tax perspective.

Income taxation is concerned with income as a means of economic command. The crucial difference between the person who transfers income-producing property and the person who pays a portion of income becomes evident the moment the property of the former taxpayer is transferred. At that point the former taxpayer has lost control of the property while the latter has only lost control of the final application of his or her income. He or she retains

assuring that spouses do not become public charges." However, not all courts consider this to be an important factor. See, e.g., Schartner, supra note 55. But see contra Coupland, supra note 64. The unique character of the alimony obligation is well illustrated by the Felix v. Felix decision, [1973] 2 O.R. 424, 10 R.F.L. 313 (Ont. H.C.) where the petitioning husband was ordered to pay maintenance to his wife who was unable to support herself because of physical and mental problems. The order creating the obligation specified that it would run for an indefinite period unless the wife became an involuntary patient in an Ontario mental hospital. If she were confined as a patient in such a hospital the obligation would cease. However, it would commence again if she were later discharged from the hospital.

the option of producing income or cutting off the economic power simply by not working. Useful as the property income analysis may be for other purposes, support payments fail to satisfy the crucial criterion for income tax purposes of successfully transferred property income — the severance by the transferor of initial economic control over the income. The taxpayer who successfully transfers property income for income tax purposes can claim no continuing economic power either to use the income personally or control its flow to others. The support payor can make no similar claim for he or she retains the power to cut off the flow at any time. Calling the payments a return on an investment in human capital fails to provide a sound basis for transferring tax liability on amounts paid in satisfaction of a support obligation.

3. Consequences to the Recipient

Support payments, like any net receipts, regardless of the rationale for the obligation they satisfy, are income as that term is defined in this paper; they enable the holder to exercise command over goods and services in the public market and should be included in the tax base of the recipient.\textsuperscript{179} Given the present structure of our income tax system there are two reasons why it might be preferable to exclude such amounts from taxable income. The first is to achieve a measure of horizontal equity with other taxpayers who receive equal amounts that are not now taxed because of the exclusion of gifts from taxable income. Such an argument would not be persuasive, however, in light of the inconsistent treatment presently accorded various types of income.

The second argument in favour of not taxing support payments is the need to ensure the income tax system is neutral with regard to personal or family living arrangements once we have chosen to treat individuals as separate taxable units. In an ideal income tax system support payments would be taxed in the hands of the recipient and the tax-free receipt of such amounts admittedly would be a deviation from our goal of a comprehensive tax base. However, to include support payments in the taxable income of the recipient, without at the same time addressing the anomalous treatment of support within a household, would result in the abandonment of the goal of neutrality that would be achieved by not permitting the payor a deduction for alimony payments.

a) \textit{Horizontal Equity}

Were marriages or marriage-like relationships built upon express or implied contract, support payments might be viewed as a form of pension for past household services performed or promised. There is little doubt that

\textsuperscript{179} The \textit{Gould} case, supra note 67, which established the tax treatment of support payments for the first twenty-five years of income taxation in Canada, had decided the amounts received as support were not "income". However, as explained earlier, that conclusion was most likely based on the fact that the amounts had already been taxed in the payor's hands (see text accompanying note 70, supra). Thirty-three years later, the Court of Claims was faced with an argument that alimony was not income, based on the \textit{Gould} decision, in \textit{Mahana}, \textit{supra} note 70. It noted:

[The taxpayer (recipient)] says [an alimony receipt] is not income; therefore the Sixteenth Amendment does not authorize its taxation. The argument is, at first, surprising. A large sum of money comes into the plaintiff's hands. . . . It is income to spend, to live on, to save. Is it not also income to tax, if Congress sees fit, as it has, to tax it? . . . In everyday usage the plaintiff, receiving large sums of money currently from a man who ceased to be her husband more than twenty years ago, would be regarded as having an income.
similar amounts paid to a former housekeeper or babysitter would be taxable in the hands of the recipient and it might be suggested that an ex-spouse or partner receiving support payments offered similar consideration in return for a right to support. Marriages and family relationships are not formed by contract, however, and one could view support payments as a form of income from services only by ignoring the innumerable intangible, emotive aspects of those relationships that give rise to support obligations.

But if support payments are not paid pursuant to an express or implied contract, neither are they purely gratuitous receipts like gifts. If they were not court ordered or made in satisfaction of an obligation that could be legally enforced in the absence of an agreement between the parties, the incidence of income transfers between often antagonistic and usually adverse parties would be slight.

Nevertheless, in many respects support payments are analogous to gifts. The most important similarity between the two types of transfers is the fact that in both cases the amounts are used only once, by the recipient, for actual physical consumption. Gifts are income for both the transferor and recipient and ideally should enter the tax base of both parties despite the fact they are only "used" once. Gifts are not considered taxable income in Canada, however, and the exclusion gives rise to a problem of horizontal equity.

As Bittker correctly points out, "Support is a next door neighbour of gifts and bequests; if wives and children are not taxed on the support they receive from [husbands/ fathers] in their taxable income, some mighty fine distinctions will have to be drawn." Bittker, supra note 26, at 947.

"To prescribe that gifts must be made from the tax-paid income of the donor and that they are income to the donee does not in our opinion involve 'double taxation'. We simply recommend that all income be taxed once to each unit that received it." Supra note 111, at 466.

Simons emphasized the grounds for including gratuitous receipts in income. See Simons, supra note 12, at 56-58, 125-47, 211-12. Professor Andrews claims that Simons later retreated from his assertion that such amounts should be included in the income tax base (Andrews, supra note 7, at 320, n. 25 and 352, n. 73). The reference cited by Professor Andrews in support of his claim is a plea by Simons for the imposition of a more sensible gift tax on donees. Simon's essay, however, did not suggest the gift tax was the ideal way to tax such amounts. Rather, it was a suggestion for a practical way to include gifts in a tax base so that progressive rates could be applied on the basis of the donee's ability to pay rather than the donor's, given the fact that donors paid gift taxes and not donees. Subsequent to his original proposals, Simons admitted that administrative and practical concerns might require some modification of the suggestions and that preferable approaches for dealing with gratuitous receipts might be possible, although he was not aware of any. His suggestion that they be dealt with by a progressive estate and gift tax was offered as an interim proposal for federal tax reform on the basis of its relative simplicity, which made it a proper candidate to stand "first in an agenda for discussion or for action." See Simons, Federal Tax Reform (Chicago: Univ. of Chicago Press, 1950) at 138-39.

Unlike the British income tax law in effect at the time of Canada's first federal income tax act, the Canadian act did not attempt to identify and tax separately income from various sources. Instead tax was levied on "income" generally. The exclusion of gifts from an otherwise apparently broad tax base was no doubt due to the fact that the American precedents on which the Canadian definition section was modeled also excluded gifts. Interestingly, the American Income Tax Act of 1894 did include gifts in income. That act was found to be unconstitutional and the 1913 Act, passed subsequent to a constitutional amendment, did not include gratuitous receipts in the income tax base. While the American law continues to specify that gifts are non-taxable (see §102 of the Internal Revenue Code), there is no longer a specific exclusion of gifts in the Canadian Act, although the influence of practice and precedent guarantees that such amounts will continue to be exempt from taxation.
person will be taxed on earned income and income from capital while a second
person with the same net income who neither owns capital nor worked for the
payment will claim it is a gift and pay no tax on the amount. In a number of
ways it seems logical to treat support recipients similarly to those persons
whose income is received in the form of gifts. In both cases the transferred
amount is only used once for actual physical consumption of goods or ser-
vices. In both cases the transferor exchanged services or the use of capital in
return for the initial receipt, although it may be difficult to discern any direct
services provided by the ultimate recipient to the transferor in return for the
payment. 183

These considerations might be offset, however, by the fact that in many
other ways support payments are dissimilar from gifts and resemble more
closely receipts that are presently taxable. Unlike most gifts, support payments
are made at regular intervals by a payor who has little option whether or not to
transfer the amounts. Any attempt to arrive at the appropriate treatment by
analogy to other taxable or tax-free receipts is clearly impossible given the in-
consistent treatment of these other amounts. Achieving horizontal equity with
either taxable or non-taxable income will produce an inequity with the one not
chosen as the appropriate model for support payments. A principled solution
is not possible in an income tax system that draws a dividing line between tax-
able and tax-free income without a rational basis for the distinction.

b) Neutrality

If the present inconsistencies in our income tax base preclude a solution to
the support payment question that will satisfy the concerns of horizontal equity,
the treatment chosen should at least seek to achieve the goals of an income tax
system that can be attained. Given our choice of an individual tax unit and a
tax system that in most respects, though not entirely, treats married and un-
married taxpayers similarly, the tax treatment of support payments should
maintain the tax system's neutrality vis-à-vis family relations. In other words,
support payments should receive like treatment whether made within a
household composed of separate tax units or outside an ongoing family. In-
come transfers within one tax unit should give rise to no tax consequences and
the exclusion of support payments from taxable income is a logical conse-
quence of the adoption of the family as the taxable unit. 184 But in a system that
taxes individuals, the transferred income should be taxable in the hands of the
recipient regardless of his or her family or household living arrangements. If
income transfers are not taxed in the hands of the recipient where he or she
lives with the donor in a family-like relationship, a violation of a pure com-
prehensive tax based ideal, tax liabilities should not change dramatically when
similar payments are made following the dissolution of the relationship.

183 On the other hand, in the case of spouses it may be easy to identify the services
which appear to be provided to the supporting spouse by the spouse who stays at home.
A new difficulty arises in this case, however, namely separating the exchanged services
from self-performed household services presently exempt from taxation.

184 "Under [the family unit] concept, transfers of wealth within a family unit would
not be subject to tax, just as a transfer of cash from one pocket to another is outside the
scope of the present system. Only transfers of wealth between tax units would have tax
consequences." Supra note 111, at 467.
To arrive at a principled treatment of support payments received by a separated spouse, we have to begin with the appropriate treatment of such transfers in an ongoing family. The easiest case for non-taxation of support is found in the two-earner household. In such a case it is no doubt true that there will be an intermingling of assets and purchases as well as consumption of the fruits of each other's labours. One feels comfortable ignoring the transfers back and forth for tax purposes, however, because the transfers most likely offset one another and the extent to which they do not can be treated as de minimus. A more difficult case is that of a one-earner household. If the earner hired a housekeeper to cook, clean and care for her children, we would have no hesitation in taxing the housekeeper on the payments he or she received in return for such services. What happens when the taxpayer marries the housekeeper who continues to perform the same services and receives what is now considered support (either in cash or in-kind as rent, food and vacations)? Under an individual tax unit system the earner should be taxed on the income as it is originally earned and once it is transferred in cash or kind to the earner's spouse it should be taxed again in the hands of the spouse who is a separate tax unit and who actually consumes with it. Such support would be virtually impossible to quantify in most cases. Many of the services performed by the non-working spouse remaining in the home might be viewed as self-performed services. To avoid problems of administrative complexity and difficulty of valuation we make no attempt to tax persons on the value of self-performed services when they are single; there is no reason why a married or cohabiting person should be treated differently. It would be impossible to separate the portion of the services performed by the non-working spouse that was for his or her benefit from that which was for the benefit of the spouse earning an outside income. For these reasons, no attempt is made to tax the non-working spouse on the value of support enjoyed by him or her.

It thus becomes much more problematic to consider taxing the recipient of support who is not living in the same household as the provider when the recipient living with the supporter is exempt from such tax if neutrality requires both to be treated similarly. There are three possible responses to the problem. First, we might seek some way to tax the non-working spouse living with the provider on the value of support he or she receives. Second, we might acknowledge the difficulties that would be encountered in taxing persons in these particular circumstances but resolve to tax according to our principles where the problems that prevented taxing the recipient spouse in the payor's household do not exist. Finally, we might concede that impossibility of taxing the recipient spouse living with the supporter and treat the recipient living in a separate household similarly. If it were practical, the first solution would be preferable. Adopting either of the other solutions would mean choosing between competing priorities.

The problems that would be encountered in taxing a non-working spouse living with a person supporting him or her have already been outlined. While taxing the support recipient directly is not feasible, it might be possible to achieve the same ends through the use of a surrogate. We could, for example, tax the transferor more heavily than would be the case if he or she were single and paying the person providing him or her with housekeeping or childrearing services so that the latter person would also be paying taxes on the transferred payments. The effect would be the equivalent of a withholding tax that would act as a proxy for actual taxation of the non-earning spouse. To some extent
the Canadian income tax system does this. For example, an individual with a child can deduct up to $4,000 from his or her income if the amount was paid on account of child care expenses.\textsuperscript{185} If such services are performed by the taxpayer’s spouse no deduction is allowed. Since the deduction saves a taxpayer a tax liability at his or her marginal rates, the extra tax paid by the taxpayer, who is unable to utilize the deduction because his or her spouse cares for the children, might be viewed as a proxy tax on the income of the spouse performing those services.\textsuperscript{186}

In the long run one would have to admit that the few provisions that might be seen as acting as surrogate taxes on the support in cash or kind received by a supported spouse cohabiting with his or her partner are grossly inadequate for accomplishing the end attributed to them and for which they were never designed. Furthermore, they are likely to be more than offset by other provisions extending tax preferences to married persons.\textsuperscript{187}

If our priority was to achieve a comprehensive tax base wherever possible, we might regret our inability to tax the non-working cohabiting spouse but resolve to tax support where it is technically feasible, that is, where the spouses are living apart. However, broadening the tax base is only fair where all taxpayers in receipt of the type of income that is to be included in the broader base are treated similarly. Just as it would not be acceptable to tax capital gains at full rates for separated persons and at preferential rates for those who are cohabiting, to include support in the recipient’s taxable income only where the recipient lives separately from the payor would result in a great inequity and a flagrant violation of the tax system’s neutrality towards family living situations. Broadening the tax base should only be attempted where it will be applied consistently. Ideally, support payments should be taxed in the hands of all recipients living with or separate from the supporters. In the absence of such a tax on intra-family transfers, none should be imposed on amounts paid pursuant to a support obligation that persists after the dissolution of the family.\textsuperscript{188}

\textsuperscript{185} Section 63 of the Act.

\textsuperscript{186} An alternative approach might be to argue that the ideal tax base would ignore child care expenses and the deduction is not intended to create a proxy tax for those unable to utilize it, but rather is designed to equalize the treatment of those who work to pay for child care services and those who provide their own child services and thereby realize imputed income that is not taxed.

\textsuperscript{187} For example, married persons are able to transfer a number of unused deductions such as the investment income deduction, full-time student deduction, over 65 years old deduction, blind or confined to a bed or wheelchair deduction and pension income deduction (s. 110.3). In addition, spouses may split income by making contributions to a non-working spouse’s RRSP (s. 146 (5.1)) and the deemed disposition rules can be avoided for property transfers at death to spouses (s. 70(6)).

\textsuperscript{188} Randolph Paul, the Treasury tax advisor who in 1942 introduced to Congress the Treasury proposals for altering the taxation of support, had written earlier that it made sense to tax support received by a separated spouse even if that received by a person cohabiting with the payor was not taxed because in the former case the recipient “is free to spend for any purpose she desires” and thus should not enjoy the same immunity from tax offered the latter recipient. Once again, this analysis is not consistent with a tax system that adopts the individual as a separate tax unit. See Paul, \textit{Studies in Federal Taxation} (3d series Cambridge: Harvard Univ. Press, 1940) at 245, n. 310.

1. Purposes of a Support Payments Tax Expenditure

If support represents a consumption outlay of the payor that would not be deductible in a normative tax system, the transfer of tax liability on the payments is a tax expenditure. Unlike a deduction such as that for charitable donations, the transferred amount does not escape the tax system; it is taxed in the recipient's hands instead of the payor's. The difference in marginal rates between the two parties is the measure of the government subsidy for that particular transfer.

To justify this deviation from a normative tax system two requirements should be satisfied. First, it must be shown that there is a need for government intervention to help finance this income transfer arrangement. Second, it should be demonstrated that the income tax system is an appropriate mechanism for achieving those objectives. The effect of the tax transfer provisions is to make available extra funds for families maintaining two households. The purpose of the provisions was clearly not to encourage divorce or separation. One could, however, hypothesize a number of beneficial social and economic effects resulting from the extra income made

189 Curiously enough, the Canadian government's tax expenditure account suggests that the transfer of support payments for tax purposes gives rise to a tax expenditure only where support payments are made pursuant to a written agreement, and not where they arise from a court order. Support agreements are simply out-of-court settlements that recognize the same support obligation that is incorporated into judicial decrees in other cases where the parties are unwilling or unable to agree on the extent of the obligation. The nature of the payments and their tax treatment should not vary whether they are made pursuant to a court order or to an enforceable contract that recognizes the support obligation a court would impose were the matter litigated. See Can., Dept. of Finance, Government of Canada Tax Expenditure Account (Ottawa, 1979) at 79. Professor Neil Brooks includes the entire deduction in his tax expenditure account. He claims "most people" would agree with his categorization. See Brooks, The Tax Expenditure Concept (1979), 1 Can. Tax. 31 at 34.

190 While taxpayers will often go to great lengths to lower their tax burden, including divorce in some cases (see, e.g., Boyter v. C.I.R. Service, 74 T.C. 989 (1980), aff'd and remanded 668 F. 2d 1382 (4th Cir. 1981) ), the requirements in the transfer provisions for support payments make the income-splitting available only to those whose relationship has ended (that is, who are living apart). It is highly improbable that the tax benefits would cause a relationship to end. It has nevertheless been asserted that the provisions act as tax subsidies for divorce or separation. See, e.g., Baird, Canada's Human Scrapheap (1957), 5 Can. Tax J. 106 at 108-109. The American provisions have been similarly described in Johnson, The Alimony Tax Sections Need Overhauling (1950), 28 Taxes 917 at 921: "The government sharing of costs in underwriting, for example, a grower of grain or fruits or potatoes is a subsidy, and there is no less than a subsidy for divorce with large support consequences and to the prejudice of marriage in the current tax treatment." Johnson argued, at 928, that the discrimination against married persons created by the alimony deduction could have been eliminated by permitting married persons a support deduction. As applied to the American tax law, his article was two years out of date since split incomes, introduced in 1948, eliminated the advantage enjoyed by divorced persons prior to that time.

The Australian government considered adopting provisions similar to the American changes in 1942 and rejected the idea because it felt "that a taxpayer who was separated or divorced from his wife would have been placed in a more advantageous position than a taxpayer who was not." Aust., Taxation Review Committee, Full Report (Asprey Report) (Canberra: Aust. Government Publishing Service, 1974) at 138.
available in these cases.¹⁹¹ The lower tax burden, for example, might lower the rate of default by those making support payments.¹⁹² It might make it more feasible for support payors to remarry or undertake new family responsibilities.¹⁹³ Finally, it might be designed to recognize the decreased ability of the total income to bear the tax burden as a result of the increased costs of maintaining two households on an income that formerly supported one.¹⁹⁴ A normative tax system does not recognize every decrease in ability to pay as the result of income transfers not involving actual consumption of goods or services by the transferor. It was conceded, however, that support payments present a difficult case close to the margin. Unlike most income assignments, they involve the payor forfeiting economic control over a portion of his or her income for an indefinite period to a person no longer within the family. The case for government intervention in this situation has yet to be established. However, if the state is furthering legitimate social goals by subsidizing these transfer payments, it seems appropriate that the subsidy should be designed to have its maximum impact in those cases where aid is needed most.¹⁹⁵

2. Choosing the Payments Eligible for the Tax Expenditure

The present support payments provisions are quite narrow in their application. The legislature has singled out only a small sub-set of the potential transfers between spouses or ex-spouses as qualifying for the provision. Two

¹⁹¹ One reason that must be rejected is that which motivated the original transfer provisions: "The husband’s compelling need for tax relief obscures the fundamental issue of who ought to be taxable on the portion of the husband’s income which the wife consumes." Steines, A Reappraisal of the Taxation of Wealth Transfers Incident to Divorce (1981), 56 Wash. L. Rev. 217 at 246, n. 128. In 1942 it was quite possible that some taxpayers making fixed alimony payments out of their after-tax income found that rising tax rates had left them with little or no income at all for their personal use. It would not be possible for taxes and alimony to exceed the total income of the taxpayer if the alimony obligation were negotiated in light of the tax changes. This could only occur if the payments were based on an after-tax income that changed subsequent to the fixing of the obligation as tax rates changed. Temporary relief might be necessary under those circumstances, but in an era of relative stability in tax rates, the provisions are no longer needed to help those who had calculated their obligations on the assumption of a particular tax burden only to find that their tax liability had unexpectedly increased.

¹⁹² "The availability of a tax deduction may encourage payment of support obligations as the cost factor of an individual paying a deductible expense is decreased relative to other forms of debt." Dawe, Section 60(b) of the Income Tax Act: An Analysis and Some Proposals for Reform (1979), 5 Queen’s L. J. 153 at 162. Baird, supra note 190, claimed it was impossible for some taxpayers to afford support payments without a deduction. See also Bence in Debates, July 17, 1942, at 4360.


¹⁹⁴ Or, as one commentator described it, a "sharing" of support costs by the government. Rich, Recent Cases and Trends Involving the Alimony Deduction (1948), 6 N.Y.U. Inst. Fed. Tax. 1088 at 1090.

¹⁹⁵ It may be possible to design a programme involving government intervention to further these ends without resorting to the traditional solution of periodic support payments. For example, a study paper produced for the Law Reform Commission of Canada suggested that the government could establish a system of government-insured loans for lump sum settlements of support obligations to solve the existing problems of inability to pay and enforce support orders and agreements. See Ryan, Enforcement of Maintenance Obligations (Ottawa: Information Canada for Law Reform Commission of Canada, 1976) at 42-43.
restrictions imposed on payments eligible for the deduction and consequent inclusion in the recipient's income are especially important: first, the payment must appear to be of a compulsory nature, equally binding on both parties and second, the use of the transferred income must be entirely within the discretion of the recipient. But while both restrictions might serve to delineate the type of transfers appropriate for government attention and aid, they do not alter the basic nature of the payments nor change the fact that the government intervention is essentially a subsidy programme.

a) Compulsory Nature of the Payments

In its original form the Canadian provision permitting a deduction of support payments appeared more liberal than the United States provision on which it was modeled. The Canadian provision permitted a deduction for payments made pursuant to a court order or a separation agreement. In the United States, Congressional leaders feared that allowing a deduction for payments that were not ordered by a court would open the door to income splitting through the use of contracts that were not bona fide separation agreements. Accordingly, they drafted their provision so that only payments satisfying an obligation imposed by a court could be deducted. After the 1948 changes to the Internal Revenue Code that permitted spouses living together to split income, the fear that agreements would be used as tax avoidance devices vanished and the provision was altered in the 1954 Code to also permit deductions for payments made pursuant to agreements between the parties.

The courts have interpreted the Canadian provisions rather narrowly. The only agreements that are recognized for the purposes of the deduction provision are those that have been accepted by both parties and can be construed as a settlement in lieu of a court determination. Thus, tax courts have held that agreements must be acknowledged by both sides and payments made pursuant to an unacknowledged letter or to correspondence between the parties' lawyers acting as their agents have been held to be outside the scope of the deduction provision.

b) Allowance Nature of the Payments

In a different respect the Canadian deduction provision was, and remains, much stricter in application than its American counterpart. To qualify for a deduction, the payment must be made in the form of an allowance, which has been defined as an amount determined in advance which, once paid, "is at the

196 The provision was later amended to include "written agreements" and not just "separation agreements" so that marriage contracts and similar arrangements would be given the same effect. Supra note 109.

197 G.C.M. 25250, 1947-2 C.B. 32 (1947) suggested, "Such limitations on alimony deductions was [sic] probably due to the apprehension that unless the payments were part of or incident to some publicly recorded action of a court, separation agreements might be used for tax avoidance."


complete disposition of the recipient who is not required to account for it." 201

Relying on the allowance requirement, the Canadian courts declined to follow American precedent which permitted taxpayers to deduct amounts paid to third parties with the agreement of the other spouse. American courts treated these payments as income assignments by the recipient spouse, that is, they were treated as though the income was constructively received in the recipient's hands. 202 A provision was added to the Canadian Act in 1974 to specifically authorize taxpayers to deduct payments made to third parties. 203 However, Revenue Canada has adopted the position that the new section does not enlarge the scope of the deduction provision but merely deems the beneficiary spouse to have received amounts paid to third parties. Thus, the Minister has insisted that to qualify for the deduction payments must continue to be in the form of an allowance, meaning that the recipient can "at any time change [the] arrangement and require the [payments be made] directly to her to do with as she wishes." 204 Taxpayers argued that the new provision authorizing payments to third parties did not act only as a deeming provision but in fact enlarged the scope of the deduction to cover payments that fail to meet the "allowance" definition utilized by the Department of Revenue. Following a number of decisions in taxpayers' favour on this point, 205 the section was amended in 1981206 through the addition of a qualifying phrase designed to limit its operation by stipulating that the new provision applied to payments that would otherwise qualify for the deduction were they made directly to the recipient, which presumably imposes the allowance requirement on these payments. It appears that the courts will continue to apply this restriction to allowable deductions. 207

Support payments made within a family can be deducted from a taxpayer's income, to a maximum of $1,400. Certain support payments to spouses or ex-spouses living apart from the payor are presently entitled to a much more generous tax treatment if they meet the requirements set out above as to the compulsory nature of the payment and the lack of control over the use of the money by the payor. It is important to realize that, although these restrictions are useful in determining the type of payments entitled to special treatment, they do not in themselves change the character of the payments.

202 See Note (1966), 66 Col. L. Rev. 1118 at 1120.
203 S.C. 1974-75-76, c. 26, s. 31.
204 IT-1118R, par. 15.
205 The leading decision on the point to work its way through the courts is The Queen v. Bryce, [1978] C.T.C. 3144, 78 D.T.C. 1833. The Tax Review Board allowed the taxpayer to deduct one half of mortgage, property tax and utility payments made directly to appropriate parties when they arose from a jointly owned matrimonial home and the payments were authorized by the decree nisi. That holding was followed in a number of subsequent Tax Review Board decisions.
206 S.C. 1980-81, c. 48, s. 30.
207 The Federal Court — Trial Division affirmed the Bryce decision, supra note 205 ([1980] C.T.C. 401). The Federal Court of Appeal, hearing the case subsequent to the amendment, reversed the court below and held that the payments must meet the allowance requirement to be deductible, and that the amounts in question were not of an allowance nature ([1982] C.T.C. 132). The taxpayer is appealing that decision to the Supreme Court of Canada.
A number of American writers have suggested the effect of the provisions, which permit taxpayers to deduct amounts paid as alimony from income and which subsequently include the same amounts in the recipients' taxable income, is to treat the transferred part of the payor's income as though it were earned directly by the recipient, so that the person who is given ultimate control over the use of the income is considered the owner of that money for tax purposes, while the payor acts as a mere conduit.\textsuperscript{208} Under this analysis, the deduction is not a tax expenditure but rather a tool for determining the appropriate taxpayer. The conduit interpretation can only be valid, if at all, when the transferred income is paid from one taxpayer to another in the same tax unit,\textsuperscript{209} a point not realized by some commentators. For example, Professor Boris Bittker strongly criticized American advocates of a comprehensive tax base for their failure to classify the alimony deduction and consequent inclusion in the recipient's income as a deviation from a normative tax base, in light of the fact that other support payments within an existing family were not treated similarly.\textsuperscript{210} Professor Bittker was wrong. At the time he wrote, the United States tax system did permit married taxpayers to deduct support via the income splitting schedule for married persons. Since 1969, the ability to split income has been decreased slightly, but it still exists.\textsuperscript{211} It could be argued that the alimony deduction is not a deviation from the normative tax base at all, once a marital tax unit is chosen — support payments before and after family dissolution are treated in a similar fashion. After family dissolution there are two separate tax units for most purposes; for the purpose of support payments flowing from the marital obligation, however, there remains one in the United States income tax system.

In a system that treats each person, whether married or not, as a separate tax unit, the lack of control by the payor over support payments subsequent to the transfer is not sufficient to reduce his or her status to that of a conduit. At the same time, if a deviation is to be made from some purpose extraneous to the tax system, these characteristics of transfers made pursuant to compulsion that afford the transferor no further control over the disposition of the funds are appropriate for flagging the payments eligible to receive preferential treatment. Any proposals for reform of this tax expenditure can begin with similar restrictions on the type of payments eligible for the programme.

\textsuperscript{208} Vickrey makes an analogy to trust payments, \textit{supra} note 128, at 302. See also Magill, \textit{Taxable Income} (rev. ed. New York: Ronald Press, 1945) at 275 where he suggests the tax treatment of support payments brings "the concept of income in the alimony field back into accord with a fundamental principle that 'the legal concept of ownership of income and the economic realities of enjoyment or fruition' should correspond." See also Davies, \textit{The Taxation of Alimony: Policies, Problems and a Proposal} (1977), 31 Univ. Miami L. Rev. 1355 at 1406: "The legislature's reason seems to be premised on the belief that a portion of the husband's income is really the wife's income, . . . The question [is] whether the wife could stand in the husband's shoes and thus derive 'income' from the same sources as the husband could have done."

\textsuperscript{209} If income passes from one tax unit to a separate tax unit, it affords both units economic command. Failure to exercise the potential command by the first unit does not alter its character as a taxable quality.

\textsuperscript{210} Bittker, \textit{supra} note 26, at 946-47, 974-76.

\textsuperscript{211} Bittker continued his criticism following the changes. See Bittker, \textit{Income Tax Deductions, Credits, and Subsidies for Personal Expenditures} (1973), 16 J. Law & Econ. 193 at 202, 210-11.
3. The Income Tax System as a Vehicle for Distributing the Subsidy

The income tax system would appear to be an ideal vehicle for distributing government aid to persons making and receiving support payments if the provisions were structured to ensure that the benefits could be targeted to those who need them. Because the benefits act as income supplements in those situations where two households are living off the income of one earner, it seems logical that benefit levels could be determined at the same time the total income available to the parties and its relative distribution is calculated. Before a tax provision to distribute the benefits can be endorsed, however, it should first be demonstrated that the benefits are being appropriately distributed between the parties in any one case and, second, that they are equitably distributed between taxpayers in different income brackets and between taxpayers transferring different percentages of the total available income.

Papers on the income tax consequences of divorce and separation are routinely presented at family law conferences and appear in family law journals, texts, case reports and looseleaf reporter services. It is not unreasonable to assume that most family law lawyers have an understanding of the fundamental tax consequences of family dissolution. If judicial action is commenced before a settlement is reached, the parties can obtain particulars of the property, income and expenses of the other party, as well as a copy of their income tax return for the previous year. It would be irresponsible for any lawyer to ignore the tax effects of a proposed settlement. However, no studies have determined the extent to which the extra after-tax income available for splitting between the spouses once they have ceased to cohabit benefits the payor or recipient. Most commentators claim the extra benefit is distributed during the settlement negotiations, although some believe it often flows only to the payor. In addition to the information on the tax consequences of divorce and separation generally available to family law practitioners, papers on the subject are presented at judicial conferences on family
Family Dissolution in Tax


221 See, e.g., Wittke v. Wittke (1974), 16 R.F.L. 349 at 363 (Sask. Q.B.): The Income Tax Act, [citations omitted], allows [the husband] in computing his income tax to deduct all maintenance payments. . . . On the other hand, such periodic payments [for the wife and children] must be included by the [wife] in computing her income, and to the extent that such exceeds the statutory exemptions such become taxable income in her hands. . . . [The court then calculated the respective tax liabilities flowing from the proposed support order]. . . . When Parliament direct the Court by said s. 11 [of the Divorce Act, R.S.C. 1970, c.D-8] to provide reasonable maintenance for spouses and infants, Parliament was aware of the provisions of the then existing Income Tax Act. . . . It seems to me to logically follow that the incidence of tax is it affects both the payer and recipient of maintenance payments made under court orders is a matter to be considered along with other relevant matters when determining the amount necessary to be paid to make sure that the dependent will receive what is reasonable maintenance in all the circumstances of the case for such dependant.

See also Sharpe v. Sharpe (1971), 4 R.F.L. 241 (Nfld. S.C.) where the court considered the tax advantage of paying maintenance when assessing quantum; Sheppard, supra note 217, at 294: "In deciding the amount of alimony or maintenance where the matter is in issue, courts will bear in mind the tax consequences to the parties." Sheppard provides a number of examples at 307, n. 10.

The matrimonial property laws of Alberta, New Brunswick, Nova Scotia and Saskatchewan specify that the tax consequences of any property division must be taken into account when making a distribution of property. See, e.g., Millhaem v. Millhaem (1981), 16 A.L.R. (2d) 355, 24 R.F.L. (2d) 44 (Alta. Q.B.). The significance of tax consequences are similarly considered in provinces without specific statutory direction. For example, in Silverstein, supra note 157, at 204, counsel for the wife suggested that she would trade the interest in rental properties that the court had awarded her in exchange for her husband’s interest in the family home. Galligan J. refused the request saying it would not be “equitable to deprive one spouse of his share in one of the few assets which do not attract capital gains tax, the matrimonial home.” The tax implications were central to his award and he noted, “If a spouse is to share in a non-family asset [interest in rental property awarded the wife] . . . such spouse should also share the burdens that go with the asset [capital cost recapture].”

222 See, e.g., Schultz, supra note 161, appendix.
pay of the taxpayer who has lost economic control over the part of his or her income transferred as support, the taxpayer in the highest marginal bracket still merits a subsidy when compared to another taxpayer in the same bracket without a support obligation. At the same time, the relief should only be a partial compensation for the transfer, given the consumption nature of the expenditure. The difficulties in achieving these aims through tax provisions can be demonstrated by first examining the effects of distributing benefits via the tax system through a number of alternate techniques. This exercise will establish the parameters of a preferable provision.

An unlimited deduction for the transferor is not suitable for two reasons. It is true that this approach does achieve a measure of horizontal equity by treating the taxpayer who has lost economic control over amounts paid as support preferentially to taxpayers at the same income level without that obligation. The relief offered will overcompensate the support payor relative to those who have lost economic control over income for other reasons, however, because the support obligation is a consumption expense of the payor from an income theory perspective and total tax relief on the transfer is therefore inappropriate. Furthermore, the deduction for support payments will fail to achieve vertical equity when the subsidy nature of the provision is considered. It makes little sense for the support payor with a $100,000 income who transfers four percent of his or her income or $4,000 to a spouse to receive a larger subsidy than the taxpayer with $10,000 who transfers fifty percent or $5,000. And yet the upside-down effect of subsidies offered through the deduction from taxable income mechanism would accomplish just that.

A provision permitting a full deduction of transfer payments up to a fixed percentage of total income limit is now used in the United States and Canada for charitable donations. While such a provision would prevent the highest bracket taxpayers from receiving too great a subsidy, it achieves neither horizontal nor vertical equity. The upside-down effect is compounded by the fact that the taxpayer in the lower brackets faces the same percentage limit as those in the highest. And because the limit will be set at an arbitrary point, it will simply shift the problem of horizontal inequity from a line drawn between those who pay support and those who do not in a tax system with no deduction permitted, to a new line drawn between those who pay less than the limit as support and those who pay more in a system where a limited deduction is possible.

As mentioned earlier, provisions designed to partially transfer tax liability from the support payor to the recipient by giving the payor a tax credit for the amount of tax paid by the recipient on the support payment were utilized from 1942 until 1944 in Canada. Such a scheme does provide some relief for some transferors but none is provided in those cases in which it is most needed, that is, where the transferor and recipient have low incomes and the recipient pays no taxes or pays a minimum tax. These provisions also fail to provide any real government subsidy because the tax burden on the pre-transfer total income is not changed but is merely divided unevenly between the parties.

Where the government wants to subsidize a specific type of expenditure by a taxpayer, a subsidy in the form of a tax credit can provide direct relief while still affording the government an acceptable degree of control over its expenditures and eliminating the upside-down effect of deductions. This is ac-
complished by carefully drafting restrictions on the type of expenditures for which credit will be given and then imposing a limit on the credit to control the amount of the subsidy to any particular taxpayer. A refundable credit extends the subsidy to persons who pay no taxes, if they file returns. If a tax credit were used to direct the government subsidy for income transfers in the form of support payments, a limit would not be feasible because the government would not be able to set a reasonable maximum amount and any arbitrary cut-off point would unfairly discriminate against some taxpayers.

Unlike a deduction, a credit does not refund a greater portion of each dollar of subsidized expenditures of higher bracket taxpayers than of lower bracket taxpayers. However, a credit equally available to all taxpayers would be undesirable in light of the consumption element of support payments. It does not make sense to subsidize the wealthiest taxpayers to the same extent as the poorest because this consumption imposes less of a burden as income increases.

Any solution to the problems outlined above must satisfy two requirements: 1) it should recognize the consumption element of support payments and provide a lower subsidy per dollar transferred for higher income taxpayers; and 2) it should acknowledge that one of the goals of the subsidy programme is to recognize, in part, a taxpayer's loss of economic power over amounts paid as support so that the taxpayer who transfers a higher proportion of his or her income than another taxpayer in the same income bracket will receive a greater subsidy (but still less on a per dollar basis than the poorer taxpayer). These goals could be accomplished through the use of an appropriate disappearing credit or disappearing deduction mechanism. Because of the popular perception of a credit as a subsidy and the probable public resistance to a subsidy for divorce or separation, a deduction is a more viable alternative politically, especially if framed as a modification of the present provisions.

A number of alternative models are possible. The one presented here is designed to achieve the two goals described above while using the taxpayer's portion of his or her income paid as support as a yardstick for measuring the burden of a transfer.\(^\text{223}\) To calculate the modified deduction, the taxpayer

\(^{223}\) The ratio of support payments to total taxable income is only a rough measurement of the relative burden on a taxpayer of any given transfer and may be more or less inaccurate in specific cases. For example, a taxpayer with $10,000 worth of taxable capital gains has $20,000 of income available from which support payments could be made. While capital gains may be taxed in the hands of the recipient at a preferential rate for any number of reasons, it has the same economic power as fully-taxed earned income. The formula used to tax these amounts preferentially excludes a portion of the capital gains from taxable income. This distorts the ability-to-pay calculation used to determine the proposed support payment deduction because the real income available for making support payments is not taken into account. It may be desirable, therefore, to require a gross-up of these amounts for the purpose of calculating the support payment deduction.

An interesting look at the reverse side of this coin is to be found in Lewis and Maxwell, *Capital Gain as Basis for Alimony and Non-Support Awards* (1954), 16 U. Pitt. L. Rev. 1 where the authors claimed the alimony formula contained in the Pennsylvania divorce law in effect at that time was based on a definition of income that was much narrower than that used for federal income tax purposes. Thus they argued that capital gains were not "income" available for support payments under Pennsylvania law.
would subtract from taxable income the fraction of the support equal to the portion of taxable income that is transferred as support. For example, a taxpayer earning $10,000 a year and paying $5,000 in support payments could deduct fifty percent of the payment, or $2,500, from income while the same taxpayer paying $1,000 in support payments could deduct ten percent of the payment, or $100. To increase the subsidy the deduction fraction can be altered by any amount while retaining its proportional effect. For example, the deduction could be two times the fraction, or 100 percent and twenty percent respectively in the above examples. In the table below the proposed deduction has been labelled a "modified deduction," and the more generous proposed deduction (calculated as two times the ratio of support payments to available income) an "enriched modified deduction."

**TABLE 1**

<table>
<thead>
<tr>
<th>Earner's Taxable Income</th>
<th>10,000</th>
<th>10,000</th>
<th>30,000</th>
<th>30,000</th>
<th>30,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Support Payment</td>
<td>5,000</td>
<td>1,000</td>
<td>15,000</td>
<td>5,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Support as a % of Taxable Income</td>
<td>50%</td>
<td>10%</td>
<td>50%</td>
<td>16%</td>
<td>3%</td>
</tr>
<tr>
<td>Tax Subsidy from Present Deduction</td>
<td>931</td>
<td>190</td>
<td>1,918</td>
<td>1,248</td>
<td>248</td>
</tr>
<tr>
<td>Tax Subsidy from Modified Deduction</td>
<td>475</td>
<td>10</td>
<td>340</td>
<td>198</td>
<td>8</td>
</tr>
<tr>
<td>Tax Subsidy from Enriched Modified Deduction</td>
<td>931</td>
<td>38</td>
<td>1,918</td>
<td>398</td>
<td>13</td>
</tr>
</tbody>
</table>

224 Calculations are based on tax rates applicable to the 1982 tax year. The figures refer to federal income taxes only. The tax subsidy is calculated as the difference between tax liability were no deduction allowed the payor and the support payments not taxed in the hands of the recipient, and the combined tax liabilities of the payor and recipient if the payor is allowed a full or modified deduction for any support paid and the support amounts were treated as taxable income to the recipient. When calculating the tax subsidy for the modified and enriched modified deductions, it is assumed that the entire support payment (less those deductions described below) will be taxable to the recipient even where the payor may be allowed a partial deduction only. For the purpose of calculating the payor's tax liability were no deduction permitted, taxable income is assumed to be the amount left after deductions, excluding support payments but including the deduction for a dependent spouse. In calculating the payor's tax liability, if a deduction for support payments were permitted, the support deduction would be lowered by the lost spousal deduction. For the purpose of calculating the tax liability of the recipient, a standard medical/charitable deduction and a standard personal exemption has been deducted from the receipt. The modified deduction is calculated as follows for the five examples, from left to right: first taxpayer — fifty percent of the support payment; second taxpayer — ten percent of the support payment; third taxpayer — fifty percent of the support payment; fourth taxpayer — sixteen percent of
The effects of the modified support payments deduction can be illustrated by comparing the subsidies provided under the present scheme to those under the proposed formula. An enriched version of the modified deduction shows the effects of the formula when it is adjusted to preserve the present level of subsidy for families splitting available income. The problems with the present subsidy are readily apparent. The total government subsidy for the income transfer in the family where the earner making $10,000 gives away $5,000, or half her income, is $931. The family where the earner makes three times as much, $30,000, but still transfers only $5,000, receives a total subsidy of $1,248 for the same amount transferred. The effects of the subsidy are even more skewed when smaller portions of income are transferred. When the recipient receives only $1,000 from the available income, the government subsidy is $190 for the $10,000 family and $248 for the $30,000 family.

Under the modified deduction, the lower income family transferring the same amount as the higher income family receives a greater subsidy, not a lesser. The enriched modified deduction can be used to maintain the vertical differentiation of the modified deduction (lower brackets receive higher subsidies for the same income transfer) while treating the concern about loss of economic power over the transferred money as more important than that about fairly taxing the consumption element of support payments. If the concern of horizontal equity is primarily to recognize the consumption element of the transfer, the modified deduction is preferable, whereas the enriched modified deduction should be used if the concern over loss of economic power is an important motivation for the subsidy.

5. Achieving Temporal Equity with the Tax Expenditure

Before any changes are made to the existing provisions dealing with support payments, the problem of temporal equity must be addressed. When income tax amendments alter the tax liabilities of persons who have entered into agreements on the basis of existing law, one or both of the parties to the pre-existing agreements will bear an unanticipated burden or enjoy an unexpected relief. On the two previous occasions in which major changes to the tax treatment of support payments were enacted, in 1942 and 1944, no transition measures were implemented to cover persons who had entered into agreements on the basis of prior law. Both the 1942 and 1944 amendments altered the relative positions of payors and recipients who had negotiated in the expectation that the tax treatment accorded support payments prior to the changes would continue. The changes did not have a dramatic effect on persons whose

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support obligation predated the large tax increases of the war period since the amendments often returned them to the after-tax, after-support positions they enjoyed before the war. Persons receiving support payments that had been negotiated or awarded prior to the changes were dramatically affected, however, and suddenly found the amounts they had received as after-tax income were subject to high war-time tax rates.\footnote{226}{If the effect of the deduction were too generous and the payor ended up in almost the same position he was in prior to the war, the provisions would have been quite unfair. High war time taxes were designed to reduce personal consumption and divert resources to the government to devote to war purposes. Ideally the reduction in consumption should have been distributed between the payor and recipient. See supra, note 105.}

In the case of tax measures affecting individuals, temporal equity can be achieved by permitting taxpayers who had organized their affairs in anticipation of the past tax law a transitional period in which they can reorganize in light of the altered law. This is not possible where the provisions affect agreements between two persons where one party might prefer the consequences of the tax changes on the existing agreement. Where support payments are made pursuant to a court order and not private agreement, it is possible to petition the court for a modification of the terms of the order if circumstances change.\footnote{227}{See, e.g., Divorce Act, R.S.C. 1970, c. D-8, s. 11(2) and Family Law Reform Act, R.S.O. 1980, c. 152, s. 21(1).}

However, such a route is complicated and would lead to a bureaucratic nightmare if all persons with existing court ordered obligations sought changes to those orders at the same time, following a change in taxation of support payments.

Any amendment of the taxation of support payments should apply only to obligations commencing after the new provisions come into effect. The changes should be introduced some time before the date on which they will become law so that persons negotiating agreements that would begin after the new provisions are in force could do so with the knowledge of the tax consequences they will face.\footnote{228}{In 1954 Congress expanded and liberalized the American deduction provision. For example, a deduction for payments made pursuant to a separation agreement where there was no court decree was allowed for the first time (see text accompanying notes 197 and 198, supra). At that time Congress was aware of the unfairness which would result if the new law were applied to prior agreements, especially if a recipient had agreed to an amount on the assumption that it would continue to be non-taxable. Accordingly, the new provision applied only to agreements entered into after the change was implemented. See Horne, supra note 125, at 752-53; S. 1622, 83rd Cong., 2nd Sess., at 10-11 (1954).}

IV. CONCLUSION

Income connotes many different concepts in a number of diverse contexts. The preferable way to arrive at an appropriate construction for the purposes of an income tax base is to commence by accepting the desirability of a progressive taxation system. Income must be construed in a manner that will further the aims of a graduated income tax. Only after this is done will it be possible to apply the analysis to a particular situation or provision and determine its appropriate treatment in a normative tax system.
The Haig-Simons definition of income is generally conceded to be a reasonable place to commence an inquiry into the meaning to be accorded that term for the purposes of a benchmark income tax system. This definition states that income comprises two elements: consumption and savings. Controversy revolves around the question of which deductions are appropriate for refining the measurement of income and which are deviations from the normative tax base. This issue is discussed from two distinct perspectives. On one level, commentators disagree as to whether it is reasonable to treat involuntary expenditures in the same fashion as voluntary expenditures in the same fashion as voluntary disbursements. It is generally conceded that the term consumption embraces both these forms of expenditure and the issue is whether all types of consumption should be treated similarly.

A separate question to be resolved is whether consumption is synonymous with appropriation of goods or services, or whether it contains two elements, actual physical consumption and potential consumption, which is understood to mean economic power that could have been used in the marketplace but instead was transferred to another taxpayer.

The choice of definition will turn on the purposes one attributes to a progressive tax system. A narrow view of consumption is appropriate if one views the income tax system as a means for redistributing pieces of the social goods and services pie. At the same time, if one believes that an aim of a progressive income tax is to redistribute economic power, that is, the ability to cut the pie in the first place and then allocate the pieces, one should commence with a definition of income that will include all accretions in economic power, not only the utilization of that power. Of the alternative accretion tax bases available, only income has the potential to accomplish this end and this is the reason we have adopted and retained a progressive income tax system. The quality that a progressive income tax system seeks to tax is accretions in control over economic potential, not utilization of that potential.

If the progressive income tax system is to accomplish its non-fiscal ends, it must reduce the disparities among taxpayers in their ability to exercise control over the distribution of market commodities and services. The control may be utilized to directly appropriate from the market or to affect the distribution of goods and services by permitting someone else to use the power. For this reason the Canadian income tax system measures a taxpayer’s income without taking into account the identity of the person who finally used the economic power it entailed. There is no more reason to relieve a taxpayer of liability for taxes on amounts given away than on amounts saved or exchanged for produce. If one starts with the premise that a person’s marginal tax rates should be based on the economic potential they command and not the application of that potential, it follows that neither purchases intended for the personal consumption of the taxpayer nor transfers to others should be relieved of taxation in the earner’s hands. This is equally true for a one-time transfer of a portion of a taxpayer’s income and an assignment of all that person’s income for an indefinite period.

The development of a continuing support obligation as an incident of certain relationships is a unique phenomenon not directly analogous to other property or contractual or gratuitous income transfers. While it is not easy to identify the underlying nature of the obligation, its appropriate treatment in a
normative income tax system is not difficult to determine. If one applies the comprehensive Haig-Simons income definitions, as established above, it is clear that there are no tax policy grounds for relieving the payor from taxation on the transferred amounts. Because no deduction would be allowed the payor for these transfers under a normative income tax system, the present deduction allowed the payor, along with the subsequent inclusion of these amounts in the recipient’s taxable income, where they will be subject to a lower marginal rate of taxation, operates as a subsidy toward the cost of these income transfers.

It is true that support payments are more difficult to fit into the mold of income over which the payor voluntarily relinquished control than many other income transfers. Furthermore, the government might wish to subsidize those family units that support two households on an income that formerly supported one. Both these concerns can be addressed through the income tax treatment of support payments. However, the appropriate treatment of these transfers cannot be established unless the subsidy nature of the existing provisions and any proposed modification of them is recognized. If the taxation of support is to contain a subsidy, the aid should be distributed in a manner that treats dissolved families with differing amounts of total income available for splitting and dissolved families making different divisions of available income in an equitable fashion relative to each other and to those families which remain intact and ineligible for the subsidy.