CHAPTER 17

GIFTS, INCLUDING INHERITANCES

In this chapter and elsewhere in this Report the term "gift" refers to any gratuitous receipt, whether or not it is a gift in the technical sense, unless the context requires another meaning. It includes a transfer for inadequate consideration to the extent of the inadequacy. It also includes a bequest or device or transmission under intestate succession laws. The term "donee" refers to the recipient of any such gift. "Donor" includes a deceased person who leaves property, and also a person who sells or transfers property for inadequate consideration.

The allocation of taxes according to ability to pay requires the imposition of progressive rates of tax on a tax base that measures the change in the economic power of each individual and family. No one can doubt that gifts increase the economic power of those who receive them, for they either "save the pocket" or provide an asset that can be exchanged for consumer goods and services. We recommend that gifts from one tax unit to another should be brought into the comprehensive tax base of the recipient in the same way as wages, business income, dividends, interest, rents, property gains and windfall gains. As we have stressed, the source of a gain and the expectations and intentions of the recipient of a gain are completely irrelevant. Anything that increases an individual's or a family's capacity to command goods and services should be included in the tax base. However, in order to simplify administration, by reducing the need to value and account for many small gifts, we will propose that there should be certain annual exemptions, as well as a lifetime exemption, for gifts received.

While this chapter is primarily concerned with gifts from the point of view of the recipient, we want to emphasize that the inclusion of gifts in the tax base of the donee would not mean that gifts should be deducted from the tax base of the donor. The only deductions we recommend are expenses which are reasonably related to the earning of income, and certain special types of deductions such as charitable donations within specified limits. Inter vivos gifts are a voluntary exercise of the donor's economic power. They are personal expenditures that should be treated in exactly the same way as personal consumption expenditures. Neither inter vivos gifts nor testamentary gifts are related to the earning of the donor's income. Indeed, as we have said in Chapter 15, a gift from one tax unit to another is a disposition of property and the gain, if any, calculated on the basis of the fair market value, should be brought into the tax base of the donor. In other words, gifts should be made only from tax-paid income.

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. No one thinks that the taxation of a worker's wages and the taxation of a merchant's profit derived from selling goods and services to the worker is "double taxation". The merchant must include the price of the goods or services in his income, while the worker cannot deduct that amount, because it is a personal or living expense. Our approach to gifts is basically the same.

We have taken the position in this Report that consumption and savings should be taxed on the same basis. This means that changes in the taxpayer's capacity to command goods and services for personal use should be taxed, and not only the command actually exercised. On the basis of this test, the donee should be deemed to have received a gift when he has received the right to it rather than when he exercised the right. Any other approach would make it possible to arrange gifts in such a way as to achieve an unwarranted deferment of tax. As we have said, postponed taxes are less onerous taxes and are unfair taxes because the ability to postpone is not available to everyone to the same extent.

The family unit concept that we recommend in Chapter 10 has important implications for the taxation of gifts. The recommendations set forth in this chapter are predicated on the adoption of the family unit concept. Under that 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. By recommending that spouses and their dependants should form a family unit for tax purposes, and by stipulating that it should continue until the death of the last surviving spouse or until all children have lost their dependant status, whichever comes later, the tax system we recommend would probably exempt from tax a large proportion of all gifts. Professor Carl Shoup, in his study of death and gift taxation in the United States, has estimated that well over one half of all transfers are among persons who fall within our definition of the family unit 1/. While comparable data are not available for Canada, we expect that a similar proportion prevails here.

In Chapter 10, we explain why we recommend that transfers between spouses and between parents and dependent children should not have tax consequences. It is our view that the property is accumulated by a family as a result of joint decisions and a common effort of both husband and wife, either in earning or in refraining from spending. Accordingly, it should be possible to transfer property freely and without tax consequences within the family unit. Children should be included in this unit during the period when they are the financial responsibility of the parents and unable to support themselves. In some circumstances the income of children increases the economic power of families; and when this occurs the income of dependants should be aggregated with the income of the family. We believe it would be neither desirable nor feasible to differentiate between the expenses of parents that are legal or social obligations, and expenses that are essentially gifts from parents to their children. For these and for other reasons relating to the need to aggregate family income, we believe that the consumption of dependants should be treated as family consumption; and the money saved by children, unless kept outside the family unit through the deposit system we suggest, should be treated as family saving.

There comes a point in the life of most children when they both want and need independence. They are capable of making their own way. Because this point is difficult to define, we have specified a number of conditions and have provided certain options to accommodate the diverse circumstances that exist. It is our approach that prior to reaching this point in their lives children have no ability to pay taxes except as members of a family unit. But having become independent, they immediately acquire an ability to pay taxes. As in the case of other individuals and families, their ability to pay depends on what property they receive in the form of gifts, on what they earn, and on their own obligations and responsibilities. Accordingly, we propose that when a child leaves a family unit, he, or his new family unit if he has married, should include in income the market value of all property taken from the original unit. This would be subject to the lifetime exemption for gifts to each individual in the amount of $5,000 that we recommend later in this chapter. The smaller annual exemptions which we propose should also apply, and the averaging provisions which we discuss in Chapter 13 should be available with respect to this income.

When a new tax unit is established, its biggest asset will often be the health, strength and knowledge of the new taxpayer; but because we do not propose to tax human capital, this is not taxable to the new tax unit. Apart from the administrative exemptions referred to above, this would be the only net gain of the new tax unit that should not be subject to tax. All of the money and other property brought into the new tax unit should be taxable to that unit as income. This applies to property taken from the child's original family unit on termination of his dependant status and anything subsequently received from the original unit, as well as income subsequently earned by the child or other members of his new unit.

Some children will have greater material advantages than others because their families are more affluent. The proposed system ensures that well-to-do parents who support their children lavishly can do so only by spending income taxed to the family at progressive rates. Some children will receive substantial gifts from their parents either before or after losing their dependant status. The proposed system would not eliminate this advantage; but it would ensure that these gifts were taxed to the newly independent individual at the same rates as other gains.

In summary then, our approach to the taxation of gifts and bequests would have two major effects. First, it would completely remove the tax burden from gifts and bequests flowing from the taxpayer to his spouse and dependent children. Second, our proposals would in general increase the tax burden on other gifts and bequests that exceed the exemption level. Thus, a widow would be free of tax on transfers from a deceased spouse,while large transfers between generations would usually be subject to substantially higher tax, although not higher than the recipient would pay on any other kind of income.

THE PRESENT SYSTEM

Under the present tax system gifts are not included in the income of the recipient. Taxes are imposed on gifts, but the provisions for taxing inter vivos gifts are quite different from and independent of those which tax gifts of property passing on death.

Inter Vivos Gifts

Part IV of the Income Tax Act imposes gift tax on donors of inter vivos gifts made by individuals and personal corporations. The aggregate taxable value of gifts made by a donor is calculated annually. After excluding gifts which are exempt under the provisions referred to below, the remaining gifts are reduced by a deduction equal to $4,000 or one half of the difference between the donor's taxable income and the tax thereon for the preceding year, whichever is greater. The resulting aggregate taxable value is subject to tax at a flat rate which varies from 10 per cent, where the aggregate taxable value does not exceed $5,000, to 28 per cent, where that value exceeds $1,000,000. The donor is primarily liable for the tax, but if he fails to pay, the donee is jointly and severally liable with him. Gifts out of a community of property are considered to be given partly by each spouse.

The term "gift" is not given a broad meaning in Part IV of the Act 2/. However, a general tax avoidance section provides that where one person confers a benefit on another the payment may, depending on the circumstances, be deemed to be a disposition by way of gift 3/. This provision might apply in the case of a transfer for inadequate consideration, or any other transaction or series of transactions which results in a measurable benefit being conferred directly or indirectly.

Part IV of the Act specifically exempts gifts taking effect on the death of the donor, because these will be subject to estate tax. It recognizes the idea of the family unit to some extent by providing a once-in-a-lifetime exemption of $10,000 for a gift of real property (a) to a spouse, if the property is to be used as a place of residence by the parties, or (b) to a child, if the property is to be used in farming operations. Gifts to certain charities are exempt, as are gifts to the federal government or provincial or municipal governments. Where the value of all gifts to one donee in a year does not exceed $1,000, such gifts are exempt, presumably for administrative reasons, and are not included in computing aggregate taxable value.

The gift tax provisions were originally introduced in 1935. The present rate structure has been in force since 1942. Since the introduction of the present Income Tax Act in 1948, the only significant change has been the introduction in 1958 of the once-in-a-lifetime exemption of $10,000.

Property Passing on Death

Where property passes on the death of an individual, it is not subject to gift tax but it may be subject to estate tax under the Estate Tax Act. This tax is imposed in two situations. Where the deceased was domiciled in Canada at the time of his death, all property passing on his death is taken into account in computing the aggregate taxable value which is taxed at progressive rates. Where the deceased was domiciled outside Canada at the time of his death, his property then situated in Canada which passes on his death is taxable at a flat rate of 15 per cent, although this is reduced where provincial duty has been paid on the property.

In the case of a person domiciled in Canada the property passing on death is valued and reduced by the debts. The resulting aggregate net value is reduced by a standard deduction of $60,000 if he had a dependent spouse and $40,000 otherwise, and by deductions of $10,000 or $15,000 for each dependent child. It is also reduced by certain gifts to charities. The resulting aggregate taxable value is subject to tax at progressive rates which start at 10 per cent and reach 54 per cent on amounts in excess of $2,000,000. If the deceased was domiciled in a province which imposes succession duties (Quebec, Ontario or British Columbia), or has left property situated in such a province, a provincial tax credit is allowed. In the cases of Quebec and Ontario this credit is equal to one half of the applicable estate tax, while in the case of British Columbia it is equal to three quarters of the estate tax. If any of the property was situated in a foreign country and was subject to foreign estate taxes or succession duties, a foreign tax credit may be claimed to the extent of the estate tax applicable to the property. The executor of the estate is primarily liable for the tax on property under his control. Each successor is also liable for the estate tax applicable to property which passes to him.

The Estate Tax Act contains numerous specific provisions as to what amounts are to be taken into account in determining the value of property passing on death. Many of these are based on similar provisions in the United Kingdom legislation. For example, property disposed of by the deceased during his lifetime may be included if he has reserved a benefit or other interest. A gift or transfer for partial consideration which is made within three years prior to death is also included. However, if gift tax has been paid on the disposition, this will be allowed as a credit against estate tax thereon. If the gift tax exceeds the estate tax on the disposition, the excess is refundable to the person who has paid the gift tax.

Interests in annuities, trusts or other property which arise on death are included if provided by the deceased alone or by arrangement with others. Pensions, death benefits, and payments from a former employer of the deceased in recognition of his services are also taken into account. Life insurance is included if owned by the deceased and in some circumstances if owned by a corporation he controlled. However, life insurance is not included, unless under the gift provisions, if owned by a spouse or child of the deceased or by a trust created in his lifetime for their benefit. The interest of a spouse in a community of property is not taken into account.

The Estate Tax Act came into effect on January 1, 1959. At that time it replaced the Dominion Succession Duty Act which had been in force since 1941. The rates of tax imposed under the latter Act, unlike those under the present Act, depended in part on the value of the amounts passing to each successor.

Appraisal of Present System

Having regard to our concept of the comprehensive tax base, we find the present system illogical, inequitable, and inadequate for a number of reasons.

The gift tax and the estate tax are not integrated, except to the extent necessary to grant relief from the imposition of both taxes on the same gift. The calculation of the taxable amount and the rate structure of one bear no resemblance to those of the other. For example, the gift tax is not included in the gift tax base, while the estate tax is payable out of the amount on which it is calculated. Likewise, neither of them is integrated to any significant extent with the income tax. The Estate Tax Act specifically provides 4/ that in determining the value of any property no allowance or deduction shall be made on account of income tax 5/. However, despite certain provisions which deal with specific anomalies, the income tax, the gift tax, and the estate tax each operates on its own. They are not based on any common rationale. We think that because they all deal with accretions to wealth and acquisitions of economic power by individuals, their subject matters should all be dealt with in a consistent way through one integrated system of taxation.

The gift tax is largely ineffective, except to inhibit the making of very large gifts which might otherwise be made in order to avoid the impact of the estate tax and provincial succession duties. In addition to the once-in-a-lifetime exemption, the gift tax is subject to fairly substantial annual exemptions. Because the amount of the principal annual exemption depends upon the taxable income of the donor for the preceding year, those with the greatest means can make the largest donations without incurring gift tax. In these circumstances most taxpayers keep their gifts within the exemptions and seldom is gift tax paid 6/. Because the exemptions are available each year, a taxpayer can arrange through a programme of gifts extending over several years to make very substantial gifts without incurring gift tax.

It is our considered opinion that an equitable and effective tax system can only be achieved by abolishing the estate tax and the gift tax, and by treating gifts as income of the recipients. In this way the tax liability of each person will be determined by his ability to pay and all receipts will be taxed in a neutral and equitable manner. Our proposals for doing this are outlined below.

The witnesses before us generally recommended the abolition of estate taxes, supporting the recommendation by referring to its relatively low yield, or they asked for an extended time period to realize on assets, and alternative dates of valuation. The comprehensive tax base we recommend in this Report makes it clear that we find no difference between capacity to pay taxes resulting from different forms of economic gain; gifts and legacies under our concept are equally as taxable as recurring income, such as wages and salaries. We believe that our recommendations as to averaging of income, alternative dates for valuation, and deferred payment of taxes, together with a reduced top marginal rate of personal tax, provides as equitable a system of taxation of estates as can be achieved. In addition, our proposals for the family unit will relieve the widow of having to pay any tax at all on the transfer of property from her husband, a result that should end concern as to the impact of estate taxes upon the surviving members of the family unit.

The argument that the revenue derived from the taxation of gifts and bequests is insignificant warrants specific comment. Certainly the federal collections in 1964 of just under $150 million (before provincial tax credits and abatements) are not substantial when compared to the total revenues of the federal government. However, in assessing materiality of revenue it is probably more significant to examine what the alternative sources of the revenue would be. If personal income taxes were to be increased by a flat percentage amount sufficient to raise the equivalent amount of revenue that is now raised from the gift and estate taxes, individual income taxes would have been increased in 1964 by over 5 per cent. However, it is more likely that it would not be considered reasonable to offset the loss of estate and gift tax revenue by tax increases bearing on the lower income groups. If, as a consequence, the tax increase applied only to persons with income over $5,000, the personal taxes of such persons would have to be increased on average by about 7 per cent and the upper income groups would face tax increases of over 10 per cent. Tax increases of this magnitude are obviously not immaterial, and we do not believe that most Canadians would find them to be an acceptable alternative to the present estate and gift taxes.

In appraising the present system, it is also useful to compare the level of estate taxes in Canada to those applicable in the United Kingdom and the United States. Table 17-1 indicates, for estates of certain sizes, what the tax impact is in each jurisdiction. The figures for Canada and the United States are to some extent understated, as non-creditable provincial and state taxes are not taken into consideration.

TABLE 17-1

ESTATE TAX AS A PERCENTAGE OF TOTAL TAXABLE ESTATE a/
IN CANADA, UNITED KINGDOM AND UNITED STATES

Size of Estate (in '000)			Canada		United Kingdom	United States	
$ Can.	£U.K.	$ U.S.	(a) b/	(b) c/		(a) b/	(b) c/
30	10	28	--	--	4	--	--
60	20	56	4.3	--	12	--	--
120	40	112	12.2	5.2	24	6.7	--
180	60	168	15.9	10.6	35	13.8	1.3
300	100	280	20.3	18.4	45	20.3	5.4
900	300	840	30.2	28.4	60	29.1	12.0
1,500	500	1,400	36.3	35.0	65	32.9	13.9
3,000	1,000	2,800	44.5	42.8	75	40.2	16.5
6,000	2,000	5,600	49.2	48.9	80	50.5	20.1
15,000	5,000	14,000	52.1	51.9	80	65.2	27.1

a/ Before the deduction of any basic or survivor exemptions.

b/ It is assumed that no marital, child or dependant deduction is available.

c/ It is assumed that the maximum deduction for relationship is available in the United States and that in Canada, the deceased (a man) left a widow and two dependent children.

Source: Estate and Gift Taxation (ed. G. S. A. Wheatcroft; Sweet & Maxwell, 1965), pages 108 and 109.

It is evident that the present level of estate tax in Canada is substantially less than that applicable in the United Kingdom, but, except for very large estates, is greater than that applicable in the United States. In particular, the United States tax is substantially lower on that portion of the estate passing to the widow.

Effect of Estate Tax on
Sales of Businesses

Many witnesses before the Commission made reference to the impact of estate taxes on the sale of private businesses, particularly sales to non-residents 7/. In questioning these witnesses, we examined their statements carefully to appraise the seriousness of the charge and to determine whether or not such sales appeared to have unfavourable economic consequences. Most witnesses very quickly stated that taxation would not, by itself, direct business assets to non-resident purchasers, but would cause them to be placed on the market and because of circumstances apart from taxation they might be purchased by non-residents. Some witnesses undertook to conduct further enquiry into this matter and to furnish us, on a confidential basis, with any facts adduced concerning the enforced sale of family businesses. Although some material was, as a result, supplied to the Commission, it did not lead to any clear conclusions. We made enquiries into the more conspicuous incidents which have appeared in the press. In none of these cases did the impact of estate taxes seem to have even a minor influence in favour of sale.

Despite our inability to find support for this alleged unfortunate incidence of estate taxes, it appears reasonable to conclude that taxation imposed on the value of a business will in some instances influence the owner to sell part, or all, of the business. It is highly unlikely that sales of businesses will result from one motive only, and if estate tax is a contributing factor its impact will vary in each instance. However, assuming the extreme position where a business is sold only to meet taxes, the result of the sale may in economic terms be good or bad depending on whether or not it advances the future prospects of the company. There is little evidence to support the position that businesses tend to prosper to a greater extent because they remain in the same family.

It is not the purpose of the tax system to cause businesses to be sold or to protect them from sale. Taxation should be levied in the most neutral manner possible. However, this does not mean that if a taxpayer elects to place his resources in such a way that they are not readily realizable, he should secure a tax preference over other taxpayers with liquid assets. The tax system should, of course, provide for an orderly realization subject to the securing of debts to the Crown and the payment of appropriate interest. As long as tax can be readily computed there seems little excuse for the failure by taxpayers to make provision for such taxes as will apply to their estates.

THE PROPOSED SYSTEM

Proposal in Outline

Under the concept of a comprehensive tax base and a tax determined by ability to pay, the present gift taxes and estate taxes would be eliminated and gifts received from another tax unit would form part of the income of the tax unit receiving them. Gifts are by definition transfers of value for which no (or inadequate) payment or consideration is given. They include gifts made between living persons, that is, gifts <u>inter vivos</u>, and the passing of property on the death of the donor, that is, testamentary gifts or inheritances.

We also propose that where property has been given, either on death or during the lifetime of the donor, this should in general amount to a disposal of the property by the donor at its fair market value. Thus, any accrued property gain would be realized and would become taxable to the donor. However, a transfer to a member of the donor's family unit should be specifically excluded from being a disposition for tax purposes. This treatment would ensure that property gains, whether realized or unrealized, would be taxed not later than the date on which the family unit was terminated.

It will also prevent the inequity that would arise if one person could give away property to a person who was not a member of his tax unit on which full tax had not been paid, because of an accrued gain, while another could only give away after-tax income 8/. This subject is discussed in Chapter 15.

One of the important features of our proposals is that property accumulated in a family unit should be freely transferable within that unit. In this way the estate which had been built up by a family unit could be used without restriction to support members of the family unit as long as it existed. This treatment would be applicable whether the transfer was made during the lifetime of the donor or on his death. However, a dependent child withdrawing from a unit would be required to include in his income, subject to a $5,000 lifetime exemption, the market value of property taken from the unit. This would be necessary so that if a dependent child received gifts from his parents in excess of that needed for consumption, the excess would be treated in the same way as gifts received by him after he has ceased to be a dependant. This proposal is dealt with in more detail in Chapter 10.

One of the main reasons why people build up estates is to protect their families. The popularity of life insurance attests to this. The desirability of giving further relief to dependants of deceased heads of households was stressed constantly in briefs presented to the Commission. We agree with this objective and meet it with our recommendation concerning the family unit.

We also propose that each person should be entitled to certain exemptions, mainly for the sake of administrative simplicity. These would include the lifetime exemption of $5,000 for gifts received. In addition, we suggest annual exemptions of $250 for a person filing as a single individual, $250 for each spouse in a family unit, and $100 for each child in a family unit. Because of these exemptions it would be expected that most people will never pay any tax on gifts.

In many cases gifts will not be made directly to the donee but will be transferred so as to be held in trust. This may be either an <u>inter vivos</u> trust or a trust arising on death under the terms of a will. We do not regard a trust as a donee but rather as an intermediary. If the beneficiary of all the income from a trust or the prospective beneficiary of the corpus of the trust were a member of the family unit of the donor, the trust would receive the gift free of tax as if the gift had been made directly to the beneficiary. In other cases the trust would be subject to an initial tax on the gift in order to prevent avoidance or deferment of the tax. When the beneficiary eventually received the trust property he would include it in his income on a grossed-up basis and would receive credit for the initial tax paid by the trust. This proposal is discussed in detail in Chapter 21.

Gifts That Should be Included in the Comprehensive Tax Base

We recommend that all property received from another tax unit by way of gift should be included in the tax base of the recipient. For this purpose the term "gift" should have an extended meaning and should include the following:

1. Gifts <u>inter vivos</u>.
2. Transfers of property for inadequate consideration, unless the transfer price was reached as a result of bona fide arm's length bargaining.
3. An extinguishment of debt, including non-enforcement by reason of limitation provisions, or the creation of an "artificial" debt, that is, where the parties were not dealing at arm's length and satisfactory terms of repayment had not been arranged 9/.
4. Successions to property under intestate succession laws.
5. Succession under a will.
6. Receipt of property pursuant to laws for the relief of dependants.
7. Property accruing to the taxpayer by survivorship.
8. Receipt of a power of encroachment or a power of appointment which would permit the property to be used by or appointed to the taxpayer for his own use during his lifetime.
9. Receipt of property as a result of the exercise of a power of appointment.

Inter Vivos Gifts

When property is received by way of gift, it means that the recipient obtains the property free and does not pay or give anything of economic value in return for the property. There are other legal conditions of making an effective gift. The gift must be accepted, and in the case of chattels delivery must be made. Gifts may also be made by written instrument under seal. In this respect we recommend that there should be no special definition of gift, so that the meaning of a completed gift would continue to be that declared by the courts from time to time.

In order that there be a gift there must be a donor. Consequently some pure windfall gains, such as found money or property or gambling gains, would not come within the definition but would be included in the tax base as windfalls. Gambling gains and losses are discussed in Chapter 18. The value of property received without consideration would therefore be included in the tax base regardless of how the property was obtained.

Transfers For Inadequate Consideration

Pure gifts create no special problems, but it is easy to disguise a gift as a sale or other transfer where some payment or consideration is given in return. To take an extreme example, a father might "sell" his new car worth $4,000 to his son (over 21) for $1. Legally this is a sale, but for the purposes of taxation it is the equivalent of a gift of $3,999. It is easy to see the principle in an extreme example but it is not so easy to apply it in practice. Under the Estate Tax Act and the provincial succession duty acts such cases are treated as gifts or dispositions for "inadequate consideration", and the difference between the value transferred and the value received is taxed as a gift if made within the dutiable period. The benefit may also be subject to gift tax under the Income Tax Act 10/.

The present inadequate consideration provisions in the Estate Tax Act are broad enough to include the case in which a stranger buys property at a bargain price within 3 years of the seller's death 11/. Where bargaining has been at arm's length, such sales are not the equivalent of gifts and we understand that in practice assessments are not made. However, we do not think that a gift should escape tax by payment of a nominal consideration merely because the donor and donee are not related. We recommend that gifts should be defined to include all transfers for inadequate consideration, unless it can be established that the transfer price was reached as a result of bona fide bargaining at arm's length.

There would be some circumstances in which a transfer for inadequate consideration should not be treated as a gift. A transfer of property on the incorporation of a proprietorship, or on a corporate reorganization, may take place at other than market value. This is dealt with in Chapter 15 where we recommend that in some circumstances these transfers be deemed not to be realizations and therefore not gifts.

Powers of Appointment and Encroachment

In some cases an individual is given a power under a will or trust instrument to encroach on property for his own benefit or to appoint the property to himself or others. The power of appointment may be exercisable either during his lifetime by deed or on his death by will, and it may be either special or general. A general power is exercisable in favour of any person without restriction, while a special power can be exercised only in favour of one or more members of a limited group or class of possible beneficiaries.

Where the terms of a power are such that the person having the power can appoint the property to himself or otherwise acquire it for his own benefit during his lifetime, the property is at his disposal. In these circumstances, the property should be included in his tax base when the power becomes exercisable as if it had been given to him outright. However, we recommend that if he renounced the power within a period of 90 days after he became aware of it or after it became exercisable, whichever was later, the property which was subject to the power should not be included in his tax base. This would be consistent with the legal position in relation to ordinary gifts, that a gift is not complete unless accepted by the intended donee.

There are various types of power that we recommend should not result in the subject property being included in the tax base of the person having the power. These are cases in which that person is not entitled to use the property himself, but is instead in a position similar to that of a trustee with discretionary powers. For example, if a person had a power of encroachment which could not be exercised without the concurrence of some other person, the property would not be at his disposal and should not be included in his tax base unless or until the power is exercised. If a power of appointment, whether general or special, were subject to a restriction which prevented an appointment in favour of the person having the power, the property would not be available for his personal use and should not be included in his income. If a general power of appointment is exercisable only by will, it would not be possible for the grantee of the power to exercise it in his own favour during his lifetime, and accordingly it should not be included in his tax base. It is our view that the legislation should not distinguish specifically between general and special powers of appointment, but should provide in a general rule that if a person is granted a power which he did not renounce within a stipulated period and under which he would be entitled on the exercise of the power to acquire property for his own use, the property would be regarded as having been given to him.

Property transferred to a beneficiary on the exercise of a power of appointment should be included in the beneficiary's tax base as a gift. This should be the case whether or not the property has been included in the tax base of the appointer under the rule outlined above. If it had been included in his tax base because it was available to him for his own use, his position would be similar to that of a person who had actually received property by way of gift and then had given it to another.

Conditional Gifts

A further problem arises where, although there is no direct consideration for a transfer of property, it is conditional on the transferee's doing some collateral act. For example, a father might transfer to his adult son a farm having a fair market value of $15,000, on condition that the son pay $10,000 to his sister, who is also adult and thus outside the family unit. If parties to such a transaction had been dealing at arm's length, the transferee of the farm would pay no tax if he could establish a bona fide transaction. The sister would pay tax on the $10,000 she received. Because the father and son would not be dealing at arm's length, the son should be taxed on $5,000, the difference between the consideration given and the fair market value of the property. In other words, the cost to the transferee of complying with the condition should be treated as an expense of acquiring the gift.

An essentially similar case arises where the condition for receipt of a gift is the payment by the donee of an annuity to another person. The courts have decided these cases on the basis of whether the annuity was charged on or directly connected with the transfer of the property. We recommend that conditional gifts should be recognized as such where their conditional nature is clear, whether or not there is a legal charge on the property, and that only the net proceeds be taxed to the donee.

Meaning of "Property"

We have concluded that the acquisition of anything which adds to a person's economic power should be included in his tax base. This means that the concept of "property" should be all-inclusive. Definitions similar to those now in the Income Tax Act and the Estate Tax Act would appear to be satisfactory. For example, the Estate Tax Act provides that

> "'property' means property of every description whatever, whether real or personal, movable or immovable, or corporeal or incorporeal, and without restricting the generality of the foregoing, includes any estate or interest in any such property, a right of any kind whatever and a chose in action;...." 12/

The definition of property includes partial interests in property. A common division of interests is to give one person an interest in the income of a fund, for example, an interest during his lifetime, and another person an interest in the capital on the death of the first person. The ability to divide property into lesser interests causes some difficult problems. We propose that where property had been given in trust it should only be required to be included in the tax base of a beneficiary when he becomes entitled to receive it or other property from the trust. In order to prevent avoidance or deferment of tax, the trust should be subject to an initial tax for which the beneficiary would receive credit. The treatment of trusts is discussed in Chapter 21. Where a person received a gift of a property interest which was not held in trust, such as an undivided interest in real estate, it would be included in his tax base immediately upon the interest vesting in him.

Ordinarily, a person with the legal title to property is also the beneficial owner. However, property is sometimes conveyed to one person as nominee for another. Such a nominee may be a bare trustee or he may be holding the property to ensure fulfilment of a condition by the beneficial owner. In either case the beneficial ownership of the property rather than the legal title should be considered for tax purposes. A person who acquired the beneficial ownership of an interest in property by way of gift should include in his tax base the value of that interest. On the other hand, a person who acquired the legal title to property but no beneficial interest should not be subject to tax in his personal capacity. As already indicated, if he was a trustee he may be required to pay an initial tax out of the trust funds.

If property is loaned to another, the right to use that property, for example, a car, is a valuable right. We recommend that such property should not be included in the tax base of the borrower, because it would not be owned by him, and he would be under an obligation to return it. However, if he had a legal right to use it without consideration, the rental value of the property in each year should be treated as a gift to him. If he had a legal right to obtain services without consideration, the value of the services should likewise be treated as a gift.

Similarly, if a trust or will permitted a beneficiary to use property without payment of a reasonable rent, the rental value should be included in his income. This is presently provided for by section 65 of the Income Tax Act, and we recommend that this or a similar provision be retained 13/.

"Net" Property Received

Because we are proposing that taxes be based on ability to pay, it follows necessarily that only the "net" value of property should be taxed. For example, if a father gave to a son land worth $20,000 which had an unpaid mortgage of $5,000, the taxable value of the property would be $15,000.

When an individual dies, his estate may be liable for tax, either as a result of deemed realization of appreciated property at his death or otherwise. This tax liability would be deducted in arriving at the amount of gifts to his beneficiaries. Each of them would be taxed only on the net value actually received.

This concept also means that reasonable costs of administration and any losses incurred in the course of administration would be excluded from the net receipt by a beneficiary. The expenses and losses in administration are not, strictly speaking, allowed as deductions to the donee. The amounts are never received and thus should not be taxable to him. There is a primary control on the reasonableness of expenses, because the expenses of executors and administrators are subject to review by the court on the audit of their accounts.

Meaning of "Receipt"

The term "receipt" assumes that there has been a transfer of title to or beneficial ownership of the property. Ordinarily, a gift is completed and received when there has been a complete transfer of legal title and possession to the donee. Possession by an agent, nominee or bare trustee for the donee would be the equivalent of possession by the donee.

A prospective donee cannot renounce a gift after it has been completed. Completion of the gift requires acceptance by the donee, and in order to render the proposed gift ineffective the donee must not accept it but should renounce the gift as soon as possible after he receives knowledge of it. We recommend that provision should be made that renunciation would not be effective for the purposes of the taxing act unless made within, say, 90 days of the time when the prospective donee received knowledge of the gift.

Where there was no legal transfer of property, but a property owner conferred on another person a right or benefit that was less than beneficial ownership of an interest in property, the other person should not be treated as a donee of the property, but should be regarded as having received a gift equal to the value of the benefit received. Similarly, if an individual took one or more steps which did not involve a transfer of property but resulted in his property becoming less valuable, while the property of another person increased in value, the individual would have conferred a benefit on the other person which should be included in the tax base of the latter. This would occur, for example, if a father owned shares of one class in a company while his son owned shares of another class and transactions were carried out which had the effect of decreasing the value of the father's shares and increasing the value of the son's shares. This type of transaction could be dealt with by a provision to the effect that, if as a result of one or more transactions one person conferred a benefit on another, he would be regarded as having made a payment to the other 14/. It should also be provided that, if the value of any property owned by the person conferring the benefit was reduced by any such transaction or transactions, the cost basis of the property to him would be reduced by that amount.

Consideration should also be given to the situation which would arise where a donor transferred property to a donee, but reserved a right or benefit to himself. Understandably, administrations in Canada, the United States and the United Kingdom have exercised considerable ingenuity in making these gifts subject to estate tax 15/. Typical examples of this would be the transfer of a farm with a reservation of the right to reside and be maintained thereon, a transfer of a business with an annuity reserved out of the profits, or a transfer of property in trust on terms which reserved a reversionary interest to the settlor 16/.

The taxation of the family as a unit under our proposals would reduce the incentive for these arrangements, for there would be no tax on the transfer to a wife or dependent children and the income from property would be taxed in the family unit in any event. Nevertheless, there may remain an area where it would be to the donor's advantage to transfer rights of immediate enjoyment in the property to the donee, but retain a "string" by which he could recover the property or obtain a benefit from it. We have concluded that, in the light of our proposed system of taxing donees, the problems in this area could be satisfactorily dealt with (assuming the property is not held in trust) by the two following rules:

1. Where a donee has received an immediate property interest which could be valued, it should be valued and tax paid on the transfer notwithstanding that the donor has retained a benefit. This would apply to interests in property for a term of years with a reversion to the donor.

2. Where the interest retained by the donor takes effect only on the failure of the gift or where it is of uncertain value, the donee should be taxed on the full value of the property transferred. However, if the property was reacquired by the donor, the donee should be entitled to claim a property loss equal to the value of the property at the time it was so reacquired.

The foregoing would apply only where the benefit or interest retained by the donor may benefit him or his estate. Where the donor retained a lesser power, such as a power to alter beneficiaries, accumulate income, distribute income among named beneficiaries, or encroach on principal for the benefit of income beneficiaries, the principles set out in Chapter 21 would apply.

Tax-Paid Gifts

Many wills now provide that certain gifts to individuals are to be tax free; that is, that taxes are to be paid out of the estate and thus are to be borne by someone else, such as the beneficiary of the residue of the estate. Under our proposals, the payment of tax out of one beneficiary's share on behalf of another beneficiary would increase the benefited person's taxable capacity to the extent of the amount so paid. It would thus be necessary to impute as additional income of a recipient taxes paid on his behalf by the executors out of the estate. The amount of income to be imputed would depend on the tax payable, which in turn would depend on the original gift plus the amount of the tax which was imputed as an additional gift. This leads to a series of gifts of tax on tax. The sum of this series can be readily calculated by the use of a mathematical formula. This leads to complications when the result puts the beneficiary in a higher tax bracket, but the correct answer can be obtained by the application of an adjusted formula 17/. This is much simpler than the present method used by the Estate Tax Division of the Department of National Revenue, which has recently been upheld by the Supreme Court of Canada, 18/ and we recommend that such a formula should be used.

Gifts to Corporations

We propose that gifts to corporations should be taxable at full corporate rates. There is no reason in principle to exempt ordinary corporations from the tax on gifts, and in practice the exemption of corporations might permit tax avoidance. If a gift to a corporation were tax free, the amounts given could then be returned to shareholders by redemption of shares or in some other manner without tax liability. Thus, gifts could be made indirectly from one individual to another without immediate tax. For this reason we recommend that, in general, gifts should be taxable when received by corporations.

It is necessary to provide for certain exceptions to this general rule. For example, where an individual had been carrying on business as a proprietor he should be entitled to transfer the assets of the business to a corporation whose shares he owned at the book value rather than the fair market value. There may be other circumstances in which it would be desirable for the shareholders to make a capital contribution to a corporation. This might be accomplished by a transfer of funds or other property to the corporation without consideration or for a consideration less than the fair market value. It might also be accomplished, in effect, by a subscription for shares at more than their fair market value. However, exceptions to the general rule should be strictly limited so that they would not be open to abuse. Accordingly, we are prepared to recommend exclusion of gifts received by a corporation only if they are made by a shareholder who had a 100 per cent interest in the corporation, or by all the shareholders _pro rata_ in accordance with their shareholdings. This exception should apply only where the corporation had only one class of shares outstanding or where the shares of each class are held by the same shareholders in the same proportions at the time of the gift. This is discussed further in Chapter 15.

Gifts in Instalments

Gifts which are paid immediately present no major problems respecting the proper time of valuation or time of payment of tax. However, gifts which are paid in instalments over a period of time raise these problems, particularly the problem of whether the gifts should be taxed when the right to receive them arises at their present value or as they are received. We recommend the taxation of the present value of future enforceable rights obtained by way of gift, but in Appendix F to this Volume, we outline an alternative method of taxing instalment gifts as received.

A gift may be made in instalments in a variety of circumstances. If the donor retains the property and does not enter into a binding commitment with the donee to pay the future instalments, there will be a completed gift only as each instalment is paid. In this case the instalment would be valued and included in the tax base of the donee at the time of each transfer or payment.

If the donor enters into a binding agreement under which he is committed to make future payments, the donee will have acquired valuable rights at the time of the agreement. The same will be true if the donor has made an arrangement under which some third party has become obligated to make future instalment payments to the donee, provided the donee is entitled to enforce payment.

In either of the above cases it would seem reasonable that the total gift should be included in the donee's tax base at the time he acquired valuable rights. However, if there were some possibility of non-payment, and particularly if the donee could not collect, then the donee should be entitled to deduct a provision for risk of non-payment. It might also be provided that the donee would be entitled to pay the tax by instalments with interest, on the ground that the amount included in income was not liquid.

If a gift were paid into a trust with provision for payments to a beneficiary in instalments over a period of time, the trustee would be subject to an initial tax on the value of the gift, and the beneficiary would include the instalment payments in his tax base as they were received. In computing his income the payments would be grossed-up to include the initial tax on the gift, and he would receive credit for the initial tax. This is discussed in Chapter 21.

Annuities

One widely used form of gift is the annuity 19/. A donor during his lifetime may purchase an annuity which is payable to another (the donee). Alternatively, he may direct his executors or trustees to pay an annual amount to a specified person after his death. In either case the annuity would normally be payable during the lifetime of the donee and the total amount to be paid to the donee would depend upon how long he lived. Where the annuity is purchased from an insurer, its cost, which may be regarded as its present value at the time of purchase, is based primarily upon the annuitant's expectation of life as determined from mortality tables 20/.

Because an annuity has a present value, it is a form of property which can be bought and sold. This feature can be changed by a provision to the effect that it will be non-assignable and non-commutable. Such a provision will effectively prevent the beneficiary from realizing on its value in advance of the contractual times of payment.

When an annuity is established a sum is normally paid or set aside to provide for its payment. This sum will earn interest while invested by the insurer or the trust providing the annuity. Each payment to the annuitant can be regarded as partly a return of the amount paid in and partly income from the investment of that sum.

Where an annuity has been purchased under a Registered Retirement Income Plan the annuity payments should be included in the income of the recipient in full when received, because the contributions made to provide the annuity will have been deducted in computing the contributor's income when made. The treatment of such a plan is discussed in Chapter 16. That chapter also deals with the case in which an individual purchases an annuity for himself or a member of his family unit or both as joint annuitants under a non-registered plan. In this latter case the income element of the annuity would be subject to tax as it arises, and the capital element, representing a return of contributions which were non-deductible, would be tax free.

The subsequent discussion of annuities in this chapter will relate only to the case in which an annuity is provided by a donor for a donee who is not a member of his family unit. Such cases will probably be a small proportion of all annuities.

Where the person who purchased or provided the annuity was not himself the annuitant or a member of the annuitant's family unit, the annuity would be a gift, the amount of which would be included in the donee's income and taxed. The principal question is at what time and at what rate should the tax be levied.

Where an annuity was payable under the terms of a will on an *inter vivos* trust, it should be dealt with in a manner consistent with other payments out of trusts. Because of the complexities of trusts, the mechanics of taxing such annuities would be different than for contractual annuities, but in most cases the overall effect would be similar.

The recommended procedure for taxing annuities payable under a will or trust is dealt with fully in Chapter 21, but the proposed treatment may usefully be summarized here. Such an annuity may be payable entirely out of trust income or partly out of income and partly out of corpus. Assuming that the beneficiary was not a member of the family unit of the donor, the trust would pay an initial tax on the gift of corpus when it was received. The trust would also pay an initial tax on trust income as it arose. In many cases the trustee would have the option of paying the initial tax at a rate which would be applicable if the beneficiary had received it. The beneficiary would then include in his tax base the full amount of each annuity payment as it was received. This would be grossed-up to include the initial tax paid by the trust on both the corpus and the income from which the distribution was made, and the beneficiary would receive credit for that initial tax. To the extent that the annuity was payable out of the current income of the trust, the beneficiary would be entitled to elect that no initial tax be payable but that the income distributed be included in his income.

Where an annuity was purchased by one person for another from an insurer, there are two principal alternative methods of dealing with it in the proposed tax system. One would be to tax each annuity payment as it was received without distinguishing between the capital and income elements. The other, which we recommend, would be to include in the donee's tax base the amount required to purchase the annuity, and then to tax the interest or income element each year as it was accumulated by the insurer. There would then be no tax on the annuity payments unless and until they aggregated more than the amounts previously included in income.

One of the principal considerations is to maintain neutrality among different kinds of gift and other types of income. For example, if a donor were to make a gift of cash with which the donee purchased an annuity, the value of the gift would be included in the donee's tax base immediately. The income element would then be subject to tax as it arose. However, if the donor had purchased an annuity for the donee, and if the annuity payments were included in the donee's income only when received, there would be a deferment of tax. Such a deferment should be prevented to the extent possible.

On the other hand, if a donee were to receive a cash gift, he would have immediate control over the subject matter of the gift, and would be free to invest it or deal with it in any manner he wished. A donee of an annuity would often not have this choice if the annuity were non-commutable or if it could only be commuted for an amount substantially less than its present value. If the annuitant were required to pay tax immediately on the present value of the annuity, this could create a hardship because this value might be very high and the tax would exceed the amount of annuity he would have received when the tax became payable. The nature of the gift would be such that he could not place it in a deposit account so as to defer tax. However, he could qualify it as a Registered Retirement Income Plan in the same way that any other property could be transferred to such a plan, and thus would be able to defer the tax liability. To the extent that there remained an amount that was not eligible for a Registered Retirement Income Plan and therefore had to be included in income, the liquidity problem could be reduced if provision were made for payment of the tax over a period of several years. If the annuitant should pay tax on an amount that was not in fact received, the shortfall would be a property loss which could be deducted from other income, and in this way provide, in effect, a refund of the taxes paid. It may be necessary to have a special backward averaging provision which would be applicable where a loss on an annuity occurred at death, because the proposed five-year provision may not be adequate.

For these reasons we recommend that an annuity contract which was the subject of a gift should, in the first instance, be included in income in the year the gift was made at its present value at that time. The subsequent investment earnings should be included in income each year as earned, just as we recommend in Chapter 16 for all non-registered retirement plans. The annuity payments would then be free of tax as a return of investment, with any difference between the total amount received and the cost basis, that is, original gift plus investment earnings included in income, being included in income as a gain or loss. This treatment would tax the donee in the same way as if he had received a cash gift and had himself purchased the annuity. If the donee qualified the annuity as a Registered Retirement Income Plan, then no tax would be payable at the time of gift or when the investment income was earned, but rather the payments would be included in income when received. We would expect that this latter option would be employed, for example, by parents or other dependants of the deceased who received a bequest in this form to ensure that they had the funds available for their continued maintenance. In this way the beneficiary would only pay tax when the annual benefits were received.

As in the case of other proposals in this Report, we do not intend the recommended treatment of annuities to be retroactive. Accordingly, if an annuity had been given prior to the effective date, the present gift tax or estate tax provisions would have been applicable, and the capital element of the annuity should not be included in the tax base of the recipient. The income element will have been taxable under the present provisions before the effective date, and would be taxable under the proposed provisions after the effective date.

Gifts Involving Proceeds of
Insurance and Pension Plans

This rather similar group of payments can be considered as a whole. It includes pension payments, death benefit payments, benefits from profit sharing plans, deferred profit sharing plans, supplementary unemployment insurance plans and payments under life insurance policies.

We are not concerned here with the payments made to the employee, the contributor, or the policyholder. We discuss the treatment of benefits paid to these persons in Chapter 16. In this chapter we are concerned only with a person who receives such benefits and who was not himself the original employee, member, or contributor who caused the benefits to accrue. For such a person the benefits received would be a gift as we have defined it and should be taxed accordingly.

By far the largest group of beneficiaries would doubtless be the wives and dependent children of the contributors. Generally speaking, these beneficiaries would include in their incomes such amounts as would have been included in the deceased's income if he had received them. Death benefits and similar payments from an employer on which the deceased had not paid tax would be included in the income of a member of a family unit who received them. This would also be true in the case of payments from a Registered Retirement Income Plan. One of the requirements of registration is that benefits must be payable to the contributor or to a member of his family. Thus, payments would have to be included in the income of the family or the estate of a deceased member. However, where payments have been made into a non-registered plan which had been purchased by the deceased out of tax-paid income, these payments would be free of tax on being returned to a member of his family unit. The income arising under such a plan would be taxable to the beneficiary to the same extent as if the deceased were receiving the payments. The proceeds of life insurance policies, other than group life insurance, purchased by one member of a family unit would be excluded from income when received by any other member of that unit in the same way as if they had been received by the person paying the premiums, at least in the initial period where mortality gains and losses on such policies would not be taken into account. Thus, the benefits received on cancellation, maturity, or death would be excluded from taxable income.

If payments of this kind were made to a person who was not a member of the deceased's family unit, they should be treated as gifts and included in the recipient's tax base. If the payments were made under a non-registered retirement income plan and were payable during the lifetime of the donee, they would be treated as annuities. If payment were made in a lump sum, it would be included in the donee's income and taxed at his personal rate. The proceeds of a life insurance policy owned by a taxpayer but payable to a beneficiary outside his family unit would also be included in the beneficiary's income, either as a lump sum or at an arbitrary valuation if the benefits were in the form of an annuity. In all cases the amount of tax liability would be subject to such elections as the donee may make with respect to averaging, payments of tax by instalments, or payment of all or part of the amount received into a Registered Retirement Income Plan.

Exemptions

The exemptions contained in the present gift and estate tax legislation can be divided into the following types:

1. Gifts to exempt persons and institutions, such as charities and government bodies.

2. Deductions of specified amounts permitted, regardless of the identity of donor or recipient, such as the $40,000 basic deduction under the Estate Tax Act and the $4,000 minimum under the gift tax provisions.

3. Deductions made to simplify administration, such as those under the Estate Tax Act for gifts made by the deceased as part of his ordinary and normal expenditure, and under the gift tax provisions of gifts up to $1,000.

4. Deductions dependent on the existence of family relationships, such as the estate tax deductions for spouse and dependent children, and the gift tax deductions for the once-in-a-lifetime gift of an interest in real property.

Whether a tax is imposed upon the donor or the donee, reliefs such as those listed above are usually given by way of a deduction from the tax base. There may be no tax at all if the donee is exempted from taxation. Gifts to charitable organizations, which are exempt under section 112 (4)(c) of the Income Tax Act, would not be subject to gift tax.

Under our proposal, transfers of wealth among members of a family unit, either during the lifetime of the transferor or on his death, would not be subject to taxation. This would reduce the need for specific exemptions. However, we propose certain exemptions partly based on social grounds and partly designed to relieve administrative problems.

The present exemptions from estate and gift taxes would, of course, no longer apply, since those taxes would be abolished, and gifts and inheritances would be taxed in the hands of the donee.

Apart from gifts from members of the family, individuals generally receive gifts from relatives and close friends on special occasions such as Christmas, birthdays and marriage. To include all such gifts, large or small, in the recipient's tax base would cause general taxpayer inconvenience, and would lay a burden on the administration out of proportion to the value of the resulting revenue. However, the higher the annual exemptions, the greater the possibilities of tax-free gifts which, if made systematically, could aggregate considerable amounts. High annual exemptions benefit the wealthy more than others. Thus, a wealthy person could make full use of the annual exemptions by giving the maximum amounts each year.

Under the present gift tax provisions, gifts of under $1,000 to any one individual in a year are not included in the taxable base. This has two effects. First, a donor may make several gifts of under $1,000 to different individuals and in that way give away a substantial amount of money free of gift tax. Second, individuals may receive gifts of under $1,000 from several different donors and thus receive a total amount of far more than $1,000 a year without any tax being paid. Furthermore, such gifts are not included when computing the general exemption of $4,000 or one half the difference between the taxable income of the donor and the tax thereon for the immediately preceding taxation year.

We consider the present levels of exemption from gift tax much too high to be justified on administrative grounds alone. We have considered the level of exemptions which would relieve administrative problems with respect to reporting annual gifts and yet not afford a loophole for tax-free transfers of wealth in substantial amounts. We have concluded that an annual exemption for individuals of $250, for spouses who were members of a family unit of $250 each, and for dependants who were members of a family unit of $100 each, would satisfy these requirements. Transfers between members of the family unit would not enter into the calculation. A family unit would be entitled to aggregate the exemptions of all its members for the purpose of calculating its aggregate annual exemption. Thus, a family unit consisting of two spouses and two children could claim an annual exemption of $700. The annual tax return should have a section dealing with gifts in which all gifts received from outside the unit would have to be reported if their total exceeded in value the amount of the unit's exemption.

We considered the possibility of other deductions on social and administrative grounds and we recommend that in addition to the annual exemptions each individual should be allowed an aggregate lifetime exemption of $5,000. We think it is reasonable that a child who leaves the family unit should have an exemption of this amount to assist him in becoming established. This would eliminate the tax liability that otherwise could have arisen when the child leaving the family took with him his personal effects. In addition it should suffice to exempt most married couples from tax on their wedding gifts because the couple would be able to aggregate the unused portions of their individual exemptions. The lifetime exemption should apply to gifts in excess of the annual exemption in any year. It should be cumulative and any part of the $5,000 exemption not used in one year would be carried forward to subsequent years. If a child or married couple did not use the full exemption at one time, he or they should not be deprived of it, and should be entitled to the balance of the deduction when it could be used.

We believe that with these proposed exemptions a majority of people would never pay tax on gifts.

Successive Transfers

Strict adherence to the principle of taxation according to ability to pay would not permit a general concession based on the frequency with which gifts _inter vivos_ were made 21/. One would expect that because tax would arise every time property was transferred, transfers would not be made more often than necessary.

It would appear, however, that a concession could justifiably be made where a second transfer was involuntary, as when death occurred, within a short time after the first transfer to the deceased. In this case it could reasonably be assumed that where the deceased was leaving assets to his beneficiaries, he did not have an adequate opportunity to enjoy the use of the property received by him on the first transfer. Accordingly, we propose an exemption for the recipients of gifts arising on death, where the deceased donor had himself paid tax on gifts he received from persons outside his tax unit within four years of the date of his death. The amount of the exemption would be a diminishing percentage of the gifts received by the donor and included in his tax base in each of those four years. This percentage might be 80 per cent of the taxable gifts received by the donor within a year before his death, 60 per cent of such gifts received by him between one and two years before his death, 40 per cent of such gifts received by him between two and three years before his death, and 20 per cent of such gifts received by him between three and four years before his death. The amount of the gifts on which these percentages would be calculated would be subject to an overall limitation equal to the gifts passing on his death which would otherwise be taxable. The exemption would be allocated among his beneficiaries who were subject to tax in proportion to the amounts received by them on the donor's death.

This exemption would be similar in principle to the present "quick succession" provisions in section 33 of the Estate Tax Act. Under that section it is necessary to identify the property passing on death on which the reduction in value is calculated as property previously subject to tax or property exchanged or substituted therefor. In our view this requirement is likely to cause administrative difficulties both for the Department and the estate in tracing properties and is likely to produce capricious results. It would penalize the estate of the person who had consumed the subject matter of the gift but elected to save other property. Identification would usually be impossible in the case of a gift received in cash or converted into cash which had then been intermingled with other funds in a bank account. For these reasons we recommend that there should not be any such requirement for identification of property, but that the exemption be calculated under a formula such as that referred to above.

Valuation of Property

The general rule under the Estate Tax Act is that the value for tax purposes is the "fair market value" of the property. The same is true under the gift tax provisions, although it is not made explicit. The term is not defined in the statutes but has received considerable judicial consideration. Nichols states:

> "By fair market value is meant the amount of money which a purchaser willing but not obliged to buy the property would pay to an owner willing but not obliged to sell it." 22/

Values arrived at by many different methods may be taken into account: for example, intrinsic value, replacement value, cost, comparative market data, and income-earning capacity of the property.

Generally, fair market value is the accepted test and under the Estate Tax Act, for example, the price of listed shares on a recognized stock exchange is deemed to be fair market value, except in the case referred to below. The Estate Tax Act and some of the provincial succession duty acts recognize the special problems of valuing the shares of companies or other business interests which are not traded publicly, particularly if they are closely held. Under the Estate Tax Act the rule that the listed or quoted price is conclusive does not apply where the deceased by himself, or with others with whom he was connected by blood, marriage or adoption, controlled the enterprise. The value per share of a block of shares sufficient to control an enterprise is often greater than the value of shares which are not part of such a block. In private companies, the value of a minority interest is usually discounted because the market for such an interest is usually very limited. However, a common problem in valuing publicly traded shares is the possible depressing effect on the market if a large number of shares have to be sold within a short period.

One possible solution would be to have special rules which would attempt to deal with all the different types of valuation problem that arise. We have concluded that on the whole it would be better to rely on the standard of fair market value as interpreted by the courts, without any legislative guidelines. The circumstances which may exist are so diverse that almost any conceivable set of rules would be inadequate and in some cases would produce unfair results. We think that legislative provisions tend to become too rigid and hinder effective valuation as much as they promote it, and that the rules developed by the courts provide adequate guidance. However, in recommending this we recognize that the administering authority must develop some policy rules as a guide. We expect they will continue to develop and refine "rules of thumb" dealing with controlling and minority interests, problems of lack of marketability, and so on. The taxpayer will always, however, have a right of appeal. If the administrative authorities are reasonable in their valuations there should not be an excessive number of valuation appeals.

Time of Valuation,
Receipt and Payment

We have given consideration to the appropriate time for valuation of gifts. Under the present laws inter vivos gifts have generally been valued at the time they were made and gifts arising on death at the time of death. However, there have been special provisions governing the time of valuation of inter vivos gifts which were deemed to be property passing on death. Because under our proposals the donee would be the person subject to tax on gifts, we recommend that the basic time for valuation should be the time of receipt or of constructive receipt by him of the gift. The question then arises whether there should be an alternative date for valuation.

A number of submissions advocating an alternative date for valuation in the case of gifts arising on death were made to the Commission. There is often a delay between the date of death and the distribution of the estate. The normal processing and administration of an estate takes time. If the time of inclusion in the donee's tax base were the time of vesting of the donee's interest (which would often be the date of death), the donee might have to pay tax based on the fair market value at a time well before receiving the gift. However, in Chapter 15 we recommend that revaluations of certain types of property be permitted at the option of the taxpayer. Accordingly, if the value declined before he received the gift he would, generally speaking, be able to claim the decline in the value of his property interest as a loss and would, in effect, obtain a tax refund. Until such time as the optional revaluation procedure became applicable to all property, it should also be provided that any property received by way of bequest or gift would be eligible for revaluation within two years from the date it was included in income. Therefore, the donee would have all the advantages of alternative valuation dates.

There remains the question of when a gift arising on death should be included in the income of the donee or in the income of the trust arising on death. We have suggested this should occur when the gift was received. For this purpose receipt should be deemed to take place at the date of actual or constructive receipt, provided that in any case the gift would be regarded as having been received not later than twenty-four months after the date of death. If the identity of the beneficiary were not known twenty-four months after death, the gift should then be included in the income of the trust arising on death. If the gift was to be held in trust under the terms of a will, it should be included in the income of the trust at the time letters probate or letters of administration were obtained, but in no case later than twenty-four months after the date of death. The treatment of gifts arising on death is dealt with further in Chapter 21.

Gifts <u>inter vivos</u> do not entail the same problems of administration as gifts arising on death. Because such a gift is made voluntarily, the parties would be in a position to foresee, at least to some extent, possible changes in value and the necessity for the availability of funds to pay the tax. For these reasons we recommend that <u>inter vivos</u> gifts should be valued on the date of actual or constructive receipt and should be included in the donee's income in the year in which such receipt occurred.

Gifts consisting of property other than cash or marketable securities merit special treatment as to the time of payment. If the property were not readily salable or must be held for special reasons, as in the case of an interest in a business or an art collection, it may result in hardship to require payment of tax when the gift was received. Such gifts cannot be deposited in an Income Adjustment Account, although they could be put into a Registered Retirement Income Plan if such a plan were not already at its maximum level. If money to pay the tax could not be borrowed on the security of the property, some form of deferment of payment would be warranted. We recommend that the tax in respect of such property be made payable in instalments, with interest, over at least five years, and perhaps ten years for specific property such as the shares of a private company or an interest in a farm, provided that if the property were realized for cash or marketable securities, the time for payment would be accelerated. This is similar to the present section 16 of the Estate Tax Act, except that under our proposal the taxpayer would be entitled to deferment as of right instead of relying on the Minister's discretion.

While we think our proposal would solve the problem of lack of liquidity to a reasonable extent, we would recommend that this matter be kept under review.

Rate Schedules and Averaging

While the proposed rates applicable to taxable gifts would generally be higher than the present gift or estate tax rates, comparisons between these rates can be misleading 23/.

Of primary importance in any comparison is the exclusion from the recommended tax base of gifts from one member of a family unit to another, including property which passed on death to a surviving spouse. In addition, our proposals entail a number of basic changes which would make it difficult to predict what the changes in tax rates applying to individuals would be or what changes in revenue would take place.

Under our recommendations gifts would be part of the defined tax base. Apart from intra-family gifts, gifts in excess of the exemptions that we propose would normally be taxable to the donee. Tax would be imposed at the donee's rate which would usually be lower than that of the donor. The effective rates would also be reduced in many cases by the application of the averaging provisions we discuss in Chapter 13, or because of the donee's investments in Registered Retirement Income Plans which we discuss in Chapter 16.

Perhaps the best way to appreciate the effect of including gifts in the comprehensive tax base is to look at some examples. Table 17-2 gives a summary of typical tax rates which might apply to gifts from an estate.

TABLE 17-2

EFFECT OF INCLUSION OF GIFTS FROM OUTSIDE THE FAMILY UNIT IN EXCESS OF EXEMPTIONS IN THE COMPREHENSIVE TAX BASE FOR MARRIED COUPLES WITH THREE DEPENDENT CHILDREN a/

Panel A

Annual Income	Average Tax Rate On Annual Income Before Gift	Average Tax Rate on Income, Including Gift After Averaging		
		$25,000 Gift	$100,000 Gift	$250,000 Gift
$6,500	7.1	10.8	16.6	23.9
10,000	12.5	14.3	18.7	25.5
25,000	21.2	22.4	25.5	30.1
		Average Rate of Tax on Gift		
6,500		19.5	22.3	27.9
10,000		21.5	24.9	30.7
25,000		33.9	36.2	38.9

Panel B

Effective Rate of Tax on Gifts Under Present Estate Tax Rates at Selected Levels b/

Net Value of Estate Before Personal Deductions		
$15,000	$75,000	$300,000
nil	7.067%	20.27%

a/ It is assumed that the taxpayer and spouse have already made use of their lifetime exemptions of $5,000 each. If this were not the case then the tax liability would be reduced substantially.

There is deducted from tax the tax credits for family unit and dependants. It is assumed that the wife is not working and that the income level does not change during the averaging period.

To achieve the best averaging result, one half of the gift would be included in the current year's income and form part of a backward five-year block average. The other half would be deposited for one year into an Income Adjustment Account. This latter portion could then be included in the subsequent five-year period so that the gift would be spread over ten years. Although such a procedure entails a loss of some investment income for one year, and although the tax refund from the forward averaging could not be claimed for five years, nevertheless the procedure does effectively result in averaging the gift over ten years.

b/ It is assumed that the deceased has neither a widow nor dependent children, and also that there are no other deductions or credits.

In provinces which have a separate succession duty, the combined estate tax and succession duty could be higher.

The annual income of the donee has no effect on the rate of estate tax.

We have pointed out that it is difficult to compare the impact of our proposals with the present taxation of estates. Table 17-2 illustrates that while small estates are not now subject to tax, our proposals would result in the application of full personal rates to most of any bequest from such an estate passing outside the family unit. Transfers within the family unit, which would be the method of distribution of a substantial proportion of smaller estates, would continue to be free of tax. In the case of larger estates an answer to the question of whether the level of tax would increase or decrease would depend upon the proportion of the total estate that passed to persons outside the deceased's family unit. Table 17-2 indicates that in general the rate of tax would increase substantially if all the estate passed to another family unit. On the other hand, if the whole estate passed to the widow or a dependent child, then no tax would be payable under our proposals. If one assumes that one half of the estate passed outside the family unit and one half to the widow, then the level of tax on transfers from most estates exceeding $250,000 would decline from what would at present apply.

However, it must also be kept in mind that while under the present gift and estate tax laws it is possible to arrange many transfers (even of substantial amounts) that will be subject to little or no gift or estate tax, under the comprehensive tax base all gifts received from outside the family unit would be brought into the income of the donee. One significant item that would, as a result, be included in the income of many beneficiaries would be the proceeds of life insurance policies, only a small proportion of which are now taxable. Thus, although the rate of tax on many gifts may decline, other gifts not now taxed would become subject to tax and therefore the total tax revenues from gifts should increase substantially.

As our proposals mean that the tax on transfers within the family unit would be eliminated, Canada would certainly compare favourably in this regard with the United States and the United Kingdom. On the other hand, the level of Canadian tax on transfers outside the family unit would in general be increased under our proposals so that, except for the very large estates, the Canadian taxes on these transfers would exceed those levied in the United States.

Nevertheless, the Canadian tax on transfers outside the family unit would still be less than that levied in the United Kingdom for most estates of over $200,000.

Gifts To Non-Residents

At the present time, a Canadian resident is subject to gift tax on any gift which he makes, whether the donee is a resident or non-resident. If an individual dies domiciled in Canada the property passing on his death will be subject to estate taxes regardless of where the beneficiaries reside. A person may not necessarily be domiciled in a jurisdiction in which he is resident, although ordinarily he will be.

In view of the proposal to abolish the gift tax and estate tax and to tax Canadian residents on gifts received by them, it would be necessary to impose a tax on certain gifts made to non-residents. In the case of *inter vivos* gifts this tax should be imposed where the donor was resident in Canada. In the case of inheritances, the tax should be imposed if the deceased was domiciled in Canada at the time of his death. The reason for this distinction is that it is customary and most convenient to tax *inter vivos* gifts on the basis of the donor's residence, but it is recognized internationally that the taxation of inheritances should be based on the domicile of the deceased or the situs of the property. The taxation of gifts to non-residents which arise on death on the basis of the domicile of the deceased would not violate either the letter or the spirit of International Tax Conventions to which Canada is a party 24/.

In our opinion this proposed tax should be a withholding tax and should operate in the same manner as the withholding tax on investment income paid by residents to non-residents. We recommend in Chapter 26 that the withholding tax on such income other than dividends should be at the rate of 30 per cent. In our opinion this would be an appropriate rate for the taxation of gifts made to non-residents. It has the advantage of administrative simplicity in that it would be a flat rate. We also suggest that in order to avoid the necessity of reporting small gifts and to simplify administration, there should be an exemption of, say, $1,000 for gifts made by a donor to non-residents in a year.

In order to preserve neutrality between the treatment of gifts received by residents and those received by non-residents, in our opinion it would be desirable to permit a non-resident who received a gift which had been subject to withholding tax to elect to file a return as a Canadian resident. If he made such an election he would be required to include in his income the full amount of the gift before deduction of withholding tax, as well as his other income. He would have to agree to make all documents and records which were relevant to the calculation of his income available to the Canadian tax authorities. He would be entitled to a credit for foreign tax paid on his income from foreign sources. He would also receive credit for the withholding tax on the gift and, if it exceeds the tax payable on his income, including the gift, as reported in the return, he would be entitled to a refund.

One question that is often raised in any discussion on the taxation of transfers of wealth is whether such taxes should be reduced or eliminated to prevent residents from moving to another jurisdiction in order to reduce the tax on their estates. We have rejected the argument that Canada should either lower some or all of its taxes to the level of its lowest tax "competitor", or that Canada should turn itself into a tax haven of some sort. Both types of action can in the long run be self-defeating, are inequitable, and certainly should not be introduced by Canada. Under our proposals there would be no point in a taxpayer taking such action if his concern were the transfer of property to his widow, because such transfers would not be subject to tax. However, it would still be possible to reduce or eliminate the tax impact on other donees. If the donor left the country and the donee remained resident, then the full Canadian tax would continue to apply. However, under the reverse situation only the 30 per cent withholding tax would apply, so that this arrangement could be attractive for some taxpayers. If both donor and donee became non-resident, then no Canadian tax would be payable.

To offset tax avoidance by a donee who temporarily became non-resident, it would be necessary to provide that any Canadian taxpayer who became non-resident, and then became resident again, would have to include in his income, in the year he returned to Canada, the value of all gifts received during the period in which he was a non-resident. A tax credit would be given for any gift taxes or estate taxes paid to a foreign country on such receipts.

Credit For Foreign Taxes

Any gift received by a resident of Canada would be included in his tax base regardless of where the donor resided. However, if a gift were received from a person resident or domiciled outside Canada it may have been subject to gift tax or estate tax in another country. Similarly, if a gift arising on death consisted of property situated in another country it may have been subject to estate tax in that country. In order to avoid double taxation we recommend that a person who received a gift which was in any of these categories should be entitled to a foreign tax credit for the gift tax, estate tax, or any similar tax which had been imposed on the gift in the country in which the donor was resident or domiciled or in which the property was situated. Such a credit should not be allowed, however, where the gift arose on death and consisted of property situated in Canada, since in these circumstances the other country should give credit for the Canadian tax.

The credit should be available whether the foreign tax was paid by the donor, or his estate, or by the donee. The amount deductible from Canadian tax would be limited to the Canadian tax which is applicable to the gift.

Gifts of Property Situated
in Canada

Under Part II of the Estate Tax Act a tax is imposed at the rate of 15 per cent on property situated in Canada which passes on the death of a person domiciled outside Canada. Credit for this tax will ordinarily be allowed in the country in which the deceased was domiciled. This tax is payable regardless of where the beneficiaries are resident or domiciled.

Under our proposals, if a beneficiary were resident in Canada, he would include the gift in his tax base in the manner already described. Because it is normal for a country to impose a tax on property situated therein when the property passes on the death of a person domiciled elsewhere, we recommend that a tax similar to that provided for in Part II of the Estate Tax Act should be imposed at the rate of 15 per cent on property situated in Canada that passed on the death of a person domiciled outside Canada to beneficiaries who were not resident in Canada.

Tax Conventions

Canada has an Estate Tax Convention with the United States, which was entered into in 1961, and with the United Kingdom, Ireland, France and South Africa, which were entered into some years prior to the introduction of the Estate Tax Act and which refer to succession duties. However, these latter Conventions may be interpreted as being applicable to the Canadian estate tax which was subsequently imposed.

It does not appear to us that the proposals outlined in this chapter are contrary to the provisions of any of these Conventions. Most of the restrictions which they would impose would be applicable only if Canada levied tax solely because the deceased had a Canadian domicile, or because he left property having a Canadian situs. Apart from the proposed 15 per cent tax similar to that imposed by Part II of the Estate Tax Act, the taxes we propose would not come within these categories. In any event, if there were a conflict between the Canadian taxing statute and an international Convention, the provisions of the Convention would prevail. However, if our recommendations were implemented, it might prove to be necessary or desirable for Canada to take steps to renegotiate the Conventions in such a way as to take account of the new system of taxing gifts.

Taxpayer Compliance, Administration
and Enforcement

At the present time the administration and enforcement provisions of the Income Tax Act apply to the income tax and the gift tax. The Estate

Tax Act provides for the administration of the estate tax; many of the provisions are similar to those contained in the Income Tax Act, while others are different and pertain only to an estate tax. Because gifts and inheritances under our proposal would be taxed as part of the comprehensive tax base, it would be necessary to include in the administrative structure special provisions to take into account the characteristics of gifts.

Because gifts are included in the tax base, the general income tax administration and enforcement provisions would apply to gifts as well as to other income. All components of the tax base would be reported in the same annual return. The filing of annual returns and information returns, the procedure relating to assessments and appeals, collection procedures and enforcement would be the same for gifts as for other forms of accretion to wealth. For these purposes it would be immaterial whether the recipient was an individual, a trust, or a corporation. Except for the special provisions referred to below, we have concluded that the administrative provisions as recommended can apply equally to the taxation of gifts.

For several reasons it would be necessary to take into account the position of the donor or his estate if the gift arose on death 25/. First, the returns filed by the estate of the donor could be utilized to ensure that donees would report and pay tax on the amounts they receive. Second, it may be desirable to require that an initial tax be paid on behalf of the donee by the executor or administrator of the donor. This is discussed in Chapter 21.

Wills commonly provide that the executors are to pay all taxes and death duties on property under their control out of the estate. It would be necessary to ensure that the provisions in our proposed tax structure relating to withholding by financial agents and intermediaries take such provisions into account.

While most of the general administrative provisions would be applicable to the taxation of gifts, we recommend that additional provisions should be added to deal with the following matters:

Reporting. It would be necessary to provide that donors or their personal representatives must report any gifts made to any individual other than a member of the donor's family unit which were over $100 in any taxation year.

Payment and Liability for Tax. In the case of a gift arising on death or through an inter vivos trust, it should be provided that the trustee could not make a distribution unless he had paid the initial tax, or had retained sufficient funds to pay the initial tax, or had obtained the consent of the tax authorities to the distribution.

It should also be provided that a donor who made a gift to a non-resident should withhold and remit the withholding tax payable with respect to the gift.

Ministerial Consents. In order to strengthen enforcement, it would be useful to have provisions such as sections 47 and 48 of the Estate Tax Act. These prohibit transfers of property, by anyone other than an executor, and the opening by any person, without the Minister's consent, of safes, vaults and other depositories which contain property of a deceased.

Liens on Property. There is no general lien on property for taxes owing under the Income Tax Act similar to that provided for in section 43 of the Estate Tax Act. That section provides in effect that any tax, interest or penalties payable under the Act by a successor to any real estate passing on the death of the deceased shall be a lien upon the real estate in favour of Her Majesty. The purpose of this lien is to prevent successors from selling the property and either leaving the country or spending the proceeds, leaving the Crown no way of collecting the tax. The present section 43 puts the onus on the purchasers of property to see that there is no lien for taxes.

We have considered whether the need for a lien would be reduced under our proposals where the gift would be included in the donee's tax base in the same way as other income. We recommend that it should be removed. We think that the inconvenience it causes in real estate transactions generally is greater than its value in the collection of taxes. If, in practice, evasion of tax through lack of security should prove to be a serious problem, the government could consider returning to a system under which it would have agreements with the provinces to the effect that the provincial land transfer officials would require a waiver of the Minister in any case where property was transferred following the death of the owner. However, we would prefer to avoid this unless it was found necessary.

CONCLUSIONS AND RECOMMENDATIONS

1. All gifts, that is, all receipts of wealth, whether inter vivos gifts or inheritances, should be included in the comprehensive tax base of the recipient. Transfers for inadequate consideration should also be regarded as gifts to the extent that the value of the property transferred exceeds the consideration.

2. The inclusion of all gifts in the comprehensive tax base should replace the present estate and gift taxes, and the legislation levying these taxes should be repealed.

3. Transfers between members of a family unit, for example to a spouse or dependent child, should not be taxable gifts.

4. The amount to be included in the tax base should be the net amount received, that is, the gross amount less legitimate expenses such as the expenses of administering an estate. If the gift were received subject to a condition, the cost of complying with the condition would be deducted.

5. Any gift which was renounced by the donee should not be included in his tax base but should be included in the base of the ultimate recipient, unless it reverted to the donor.

6. Where an individual has been given a power of appointment or a power of encroachment which would give him the uncontrolled right to apply property for his own use, he should be regarded as having received

the property unless he renounced it within 90 days after he became aware of it, or after it became exercisable, whichever was later.

7. A gift to a corporation should be included in its tax base unless made by the sole beneficial shareholder or by all the shareholders pro rata in accordance with their shareholdings.

8. Gifts to be held in trust would, generally speaking, be subject to an initial tax in the hands of the trust and the beneficiaries would receive credit for this tax on distribution. This is dealt with in Chapter 21.

9. In the case of a gift of an annuity, the present value of the annuity should be included in the income of the donee unless the donee qualified the annuity as a Registered Retirement Income Plan.

10. The following exemptions should be allowed:

   a) An annual exemption of $250 for each individual who filed a separate return, $250 for each spouse in a family unit, and $100 for each dependant who was a member of a family unit; the exemptions of the members of a family unit would be aggregated.

   b) A once-in-a-lifetime cumulative exemption of $5,000 for each individual on or after leaving his original family unit, applicable to gifts in excess of the annual exemption.

11. Gifts to tax-exempt bodies should, as under the present legislation, be free of tax.

12. Where a taxable gift had been received by a donor within four years before his death, a percentage of the gift should be exempt when passed on to his beneficiaries on his death. This percentage should range from 20 per cent to 80 per cent depending on how long before the donor's death the gift had been received.

13. Gifts arising on death should be included in income at the earlier of the date of actual or constructive receipt, or twenty-four months after the date of death. If the donee has not been identified within twenty-four months after the date of death, the gift would be included in the income of the trust that arose on death. If the gift were to be held in trust it would be included in the income of the trust at the time of obtaining probate, but in any event not later than twenty-four months after the date of death.

14. Fair market value, as developed by the courts, should be the test of the value of gifts and inheritances without additional statutory rules. Gifts arising on death should be valued at the date of death, but the donee, or trust, should have the right to revalue any of the property received by way of such a gift within two years from the date it had been included in income, or possibly longer under the general provisions for revaluation, and claim any loss resulting from the revaluation.

15. The rate schedule applicable to gifts should be the same as for other components of the comprehensive tax base. The same provisions with respect to averaging and with respect to deposits in Income Adjustment Accounts or investments in Registered Retirement Income Plans would apply to gifts as to any other income.

16. Where gifts consist of property other than money or marketable securities, the donee should have the right to pay the tax thereon in instalments over a five-year period, or in some cases ten years, with interest.

17. Gifts to non-residents should be subject to a 30 per cent withholding tax, subject to an annual exemption of $1,000 for each donor. A non-resident donee should have the option of filing a return as a Canadian resident. This tax would apply in the case of inter vivos gifts where the donor was resident in Canada, and in the case of inheritances where the deceased was domiciled in Canada.

18. Gifts received from non-residents should be included in income, but the donee would be entitled to a credit for foreign gift taxes or estate taxes paid.

19. A credit should also be allowed for estate tax imposed on property by the country in which the property was situated at the date of the donor's death.

20. Where property situated in Canada passed to a non-resident on the death of a person domiciled outside Canada, it should be subject to a 15 per cent tax of the type now imposed by the Estate Tax Act.

21. A number of special administrative provisions would be necessary to deal with gifts. However, the provision in the Estate Tax Act for a lien on real property should be removed.

REFERENCES

1/ C.S. Shoup, Federal Estate and Gift Taxes, Washington: The Brookings Institution, 1966.

2/ Section 111(2).

3/ Section 137(2).

4/ Section 26.

5/ However, the Income Tax Act provides in section 11(1)(v) that in the case of certain pension and annuity benefits, estate taxes and succession duties which are applicable to the payments are deductible in computing the recipient's income.

6/ Figures supplied to the Commission by the Department of National Revenue show that of over 14,000 gift tax returns filed in 1964, only 2,563 reported gifts which were subject to some gift tax and they reported taxable gifts of $38 million on which tax was paid of just over $6 million. Non-taxable gifts reported were approximately $125 million, and gifts unreported, because they were less than the exemptions, would also have been substantial.

7/ Representatives of the following groups made reference to this point: Canadian Manufacturer's Association; Canadian Chamber of Commerce; Estate Planning Association of Canada; Trust Companies Association of Canada.

8/ Alternative methods of taxing gifts are given in Appendix D to this Volume.

9/ See Chapter 18 for a description of the problems of deemed receipt of income on cancellation of debt, particularly in personal bankruptcies, as an exception to the general rule that there will be no deemed income from non-business debts. See Estate Tax Act, section 3(3)(a), (b) and

(e) which include in the taxable estate in some circumstances an artificial creation of a debt, the extinction of a debt, and debts rendered unenforceable by a limitation statute.

10/ Section 137(2).

11/ Section 4(1) and (2).

12/ Section 58(1)(o).

13/ Items now taxed under this section are principally the current expenses or taxes paid by the estate on property occupied by a beneficiary.

14/ This provision would be similar to section 137(2) of the Income Tax Act.

15/ Section 3(1)(d) of the Estate Tax Act is a general section bringing into tax gifts whenever made, of which actual and bona fide possession and enjoyment was not, at least 3 years prior to the death of the deceased, assumed by the donee and retained to the entire exclusion of the deceased.

16/ The various types of reserved powers and interests are set out in E.J. Mockler, J.G. Smith, and C. Frenette, Taxation of the Family, a study published by the Commission.

17/ The formulae which could be applied for this purpose are set out in Appendix E to this Volume.

18/ M.N.R. v. Estate of Edward William Bickle 66 DTC 5179.

19/ At common law a gift of an annuity is an income gift and the total payment is income, whether paid out of capital or not. Under the present Income Tax Act and practice, the part paid from capital is not taxable; section 11(1)(k) and Part III of the Income Tax Regulations.

20/ Under the present Estate Tax Act when non-commutable annuities are required to be valued they must be valued according to an annuity table prescribed in the Act, which assumes a rate of interest of 4 per cent.

This may result in the present value of the annuity for tax purposes being different from the cost of the annuity. If the annuity is commutable, the practice is to value the annuity at the rate of interest given in the annuity contract.

21/ Credits based on frequency of transfer may frequently be allowed under transfer tax systems which are not integrated with an income tax system. In some of these systems there is an assumption that the transfer tax should operate "once-in-a-lifetime".

22/ P. Nichols, Eminent Domain, 2nd ed., Albany, N.Y.: Mathew Bender and Co., 1917 p. 658, quoted in the Exchequer Court in many valuation cases.

23/ See Chapter 11 for the proposed rate schedule and a discussion of the principles involved.

24/ If it were found that this led to tax avoidance practices, consideration could be given to imposing a withholding tax on a gift passing to a non-resident on the death of a person who was resident in Canada but not domiciled in Canada, but the international implications would have to be carefully considered.

25/ It is to be noted that if the property given away has appreciated in value, tax will be levied on the donor in respect of his gains on the disposition of the property; such a tax may have to be calculated before the value of the gift can be computed, particularly where the gift arises on death.

CHAPTER 18

TRANSFER PAYMENTS AND MISCELLANEOUS RECEIPTS

In previous chapters the major components of income have been discussed. In this chapter we propose to deal with some additional types of receipts, most of which are not at present included in income for tax purposes but all of which fall within the proposed comprehensive tax base. These are: government transfer payments (unemployment insurance, workmen's compensation, family allowances and old age pensions), gambling gains and cancellation of debt. In addition we will discuss some other sundry kinds of income presently dealt with in sections 10 and 62 of the Income Tax Act. By restricting the discussion to these items we do not wish to imply that these are the only "other" receipts and gains that should be included in the comprehensive tax base. We make no claims to completeness. We hope it is well understood that under our approach all receipts and gains should be brought into income unless explicitly excluded, and that the absence of any discussion here does not mean that we would accept their exclusion from the tax base.

GOVERNMENT TRANSFER PAYMENTS

One function of government is to divert some of the flows of goods and services to the satisfaction of the collective wants of citizens. Another function is to alter the flows of goods and services within the private sector of the economy so as to achieve a more equitable distribution of purchasing power than might otherwise prevail. This redistribution function has two aspects, the tax side and the transfer side; here we are primarily concerned with the tax aspects of the latter. We are concerned mainly with the individual taxpayer-beneficiary, although we take this opportunity to discuss briefly some aspects of the transfer schemes themselves.

Government transfer payments are defined to include cash payments by governments to individuals other than those made in exchange for goods or services 1/. Among the more obvious and important transfer payments are the following: family allowances, old age security benefits, unemployment insurance benefits, workmen's compensation benefits and social assistance and relief of all kinds. We feel that the present treatment of these receipts is confusing and inconsistent.

Family allowances are financed out of general government revenues. They are not included in the recipients' incomes for tax purposes. Any person who is entitled to receive them in respect of a child (whether he accepts them or not) is required to reduce the personal exemption for the child from $550 to $300. 2/ As a consequence of this arrangement taxpayers with low marginal rates of tax receive more in family allowances than they lose through the reduction of the exemption. The converse is true for taxpayers with high marginal rates who would be better off if no family allowances were paid and the full exemption were allowed.

Old age security is a funded scheme financed by three earmarked federal taxes: a 4 per cent tax added to the personal income tax rate (with a $120 limit), a 3 per cent tax added to the sales tax rate, and a 3 per cent tax added to the regular corporate income tax rate 3/. The recipients of these pensions take them into their incomes and are taxed on them in full.

Unemployment insurance benefits are financed by a tax on covered employees and their employers. It is a funded scheme. The tax is related to the level of earnings of the employee, as are the benefits. The employer's contributions are deductible as a business expense, but the employee's contributions are not deductible from personal income. Neither the employer's contributions on behalf of the employee nor the benefits themselves are subject to personal income tax.

Workmen's compensation is dealt with by provincial plans financed by pay-roll taxes on employers. Contributions are deducted as an expense by the employers. Covered employees make no contribution, and are not required to take the employer's contributions into their income for tax purposes. The proceeds are not taxable in the hands of the compensated worker.

It would be difficult to conceive of a greater variation in arrangements than this.

Having reluctantly accepted the present transfer programmes, including the methods under which they are financed (except for old age security) for the reasons advanced in Chapters 6 and 7, we have developed our proposal; it does not go so far as we should like but it does have the merit of consistency. It is consistent with respect to our whole concept of the tax base, with respect to the treatment of any one programme relative to the others, and with respect to the private insurance-pension programmes beside which the government programmes frequently operate.

However, we recommend that before our proposals are implemented the amounts of all government transfer payments should be reviewed to ensure that their inclusion in income does not result in hardships.

In accordance with our concept of ability to pay, we recommend that the recipient of a transfer payment should include the benefit in his income because it increases the taxable capacity of the individual or the family. On the other hand, specific contributions to transfer programmes should be deductible from the individual's tax base 4/.

If all government transfers are brought into the tax base, those payments not now taxed may have to be increased in order to compensate for the new tax liability; for we do not mean to imply by our recommendation that the present payments are too large and should be reduced through taxation. Our recommended rate structure and system of tax credits will mean that some tax units will pay less tax even if their bases are increased by the addition of government transfers. The converse will be true for other taxpayers. On balance, we believe that our recommendations in this Report would increase the degree of redistribution achieved by the overall tax-transfer system, even if the transfers themselves were not increased. We have made no attempt to determine what adjustments in the payments might be required, because this would take us outside our terms of reference.

Family Allowances

The present approach, under which the personal exemptions for dependants are reduced when they qualify for family allowances, should be abandoned. The tax credits for dependants that we recommend elsewhere in the Report should not be reduced for the family unit in receipt of family allowance payments. To be consistent with our basic approach to taxable capacity, we recommend that all family allowances should be included in the tax base of the tax unit which included as a dependant the child on whose behalf the benefits were paid. The minimum income below which no tax would be paid by reason of tax credits would therefore be unaffected by the family allowance status of dependent children. Over this minimum, full progressive rates of tax would apply to family allowance receipts. This also means that no taxpayer could be made worse off because a dependant qualifies for the family allowance, as can occur at present.

Old Age Security

We have said that we have reluctantly accepted the present methods of financing transfer programmes. To this general proposition we wish to make one exception. There seems no legitimate reason to continue to earmark taxes to finance the old age security programme. To maintain the three separate levies seems to serve no useful purpose, and is a source of inconvenience and needless complexity. The rate structures of the three relevant taxes should be adjusted accordingly. There also appears to be little if any merit in a continuation of the funding of the plan. We suggest that henceforth old age security pensions should be financed out of general revenues like family allowances.

Old age security receipts are now included in the tax base of the individual. This is consistent with our approach and we recommend that this should be continued.

Unemployment Insurance

Unemployment insurance contributions are made by employees and employers. In Chapter 14 we recommend that the employer's contributions should continue to be deducted as a business expense and not added to the income of the employee, and that the employee's contributions should be deductible by the employee whether or not the 3 per cent optional expense deduction in respect of employment income is taken. Benefits should be fully taxable in the hands of the recipient.

We believe that this is a fair treatment of unemployment insurance. It brings into income only the net benefit as measured by the difference between what the employee put into the plan, either directly or indirectly, and what the employee takes out. Not to tax unemployment insurance benefits would bestow a tax advantage on the man who, despite the fact that he was unemployed for some time during the year, had a larger total income, including unemployment insurance benefits, than the man who worked full time for lower wages. Throughout this Report we have tried to minimize the significance of the source of a man's income; it is the change in economic power that counts. We can see no reason for departing from that principle here. Of course, if unemployment insurance benefits were brought into income the net benefit would be reduced, particularly for individuals with substantial other income in that year. It may be necessary to increase gross unemployment insurance benefits to maintain their after-tax value for taxpayers in the lower income groups.

Workmen's Compensation

These programmes have two facets: they protect employers against costs resulting from successful damage claims by their employees; and they protect employees against losses resulting from injuries sustained at work, whether or not the employer would have been held responsible. All contributions are made by employers. The benefits include lump sums in cases of death or permanent disability, income maintenance payments, and medical-hospital treatment.

We are satisfied that the most logical tax treatment of workmen's compensation would be to continue to allow a business deduction for the employer contributions, but to tax employees on the receipt of all benefits at full personal rates. It might be argued that the contributions of employers should be added to the incomes of the employees, but we reject this because under our proposals they would be deductible by the employee in any event. Taxing income maintenance receipts at full personal rates in the hands of the employee would be equitable relative to those who are working, and would be consistent with the tax treament of benefits received under private income maintenance insurance plans. It would also be fair to tax lump sum benefits received in cases of death or permanent disability, particularly in view of the relieving provisions we recommend in Chapter 13, including the provision which would permit the recipient to spread a lump sum benefit of this kind over his lifetime by purchasing a registered government annuity. Most of these payments are made to compensate for lost income that would have been taxed had it been received. Not to tax these sums would give the worker who received them an advantage over individuals who are not protected against accidents. Here, too, the level of the benefits should presumably be reconsidered by the provinces if this recommendation is accepted.

GAMBLING GAINS AND LOSSES

Gambling gains, like any form of receipt, increase the individual's taxable capacity and therefore should be brought into income as part of the comprehensive tax base. At present such gains are not taxed in Canada unless it is shown that the taxpayer's gambling amounts to a business, and where the question has been brought before the courts the matter for decision has been whether the gains arose from a business activity or from a hobby 5/. Because the comprehensive tax base would bring in all receipts which increased economic power, regardless of source, the question of whether gambling gains arose from a business would no longer be important.

The greatest problem in bringing gambling gains into income would be enforcement. Reporting of small winnings would be largely a matter of taxpayer honesty, but it might be possible to establish a system by which large winnings would have to be reported by the payers, in much the same way as banks report the cashing of bond coupons by depositors. For reasons of administrative convenience it might be useful to provide for a small annual exemption for net gambling gains.

The treatment of gambling losses poses a problem. To the extent that gambling is a form of entertainment for the individual, gambling losses are a consumption expenditure and should not be deducted any more than theatre tickets and the costs incurred in playing golf or skiing. To the extent that gambling is a form of business activity, losses should be deducted against gambling gains and other income. There is, of course, no objective way of determining the motivations of gamblers, any more than there is for any taxpayer. The solution we suggest is a rigid rule that would achieve simplicity and at least a degree of fairness. We believe that gambling losses should be treated in the same way as other losses that are deemed to be a personal consumption nature. Thus, they should be allowed only as a deduction from gambling gains, and should not be set off against other income as ordinary losses would be. The carry-over of such losses should be limited in the same manner as other losses of a personal nature, with a two-year carry-back and an indefinite carry-forward against gambling gains. Such losses would be available for carry-forward only if reported for the year in which they were incurred.

CANCELLATION OF DEBT

Cancellation of debt occurs when there is no longer any lègal obligation binding upon a debtor to pay all or some part of his debts. Examples are court-approved or voluntary arrangements by which a liability is reduced or cancelled, or the involuntary cancellation that occurs by the operation of the Statute of Limitations under which the right to enforce collection is lost.

At present, cancellation of debt generally gives rise to income only when it is considered to be some kind of price rebate. Court cases in this area have dealt only with trade liabilities, non-trade debts being considered to be of a capital nature. In the leading case of British Mexican Petroleum Company, Ltd. v. C.I.R., 6/ the House of Lords held that cancellation of trade debts in a year subsequent to those in which they arose did not give rise to income. This decision was followed in Canada by the Exchequer Court in the case of Plimley Automobile Company Limited v. M.N.R. 7/. However, in the case of Oxford Motors Ltd. v. M.N.R. 8/ the Supreme Court of Canada held that rebates given the taxpayer by its supplier based on the number of cars sold from its stock were trade receipts and taxable, even though the rebates were to be applied against the taxpayer's indebtedness to the supplier.

In the United Kingdom the decision in the British Mexican Petroleum Company, Ltd. case was nullified in 1960 by section 36 of the Finance Act, 1960, which requires that where any debt has been allowed as a deduction for the purpose of computing income from a trade or profession and is subsequently released, the amount released must be regarded as a receipt of such trade or profession.

We believe that when a debt is cancelled the debtor has, in effect, received income. For, as the cancellation of liabilities increases a person's net assets, his economic power is increased by the amount of the debt cancelled. Where a debtor who is in business has one or more of his debts cancelled, he has claimed expenses or has recorded assets which in fact will have cost him nothing. Income in prior years has, therefore, been understated, and it appears only reasonable to require an offsetting adjustment in the current year. Because such an adjustment will usually only arise when there is a loss, it will serve to reduce the loss rather than to create taxable income.

We are not recommending that the borrower should necessarily be considered to have received income at the time the lender merely writes off all or some portion of the debt. Although to regard income as arising to one party at the time the expense was recorded by the other party has the virtue of consistency, such treatment would not be practical in this case, and in fact may not be theoretically correct, because the borrower might still regard his obligation as a liability that he intended to meet.

Deeds of gift and of forgiveness would also, under our recommendations, result in income to the beneficiary and, because all income would receive similar treatment, it would be of little importance to the beneficiary whether such a transaction were considered as a gift or as forgiveness of debt. Loans between persons not dealing at arm's length should be deemed to be gifts unless satisfactory terms of repayment were agreed upon and generally complied with. This provision would be necessary because otherwise transactions which resembled loans could be set up as a mere cloak for a gift or bequest. Therefore, in such a case income should be deemed to arise when the debt is incurred rather than when the debt is later cancelled.

There is a problem in determining when cancellation should give rise to a deemed receipt of income. Cancellation of a debt usually requires some overt act on the part of the creditor. Debts may, however, become unenforceable by reason of the Statute of Limitations. We believe it reasonable to deem that income has arisen upon the expiry of the limitation period. Therefore income should arise at the earliest of: the time of acknowledgment of the cancellation of the debt by the debtor; the time the court approved an arrangement under the Bankruptcy Act; or the expiry of the limitation period. It should be noted that, because a limitation period does not bar the right but only the remedy, it would not prevent collection unless specifically pleaded in an action to collect the debt. Furthermore, the limitation might cease to apply because of a subsequent acknowledgment of the debt or part payment by the debtor. Nevertheless, because the limitation period is fixed, we think it should be the latest time to which the recording of income should be deferred by the debtor. In any case, whenever a debtor pays an amount which he had previously included in income on the ground that his indebtedness to pay the amount was cancelled, he should be allowed a deduction from income. This should effectively prevent any hardship arising from the inclusion in income of the cancelled debt.

Under the broad concept of income advocated in this Report, cancellation of a debt would result in income whether the debtor was solvent or insolvent. However, by definition the insolvent debtor would not be in a position to pay tax. In the United States this problem has been handled by declaring that if a taxpayer is insolvent both before and after a debt is forgiven, no income is realized. If he is solvent after the debt is forgiven, income is realized to the extent that he was made solvent by the cancellation. There has been a great deal of litigation in connection with this point and the Internal Revenue Code now provides generally with respect to both corporations and individuals that the amount of trade debts cancelled will not be included in computing income if the taxpayer agrees to reduce the basis of his assets by the amount of income attributable to the discharge of the indebtedness. These provisions therefore allow a postponement of tax until the assets are realized.

The above approach may appear complex. However, for most businesses, bringing into income the cancellation of debt would generally only reduce the current year's loss, or the prior year's loss carry-forward, and would not give rise to taxable income. This would not be so where either the taxpayer was in good financial condition, or where insolvency resulted from some circumstance that did not involve a business loss. In the first case there should be no problem in meeting the tax liability, while it is difficult to conceive of the latter situation arising, particularly if our recommendation is adopted that virtually all expenditures should be deductible. The problem of discharging the tax liability could be met by allowing up to five years to pay the tax, or by introducing a provision similar to the one adopted in the United States which allows the option of adjusting the tax basis of the underlying assets.

However, in the case of personal debts (whether or not there is a bankruptcy) the problem would not always be solved merely by the alteration of a loss carry-back or carry-forward, for the expenditure may have been an item of personal consumption and not a business expense used to reduce income. In these circumstances, to add a tax assessment to the travails of an individual already burdened with the consequences of financial failure seems to us to be excessively harsh treatment, and we therefore recommend that cancellation of debt should not result in income to the debtor if the debt arose in a transaction at arm's length and if the original expenditure was not deductible in computing income.

SUNDRY OTHER ITEMS OF INCOME

There are several kinds of receipts that are specifically excluded from income under section 10 or exempt from tax under section 62(1)(a) of the Income Tax Act or under other legislation.

The comprehensive tax base we recommend should encompass all forms of income, and therefore in principle all exclusions and exemptions should be terminated. We recommend that all income should be taxed in full and, if specific relief were required in respect of payments by the government, the need should be met through higher payments.

Certain items referred to in section 10 such as workmen's compensation and unemployment insurance have already been discussed. The balance of the items are briefly discussed below, along with our specific recommendations for changes. Because some of the items will expire in time or are subject to circumstances that preclude an alteration in the current tax treatment, we have not suggested that all of these receipts should become taxable.

Statutory Exemptions:
Section 10(1)(a)

Tax exemptions provided for in other legislation should be removed. In particular, the tax-free allowances for Members of Parliament should be withdrawn. Members of Parliament should be treated on the same basis as other employees and so should be required to bring their allowances into income, and at the same time should be allowed to deduct their expenses of earning employment income including election expenses. We would expect that it would be accepted that the regular place of business of a Member of Parliament is his riding, so that all expenses incurred while in Ottawa and in travelling to and from Ottawa would be deductible as long as they fell within the limits established for such expenses.

War Savings Certificates:
Section 10(1)(b)

The last of these certificates matured in 1954, and no income has accrued since. The section appears to be no longer necessary. Similar tax exemptions should not be made in future for debt instruments sold by government.

Ship or Aircraft of Non-Residents:
Section 10(1)(c)

This exemption should be removed if enforcement is practical.

Service Pension or Allowances:
Section 10(1)(d)

Exemption should be eliminated after consideration has been given to a revision of the amounts payable.

Service Pension from Another Country:
Section 10(1)(e)

There is a problem with respect to individuals now resident in Canada in receipt of service pensions from other countries. Unless our recommended tax credits offset the tax, the inclusion of these pensions in income could create hardships. Therefore, we would suggest a five- to ten-year time lag before these pensions were taxed, so that those individuals who have come to Canada on the understanding that their service pensions are not taxable would have an opportunity to adjust their affairs.

Halifax Disaster Pensions:
Section 10(1)(f)

These pensions will soon expire, if they have not already done so. If it is impossible to adjust the amounts, the present exemption should be maintained.

German Compensation:
Section 10(1)(fa)

These payments will expire in time and, because Canada cannot adjust the amount of compensation, this exemption should be continued.

Royal Canadian Mounted Police Pension:
Section 10(1)(ga)

Same as section 10(1)(d).

Profit Sharing Plans:
Section 10(1)(i)

To the extent that these plans are not registered retirement savings plans, as discussed in Chapter 16, payments into these plans by the employer should be subject to tax in the employee's hands at that time. This is the same treatment as we recommend for unregistered pension plans.

Prospecting:
Section 10(1)(j)

This exemption should be repealed as we recommend in Chapter 23.

Governor General:
Section 10(1)(k)

The exemption of the Governor General should be maintained and extended to Lieutenant-Governors.

Expense Allowance for Members of a
Legislative Assembly:
Section 10(2)

Same as section 10(1)(a).

Municipal Officers' Expense Allowance:
Section 10(3)

Same as section 10(1)(a).

Employees of Another Country:
Section 62(1)(a)

Because of the special status of foreign diplomatic personnel this exemption must remain on a reciprocal basis. However, efforts should be made to ensure that the privilege is not abused and that foreign personnel who are essentially conducting commercial activities in Canada are subject to Canadian tax.

CONCLUSIONS AND RECOMMENDATIONS

TRANSFER PAYMENTS

1. The amounts of all government transfer payments should be reviewed in the light of our recommendations in order to ensure that their inclusion in income would not result in hardships.

2. All government transfer payments, including family allowances, old age security payments, unemployment insurance benefits and workmen's compensation payments, should be brought into the income of the recipient, with deductions allowed for specific non-tax contributions to transfer programmes.

3. Where a family is in receipt of family allowance payments, the tax credits for dependants should not be reduced.

MISCELLANEOUS RECEIPTS

4. Gambling gains should be brought into income, perhaps subject to a small annual exemption for administrative reasons. Gambling losses should not be allowed as a deduction from other income, but should be deductible from gambling gains, with a carry-back of two years and an indefinite carry-forward.

5. Cancellation or forgiveness of debt should be treated as income of the debtor, except in those instances when the debt arose in a transaction at arm's length and was not deductible in computing income. The debt should be deemed to be cancelled at the earliest of the following times: the time of acknowledgment of the cancellation of the debt by the debtor; the time the court approved an arrangement under the *Bankruptcy Act*; or the expiry of the limitation period.

6. Specific receipts now excluded from income by section 10 of the *Income Tax Act* should be included in income except in certain cases where the payments will terminate in the near future or where special circumstances warrant their continued exclusion from income.

REFERENCES

1/ This definition excludes, for example, interest charges on government bonds, superannuation payments to retired civil servants, payments under annuities purchased from the government and Canada Pension Plan benefits. See Chapter 16 for a discussion of pensions.

2/ Section 26(1)(c).

3/ Old Age Security Act, R.S.C. 1952, Chapter 200, section 10.

4/ In principle, when contributions are made by an employer on behalf of an employee the employer's contribution should be added to the employee's income and the employee should deduct both the employer's contribution and his own. However, the employee's position is simplified where there is no limitation on the deduction, by ignoring the employer's contribution.

5/ M.N.R. v. Morden, [1962] Ex. C.R. 29; M.N.R. v. Walker, [1952] Ex. C.R. 1.

6/ (1932) 16 T.C. 570.

7/ [1958] Ex. C.R. 270.

8/ [1959] S.C.R. 548.

APPENDIX A

PROBLEMS OF TAX AVOIDANCE

THE MEANING OF "TAX AVOIDANCE" AND "TAX EVASION"

Before proceeding to examine the problem of tax avoidance, it would be well to explain what we mean by that expression, and how it differs from "evasion". The terms "avoidance" and "evasion" are not defined in the Income Tax Act, and, indeed, are rarely used in that statute.

The terms "avoid" or "avoidance" appear in section 51(2) which gives the Minister certain powers where "a taxpayer is attempting to avoid payment of taxes"; in section 137(2), which provides for the imposition of tax in circumstances where certain indirect payments or transfers are made, "whether or not there was an intention to avoid or evade taxes under this Act"; in section 138(1), which confers on the Treasury Board certain powers where one of the main purposes for a transaction was "improper avoidance or reduction of taxes that might otherwise have become payable under this Act"; and in section 138A(1), which empowers the Minister to make a direction where certain transactions are carried out, one of the purposes of which, in the opinion of the Minister, is to effect a reduction or disappearance of assets of a corporation in such a manner that any tax that might otherwise have become payable under the Act on a distribution of income "has been or will be avoided".

The term "evade" appears in section 56(1), which provides for the imposition of a penalty on every person "who has wilfully, in any manner, evaded or attempted to evade payment of the tax payable by him under this Part"; in section 132, which creates offences if certain steps are taken or attempts made to evade payment of tax; and in section 137(2). (See supra.)

Writers on the subject of taxation are usually careful to draw a distinction between tax evasion and tax avoidance. The distinction drawn between these concepts by the United Kingdom Royal Commission on the Taxation of Profits and Income would seem to be equally appropriate for Canadian tax purposes. The term "evasion", said the Royal Commission:

> "...denotes all those activities which are responsible for a person not paying the tax that the existing law charges upon his income. Ex hypothesi he is in the wrong, though his wrongdoing may range from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time." 1/

The Royal Commission defined tax avoidance in the following way:

> "By tax avoidance, on the other hand, is understood some act by which a person so arranges his affairs that he is liable to pay less tax than he would have paid but for the arrangement. Thus the situation which he brings about is one in which he is legally in the right, except so far as some special rule may be introduced that puts him in the wrong." 2/

Thus, evasion is illegal; avoidance is not.

For our purposes, as will be elaborated below, the expression "tax avoidance" will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provision or lack of provision in the law. It excludes fraud, concealment and other illegal measures. Also, it presupposes the existence of alternatives, one of which would result in less tax than the other. Moreover, motive would seem to be an essential element of tax avoidance. A person who adopts one of several possible courses because that one will save him the most tax must be distinguished from the taxpayer who adopts the same course for business or personal reasons. However, a man's purpose or intention may be difficult to determine. "The devil himself knoweth not the mind of man". Unless a taxpayer makes an admission as to his purpose or has clearly indicated his motivation in some other way, his purpose or intention can be determined only by inference or assumption. If he cannot give a reasonable explanation for carrying out a particular transaction or for carrying it out in a particular way, it may be assumed from the circumstances and the nature of the transaction that his purpose was to avoid tax liability.

METHODS OF TAX AVOIDANCE

Tax avoidance may take many forms.

1. The taxpayer may wilfully avoid having income. The high tax rates are often maligned for reducing the incentive on the part of taxpayers to make investment or engage in productive activity. Some taxpayers may prefer to conserve their resources, avoid risk, and enjoy their leisure rather than share with the state a substantial portion of the fruits of their labours. For this kind of tax avoidance there can be no remedy but to lower the rates of taxation and so remove the undesirable influence on incentive.

2. Certain types of tax avoidance are openly countenanced by the law, and, of course, it is perfectly legitimate to take advantage of these types. For example, the interest from certain government bonds was tax free under section 4(j) of the <u>Income War Tax Act</u>, and the <u>Income Tax Act</u> gives taxpayers a number of options or elections as to how certain types of income are to be taxed. For example, section 85A gives the taxpayer an election as to how stock option benefits are to be taxed; section 105 permits the distribution of corporate surplus in some circumstances at a flat 15 per cent rate. A taxpayer may make a gift to charity or get married in the last month of the year with the purpose of increasing his deductions and reducing his tax liability. In these cases both the language of the statute and the policy of the statute combine to permit these courses of action. The controversy with respect to such avoidance is one of policy rather than of law.

3. In other cases the taxpayer may have availed himself of various schemes and devices in order to get relief from what might be considered his just burden of taxation by arranging his transactions so as to fall outside the four corners of the taxing statute. A few random examples are given below:

   a) Income splitting by means of intra-family arrangements, trusts and controlled corporations, so as to escape progressive tax rates.

b) Distribution of corporate surplus at less than the normal rates of personal or corporate tax, that is, "dividend stripping".

c) Dissociating associated companies so as to escape the higher corporate tax rate under section 39.

d) Depersonalizing a personal corporation by having it acquire an active business, in order that dividend income will be received tax free.

e) Purchasing a defunct company which has incurred a heavy loss so as to use up that loss against future profits.

f) Arranging for what would normally be income to be received as capital, for example, by taking a discount or a premium on a loan instead of charging a higher rate of interest to compensate for the capital risk.

g) Transferring income to a corporation or trust established in a jurisdiction which imposes no income tax or imposes such tax at low rates.

WHETHER TAX AVOIDANCE IS AN EVIL

It is to be observed that the use of such arrangements is far from being universally criticized or condemned. The United Kingdom Royal Commission on the Taxation of Profits and Income pointed out that there was no general principle that a man owed a duty not to alter the disposition of his affairs so as to reduce his existing liability to tax and ventured the opinion that such a general principle neither could nor ought to be introduced. The following reasons were given by the Commission:

"First, it is too wide to be maintainable. Suppose that a man, influenced by the high rate of taxation on his marginal income, distributes some of his investments among adult members of his family to whom he had been in the habit of paying allowances out of his taxed income. Suppose that another man, similarly influenced, sells some of his income-yielding investments in order to put the proceeds into National Savings Certificates. Is either a case in which the man ought to be treated for tax purposes as if his income was still what it was before the transaction? Secondly, there is no true equity to support such a general principle. Taken at any one moment of time the affairs of different taxpayers are arranged in the most various forms and the extent to which they respectively incur a burden of tax may vary correspondingly. There is no reason to assume that the situation of any one taxpayer at that moment is the fairest possible as between himself and others differently situated: and if there is not, it seems wrong to propound any principle that would have the effect of fixing each taxpayer in his situation, without allowing him any chance of so altering his arrangement as to reduce his liability to assessment." 3/

However, after affirming the general right of a taxpayer to arrange his affairs so as to pay the least amount of tax, the Royal Commission did go on to criticize those arrangements by which a taxpayer deflected his income to others while retaining effective control of the enjoyment and disposition of it, as where he used a corporation or trust:

"The tax avoidance that should be struck at is to be found in those situations in which a man, without being in law the owner of income, yet has in substance the power to enjoy it or control the disposition of it in his own interest. For it is in such situations that a man can be seen to be the effective owner of income, though he would not be liable, if legal forms alone were attended to, to pay his share of tax in respect of it." 4/

Others contend that a taxpayer is entitled to be astute to prevent the depletion of his resources by the government. Tax laws, they say, are an encroachment on the liberty of the citizen, who is perfectly entitled to get around them if he can legally do so. There is no obligation to contribute to the support of government when the statute does not require the taxpayer to do so. The legislation spells out the liability for taxation, which depends on objective facts regardless of the purpose or intent of the individual.

On the other hand, a variety of considerations may be catalogued in condemnation of tax avoidance of the kind referred to in paragraph 3 above:

1. Loss of revenue to the government; the amount is difficult to estimate.

2. The fruitless expenditure of intellectual effort by some of the country's ablest lawyers, accountants and administrators in the economically unproductive tax avoidance battle.

3. The sense of injustice and inequality which tax avoidance raises in the breasts of those unable or unwilling to profit by it. Opportunities of tax avoidance are not equal, for it clearly has little practical meaning to salaried and wage-earning taxpayers from whom tax is deducted at source.

4. Deterioration of tax morality. When a taxpayer employs a variety of schemes and devices to exploit the loopholes in the Income Tax Act and thereby minimize his taxes, he lowers the level of tax morality. Indeed, it may be said that the widespread practice of tax avoidance will lead to an increase in tax evasion. Taxpayers who have little opportunity to practise tax avoidance and see others using legal means to reduce their taxes are sorely tempted to adopt illegal methods to achieve the same result. As has happened in other countries, if taxpayers generally form the notion that tax avoidance is an accepted practice, the system of self-assessment may break down.

5. A taxpayer who uses devices and schemes to minimize the tax that he should pay reduces his tax burden unfairly and shifts the avoided tax to other taxpayers. There is little information available as to how much of the tax burden is shifted through tax avoidance devices.

In general we concur with the conclusions of the United Kingdom Royal Commission on this subject. If a man gives up the right to income and to any control over the income or the source of income, even with the avowed purpose of reducing his tax liability, he should not be taxed on that income. However, if he contrives matters in such a way that he continues to enjoy the benefits of income, or if he continues to control the source or disposition of income, he should not be allowed to reduce his liability below what a taxpayer in similar circumstances receiving the income would normally expect to pay under the tax system. The taxing statute should contain sufficient provisions to prevent this latter type of avoidance.

THE ATTITUDE OF THE COURTS TOWARD TAX AVOIDANCE

Canada and the United Kingdom

As a prelude to examining the legislative approach to tax avoidance, it is important to examine the attitude of the courts to the subject. The need, if any, for a legislative remedy or solution and also the form it should take must depend in part on the judicial approach to tax avoidance and to the interpretation of taxing statutes.

The traditional judicial approach to the determination of tax liability is, first, to determine the meaning of the statute in accordance with certain well-established canons of construction and, second, to determine the true legal effect of the taxpayer's transactions and arrangements, and then decide whether they fall within the statutory language.

As for the first step, it is a well-established rule of English and Canadian income tax law that taxing statutes are to be strictly construed and effect given only to the letter of the law, according to the plain, ordinary meaning of the language used, regardless of its spirit or the supposed intention of Parliament. Perhaps the most frequently quoted authority for this proposition is the following passage from the judgment of Lord Cairns in Partington v. Attorney-General:

> "If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute." 5/

This passage has been cited with approval in subsequent decisions of the House of Lords and also by the Supreme Court of Canada 6/.

According to one commentator, "The origin of this rule of strict construction of taxing statutes is not very clear. It probably originated in the dislike of judges for unmeritorious defences to civil actions based on stamp duty points and was originally stated more as a rule that the onus was on the Crown to show clearly that the case fell within the statute." 7/

The application of the rule of strict construction has been carried to extreme lengths by Canadian courts in cases arising under section 21 of the Canadian Income Tax Act. For example, in M.N.R. v. MacInnes 8/ the taxpayer gave money and bonds to his wife, who purchased bonds with the money; she then sold all of the bonds and with the proceeds purchased other property which she sold; with the proceeds of that sale she purchased still other income-yielding property. The income from the last purchased property was sought to be taxed as income of the husband. It was held that the section taxed the transferor only on the income from the property transferred by him to his wife or from property substituted therefor, and did not extend to property substituted for such substituted property. A taxable substitution was limited to one exchange. As has so often been the case when decisions have been based on a narrow, literal construction of the statutory language in disregard of legislative policy, Parliament responded immediately with an appropriate amendment 9/.

The courts frequently refer to the rule of strict construction and often rely on it to reach a decision, either in favour of the taxpayer or against him, which is not consistent with the general scheme of the legislation or its apparent intent. On the other hand, the courts sometimes ignore the rule or modify it in order to reach what seems to be a sensible result. For example, in Settled Estates Limited v. M.N.R. 10/ the Supreme Court held that a trust was not an "individual" for the purpose of determining whether a corporation was a personal corporation notwithstanding the words of section 63(2), which provides that "a trust or estate shall, for the purposes of this Act,...be deemed to be...an individual". In M.N.R. v. Pillsbury Holdings Limited 11/ the Exchequer Court restricted the meaning of the general words "a benefit or advantage has been conferred on a shareholder by a corporation", which appear in section 8(1), to refer only to benefits or advantages conferred on a shareholder qua shareholder. In other cases the wording of a statutory provision is ambiguous and the court must resolve the ambiguity. This is normally done by reference to the context and in such a way as to give a reasonable meaning to the provision 12/.

As for the second step, there is an abundance of judicial authority to the effect that the legal significance of a taxpayer's conduct and arrangements is to be determined without reference to his motives in seeking to avoid tax. The proposition is often put that a court will give effect to the substance rather than to the form of the taxpayer's transactions, meaning that the court will give effect to the true legal relationship arising from the transaction, and will collapse mere sham transactions. The leading statement of this rule was uttered by Lord Tomlin in I.R.C. v. Duke of Westminster:

> "Apart, however, from the question of contract with which I have dealt, it is said that in revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called 'the substance of the matter,' and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for the doctrine seems to involve substituting 'the incertain and crooked cord of discretion' for 'the golden and streight metwand of the law'. [4 Inst. 41]. Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable." 13/

As a general rule the reasoning in the Duke of Westminster case is regarded with favour by the courts in Canada, and taxability is normally determined according to the strict legal position of the taxpayer and the legal effect of the transaction. That is to say, the courts normally take the words of the taxing statute as they find them and apply them to any particular transaction on the basis of its legal effect also as they find it. This is the rule of the legal result or effect as opposed to that of financial or economic effect 14/.

The court will not, of course, recognize or give effect to sham transactions. Lord Tomlin in the Duke of Westminster case warned that his statement quoted above must not be taken to mean that the apparent legal form of a transaction governs even if it is not intended to have legal effect. He stated:

> "There may, of course, be cases where documents are not bona fide nor intended to be acted upon, but are only used as a cloak to conceal a different transaction. No such case is made or even suggested here. The deeds of covenant are admittedly bona fide and have been given their proper legal operation. They cannot be ignored or treated as operating in some different way because as a result less duty is payable than would have been the case if some other arrangement (called for the purpose of the appellants' argument 'the substance') had been made." 15/

This rule has also been applied in Canada. For example, in Front & Simcoe Limited v. M.N.R. 16/ the Exchequer Court refused to recognize the form in which a transaction was cast by finding that it was only a mask to hide another transaction—the money in question was asserted to be damages for cancellation of a lease, but the Court found that it was in fact prepaid rent under the lease 17/.

In time of grave national crisis, the House of Lords was critical of the doctrine set down in the Duke of Westminster case and heaped moral censure on the practitioners of tax avoidance. Lord Simon said in Latilla v. I.R.C.:

> "My Lords, of recent years much ingenuity has been expended in certain quarters in attempting to devise methods of disposition

> of income by which those who were prepared to adopt them might enjoy the benefits of residence in this country while receiving the equivalent of such income without sharing in the appropriate burden of British taxation. Judicial dicta may be cited which point out that, however elaborate and artificial such methods may be, those who adopt them are 'entitled' to do so. There is, of course, no doubt that they are within their legal rights, but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary, one result of such methods, if they succeed, is, of course, to increase pro tanto the load of tax on the shoulders of the great body of good citizens who do not desire, or do not know how, to adopt these manoeuvres." 18/

After the war, however, the Duke of Westminster principle seemed less obnoxious to the House of Lords. Thus, in Vestey's Executors v. I.R.C., Lord Normand said:

> "Parliament in its attempts to keep pace with the ingenuity devoted to tax avoidance may fall short of its purpose. That is a misfortune for the taxpayers who do not try to avoid their share of the burden, and it is disappointing to the Inland Revenue. But the court will not stretch the terms of taxing Acts in order to improve on the efforts of Parliament and to stop gaps which are left open by the statutes. Tax avoidance is an evil, but it would be the beginning of much greater evils if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved." 19/

In 1955, when the Royal Commission on the Taxation of Profits and Income submitted its report, they stated that "the prevailing doctrine in this country" is that established in the Duke of Westminster case.

The effect of the two facets of the judicial approach to taxation described above is to favour the careful or foresighted taxpayer who, by arranging his affairs, may bring his gains outside the sphere of taxation provided for in the statutory language which he hopes and expects will be strictly and literally construed by the courts. However, it also works against the unwary taxpayer who fails to arrange his affairs and runs afoul of a technical provision in the Act. He may incur a tax liability which was never intended, but he is trapped by the legal effect of his transaction and the literal interpretation of the statute.

The argument in favour of the traditional judicial approach is that it provides a degree of certainty. It enables the taxpayer to plan his affairs and make business decisions with some assurance of what the tax consequences will be. If the courts were to depart from either of the principles we have referred to without very good reason, they would be embarking on a dangerous path. Their decisions would depend on the personal views of the judge as to what the law should be, or what it was intended to be, rather than on what the legislature has said that it is.

We agree that the courts should not depart lightly from the words used in the statute or from the legal effect of a transaction in resolving its tax implications. However, it may be suggested that the courts should also have regard to the equities of the situation and the apparent purpose of Parliament, and should modify or limit the strict literal meaning of words where this is necessary to reach a sensible result. This would assist in the development of a better and more equitable tax structure. It would reduce the necessity for so many loophole-closing amendments which gradually clutter up and complicate the statute. The courts, however, must reach their decisions primarily by reference to the statute. Their job will be made much easier if the legislation is well drafted and consistent in itself.

The United States

The Construction of Taxing Statutes. It is illuminating to trace the evolution of the judicial approach to the interpretation of taxing statutes and to tax avoidance under United States income tax laws. The traditional English and Canadian rules of statutory interpretation were at one time embraced by United States judges. Thus, in United States v. Merriam 20/ the Supreme Court applied the oft-quoted passage from Lord Cairns' judgment in Partington v. Attorney-General, and in Gould v. Gould the court said:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favour of the citizen." 21/

This approach to statutory interpretation has since been discarded. The more recent approach is shown by the opinion of Stone, J. in White v. United States:

> "We are not impressed by the argument that, as the question here decided is doubtful, all doubts should be resolved in favor of the taxpayer. It is the function and duty of courts to resolve doubts. We know of no reason why that function should be abdicated in a tax case more than in any other where the rights of suitors turn on the construction of a statute and it is our duty to decide what that construction fairly should be." 22/

Judicial Anti-Avoidance Doctrines. A similar evolution has occurred with respect to the rule that every man is entitled to arrange his affairs so as to minimize his taxes. In the leading case of United States v. Isham 23/ the Supreme Court held, in a prosecution for failure to affix a stamp to an instrument, that the form of the instrument rather than its substance and effect governed and that the stamp was not required. The Court said:

> "To illustrate. The Stamp Act of 1862 imposed a duty of two cents upon a bank check, when drawn for an amount not less than twenty dollars. A careful individual, having the amount of twenty dollars to pay, pays the same by handing to his creditor two checks of ten dollars each. He thus draws checks in payment of his debt to the amount of twenty dollars, and yet pays no stamp duty. This practice and this system he pursues habitually and persistently. While his operations deprive the Government of the duties it might reasonably expect to receive, it is not perceived that the practice is open to the charge of fraud. He resorts to devices to avoid the payment of duties, but they are not illegal. He has the legal right to split up his evidences of payment, and thus to avoid the tax. The device we are considering is of the same nature." 24/

This doctrine was discarded to a large extent in the decision of Gregory v. Helvering 25/. In that case the court was required to construe the meaning of the tax-free reorganization provisions of the Revenue Act of 1928. Mrs. Gregory, in a technically perfect scheme, carried out a series of transactions each of which was tax free under a literal interpretation of the statute. The effect of all the transactions was to permit her to make a gain on the sale of stock which normally would have been taxable. But the Court refused to interpret the statute literally. It brushed aside the "elaborate and devious" form of the transaction masquerading as a reorganization and upheld the government's position. In doing so it explicitly excluded from consideration the question of motive—avowedly avoidance—and rested its conclusion on the ground that the statute meant by reorganization a transaction in furtherance of the reorganized corporation's business. It held that when measured by this test the scheme was outside the plain intent of the statute. Thus, the court interpolated into the Congressional definition something not written there, namely, the requirement of business purpose.

The "business purpose" doctrine is not limited to the reorganization provisions of the Code, but is applied to the entire statute. In Weller v. Commissioner the court said: "Thus the principle laid down in the Gregory case is not limited to corporate reorganizations, but rather applies to the federal taxing statutes generally. The words of these statutes which describe commercial transactions are to be understood to refer to transactions entered upon for commercial purposes and 'not to include transactions entered upon for no other motive but to escape taxation'" 26/. The Internal Revenue Service has used the doctrine as an overall weapon for combating tax avoidance and has succeeded in some instances and failed in others. The precise scope of the doctrine is not entirely clear. In the words of one commentator:

> "Where do we draw the line in defining the areas to which the business purpose doctrine applies? This is not an easy question to answer, and it is complicated by the fact that among the judges of the many courts over our country before whom tax cases are tried or heard on appeal, there are wide divergencies in attitudes towards the doctrine, ranging from empathy to outright hostility.... I would venture the following as a capsulized statement of the contours of the test. The business purpose doctrine is an appropriate tool for testing the tax effectiveness of a transaction, where the language, nature and purposes of the provision of the tax law under construction indicate a function, pattern and design characteristic solely of business transactions. While the courts have not articulated the doctrine in precisely these terms, most of the cases decided by courts that are not hostile to it will pretty well fit into this formulation. And as thus formulated it appears to me to be a wholesome and useful technique for preventing distortion and misuse of the statute." 27/

Two other United States judicial anti-avoidance doctrines should be mentioned. The first of these is the step transaction doctrine, under which a corporate adjustment is looked at as a whole. Even though it may consist of several steps, each of which considered alone would be tax free, the entire transaction will not be tax free if, as a whole, it does not meet the requirements of the statute. The doctrine is illustrated by the case of Helvering v. Elkhorn Coal Co. 28/ In that case Corporation M desired to acquire the operating assets of Corporation E but not its investments, which were substantial. E thereupon organized Corporation X to which it transferred all of the investment assets. X issued all of its stock to E, which distributed it to its shareholders. E then transferred its remaining assets to M for stock of M; E was dissolved and the M stock was distributed to E's shareholders. It was contended that each step in this transaction was tax free. The court held, however, that the transaction must be viewed as a whole, and that the transfer of E's operating properties to M was not tax free since it did not constitute the transfer of substantially all of E's properties, as the statute required.

The last doctrine, the economic approach to the consequences of transactions, has been applied in a number of situations to prevent tax avoidance. Briefly, the court has regard to economic considerations and not only to legal formalities such as contracts, property and so on, in order to distinguish "substance" from "form" or "sham" from "reality". In determining the reality or fictional character of a transaction—say, an indebtedness for interest payment or the ownership of a trust corpus—the court has adopted an economic test, rejecting legal tests of contract in the one case and property in the other. According to one commentator the economic approach by the courts has probably had its most important impact on the taxation of family income, particularly in the treatment of family trusts. For example, in one case the doctrine was used to defeat avoidance through the use of a short-term trust; the income from it was taxed to the grantor who retained powers of administration over the trust rather than to the beneficiary, the court refusing to recognize that the grantor ceased to be the owner of the corpus after the trust was created. According to Hellerstein, "Reliance on economic factors to strike down tax avoidance is the broadest and the most elusive of the judicial barriers to tax avoidance that we have considered; and inevitably it has produced the widest variations in acceptance and application among the judges" 29/.

THE ATTITUDE OF THE LEGISLATURE TO TAX AVOIDANCE

Having regard to the established judicial approach to the interpretation and application of taxing statutes, action to counter tax avoidance must come primarily from the legislature. The approaches available to Parliament to correct avoidance may be divided conveniently into four types:

1. The "sniper" approach, which contemplates the enactment of specific provisions which identify with precision the type of transaction to be dealt with and prescribes with precision the tax consequences of such a transaction.

2. The "shotgun" approach, which contemplates the enactment of some general provision which imposes tax on transactions which are defined in a general way.

3. The "transaction not at arm's length" approach, which applies where the parties to particular types of transactions are not dealing with each other at arm's length and provides that the tax consequences will be different than they otherwise would be.

4. The "administrative control" approach, which contemplates the grant of wide powers to an official or an administrative tribunal in order to counter tax-avoidance transactions.

In its efforts to keep pace with the ingenuity and inventiveness of taxpayers bent on minimizing their tax liability, Parliament has enacted provisions which fall into all four categories. In some cases these efforts have been too little and too late. In others they have gone beyond what was necessary and have penalized or inhibited bona fide transactions along with those which are reprehensible.

The "Sniper" Approach

Specific Provisions. Several provisions of the Income Tax Act are directed at particular types of avoidance transactions. For example, sections 21 and 22, dealing with intra-family transfers of property, are intended to avoid income splitting by property transfers to spouses and minors under 19 years of age.

Section 24 provides that where a security is received in satisfaction of an interest, dividend or other income debt, its value will be included in the recipient's income. The purpose of the section is to render inapplicable the doctrine that the giving of a promise to pay does not constitute payment, and to prevent the avoidance of taxation through the issuance of valuable securities in place of actual payment.

Another example of specific legislation aimed at tax avoidance is section 25 which deals with particular types of payments passing between an employer and an employee which, under the section, are deemed to be remuneration for services.

Other examples of the sniper approach to legislation against tax avoidance are contained in subsections (2) to (9b) inclusive of section 28 and section 105B, relating to payments of dividends out of designated surplus of a corporation.

Appraisal: Advantages. The advantages of the sniper approach may be summarized as follows:

First, it can be argued that a person's liability to pay taxes should be imposed in explicit terms and with the authority of Parliament; and that this precept is not observed where control of tax avoidance is maintained through the use of some general declaration of principle governing tax avoidance and particularly where the application of the principle and the consequential tax adjustment is left to the discretion of the Department or some other body. If general or discretionary provisions are enacted, Parliament does not know when they will be applied or how far they may be extended.

Second, where specific anti-avoidance provisions are enacted they are relatively clear and certain in their application and they tend to produce certainty in the law. If they prove inadequate they can be amended.

The United Kingdom Royal Commission on the Taxation of Profits and Income explicitly rejected any departure from the system adopted under the United Kingdom Act of detailed legislative control of the various forms of tax avoidance. The Commission concluded that the specific provisions in the British law were adequate to deal with most forms of tax avoidance and that they had been supplemented by many court decisions. The Commission considered that in any event "avoidance is not a word of exact meaning or at any rate does not denote an activity that is in all contexts obnoxious".

Appraisal: Undesirable Features. First, since it is impossible to foresee every technique of tax avoidance, specific provisions can be effective only in so far as the legislators and the draftsmen can foresee the possible actions that might be taken by tax avoiders. Specific provisions in the Candian legislation have been far from totally effective in thwarting avoidance devices: "dividend-stripping" operations were carried on openly until the resort by Parliament to ministerial discretion in 1963; repeated amendments to the "associated corporations" provisions did not establish satisfactory control until the remedial legislation of 1963, invoking ministerial discretion; several "income-splitting" arrangements have slipped through the net of section 21. 30/

Second, legislation aimed at specific avoidance often opens new loop-holes. That is, particularization breeds avoidance. The significance of this feature depends, of course, to a large extent on the skill of the draftsman. The following comment concerning the experience in the United States is interesting:

> "As the years rolled on and the Treasury and Congress awakened to the realization that avoidance was rife, the process of statutory amendment was adopted as a means of checking it; and there were enacted particular provisions to prevent specific types of avoidance. But...particularization in a statute leaves less room for the play of judicial interpretation and hence, while a particular device is eliminated, avoidance in general is not decreased. In other words, particularization reaches its immediate objective but gets no closer to the ultimate goal. It wins the battles but loses the wars. So while the legislators passed amendments right and left, they discovered that when they closed the dike in one place, they often used an implement which opened up a hole right next to it. Congress was fighting a losing battle until the Supreme Court came to its aid in the Gregory case. Taxpayers were becoming bolder and bolder, and, relying, with a confidence built up by earlier cases, on the doctrine that the law meant what it said, were pursuing every scheme that complied with the law as it read. Generally speaking, the lower courts justified this confidence, but with the Gregory decision the avoidance balloon was considerably deflated. Taxpayers discovered that no longer did safety lie in the literal meaning of the statute." 31/

Third, the sniper approach may result in inequity in circumstances where the draftsman, eager to catch all avoiders, casts the net very wide and thereby may reach situations never intended to be included. Yet the language of the statute is so specific that it is impossible for the court to afford relief through interpretation, for as the articulation of the statute increases, the room for interpretation must contract. Thus, section 139(5), (5a) to (5d) and (6), which specifically define persons who are deemed not to deal at arm's length, often apply to persons who in fact deal at arm's length, and in this way may well constitute a hardship. One commentator has described the difficulty and proposed a solution in the following terms:

> "The draftsmen of the statute, in their eagerness to catch the 'avoiders', have drawn within the range of the statute, no doubt unwittingly, situations which, when they are brought to light, were never intended to be included. Here perhaps is the worst feature of the present tendency toward particularity. Under the 1937 Act, many corporations engaged in trade or business, both domestic and foreign, and wholly legitimate in character, find themselves within the net of the personal holding company, and so face ruinous taxes. The language employed is so exact and specific that it is impossible to afford relief through interpretation. Thus the ultimate effect is to create greater

> inequalities, when the avowed purpose is to iron out inequalities.... But in the field of the so-called 'abuses'...it is suggested, although with some hesitation, that perhaps a sounder result may be obtained by the use of less particularity and more generality in language, even at the sacrifice of exactitude in the chart.... In this rather narrow field, might it not be advisable to give the Treasury and the courts somewhat more elastic language, language which will be susceptible of rational application in situations which are not foreseeable when the Act is drawn? On the one hand, this greater flexibility would tend to correct the so-called 'abuses' by deterring individuals from embarking on schemes which the very presence of such flexibility will render highly doubtful of success, and so too dangerous to attempt; and, on the other, would permit the exclusion from the punitive provisions of transactions which are quite proper and legitimate." 32/

Fourth, the use of highly particularized language aimed at specific avoidance devices assists the potential tax avoider "because it defines for him the obstacle that he must be ingenious to get around", said the United Kingdom Royal Commission on the Taxation of Profits and Income. The Commission was critical of the tendency of draftsmen, in order to meet this problem, to cast statutory provisions in language that is more and more vague and imprecise in the hope of covering some unforeseen situation— the very solution proposed in the third argument, supra, to meet the inequity and hardship discussed in that paragraph.

Fifth, anti-avoidance legislation is responsible for much of the obscurity in the Act, couched as such legislation often is in tortuous and obscure language of unrivalled complexity and difficulty. See, for example, subsections (5) to (6) inclusive of section 139, subsections (4) to (7) inclusive of section 39, subsections (2) to (9b) inclusive of section 28 and sections 105B, 105C and 139A. The United Kingdom Royal Commission recommended modification of the legislation "that will make it shorter, briefer and more precise". It would be easy to make the legislation shorter and briefer but it may be difficult to make it at the same time more precise.

The "Shotgun" Approach

The Use of General Provisions. Because of the impossibility of foreseeing all possible methods of avoidance, and perhaps also to obviate some of the undesirable features of the "sniper" approach described above, Parliament has enacted a number of anti-avoidance provisions in general language which are not directed at any specific device or technique. The rationale for such general provisions was well stated in a recent Australian judgment:

> "It is perhaps inevitable in an acquisitive society that taxation is regarded as a burden from which those who are subject to it will seek to escape by any lawful means that may be found. This is generally called tax avoidance and it is successful if by reason of what is done what is potentially taxable is put outside the effective operation of the revenue laws. Furthermore, in the absence of a special law a genuine transaction does not lose its legal effect because it was carried out to avoid, limit or postpone tax. It is the recognition of this that accounts for the legislature casting its net wide to frustrate the attempts of those confronted with tax liabilities to get round the law. As often as a particular loophole is closed through which it has been discovered that revenue is lost, another is likely to be found, so that as long as it confines itself to stopping gaps the legislature is always a step behind reluctant taxpayers and their ingenious advisers. It is not, therefore, surprising that parliament has sometimes sought to anticipate tax avoidance by general laws rendering ineffectual against the Commissioner arrangements which are not shams but are entered into to avoid taxation obligations that would otherwise in due course be incurred." 33/

Section 16(1) of the Act provides that a payment or transfer of property made on the direction of a taxpayer or with his concurrence to some other person for the benefit of the taxpayer or as a benefit which he desired to have conferred on the other person, will be included in computing the taxpayer's income to the same extent as if it had been made to him. In our opinion this provision is clear in its intent and sufficiently general in its wording to allow the courts room for interpretation and application according to the circumstances in each case. A provision of this kind should be retained in the Act.

General anti-avoidance provisions in the Income Tax Act may be grouped into a number of classes or approaches which are discussed below.

The "Reasonableness" Test. A number of sections in the Income Tax Act sanction the recognition of certain transactions for tax purposes in so far as they are reasonable, regardless of their form or legal effect. For example, section 7(1) requires the inclusion in income of that part of a payment under a contract that "...can reasonably be regarded as a payment of interest or other payment of an income nature". This provision was recently held applicable in the case of a sale of a farm where the price was higher than that paid for other farms in the area and was payable over eight years in instalments without interest 34/.

Section 11(1)(c) permits the deduction in computing income only of such an amount of an interest payment as is reasonable. Section 12(2) prohibits the deduction of an outlay or expense except to the extent that it was reasonable in the circumstances.

Section 20(6)(g) provides for the allocation of a price received partly for depreciable property of a prescribed class and partly for something else. It provides that the proceeds of disposition of the depreciable property are "the part of the amount that can reasonably be regarded as being the consideration for such disposition".

It will be observed that a number of these provisions relate to particular types of transactions or amounts. However, they depend for their operation on a general word, "reasonable", which leaves room for the exercise of judicial discretion. For this reason they may be classed as being within the "shotgun" approach rather than the "sniper" approach to legislation against tax avoidance.

The Undue and Artificial Reduction of Income. Section 137(1) provides that in computing income for the purposes of the Income Tax Act no deduction may be made in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would "unduly" or "artificially" reduce the income. The section leaves the question of undue or artificial reduction of income to be finally determined by the courts, without providing any criterion by which to determine that question.

It is to be observed that the United Kingdom Royal Commission was critical of a British tax avoidance provision that struck at "artificial" transactions and "artificial" operations. The Commission pointed out that "...a transaction is not well described as 'artificial' if it has valid legal consequences, unless some standard can be set up to establish what is 'natural' for the same purpose. Such standards are not readily discernible" 35/.

The precise scope and meaning of section 137(1) has not been clearly marked out by the courts, which have had few occasions to consider it. The Minister has relied successfully on the provision on at least three occasions 36/. In none of these cases has the meaning of "artificial" emerged with any clear meaning. In the Shulman case Ritchie, D. J. stated that: "In the context found here, 'artificially' means 'unnatural',—'opposed to natural' or 'not in accordance with normality'" 37/. It will be observed that unreasonable expenses are disallowed by section 12(2) of the Act. Expenses which are not incurred to earn income are disallowed by section 12(1)(a). Personal or living expenses are disallowed by section 12(1)(h). In view of these provisions and in view of the difficulty in determining what is artificial, it seems probable that section 137(1) would be held applicable only in rare and extreme cases. However, it may be useful as a deterrent and should be retained.

The Benefit Approach to Income. In several sections of the Act, a taxpayer is required to include in his income certain "benefits" or "advantages". For example, section 5(1)(a) includes as income from an office or employment the value of all benefits (with certain exceptions) received or enjoyed by the employee in the course of his employment. Section 8(1)(c) requires that a shareholder should include as income the value of a benefit or advantage (with certain exceptions) conferred on him by a corporation. Section 65(1) provides for the inclusion in income of the value of all benefits (other than a distribution or payment of capital) to a taxpayer during a taxation year "from or under a trust, estate, contract, arrangement or power of appointment".

Section 137(2) provides that every benefit conferred on a taxpayer as a result of one or more sales, exchanges, declarations of trust, or other transactions of any kind whatsoever will be regarded as a payment to the taxpayer equal to the amount of the benefit conferred. The value of the benefit may be taxed in a number of ways "depending upon the circumstances". It may be included in the income of the person receiving the benefit. If it is conferred on a non-resident it may be taxable under the provisions of Part III of the Act. Alternatively, it may be taxed as a gift under Part IV which relates to gift tax. Having thus imposed taxation on a very broad category of benefits, it is provided in section 137(3) that no benefit shall be considered to have been conferred if the parties were dealing at arm's length, if the transaction was bona fide and if several other conditions are met. Section 137(2) is stated to be applicable notwithstanding the form or legal effect of the transactions and whether or not there was an intention to avoid or evade taxes.

The language of this provision is far from clear. It is so broad and general that it would probably be held applicable only in extreme cases, and even then it would be difficult to determine what type of tax should be imposed. Its precise meaning must await interpretation by the courts which so far have had virtually no occasion to consider it. The section does not appear to have been significant in thwarting tax avoidance, although its deterrent effect is difficult to estimate.

The "Transaction Not at Arm's Length" Approach

It is an underlying assumption of income tax law that profits or gains made by a taxpayer can be measured in money terms and that such measurement is a proper basis for taxation because such profits or gains are achieved through the interplay of market forces which are independent of the taxpayer's control. In most cases this assumption is valid but it breaks down in circumstances where a taxpayer, either by himself or in collusion with others, is able to manipulate or control the forces which determine his profits or gains and thereby bring about a reduction in his income below what it would otherwise have been. Tax avoidance of this nature is an ever-present problem and inevitably leads to a system of statutory and administrative rules designed to counteract such avoidance.

An important facet of the tax avoidance problem, which is particularly relevant in the field of business income, arises where the parties to a transaction do not have the customary opposing economic interests but have, by virtue of the particular relationship between them, a common economic interest which enables them to arrange the terms of the transaction to produce the least amount of tax. Persons in such circumstances are said not to deal with each other "at arm's length" and transactions between them are referred to as "transactions not at arm's length".

The Income Tax Act does not contain an all-inclusive definition of "arm's length" or "not at arm's length" as such. It is, however, provided in section 139(5) that "related persons" are conclusively deemed not to deal with each other at arm's length. "Related persons" include individuals related to each other (to the extent defined) by blood, marriage or adoption, a corporation and a person who controls it alone or together with other members of a related group, and corporations which are subject to common control. It is provided that if two parties are not related to each other it is a question of fact whether they are dealing with each other at arm's length. There is as yet no significant body of case law on the question whether unrelated persons are as a matter of fact dealing at arm's length. However, it does not appear that a mere mutual interest in keeping taxes to a minimum, in itself, constitutes evidence that parties are not dealing at arm's length.

Generally speaking, an object of the legislation should be to prevent avoidance of a tax liability by carrying out non-arm's-length transactions on terms different than those which would have prevailed between independent persons dealing at arm's length. However, it should be possible to carry out some types of non-arm's-length transactions without tax consequences, where the objective is simply to achieve a change in form or organization without any real economic profit. This applies particularly where there is a technical reorganization within a group of related companies, where a proprietorship is incorporated and in certain types of transactions between related corporations. We discuss these cases in Chapter 15.

It is our hope and expectation that under the proposals which we are making for changes in the tax system there would be much less need than there is now for provisions dealing with transactions not at arm's length. We reach this conclusion because of a number of particular features of our proposals. Transactions within a family unit would be free of tax and the income received by all members of a family unit would be aggregated for taxation purposes. This would eliminate the need for some of the provisions or at least would reduce the scope of their application. Similarly, the right of related corporations to file consolidated returns would remove much of the incentive for such companies to arrange artificial transactions among themselves. The abolition of graduated rates for corporations would eliminate the need for the associated corporation provisions which are closely connected with the non-arm's-length provisions. Nevertheless, there will undoubtedly still be circumstances in which it would be necessary to legislate with respect to non-arm's-length transactions. This will be true particularly in the case of such transactions between residents of Canada and non-residents.

It is sometimes argued, and was urged before us, that the irrebuttable presumption that related persons do not deal with each other at arm's length is unjust, and that it should be open to taxpayers who are "related" within the statutory rules to demonstrate that as a matter of fact they are dealing at arm's length. In our view there should be an irrebuttable presumption that corporations which are subject to common control are not dealing with each other at arm's length. There should also be an irrebuttable presumption that a husband and wife who are living together are not dealing with each other at arm's length and that they are not dealing at arm's length with their children, whether or not their children are living with them. However, it is our opinion that in the case of transactions between brothers and sisters who are not living with their parents and between brothers-in-law and sisters-in-law there should only be a presumption of not dealing at arm's length, which could be rebutted by evidence.

Broadly speaking, the present provisions of the Act dealing with non-arm's-length transactions fall into four categories: (1) those provisions which provide for the adjustment of the terms of transactions for tax purposes; (2) those provisions which do not adjust the terms of a transaction but charge with taxation the benefits or advantages that flow from it; (3) those provisions which for tax purposes ignore or look through a transaction so as to prevent or offset the artificial tax effect which would otherwise result from it; and (4) those provisions which affect the tax consequences of a situation by treating all persons not dealing at arm's length as if they were one person. We shall comment on each category in turn.

1. Section 17 contains provisions to the effect that where a taxpayer is a party to a non-arm's-length transaction he will be deemed to have received or to have paid the fair market value for goods or services. However, these provisions do not cover all possible circumstances. Subsection (1) provides that a taxpayer who has purchased anything in such a transaction at a price higher than the fair market value will be deemed to have paid the fair market value. Subsection (2) provides that where a taxpayer has sold anything in such a transaction for less than the fair market value he will be deemed to have received the fair market value. It will be observed that each of these subsections applies the fair market value test to one side of the transaction only, and the other party is not entitled to make an equivalent adjustment in his tax accounts. This would seem to unjustly penalize the parties to a transaction which is affected by subsection (1) or (2). Subsections

(5) and (6) provide that where property of a corporation has been appropriated to shareholders on the winding-up of the corporation or otherwise the corporation will be deemed to have received the fair market value of the property. Subsection (7) provides in effect that subsections (2), (5) and (6) are not applicable in respect of depreciable property which is specifically dealt with in section 20(4) (referred to below). Subsections (3) and (4) relate to rents, royalties and other payments for the use of property or for services where the transaction is between a resident taxpayer and a non-resident with whom the taxpayer does not deal at arm's length. There are no comparable provisions which apply to similar transactions between residents.

In our opinion provisions such as those contained in section 17 are desirable, subject to the following comments:

a) Where a transaction between persons not dealing at arm's length is adjusted for tax purposes to reflect fair market values or a test of reasonableness, such adjustments should be applied so as to achieve appropriate adjustment for each party, but not necessarily of equal amounts.

b) Provisions such as subsections (3) and (4) should apply to transactions between residents as well as to transactions between residents and non-residents. They should apply to the payer and the payee in all cases so that adjustments will be made consistently on both sides of the transaction.

c) The provisions should apply to gifts as well as sales. They should also apply where services are performed or property is made available without compensation, as well as where the compensation is too low or too high.

d) The provisions should not be applicable to transactions which would qualify as tax-free reorganizations or transfers.

2. The second category consists of provisions which impose tax upon benefits or advantages which flow from transactions not at arm's length. The most important provision of this kind is undoubtedly section 137(2), which is discussed above. As previously mentioned, this provision is so broad and general and so vague in its application that it is unlikely to have much practical importance. We believe it will be necessary to have provisions of this kind, but in our view they should specify with more particularity the circumstances in which they will apply. A provision relating to benefits or advantages conferred on non-residents should be kept separate from any provision or provisions relating to benefits received by residents.

3. The third category consists of provisions which for tax purposes ignore or look through a transaction so as to prevent or offset the artificial tax effect which would otherwise flow from it. An example of this type of provision is section 20(4), which contains rules for determining the capital cost and the undepreciated capital cost of depreciable property which is acquired by a taxpayer from someone with whom he does not deal at arm's length. The essential purpose and effect of these rules is to prevent the inflation of the cost basis of depreciable assets upon which capital cost allowance may be claimed. Although a non-taxable capital gain can be achieved by the vendor, if the value of the asset at the time of transfer can be shown to exceed its original cost, he is subject to recapture of depreciation if the price exceeds his undepreciated capital cost. Regardless of the price paid, the purchaser is not permitted to take into account for depreciation purposes any amount paid in excess of the original cost of the asset to the vendor, or to a previous owner if he did not deal with the vendor at arm's length. Furthermore, if the sale is made at a price less than the vendor's capital cost, the purchaser will be treated as having the same capital cost, so that if he later sells the property at a profit he will continue to be subject to recapture of the depreciation taken by the vendor.

Under our proposals it would not be possible for a vendor to make a tax-free capital gain on the sale of depreciable property. If the purchaser sold depreciable property at a profit, he would be subject to tax regardless of whether he had taken depreciation which was subject to recapture. For these reasons it seems to us unlikely that any provision such as section 20(4) would be required, except possibly during the transitional period immediately following the implementation of our proposals.

Another provision of the present Act which falls into our third category is section 23. It provides that where a right to income is transferred in a transaction not at arm's length, the income will continue to be taxed in the hands of the transferor unless the income is from property and the property is also transferred.

4. There are many provisions in the present Act which provide that two or more persons not dealing at arm's length shall be regarded for a particular purpose as if they were one person or one corporate entity. Some examples are sections 28(3), 62(3), 85 and 85A. Section 39(4) also falls into this category, although the test is whether corporations are "associated" rather than whether they deal with each other at arm's length. The purpose of such provisions is essentially to prevent or offset the tax effects of an artificial division of interests between closely related natural persons or among a number of corporations which they control.

As already indicated, we think that the problem of tax avoidance through transactions not at arm's length would be significantly reduced by the implementation of our principal recommendations. However, the problem will not be eliminated and it will be necessary to continue provisions which would prevent the distortion of income or the reduction of tax liability through transactions or arrangements between persons not dealing with each other at arm's length. It is not practical to suggest in detail what the continuing provisions should be, because their nature and scope would depend on the legislative techniques and provisions which may be employed in giving effect to our recommendations.

The "Administrative Control" Approach

Specific Provisions. In several sections of the Income Tax Act the Minister of National Revenue has been given discretionary powers for a variety of purposes: to prevent income splitting through husband-and-wife partnerships (section 21(4)); to determine that a taxpayer's chief source of income is not farming or a combination of farming and another source of income (section 13(2)); and more recently, to make a direction that an amount received as part of a "dividend-stripping" transaction should be included in income or that two or more corporations should be deemed to be associated (section 138A). One of the conditions for making a direction under section 138A is that in the Minister's opinion one of the purposes or one of the main reasons for what the taxpayer did was the avoidance or reduction of taxes.

The provisions contained in sections 21(4) and 13(2) could just as well be dealt with by a legislative rule rather than by ministerial discretion. Section 138A was enacted as a temporary measure to halt tax avoidance practices which had become widespread and blatant. This was necessary since legislative amendments had proved inadequate. To some extent this was made inevitable by inconsistencies in the legislative scheme—the dual rate of tax for corporations, the exemption of inter-company dividends and the failure to tax capital gains.

In our opinion ministerial discretionary powers are undesirable except in extreme circumstances. Where such powers exist, taxpayers cannot be assured that they will be judged by the same standard as other taxpayers.

If an unfavourable decision is reached by the Minister, the taxpayer's rights of appeal are narrowly limited. Such a decision may have been reached privately and on the basis of evidence not communicated to the taxpayer. To the extent that discretionary powers are granted, there is a departure from the rule of law. For these reasons we think that ministerial discretion should be used in legislation only in unusual circumstances. This is discussed further in the Part of the Report dealing with Administration.

Section 138. The broadest power of administrative review is contained in section 138 of the Income Tax Act. This section seeks to meet the problem of tax avoidance through administrative action of the Canadian Treasury Board, subject to supervision by the courts. Subsection (1) provides that where the Treasury Board decides that one of the main purposes for a transaction or transactions effected before or after the coming into force of the Act was improper avoidance or reduction of taxes that might otherwise have become payable under the Act, that Board may give such directions as it considers appropriate to counteract the avoidance or reduction. Subsection (6) provides that an avoidance or reduction of taxes may be improper even if it is not illegal. Subsection (3) then provides that tax shall be assessed or reassessed and collected according to the directions of the Treasury Board notwithstanding any other provision of the Income Tax Act or any other Act.

The justification for the enactment of such a sweeping provision was explained by the Minister of Finance, Mr. Ilsley, when an earlier version of this provision was before Parliament. He stated:

> "For years the commissioner of income tax has advised that it is impossible to foresee or envisage the methods that will be adopted, and that the only possible way of dealing with the matter is to express general principles and leave it to some tribunal to decide.... Somebody has to be entrusted with the duty of watching these transactions, determining how much tax is avoided and whether the main purpose was to avoid taxation. If the main purpose was not to avoid taxation; if it was a legitimate business purpose, then the transaction should not be impugned.... Whatever

> jealousy parliament may have of the rights of the individual, parliament has to make sure that this economic system functions cleanly and justly and fairly, to the extent of its ability. I have perhaps given an impression that the practices I mentioned... are widespread. I do not think they are. But a few instances, known by a few individuals and passed from mouth to mouth, of skilful and wealthy individuals who legally are able to escape the clear spirit and intent of taxation legislation, will do more to discredit the system we live under and more to discredit the parliament that did not have the foresight to prevent these things, than almost anything you can think of; and I have come to the conclusion that we ought to strain a point here. We are at war. It may be that this would not be as necessary in time of peace....
> In the Victorian period the avoidance of taxation was a polite, gentlemanly game. Taxation was low, and if a taxpayer could find a hole in the law and crawl through it, everyone laughed about it and tried to block up the hole. But it did not make very much difference. If the crown could prevent his finding a hole, they would not get away with it. There was no moral interest involved. But when taxation becomes as heavy as it is to-day, when to a very great extent the people of this country are working for the state—and properly working for the state—then it is not an amusing matter, and is beyond the realm of a game. It becomes something—well, perhaps not exactly treason, but something considered most unpatriotic and unsocial....
> As I have said, if we make it as definite as we ought to make it for the guidance of a court we will be so definite that other ways will be found to get around it. Therefore it must be pretty wide, and there must be some discretionary powers in the tribunal making the decision." 38/

Section 138 has never been interpreted by the courts, so that its precise meaning is uncertain. Certainly it gives rise to many difficult questions. It empowers the Board to designate a perfectly legal transaction as improper from a taxation standpoint, but contains no standards or guide-posts by which impropriety is to be determined. It empowers the Board to give such directions as it thinks appropriate to counteract the avoidance or reduction, but what form those directions might take and against whom they might be made is not clear. Subsection (5) provides for judicial review of the actions of the Treasury Board, but little guidance is given as to the grounds for such review. Another question that emerges from this provision is how the Board is to determine whether one of the main purposes of a transaction was the improper avoidance or reduction of taxes. An investigation into the subjective purposes lying behind a business transaction or series of transactions is at least a highly speculative undertaking.

Section 138 may be open to the criticism that it violates the most fundamental common law concept regarding taxation—that taxing legislation must impose a tax in clear and unambiguous language and the taxpayer is free from taxation unless he comes within the letter of the law. It also offends the principle that the rules on which tax is imposed should not be changed retroactively. Businessmen object to this type of legislation because it interferes with business planning and management. Indeed, it has been said 39/ that "it casts a continuing cloud on legitimate transactions and prevents finality"; "put in the hands of a vindictive administration...it could be used vindictively"; it is "pure autocracy" to make a man pay taxes when he is not within the law. When section 138 was first before Parliament, the Minister of Finance, Mr. Abbott, assured the objectors that the power had only been used four times in the five years which had elapsed since its inception in 1943 and emphasized the large sums of money and the barefaced type of avoidance involved in those cases.

And yet if it is beyond the ability of the draftsman to fashion effective, specific anti-avoidance provisions which will pass the judicial test of strict, literal construction, as not infrequently seems to happen, it is not surprising, for reasons advanced by Mr. Ilsley, that the government occasionally resorts to administrative discretion. However, experience with section 138 has shown that where the discretion is given to a body such as the Treasury Board it is hardly ever used.

Some general anti-avoidance provisions which are somewhat similar to section 138 have been enacted in other countries. These are discussed below.

United Kingdom. Parliament adopted a general tax-avoidance provision in relation to profits tax 40/. It provided that where the Commissioners of Inland Revenue were of the opinion that the main purpose or one of the main purposes of a transaction was the avoidance of liability to profits tax, they could direct adjustments of liability to profits tax so as to counteract the avoidance of liability. If it appeared in certain specified types of transactions that the main benefit which might have been expected to accrue within the subsequent three years was the avoidance of liability to profits tax, the avoidance of liability was deemed to have been the main purpose or one of the main purposes of the transaction. The test to be applied was the objective test: would a reasonable man in fact expect that the main benefit which would accrue from the transaction would be the avoidance of tax? It was provided that the particulars of a proposed transaction could be furnished to the Commissioners and if the Commissioners were satisfied that the transaction would be "entered into for bona fide commercial reasons" they could give a binding notification that the section was not applicable.

The United Kingdom Royal Commission on the Taxation of Profits and Income gave its approval to this provision, having regard to the fact that because of the form and structure of profits tax it would be too easy for a corporation to arrange its affairs so as to reduce its liability to tax very materially without any alteration in the substance of its position or the position of its proprietors. Said the Commission:

> "We do not think that there is any serious criticism to be made of the form of the section. Subsection (3) deals with the difficult question of motive or purpose and it imputes the purpose of avoidance summarily where certain specified conditions are found to exist. But the imputation only arises from the objective test of discovering what was the main benefit that might have been expected to accrue from a given transaction. That does not seem to us materially different from saying that a man's motives are to be inferred from the probable consequence of his actions. There are circumstances in which that principle is a better test of motive than can be afforded by his own answers some time after the event. It should be added that the section does contain a provision enabling the Board to exempt a transaction altogether if they are satisfied that it was entered into for bona fide commercial reasons and that it ought not to be brought under the section." 41/

The Netherlands. The Netherlands has a general anti-avoidance provision which runs as follows:

> "In the assessment of the direct State taxes, legal transactions are not taken into account if it must be assumed—by reason of the

> fact that they have not aimed at a material modification of the existing circumstances or by reason of other specific acts or circumstances—that they would not have been entered into but for the fact that liability for any of the said taxes, in the event of it having been applied or being likely to be applied, would be avoided either in whole or in part for the future." 42/

Australia. In Australia an attempt has been made to control avoidance by a very general measure passed by the Commonwealth Legislature 43/. That section provides:

> "260. Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly—
> (a) altering the incidence of any income tax;
> (b) relieving any person from liability to pay any income tax or make any return;
> (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act; or
> (d) preventing the operation of this Act in any respect,
> be absolutely void, as against the Commissioner, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

The section was held by the Privy Council to be applicable to a complicated dividend-stripping operation 44/. In seeking to apply the section, Lord Denning held that the Court must see whether the arrangement itself discloses the purpose or effect of avoiding tax irrespective of the motives of the persons behind the plan. That is to say, the court must be able to predicate—by looking at the overt acts by which the arrangement is implemented—that it was implemented in that particular way so as to avoid tax. If the court cannot so predicate but has to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, they are not within the section. The section will apply if one of the purposes was to avoid tax—tax avoidance need not be the sole purpose.

Section 260 has been criticized as being an "annihilating" provision only. That is to say, it has no further or other operation than to eliminate from consideration for tax purposes such contracts, agreements and arrangements as fall within the description it contains. It does not, however, confer on the Commissioner the power to reconstruct transactions. Thus, to invalidate for tax purposes the transaction into which the taxpayer in fact entered is not enough to impose upon him a liability which could only arise out of another transaction into which he might have entered but in fact did not enter 45/.

SUMMARY

1. It is necessary and desirable in any modern tax system to have effective provisions to counteract tax avoidance. However, a number of other objectives and guiding principles must also be kept in mind.

   a) A taxpayer should not be penalized for deciding not to earn income, even if the reason for this decision is the reduction or avoidance of tax liability. Likewise, if he gives up a right to income and does not retain any control over the income or the source of income he should not be taxed on such income arising thereafter.

   b) If a taxpayer arranges his affairs in such a way that he avoids tax on income or reduces his liability for tax on the income below what he would expect to pay under the general scheme and intent of the legislation, while continuing to enjoy the benefits of the income or continuing to control the income or its source, he should be taxed on the income.

2. The courts should not depart lightly from the words of the statute where those words are clear and unambiguous and should not disregard the legal effect of a transaction. However, in order to work with the legislature to develop good tax laws and in order to avoid the necessity for numerous technical loophole-closing amendments, the courts should interpret the tax statute fairly and equitably and in such a way as to give effect to the legislative scheme, without any

presumption being made either for or against the taxpayer. They should also have regard to the true nature and effect of transactions and take into account their economic substance as well as their legal effect.

3. Tax avoidance provisions in the legislation should be carefully designed to accomplish the objectives in paragraph 1 above so far as possible. While the "sniper" approach or the "shotgun" approach or an approach somewhere in between may be advisable in each area, the provisions should not be so broad or so rigid as to penalize bona fide transactions. Normally a provision should be expressed in sufficiently general terms that the courts will be able to interpret the words in the context of the legislative scheme and distinguish between the cases which are deserving of correction and those which are not. On the other hand, such provisions should not be so broad and general that they are devoid of any clear meaning and therefore ineffective in operation.

4. While non-arm's-length provisions will be less important under our proposals, they will still be necessary to deal with some matters, particularly transactions between residents and non-residents. The present irrebuttable presumption as to non-arm's-length dealing should continue to apply as between corporations which are subject to common control, as between a husband and wife who are living together and as between them and their children, whether or not their children are living with them. However, there should only be a rebuttable presumption that brothers, sisters, brothers-in-law and sisters-in-law are not dealing with one another at arm's length.

5. Where a sale takes place between persons not dealing with each other at arm's length at a price other than fair market value, the price should be adjusted to fair market value in the tax accounts of both parties and for all purposes of the legislation. There should be

similar provisions to the effect that where a person renders services to, or makes property available for use by another person with whom he does not deal at arm's length, each party will be considered to have paid or received a reasonable remuneration, rent or royalty. These provisions would not apply to transactions which qualify as tax-free reorganizations or transfers or to transactions between members of a family unit.

6. Section 137(1), which disallows expenses which would unduly or artificially reduce income, would probably be held applicable only in rare and extreme cases, and should be retained mainly as a deterrent. Section 137(2), which imposes tax on benefits conferred, is so broad and general and so vague that it is unlikely to have much practical importance. Any provision of this kind should specify more particularly the circumstances in which it will apply.

7. Section 16(1), which provides for the constructive receipt by one taxpayer of a payment made to another, is sufficiently clear in its intent and at the same time is sufficiently general in its wording that it leaves room for interpretation and application by the courts according to the circumstances of each case, and it should be retained.

8. Discretionary powers should be granted to the Minister only in unusual and extreme circumstances.

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4/ Ibid., para. 1019.

5/ (1869) L.R. 4 H.L. 100, p. 122.

6/ Versailles Sweets Limited v. Attorney General of Canada, [1924] S.C.R. 466, p. 468, and M.N.R. v. Sheldon's Engineering Limited, [1955] S.C.R. 637, p. 645.

7/ G. S. A. Wheatcroft, "The Attitude of the Legislature and the Courts to Tax Avoidance", (1955) 18 Mod. L. Rev. 209, p. 215.

8/ [1954] Ex. C.R. 181.

9/ Section 22(3).

10/ [1960] S.C.R. 606.

11/ [1965] Ex. C.R. 676.

12/ See, for example, Hargal Oils Limited v. M.N.R. [1965] S.C.R. 291.

13/ [1936] A.C. 1, pp. 19-20.

14/ See, for example, Seven Up of Montreal Limited v. M.N.R., [1952] Ex. C.R. 288; Canada Safeway Limited v. M.N.R., [1957] S.C.R. 717; and Bell v. M.N.R., 62 DTC 1155 (Exchequer Court).

15/ [1936] A.C. 1, p. 21.

16/ [1960] Ex. C.R. 350.

17/ See also M.N.R. v. Shields, [1963] Ex. C.R. 91.

18/ [1943] A.C. 377, p. 381.

19/ [1949] 1 All E.R. 1108, p. 1120.

20/ (1923) 263 U.S. 179.

21/ (1917) 245 U.S. 151, p. 153.

22/ (1938) 305 U.S. 281, p. 292.

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25/ (1935) 293 U.S. 465.

26/ 270 F. 2d 294, p. 297 (3rd Cir. 1959).

27/ J. R. Hellerstein, "Judicial Approaches to Tax Avoidance", 1964 Tax Conference Report 55, pp. 65-66.

28/ 95 F. 2d 732 (4th Cir. 1938).

29/ Op. cit., p. 73.

30/ For example, M.N.R. v. MacInnes, supra; in Robins v. M.N.R., [1963] Ex. C.R. 171, the transfer of a business was held not to be a transfer of property within the meaning of section 21.

31/ H. J. Rudick, "The Problem of Personal Income Tax Avoidance", (1940) 7 Law and Contemporary Problems 243, pp. 246-47.

32/ M. B. Angell, "Tax Evasion and Tax Avoidance", (1938) 38 Columbia Law Review 80, pp. 93-94.

33/ Per Menzies J. in Peate v. Commissioner of Taxation, (1962) 36 A.L.J.R. 258, p. 259.

34/ M.N.R. v. Groulx, 66 DTC 5126 (Exchequer Court, reversing a decision of the Tax Appeal Board).

35/ Op. cit., para. 1024.

36/ Shulman v. M.N.R., [1961] Ex. C.R. 410 (an appeal to the Supreme Court of Canada was dismissed without written reasons); Rivershore Investments Limited v. M.N.R., [1964] Ex. C.R. 481; and Harris v. M.N.R., 66 DTC 5189.

37/ [1961] Ex. C.R. 410, p. 425.

38/ House of Commons Debates, April 15, 16, 1943, Vol. 3, pp. 2232, 2254-55.

39/ Standing Committee, Banking and Commerce, House of Commons, 1948, p. 690 et seq.

40/ The Finance Act, 1951, c. 43, section 32. Profits tax was abolished by the Finance Act, 1965, c. 25.

41/ Op. cit., para. 1034.

42/ Article 1 of The Netherlands Law (29th April 1925), for the Promotion of the Correct Assessment of Direct Taxes.

43/ Section 260 of the Income Tax and Social Services Contribution Assessment Act, 1936-1966.

44/ Newton v. Commissioner of Taxation of the Commonwealth of Australia [1958] A.C. 450.

45/ See Clarke v. Federal Commissioner of Taxation, (1932) 48 C.L.R. 56, p. 77; see also an article by H.A.J. Ford, "Legislation Against Tax Avoidance: The Australian Experience", [1961] British Tax Review 247, p. 257.

APPENDIX B

ESTIMATED GROWTH OF PENSION PLAN CONTRIBUTIONS AND ASSETS, AND THE TAX DEFERMENT INVOLVED

Based on the material contained in two surveys, 1/ it is estimated that during 1960 pension funds received more than $200 million in investment income and paid out approximately the same amount in benefits and withdrawals. In the three years following 1960, the number of employees covered by pension plans increased by approximately 20 per cent, the total assets under administration grew by over 40 per cent, and total employer and employee contributions, including contributions to federal and provincial government plans, increased to a rate exceeding $1 billion a year. At the end of 1963, the total market value of invested assets held by pension plans exceeded $7.5 billion, with trusteed pension plans holding approximately 70 per cent of the total assets and life insurance group annuities making up somewhat under 25 per cent of the total assets. The balance was represented by federal government group annuities. No figures are available to indicate the value of assets that have been built up in individual registered retirement savings plans because no annual reporting is required. However, by the end of 1964 over $260 million 2/ of deductions had been reported by individuals, and total assets held would probably exceed that amount.

It is difficult to project trends in this area. Although the Canada Pension Plan might slow the rate of growth of private plans, it should mean an increase in the rate of contributions and asset growth of total retirement income funds. In addition, some provincial governments (effective in Ontario in 1965, Quebec in 1966 and Alberta in 1967) have introduced solvency requirements that will mean that the growth of employer contributions and of assets will accelerate. Such an increase might also be expected to follow from our recommendations that property gains realized outside of registered plans should be taxable in full at the time of receipt, and that the gross-up and credit procedure for corporate tax should be applicable to registered plans. It would also be expected that the increased relative value of the tax deferment on property income received by registered plans would cause taxpayers with incomes exceeding $10,000 to increase their deductible contributions above the 1964 rate of almost 3 per cent of total income 3/. The rate for incomes under $10,000 in 1964 was just under 2 per cent, 3/ a level for private plans that may not increase because the Canada Pension Plan will have a major impact on this group. Even with a decline in the present rate of growth of private plans with the Canada Pension Plan in operation, it would seem reasonable to assume a growth rate of 10 per cent a year, as compared to the over 11 per cent a year for recent years. (See Table B-1.) On this assumption it could be expected that by 1970, amounts of the following magnitude would be attained:

Assets	$16.5 billion
Annual contributions (employer and employee)	1.7 billion
Annual investment income	0.9 billion
Annual pension payments and cash withdrawals	0.8 billion

In addition, the Canada and Quebec pension plans will have accumulated at least $3 billion in assets, and contributions to those plans will be at an annual level of approximately $0.7 billion. Thus by 1970, assuming that the total of these amounts will be eligible for preferential tax treatment, the total amount of income on which tax could be postponed until retirement, including both employer and employee contributions and investment income, will have reached a level of nearly $3.5 billion a year, more than double the level in 1964, or about 7 per cent of total personal income as compared to over 4 per cent in 1964. Taxable income of individuals is currently less than 40 per cent of personal income, so this could mean tax postponement for some 17 per cent of taxable income. Assuming an average rate of tax of 20 per cent on the amount postponed, there would be a postponement of nearly $700 million of taxes for the year 1970, a postponement that would be offset to the extent of about 30 per cent by tax on pension benefits brought into the income of taxpayers in that year. Part of this amount would represent taxes forgone rather than postponed, if marginal rates for the individual were lower when pensions were received than when contributions were made.

TABLE B-1

SELECTED DATA FOR LIFE INSURANCE COMPANIES GROUP ANNUITIES, FEDERAL GOVERNMENT GROUP ANNUITIES, AND TRUSTEED PENSION FUNDS, 1957-64

(1) Year	(2) Number of Plans a/	(3) Number of Employees	(4) Total Contri-butions b/ (millions of dollars)	(5) Total Assets c/ (millions of dollars)	(6) Percentage Increase in Column (5) Over Prior Year a/
1957	6,381	1,365,238	430	3,836	
1958	7,366	1,553,789	512	4,340	13.1
1959	8,404	1,633,161	567	4,822	11.1
1960	9,260	1,658,963	569	5,424	12.5
1961	10,181	1,755,706	618	6,081	12.1
1962	11,260	1,828,497	664	6,804	11.9
1963	12,446	1,973,559	732	7,616	11.9
1964	13,479	2,056,493	814	8,484	11.4

Notes: a/ Not all of the annual increase is a reflection of growth, because the coverage of the survey increased slightly in the early years. Also, the survey is not complete because not all pension plans are covered. The above figures do not include the armed forces, the federal public service, seven of the provincial civil services, and three of the provincial teachers' funds. These groups are excluded because no separate invested funds are maintained for them.

b/ Employer and employee.

c/ At book value at the end of the year.

Source: Dominion Bureau of Statistics, Trusteed Pension Plans, Financial Statistics, Ottawa: Queen's Printer, for the years 1957, 1959 and 1964, Table D.

TABLE B-2

SELECTED DATA FOR PENSION PLANS FOR 1960

Number of Plans a/	8,920
Number of Members	1,815,022
Eligible Employees who Elected not to Join	284,519
Ineligible Employees of Employers Having Plans	573,183
Proportion of Covered Employees who are Members of a Contributory Plan	82 per cent
Proportion of Covered Employees with Unit Benefit Plans b/	75 per cent
Proportion of Covered Employees with Plans Having some Vesting Rights	69 per cent
Employee Contributions c/	$334,751,777
Employer Contributions	$467,129,485
Number of Retirements During the Year	19,116

Notes: a/ This table includes the pension plans covered by Table B-1 and also the pension plans which are listed in note a/ to to that table as being excluded therefrom. Neither table covers privately operated plans which are unfunded.

b/ A unit benefit plan is a plan which contains a formula for determining the amount of each member's pension. It is to be distinguished from a money purchase plan or a profit sharing plan under which the pension is whatever the contributions will provide.

c/ Most of the difference between this figure and the amount reported in Taxation Statistics (shown in Table B-3) can be accounted for by profit sharing pension plans, unfunded plans for provincial civil servants and teachers and individual retirement savings plans that are not included in the above statistics. In addition, this figure includes some non-registered plans that do not appear in Taxation Statistics.

Source: Dominion Bureau of Statistics, Pension Plans, Non-financial Statistics, Ottawa: Queen's Printer, 1960.

TABLE B-3

PENSION AND RETIREMENT SAVINGS PLAN CONTRIBUTIONS
REPORTED BY INDIVIDUALS WITH TAXABLE RETURNS, 1957-64

(1) Year	(2) Individuals' Contributions a/ (millions of dollars)	(3) Taxable Income of All Individual Taxpayers (millions of dollars)	(4) Percentage (2) to (3)
1957	247.3	7,906	3.13
1958	278.2	8,145	3.42
1959	311.3	8,954	3.48
1960	354.0	9,727	3.64
1961	393.0	10,423	3.77
1962	420.1	11,108	3.78
1963	467.6	12,220	3.83
1964	519.7	14,172	3.67

Note: a/ Includes past service contributions.

Source: Department of National Revenue, Taxation Statistics, Ottawa, Queen's Printer, covering the years indicated.

REFERENCES

1/ Dominion Bureau of Statistics, Pension Plans, Non-financial Statistics, Ottawa: Queen's Printer, 1960, p. 11, and Pension Commission of Ontario, Pension Plans in Ontario Statistics, Toronto: Queen's Printer, 1963, p. 4.

2/ Total of amounts reported as deductions by individuals in Department of National Revenue, Taxation Statistics, Ottawa: Queen's Printer, for the years 1958 to 1964.

3/ Estimated from Department of National Revenue, Taxation Statistics, Ottawa: Queen's Printer, 1966.

APPENDIX C

ALTERNATIVE PROCEDURES FOR THE TAXATION OF INCOME RECEIVED THROUGH LIFE INSURANCE

The feasibility of the recommendation outlined in Chapter 16 with respect to the taxation of property income accumulated for the benefit of standard life insurance policyholders depends on finding a procedure which is satisfactory from the points of view of both equity and ease of computation for allocating to individual policyholders the investment income credited to policy reserves. Because the recommendation does not visualize that initially there should be taken into account in computing income the difference between policy proceeds and the total of premiums paid and investment earnings accumulated (a difference that is essentially the mortality gain or loss), the actual gain realized by the policyholder over the life of the policy would not necessarily be equal to the investment income that would be taxed. If mortality gains and losses were taken into account in computing income, the only inequity that could result from the arbitrary allocation procedures would relate to the time at which the income was and should have been brought into account. Without the balancing procedure of ultimately bringing into the computation of income the net difference between the policy proceeds and the premiums paid plus investment income already included in income, it would be necessary to rely entirely upon the allocation procedure to determine equitably the income that should be taxed to the policyholder.

If, however, our assumption that a satisfactory procedure can be developed for such allocation proves to be incorrect, one of the following alternatives should be adopted. These are alternatives to the taxation of policyholders on the investment income credited to policy reserves.

Alternative 1. Inclusion of Mortality Gains and Losses in the Computation of Income

Under this alternative, mortality gains and losses would be taken into account in the computation of income. It would be extremely simple to administer because it would not require any allocation of investment earnings to individual policyholders. The approach would be to levy a flat-rate, non-refundable tax of, say, 15 per cent, on the aggregate amount of investment income credited each year to policy reserves and, when the policy proceeds were received, to bring into the tax base of the policyholder the excess or deficiency of the policy proceeds over the premiums paid, or the excess over the net premiums paid if some adjustment was to be made for the service costs of obtaining the protection. As an alternative to using the net premiums in the computation, the total premiums paid might be deducted from the policy proceeds and only the net gain brought into income, with no deduction when premiums paid exceeded the amount of the proceeds.

The flat-rate tax levied on the investment income would in effect be a postponement fee assessed to compensate for the deferment of tax on the property income from the time it was earned until it was paid to the policyholder as part of his policy benefits. The rate suggested is relatively high because the value of the deferment would be substantial. Policy dividends would still be included in income, but the only significance of such treatment would be timing; if they were excluded from income they should be deducted from premiums paid in computing the net premiums, a procedure that would increase the portion of the policy proceeds that would ultimately be taxable.

This alternative has the advantage of producing some tax revenues from the property income accumulated each year, while avoiding the administrative problems of a detailed allocation to each policyholder. However, it would also raise some initial difficulties because all the policies outstanding at the date the new legislation became effective would have to be valued. This, of course, is a problem that would arise under any proposal that involved the taxation of mortality gains. However, this valuation would be made by the insurer under regulations developed by the industry and the government departments concerned, so that the individual policyholder would not have to make any computations.

This alternative would have some impact on the insurer. A tax on policyholder investment income should bear on the individual and should, in principle, have no effect on the insurer. However, if the tax on the investment income credited to policy reserves was collected at the insurer level in the form of a postponement fee, or for that matter as a withholding tax, then the amount of funds available to the insurer for investment would be reduced. This would in turn moderately reduce the amount of investment earnings in respect of policies currently outstanding and might, at least to some extent, be a cost to the insurer. In the case of policies issued subsequent to the effective date of a change in tax treatment, the level of premiums could be increased to reflect the imposition of the tax. In addition, the position of the insurer with respect to outstanding policies would be protected if policy liabilities were related to the level of net investment earnings or if the policy was a participating one so that the "cost" of the diminished investment yield could be passed on through reduced policy dividends. In these cases the current policyholder would have to absorb both the direct and indirect impact of the tax. However, in the case of non-participating policies that were outstanding at the time the tax was imposed, the insurer would have to absorb any indirect effect of a tax collected at the insurer level. The impact on the insurer of a tax on income which was allocable to the older policies would be somewhat mitigated by the fact that investment earnings have increased substantially in recent years 1/. However, in the case of more recent policies, the imposition of such a tax could have an unfavourable impact on the income of the insurer. Therefore, a relieving provision applicable to non-participating policies issued in recent years should be implemented if this alternative were adopted. The purpose of the provision would be to compensate the insurer, at least partially, for the decline in his net investment earnings brought about by the imposition of the tax. For example, a postponement fee or tax might be applied at reducing rates to the investment income allocable to such policies, with the lowest rate applying to the most recent policies.

A flat-rate tax would be inequitable to the policyholders to the extent that it did not reflect the progressive nature of our recommended tax system. Thus, a tax imposed at a moderate rate as a fee for postponement of the personal tax would leave a substantial deferment advantage to the higher income policyholder, but would be unduly high for the non-taxable or very low income policyholder. One method of meeting this problem would be to impose tax at a higher rate and then to allow the beneficiary a tax credit on the policy proceeds. This would be of greater relative value to the low income beneficiary.

In principle, any postponement fee should apply only to investment earnings that were applicable to Canadian residents but, because investment earnings of non-residents would in general be subject to a withholding tax, it would be reasonable to levy the postponement fee in lieu of such tax on all the investment earnings arising from business effected in Canada. However, the fee should not apply to income derived from the foreign operations of Canadian insurers.

Alternative 2. Withholding Tax on Investment Income Credited to Policy Reserves

Under this alternative, mortality gains and losses would not be taken into account in computing income, but would cause some administrative complexities because investment earnings would have to be allocated to individual policyholders when benefits became payable under a policy. The approach would be to levy a withholding tax on investment income credited by the insurer to the policy reserves 2/. When any policy benefits on maturity or termination were paid out, the accumulated investment income attributable to the policyholder would be computed and included in his income. The withholding tax would be deducted from the policy proceeds when they were paid and the policyholder would be given credit for the tax withheld on his behalf. The administrative difficulties of allocating property income to policyholders should be less than for the allocation proposed in

Chapter 16, because the allocation would have to be made only when the policy proceeds were payable rather than each year. The regulations could stipulate one method of allocation, and provide that any reasonable alternative method approved by the Department of Insurance could be employed.

The rate of withholding should be close to the average rate of tax applicable to the beneficiaries, say, 30 per cent, in view of the extended time period before it would be possible for the lower income beneficiary to claim a refund.

Under this alternative it would also be a simple matter for mortality gains and losses to be taken into account in computing income. Thus, the policyholder could be taxed either on the investment income portion of his policy proceeds, or on the total proceeds less premiums paid. In either case, he would receive credit for the withholding tax deducted from the investment income portion.

If mortality gains and losses were to be taken into account in computing income, the administrative procedures would not be as simple as under the postponement fee alternative discussed above. The tax on the investment earnings accumulated in policy reserves would be withheld each year, while the withholding tax on the mortality gain, if any, would be remitted at the time the policy proceeds were paid. In the event of a mortality loss, the insurer would claim a refund of all or a portion of the taxes withheld on the investment income accumulated for the same policy. Hence, the policyholder would receive the proceeds less 30 per cent of the excess of the proceeds over the premiums paid. The full amount of the proceeds would be taken into account in computing his income and he would receive a refundable tax credit for the 30 per cent of the income portion, if any, which was withheld by the insurer.

REFERENCES

1/ The rate of investment income earned by insurance companies has increased in every year but one since 1948 and now stands at a level 55 per cent above what it was in that year. Accordingly, a serious problem would only arise on older policies if interest rates should decline. To meet such a possibility it should be provided that the postponement fee applicable to non-participating policies outstanding at the date the law became effective should not reduce the rate of net property income in respect of such policies, including property gains and losses, below, say, 5 per cent. This would mitigate the impact of this tax on insurers if rates of investment earnings should decline.

2/ Alternatively, a postponement fee approach along the lines outlined under the first alternative could be utilized instead of a withholding tax. The lower level of a postponement fee would reduce the impact on the insurer, but the necessity of allocating investment income to the policyholder at the time the proceeds were paid would remain unless mortality gains and losses were taken into account in computing income.

APPENDIX D

ALTERNATIVE METHODS OF TAXING GIFTS

There are several ways of taxing transfers of wealth, and in reaching a conclusion on the best method for the Canadian tax system, we considered, in some detail, the following main methods:

1. The present method of taxing estates and gifts.
2. An integrated transfer tax.
3. An accessions tax.
4. A succession duty or inheritance tax.
5. A net wealth tax.

PRESENT METHOD

Conformity to Economic and Social Objectives

The present estate and gift taxes do not tax according to ability to pay as we have defined it. In our opinion, the preservation of the integrity of the new tax base would alone require the repeal of these taxes. Furthermore, the present taxes are not fully integrated so as to preserve the progressiveness of the rates. For example, gifts made over a lifetime are not aggregated to determine the rates at which either the gift tax or the estate tax is levied 1/. The estate tax does aggregate the whole of a man's estate at death and bring into tax completed gifts made within three years of death. This would be a valid method of aggregation if reduction in the rate of accumulation of wealth by means of transfers between generations was the sole objective, but it conflicts seriously with our concept of ability to pay.

Another major defect of the present taxes is the ease with which estate taxes may be avoided altogether. Because of the very generous annual gift tax exemption, which rises with income, a planned programme of annual gifts enables large amounts to be distributed over a period of time on payment of little or no tax 2/.

The wealthier a man is the more likely he is to have disposable wealth with which to implement a planned programme of inter vivos gifts. The relatively low rates of gift tax encourage such giving, but because the tax is imposed on the donor there is no advantage in distributing gifts widely. Accordingly, the present system may be described as neutral in encouraging or discouraging accumulations of wealth.

Fairness of the Tax

The present estate and gift taxes are subject to a number of defects which result in their being inequitable and in their failing to attain the objectives we consider desirable. The failure to aggregate adequately reduces progressiveness relative to other parts of the tax system, thus shifting part of the total tax burden in an arbitrary way from those who receive gifts to those who do not. The types of exemption and the ease of avoidance favour high income and large wealth groups. For example, an individual earning more than the amount of his personal deduction of $1,000 will pay at least 11 per cent income tax plus 4 per cent old age security tax up to the specified maximum on the excess, while another individual can receive $4,000 free of tax, and up to $10,000 more that is taxable at the lowest gift tax rate of 11 per cent, regardless of his own personal income tax rate.

Another major source of inequity and confusion is the inconsistent treatment of gifts. An inter vivos gift may be treated as incomplete under the estate tax and is therefore added to the donor's estate; it may be treated as complete for gift tax purposes, so that gift tax is levied on the donor, and, depending on circumstances, it may be treated as complete or incomplete under the income tax for the purpose of taxing the income from the gift. For example, if a donor transferred securities in trust for his children, reserving an annuity to himself in the event of his infirmity, the transfer to the trust would be treated as a completed gift of a beneficial interest in the trust for gift tax purposes and would be taxed immediately. However, under special provisions of the Estate Tax Act, 3/ the value of the property less the value of the annuity payments made over and above what the property could be expected to yield at 5 per cent would be taxed as part of the estate of the donor. Under the Income Tax Act the income, though received by the beneficiaries, would be taxed to the donor if the children were under 19. If they were over 19, the income would be taxed in the hands of the children 4/. If the donor reserved a reversionary right in himself in the event that any of the beneficiaries should predecease him, the income of the trust would be attributable to him in any event 5/.

Under the proposed integration of gifts into the comprehensive tax base, one set of rules would determine whether a given transfer was a completed gift or not 6/.

AN INTEGRATED TRANSFER TAX

An integrated transfer tax would eliminate for tax purposes the present distinctions between inter vivos gifts, which are taxed under the gift tax provisions of the Income Tax Act, and testamentary gifts, which are taxed under the Estate Tax Act. It would be levied at rates which were based on the amounts given by the donor and so would differ from an accessions tax, which would be imposed at rates dependent on the amount of gifts received from all sources by each donee.

The easiest approach to integration would be to retain the two present taxes but to adopt a common rate schedule that was the same as, or similar to, the estate tax schedule. There need not be any accumulation for tax purposes of taxable gifts made during the taxpayer's lifetime; the tax could be based on aggregate gifts at particular times. The present generous exemptions under the gift tax provisions could be reduced.

A more effective integration would be achieved by having one taxing statute under which all gifts would be taxed under one progressive rate schedule. The tax could be levied on either the donor or the donee, depending on the social purposes intended to be achieved. It would be desirable to have some form of aggregation, either of the gifts made by the donor or of the gifts received by the donee over a period of time 7/. Similarly, the form and extent of exemptions and deductions would be adjusted to achieve the purposes sought. Alternatively, provision might be made for lifetime dollar exemptions which would be used up as gifts were made or received. In addition, there might be a separate exemption for testamentary gifts. There would need to be special averaging provisions for large transfers.

This tax might be implemented by simply adjusting the gift tax rates to equal the estate tax rates, or there might be a more thorough integration, beginning with a harmonization of the exemptions and deductions, and concluding with a complete integration of the two taxes 8/. The following remarks apply, to greater or less degree, to all forms of this tax, depending on the amount of integration desired.

Conformity to Social and Economic Objectives

Such a tax might or might not be imposed in accordance with ability to pay. If the tax was imposed on the donor, the rates would probably be based on the aggregate of gifts made by each donor regardless of their distribution. Such a tax would not be consistent with the principle of taxing in accordance with ability to pay. This would be true, even if the tax was imposed on the donee, if the rate of tax applied was based on the aggregate gifts by the donor.

If the rates were based on the aggregate of gifts received by the donee, the tax would be levied on a basis approaching ability to pay, but not necessarily to the extent provided for in our proposals, under which gifts would be integrated into the comprehensive tax base. Depending on the rate structure, an integrated transfer tax could be used to inhibit the undue accumulation and concentration of wealth, since all wealth accumulated over a lifetime would eventually be taxed at progressive rates when it passed to others. The system could be designed in such a way that the opportunity to avoid tax would be limited 9/.

If the rates imposed on <u>inter vivos</u> gifts and gifts arising on death were equalized, the timing of gifts would become less important. If the rates depended on the amount given by the donor, there would be no incentive to spread the accumulated wealth widely. That is to say, it would be no more expensive to give or leave all of one's wealth to a single child than to distribute it widely among children or other relatives. However, it is unlikely that an incentive to distribute wealth more widely would be of much practical importance because of the apparent propensities of parents to distribute wealth equally among children.

Fairness of the Tax Base

By taxing <u>inter vivos</u> gifts and testamentary gifts equally, the avoidance of estate tax by means of <u>inter vivos</u> gifts would be prevented and the treatment of gifts would be equalized. Under the present system, the same aggregate amount of gifts made by a donor may bear widely differing amounts of tax, depending upon the timing of the distribution and the taxable income of the donor.

There would be difficulties in maintaining the progressiveness of the tax. If the tax was imposed on the donor, progressiveness could not be maintained by aggregating all forms of income in the donee's hands. There are suggestions that progressiveness could be achieved by aggregating all gifts by a donor, whether <u>inter vivos</u> or otherwise, and applying the progressive rate structure to the aggregate amount of the gifts 10/. There would, however, be administrative difficulties in keeping records of lifetime aggregations of gifts. Such an integrated transfer tax could coexist with the proposed income tax, using a broad base to determine income. Indeed, a separate transfer tax perhaps would have some additional advantage in that, being a separate and integrated tax on transfers of wealth, it could fully take into account the special problems of valuation and liquidity inherent in taxing transfers of wealth.

Assuming that the justification of exemptions would be their relation to the situation of the donees, it would be difficult to accommodate an integrated transfer tax on donors to a scheme of exemptions such as we have recommended. However, it could be done if the exemption available to the donor was made conditional on the gift actually being made to the donee 11/. The proposed exemptions would be consistent with the purposes of an integrated transfer tax as described above.

An integrated transfer tax would probably be quite acceptable as a logical extension of the present system.

ACCESSIONS TAX

An accessions tax is a cumulative tax on the recipient of gifts and bequests. Such a tax could be graduated according to the total gifts and bequests received in the recipients' lifetime 12/. The tax could be computed readily by applying current rates to aggregate taxable acquisitions to date, including those made in all prior years. From this amount would be deducted the tax computed at current rates on aggregate taxable acquisitions for prior years 13/.

To ease administrative burdens and to allow some exemption to each donee, provision could be made to exempt small gifts. Because all gifts would be aggregated, the impact of the exemption would be the same regardless of the pattern of the gifts.

Conformity to Social and Economic Objectives

An accessions tax could be used both to encourage a wide distribution of wealth and to reduce the rate of accumulation. It would be a feature of a tax on donees that a donor could reduce total taxes payable by distributing gifts widely to donees with relatively low rates of tax, thus encouraging a wider distribution of wealth. A tax on donees would lead to attempts to defer the tax by the use of trusts or by postponing possession, say, through the imposition of a condition that would have to be satisfied before the gift was complete.

An accessions tax would be more equitable than an integrated transfer tax in that it would come closer to taxing in accordance with ability to pay. Progressiveness could be maintained, to some extent, by various schemes of aggregation. Many countries having integrated transfer taxes limit the aggregation of gifts to a period of time, usually not more than ten years, as it appears that the administrative difficulties of aggregating over a lifetime are substantial. It is also usual for the rates to vary according to the relationship of the donor to the donee. Presumably this type of provision would not be needed if the family unit concept was accepted. Aggregation would meet the problem of dealing fairly with the irregularity of transfers and gifts so as to prevent erosion of the tax base and maintain progressiveness. It would also substantially eliminate opportunities for avoidance.

Fairness of the Tax Base

An accessions tax, like the tax we propose, would be based on the ability of the donee to pay. It would be relatively more closely related to the comprehensive tax base than a separate transfer tax would be, but somewhat less desirable than our proposal from the standpoint of progressiveness, as other forms of income received by the donee would not be taken into account in determining the applicable rate. Deductions and exemptions could be similar to those recommended for gifts under the proposed comprehensive tax base.

SUCCESSION DUTY OR INHERITANCE TAX

A succession duty or inheritance tax is a form of death duty that is imposed on the recipient of a gift. In Canada, succession duties with somewhat differing characteristics are at present levied by three provinces: British Columbia, Ontario and Quebec. The rates of duty imposed by all three statutes vary for three classes of beneficiaries: immediate family, collateral relatives and strangers. Under the present rate structures in Ontario and Quebec, two sets of duties at progressive rates are levied, one depending on the size of the total estate and thus having features of an estate tax, and the other an additional levy depending on the amount received by each beneficiary, in this respect resembling a transfer tax on donees or a true succession duty. Under the Ontario act the additional levy does not apply in the case of gifts to strangers, although they are taxable at the highest initial rate. The British Columbia statute has only one set of rates for each class of beneficiaries and these depend on the size of the total estate. Under all three statutes the tax rate is not concerned with the wealth of the recipient derived from other sources or, indeed, with gifts received from other donors or from the same donor at different times, except gifts made by the donor within three or five years prior to his death.

Canada also imposed a succession duty under the Dominion Succession Duty Act, which was in force from 1941 until it was replaced by the Estate Tax Act, which is applicable in the case of deaths occurring on or after January 1, 1959. Like the Ontario and Quebec statutes, the Dominion Succession Duty Act levied two sets of duties. The initial rate applicable to a gift was determined solely by the size of the total estate, while the additional rate depended both on the amount of the gift and on the relationship of the deceased to the beneficiary, there being four classes of beneficiaries to which different rates applied.

Succession duties and inheritance taxes usually have exemptions and deductions for debts, small bequests and charitable bequests, and substantial exemptions or deductions for testamentary gifts passing to members of the deceased's family. The differences in treatment of these exemptions under an estate tax and a succession duty are not sufficient to be a factor in the system chosen. The scope of the family exemptions varies according to whether they are intended to compensate for the loss of the provider, in which case they are confined to a wife and dependent children, or whether they are based on blood relationship, in which case the definition of family is broader.

Conformity to Social and Economic Objectives

Like an accessions tax, a succession duty places more emphasis on taxing in accordance with ability to pay than on slowing the rate of the accumulation of wealth. Like the present estate tax, a pure succession duty is subject to avoidance by the use of <u>inter vivos</u> gifts unless it is combined or integrated with a gift tax imposed at comparable rates. It fails to achieve true progressiveness because it does not aggregate successions with other gifts or other forms of income. Hence, a succession duty or inheritance tax is inferior to either an accessions tax or an integrated transfer tax in terms of both maintaining progressiveness and preventing avoidance.

Fairness of the Tax Base

Like the proposed comprehensive tax base and an accessions tax, a succession duty or inheritance tax is based at least to some extent on the ability to pay of the donee. The provision for the inclusion in an estate of gifts made within three or five years of death as is required for the purpose of the federal estate tax and the provincial succession duties is arbitrary and uneven in application, and fails to achieve its purpose of thwarting tax avoidance almost directly in proportion to the wealth and sophistication of the donor. Thus, a pure succession duty is less satisfactory in these respects than either the proposed comprehensive tax base or an accessions tax.

NET WEALTH TAX

A net wealth tax is a tax levied on the net value of a taxpayer's assets at a point of time, including unrealized capital gains. Several countries have such a tax 14/, which is levied annually, usually at a low flat rate of between one half of 1 per cent and 3 per cent. Some European countries, such as Austria, Finland, The Netherlands and West Germany, have both a net wealth tax and death taxes.

In order to reduce administrative problems it is usual to exempt property under certain aggregate amounts. For example, West Germany has exemptions of about $2,500 for single persons, $5,000 for married persons, and $7,500 for old people and invalids. In Sweden, where the property of a husband and wife is aggregated, the exemption is approximately $16,000. Some commentators have suggested an exemption of up to $50,000 which would diminish as wealth increased 15/. Another has taken the view 16/ that, in order to reduce the administrative burden, $200,000 would not be too high an exemption. The proper rate of exemption is a matter of the degree of redistribution of wealth that is desired.

It is also common to exempt certain kinds of property which are for personal use, are of small importance or are relatively hard to value. Most commonly exempted are personal and household effects except jewellery and works of art, life insurance policies and pension rights, and, occasionally, certain types of property of particular importance to the economy of the country, such as livestock in Switzerland and assets used in agriculture in India.

The frequency with which a net wealth tax is imposed is important, particularly in determining an appropriate rate. Such a tax might be levied annually or at longer intervals; if levied only at death it would be similar to an estate tax. Most countries which levy such taxes do so annually.

It should not be assumed that because a number of European countries have a net wealth tax, it could necessarily be successfully introduced in Canada. In the first place, the regular income tax may be less efficient in many countries, so that they rely on a multi-base tax system. Secondly, in many cases the collection of the tax is inequitable. Some assets may continue to be valued at cost without adjustment for increases in market value. Some assets, such as corporate shares and other intangibles, and particularly those held abroad, may escape the tax net. Some types of assets which are difficult to value may be largely ignored, although the valuation problem is often specifically alleviated for assets for which there is no ready market value by requiring valuation only every three to five years. Thus, there are difficulties in imposing and collecting a net wealth tax on an equitable basis.

Conformity to Social and Economic Objectives

A net wealth tax might apply to a wide or narrow base, that is, to the world-wide wealth of a resident of Canada or only to the wealth situate in Canada. Because the situs of securities and other intangible property could easily be arranged to be outside Canada, thereby removing a substantial part of the base, we have given consideration to the more effective alternative of an annual net wealth tax on all the wealth of persons resident in Canada.

A net wealth tax that is imposed at death is essentially an estate tax, which has been considered earlier. An annual net wealth tax would better satisfy the criteria of a broad base and ability to pay. Since much of the wealth is concentrated in relatively few hands, the tax would be hard to avoid because there would be a year-by-year check on assets. However, the problems of valuation and administration emerge as serious difficulties which in practice might limit the effectiveness of the tax. Most net wealth taxes are imposed at flat rates, and so have little effect on the distribution of wealth. Whether or not such a tax would affect the accumulation of wealth would depend on the rates. At the rates usually imposed, it might slow the rate of accumulation of wealth, but whether it would do so to any greater extent than the present estate tax is difficult to say 17/.

Fairness of the Tax Base

Transfers of wealth, as such, would in general cease to have tax consequences. The new owner of the wealth would pay tax on his increased base.

The major problems, however, of an annual net wealth tax are such that we do not recommend it at this time. The reasons for this view are discussed in Chapter 7 where we point out some of its advantages and disadvantages. It has been criticized as inhibiting growth, but this argument would appear to be inconclusive, considering the experience of European nations which have such taxes and, in some cases, death taxes as well. It is sometimes suggested that the tax might be restricted to certain kinds of assets, such as land and securities, in order to simplify administration. However, if the tax was not comprehensive, it would be neither fair nor neutral. There would, of course, be valuation problems if market values were used, as they should be. These would be unavoidable under any system of wealth tax.

REFERENCES

1/ In contrast, under the United States gift tax, lifetime gifts are aggregated, subject to a generous deduction. Such gifts are not liable to estate tax, except for gifts made in contemplation of death. Gifts made within three years of death are presumed to have been made in contemplation of death, unless the presumption is rebutted. In <u>Estate and Gift Taxation</u>, ed. G. S. A. Wheatcroft, Sweet and Maxwell, 1965, it is suggested at p. 129 that <u>inter vivos</u> gifts should be aggregated with property passing on death for purposes of the estate tax.

2/ See D. B. Fields and E. J. Mockler, <u>Gift Tax</u>, a study published by the Commission, for a detailed discussion of the faults of the present gift tax exemptions.

3/ Sections 3(1)(h) and 4(2).

4/ Section 22(1).

5/ Section 22(2)(a)(i).

6/ The problems which would be solved and those which would remain are considered in Chapter 17. In particular, the adoption of the family unit would remove the need for the exemption of certain once-in-a-lifetime gifts of real property. The provision for inclusion in an estate, for estate tax purposes, of gifts made within three years of death could also be dropped.

7/ For a comparison of the French, German and Swedish gift tax systems, especially the provisions for aggregating gifts of previous years, see the study on gift tax cited above. See also the discussion of an integrated transfer tax in Appendix E to J. G. Smith and E. J. Mockler's <u>Estate Tax</u>, a study published by the Commission.

8/ See Federal Estate and Gift Taxes: A Proposal for Integration and for Correlation with the Income Tax, Washington: United States Government Printing Office, 1947, for a comprehensive study of an integrated transfer tax on the donor, including a draft of a statute to implement the proposal.

9/ When a transfer tax is imposed on the donor, the experience of most taxing jurisdictions is that there are increasingly elaborate attempts to take advantage of relatively low rates of tax on *inter vivos* gifts. This results in increasingly complex legislation designed to bring into tax property which the donor, by the use of trusts or otherwise, has transferred during his lifetime, but over which he often retains a considerable measure of control.

10/ Section 2502 of the United States Internal Revenue Code requires the aggregation of lifetime gifts in establishing the rate of tax on each successive gift.

11/ Unlike the exemptions for a surviving wife and dependent children under the present Estate Tax Act, which are available whether or not the gifts are actually made to the wife and children.

12/ See C. S. Shoup, Report on Japanese Taxation by the Shoup Mission, General Headquarters Supreme Commander for the Allied Powers, Tokyo, Japan, 1949, for a detailed exposition of an accessions tax. See also the study on gift tax published by the Commission, cited above, for a discussion in detail of the advantages and disadvantages of such a tax.

13/ The gift tax on donors under the United States Internal Revenue Code is computed in a similar way.

14/ Net wealth taxes are levied by Austria, Denmark, Finland, West Germany, Luxembourg, The Netherlands, Norway, Switzerland, Sweden, India and Japan.

15/ R. I. Downing, H. W. Arndt, A. H. Boxer, R. L. Mathews, Taxation in Australia: Agenda for Reform, Melbourne University Press, 1964, p. 111.

16/ G. S. A. Wheatcroft, "The Administrative Problems of a Wealth Tax", [1963] British Tax Review 410, p. 422.

17/ The available data suggest that the European net wealth taxes raise between 1.5 per cent and 2 per cent of total tax revenue, which is similar to our yield from estate and gift taxes.

APPENDIX E

FORMULAE FOR DETERMINING THE TAX ON A TAX-PAID GIFT

Where a gift is made on the basis that the tax is paid by someone other than the donee, it is necessary to compute the tax and also the gross amount of the gift, which is the total of the net gift and the tax on the gross gift. Under the Estate Tax Act the Department of National Revenue has followed an elaborate procedure involving ten successive calculations of tax for this purpose. Although this method was upheld by the Supreme Court of Canada in M.N.R. v. Estate of E.W. Bickle, Mr. Justice Judson stated that "It should be possible to state the Minister's proposition in such a way that an actuarial training is not needed to understand it." 1/ He went on to say that, according to the evidence, the same result might be obtained by the application of an algebraic formula.

In this appendix we set out the appropriate formulae for determining the tax in this situation. The formula is simple where the entire tax on the gift falls within one rate bracket. When the gross amount of the gift is such that the tax thereon falls within two or more rate brackets, the formula must be modified.

Legend

N - the net gift after federal tax, but including any provincial tax which, it is assumed, will always be constant.

T(1) - the tax calculated on N.

T(2) - the tax on the gross gift, that is, on N+T(2).

k - the part of the tax bracket within which the upper limit of N falls which is in excess of N unless this is the top bracket.

r - the rate of tax applicable to k, or the rate of tax applicable to the top bracket if the upper limit of N is in the top bracket.

k' - the amount included in the tax bracket next above k.

r' - the rate of tax applicable to k'.

k" - the amount included in the tax bracket next above k'.

r" - the rate of tax applicable to k".

If the gift, including the tax, or some portion of it is eligible for a provincial tax credit, this must be taken into account in determining r, r' and r". For example, if the rate of tax stated to be applicable to k was 30 per cent while two thirds of the property was located in Quebec (50 per cent credit), one sixth in British Columbia (75 per cent credit) and one sixth in New Brunswick (no credit), r would be 30 per cent minus 50 per cent of two thirds of 30 per cent (10 per cent) and minus 75 per cent of one sixth of 30 per cent (3.75 per cent), or 16.25 per cent.

Formula 1 - where the tax on the gifts falls within one rate bracket.

$$T(2) = \frac{T(1)}{1-r}$$

If the tax on the gift T(2) falls within more than one rate bracket, the application of this formula will usually indicate the number of brackets within which this tax will fall. If it is more than one bracket, it will then be necessary to apply one of the following formulae.

Formula 2 - where the tax on the gift falls within two rate brackets.

$$T(2) = \frac{T(1) + rk - r'k}{1 - r'}$$

Formula 3 - where the tax on the gift falls within three rate brackets.

$$T(2) = \frac{T(1) + rk + r'k' - r''(k + k')}{1 - r''}$$

If the tax falls within more than three rate brackets, which is unlikely, the formula can be further modified to provide for this case.

REFERENCE

1/ 66 DTC 5179 at p. 5180.

APPENDIX F

ALTERNATIVE METHOD OF TAXING DEFERRED GIFTS

Under the system of taxing deferred gifts that is proposed in Chapter 17, an initial tax would be levied on gifts payable in instalments and on gifts in trust, in order to achieve the important objectives of equality and neutrality in the taxation of all forms of income at a point of time. Although this method of achieving equality would add some complexity to the system, the exclusion from taxation of gifts between spouses in the family unit, which would constitute a large proportion of deferred gifts, would serve to minimize this feature.

Nevertheless, an alternative system of taxing deferred gifts which has the attraction of somewhat greater simplicity can be outlined. Such a system would entail deferring the tax on such gifts until the gift was received in possession by the annuitant, life tenant or beneficiary of a trust. Because the tax would be levied only as and when the amounts were received, this method would also provide a simple way of taxing life interests. If our recommendations regarding the integration of gifts into the comprehensive tax base are not adopted, this alternative method of taxing gifts which are payable in instalments, or the possession of which is deferred, should be given consideration.

The principal feature of such a system is that it would permit deferment of tax with respect to all forms of gift, in contrast to other kinds of income. Thus, a form of preferential tax treatment would be extended to gifts that would not be available to other forms of income. It should perhaps be emphasized that this system could be applied equally under the comprehensive tax base proposed in this Report, under the alternative of an integrated transfer tax referred to in Appendix D to this Volume, or under the present system of estate and gift taxation. It could be applied either to a system which taxed the donor or to a system which taxed the donee.

The treatment of the various forms of gift may be outlined as follows:

1. Direct Gifts. The donee of a direct gift would have the option of taking the gift into income immediately and paying tax at his marginal rate or of depositing the gift in an interest-bearing Income Adjustment Account bearing interest at 5 per cent.

2. Annuities and Life Interests. Annuitants and the beneficiaries of life interests, including widows who were beneficiaries of pensions under a provision for a joint life pension with continued payments to the survivor, would pay tax on the full amount of payments received as and when received, assuming that our recommendations with respect to tax-free transfers within the family unit were not accepted. If the annuitant or life tenant died prematurely, there would be no liability for tax in respect of payments which were not ultimately received, as may be the case under the present Estate Tax Act, which contains only limited provisions for adjusting the tax in case of premature death of an annuitant.

   Assuming that the family unit proposals were adopted, if a gift was made to a spouse or other member of a family unit, the part of the payments attributable to the original fund would be exempt and only the interest element would be taxed as and when received.

3. Pension and Retirement Savings Payments. Payments out of Registered Retirement Income Plans would be fully taxable no matter to whom they were payable. This would be so because the fund from which the payments were made would have been created from tax-free contributions, so that all payments should be taxed whether paid to the employee, his spouse or other beneficiaries. This is similar to the treatment which is proposed in Chapter 16. As explained in that chapter, the deferment of income tax at the time of contribution is justified on broad social grounds.

4. Remainder Interests. Remainder interests would be taxed in full when they were received at their then value, which would include any gain in value between the time when the property was placed in trust and the time when it came into the possession of the remainderman. There would be no need to distinguish between vested and contingent remainders, as tax would be imposed only when the property came into possession. This would simplify considerably the taxation of complex trust interests, although it would still be necessary to provide for the taxation of income other than a gift when it was received by a trust.

5. Powers of Appointment and Powers of Encroachment. Persons benefiting from the exercise of powers of appointment and powers of encroachment would pay tax at their personal rates on the property when received. There would be no need to tax the holders of general powers of appointment or encroachment.

The foregoing is a brief outline of an alternative system of taxing gifts. It would achieve some simplicity at the cost of giving all gifts a deferment of tax in comparison with other forms of income, which would be taxed when received or, in some cases, when accrued.

APPENDIX G

A SUMMARY OF THE UNITED KINGDOM ESTATE TAX AND THE UNITED STATES GIFT TAX AND ESTATE TAX

We are outlining only the United Kingdom and the United States methods of taxing transfers of wealth because the general tax environment of these countries is relatively similar to that of Canada. Summaries of other methods of taxing transfers of wealth can be found in the study on gift tax published by the Commission 1/.

UNITED KINGDOM

The United Kingdom levies an estate duty under the provisions of the Finance Act of 1894, as amended, but does not levy any tax on inter vivos gifts, except that those made within five years of the death of the donor are subject to estate duty. In general, the estate duty applies to property situate in the United Kingdom passing on the death of a deceased. Property situate outside the United Kingdom is also taxed unless the law applying to the devolution is neither English nor Scottish, and either (a) the deceased died domiciled outside the United Kingdom, or (b) the property passed under a disposition made by a person who was domiciled outside the United Kingdom when he made it.

Estate duty is levied on "property passing on the death" of a deceased. The definition of such property is quite complex, and includes items which are generally similar to the types of property included under section 3 of the Canadian Estate Tax Act, for example, property that the deceased owned or was competent to dispose of, gifts made within five years of death, gifts with a reservation of benefit, benefits from insurance policies provided by the deceased, and the beneficial interest in joint annuities arising on death.

One property interest that is taxed in the United Kingdom but is not taxed in Canada is the value of a life interest which has terminated 2/. Under the United Kingdom law, when a life interest created under a will has terminated there is a second tax on the property interest passing because of the termination, the first tax having been paid, of course, on the death of the testator. The same position obtains where the life interest is created under an inter vivos settlement and the settlor fails to live for five years after the settlement 3/. Because this duty was being avoided by life tenants selling their interests to remaindermen, or by remaindermen releasing or selling their interests to life tenants, provisions were introduced to include in the estate of a person who transferred such an interest the value of the interest transferred, unless the transfer was made more than five years prior to death.

Deductions from the estate include expenses (but not the costs of administration or losses incurred during administration), debts and gifts made for public or charitable purposes. There are various other exemptions of considerable importance, such as an exemption for estates not exceeding £5,000. Of particular interest, in view of our recommendations relating to the family unit, is a provision that where the surviving spouse has only a limited interest in settled property, the estate is exempt on the death of that spouse. There are also special reliefs or credits against the duty which reduce the rate. The rate of duty on the agricultural value of agricultural land and on industrial plant and machinery used for the purposes of a business is reduced by 45 per cent. Some property in which the deceased did not have an interest is dutiable but is not aggregated with the rest of his assets for estate duty, duty being levied on that property separately.

There is a graduated reduced rate for quick successions and a tax credit for foreign taxes paid on property situate in a foreign country. Unilateral relief given by the statute to relieve double taxation is superseded when the United Kingdom has a reciprocal convention with another country such as Canada or the United States.

Valuation is generally at market value, with special rules applying in particular to shares of controlled companies. Duty is levied on a graduated scale from 1 per cent where the principal value is from £5,000 to £6,000, to 8 per cent where the value is over £1,000,000. The rate in each bracket applies to the whole estate and is therefore also the average rate and not the marginal rate on the excess over the previous bracket, as under the Canadian estate tax.

Generally, tax is due six months from death and is payable by the person who owns the property. Thus, if the donor of property dies within five years after making a gift, the donee is liable for the tax. If there is a tax on a trust on the termination of a life interest, the trustees pay the tax. Tax which applies to property owned by the deceased at the date of death, or which he could have owned, say, by exercising a power of appointment, is payable by the personal representatives of the deceased.

UNITED STATES

The United States federal government levies both an estate tax and a gift tax under the Internal Revenue Code and Regulations 4/. The taxes apply to all citizens and residents in respect of property subject to tax, whether the property is situate inside or outside the United States. The jurisdiction assumed over non-resident aliens is more complex. Estate tax is levied on all taxable property situate in the United States. Gift tax applies to all such property if the non-resident alien is carrying on business in the United States, but only to real and tangible personal property situated in the United States if he is not 5/.

Gift Tax

Gifts, though not specifically defined, include all inter vivos gratuitous transfers, direct or indirect, and also transfers made for inadequate consideration. Arm's length transactions for business purposes are not included. The rates are progressive by brackets, and vary from

2.25 per cent on taxable gifts up to $5,000 to 57.75 per cent on taxable gifts over $10,000,000. The gift tax rates, after taking all matters into account, are established at a level equal to 75 per cent of the estate tax rates on equal stated bracket amounts. Unlike the position with respect to estate tax, the gift tax liability itself does not form part of a taxable gift.

In determining taxable gifts, there is an annual exclusion of gifts of a present interest of up to $3,000 a year for each donee, in addition to a lifetime exemption of $30,000 for each donor and an unlimited deduction for charitable gifts.

Generally speaking, property is valued at fair market value at the date of the gift, and liability for the tax is on the donor, the donee being liable if the tax is not paid by the donor.

Two features of the tax are noteworthy in the light of our proposed treatment of gifts and inheritances. In mitigation of the tax, a gift by a married person to any person other than his spouse may, by election applicable to all gifts made in the year, be considered to have been made one half by each spouse. In addition, there is a marital deduction to the extent of 50 per cent of gifts by one spouse to the other. On the other hand, all previous taxable gifts made by a donor must be aggregated in computing the rate of tax. The procedure is quite simple: tax is calculated at current rates, first, on the aggregate of all taxable gifts made by a donor in preceding years and, second, on the aggregate of all taxable gifts in the current year and preceding years; the difference between the first and the second calculation is the gift tax for the current year.

Estate Tax

The federal estate tax is levied at progressive rates on taxable estates at rates from 3 per cent on taxable estates not over $5,000 to 77 per cent on amounts in excess of $10,000,000. The gross estate includes all property owned beneficially by the deceased plus a wide variety of types of property in which the deceased had an interest. The property included is generally similar to the property brought into tax by section 3 of the Canadian Estate Tax Act. The gross estate is subject to deductions for administration expenses, casualty losses during administration, debts and charitable deductions. There is also a most important marital deduction which, in effect, allows a spouse to pass one half of his adjusted gross estate 6/ to his surviving spouse tax free, but only if the transfer is outright or in trust with a general power of appointment in the surviving spouse so as to render it subject to estate tax on her death.

There is also a system of tax credits for state death duties of all kinds and for gift tax paid on amounts brought into the gross estate 7/. A foreign tax credit is given by the Code or by tax treaties, and is generally limited to the United States federal tax applicable to the property situate in a foreign country. There is a diminishing credit for tax on prior transfers which is intended to avoid double taxation in the case of two deaths occurring within a comparatively short time.

Valuation is at fair market value, securities listed on exchanges being valued at prices on the exchange, subject to recognition of the problem of disposing of large blocks of stock without depressing the price. Valuation is made as of the date of death of the deceased unless the alternate date of one year from death is elected.

Most of the states also levy death duties of one kind or another.

REFERENCES

1/ D.B. Fields and E.J. Mockler, Gift Tax.

2/ As is explained in Chapter 21, a life interest is created when a donor directs his trustees to pay the income or a fixed amount from a fund to a designated beneficiary for his lifetime. The trust or will usually provides for the disposition of the fund on the death of the life tenant.

3/ It is to be observed that where a trust is entirely discretionary, that is, where an absolute discretion is given to trustees as to the application of the income and capital of the trust fund, estate tax is not charged until the trust finally ends, which could well be several decades after its creation. This loophole has been extensively used for many years.

4/ Estate tax under Subtitle B, Chapter 11, sections 2001 to 2209, and gift tax under Subtitle B, Chapter 12, sections 2501 to 2504.

5/ H.R. 13103, recently passed by the House of Representatives, would eliminate from gift tax transfers of intangible property with a United States situs by any non-resident alien.

6/ The gross estate less deductions for administration expenses, losses and debts is the adjusted gross estate. See section 2056 of the Internal Revenue Code.

7/ The United States rule on the inclusion in the estate of a deceased of transfers of property made before death, other than bona fide sales for full consideration, is more complex than the Canadian rule. Under the United States rule, transfers made within three years of death are deemed to have been made in contemplation of death, subject to rebuttal, and are includible. Transfers made more than three years before death are not considered to have been made in contemplation of death.

APPENDIX H

COMPARISON OF INCOME TAXES PAYABLE AT DIFFERENT INCOME LEVELS IN CANADA AND THE UNITED STATES

This appendix provides more detailed data on income taxes paid at different income levels in Canada and the United States than is provided in the text of Chapter 11, and in doing so makes clear the assumptions used in these comparisons. The important assumptions are the following:

1. In all of these comparisons, the income of a taxpayer is made up entirely of wages and salaries.

2. Any transfer payments received by a taxpayer are excluded from the comparison 1/.

3. No attempt is made to allow for provisions which affect taxes only in subsequent years 2/.

Other assumptions are referred to in notes to the various tables.

The most important single factor resulting in lower income taxes in the United States for middle income families is the much more liberal allowance of deductions from income. Table H-1 shows the total income taxes which would be paid in Canada and the United States by a family that had two children, owned its own home and had an income of $12,000 earned by the head of the household. The second column of Table H-1 shows what tax would be paid by this family if Canadian tax rates were applied to a tax base defined in accordance with United States tax law. As can be seen by comparing this tax with the taxes calculated in the other three columns, the much lower taxes in the United States arise only in part from a lower overall rate schedule. Including average state income taxes, the United States middle income taxpayer pays roughly 10 per cent less tax than does a Canadian taxpayer with the same amount of taxable income 3/. However, because taxable income is, on the average, a lower fraction of gross income for the United States taxpayer, the middle income United States taxpayer in fact pays almost 30 per cent less tax.

The lower United States taxes result largely from a lower ratio of taxable income to gross income. This lower ratio, in turn, results from the deductibility of items such as mortgage interest, property taxes, state and local sales taxes and state income taxes, as well as from a more liberal definition of what can be claimed as charitable donations, expenses of earning employment income and other deductions.

In the comparisons which follow, taxpayers are compared in three situations:

1. The taxpayer is assumed to be the head of a family with a wife and two children and to claim itemized deductions equal to the average deductions claimed by taxpayers who itemize.

2. The taxpayer is assumed to be single, to have no dependants and to claim only the standard deductions 4/.

3. The taxpayer is assumed to be married, to have no children and to claim only the standard deductions.

Data on estimated average itemized deductions are presented in Tables H-3 and H-4; tax comparisons are presented in Tables H-5, H-6 and H-7.

Some previous comparisons of United States and Canadian income taxes have been made using income taxes paid by residents of New York State as representative of state and local income tax payments in the United States 5/. As Table H-2 shows, income taxes in New York State are actually higher than in any other major state except Wisconsin. In fact, they are roughly 2.7 times as high as average state and local income taxes combined in the United States. All comparisons reported in Tables H-5, H-6 and H-7 are consequently based on the average state and local income taxes deducted by all taxpayers filing returns with itemized deductions. Since it may be of interest, average income taxes paid by a resident of New York State with a wife and two children and with deductions itemized are shown in Table H-8. As can be seen by comparing this table with Table H-5, income taxes are lower than Canadian income taxes, even for taxpayers in New York State.

It should be emphasized that the comparisons in this appendix and in Chapter 11 include personal income taxes only. The United States capital gains tax is not taken into account and it is assumed that gross income is defined in the same way in the two countries. No attempt has been made to take into account other direct taxes, such as corporate income taxes or gift taxes, which reduce the net economic power of a taxpayer. Compulsory payments into government pension plans have also been excluded. Because compulsory payments into government pension schemes have been included in an earlier comparison, 6/ a comparison including Social Security taxes for United States taxpayers and Canada Pension Plan payments for Canadian taxpayers is presented in Table H-9. As can be seen by comparing the figures in Table H-9 with those in Tables H-5 and H-6, the inclusion of these compulsory government pension plan contributions does not materially affect the range of incomes for which taxes are lower in the United States. In spite of the recent large increase in Social Security taxes in the United States to pay for a restricted medicare programme, income taxes and compulsory social security contributions are still less in the United States than in Canada for taxpayers with incomes over $8,000 who have two children and itemize deductions.

TABLE H-1

COMPARISON OF INCOME TAXES WHICH WOULD BE PAYABLE UNDER CANADIAN AND UNITED STATES TAX LAWS BY A HOME-OWNING HUSBAND AND WIFE WITH 2 CHILDREN AND INCOME OF $12,000

	Canadian Tax Calculation Using 1966 Rates		United States Tax Calculation Using 1966 Canadian Rates		United States Tax Calculation Using 1966 United States Rates and 1965 New York State Rates		United States Tax Calculation Using 1966 United States Rates and Average 1962 State Income Tax for All States	
	Dollars							
Income		12,000		12,000		12,000		12,000
Deductions:								
Personal exemptions	2,600		2,400		2,400		2,400	
Medical expenses	136		211		211		211	
Contributions to charities	328		358		358		358	
Retirement savings premiums and pension contributions	335		-		-		-	
Canada Pension Plan contributions	79							
Mortgage interest	-		975		975		975	
Property taxes	-		700		700		700	
Provincial or state sales tax	-		198		198		198	
Provincial or state income tax	-	3,478	324	5,166	245	5,087	123	4,965
Taxable Income		8,522		6,834		6,913		7,035
Federal income tax		1,293		943		1,173		1,196
Old Age Security tax		120		120		-		-
Provincial income tax		414		324		-		-
State income tax		-		-		245		123
Total Income Taxes		1,827		1,387		1,418		1,319

Notes:

1. Personal exemptions are assumed to be two $1,000 exemptions and two $300 exemptions for the Canadian calculation; and four $600 exemptions for the United States calculations, which assume joint returns to have been filed.

2. For the Canadian calculation, medical expenses and contributions to charities are assumed to be the average for all Canadian taxpayers with incomes between $10,000 and $15,000 in 1964 with itemized deductions; retirement savings premiums and pension contributions are assumed to be equal to the average for all taxpayers in that income class. These average figures were multiplied by the ratio of $12,000 to mean income in the class to make them consistent with an income of $12,000. The data were obtained from Table 2 of 1966 Taxation Statistics: Individual Tax Statistics for 1964, Ottawa; Department of National Revenue, preliminary figures. For the United States calculations, medical expenses and contributions to charities were estimated in the same way from data in Tables 13 and 14 of the Statistics of Income 1962: Individual Income Tax Returns, Washington; Internal Revenue Service, 1965.

3. Mortgage interest and property taxes are assumed to correspond to what would be paid by the family if it owned a $25,000 home with a 6½ per cent mortgage of $15,000 outstanding, and if property taxes were assessed at 70 mills on an assessment equal to 40 per cent of market value.

4. Provincial sales taxes are assumed to be the amount deductible without documentation as given by the optional state sales tax tables provided in the United States federal income tax form (Form 1040 for 1965) for a state with a 5 per cent retail sales tax.

5 For the calculations according to United States procedures, but using 1966 Canadian rates, provincial income tax is computed as 24 per cent of the "basic" federal income tax on taxable income before deducting provincial income tax. "Basic" federal tax is the federal income tax before deduction of the 24 per cent provincial tax abatement and of the $20 tax decrease introduced in 1966.

6 New York State income taxes were calculated using 1965 New York State rates on taxable income as defined for federal income tax purposes, less New York State tax. Average 1962 state income taxes were estimated as in Table H-2.

TABLE H-2

AVERAGE STATE AND LOCAL INCOME TAXES DEDUCTED ON UNITED STATES FEDERAL INCOME TAX RETURNS WITH ITEMIZED DEDUCTIONS IN 1962, BY STATES WITH MORE THAN 1,000,000 TAX RETURNS

States	Number of Tax Returns	Number of Tax Returns With Itemized Deductions	Average State Income Tax Deducted
Wisconsin	1,407,472	493,951	$ 278.2
New York	6,629,260	3,524,191	232.8
Minnesota	1,191,577	513,152	170.6
Massachusetts	2,029,442	865,839	142.7
North Carolina	1,353,694	571,113	142.4
Maryland (inc. D.C.)	1,619,915	593,313	139.9
Virginia	1,320,568	462,375	129.9
Indiana	1,590,890	438,991	97.1
All United States Returns	62,709,083	26,455,432	85.4
Georgia	1,096,984	433,546	84.1
California	6,186,519	3,298,793	77.4
Missouri	1,483,258	611,231	69.8
New Jersey	2,386,667	1,147,262	29.1
Connecticut	1,007,534	398,117	27.0
Tennessee	1,090,583	427,577	14.8
Pennsylvania	4,021,286	1,645,179	12.4
Washington	1,018,194	426,865	7.3
Florida	1,685,127	835,994	5.6
Ohio	3,360,412	1,303,862	5.2
Michigan	2,612,414	1,197,409	5.2
Illinois	3,806,569	1,461,373	4.5
Texas	3,020,013	1,072,486	3.4

Source: Statistics of Income, 1962: Individual Income Tax Returns, Washington; Internal Revenue Service, 1965, Tables 26, 28 and 29.

TABLE H-3

AVERAGE ITEMIZED DEDUCTIONS IN THE UNITED STATES
AT DIFFERENT INCOME LEVELS FOR
MARRIED TAXPAYERS FILING JOINT RETURNS IN 1962

Income	Medical Expenses	Charitable Contributions	State and Local Income Taxes	Other State and Local Taxes	Interest	Other Deductions	Total Deductions
$ 1,500	-	-	$ 3	-	-	-	-
2,500	$ 169	$ 88	23	$ 112	$ 70	$ 55	$ 517
3,500	222	143	39	183	152	97	836
5,000	193	180	56	268	290	133	1,120
6,500	232	218	68	322	350	161	1,351
8,000	191	248	86	409	453	165	1,552
10,000	184	312	106	510	519	191	1,822
12,000	211	358	123	584	597	220	2,093
15,000	248	483	154	736	595	285	2,501
25,000	314	842	247	1,176	757	490	3,826
40,000	493	1,323	388	1,850	1,191	770	6,015
70,000	677	2,954	676	3,233	1,944	1,622	11,106
100,000	711	6,083	912	4,352	3,006	2,721	17,785
200,000	562	19,854	1,640	7,826	5,334	4,893	40,109
350,000	1,031	36,450	3,010	14,368	9,794	8,983	73,636
600,000	1,783	63,040	5,206	24,849	16,938	15,537	127,353

Note: The deductions presented in this table were estimated from separate estimates of average total deductions associated with each income level and of the average percentage breakdown of total deductions. Total deductions were interpolated from data in Table 13 on average total deductions by income class for joint returns of husbands and wives with itemized deductions, assuming each average deduction to correspond to total deductions claimed by a taxpayer with income equal to the average adjusted gross income of taxpayers in the class. The percentage breakdown of total deductions was likewise interpolated from data in Table 14 on total deductions of each type claimed in each income class by all returns with itemized deductions. State and local income taxes were assumed to be a constant 17.3 per cent of total state and local taxes deducted, based on average United States data in Table 29.

Source: Statistics of Income, 1962: Individual Income Tax Returns, Washington; Internal Revenue Service, 1965, Tables 13, 14, and 29.

TABLE H-4

AVERAGE ITEMIZED DEDUCTIONS AT DIFFERENT INCOME LEVELS FOR CANADIAN TAXPAYERS IN 1964 ADJUSTED FOR CANADA PENSION PLAN CONTRIBUTIONS

Income	Pension Contributions	Retirement Savings Plan Premiums	Medical Expenses	Charitable Contributions	Canada Pension Plan	Total Deductions
$ 1,500	6	-	83	97	16	202
2,500	19	-	90	140	34	283
3,500	50	1	101	166	52	370
5,000	107	3	121	178	79	488
6,500	152	7	126	191	79	555
8,000	190	12	142	271	79	694
10,000	228	44	131	280	79	762
12,000	270	66	135	328	79	878
15,000	301	153	143	370	79	1,046
25,000	341	386	160	683	79	1,649
40,000	402	594	189	1,145	79	2,409
70,000	483	628	255	2,302	79	3,747
100,000	496	523	306	3,841	79	5,245
200,000	536	632	449	9,984	79	11,680
350,000	608	1,086	652	19,727	79	22,152
600,000	1,043	1,862	1,117	33,817	79	37,918

Note: Deductions presented in this table were interpolated as in Table H-3 from estimates of average deductions of each type for taxpayers classified by income class. Average pension contributions and retirement savings plan premiums were estimated for all taxpayers in an income class; medical expenses and contributions to charities were averaged over taxpayers not claiming the standard deduction (equal to the total amount claimed as standard deductions divided by 100). Although the Canada Pension Plan did not exist in 1964, the table gives the amounts which would have been payable by taxpayers receiving their income in the form of wages and salaries if the Plan had been in force in 1964.

Source: 1966 Taxation Statistics: Individual Tax Statistics for 1964, Ottawa; Department of National Revenue, preliminary figures Table 2.

TABLE H-5

INCOME TAXES PAYABLE IN THE UNITED STATES AND CANADA BY A MARRIED TAXPAYER WITH A WIFE AND 2 CHILDREN FILING AVERAGE ITEMIZED DEDUCTIONS AT DIFFERENT INCOME LEVELS
(1966 RATES)

	United States Income Taxes				Canadian Income Taxes			
Income	Taxable Income	Federal Income Tax	State and Local Income Tax	Total	Taxable Income	Income Tax	Old Age Security Tax	Total
$ 1,500	-	-	3	3	-	-	-	-
2,500	-	-	23	23	-	-	-	-
3,500	264	37	39	76	530	46	21	67
5,000	1,480	292	56	348	1,912	218	76	294
6,500	2,749	410	68	478	3,345	466	120	586
8,000	4,048	629	86	715	4,706	745	120	865
10,000	5,778	958	107	1,065	6,638	1,196	120	1,316
12,000	7,507	1,286	123	1,409	8,522	1,707	120	1,827
15,000	10,099	1,842	154	1,996	11,354	2,624	120	2,744
25,000	18,774	4,037	247	4,284	20,751	6,638	120	6,758
40,000	31,585	8,498	388	8,886	34,991	13,546	120	13,666
70,000	56,494	20,441	676	21,117	63,653	29,242	120	29,362
100,000	79,815	33,233	912	34,145	92,155	46,451	120	46,571
200,000	157,491	81,924	1,640	83,564	185,720	110,304	120	100,424
350,000	273,964	162,755	3,010	165,765	325,248	212,986	120	213,106
600,000	470,247	300,153	5,206	305,359	559,482	396,635	120	396,755

Note: For both countries, taxable income was calculated by subtracting from income the sum of allowable personal exemptions ($2,400 in the United States and $2,600 in Canada) and total itemized deductions presented in Tables H-3 and H-4. All taxes except United States state and local taxes were calculated at 1966 rates. United States state and local taxes were assumed to be the 1962 averages presented in Table H-2. For the United States calculations, it was assumed that joint returns were filed. Canadian income tax is the federal income tax before deduction of the provincial abatement.

TABLE H-6

INCOME TAXES PAYABLE IN THE UNITED STATES AND CANADA BY SINGLE TAXPAYERS WITH NO DEPENDANTS CLAIMING STANDARD DEDUCTIONS ONLY (1966 RATES)

	United States Income Taxes				Canadian Income Taxes			
Income	Taxable Income	Federal Income Tax	State and Local Income Tax	Total	Taxable Income	Income Tax	Old Age Security Tax	Total
$ 1,500	600	87	3	90	400	35	16	51
2,500	1,600	244	23	267	1,400	142	56	198
3,500	2,600	419	39	458	2,400	298	96	394
5,000	3,900	671	56	727	3,900	571	120	691
6,500	5,250	965	68	1,033	5,400	898	120	1,018
8,000	6,600	1,280	86	1,366	6,900	1,264	120	1,384
10,000	3,400	1,742	107	1,849	8,900	1,820	120	1,940
12,000	10,400	2,318	123	2,441	10,900	2,465	120	2,585
15,000	13,400	3,334	154	3,488	13,900	3,610	120	3,730
25,000	23,400	7,730	247	7,977	23,900	8,055	120	8,175
40,000	38,400	15,942	388	16,330	38,900	15,500	120	15,620
70,000	68,400	34,166	676	34,842	68,900	32,390	120	32,510
100,000	98,400	54,386	912	55,298	98,900	50,835	120	50,955
200,000	198,400	124,370	1,640	126,010	198,900	119,530	120	119,650
350,000	348,400	229,370	3,010	232,380	348,900	230,725	120	230,845
600,000	598,400	404,370	5,206	409,576	598,900	428,170	120	428,290

Note: The same assumptions were used as in Table H-5, except that joint returns were not assumed to have been filed and that standard statutory deductions were used rather than itemized deductions.

TABLE H-7

INCOME TAXES PAYABLE IN THE UNITED STATES AND CANADA BY MARRIED TAXPAYERS WITH NO DEPENDENT CHILDREN, CLAIMING STANDARD DEDUCTIONS ONLY
(1966 RATES)

	United States Income Taxes				Canadian Income Taxes			
Income	Taxable Income	Federal Income Tax	State and Local Income Tax	Total	Taxable Income	Income Tax	Old Age Security Tax	Total
$ 1,500	-	-	3	3	-	-	-	-
2,500	1,100	155	23	178	400	35	16	51
3,500	1,900	275	39	314	1,400	146	56	202
5,000	3,300	501	56	557	2,900	383	116	499
6,500	4,650	744	68	812	4,400	678	120	798
8,000	6,000	1,000	86	1,086	5,900	1,008	120	1,128
10,000	7,800	1,342	107	1,449	7,900	1,524	120	1,644
12,000	9,800	1,776	123	1,899	9,900	2,120	120	2,240
15,000	12,800	2,460	154	2,614	12,900	3,210	120	3,330
25,000	22,800	5,276	247	5,523	22,900	7,605	120	7,725
40,000	37,800	11,150	388	11,538	37,900	15,000	120	15,120
70,000	67,800	26,510	676	27,186	67,900	31,790	120	31,910
100,000	97,800	43,860	912	44,772	97,900	50,185	120	50,305
200,000	197,800	109,462	1,640	111,102	197,900	118,830	120	118,950
350,000	347,800	214,440	3,010	217,450	347,900	229,975	120	230,095
600,000	597,800	389,440	5,206	394,646	597,000	427,370	120	427,490

Note: The same assumptions were used as in Table H-5, except that standard statutory deductions were used rather than itemized deductions.

TABLE H-8

INCOME TAXES PAYABLE IN NEW YORK STATE BY A HUSBAND AND WIFE WITH 2 DEPENDENT CHILDREN CLAIMING ITEMIZED DEDUCTIONS

Income	New York State Taxable Income	New York State Income Tax	Taxable Income for Federal Tax	Federal Income Tax	Total Income Taxes
$ 1,500	-	-	-	-	-
2,500	-	-	-	-	-
3,500	303	-	303	42	42
5,000	1,536	11	1,525	219	230
6,500	2,817	50	2,767	413	463
8,000	4,134	100	4,034	621	721
10,000	5,885	179	5,706	944	1,123
12,000	7,630	273	7,357	1,256	1,529
15,000	10,253	443	9,810	1,778	2,221
25,000	19,021	1,237	17,784	3,760	4,997
40,000	31,973	2,532	29,441	7,662	10,194
70,000	57,170	5,052	52,118	18,123	23,175
100,000	80,727	7,408	73,319	29,545	36,953
200,000	159,131	15,248	143,883	72,943	88,191
350,000	276,974	27,032	249,942	145,939	172,971
600,000	475,453	46,880	428,573	270,981	317,861

Note: Taxable income for New York State income tax was estimated by subtracting from income the sum of allowable personal exemptions ($2,600) and average total itemized deductions less average state and local income taxes, presented in Table H-2. New York State income tax was calculated using 1965 rates and credits. Federal income tax was calculated using 1966 rates.

TABLE H-9

TOTAL INCOME AND SOCIAL SECURITY TAXES PAYABLE IN THE UNITED STATES AND TOTAL INCOME TAX AND CANADA PENSION PLAN CONTRIBUTIONS PAYABLE IN CANADA (1966 RATES)

	Single Individual, Claiming Standard Deductions Only		Married Taxpayer With Two Children Claiming Itemized Deductions	
Income	United States	Canada	United States	Canada
$ 1,500	153	67	66	16
2,500	372	232	128	34
3,500	605	446	223	119
5,000	937	770	558	373
6,500	1,306	1,097	751	665
8,000	1,643	1,463	992	944
10,000	2,126	2,019	1,342	1,395
12,000	2,718	2,664	1,686	1,906
15,000	3,765	3,809	2,273	2,823
25,000	8,254	8,254	4,561	6,837
40,000	16,607	15,699	9,163	13,745
70,000	35,119	32,589	21,394	29,441
100,000	55,575	51,034	34,422	46,650
200,000	126,287	119,729	83,841	110,503
350,000	232,657	230,924	165,765	213,106
600,000	409,853	428,369	305,359	396,755

Note: Income is assumed to be composed entirely of wages and salaries in computing Canada Pension Plan payments and United States Social Security taxes. United States calculations include average state and local taxes. Canadian income tax is the federal income tax before deduction of the provincial abatement. All amounts except United States state and local taxes were calculated at 1966 rates. United States state and local taxes were assumed to be the 1962 averages presented in Table H-2. Canada Pension Plan contributions are deductible in computing income, but United States Social Security taxes are not.

REFERENCES

1/ This assumption results in the exclusion of family allowances in the comparisons of taxes paid by families with children. If family allowances were included, it would be necessary to take other transfer payments into account as well in order to be consistent.

2/ This assumption results in giving no weight to the fact that, in the United States, pensions based on a taxpayer's pension contributions will subsequently be received free of tax. At the same time the Canadian allowance of the deduction of pension contributions is not discounted by reason of the fact that the pensions based thereon will later be taxable.

3/ For example, on taxable income of $8,522, the United States taxpayer in an average state would pay state and federal income taxes totalling $1,634; this is $193 less than a Canadian taxpayer living in a province other than Manitoba, Saskatchewan or Quebec would pay.

4/ In Canada, the standard deduction is a flat $100 per taxpayer in lieu of itemized deductions for charitable donations and allowable medical expenses. In the United States, the standard deduction is the greater of: (a) 10 per cent of income; or (b) $100 plus an additional $100 for each dependant claimed; with a maximum standard deduction of $1,000. The United States standard deduction is in lieu of the broader range of itemized deductions, including home owner deductions and state income and sales tax deductions, allowed in that country.

5/ An example is provided by the 1965-66 Budget Speech reported in House of Commons Debates, April 26, 1965. The comparisons made in the Budget Speech differ from the comparisons made in this appendix in that the former are based on an estimate of deductions which is substantially below the United States average and, in the case of a taxpayer with $15,000 income, is actually lower than what can be claimed as a standard deduction.

6/ Budget Speech, House of Commons Debates, April 26, 1965.

APPENDIX I

COMPARISON OF TAX LIABILITIES FOR WAGE EARNERS IN DIFFERENT FAMILY SITUATIONS UNDER THE CURRENT AND PROPOSED TAX SYSTEMS

The tables in this appendix give a detailed comparison of the tax liabilities of different families earning income from employment under the current tax system and the proposed tax system in four cases reflecting different family situations.

These cases are as follows:

1. An unattached individual or a family unit with one income recipient.
2. A family unit with 20 per cent of its income earned by a working wife and the balance by the husband.
3. A family unit with 35 per cent of its income earned by a working wife and the balance by the husband.
4. A family unit in which the husband and wife each earn 50 per cent of the income.

In all cases, it is assumed that all of the income is from employment and that the children are qualified for family allowances, each at the rate of $72 a year.

For each case, three tables are presented. The first table lists the total federal income taxes, before the deduction of the provincial tax abatements, that are payable by unattached individuals and by family units composed of married couples with different numbers of children, given different levels of employment income. The second table shows the effective average tax rate for taxpayers in each situation. The effective average tax rate is the ratio of taxes paid to income. The third table presents estimates of the effective marginal rates applicable to taxpayers in each situation. These estimates are based on the assumption that, currently, tax is imposed on the same proportion of the additional income as of the taxpayer's entire income. The marginal rates are computed as the effective rate of tax on an additional $500 of income.

The four cases analyzed in this fashion show the effect of different proportions of income being earned by husbands and wives. In the last three cases, it is assumed that families with dependent children are eligible for the $80 working mother credit but not for the additional $120 credit for families with children younger than seven, although it is unlikely that families with many children would not be eligible for the latter credit.

In all these tables, in calculating tax liabilities under the proposed system, income is determined under the comprehensive definition, and is assumed, for illustrative purposes, to be employment income only, apart from family allowances, which are also taken into account. It is assumed that the $50 standard deduction and the 3 per cent optional standard employment expense deduction are claimed and that no additional allowable deductions are itemized. Alternatively, it may be assumed that any additional deductions beyond these amounts are offset by the attribution of fringe benefits and other components of the comprehensive tax base which at present are untaxed. Current tax includes both income tax and old age security tax. Parents of dependent children are assumed to be receiving family allowances of $6 per month per child.

The way in which the taxes are computed under the first table for each case can best be described by reference to several examples. Example 1 (a single individual earning $3,500) shows the method of calculation of the two tax figures which are presented in the fifth set of three figures in the column headed "unattached individual" in Table I, 1-1. Gross taxes under our proposals are calculated using the rate schedule for individuals presented in Table 11-4 of Chapter 11. Example 2 (a family with a wife and three children with one income recipient earning $6,500) gives the calculations underlying the two tax figures shown in the eighth set of numbers in the fifth column of Table I, 1-1. Gross taxes in this example are calculated using the family rate schedule presented in Table 11-6 of Chapter 11. Example 3 (a family with two school-age children in which both spouses work, the husband earning $5,200 and the wife $2,800) gives the calculations underlying the two tax figures shown in the ninth set of figures, that is, the row corresponding to total family income of $8,000, in the third column of Table I, 3-1.

CALCULATION OF TAXES UNDER THE CURRENT AND PROPOSED SYSTEMS
EXAMPLE 1: SINGLE INDIVIDUAL
EARNING $3,500

	Current Tax Calculation	Tax Calculation Under the Proposed System
1. Income Received		
Income earned from employment	$3,500	$3,500
Family allowances	N.A.	0
	$3,500	$3,500
2. Deductions		
Employment expense deduction	N.A.	$ 105
Personal exemption	$1,000	N.A.
Dependant allowances	0	N.A.
Standard deduction	100	50
	$1,100	$ 155
3. Net Taxable Income	$2,400	$3,345
4. Gross Tax		
Income tax (1966 rates for current tax calculation)	$ 298	$ 374
Old age security tax	96	N.A.
	$ 394	$ 374
5. Tax Credits		
Tax credit for first child	N.A.	0
Tax credit for additional children	N.A.	0
Tax credit for working mothers	N.A.	0
Additional tax credit for working mothers with pre-school children	N.A.	0
	0	0
6. Net Tax Paid	$ 394	$ 374

Note: "N.A." means that the item is not applicable.

CALCULATION OF TAXES UNDER THE CURRENT AND PROPOSED SYSTEMS
EXAMPLE 2: FAMILY WITH WIFE AND THREE CHILDREN
HUSBAND EARNING $6,500

	Current Tax Calculation	Tax Calculation Under the Proposed System
1. Income Received		
Income earned from employment	$6,500	$6,500
Family allowances ($6 per month per child)	N.A.	216
	$6,500	$6,716
2. Deductions		
Employment expense deduction	N.A.	$ 195
Personal exemptions	$2,000	N.A.
Dependant allowances	900	N.A.
Standard deduction	100	50
	$3,000	$ 245
3. Net Taxable Income	$3,500	$6,471
4. Gross Tax		
Income tax (1966 rates for current tax calculation)	$ 495	$ 741
Old age security tax	120	N.A.
	$ 615	$ 741
5. Tax Credits		
Tax credit for first child	N.A.	$ 100
Tax credit for additional children	N.A.	120
Tax credit for working mothers	N.A.	0
Additional tax credit for working mothers with pre-school children	N.A.	0
	0	$ 220
6. Net Tax Paid	$ 615	$ 521

Note: "N.A." means that the item is not applicable.

CALCULATION OF TAXES UNDER THE CURRENT AND PROPOSED SYSTEMS
EXAMPLE 3: FAMILY WITH TWO SCHOOL-AGE CHILDREN,
BOTH HUSBAND AND WIFE WORKING, HUSBAND EARNING
$5,200, WIFE EARNING $2,800

	Current Tax Calculation		Tax Calculation Under the Proposed System
	Husband's Return	Wife's Return	Family Return
1. Income Received			
Income earned from employment	$5,200	$2,800	$8,000
Family allowances ($6 per month per child)	N.A.	N.A.	144
	$5,200	$2,800	$8,144
2. Deductions			
Employment expense deduction	N.A.	N.A.	$ 240
Personal exemptions	$1,000	$1,000	N.A.
Dependant allowances	600	0	N.A.
Standard deduction	100	100	50
	$1,700	$1,100	$ 290
3. Net Taxable Income	$3,500	$1,700	$7,854
4. Gross Tax			
Income tax (1966 rates for current tax calculation)	$ 495	$ 188	$1,018
Old age security tax	120	68	N.A.
	$ 615	$ 256	$1,018
	$871		
5. Tax Credits			
Tax credit for first child	N.A.		$ 100
Tax credit for additional children	N.A.		60
Tax credit for working mothers	N.A.		80
Additional tax credit for working mothers with pre-school children	N.A.		0
	0		$ 240
6. Net Tax Paid	$871		$ 778

Note: "N.A." means that the item is not applicable.

TABLE I, 1-1

CHANGES IN TAX LIABILITIES UNDER THE PROPOSED TAX SYSTEM FOR AN UNATTACHED INDIVIDUAL AND A FAMILY UNIT WITH ONE INCOME RECIPIENT

		STATUS OF TAXPAYER						
GROSS EMPLOYMENT INCOME		UNATTACHED INDIVIDUAL	MARRIED COUPLE					
			NUMBER OF CHILDREN					
			0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	51.	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	49.	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-3.	0.	0.	0.	0.	0.	0.
2000	CURRENT TAX (1966 RATES)	115.	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	119.	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	3.	0.	0.	0.	0.	0.	0.
2500	CURRENT TAX (1966 RATES)	202.	51.	13.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	199.	36.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-3.	-15.	-13.	0.	0.	0.	0.
3000	CURRENT TAX (1966 RATES)	292.	115.	77.	38.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	281.	99.	8.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-11.	-16.	-69.	-38.	0.	0.	0.
3500	CURRENT TAX (1966 RATES)	394.	202.	148.	102.	64.	0.	0.
	TAX UNDER OUR PROPOSALS	374.	172.	84.	35.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-20.	-30.	-64.	-67.	-64.	0.	0.
4000	CURRENT TAX (1966 RATES)	499.	292.	238.	184.	130.	51.	0.
	TAX UNDER OUR PROPOSALS	471.	250.	161.	113.	65.	0.	0.
	INCREASE OR DECREASE IN TAX	-28.	-42.	-77.	-71.	-65.	-51.	0.
5000	CURRENT TAX (1966 RATES)	691.	499.	436.	373.	310.	202.	64.
	TAX UNDER OUR PROPOSALS	681.	421.	334.	287.	240.	147.	8.
	INCREASE OR DECREASE IN TAX	-10.	-78.	-102.	-86.	-70.	-55.	-56.
6500	CURRENT TAX (1966 RATES)	1018.	798.	732.	672.	615.	499.	310.
	TAX UNDER OUR PROPOSALS	1016.	698.	612.	567.	521.	430.	293.
	INCREASE OR DECREASE IN TAX	-2.	-100.	-120.	-105.	-94.	-69.	-17.
8000	CURRENT TAX (1966 RATES)	1384.	1128.	1062.	996.	930.	798.	615.
	TAX UNDER OUR PROPOSALS	1365.	989.	903.	858.	812.	722.	587.
	INCREASE OR DECREASE IN TAX	-19.	-139.	-159.	-138.	-118.	-76.	-28.
10000	CURRENT TAX (1966 RATES)	1940.	1644.	1566.	1488.	1410.	1254.	1040.
	TAX UNDER OUR PROPOSALS	1864.	1393.	1309.	1264.	1219.	1129.	997.
	INCREASE OR DECREASE IN TAX	-76.	-251.	-257.	-224.	-191.	-125.	-43.
12000	CURRENT TAX (1966 RATES)	2585.	2240.	2150.	2060.	1970.	1790.	1540.
	TAX UNDER OUR PROPOSALS	2400.	1817.	1733.	1688.	1644.	1556.	1427.
	INCREASE OR DECREASE IN TAX	-185.	-423.	-417.	-372.	-326.	-234.	-113.
15000	CURRENT TAX (1966 RATES)	3730.	3330.	3210.	3090.	2970.	2760.	2445.
	TAX UNDER OUR PROPOSALS	3265.	2507.	2424.	2382.	2339.	2253.	2128.
	INCREASE OR DECREASE IN TAX	-465.	-823.	-786.	-708.	-631.	-507.	-317.
20000	CURRENT TAX (1966 RATES)	5925.	5475.	5340.	5205.	5070.	4800.	4395.
	TAX UNDER OUR PROPOSALS	4839.	3828.	3748.	3707.	3667.	3586.	3465.
	INCREASE OR DECREASE IN TAX	-1086.	-1647.	-1592.	-1498.	-1403.	-1214.	-930.
25000	CURRENT TAX (1966 RATES)	8175.	7725.	7590.	7455.	7320.	7050.	6645.
	TAX UNDER OUR PROPOSALS	6572.	5356.	5279.	5241.	5203.	5128.	5016.
	INCREASE OR DECREASE IN TAX	-1603.	-2369.	-2311.	-2214.	-2117.	-1922.	-1629.
30000	CURRENT TAX (1966 RATES)	10620.	10120.	9970.	9820.	9670.	9370.	8920.
	TAX UNDER OUR PROPOSALS	8411.	7084.	7010.	6975.	6940.	6870.	6767.
	INCREASE OR DECREASE IN TAX	-2209.	-3036.	-2960.	-2845.	-2730.	-2500.	-2153.
40000	CURRENT TAX (1966 RATES)	15620.	15120.	14970.	14820.	14670.	14370.	13920.
	TAX UNDER OUR PROPOSALS	12300.	10868.	10795.	10763.	10730.	10665.	10568.
	INCREASE OR DECREASE IN TAX	-3320.	-4252.	-4175.	-4057.	-3940.	-3705.	-3352.
50000	CURRENT TAX (1966 RATES)	21065.	20515.	20350.	20185.	20020.	19690.	19195.
	TAX UNDER OUR PROPOSALS	16484.	15046.	14976.	14946.	14917.	14857.	14768.
	INCREASE OR DECREASE IN TAX	-4581.	-5469.	-5374.	-5239.	-5103.	-4833.	-4427.
70000	CURRENT TAX (1966 RATES)	32510.	31910.	31730.	31550.	31370.	31010.	30470.
	TAX UNDER OUR PROPOSALS	25462.	24024.	23957.	23930.	23903.	23850.	23769.
	INCREASE OR DECREASE IN TAX	-7048.	-7886.	-7773.	-7620.	-7467.	-7160.	-6701.
100000	CURRENT TAX (1966 RATES)	50955.	50305.	50110.	49915.	49720.	49330.	48745.
	TAX UNDER OUR PROPOSALS	39845.	38407.	38343.	38318.	38293.	38244.	38170.
	INCREASE OR DECREASE IN TAX	-11110.	-11898.	-11767.	-11597.	-11427.	-11086.	-10575.
200000	CURRENT TAX (1966 RATES)	119650.	118950.	118740.	118530.	118320.	117900.	117270.
	TAX UNDER OUR PROPOSALS	89840.	88402.	88338.	88314.	88290.	88242.	88170.
	INCREASE OR DECREASE IN TAX	-29810.	-30548.	-30402.	-30216.	-30030.	-29658.	-29100.

Note: See assumptions in Appendix I.

TABLE I, 1-2

EFFECTIVE AVERAGE TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR AN UNATTACHED INDIVIDUAL AND A FAMILY UNIT WITH ONE INCOME RECIPIENT

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER: UNATTACHED INDIVIDUAL	MARRIED COUPLE, NUMBER OF CHILDREN: 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.034	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.032	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	-0.002	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.058	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.059	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.002	0.000	0.000	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.081	0.020	0.005	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.079	0.014	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	-0.001	-0.006	-0.005	0.000	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.097	0.038	0.026	0.013	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.094	0.033	0.003	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	-0.004	-0.005	-0.023	-0.013	0.000	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.113	0.058	0.042	0.029	0.018	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.107	0.049	0.024	0.010	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	-0.006	-0.009	-0.018	-0.019	-0.018	0.000	0.000
4000	CURRENT TAX (1966 RATES)	0.125	0.073	0.059	0.046	0.032	0.013	0.000
	TAX UNDER OUR PROPOSALS	0.118	0.062	0.040	0.028	0.016	0.000	0.000
	CHANGE IN EFFECTIVE RATE	-0.007	-0.011	-0.019	-0.018	-0.016	-0.013	0.000
5000	CURRENT TAX (1966 RATES)	0.138	0.100	0.087	0.075	0.062	0.040	0.013
	TAX UNDER OUR PROPOSALS	0.136	0.084	0.067	0.057	0.048	0.029	0.002
	CHANGE IN EFFECTIVE RATE	-0.002	-0.016	-0.020	-0.017	-0.014	-0.011	-0.011
6500	CURRENT TAX (1966 RATES)	0.157	0.123	0.113	0.103	0.095	0.077	0.048
	TAX UNDER OUR PROPOSALS	0.156	0.107	0.094	0.087	0.080	0.066	0.045
	CHANGE IN EFFECTIVE RATE	-0.000	-0.015	-0.018	-0.016	-0.014	-0.011	-0.003
8000	CURRENT TAX (1966 RATES)	0.173	0.141	0.133	0.124	0.116	0.100	0.077
	TAX UNDER OUR PROPOSALS	0.171	0.124	0.113	0.107	0.102	0.090	0.073
	CHANGE IN EFFECTIVE RATE	-0.002	-0.017	-0.020	-0.017	-0.015	-0.010	-0.003
10000	CURRENT TAX (1966 RATES)	0.194	0.164	0.157	0.149	0.141	0.125	0.104
	TAX UNDER OUR PROPOSALS	0.186	0.139	0.131	0.126	0.122	0.113	0.100
	CHANGE IN EFFECTIVE RATE	-0.008	-0.025	-0.026	-0.022	-0.019	-0.012	-0.004
12000	CURRENT TAX (1966 RATES)	0.215	0.187	0.179	0.172	0.164	0.149	0.128
	TAX UNDER OUR PROPOSALS	0.200	0.151	0.144	0.141	0.137	0.130	0.119
	CHANGE IN EFFECTIVE RATE	-0.015	-0.035	-0.035	-0.031	-0.027	-0.020	-0.009
15000	CURRENT TAX (1966 RATES)	0.249	0.222	0.214	0.206	0.198	0.184	0.163
	TAX UNDER OUR PROPOSALS	0.218	0.167	0.162	0.159	0.156	0.150	0.142
	CHANGE IN EFFECTIVE RATE	-0.031	-0.055	-0.052	-0.047	-0.042	-0.034	-0.021
20000	CURRENT TAX (1966 RATES)	0.296	0.274	0.267	0.260	0.253	0.240	0.220
	TAX UNDER OUR PROPOSALS	0.242	0.191	0.187	0.185	0.183	0.179	0.173
	CHANGE IN EFFECTIVE RATE	-0.054	-0.082	-0.080	-0.075	-0.070	-0.061	-0.046
25000	CURRENT TAX (1966 RATES)	0.327	0.309	0.304	0.298	0.293	0.282	0.266
	TAX UNDER OUR PROPOSALS	0.263	0.214	0.211	0.210	0.208	0.205	0.201
	CHANGE IN EFFECTIVE RATE	-0.064	-0.095	-0.092	-0.089	-0.085	-0.077	-0.065
30000	CURRENT TAX (1966 RATES)	0.354	0.337	0.332	0.327	0.322	0.312	0.297
	TAX UNDER OUR PROPOSALS	0.280	0.236	0.234	0.232	0.231	0.229	0.226
	CHANGE IN EFFECTIVE RATE	-0.074	-0.101	-0.099	-0.095	-0.091	-0.083	-0.072
40000	CURRENT TAX (1966 RATES)	0.390	0.378	0.374	0.370	0.367	0.359	0.348
	TAX UNDER OUR PROPOSALS	0.308	0.272	0.270	0.269	0.268	0.267	0.264
	CHANGE IN EFFECTIVE RATE	-0.083	-0.106	-0.104	-0.101	-0.098	-0.093	-0.084
50000	CURRENT TAX (1966 RATES)	0.421	0.410	0.407	0.404	0.400	0.394	0.384
	TAX UNDER OUR PROPOSALS	0.330	0.301	0.300	0.299	0.298	0.297	0.295
	CHANGE IN EFFECTIVE RATE	-0.092	-0.109	-0.107	-0.105	-0.102	-0.097	-0.089
70000	CURRENT TAX (1966 RATES)	0.464	0.456	0.453	0.451	0.448	0.443	0.435
	TAX UNDER OUR PROPOSALS	0.364	0.343	0.342	0.342	0.341	0.341	0.340
	CHANGE IN EFFECTIVE RATE	-0.101	-0.113	-0.111	-0.109	-0.107	-0.102	-0.096
100000	CURRENT TAX (1966 RATES)	0.510	0.503	0.501	0.499	0.497	0.493	0.487
	TAX UNDER OUR PROPOSALS	0.398	0.384	0.383	0.383	0.383	0.382	0.382
	CHANGE IN EFFECTIVE RATE	-0.111	-0.119	-0.118	-0.116	-0.114	-0.111	-0.106
200000	CURRENT TAX (1966 RATES)	0.598	0.595	0.594	0.593	0.592	0.589	0.586
	TAX UNDER OUR PROPOSALS	0.449	0.442	0.442	0.442	0.441	0.441	0.441
	CHANGE IN EFFECTIVE RATE	-0.149	-0.153	-0.152	-0.151	-0.150	-0.148	-0.146

Note: See assumptions in Appendix I.

TABLE I, 1-3

EFFECTIVE MARGINAL TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR AN UNATTACHED INDIVIDUAL AND A FAMILY UNIT WITH ONE INCOME RECIPIENT

		STATUS OF TAXPAYER						
GROSS EMPLOYMENT INCOME		UNATTACHED INDIVIDUAL	MARRIED COUPLE					
			NUMBER OF CHILDREN					
			0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.128	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.140	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.012	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.174	0.102	0.026	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.160	0.071	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	-0.013	-0.031	-0.026	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.180	0.128	0.128	0.077	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.165	0.126	0.016	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	-0.015	-0.002	-0.112	-0.077	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.204	0.174	0.142	0.128	0.128	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.186	0.147	0.151	0.070	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	-0.018	-0.027	0.009	-0.058	-0.128	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.210	0.180	0.180	0.163	0.132	0.102	0.000
	TAX UNDER OUR PROPOSALS	0.194	0.155	0.155	0.155	0.131	0.000	0.000
	CHANGE IN MARGINAL RATE	-0.016	-0.025	-0.025	-0.008	-0.001	-0.102	0.000
4000	CURRENT TAX (1966 RATES)	0.194	0.204	0.186	0.180	0.180	0.128	0.000
	TAX UNDER OUR PROPOSALS	0.207	0.168	0.171	0.174	0.175	0.117	0.000
	CHANGE IN MARGINAL RATE	0.013	-0.036	-0.015	-0.006	-0.005	-0.011	0.000
5000	CURRENT TAX (1966 RATES)	0.214	0.194	0.206	0.210	0.210	0.180	0.132
	TAX UNDER OUR PROPOSALS	0.219	0.180	0.182	0.183	0.184	0.184	0.184
	CHANGE IN MARGINAL RATE	0.005	-0.014	-0.024	-0.027	-0.026	0.004	0.052
6500	CURRENT TAX (1966 RATES)	0.220	0.220	0.220	0.208	0.190	0.194	0.210
	TAX UNDER OUR PROPOSALS	0.233	0.194	0.194	0.194	0.194	0.194	0.194
	CHANGE IN MARGINAL RATE	0.013	-0.026	-0.026	-0.014	0.004	0.000	-0.016
8000	CURRENT TAX (1966 RATES)	0.260	0.252	0.228	0.220	0.220	0.220	0.190
	TAX UNDER OUR PROPOSALS	0.241	0.198	0.199	0.201	0.202	0.204	0.204
	CHANGE IN MARGINAL RATE	-0.019	-0.054	-0.029	-0.019	-0.018	-0.016	0.014
10000	CURRENT TAX (1966 RATES)	0.300	0.292	0.268	0.260	0.260	0.260	0.220
	TAX UNDER OUR PROPOSALS	0.258	0.206	0.208	0.209	0.211	0.213	0.213
	CHANGE IN MARGINAL RATE	-0.042	-0.086	-0.060	-0.051	-0.049	-0.047	-0.007
12000	CURRENT TAX (1966 RATES)	0.350	0.340	0.310	0.300	0.300	0.300	0.260
	TAX UNDER OUR PROPOSALS	0.275	0.216	0.219	0.222	0.225	0.231	0.233
	CHANGE IN MARGINAL RATE	-0.075	-0.124	-0.091	-0.078	-0.075	-0.069	-0.027
15000	CURRENT TAX (1966 RATES)	0.400	0.400	0.400	0.400	0.400	0.350	0.350
	TAX UNDER OUR PROPOSALS	0.291	0.233	0.236	0.241	0.245	0.253	0.262
	CHANGE IN MARGINAL RATE	-0.109	-0.167	-0.164	-0.159	-0.155	-0.096	-0.088
20000	CURRENT TAX (1966 RATES)	0.450	0.450	0.450	0.450	0.450	0.450	0.450
	TAX UNDER OUR PROPOSALS	0.320	0.270	0.272	0.278	0.283	0.295	0.310
	CHANGE IN MARGINAL RATE	-0.130	-0.180	-0.178	-0.172	-0.167	-0.155	-0.140
25000	CURRENT TAX (1966 RATES)	0.450	0.450	0.450	0.450	0.450	0.450	0.450
	TAX UNDER OUR PROPOSALS	0.350	0.310	0.312	0.318	0.323	0.335	0.350
	CHANGE IN MARGINAL RATE	-0.100	-0.140	-0.138	-0.132	-0.127	-0.115	-0.100
30000	CURRENT TAX (1966 RATES)	0.500	0.500	0.500	0.500	0.500	0.500	0.500
	TAX UNDER OUR PROPOSALS	0.370	0.350	0.351	0.356	0.360	0.369	0.380
	CHANGE IN MARGINAL RATE	-0.130	-0.150	-0.149	-0.144	-0.140	-0.131	-0.120
40000	CURRENT TAX (1966 RATES)	0.500	0.500	0.500	0.500	0.500	0.500	0.500
	TAX UNDER OUR PROPOSALS	0.390	0.380	0.382	0.388	0.393	0.405	0.420
	CHANGE IN MARGINAL RATE	-0.110	-0.120	-0.118	-0.112	-0.107	-0.095	-0.080
50000	CURRENT TAX (1966 RATES)	0.550	0.550	0.550	0.550	0.550	0.550	0.550
	TAX UNDER OUR PROPOSALS	0.420	0.420	0.421	0.424	0.427	0.432	0.440
	CHANGE IN MARGINAL RATE	-0.130	-0.130	-0.129	-0.126	-0.123	-0.118	-0.110
70000	CURRENT TAX (1966 RATES)	0.600	0.600	0.600	0.600	0.600	0.600	0.600
	TAX UNDER OUR PROPOSALS	0.460	0.460	0.460	0.460	0.460	0.460	0.460
	CHANGE IN MARGINAL RATE	-0.140	-0.140	-0.140	-0.140	-0.140	-0.140	-0.140
100000	CURRENT TAX (1966 RATES)	0.650	0.650	0.650	0.650	0.650	0.650	0.650
	TAX UNDER OUR PROPOSALS	0.490	0.490	0.490	0.492	0.493	0.496	0.500
	CHANGE IN MARGINAL RATE	-0.160	-0.160	-0.160	-0.158	-0.157	-0.154	-0.150
200000	CURRENT TAX (1966 RATES)	0.700	0.700	0.700	0.700	0.700	0.700	0.700
	TAX UNDER OUR PROPOSALS	0.500	0.500	0.500	0.500	0.500	0.500	0.500
	CHANGE IN MARGINAL RATE	-0.200	-0.200	-0.200	-0.200	-0.200	-0.200	-0.200

Note: See assumptions in Appendix I.

TABLE I, 2–1

CHANGES IN TAX LIABILITIES UNDER THE PROPOSED TAX SYSTEM FOR A FAMILY UNIT WITH 20 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER — MARRIED COUPLE — NUMBER OF CHILDREN 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	0.	0.	0.	0.	0.	0.
2000	CURRENT TAX (1966 RATES)	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	0.	0.	0.	0.	0.	0.
2500	CURRENT TAX (1966 RATES)	19.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	36.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	17.	0.	0.	0.	0.	0.
3000	CURRENT TAX (1966 RATES)	83.	45.	6.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	99.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	16.	–45.	–6.	0.	0.	0.
3500	CURRENT TAX (1966 RATES)	157.	109.	70.	32.	0.	0.
	TAX UNDER OUR PROPOSALS	172.	4.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	15.	–105.	–70.	–32.	0.	0.
4000	CURRENT TAX (1966 RATES)	247.	193.	139.	96.	19.	0.
	TAX UNDER OUR PROPOSALS	250.	81.	33.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	3.	–112.	–106.	–96.	–19.	0.
5000	CURRENT TAX (1966 RATES)	446.	383.	320.	265.	157.	32.
	TAX UNDER OUR PROPOSALS	421.	254.	207.	160.	67.	0.
	INCREASE OR DECREASE IN TAX	–25.	–130.	–114.	–105.	–90.	–32.
6500	CURRENT TAX (1966 RATES)	758.	698.	641.	584.	462.	282.
	TAX UNDER OUR PROPOSALS	698.	532.	487.	441.	350.	213.
	INCREASE OR DECREASE IN TAX	–60.	–165.	–154.	–142.	–112.	–68.
8000	CURRENT TAX (1966 RATES)	1060.	994.	928.	862.	736.	563.
	TAX UNDER OUR PROPOSALS	989.	823.	778.	732.	642.	507.
	INCREASE OR DECREASE IN TAX	–71.	–171.	–150.	–130.	–94.	–56.
10000	CURRENT TAX (1966 RATES)	1499.	1421.	1343.	1265.	1133.	935.
	TAX UNDER OUR PROPOSALS	1393.	1229.	1184.	1139.	1049.	917.
	INCREASE OR DECREASE IN TAX	–106.	–193.	–159.	–126.	–84.	–18.
12000	CURRENT TAX (1966 RATES)	2004.	1914.	1828.	1750.	1594.	1360.
	TAX UNDER OUR PROPOSALS	1817.	1653.	1608.	1564.	1476.	1347.
	INCREASE OR DECREASE IN TAX	–187.	–261.	–220.	–186.	–118.	–13.
15000	CURRENT TAX (1966 RATES)	2877.	2772.	2667.	2562.	2382.	2112.
	TAX UNDER OUR PROPOSALS	2507.	2344.	2302.	2259.	2173.	2048.
	INCREASE OR DECREASE IN TAX	–370.	–428.	–365.	–303.	–209.	–64.
20000	CURRENT TAX (1966 RATES)	4629.	4509.	4389.	4269.	4029.	3669.
	TAX UNDER OUR PROPOSALS	3828.	3668.	3627.	3587.	3506.	3385.
	INCREASE OR DECREASE IN TAX	–800.	–841.	–762.	–682.	–523.	–284.
25000	CURRENT TAX (1966 RATES)	6616.	6481.	6346.	6211.	5941.	5336.
	TAX UNDER OUR PROPOSALS	5356.	5199.	5161.	5123.	5048.	4936.
	INCREASE OR DECREASE IN TAX	–1260.	–1282.	–1185.	–1088.	–893.	–600.
30000	CURRENT TAX (1966 RATES)	8633.	8498.	8363.	8228.	7958.	7553.
	TAX UNDER OUR PROPOSALS	7084.	6930.	6895.	6860.	6790.	6687.
	INCREASE OR DECREASE IN TAX	–1549.	–1568.	–1468.	–1368.	–1168.	–866.
40000	CURRENT TAX (1966 RATES)	13004.	12854.	12704.	12554.	12254.	11804.
	TAX UNDER OUR PROPOSALS	10868.	10715.	10683.	10650.	10585.	10488.
	INCREASE OR DECREASE IN TAX	–2136.	–2139.	–2021.	–1904.	–1669.	–1316.
50000	CURRENT TAX (1966 RATES)	17560.	17410.	17260.	17110.	16810.	16360.
	TAX UNDER OUR PROPOSALS	15046.	14896.	14866.	14837.	14777.	14688.
	INCREASE OR DECREASE IN TAX	–2514.	–2514.	–2394.	–2273.	–2033.	–1672.
70000	CURRENT TAX (1966 RATES)	27695.	27530.	27365.	27200.	26870.	26375.
	TAX UNDER OUR PROPOSALS	24024.	23877.	23850.	23823.	23770.	23689.
	INCREASE OR DECREASE IN TAX	–3671.	–3653.	–3515.	–3377.	–3100.	–2686.
100000	CURRENT TAX (1966 RATES)	44435.	44255.	44075.	43895.	43535.	42995.
	TAX UNDER OUR PROPOSALS	38407.	38263.	38238.	38213.	38164.	38090.
	INCREASE OR DECREASE IN TAX	–6028.	–5992.	–5837.	–5682.	–5371.	–4905.
200000	CURRENT TAX (1966 RATES)	107270.	107060.	106850.	106640.	106220.	105590.
	TAX UNDER OUR PROPOSALS	88402.	88258.	88234.	88210.	88162.	88090.
	INCREASE OR DECREASE IN TAX	–18868.	–18802.	–18616.	–18430.	–18058.	–17500.

Note: See assumptions in Appendix I.

TABLE I, 2-2

EFFECTIVE AVERAGE TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR A FAMILY UNIT WITH 20 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER — MARRIED COUPLE — NUMBER OF CHILDREN 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	0.000	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.008	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.014	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.007	0.000	0.000	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.028	0.015	0.002	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.033	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.005	-0.015	-0.002	0.000	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.045	0.031	0.020	0.009	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.049	0.001	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.004	-0.030	-0.020	-0.009	0.000	0.000
4000	CURRENT TAX (1966 RATES)	0.062	0.048	0.035	0.024	0.005	0.000
	TAX UNDER OUR PROPOSALS	0.062	0.020	0.008	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.001	-0.028	-0.027	-0.024	-0.005	0.000
5000	CURRENT TAX (1966 RATES)	0.089	0.077	0.064	0.053	0.031	0.006
	TAX UNDER OUR PROPOSALS	0.084	0.051	0.041	0.032	0.013	0.000
	CHANGE IN EFFECTIVE RATE	-0.005	-0.026	-0.023	-0.021	-0.018	-0.006
6500	CURRENT TAX (1966 RATES)	0.117	0.107	0.099	0.090	0.071	0.043
	TAX UNDER OUR PROPOSALS	0.107	0.082	0.075	0.068	0.054	0.033
	CHANGE IN EFFECTIVE RATE	-0.009	-0.025	-0.024	-0.022	-0.017	-0.011
8000	CURRENT TAX (1966 RATES)	0.132	0.124	0.116	0.108	0.092	0.070
	TAX UNDER OUR PROPOSALS	0.124	0.103	0.097	0.092	0.080	0.063
	CHANGE IN EFFECTIVE RATE	-0.009	-0.021	-0.019	-0.016	-0.012	-0.007
10000	CURRENT TAX (1966 RATES)	0.150	0.142	0.134	0.127	0.113	0.094
	TAX UNDER OUR PROPOSALS	0.139	0.123	0.118	0.114	0.105	0.092
	CHANGE IN EFFECTIVE RATE	-0.011	-0.019	-0.016	-0.013	-0.008	-0.002
12000	CURRENT TAX (1966 RATES)	0.167	0.159	0.152	0.146	0.133	0.113
	TAX UNDER OUR PROPOSALS	0.151	0.138	0.134	0.130	0.123	0.112
	CHANGE IN EFFECTIVE RATE	-0.016	-0.022	-0.018	-0.015	-0.010	-0.001
15000	CURRENT TAX (1966 RATES)	0.192	0.185	0.178	0.171	0.159	0.141
	TAX UNDER OUR PROPOSALS	0.167	0.156	0.153	0.151	0.145	0.137
	CHANGE IN EFFECTIVE RATE	-0.025	-0.029	-0.024	-0.020	-0.014	-0.004
20000	CURRENT TAX (1966 RATES)	0.231	0.225	0.219	0.213	0.201	0.183
	TAX UNDER OUR PROPOSALS	0.191	0.183	0.181	0.179	0.175	0.169
	CHANGE IN EFFECTIVE RATE	-0.040	-0.042	-0.038	-0.034	-0.026	-0.014
25000	CURRENT TAX (1966 RATES)	0.265	0.259	0.254	0.248	0.238	0.221
	TAX UNDER OUR PROPOSALS	0.214	0.208	0.206	0.205	0.202	0.197
	CHANGE IN EFFECTIVE RATE	-0.050	-0.051	-0.047	-0.044	-0.036	-0.024
30000	CURRENT TAX (1966 RATES)	0.288	0.283	0.279	0.274	0.265	0.252
	TAX UNDER OUR PROPOSALS	0.236	0.231	0.230	0.229	0.226	0.223
	CHANGE IN EFFECTIVE RATE	-0.052	-0.052	-0.049	-0.046	-0.039	-0.029
40000	CURRENT TAX (1966 RATES)	0.325	0.321	0.318	0.314	0.306	0.295
	TAX UNDER OUR PROPOSALS	0.272	0.268	0.267	0.266	0.265	0.262
	CHANGE IN EFFECTIVE RATE	-0.053	-0.053	-0.051	-0.048	-0.042	-0.033
50000	CURRENT TAX (1966 RATES)	0.351	0.348	0.345	0.342	0.336	0.327
	TAX UNDER OUR PROPOSALS	0.301	0.298	0.297	0.297	0.296	0.294
	CHANGE IN EFFECTIVE RATE	-0.050	-0.050	-0.048	-0.045	-0.041	-0.033
70000	CURRENT TAX (1966 RATES)	0.396	0.393	0.391	0.389	0.384	0.377
	TAX UNDER OUR PROPOSALS	0.343	0.341	0.341	0.340	0.340	0.338
	CHANGE IN EFFECTIVE RATE	-0.052	-0.052	-0.050	-0.048	-0.044	-0.038
100000	CURRENT TAX (1966 RATES)	0.444	0.443	0.441	0.439	0.435	0.430
	TAX UNDER OUR PROPOSALS	0.384	0.383	0.382	0.382	0.382	0.371
	CHANGE IN EFFECTIVE RATE	-0.060	-0.060	-0.058	-0.057	-0.054	-0.049
200000	CURRENT TAX (1966 RATES)	0.536	0.535	0.534	0.533	0.531	0.528
	TAX UNDER OUR PROPOSALS	0.442	0.441	0.441	0.441	0.441	0.440
	CHANGE IN EFFECTIVE RATE	-0.094	-0.094	-0.093	-0.092	-0.090	-0.087

Note: See Assumptions in Appendix I.

TABLE I, 2-3

EFFECTIVE MARGINAL TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR A FAMILY UNIT WITH 20 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER: MARRIED COUPLE — NUMBER OF CHILDREN 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.038	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.071	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.033	0.000	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.128	0.090	0.013	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.126	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	–0.002	–0.090	–0.013	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.148	0.128	0.128	0.064	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.147	0.007	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	–0.001	–0.121	–0.128	–0.064	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.180	0.168	0.137	0.128	0.038	0.000
	TAX UNDER OUR PROPOSALS	0.155	0.155	0.066	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	–0.025	–0.013	–0.072	–0.128	–0.038	0.000
4000	CURRENT TAX (1966 RATES)	0.189	0.180	0.180	0.158	0.128	0.000
	TAX UNDER OUR PROPOSALS	0.168	0.171	0.174	0.145	0.000	0.000
	CHANGE IN MARGINAL RATE	–0.021	–0.009	–0.006	–0.013	–0.128	0.000
5000	CURRENT TAX (1966 RATES)	0.204	0.210	0.210	0.195	0.180	0.128
	TAX UNDER OUR PROPOSALS	0.180	0.182	0.183	0.184	0.184	0.041
	CHANGE IN MARGINAL RATE	–0.024	–0.028	–0.027	–0.011	0.004	–0.087
6500	CURRENT TAX (1966 RATES)	0.202	0.190	0.178	0.178	0.194	0.176
	TAX UNDER OUR PROPOSALS	0.194	0.194	0.194	0.194	0.194	0.194
	CHANGE IN MARGINAL RATE	–0.008	0.004	0.016	0.016	0.000	0.018
8000	CURRENT TAX (1966 RATES)	0.202	0.202	0.202	0.202	0.190	0.182
	TAX UNDER OUR PROPOSALS	0.198	0.199	0.201	0.202	0.204	0.204
	CHANGE IN MARGINAL RATE	–0.004	–0.002	–0.001	0.001	0.014	0.022
10000	CURRENT TAX (1966 RATES)	0.238	0.238	0.238	0.238	0.206	0.206
	TAX UNDER OUR PROPOSALS	0.206	0.208	0.209	0.211	0.213	0.213
	CHANGE IN MARGINAL RATE	–0.031	–0.030	–0.028	–0.027	0.008	0.008
12000	CURRENT TAX (1966 RATES)	0.276	0.276	0.268	0.244	0.244	0.244
	TAX UNDER OUR PROPOSALS	0.216	0.219	0.222	0.225	0.231	0.233
	CHANGE IN MARGINAL RATE	–0.060	–0.057	–0.046	–0.019	–0.013	–0.011
15000	CURRENT TAX (1966 RATES)	0.316	0.316	0.316	0.316	0.276	0.276
	TAX UNDER OUR PROPOSALS	0.233	0.236	0.241	0.245	0.253	0.262
	CHANGE IN MARGINAL RATE	–0.083	–0.080	–0.075	–0.071	–0.022	–0.014
20000	CURRENT TAX (1966 RATES)	0.392	0.362	0.362	0.362	0.362	0.362
	TAX UNDER OUR PROPOSALS	0.270	0.272	0.278	0.283	0.295	0.310
	CHANGE IN MARGINAL RATE	–0.122	–0.090	–0.084	–0.079	–0.067	–0.052
25000	CURRENT TAX (1966 RATES)	0.398	0.398	0.398	0.398	0.398	0.398
	TAX UNDER OUR PROPOSALS	0.310	0.312	0.318	0.323	0.335	0.350
	CHANGE IN MARGINAL RATE	–0.088	–0.086	–0.080	–0.075	–0.063	–0.048
30000	CURRENT TAX (1966 RATES)	0.404	0.404	0.404	0.404	0.404	0.404
	TAX UNDER OUR PROPOSALS	0.350	0.351	0.356	0.360	0.369	0.380
	CHANGE IN MARGINAL RATE	–0.054	–0.053	–0.048	–0.044	–0.035	–0.024
40000	CURRENT TAX (1966 RATES)	0.452	0.452	0.452	0.452	0.452	0.452
	TAX UNDER OUR PROPOSALS	0.380	0.382	0.388	0.393	0.405	0.420
	CHANGE IN MARGINAL RATE	–0.072	–0.070	–0.064	–0.059	–0.047	–0.032
50000	CURRENT TAX (1966 RATES)	0.460	0.460	0.460	0.460	0.460	0.460
	TAX UNDER OUR PROPOSALS	0.420	0.421	0.424	0.427	0.432	0.440
	CHANGE IN MARGINAL RATE	–0.040	–0.039	–0.036	–0.033	–0.028	–0.020
70000	CURRENT TAX (1966 RATES)	0.520	0.520	0.520	0.520	0.520	0.520
	TAX UNDER OUR PROPOSALS	0.460	0.460	0.460	0.460	0.460	0.460
	CHANGE IN MARGINAL RATE	–0.060	–0.060	–0.060	–0.060	–0.060	–0.060
100000	CURRENT TAX (1966 RATES)	0.570	0.570	0.570	0.570	0.570	0.570
	TAX UNDER OUR PROPOSALS	0.490	0.490	0.492	0.493	0.496	0.500
	CHANGE IN MARGINAL RATE	–0.080	–0.080	–0.078	–0.077	–0.074	–0.070
200000	CURRENT TAX (1966 RATES)	0.660	0.660	0.660	0.660	0.660	0.660
	TAX UNDER OUR PROPOSALS	0.500	0.500	0.500	0.500	0.500	0.500
	CHANGE IN MARGINAL RATE	–0.160	–0.160	–0.160	–0.160	–0.160	–0.160

Note: See assumptions in Appendix I.

TABLE I, 3-1

CHANGES IN TAX LIABILITIES UNDER THE PROPOSED TAX SYSTEM FOR A FAMILY UNIT WITH 35 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER — MARRIED COUPLE — NUMBER OF CHILDREN: 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	0.	0.	0.	0.	0.	0.
2000	CURRENT TAX (1966 RATES)	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	0.	0.	0.	0.	0.	0.
2500	CURRENT TAX (1966 RATES)	19.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	36.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	17.	0.	0.	0.	0.	0.
3000	CURRENT TAX (1966 RATES)	83.	45.	6.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	99.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	16.	–45.	–6.	0.	0.	0.
3500	CURRENT TAX (1966 RATES)	173.	125.	86.	48.	0.	0.
	TAX UNDER OUR PROPOSALS	172.	4.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	–1.	–121.	–86.	–48.	0.	0.
4000	CURRENT TAX (1966 RATES)	258.	204.	154.	115.	38.	0.
	TAX UNDER OUR PROPOSALS	250.	81.	33.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	–9.	–123.	–121.	–115.	–38.	0.
5000	CURRENT TAX (1966 RATES)	425.	366.	312.	258.	166.	51.
	TAX UNDER OUR PROPOSALS	421.	254.	207.	160.	67.	0.
	INCREASE OR DECREASE IN TAX	–4.	–112.	–105.	–98.	–99.	–51.
6500	CURRENT TAX (1966 RATES)	705.	645.	582.	519.	404.	247.
	TAX UNDER OUR PROPOSALS	698.	532.	487.	441.	350.	213.
	INCREASE OR DECREASE IN TAX	–7.	–112.	–95.	–78.	–54.	–33.
8000	CURRENT TAX (1966 RATES)	988.	928.	871.	814.	692.	512.
	TAX UNDER OUR PROPOSALS	989.	823.	778.	732.	642.	507.
	INCREASE OR DECREASE IN TAX	1.	–105.	–93.	–82.	–50.	–5.
10000	CURRENT TAX (1966 RATES)	1412.	1346.	1280.	1214.	1085.	908.
	TAX UNDER OUR PROPOSALS	1393.	1229.	1184.	1139.	1049.	917.
	INCREASE OR DECREASE IN TAX	–19.	–117.	–96.	–75.	–36.	9.
12000	CURRENT TAX (1966 RATES)	1871.	1793.	1715.	1645.	1513.	1315.
	TAX UNDER OUR PROPOSALS	1817.	1653.	1608.	1564.	1476.	1347.
	INCREASE OR DECREASE IN TAX	–54.	–140.	–107.	–81.	–37.	32.
15000	CURRENT TAX (1966 RATES)	2608.	2518.	2428.	2348.	2192.	1958.
	TAX UNDER OUR PROPOSALS	2507.	2344.	2302.	2259.	2173.	2048.
	INCREASE OR DECREASE IN TAX	–101.	–174.	–126.	–89.	–19.	90.
20000	CURRENT TAX (1966 RATES)	4063.	3958.	3853.	3748.	3538.	3248.
	TAX UNDER OUR PROPOSALS	3828.	3668.	3627.	3587.	3506.	3385.
	INCREASE OR DECREASE IN TAX	–235.	–290.	–226.	–161.	–32.	137.
25000	CURRENT TAX (1966 RATES)	5816.	5689.	5569.	5449.	5209.	4849.
	TAX UNDER OUR PROPOSALS	5356.	5199.	5161.	5123.	5048.	4936.
	INCREASE OR DECREASE IN TAX	–460.	–490.	–408.	–326.	–161.	87.
30000	CURRENT TAX (1966 RATES)	7790.	7655.	7520.	7385.	7115.	6710.
	TAX UNDER OUR PROPOSALS	7084.	6930.	6895.	6860.	6790.	6687.
	INCREASE OR DECREASE IN TAX	–706.	–725.	–625.	–525.	–325.	–23.
40000	CURRENT TAX (1966 RATES)	11955.	11820.	11685.	11550.	11280.	10875.
	TAX UNDER OUR PROPOSALS	10868.	10715.	10683.	10650.	10585.	10488.
	INCREASE OR DECREASE IN TAX	–1087.	–1105.	–1002.	–900.	–695.	–387.
50000	CURRENT TAX (1966 RATES)	16670.	16520.	16370.	16220.	15920.	15470.
	TAX UNDER OUR PROPOSALS	15046.	14896.	14866.	14837.	14777.	14688.
	INCREASE OR DECREASE IN TAX	–1624.	–1624.	–1504.	–1383.	–1143.	–782.
70000	CURRENT TAX (1966 RATES)	26540.	26375.	26210.	26045.	25715.	25220.
	TAX UNDER OUR PROPOSALS	24024.	23877.	23850.	23823.	23770.	23689.
	INCREASE OR DECREASE IN TAX	–2516.	–2498.	–2360.	–2222.	–1945.	–1531.
100000	CURRENT TAX (1966 RATES)	42630.	42450.	42270.	42090.	41730.	41190.
	TAX UNDER OUR PROPOSALS	38407.	38263.	38238.	38213.	38164.	38090.
	INCREASE OR DECREASE IN TAX	–4223.	–4187.	–4032.	–3877.	–3566.	–3100.
200000	CURRENT TAX (1966 RATES)	103160.	102950.	102740.	102530.	102110.	101480.
	TAX UNDER OUR PROPOSALS	88402.	88258.	88234.	88210.	88162.	88090.
	INCREASE OR DECREASE IN TAX	–14758.	–14692.	–14506.	–14320.	–13948.	–13390.

Note: See Assumptions in Appendix I.

TABLE I, 3-2

EFFECTIVE AVERAGE TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR A FAMILY UNIT WITH 35 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER — MARRIED COUPLE — NUMBER OF CHILDREN 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	0.000	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.008	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.014	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.007	0.000	0.000	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.028	0.015	0.002	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.033	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.005	−0.015	−0.002	0.000	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.049	0.036	0.025	0.014	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.049	0.001	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	−0.035	−0.025	−0.014	0.000	0.000
4000	CURRENT TAX (1966 RATES)	0.065	0.051	0.038	0.029	0.010	0.000
	TAX UNDER OUR PROPOSALS	0.062	0.020	0.008	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	−0.002	−0.031	−0.030	−0.029	−0.010	0.000
5000	CURRENT TAX (1966 RATES)	0.085	0.073	0.062	0.052	0.033	0.010
	TAX UNDER OUR PROPOSALS	0.084	0.051	0.041	0.032	0.013	0.000
	CHANGE IN EFFECTIVE RATE	−0.001	−0.022	−0.021	−0.020	−0.020	−0.010
6500	CURRENT TAX (1966 RATES)	0.108	0.099	0.089	0.080	0.062	0.038
	TAX UNDER OUR PROPOSALS	0.107	0.082	0.075	0.068	0.054	0.033
	CHANGE IN EFFECTIVE RATE	−0.001	−0.017	−0.015	−0.012	−0.008	−0.005
8000	CURRENT TAX (1966 RATES)	0.123	0.116	0.109	0.102	0.086	0.064
	TAX UNDER OUR PROPOSALS	0.124	0.103	0.097	0.092	0.080	0.063
	CHANGE IN EFFECTIVE RATE	0.000	−0.013	−0.012	−0.010	−0.006	−0.001
10000	CURRENT TAX (1966 RATES)	0.141	0.135	0.128	0.121	0.108	0.091
	TAX UNDER OUR PROPOSALS	0.139	0.123	0.118	0.114	0.105	0.092
	CHANGE IN EFFECTIVE RATE	−0.002	−0.012	−0.010	−0.008	−0.004	0.001
12000	CURRENT TAX (1966 RATES)	0.156	0.149	0.143	0.137	0.126	0.110
	TAX UNDER OUR PROPOSALS	0.151	0.138	0.134	0.130	0.123	0.112
	CHANGE IN EFFECTIVE RATE	−0.005	−0.012	−0.009	−0.007	−0.003	0.003
15000	CURRENT TAX (1966 RATES)	0.174	0.168	0.162	0.157	0.146	0.131
	TAX UNDER OUR PROPOSALS	0.167	0.156	0.153	0.151	0.145	0.137
	CHANGE IN EFFECTIVE RATE	−0.007	−0.012	−0.008	−0.006	−0.001	0.006
20000	CURRENT TAX (1966 RATES)	0.203	0.198	0.193	0.187	0.177	0.162
	TAX UNDER OUR PROPOSALS	0.191	0.183	0.181	0.179	0.175	0.169
	CHANGE IN EFFECTIVE RATE	−0.012	−0.015	−0.011	−0.008	−0.002	0.007
25000	CURRENT TAX (1966 RATES)	0.233	0.228	0.223	0.218	0.208	0.194
	TAX UNDER OUR PROPOSALS	0.214	0.208	0.206	0.205	0.202	0.197
	CHANGE IN EFFECTIVE RATE	−0.018	−0.020	−0.016	−0.013	−0.006	0.003
30000	CURRENT TAX (1966 RATES)	0.260	0.255	0.251	0.246	0.237	0.224
	TAX UNDER OUR PROPOSALS	0.236	0.231	0.230	0.229	0.226	0.223
	CHANGE IN EFFECTIVE RATE	−0.024	−0.024	−0.021	−0.017	−0.011	−0.001
40000	CURRENT TAX (1966 RATES)	0.299	0.295	0.292	0.289	0.282	0.272
	TAX UNDER OUR PROPOSALS	0.272	0.268	0.267	0.266	0.265	0.262
	CHANGE IN EFFECTIVE RATE	−0.027	−0.028	−0.025	−0.022	−0.017	−0.010
50000	CURRENT TAX (1966 RATES)	0.333	0.330	0.327	0.324	0.318	0.309
	TAX UNDER OUR PROPOSALS	0.301	0.298	0.297	0.297	0.296	0.294
	CHANGE IN EFFECTIVE RATE	−0.032	−0.032	−0.030	−0.028	−0.023	−0.016
70000	CURRENT TAX (1966 RATES)	0.379	0.377	0.374	0.372	0.367	0.360
	TAX UNDER OUR PROPOSALS	0.343	0.341	0.341	0.340	0.340	0.338
	CHANGE IN EFFECTIVE RATE	−0.036	−0.036	−0.034	−0.032	−0.028	−0.022
100000	CURRENT TAX (1966 RATES)	0.426	0.424	0.423	0.421	0.417	0.412
	TAX UNDER OUR PROPOSALS	0.384	0.383	0.382	0.382	0.382	0.381
	CHARGE IN EFFECTIVE RATE	−0.042	−0.042	−0.040	−0.039	−0.036	−0.031
200000	CURRENT TAX (1966 RATES)	0.516	0.515	0.514	0.513	0.511	0.507
	TAX UNDER OUR PROPOSALS	0.442	0.441	0.441	0.441	0.441	0.440
	CHANGE IN EFFECTIVE RATE	−0.074	−0.073	−0.073	−0.072	−0.070	−0.067

Note: See assumptions in Appendix I.

TABLE I, 3-3

EFFECTIVE MARGINAL TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR A FAMILY UNIT WITH 35 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER — MARRIED COUPLE — NUMBER OF CHILDREN: 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.038	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.071	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.033	0.000	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.128	0.090	0.013	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.126	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	−0.002	−0.090	−0.013	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.180	0.160	0.160	0.096	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.147	0.007	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	−0.033	−0.153	−0.160	−0.096	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.171	0.159	0.134	0.134	0.077	0.000
	TAX UNDER OUR PROPOSALS	0.155	0.155	0.066	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	−0.016	−0.004	−0.069	−0.134	−0.077	0.000
4000	CURRENT TAX (1966 RATES)	0.162	0.162	0.155	0.129	0.128	0.006
	TAX UNDER OUR PROPOSALS	0.168	0.171	0.174	0.145	0.000	0.000
	CHANGE IN MARGINAL RATE	0.006	0.009	0.018	0.016	−0.128	−0.006
5000	CURRENT TAX (1966 RATES)	0.181	0.172	0.162	0.162	0.131	0.128
	TAX UNDER OUR PROPOSALS	0.180	0.182	0.183	0.184	0.184	0.041
	CHANGE IN MARGINAL RATE	−0.001	0.009	0.021	0.022	0.053	−0.087
6500	CURRENT TAX (1966 RATES)	0.186	0.193	0.199	0.199	0.180	0.171
	TAX UNDER OUR PROPOSALS	0.194	0.194	0.194	0.194	0.194	0.194
	CHANGE IN MARGINAL RATE	0.007	0.000	−0.005	−0.005	0.014	0.023
8000	CURRENT TAX (1966 RATES)	0.026	0.194	0.186	0.186	0.199	0.181
	TAX UNDER OUR PROPOSALS	0.198	0.199	0.201	0.202	0.204	0.204
	CHANGE IN MARGINAL RATE	−0.008	0.005	0.014	0.016	0.004	0.022
10000	CURRENT TAX (1966 RATES)	0.216	0.216	0.216	0.216	0.210	0.187
	TAX UNDER OUR PROPOSALS	0.206	0.208	0.209	0.211	0.213	0.213
	CHANGE IN MARGINAL RATE	−0.010	−0.009	−0.007	−0.006	0.003	0.027
12000	CURRENT TAX (1966 RATES)	0.235	0.235	0.235	0.219	0.209	0.209
	TAX UNDER OUR PROPOSALS	0.216	0.219	0.222	0.225	0.231	0.233
	CHANGE IN MARGINAL RATE	−0.019	−0.016	−0.013	0.006	0.021	0.023
15000	CURRENT TAX (1966 RATES)	0.272	0.272	0.272	0.252	0.246	0.246
	TAX UNDER OUR PROPOSALS	0.233	0.236	0.241	0.245	0.253	0.262
	CHANGE IN MARGINAL RATE	−0.039	−0.036	−0.031	−0.007	0.008	0.016
20000	CURRENT TAX (1966 RATES)	0.333	0.310	0.310	0.310	0.310	0.278
	TAX UNDER OUR PROPOSALS	0.270	0.272	0.278	0.283	0.295	0.310
	CHANGE IN MARGINAL RATE	−0.063	−0.039	−0.033	−0.027	−0.016	0.032
25000	CURRENT TAX (1966 RATES)	0.383	0.368	0.351	0.351	0.351	0.351
	TAX UNDER OUR PROPOSALS	0.310	0.312	0.318	0.323	0.335	0.350
	CHANGE IN MARGINAL RATE	−0.073	−0.057	−0.033	−0.028	−0.016	−0.001
30000	CURRENT TAX (1966 RATES)	0.397	0.397	0.397	0.397	0.397	0.397
	TAX UNDER OUR PROPOSALS	0.350	0.351	0.356	0.360	0.369	0.380
	CHANGE IN MARGINAL RATE	−0.047	−0.046	−0.042	−0.038	−0.029	−0.017
40000	CURRENT TAX (1966 RATES)	0.455	0.432	0.432	0.432	0.432	0.432
	TAX UNDER OUR PROPOSALS	0.380	0.382	0.388	0.393	0.405	0.420
	CHANGE IN MARGINAL RATE	−0.075	−0.051	−0.045	−0.039	−0.028	−0.012
50000	CURRENT TAX (1966 RATES)	0.482	0.482	0.482	0.482	0.482	0.482
	TAX UNDER OUR PROPOSALS	0.420	0.421	0.424	0.427	0.432	0.440
	CHANGE IN MARGINAL RATE	−0.063	−0.062	−0.059	−0.056	−0.050	−0.043
70000	CURRENT TAX (1966 RATES)	0.515	0.515	0.515	0.515	0.515	0.515
	TAX UNDER OUR PROPOSALS	0.460	0.460	0.460	0.460	0.460	0.460
	CHANGE IN MARGINAL RATE	−0.055	−0.055	−0.055	−0.055	−0.055	−0.055
100000	CURRENT TAX (1966 RATES)	0.565	0.565	0.565	0.565	0.565	0.565
	TAX UNDER OUR PROPOSALS	0.490	0.490	0.492	0.493	0.496	0.500
	CHANGE IN MARGINAL RATE	−0.075	−0.075	−0.073	−0.072	−0.069	−0.065
200000	CURRENT TAX (1966 RATES)	0.665	0.665	0.665	0.665	0.665	0.665
	TAX UNDER OUR PROPOSALS	0.500	0.500	0.500	0.500	0.500	0.500
	CHANGE IN MARGINAL RATE	−0.165	−0.165	−0.165	−0.165	−0.165	−0.165

Note: See Assumptions in Appendix I.

TABLE I, 4-1

CHANGES IN TAX LIABILITIES UNDER THE PROPOSED TAX SYSTEM FOR A FAMILY UNIT WITH 50 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER: MARRIED COUPLE — NUMBER OF CHILDREN: 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	0.	0.	0.	0.	0.	0.
2000	CURRENT TAX (1966 RATES)	0.	0.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	0.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	0.	0.	0.	0.	0.	0.
2500	CURRENT TAX (1966 RATES)	38.	19.	0.	0.	0.	0.
	TAX UNDER OUR PROPOSALS	36.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-3.	-19.	0.	0.	0.	0.
3000	CURRENT TAX (1966 RATES)	102.	64.	26.	13.	0.	0.
	TAX UNDER OUR PROPOSALS	99.	0.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	-4.	-64.	-26.	-13.	0.	0.
3500	CURRENT TAX (1966 RATES)	166.	128.	90.	51.	6.	0.
	TAX UNDER OUR PROPOSALS	172.	4.	0.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	6.	-124.	-90.	-51.	-6.	0.
4000	CURRENT TAX (1966 RATES)	230.	192.	154.	115.	38.	0.
	TAX UNDER OUR PROPOSALS	250.	81.	33.	0.	0.	0.
	INCREASE OR DECREASE IN TAX	19.	-111.	-121.	-115.	-38.	0.
5000	CURRENT TAX (1966 RATES)	404.	350.	296.	250.	166.	51.
	TAX UNDER OUR PROPOSALS	421.	254.	207.	160.	67.	0.
	INCREASE OR DECREASE IN TAX	17.	-96.	-89.	-90.	-99.	-51.
6500	CURRENT TAX (1966 RATES)	683.	624.	566.	512.	404.	245.
	TAX UNDER OUR PROPOSALS	698.	532.	487.	441.	350.	213.
	INCREASE OR DECREASE IN TAX	15.	-92.	-79.	-71.	-54.	-32.
8000	CURRENT TAX (1966 RATES)	998.	935.	872.	809.	683.	512.
	TAX UNDER OUR PROPOSALS	989.	823.	778.	732.	642.	507.
	INCREASE OR DECREASE IN TAX	-9.	-112.	-94.	-77.	-41.	-5.
10000	CURRENT TAX (1966 RATES)	1382.	1325.	1268.	1211.	1085.	908.
	TAX UNDER OUR PROPOSALS	1393.	1229.	1184.	1139.	1049.	917.
	INCREASE OR DECREASE IN TAX	12.	-96.	-84.	-72.	-36.	9.
12000	CURRENT TAX (1966 RATES)	1816.	1750.	1684.	1618.	1486.	1306.
	TAX UNDER OUR PROPOSALS	1817.	1653.	1608.	1564.	1476.	1347.
	INCREASE OR DECREASE IN TAX	1.	-97.	-76.	-54.	-10.	41.
15000	CURRENT TAX (1966 RATES)	2508.	2430.	2352.	2282.	2146.	1948.
	TAX UNDER OUR PROPOSALS	2507.	2344.	2302.	2259.	2173.	2048.
	INCREASE OR DECREASE IN TAX	-1.	-86.	-50.	-23.	27.	100.
20000	CURRENT TAX (1966 RATES)	3880.	3790.	3700.	3610.	3430.	3184.
	TAX UNDER OUR PROPOSALS	3828.	3668.	3627.	3587.	3506.	3385.
	INCREASE OR DECREASE IN TAX	-52.	-122.	-73.	-23.	76.	201.
25000	CURRENT TAX (1966 RATES)	5520.	5415.	5310.	5205.	4995.	4680.
	TAX UNDER OUR PROPOSALS	5356.	5199.	5161.	5123.	5048.	4936.
	INCREASE OR DECREASE IN TAX	-164.	-216.	-149.	-82.	53.	256.
30000	CURRENT TAX (1966 RATES)	7460.	7340.	7220.	7100.	6860.	6500.
	TAX UNDER OUR PROPOSALS	7084.	6930.	6895.	6860.	6790.	6687.
	INCREASE OR DECREASE IN TAX	-376.	-410.	-325.	-240.	-70.	187.
40000	CURRENT TAX (1966 RATES)	11850.	11715.	11580.	11445.	11175.	10770.
	TAX UNDER OUR PROPOSALS	10868.	10715.	10683.	10650.	10585.	10488.
	INCREASE OR DECREASE IN TAX	-982.	-1000.	-897.	-795.	-590.	-282.
50000	CURRENT TAX (1966 RATES)	16350.	16215.	16080.	15945.	15675.	15270.
	TAX UNDER OUR PROPOSALS	15046.	14896.	14866.	14837.	14777.	14688.
	INCREASE OR DECREASE IN TAX	-1304.	-1319.	-1214.	-1108.	-898.	-582.
70000	CURRENT TAX (1966 RATES)	26240.	26090.	25940.	25790.	25490.	25040.
	TAX UNDER OUR PROPOSALS	24024.	23877.	23850.	23823.	23770.	23689.
	INCREASE OR DECREASE IN TAX	-2216.	-2213.	-2090.	-1967.	-1720.	-1351.
100000	CURRENT TAX (1966 RATES)	42130.	41965.	41800.	41635.	41305.	40810.
	TAX UNDER OUR PROPOSALS	38407.	38263.	38238.	38213.	38164.	38090.
	INCREASE OR DECREASE IN TAX	-3723.	-3702.	-3562.	-3422.	-3141.	-2720.
200000	CURRENT TAX (1966 RATES)	101910.	101715.	101520.	101325.	100935.	100350.
	TAX UNDER OUR PROPOSALS	88402.	88258.	88234.	88210.	88162.	88090.
	INCREASE OR DECREASE IN TAX	-13508.	-13457.	-13286.	-13115.	-12773.	-12260.

Note: See assumptions in Appendix I.

TABLE I, 4-2

EFFECTIVE AVERAGE TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR A FAMILY UNIT WITH 50 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER: MARRIED COUPLE — NUMBER OF CHILDREN					
		0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.000	0.000	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.015	0.008	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.014	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	−0.001	−0.008	0.000	0.000	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.034	0.021	0.009	0.004	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.033	0.000	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	−0.001	−0.021	−0.009	−0.004	0.000	0.000
3500	CURRENT TAX (1966 RATES)	0.048	0.037	0.026	0.015	0.002	0.000
	TAX UNDER OUR PROPOSALS	0.049	0.001	0.000	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.002	−0.036	−0.026	−0.015	−0.002	0.000
4000	CURRENT TAX (1966 RATES)	0.058	0.048	0.038	0.029	0.010	0.000
	TAX UNDER OUR PROPOSALS	0.062	0.020	0.008	0.000	0.000	0.000
	CHANGE IN EFFECTIVE RATE	0.005	−0.028	−0.030	−0.029	−0.010	0.000
5000	CURRENT TAX (1966 RATES)	0.081	0.070	0.059	0.050	0.033	0.010
	TAX UNDER OUR PROPOSALS	0.084	0.051	0.041	0.032	0.013	0.000
	CHANGE IN EFFECTIVE RATE	0.003	−0.019	−0.018	−0.018	−0.020	−0.010
6500	CURRENT TAX (1966 RATES)	0.105	0.096	0.087	0.079	0.062	0.038
	TAX UNDER OUR PROPOSALS	0.107	0.082	0.075	0.068	0.054	0.033
	CHANGE IN EFFECTIVE RATE	0.002	−0.014	−0.012	−0.011	−0.008	−0.005
8000	CURRENT TAX (1966 RATES)	0.125	0.117	0.109	0.101	0.085	0.064
	TAX UNDER OUR PROPOSALS	0.124	0.103	0.097	0.092	0.080	0.063
	CHANGE IN EFFECTIVE RATE	−0.001	−0.014	−0.012	−0.010	−0.005	−0.001
10000	CURRENT TAX (1966 RATES)	0.138	0.132	0.127	0.121	0.108	0.091
	TAX UNDER OUR PROPOSALS	0.139	0.123	0.118	0.114	0.105	0.092
	CHANGE IN EFFECTIVE RATE	0.001	−0.010	−0.008	−0.007	−0.004	−0.001
12000	CURRENT TAX (1966 RATES)	0.151	0.146	0.140	0.135	0.124	0.109
	TAX UNDER OUR PROPOSALS	0.151	0.138	0.134	0.130	0.123	0.112
	CHANGE IN EFFECTIVE RATE	0.000	−0.008	−0.006	−0.004	−0.001	0.003
15000	CURRENT TAX (1966 RATES)	0.167	0.162	0.157	0.152	0.143	0.130
	TAX UNDER OUR PROPOSALS	0.167	0.156	0.153	0.151	0.145	0.137
	CHANGE IN EFFECTIVE RATE	0.000	−0.006	−0.003	−0.002	0.002	0.007
20000	CURRENT TAX (1966 RATES)	0.194	0.189	0.185	0.180	0.171	0.159
	TAX UNDER OUR PROPOSALS	0.191	0.183	0.181	0.179	0.175	0.169
	CHANGE IN EFFECTIVE RATE	−0.003	−0.006	−0.004	−0.001	0.004	0.010
25000	CURRENT TAX (1966 RATES)	0.221	0.217	0.212	0.208	0.200	0.187
	TAX UNDER OUR PROPOSALS	0.214	0.208	0.206	0.205	0.202	0.197
	CHANGE IN EFFECTIVE RATE	−0.007	−0.009	−0.006	−0.003	0.002	0.010
30000	CURRENT TAX (1966 RATES)	0.249	0.245	0.241	0.237	0.229	0.217
	TAX UNDER OUR PROPOSALS	0.236	0.231	0.230	0.229	0.226	0.223
	CHANGE IN EFFECTIVE RATE	−0.013	−0.014	−0.011	−0.008	−0.002	0.006
40000	CURRENT TAX (1966 RATES)	0.296	0.293	0.289	0.286	0.279	0.269
	TAX UNDER OUR PROPOSALS	0.272	0.268	0.267	0.266	0.265	0.262
	CHANGE IN EFFECTIVE RATE	−0.025	−0.025	−0.022	−0.020	−0.015	−0.007
50000	CURRENT TAX (1966 RATES)	0.327	0.324	0.322	0.319	0.313	0.305
	TAX UNDER OUR PROPOSALS	0.301	0.298	0.297	0.297	0.296	0.294
	CHANGE IN EFFECTIVE RATE	−0.026	−0.026	−0.024	−0.022	−0.018	−0.012
70000	CURRENT TAX (1966 RATES)	0.375	0.373	0.371	0.368	0.364	0.358
	TAX UNDER OUR PROPOSALS	0.343	0.341	0.341	0.340	0.340	0.338
	CHANGE IN EFFECTIVE RATE	−0.032	−0.032	−0.030	−0.028	−0.025	−0.019
100000	CURRENT TAX (1966 RATES)	0.421	0.420	0.418	0.416	0.413	0.408
	TAX UNDER OUR PROPOSALS	0.384	0.383	0.382	0.382	0.382	0.381
	CHANGE IN EFFECTIVE RATE	−0.037	−0.037	−0.036	−0.034	−0.031	−0.027
200000	CURRENT TAX (1966 RATES)	0.510	0.509	0.508	0.507	0.505	0.502
	TAX UNDER OUR PROPOSALS	0.442	0.441	0.441	0.441	0.441	0.440
	CHANGE IN EFFECTIVE RATE	−0.068	−0.067	−0.066	−0.066	−0.064	−0.061

Note: See Assumptions in Appendix I.

TABLE I, 4-3

EFFECTIVE MARGINAL TAX RATES UNDER THE CURRENT AND PROPOSED TAX SYSTEMS FOR A FAMILY UNIT WITH 50 PER CENT OF ITS INCOME FROM A WORKING WIFE

GROSS EMPLOYMENT INCOME		STATUS OF TAXPAYER — MARRIED COUPLE — NUMBER OF CHILDREN: 0	1	2	3	5	8
1500	CURRENT TAX (1966 RATES)	0.000	0.000	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.000	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.000	0.000	0.000	0.000	0.000	0.000
2000	CURRENT TAX (1966 RATES)	0.077	0.038	0.000	0.000	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.071	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	−0.005	−0.038	0.000	0.000	0.000	0.000
2500	CURRENT TAX (1966 RATES)	0.128	0.090	0.051	0.026	0.000	0.000
	TAX UNDER OUR PROPOSALS	0.126	0.000	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	−0.002	−0.090	−0.051	−0.026	0.000	0.000
3000	CURRENT TAX (1966 RATES)	0.128	0.128	0.128	0.077	0.013	0.000
	TAX UNDER OUR PROPOSALS	0.147	0.007	0.000	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.019	−0.121	−0.128	−0.077	−0.013	0.000
3500	CURRENT TAX (1966 RATES)	0.128	0.128	0.128	0.128	0.064	0.000
	TAX UNDER OUR PROPOSALS	0.155	0.155	0.066	0.000	0.000	0.000
	CHANGE IN MARGINAL RATE	0.027	0.027	−0.062	−0.128	−0.064	0.000
4000	CURRENT TAX (1966 RATES)	0.167	0.148	0.128	0.128	0.128	0.000
	TAX UNDER OUR PROPOSALS	0.168	0.171	0.174	0.145	0.000	0.000
	CHANGE IN MARGINAL RATE	0.001	0.023	0.046	0.017	−0.128	0.000
5000	CURRENT TAX (1966 RATES)	0.180	0.180	0.180	0.163	0.137	0.128
	TAX UNDER OUR PROPOSALS	0.180	0.182	0.183	0.184	0.184	0.041
	CHANGE IN MARGINAL RATE	0.000	0.002	0.003	0.021	0.047	−0.087
6500	CURRENT TAX (1966 RATES)	0.210	0.201	0.192	0.186	0.180	0.174
	TAX UNDER OUR PROPOSALS	0.194	0.194	0.194	0.194	0.194	0.194
	CHANGE IN MARGINAL RATE	−0.016	−0.007	0.002	0.008	0.014	0.020
8000	CURRENT TAX (1966 RATES)	0.198	0.204	0.204	0.204	0.210	0.180
	TAX UNDER OUR PROPOSALS	0.198	0.199	0.201	0.202	0.204	0.204
	CHANGE IN MARGINAL RATE	0.000	−0.005	−0.003	−0.002	−0.006	0.024
10000	CURRENT TAX (1966 RATES)	0.208	0.199	0.190	0.190	0.209	0.188
	TAX UNDER OUR PROPOSALS	0.206	0.208	0.209	0.211	0.213	0.213
	CHANGE IN MARGINAL RATE	−0.002	0.009	0.019	0.021	0.004	0.025
12000	CURRENT TAX (1966 RATES)	0.220	0.220	0.220	0.220	0.220	0.190
	TAX UNDER OUR PROPOSALS	0.216	0.219	0.222	0.225	0.231	0.233
	CHANGE IN MARGINAL RATE	−0.004	−0.001	0.002	0.005	0.011	0.043
15000	CURRENT TAX (1966 RATES)	0.260	0.260	0.260	0.244	0.224	0.220
	TAX UNDER OUR PROPOSALS	0.233	0.236	0.241	0.245	0.253	0.262
	CHANGE IN MARGINAL RATE	−0.027	−0.024	−0.019	0.001	0.030	0.042
20000	CURRENT TAX (1966 RATES)	0.300	0.300	0.300	0.300	0.300	0.260
	TAX UNDER OUR PROPOSALS	0.270	0.272	0.278	0.283	0.295	0.310
	CHANGE IN MARGINAL RATE	−0.030	−0.028	−0.022	−0.017	−0.005	0.050
25000	CURRENT TAX (1966 RATES)	0.350	0.350	0.350	0.350	0.350	0.350
	TAX UNDER OUR PROPOSALS	0.310	0.312	0.318	0.323	0.335	0.350
	CHANGE IN MARGINAL RATE	−0.040	−0.038	−0.032	−0.027	−0.015	0.000
30000	CURRENT TAX (1966 RATES)	0.400	0.400	0.400	0.400	0.400	0.400
	TAX UNDER OUR PROPOSALS	0.350	0.351	0.356	0.360	0.369	0.380
	CHANGE IN MARGINAL RATE	−0.050	−0.049	−0.044	−0.040	−0.031	−0.020
40000	CURRENT TAX (1966 RATES)	0.450	0.450	0.450	0.450	0.450	0.450
	TAX UNDER OUR PROPOSALS	0.380	0.382	0.388	0.393	0.405	0.420
	CHANGE IN MARGINAL RATE	−0.070	−0.068	−0.062	−0.057	−0.045	−0.030
50000	CURRENT TAX (1966 RATES)	0.450	0.450	0.450	0.450	0.450	0.450
	TAX UNDER OUR PROPOSALS	0.420	0.421	0.424	0.427	0.432	0.440
	CHANGE IN MARGINAL RATE	−0.030	−0.029	−0.026	−0.023	−0.018	−0.010
70000	CURRENT TAX (1966 RATES)	0.500	0.500	0.500	0.500	0.500	0.500
	TAX UNDER OUR PROPOSALS	0.460	0.460	0.460	0.460	0.460	0.460
	CHANGE IN MARGINAL RATE	−0.040	−0.040	−0.040	−0.040	−0.040	−0.040
100000	CURRENT TAX (1966 RATES)	0.550	0.550	0.550	0.550	0.550	0.550
	TAX UNDER OUR PROPOSALS	0.490	0.490	0.492	0.493	0.496	0.500
	CHANGE IN MARGINAL RATE	−0.060	−0.060	−0.058	−0.057	−0.054	−0.050
200000	CURRENT TAX (1966 RATES)	0.650	0.650	0.650	0.650	0.650	0.650
	TAX UNDER OUR PROPOSALS	0.500	0.500	0.500	0.500	0.500	0.500
	CHANGE IN MARGINAL RATE	−0.150	−0.150	−0.150	−0,150	−0.150	−0.150

Note: See assumptions in Appendix I.

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