PRB 06-36E

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INCOME SPLITTING: A BRIEF OVERVIEW

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31 January 2007

PARLIAMENTARY INFORMATION AND RESEARCH SERVICE
SERVICE D’INFORMATION ET DE RECHERCHE PARLEMENTAIRES

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INCOME SPLITTING

"Income splitting" is referred to as the ability of spouses to divide their total taxable family income for tax purposes in order to reduce their total family income tax liability. Because of the progressive nature of the Canadian tax system, the higher-income spouse may be taxed at a higher marginal tax rate than the lower-income spouse. By splitting their total taxable income, some couples would benefit from a lower effective tax rate.

ARGUMENTS IN FAVOUR OF INCOME SPLITTING

The principle that taxpayers in similar financial circumstances should pay similar amounts in taxes is one of the pillars of the Canadian tax system. At the household level, however, single-earner families often pay more in taxes than do dual-earner families with equivalent taxable income because of the progressive nature of the Canadian tax system. For example, two-parent families with children earning between $60,000 and $90,000 annually, and with one parent earning from 0% to 10% of family income, would – in 2007 – save an average of $1,696 in federal income tax by splitting their income equally for tax purposes.(1) Income splitting would bring about greater equity among different types of families, since single-earner and dual-earner families with equivalent taxable income would pay the same amount in taxes.

Income splitting would also provide federal assistance through the tax system to some families with children where one parent earns more than the other and/or where one parent has decided to limit his/her labour market participation in order to care for the family's children. For example, a family with one parent earning $10,000 annually and the other parent earning $60,000 annually currently pays more in income tax than a family with each parent earning $35,000. As well, income splitting would provide some federal tax relief to single-earner

(1) This example is shown in Table 4.

families with children who do not benefit from the Child Care Expense Deduction. Moreover, income splitting would also provide further tax assistance to those families with one spouse providing in-home care for a senior parent or grandparent, or for an infirm dependent relative.

Income splitting could have a positive impact on fertility rates by reducing the federal tax burden typically experienced by some families with children, particularly single-earner families. Increased fertility rates, coupled with immigration, may help to address Canada's demographic challenges related to future labour shortages and the ability of taxpayers to pay for increasingly expensive social programs.

Many countries – including France, the United States, Germany, Belgium, Greece, Luxembourg, Portugal, Switzerland, Iceland, Ireland, Norway, Poland and Spain – allow some form of income splitting. In most countries, including Germany and the United States, married spouses have the option of filing income taxes jointly on their combined income, while the income of their dependent children is taxed individually.

In France, spouses are always taxed jointly, while other family members may choose to be taxed separately. The French system is based on "adult equivalents," which allows different types of families to be taxed in a similar manner. For example, married couples are considered to be two adult equivalents, while the first and second dependent children of a two-parent family are counted as one-half of an adult equivalent each. The third and subsequent dependent children are counted as a full adult equivalent each, as is the first child of a single-parent family. For tax purposes, total family income is divided by the number of adult equivalents; this income level is then used to compute tax payable per adult equivalent. Total family income tax is equal to tax payable per adult equivalent multiplied by the number of adult equivalents.

ARGUMENTS AGAINST INCOME SPLITTING

For opponents of income splitting, the notion of "control" over income is important.(2) For them, the existence of a relationship between two people does not necessarily imply that their income is shared equally, or that one person has any control over the income of the other person. At present, the Canadian income tax system is designed in a manner such that taxation occurs primarily at the level of the individual, which reflects the view that individuals

(2) For example, see the Law Commission of Canada, *Beyond Conjugality, Recognizing and Supporting Close Personal Adult Relationships*, Ottawa, 2001, Chapter 3, Part 2, Subsection VIII, and Lisa Philipps, *Income splitting: Who really benefits?*, CBCNews Analysis and Viewpoint, 22 November 2006, http://www.cbc.ca/news/viewpoint/vp_philipps/index.html.

should pay tax on the income they control rather than the income from which they personally benefit. For example, the value of gifts cannot be deducted from the taxable income of donors; nor do gifts have to be declared as income on recipients' tax returns. Therefore, it is sometimes argued that personal relationships should not be considered in the tax system in order to ensure that all personal decisions are treated neutrally.

Currently, there are few opportunities for couples to split income; these opportunities involve the sharing of income-generating assets, with one person granting control over both the transferred assets and the income flowing from these assets to the other person. For example, a business owner may issue dividend-paying shares to his/her partner from his/her corporation in order to split the income flowing from the business, in which case the transfer of income is accompanied by a transfer of assets. Also, although a taxpayer may contribute to a spousal Registered Retirement Savings Plan (RRSP), which results in income splitting, the spouse of the taxpayer becomes both the owner and the beneficiary (annuitant) of the spousal RRSP, and therefore has control over the funds invested in the spousal RRSP. Similarly, section 74.1 of the *Income Tax Act* permits a taxpayer to transfer a right to receive benefits under the Canada Pension Plan (or a similar provincial plan) to his/her spouse, in which case the benefits transferred are taxable in the hands of the spouse.

Furthermore, it has been argued that when the after-tax income of single-earner families is compared to that of dual-earner families, and when child care costs and work-related expenses are considered, the "Canadian income tax system does not disadvantage one-earner families with children in favour of two-earner families with children."(3) This finding is based on the view that a simple comparison of a single-earner family with a dual-earner family, each having the same level of earned income, does not take into account the value of household production. In a single-earner family, one parent usually stays at home and may be able to care for the family's children and to do a variety of household work. In the case of a dual-earner family, child care and household work may have to be provided in other ways, such as through child care and housekeeping services, or the family may have to take time during evenings and weekends to perform these activities. Either way, if both family types have the same level of family income, the argument is made that a single-earner family has a "higher level of well-being and should therefore pay more tax."(4)

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(3) Gordon Cleveland and Michael Krashinsky, *Tax Fairness for One-Earner and Two-Earner Families: An Examination of the Issues*, Canadian Policy Research Networks, Ottawa, 1999, p. iii.

(4) *Ibid*., p. 7.

It has also been argued that income splitting would, in some families, have negative implications for the work incentive of the lower-income spouse, since any increase in the lower-income spouse's earnings would reduce the amount of tax savings the family would derive from income splitting. Since women are historically the main providers of child care and household work,(5) and historically have had lower earned income than men, it has been argued that this disincentive would fall disproportionately on women.

ESTIMATED FEDERAL FISCAL COST AND IMPACT ANALYSIS ON FAMILIES

Table 1 presents the estimated fiscal cost to the federal government of allowing income splitting – that is, the splitting of net income from all sources for tax purposes – for couples with children, couples without children, and elderly couples with at least one spouse aged 65 or older. The proposed measure announced on 31 October 2006 to allow pension income splitting is included in the estimated fiscal cost. With this announcement, mention was made of the possibility for the spouse receiving a transfer of pension income to claim a pension income tax credit, and for the transferrer of pension income to reduce the amount of Old Age Security benefits that are repaid; these effects are also included in the estimation. Furthermore, the fiscal cost is estimated assuming that spouses would not be able to split unused losses from self-employment, farming, business operations or eligible capital investments. The estimation was performed using Statistics Canada's Social Policy Simulation Database and Model (SPSD/M), modified version 14.1.(6) The total federal fiscal cost of these initiatives is estimated to be about $4,894 million in 2007.

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(5) Surveys have repeatedly shown that women spend more time on household work than do men.

(6) Statistics Canada's SPSD/M is a micro-simulation model used by the Parliamentary Information and Research Service and several other organizations across Canada to assess the implications of changes in the tax/transfer system. The SPSD/M model does not attempt to simulate how individual behaviour is likely to change in response to policy changes. Finally, it should be noted that the assumptions and calculations underlying the simulations that generated these estimates were specified by the author.

Table 1
Estimated Federal Fiscal Cost of Income Splitting Between Spouses for Couples with Children, Couples Without Children and Elderly Couples, 2007 Taxation Year
($ millions)

Married or common-law couples	Family income				Total
	Not more than $30,000	$30,001 – $60,000	$60,001 – $90,000	$90,001 and over	
With children	12	166	661	1,325	2,164
Without children	20	216	691	1,116	2,043
Elderly	4	172	290	221	687
Total	**36**	**554**	**1,643**	**2,662**	**4,894**

Notes:

(1) Totals may not add due to rounding.

(2) Family income refers to the total taxable annual income of both spouses.

(3) Elderly couples are those with at least one spouse aged 65 years or older.

(4) The estimated federal fiscal cost includes any incremental federal commodity tax revenues – mainly the Goods and Services Tax – resulting from higher after-tax incomes.

Source: Author’s calculations using SPSD/M, modified version 14.1.

A detailed analysis of the impact of income splitting on various types of families is shown in Tables 2 to 10. These tables provide estimates of the number and the proportion of families that would benefit from income splitting, as well as the average federal tax savings for these families, by level of family income and distribution of income within the family.

Tables 2, 3 and 4 present estimation results for two-parent families with children. In total, about 2.3 million two-parent families with children – accounting for about 73% of all two-parent families with children – would benefit from income splitting, with average federal tax savings of $948 per family.

Tables 5, 6 and 7 present estimation results for elderly couples (couples with at least one spouse aged 65 years or older). In total, about 866,000 elderly couples, representing about 60% of all elderly couples, would benefit from income splitting, with average federal tax savings of $794 per couple.

Finally, Tables 8, 9 and 10 present estimation results for all other couples – that is, couples without children and without a spouse aged 65 years or older. In total, approximately 2.3 million such couples – or 70% of these couples – would benefit from income splitting, with average federal tax savings of $883 per couple.

A. Two-Parent Families With Children

Table 2
Number of Two-Parent Families With Children Who Would Benefit From Income Splitting, 2007 (thousands)

Family income	The lower-income spouse earns …					Total
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	39	10	16	11	13	**89**
$30,001 – $60,000	208	68	84	64	58	**482**
$60,001 – $90,000	189	109	139	164	137	**738**
$90,001 and over	186	161	205	271	151	**975**
Total	**622**	**347**	**444**	**511**	**359**	**2,283**

Notes:

(1) Totals may not add due to rounding.

(2) Family income refers to the total taxable annual income of both spouses.

Source: Author's calculations using SPSD/M, modified version 14.1.

Table 3
Proportion of Two-Parent Families With Children Who Would Benefit From Income Splitting, 2007

Family income	The lower-income spouse earns …					All
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	27%	29%	47%	40%	29%	**31%**
$30,001 – $60,000	93%	90%	72%	47%	38%	**68%**
$60,001 – $90,000	99%	97%	97%	91%	61%	**87%**
$90,001 and over	94%	97%	97%	86%	41%	**77%**
All	**82%**	**89%**	**88%**	**77%**	**45%**	**73%**

Note:

(1) Family income refers to the total taxable annual income of both spouses.

Source: Author's calculations using SPSD/M, modified version 14.1.

Table 4
Average Federal Tax Savings of Two-Parent Families With Children Who Would Benefit From Income Splitting, 2007

Family income	The lower-income spouse earns …					All
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	$120	$121	$202	$137	$104	**$135**
$30,001 – $60,000	$495	$399	$212	$106	$197	**$345**
$60,001 – $90,000	$1,696	$1,196	$799	$437	$207	**$896**
$90,001 and over	$3,276	$2,111	$1,083	$441	$224	**$1,359**
All	**$1,667**	**$1,433**	**$798**	**$391**	**$209**	**$948**

Notes:

(1) Family income refers to the total taxable annual income of both spouses.

(2) The estimated federal tax savings include any incremental federal commodity taxes – mainly the Goods and Services Tax – resulting from higher after-tax incomes.

Source: Author’s calculations using SPSD/M, modified version 14.1.

B. Elderly Couples

Table 5
Number of Elderly Couples Who Would Benefit From Income Splitting, 2007
(thousands)

Family income	The lower-income spouse earns …					Total
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	0	4	9	14	12	**40**
$30,001 – $60,000	4	6	40	99	302	**452**
$60,001 – $90,000	11	9	23	47	165	**254**
$90,001 and over	13	14	15	21	58	**121**
Total	**28**	**33**	**87**	**181**	**537**	**866**

Notes:

(1) Totals may not add due to rounding.

(2) Family income refers to the total taxable annual income of both spouses.

(3) Elderly couples are those with at least one spouse aged 65 years or older.

Source: Author’s calculations using SPSD/M, modified version 14.1.

Table 6
Proportion of Elderly Couples Who Would Benefit From Income Splitting, 2007

Family income	The lower-income spouse earns …					All
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	1%	23%	30%	16%	7%	**11%**
$30,001 – $60,000	45%	53%	65%	64%	72%	**69%**
$60,001 – $90,000	99%	96%	95%	93%	92%	**93%**
$90,001 and over	87%	87%	74%	67%	77%	**77%**
All	**38%**	**61%**	**64%**	**56%**	**63%**	**60%**

Notes:

(1) Family income refers to the total taxable annual income of both spouses.

(2) Elderly couples are those with at least one spouse aged 65 years or older.

Source: Author’s calculations using SPSD/M, modified version 14.1.

Table 7
Average Federal Tax Savings of Elderly Couples Who Would Benefit From Income Splitting, 2007

Family income	The lower-income spouse earns …					All
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	$4	$87	$124	$152	$40	**$103**
$30,001 – $60,000	$986	$489	$436	$390	$359	**$380**
$60,001 – $90,000	$1,999	$1,846	$1,303	$1,115	$1,039	**$1,145**
$90,001 and over	$3,552	$1,949	$1,511	$1,354	$1,681	**$1,832**
All	**$2,530**	**$1,412**	**$812**	**$672**	**$703**	**$794**

Notes:

(1) Family income refers to the total taxable annual income of both spouses.

(2) Elderly couples are those with at least one spouse aged 65 years or older.

(3) The estimated federal tax savings include any incremental federal commodity taxes – mainly the Goods and Services Tax – resulting from higher after-tax incomes.

Source: Author’s calculations using SPSD/M, modified version 14.1.

C. Couples Without Children and Without a Spouse Aged 65 Years or Older

Table 8
Number of Couples Without Children and Without a Spouse Aged 65 Years or Older Who Would Benefit From Income Splitting, 2007
(thousands)

Family income	The lower-income spouse earns …					Total
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	63	11	27	22	16	**139**
$30,001 – $60,000	168	85	94	105	118	**569**
$60,001 – $90,000	135	120	139	191	178	**762**
$90,001 and over	140	127	202	227	147	**842**
Total	**506**	**342**	**461**	**545**	**459**	**2,313**

Notes:

(1) Totals may not add due to rounding.

(2) Family income refers to the total taxable annual income of both spouses.

Source: Author’s calculations using SPSD/M, modified version 14.1.

Table 9
Proportion of Couples Without Children and Without a Spouse Aged 65 Years or Older Who Would Benefit From Income Splitting, 2007

Family income	The lower-income spouse earns …					All
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	29%	39%	54%	39%	22%	**33%**
$30,001 – $60,000	87%	88%	71%	61%	48%	**68%**
$60,001 – $90,000	95%	98%	93%	91%	63%	**84%**
$90,001 and over	93%	95%	96%	83%	40%	**74%**
All	**72%**	**90%**	**85%**	**77%**	**48%**	**70%**

Note:

(1) Family income refers to the total taxable annual income of both spouses.

Source: Author’s calculations using SPSD/M, modified version 14.1.

Table 10
Average Federal Tax Savings of Couples Without Children and Without a Spouse Aged 65 Years or Older Who Would Benefit From Income Splitting, 2007

Family income	The lower-income spouse earns …					All
	from 0% to 10% of family income	from 10% to 20% of family income	from 20% to 30% of family income	from 30% to 40% of family income	from 40% to 50% of family income	
$30,000 or less	$111	$153	$216	$153	$117	**$142**
$30,001 – $60,000	$445	$406	$311	$341	$355	**$379**
$60,001 – $90,000	$1,666	$1,313	$838	$532	$515	**$906**
$90,001 and over	$3,409	$2,156	$1,060	$469	$316	**$1,326**
All	**$1,548**	**$1,362**	**$791**	**$453**	**$396**	**$883**

Notes:

(1) Family income refers to the total taxable annual income of both spouses.

(2) The estimated federal tax savings include any incremental federal commodity taxes – mainly the Goods and Services Tax – resulting from higher after-tax incomes.

Source: Author’s calculations using SPSD/M, modified version 14.1.