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TEMPORAL EQUITY IN TAXATION

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Equity has two dimensions. Horizontal equity requires that individuals and families in similar circumstances bear the same taxes. Vertical equity requires that those in different circumstances bear appropriately different taxes.¹

I. Introduction.

Equal tax treatment of those in equal circumstances is simply a particular tax application of the idea of justice derived from the association of justice with legal proceedings and the principle of treating like cases in the same way. Horizontal equity is a consensus criterion espoused by all tax theorists. Unfortunately the consensus rapidly dissipates when one attempts to formulate specific rules to determine when persons are in equal circumstances. There is also some debate as to whether tax equity has two distinct dimensions. Vertical equity may be but a corollary of horizontal equity which requires that almost equal tax treatment should be accorded to those taxpayers in almost equal circumstances as compared with taxpayers in equal circumstances. A pre-eminent public finance scholar considers that horizontal and vertical equity are strictly co-ordinate and that: "The principle of

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¹ Report of the Royal Commission on Taxation (1966), Vol. 1, pp. 4-5, subsequently cited as Carter Report.

horizontal equity must be seen against the backdrop of an explicit view of vertical equity.”²

Whether horizontal and vertical equity are distinct or co-ordinate concepts will not be debated; instead it will be argued that recognition should also be accorded to an ancillary concept, temporal equity. An attempt will be made to indicate that by ignoring the concept of temporal equity, serious mistakes in tax policy have been made. These mistakes might have been avoided if attention had been directed towards temporal equity. Temporal equity, it is submitted, is an aspect of both horizontal and vertical equity. Temporal equity in its baldest formulation would require that taxpayers in the same circumstances but distinguishable only by separation in the temporal dimension should pay the same tax. It is obvious that this formulation of temporal equity must be qualified in at least three respects.

II. Qualifications to the Concept of Temporal Equity.

Tax rates must clearly be flexible in order to accommodate changing governmental revenue requirements and to assist in a policy of achieving a high level of employment with an acceptable price performance for the economy. Thus in order to promote a policy of economic stabilization or to satisfy revenue needs it will be necessary to accord varying tax treatment to taxpayers in the same circumstances who differ only in the time dimension. This departure from temporal equity is an unfortunate price which must be paid by some taxpayers in the interest of a well regulated economy. It will adversely affect those taxpayers who, for instance, receive abnormally high incomes during periods when tax rates are raised in order to reduce inflationary pressure, compared with taxpayers who receive the same total income over a period of years but who receive it in an even flow. The departure from temporal equity will also detrimentally affect those taxpayers whose incomes are abnormally low during periods when tax rates are diminished in

² R. A. Musgrave, *The Theory of Public Finance* (1959), p. 160. Musgrave elaborating on this theme states: “It has been suggested that the rule of horizontal equity is valid, even though little can be said about the matter of vertical equity or about how the taxation of people in different positions should differ.

This is hardly justified. The requirements of horizontal and vertical equity are but different sides of the same coin. If there is no specified reason for discriminating among unequals, how can there be a reason for avoiding discrimination among equals? Without a scheme of vertical equity, the requirement of horizontal equity at best becomes a safeguard against capricious discrimination — a safeguard which might be provided equally well by a requirement that taxes be distributed at random.”

order to combat unemployment and deflationary pressures. Conversely, a departure from temporal equity will discriminate in favour of those taxpayers who receive abnormally low incomes during periods of high tax rates implemented to deflate the economy or abnormally high incomes during periods when tax rates are lowered to stimulate the economy, compared with the taxpayer who receives the same total income over a period of years but who receives it in an even flow. For the great bulk of taxpayers whose incomes do not vary significantly from one year to the next, changing tax rates will not involve serious temporal equity problems.³

Another departure from the concept of temporal equity, which has been defined as requiring the same tax payment from taxpayers in the same circumstances but differing only in the time dimension, must also be made in order to permit any tax reform. A rigid adherence to temporal equity would completely stultify all tax reform unless tax reform could be made retroactively. Since retroactive tax reform is in general not feasible, it is obvious that temporal equity must be abrogated in the interest of attaining a fairer tax system. It must, nevertheless, be recognized that tax reform enacted to achieve greater horizontal equity, in a particular time period and in the future, necessarily means that temporal equity is sacrificed. Tax reform rooted in the Haig-Simons concept of income or based on the analogous concept of the comprehensive tax base will probably warrant the jettisoning of temporal equity.⁴

³ It should, however, be recognized that even if tax rates remained the same over a taxpayer's lifetime progressive tax rates do produce tax inequity over a lifetime if the time pattern of income receipts differ among individuals. The averaging provisions of the Income Tax Act, R.S.C., 1952, c. 148, now S.C., 1970-71-72, c. 63, do provide some mitigation for short-term fluctuating incomes. For a criticism of these provisions see Bale, *The Tax Reform Bill and the Problem of Income Fluctuation* (1971), 19 *Can. Tax J.* 487. Variations in income over a lifetime are not recognized. Two persons whose lifetime income are equal will not necessarily pay the same tax. The person whose income is constant throughout his life will pay less tax than the person whose income peaks and then declines. For examples of how lifetime patterns of income affect the tax liability on the same total income see Robinson, *Lifetime Averaging* (1974), 22 *Can. Tax J.* 595. If it is desired to achieve tax equity over a lifetime then William Vickrey's cumulative lifetime averaging scheme is to be recommended. See W. Vickrey, *Agenda for Progressive Taxation* (1947), pp. 172-195; Bravman, *Equalization of Tax on All Individuals with Same Aggregate Income over Same Number of Years* (1950), 50 *Col. L. Rev.* 1; and Anthoine, *Tax Reduction and Reform: A Lawyer's View* (1963), 63 *Col. L. Rev.* 808.

⁴ An interesting debate about the value of the Haig-Simons definition of income (accretion in wealth plus consumption) as a useful guide in the construction of an equitable income tax has taken place. See Bittker, A

However, one should be mindful that in sacrificing temporal equity, there will be some unfairness introduced especially between persons in differing stages of the life cycle and having differing patterns of the receipt of income.

Another qualification to the concept of temporal equity would also appear to be necessary in order to accommodate new incentive measures which the government wishes to introduce by way of the tax system. It may be a very general incentive such as the reduction in the corporate income tax for manufacturing and processing which was proposed in the May budget of 1972 and finally adopted in July 1973. It may be a much more specialized incentive such as that embodied in the registered home ownership savings plan. Such incentive measures depart from the goal of neutrality in taxing statutes and also create problems in regard to temporal equity. The corporation which initially engaged in manufacturing and processing may now be restricting its activities to the wholesale or retail business and therefore will not benefit from the new incentive legislation. A person who has already acquired a home may not be able to take advantage of the registered home ownership savings plan. However, in addition to the temporal equity problems which are created by new incentive measures introduced into taxing statutes, the cost of these incentives in the form of revenue foregone should receive careful scrutiny. The tax foregone through incentive measures has been described as a tax expenditure by Professor Surrey and he argues that such foregone revenue warrants the same annual critical examination as actual governmental expenditure programmes.⁵

"Comprehensive Tax Base" as a Goal of Income Tax Reform (1967), 80 Harv. L. Rev. 925; Musgrave, In Defense of an Income Concept (1967-68), 81 Harv. L. Rev. 44; Pechman, Comprehensive Income Taxation: A Comment (1967-68), 81 Harv. L. Rev. 63; Galvin, More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR (1967-68), 81 Harv. L. Rev. 1016; Bittker, Comprehensive Income Taxation: A Response (1967-68), 81 Harv. L. Rev. 1032. For a continuation of this debate see Bittker, Galvin, Musgrave and Pechman, A Comprehensive Income Tax Base? A Debate (1968). Although Bittker has rendered valuable service in indicating the many difficulties in translating the Haig-Simons definition of income into a taxing statute, his approach seems somewhat negative and iconoclastic. The Haig-Simons definition of income is not a talisman but it is a useful analytical tool in the formulation of an equitable income tax base.

⁵ Speech to Money Marketeters, New York City, Nov. 15th, 1967; for excerpts see Annual Report of the Secretary of the Treasury for the fiscal year 1968, p. 322. For a debate on the tax expenditure budget see Bittker, Accounting for Federal "Tax Subsidies" in the National Budget (1969), 22 Nat. Tax J. 244; Surrey and Hellmuth, The Tax Expenditure Budget—Response to Professor Bittker (1969), 22 Nat. Tax J. 528;

III. Temporal Equity and Death Taxes.

The concept of temporal equity can perhaps be most vividly illustrated by considering death taxes. This field of taxation was exclusively occupied by the provinces up to 1941. In 1892, Ontario,⁶ New Brunswick,⁷ Nova Scotia⁸ and Quebec⁹ introduced succession duty legislation to Canada.¹⁰ Within the following two

Bittker, *The Tax Expenditure Budget — A Reply to Professors Surrey and Hellmuth* (1969), 22 *Nat. Tax J.* 538. Surrey has subsequently argued that tax incentives are in general inferior to a direct subsidy in achieving social goals; see *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures* (1960-70), 83 *Harv. L. Rev.* 705.

⁶ The Succession Duty Act, 1892, S.O., 1892, c. 6.

⁷ The Succession Duty Act, 1892, S.N.B., 1892, c. 6.

⁸ The Succession Duty Act, 1892, S.N.S., 1892, c. 6.

⁹ An Act respecting duties on successions and on the transfers of real estate, S.Q., 1892, c. 17.

¹⁰ It is a commonly held opinion that Ontario was the first province to enact a succession duty. For instance, M.B. Jameson, *Ontario Succession Duties* (1959), at p. 1, states: "Succession duty was first introduced in Canada in 1892 when the province enacted a statute entitled, 'An Act to Provide for the payment of Succession Duties in certain cases', which became effective on April 14, 1892, under the statute, 1892 (Ont.), c. 6." Also M. B. Jameson, *Canadian Estate Tax* (1960), at p. 2, states "A death duty was first introduced in Canada in 1892 when the Province of Ontario enacted a statute entitled 'An Act to provide for the payment of succession duties in certain cases'." In the Report of the Ontario Committee on Taxation (1967), Vol. III, at p. 144, it is stated, "Ontario first levied a succession duty in 1892, and in doing so initiated this form of taxation in Canada".

It was New Brunswick that enacted the first succession duty in Canada and duty was levied in regard to persons dying on or after April 7th, 1892 when the statute received Royal assent. The Ontario statute did not receive Royal assent until April 14th, 1892 and s. 1 stated: "This Act may be cited as 'The Succession Duty Act, 1892' and shall go into effect as respects the estates of persons dying on or after the 1st July next." It may very well be that the Ontario bill was the model used by New Brunswick and Nova Scotia. R. A. Bayly, *Succession Duty in Canada* (1902), at p. 10 states, "The first Canadian Act was drafted in the office of the Attorney-General for Ontario, and was modelled upon the Acts of New York passed in 1887 and 1892 and on the Pennsylvania Act...", and at p. 12 the author says "The Ontario Act of 1892 was used as a model with very slight variations in anything but the tax rate, by all the other Provinces, with the exception of Quebec. Even the 'charitable' excuse was repeated in them." In Ontario, the bill was introduced on March 11th, 1892 (*Journals of the Legislative Assembly of Ontario*, Vol. 25, 1892, p. 78). In New Brunswick, the bill was introduced on March 26th, 1892 (*Journals of the House of Assembly of Nova Scotia* 1892, p. 103). It may be that the Ontario bill was the model used by New Brunswick and Nova Scotia but it would appear that enactment of succession duty legislation by the four provinces was probably as a result of prior consultation among the

years, Manitoba,¹¹ Prince Edward Island¹² and British Columbia¹³ also entered the field of succession duty. A succession duty was imposed in the Northwest Territories in 1903¹⁴ and when Saskatchewan¹⁵ and Alberta¹⁶ were accorded provincial status in 1905, the legislation was received into these provinces.

The preamble to The Succession Duty Act, 1892, of Ontario stated that: "Whereas this Province expends very large sums annually for asylums for the insane and idiots, and for institutions for the blind and for deaf mutes, and towards the support of hospitals and other charities, and it is expedient to provide a fund for defraying part of the said expenditure by a succession duty. . . ." As might be expected the rates of duty of the first Ontario statute were relatively modest with, for that time, high exemptions. Property passing to a spouse, a child or a spouse of a child, a grandchild or a father or mother was exempt where the aggregate value of the deceased's property did not exceed \$100,000.00. If the aggregate value exceeded \$100,000.00 but not \$200,000.00 and passed to a beneficiary previously enumerated, the rate of duty applicable to such beneficiary was two and one half per cent. Where the aggregate value exceeded \$200,000.00 and passed to such a beneficiary, the duty applicable was five per cent. In the case of other beneficiaries, duty was levied if the aggregate value exceeded \$10,000.00 and the two rates were prescribed, five per cent in regard to property passing to lineal ancestors, other than parents, and certain collateral relatives and ten per cent where the beneficiaries were more distant collateral relatives or any stranger in blood. This statute only applied in respect of persons who died on or after July 1st, 1892. There was thus some temporal inequity since the beneficiaries of a person who died on June 30th, 1892, would be treated differently than

provinces. The time elapsing between the introduction of the bill in Ontario and in New Brunswick and Nova Scotia points to prior consultation. It should also be noted that although the Quebec statute did not receive Royal assent until June 24th, 1892, Quebec as well as New Brunswick commenced to levy a succession duty before Ontario as s. 2 of the Quebec statute provides that: "This Act shall come into force on the day of its sanction."

¹¹ The Succession Duty Act, 1893, S.M., 1893, c. 31.

¹² The Succession Duty Act, 1894, S.P.E.I., 1894, c. 5.

¹³ Succession Duty Act, 1894, S.B.C., 1894, c. 47.

¹⁴ The Succession Duty Ordinance, O.N.W.T., 1903 (2nd Sess.), c. 5.

¹⁵ The Saskatchewan Act, S.C., 1905, c. 42, s. 16 and The Revised Statutes Act 1906, S.S., 1906, c. 45.

¹⁶ The Alberta Act, S.C., 1905, c. 3, s. 16.

beneficiaries of a person of comparable wealth who died on July 1st, 1892, provided the aggregate value of the estate of the two deceased persons exceeded the exemption limit. However, the amount of inequity was not great because few persons dying at that time had estates in excess of the exemption levels and with regard to those who had, the modest rates of tax tended to minimize the temporal inequity. Succession duty revenue was gradually increased through a combination of increasing the tax base and tax rates and diminishing the exemption levels. In Ontario, succession duty revenue as a percentage of total provincial revenue reached its zenith in the 1920's. For instance in 1921 and in 1926 succession duty revenue constituted twenty per cent of total provincial revenue.¹⁷ The growing significance of succession duty revenue in the early decades of the twentieth century involved some temporal inequity but because it was a gradual process, the inequity was not pronounced.

In 1941, the federal government was propelled into the field of death taxation by the insatiable fiscal demands of war mobilization with an undoubted assist from the Rowell-Sirois Commission which had recently recommended exclusive occupation of the death duty field by the Dominion.¹⁸ In the first budget speech of the Honourable J. L. Hsley, there is a clear appreciation that, in the field of death taxation, temporal equity imposes a much more serious problem than it does with regard to an annual tax

¹⁷ These percentages are based on financial statistics in Urquhart and Buckley, *Historical Statistics of Canada* (1965), pp. 215-216. With the exception of Quebec, succession duty revenues constituted a very much smaller proportion of the total revenues of other provinces. For the period 1926 to 1937 see a table of percentages in the Report of The Royal Commission on Dominion-Provincial Relations (1940), Book II, p. 119.

¹⁸ The Report of The Royal Commission on Dominion-Provincial Relations, *ibid.*, at p. 120 stated that it "recommends that the provinces withdraw entirely from the inheritance tax field. Such a step is an essential part of the Financial Plan recommended by the Commission. But, in any case, the Commission is convinced that inheritance taxes are not a satisfactory source of provincial revenue, whether from the point of view of stability of revenues, or of the effects of the tax on the national economy. The Dominion would be a more efficient tax-gatherer than nine provincial jurisdictions in that it could collect the most revenue at any given rate with least injury to the taxpayer and least harm to the national income. If our financial recommendations are not adopted, and if the provinces still elect to retain inheritance taxes, we think that every effort should be made to work out a common inheritance tax program for all provinces, and to entrust collection to the Dominion which would redistribute on an agreed basis. This at least would have the merit of minimizing double taxation and the present tendencies of inheritance taxes towards immobilizing investments".

such as an income tax. The Minister of Finance in speaking of the proposed Dominion Succession Duty Act stated:¹⁹

The compelling need for revenue which induces us to enter this new field arises from the war, but I would not suggest that this new dominion tax is a temporary war-time tax only. It would be manifestly unfair to pick out for special heavy taxation that minority of the population whose parents or husbands happened to die during the war rather than after it. Consequently, one should regard this measure as something of more permanence than, say, our proposed increases in income taxes or indirect taxes. The rates of tax proposed must also be judged in this light.

Since a death duty is comparable to a once in a generation wealth tax,²⁰ Mr. J. L. Ilsley understood the need for a considerable amount of stability in this field of taxation if serious temporal equity problems were to be avoided. The pressing need for tax revenue meant that as a necessary concomitant to the enactment of The Dominion Succession Duty Act,²¹ there would be temporal inequity in regard to the tax treatment of beneficiaries of persons who died on or after June 14th, 1941, as compared with beneficiaries of persons who died prior to that time. With regard to persons who died prior to June 14th, 1941, beneficiaries were faced with only provincial succession duties, but on or after that date, the beneficiaries were confronted with both provincial and federal succession duties. The temporal inequity which Mr. Ilsley believed should be avoided was in regard to persons who died during the war and after June 13th, 1941, as compared with those who died after the end of hostilities. Such inequity could be eliminated through regarding the Dominion Succession Duty Act as a permanent component of the federal tax system. Or, if the statute was not to be a continuing part of the tax structure, temporal inequity could be reduced by a gradual phasing out of the statute over an extended period of time.²²

¹⁹ H. of C. Deb., Apr. 29th, 1941, Vol. 3, p. 2349.

²⁰ It is, however, only a very crude once in a generation wealth tax. All death duties face the problem of generation-skipping transfers. If a fair death duty is one which taxes wealth once every generation then bequests to grandchildren instead of children should be regarded as constituting two transfers. See Westfall, *Revitalizing the Federal Estate and Gift Taxes* (1970), 83 Harv. L. Rev. 986, at pp. 1006-13 and Jantscher, *Trusts and Estate Taxation* (1967), pp. 156-190.

²¹ S.C., 1941, c. 14.

²² An outline of the important changes in death duties which occurred between 1941 and 1972 is presented in order to illustrate that not all the temporal inequity revolved around the dates of June 14th, 1941 and January 1st, 1972. In 1947, all provinces with the exception of Ontario and Quebec, entered into agreements with the federal government and suspended their succession duty legislation initially for five years. This did not create any

significant temporal inequity because the federal government, obtaining about fifty per cent of the total death duty taxes, doubled its taxes rates. At the same time, the federal government provided certain credits for succession duties levied by Ontario and Quebec to avoid double taxation. The Dominion Succession Duty Act was replaced by the Estate Tax Act, S.C., 1958, c. 29, which came into force on January 1st, 1959, and applied to the estates of persons dying on or after that date. Again this change did not produce any substantial amount of temporal inequity. The Dominion Succession Duty Act was not a pure inheritance tax but, in common with provincial succession duty legislation was a hybrid, possessing a strong element of an estate tax because the basic rate of duty was dependent on the aggregate value of the estate. Thus the change to an estate tax was not so very great except that the estate became liable for the tax rather than the beneficiaries. Mr. Fleming in his budget speech of June 17th, 1958, emphasized that the proposed estate tax was a minor tax reduction measure. He stated, "In every tax bracket, however, according to the size of estates the revenue yield will ordinarily be less under the new bill although in the upper brackets it will be only slightly less", H. of C. Deb., June 17th, 1958, Vol. 2, p. 1245. On April 1st, 1963, British Columbia re-entered the succession duty field, joining Ontario and Quebec. The provision for tax credits in the Estate Tax Act did much to eliminate double taxation and to avoid any temporal inequity.

A large amount of temporal inequity was introduced when Alberta enacted The Estate Tax Rebate Act, S.A., 1967, c. 18. On April 1st, 1967, Alberta commenced to provide to eligible estates a rebate of the province's seventy-five per cent share of the federal estate tax. In order to qualify for the rebate the deceased must have died on or after April 1st, 1967, and must have been domiciled in Alberta at the time of his death or must have been domiciled elsewhere in Canada but have resided in Alberta for at least 183 days in each of the three years preceding his death. The amount of the rebate was equal to seventy-five per cent of the estate tax payable in regard to property situated in Alberta and any property situated outside Canada that passed to an Alberta resident or domiciliary. If an Alberta domiciliary died on March 31st, 1967, full estate tax would be paid. If an Alberta domiciliary died on April 1st, 1967, with all his property situated in Alberta the net effect after the seventy-five per cent rebate was that the estate paid only twenty-five per cent of the full estate tax. A very pleasant April Fools joke for beneficiaries of the deceased who died on April 1st, 1967, but, nevertheless one which introduced enormous temporal inequity, compared with beneficiaries of persons who died on or before March 31st, 1967. Precisely the same type of temporal inequity occurred in Saskatchewan when The Estate Tax Rebate Act, S.S., 1969, c. 17 was enacted. The statute was modelled on the Alberta statute but the temporal inequity focused on the date of April 1st, 1969. Full estate tax was payable if the death occurred before that date but as a result of the rebate only twenty-five per cent of the estate tax was ultimately levied on Saskatchewan estates of Saskatchewan domiciliaries dying on or after that date.

Some temporal inequity was brought about by the enactment of An Act to amend the Income Tax Act and the Estate Tax Act, S.C., 1968-69, c. 33. This Act wholly replaced the gift tax provisions of the Income Tax Act, *supra*, footnote 3, and made important changes to the Estate Tax Act, *supra*, footnote 21. Property passing absolutely and indefeasibly to a spouse was made exempt from gift and estate tax if the gift or death occurred after October 22nd, 1968. This meant that there was very substantial inequity between a person who died on October 22nd, 1968 and one who

Unfortunately this comprehension of the problem of temporal equity was not shared by one of Mr. Ilsley's successors in office. Mr. Benson in announcing the government's decision to discontinue federal estate and gift taxes as of January 1st, 1972, simply stated:²³

died on October 23rd, 1968, and each left their estate to their spouse. The estate of the person dying on October 22nd, 1968 was discriminated against in comparison with the estate of the person dying on October 23rd, 1968. However, if one accepts the proposition that a death duty is a type of wealth tax which should only be levied when property passes from one generation to the next the spousal exemption appears justified. It was also introduced in recognition that, in general, wealth accumulation is the result of the joint effort of spouses. The temporal inequity which occurred can then be justified in that it promoted a more rational wealth transfer tax. The amendments to the Estate Tax Act and the new gift tax provisions introduced a new unified transfer tax on the disposition of wealth which reduced the broad avenue for estate tax avoidance through the making of substantial *inter vivos* gifts. Gifts made after October 22nd, 1968, in excess of the new gift tax exemptions were taxed on the basis of the cumulative total of gifts and no longer taxed independently year by year. The gift and estate tax were integrated so that all amounts given away during a person's lifetime after October 22nd, 1968 in excess of the annual gift tax exemptions, plus gift tax paid, together with property passing on death, was cumulated at death and tax levied under the estate tax with any gift tax paid being treated as a credit against the estate tax. Thus gift tax simply became a prepayment of the ultimate estate tax liability. It definitely became more difficult to avoid or substantially reduce taxation on wealth transmitted to another generation. This can certainly be regarded as temporal inequity. However, provided one concedes that wealth transfer taxation is an appropriate part of a tax system, the temporal inequity can be condoned since the amendments gave Canada the most sophisticated system of wealth transfer taxation in the world.

²³ H. of C. Deb., June 18th, 1971, Vol. 7, p. 6897. Another explanation was offered in Summary of 1971 Tax Reform Legislation, p. 33. It stated: "Since 1964, provincial governments have received about 75 per cent of all death duties in Canada; 75 per cent of federal estate taxes are turned over to seven provinces and the others either levy their own death duties to the same extent or receive the equivalent amount by combining their own death duties and federal payments.

Two provinces now return their entire share of estate taxes to estates and it is no longer possible to establish a uniform national system of death duties through federal legislation.

In these circumstances, it has been decided that the federal government will vacate the estate and gift tax field on December 31, 1971."

The disapproval of the estate tax by the governments of Alberta and Saskatchewan appeared to be an insufficient reason for the federal government to abandon a central and efficient way of levying estate and gift taxes. Particularly in view of the fact that both governments which passed legislation providing for the rebate of the estate tax had been defeated, and in Saskatchewan a government had been elected which would not have condoned the continuation of the rebate.

The White Paper proposed that shares in widely held Canadian companies be revalued every five years. This proposal has been dropped. In its place, the government has adopted the recommendation of the Commons committee, several of the provinces and many taxpayers, to tax accrued gains when a taxpayer dies. The Commons committee also recommended that if this alternative was adopted, there should be a substantial reduction of death duties so that estates would not face the burden of two substantial taxes at the same time. When considering this issue, the government took into account that it receives only 25 per cent of the revenue from estate tax. We felt that an appropriate reduction would have to be of that order of magnitude to compensate for the new capital gains tax.

The Commons committee to which the Minister of Finance referred had considered three alternative solutions to the problem of the concurrent impact of the deemed realization of capital gains on death and the estate tax. The three were: 1) a credit for capital gains tax arising on death against the estate tax liability, 2) elimination of the estate tax, 3) an across the board reduction of the estate tax.²⁴ The Commons committee recommended the third alternative and suggested that there be "alleviation of the estate tax at least to the extent that: all exemptions be significantly increased, no estate of a value of less than \$150,000 bear tax, rate brackets be expanded and the maximum rate not cut in until a value of above \$800,000 is reached".²⁵ The Commons committee was cognizant of what has been described as temporal equity. The committee rejected full or partial credit for actual or deemed capital gains tax arising on death against the estate tax because it "would discriminate against the person who realizes his assets before his death as compared with one who does not".²⁶ The committee also commented that full credit would render the deemed realization on death pointless.

The Commons committee was concerned about temporal inequity. However, the variety of temporal inequity to which the committee directed its attention was that of a continuing nature. If full or partial credit for tax arising out of the deemed realization of capital gains on death were granted against the estate tax, the credit would discriminate and would continue to discriminate in favour of the person who did not sell capital assets before death and against the person who did sell such assets before death. The Commons committee appeared to be mainly concerned about the

²⁴ Eighteenth Report of the Standing Committee on Finance, Trade and Economic Affairs, Respecting the White Paper on Tax Reform (1970), p. 34.

²⁵ *Ibid.*

²⁶ *Ibid.*

continuing temporal inequity which such a credit would produce but it may also have been influenced by the "lock-in" effect of such a credit.

The Commons committee was thus aware and disturbed by temporal inequity of a continuing nature.²⁷ The committee did not explicitly consider the problem of temporal inequity which would exist with regard to one fixed date as between a person who died before that date and one who died after that date should the estate tax be abolished. The committee probably did not consider this problem because it had recommended against the abolition of the estate tax. However, since the committee did not recommend a gradual reduction in the estate tax to come into effect as the capital gains tax matured and commenced to take a significant bite in regard to estates of deceased persons, it may perhaps

²⁷ This type of continuing temporal inequity was exactly what was continued in the new Income Tax Act, *supra*, footnote 3, by the median rule contained in clause 70(5)(b). Where depreciable property is transferred on death to other than a spouse, the deceased is deemed to have disposed of the property at an amount midway between the undepreciated capital cost and the fair market value for the purpose of calculating recapture of capital cost allowance and capital gains. Where fair market value of the depreciable asset is equal to the original capital cost only half the capital cost allowance taken will be recaptured at death. However, if the person sold the asset immediately before death or made an *inter vivos* gift of the asset, there would be full recapture of all the capital cost allowance taken. This continuing temporal inequity was probably provided for since prior to 1972, the former legislation had contained greater temporal inequity. On death, there was no recapture of capital cost allowance to the estate of the deceased and the successor to depreciable property was permitted to take capital cost allowance on its fair market value. However, if the asset had been sold immediately prior to death for its original capital cost, there was full recapture of capital cost allowance taken. Clause 70(5)(b) does incorporate continuing temporal inequity in that the sale of depreciable property the minute before death and the gift of the proceeds of the sale has very different tax consequences than a disposition of the depreciable property by will. However, the amount of temporal inequity is not nearly as great as under the former Act. There is no forgiveness of excessive capital cost allowance taken under the new legislation. There is, at most, postponement of recapture in regard to excessive capital cost allowance that may have been deducted.

By providing for some continuing temporal inequity the amount of discreet temporal inequity, *i.e.*, temporal inequity focused on a particular point in time, was reduced. There was not as much discreet temporal inequity in regard to a person who died on December 31st, 1971, who owned depreciable property and one who died on January 1st, 1972, as there would have been if the deemed disposition in regard to depreciable property were at fair market value as compared with the median rule which was adopted. Thus providing for continuing temporal inequity may be justified where it reduces the amount of discreet temporal inequity.

be inferred that the committee was prepared to tolerate more temporal inequity if it revolved around one fixed point in time than if it were of a continuing nature. It does not appear to be legitimate to conclude that the committee would have condoned the enormous amount of temporal inequity involved in the elimination of the estate tax. It would appear reasonable to infer from the first budget speech of Mr. Ilsley who was instrumental in introducing death duties into the federal tax system that Mr. Ilsley would not have approved of the temporal inequity produced by the precipitous withdrawal by the federal government from the estate tax field.

The *Carter Report* did advocate the abolition of estate and gift taxes but only on the premise that any capital appreciation would be fully included in the income tax base of the deceased person or donor and that the succession or gift would be included in the income tax base of the recipient. Having accepted only half inclusion of capital gains in the income tax base and having totally rejected the inclusion of gifts and inheritances in the income tax base of the recipient,²⁸ no support could be garnered from the *Carter Report* for the abolition of estate and gift taxes.

The abolition of estate and gift taxation as of January 1st, 1972, should not be regarded as a defensible part of a rationally inspired tax reform. Instead, it must, I think, be largely attributed to political considerations. The federal government only retained twenty-five per cent of the estate tax collected in those provinces which did not levy a succession duty. However, it seems likely that the federal government incurred 100 per cent of the opprobrium for levying the tax. It is, from the political perspective, a very unstable situation when one level of government obtains only twenty-five per cent of the revenue from a tax and at the same time bears 100 per cent of the wrath of irate prospective taxpayers.

²⁸ Mr. Benson had rejected the Carter proposal to include gifts and inheritances in the income tax base of the recipient in his budget speech of October 22nd, 1968. He stated, "While respecting the intellectual coherence and elegance of the case made by the Royal Commission on Taxation on this matter — crudely summed up in the phrase that 'a buck is a buck is a buck' — I believe that the overwhelming weight of Canadian opinion is against it now, and many Canadian practices and institutions would be seriously disrupted if we embraced this proposal. Instead, I propose that the estate and gift taxes continue to be levied on the transferor and that they be reformed along different lines." H. of C. Deb., Oct. 22nd, 1968, Vol. 2, p. 1685. Mr. Benson had in effect opted for the integrated wealth transfer proposal contained in Study No. 11 for The Royal Commission on Taxation, Death Taxes, by Smith, Fields and Mockler (1967).

It was this politically unstable situation which led to the demise of the estate tax and since the gift tax is basically just a policeman who protects the estate tax revenue, it also led to the demise of the federal gift tax. The temporal inequity produced by the abolition of estate tax can be regarded as a bi-product of the politically unstable situation. There is also a lesson to be derived from the elimination of the estate tax. The lesson is that the revenue division from a good tax should never be permitted to produce a political imbalance which will engender sufficient pressure for abolition of such a tax. The level of government levying the tax should probably retain something in the order of fifty per cent of the revenue so that there will be a substantial revenue loss to counterbalance the political rewards to be gained by eliminating the tax.

The temporal inequity produced by the elimination of the estate tax was ameliorated by the action of the provinces. Their action was prompted perhaps largely by revenue requirements but also in part out of concern for temporal equity and possibly by a belief that wealth taxation should constitute part of a good tax system. This can be illustrated by referring to the speech of the Treasurer of Ontario on December 13th, 1971. He stated:²⁹

The immediate elimination of the estate tax was an incredible about-face. It put the onus on the provinces to prevent the obvious inequities inherent in a tax system that eliminated death and gift taxes when the tax on capital gains has barely started. . . . In the absence of any policy change by Ontario, the elimination of federal estate tax on January 1 would mean an abrupt reduction of \$56 million in wealth taxation and a revenue loss to the province of \$28 million annually. The province cannot afford such a precipitous revenue loss nor does it agree that such a large one-step reduction in wealth taxation is equitable.

The result was that Ontario doubled its rate schedule but eliminated surtaxes and increased exemptions for surviving spouses

²⁹ Ont. Leg. Deb. (1st Sess., 29th Leg.), pp. 12-13. There were substantial revenue losses for Quebec, Manitoba and the four Atlantic provinces. Under the Federal-Provincial Fiscal Arrangements Act, R.S.C., 1970, c. F-6, provinces which did not levy succession duties received seventy-five per cent of the estate tax collected in regard to property situated in the province or personal property outside Canada passing to persons domiciled or resident in the province and included in estates of persons dying domiciled in the province. Ontario and Quebec received twenty-five per cent of the estate tax revenue.

There was no revenue loss for British Columbia for in 1964 after the federal government agreed to permit the province to increase their share of the death duty revenue, British Columbia opted to increase its succession duty rates. Alberta and Saskatchewan although receiving seventy-five per cent of the estate tax revenue, encountered no significant revenue loss since these provinces rebated their share to their domiciliaries.

and for all estates.³⁰ Quebec met the situation by providing for a twenty-five per cent surcharge in regard to estates of persons who died during 1972.³¹ All provinces which did not levy a succession duty entered the field with the exception of Alberta.

The succession duty Acts enacted by Manitoba,³² Saskatchewan³³ and the four Atlantic provinces³⁴ were generally uniform and except for levying the duty on the beneficiary were closely modelled on the federal Estate Tax Act. The statutes were not enacted until about the middle of 1972 but each statute provided that it was to apply in regard to the death of a person after December 31st, 1971, so that there would not be a hiatus in death duties, which would result in temporal inequity. One interesting innovation in the new succession duty legislation was the adoption of an accessions basis.³⁵ All beneficiaries resident within the province who inherit any kind of property situated outside the province were subject to tax whether or not the deceased died domiciled in or outside the province. This charging provision was in addition to the tax levied in regard to property situated in the province at the time of the death of the deceased. Ontario, Quebec and British Columbia had taxed on the basis of situs and of a transmission. A transmission is defined as a passing of personal property (moveable property in the case of Quebec) situated outside the province to a person resident or domiciled in the province on the death of a person domiciled in the province. British Columbia was quick to take advantage of the accessions basis in addition to the situs and transmission basis.³⁶

The unique venture in which six provinces passed basically uniform succession duty Acts and the federal government agreed

³⁰ An Act to amend The Succession Duty Act, S.O., 1971 (2nd Sess.), c. 3. The doubling of the rates was not totally effective because of the notch provisions contained in the Act.

³¹ An Act to amend the Succession Duties Act, S.Q., 1972, c. 29, s. 37.

³² The Succession Duty Act (Manitoba), S.M., 1972, c. S-215.

³³ The Succession Duty Act, 1972, S.S., 1972, c. 124.

³⁴ Succession Duty Act, S.N.B., 1972, c. 14; The Succession Duty Act, 1972, S.N., 1972, No. 40; An Act Respecting Succession Duties, S.N.S., 1972, c. 17.; The Succession Duty Act, S.P.E.I., 1972, c. 45.

³⁵ For a description of the new succession duty legislation see W. D. Goodman, *The New Provincial Succession Duty System: An Examination of the Succession Duty Acts of the Atlantic Provinces, Manitoba and Saskatchewan* (1972).

³⁶ An Act to Amend the Succession Duty Act, S.B.C., 1972, c. 59, s. 14.

to collect a purely provincial tax for the provinces had an extremely short life. In 1973, Prince Edward Island repealed its Act retroactively to January 1st, 1972.³⁷ Thus it was as if Prince Edward Island had never re-entered the succession duty field. All duties levied under the Act were returned to the payors with interest. New Brunswick repealed its Act for persons dying after December 31st, 1973, but it also excluded the value of any property used in farming or fishing where the deceased died after March 20th, 1973.³⁸ Nova Scotia repealed its Act for persons dying on or after April 1st, 1974,³⁹ and the date selected by Newfoundland was April 9th, 1974.⁴⁰ The legislative activity of the Atlantic provinces with the exception of Prince Edward Island had the result of shifting the focus of the temporal inequity from January 1st, 1972, to different dates but the amount of temporal inequity was undiminished.

Prior to 1972, Canada had an integrated gift and estate tax which was the most sophisticated system of wealth transfer taxation in existence anywhere in the world. It could be described as a cumulative lifetime donor's tax since the cumulative gift tax was treated as a partial payment of the final estate tax. It was complicated by separate succession duties levied by Ontario, Quebec and British Columbia and by a rebate of seventy-five per cent of the shares of Alberta and Saskatchewan in the estate tax revenue.⁴¹ Nevertheless the state of death duties prior to 1972 was a model of efficiency compared with the chaotic state which now prevails. There are now five provinces, Alberta and the four Atlantic provinces, and the two territories, the Yukon and Northwest Territories, which are death duty and gift tax havens. Of the five provinces levying succession duty and gift taxes, only Manitoba and Saskatchewan have modern well drafted succession duty statutes. The *Smith Report* in commenting on The Succession Duty Act of Ontario stated: "This brief summary should give the reader a notion of the bewildering complexity of the tax. . . . The actual

³⁷ An Act to Repeal The Succession Duty Act, S.P.E.I., 1973, c. 34.

³⁸ An Act to Amend The Succession Duty Act, S.N.B., 1973, c. 76. The legislation was initially enacted for a three year period, commencing January 1st, 1972. The amendment reduced its operation to two years (s. 2). S. 1 excluded property used in farming and fishing for persons who died after March 20th, 1973.

³⁹ An Act to Amend An Act Respecting Succession Duties, S.N.S., 1974, c. 30.

⁴⁰ The Succession Duty (Repeal) Act, S.N., 1974, No. 76.

⁴¹ For a very brief discussion of these rebates see *supra*, footnote 22.

statute that dictates these intricacies is frequently so abstruse that it has gained almost universal notoriety among practitioners as being the worst piece of tax legislation on the books of the Province.”⁴² The Langford committee urged “the immediate repeal of the Succession Duty Act and the simultaneous enactment of a modern simplified death tax. . . . The need is not simply to update the terminology or to simplify the statute. We see the present Act condemned for more serious offences. We cannot justify the substantial differences in tax that fall on similar estates simply because of minor differences in the provisions in the will. . . . Equitable distribution of the tax burden also suffers because of the ease with which the tax burden can be reduced substantially—even avoided completely in some circumstances by perfectly legal estate planning measures”.⁴³ The Succession Duties Act of Quebec and to a somewhat lesser extent that of British Columbia are open to the same type of indictment.

The taxation of wealth requires a reappraisal. We must examine the proposition that: “The ownership of wealth, whether it produces income or not, adds to the economic resources of a taxpayer so that the person who has wealth as well as income of a given size necessarily has a greater taxable capacity than one who has only income of that size.”⁴⁴ The proposition has been more vividly posed by Professor Kaldor when he states that a beggar and a hoarder of gold may each have zero income but their capacity for bearing tax is not the same.⁴⁵ When this proposition becomes politically acceptable, there may be merit in imposing a net wealth tax rather than a wealth transfer tax in the form of a cumulative lifetime donor’s tax or a cumulative lifetime accessions tax. The reason is that the imposing of an annual tax such as a net wealth tax would not involve the large amount of temporal inequity which occurs when any form of death duty is either imposed or abolished. Similarly from the point of view of temporal equity the imposition of an annual net wealth tax would impose less temporal inequity than the Carter proposal to include gifts and inheritances in the income tax base of the recipient.

⁴² Report of The Ontario Committee on Taxation (1967), Vol. III, pp. 146-147.

⁴³ Report of the Advisory Committee on Succession Duties (1973), pp. 15-16.

⁴⁴ *Wealth Tax* (1974), Cmnd. 5704, p. iii.

⁴⁵ N. Kaldor, *Indian Tax Reform* (Dept. of Economic Affairs, Ministry of Finance, India, 1956), p. 20, cited in A.R. Prest, *Public Finance* (4th ed., 1970), p. 312.

IV. *Temporal Equity and the Taxation of Income.*

Temporal equity is a concept which is undoubtedly of greatest significance when you are concerned with death duties which can be regarded as a once in a lifetime wealth tax. However, it still has some importance with regard to an annual tax such as the income tax. For instance, the introduction of capital gains taxation in 1972 does mean that there is some temporal inequity introduced as between generations. There is discrimination against the younger person and in favour of the older person. The older person will have had a much longer period to accumulate wealth without capital gains taxation than the younger person. Wealth accumulation will not be as easy for the younger person because he is now confronted with capital gains taxation whenever capital assets are realized. This is not intended to be an argument against the taxation of capital gains. In fact, the contention of the Carter Report that capital gains and losses should be fully included in the income tax base is compelling.⁴⁶ However, inflation at the rates which have been experienced in the past decade would probably necessitate full indexing of the cost base of the asset if capital gains are to be fully included in income.⁴⁷

The temporal inequity as between generations should not be completely ignored. The temporal inequity is part and parcel of moving to a fairer distribution of the tax burden. However, since it makes it more difficult for the younger person to accumulate wealth as compared with the person or family whose wealth accumulation occurred largely or totally before 1972, the change does have the tendency to ossify wealth distribution. Opinion will

⁴⁶ Carter Report, *op. cit.*, footnote 1, Vol. 3, pp. 326-463 and Study #19 for the Royal Commission on Taxation, *The Taxation of Capital Gains*, by E. R. Conway (1967). See also Drache, *An Evaluation of the Criticisms of the Capital Gains Proposals of the Report of the Royal Commission on Taxation* (1969), 47 Can. Bar Rev. 583. An excellent book on the subject is L. H. Seltzer, *The Nature and Tax Treatment of Capital Gains and Losses* (1951).

⁴⁷ This is preferable in that half inclusion may result in over or under taxation of real as opposed to nominal appreciation. For instance, if a person purchased a capital asset in 1972 for \$1,000.00 and sold it for \$2,000.00 in 1980 and if the consumer price index had increased by 100 per cent, half the gain of \$1,000.00 would be included in income even though there is no gain in real terms. Conversely, a person might purchase a corporate security for \$1,000.00 and as a result of a discovery or invention, he might be able to sell the security for \$2,000.00 within a short period of time during which there was no change in the consumer price index. In each case, \$500.00 would be included in income. Everyone would probably agree that there is under taxation of the second gain as compared with the first gain.

differ as to the seriousness of the implication of this tendency. However, it is submitted that to ameliorate this inclination towards wealth fossilization, greater emphasis, rather than the currently diminishing emphasis, should be placed on wealth taxation. This might be in the form of death duties or of an annual wealth tax or as Carter proposed by inclusion of the inheritance in the income tax base of the recipient.

The broadening of the tax base to include half of capital gains makes future wealth accumulation more difficult. However, it is not simply the broadening of the tax base that brings about a tendency towards wealth ossification. The enormous increase in the rates of income taxation that have occurred since 1940 would have this tendency even if the tax base had not been expanded. As Alan Tait states: "High taxation of current money income makes the charmed circle of the already rich that much more charmed, because admittance to the circle becomes increasingly less attainable."⁴⁸ Thus increasing either the income tax base or the rate of taxation of income is a strong reason for placing greater emphasis on wealth taxation in order to achieve greater temporal equity as between different generations.

Initially, the Carter *Report* was quoted for the proposition that equity has two dimensions, horizontal and vertical and attention has subsequently been drawn to the proposition that equity also has a temporal aspect. This perhaps leaves the impression that the Carter *Report* was unconcerned about temporal equity. Although the Carter *Report* never explicitly mentions temporal equity, it would not be fair to infer that the *Report* was oblivious to this aspect of equity. For instance, the proposal, for complete integration of corporate and personal income taxation, was recognized by the *Report* as a source of a serious transitional problem. Substantial windfall gains would accrue to the holders of most equity shares. The Carter *Report* states:⁴⁹

The problem of the immediate windfall gains would be partially resolved if the full taxation of share gains was implemented before the market anticipated the favourable effects of integration. Shareholders

⁴⁸ A. A. Tait, *The Taxation of Personal Wealth* (1967), p. 12. The author goes on to state that: "Redistribution by income tax and transfer is self-defeating in that it fossilizes the existing inequalities of wealth. So we are forced to look to the taxation of wealth itself."

⁴⁹ Carter *Report*, *op. cit.*, footnote 1, Vol. 4, p. 77. The Carter proposal for integration of personal and corporate income taxes has recently been categorized as the best approach. See McLure, *Integration of the Personal and Corporate Income Taxes: The Missing Element in Recent Tax Reform Proposals* (1974-75), 88 Harv. L. Rev. 532.

who experienced large share gains from the adoption of our integration proposal would at least be taxed on such gains at full personal rates. However, since it would probably not be possible to arrange the timing of the taxation of share gains in this fashion, there would likely be some untaxed windfall gains. A transition tax on shareholders, which temporarily depressed share prices, might serve to reduce these windfall gains.

Another instance in which the temporal equity problem was recognized by the *Carter Report* was in regard to government transfer payments. The *Carter Report* advocated that all government transfer payments, including family allowances, unemployment insurance benefits and workmen's compensation payments should be included in the tax base of the recipient with a deduction permitted for specific non-tax contributions to such transfer programmes. This proposal was implemented with regard to family allowances and unemployment insurance but not with regard to workmen's compensation payments.⁵⁰ The *Carter Report* perhaps mindful of what I have termed temporal equity went on to say, "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".⁵¹ Presumably, the purpose of the review would be so that the person in average circumstances would have approximately the same after tax income following the implementation of the proposed tax reform as that person enjoyed prior to tax reform.

The *Carter Report* also accorded recognition to what has been referred to as temporal equity in its recommendations in relation to provisions for retirement income. The *Carter Report* affirmed that it was a desirable social goal for individuals to save a portion of their income in their working years to ensure an adequate retirement income and that it was legitimate to use the tax system as a tool to encourage retirement saving. However, the *Carter Report* believed that deferment of income for tax purposes

⁵⁰ The failure to tax workers' compensation payments is an anomaly. However, it is more serious than a simple tax anomaly. Failure to tax these payments leads to a misallocation of the resources of our economy because the dangerous activity is not paying its full social cost. Workers' compensation payments are lower than they would be if the payments were taxable. Dangerous activities are not made sufficiently more expensive for there to be an adequate amount of market deterrence to such activities. Consequently, there is not sufficient transfer of resources out of dangerous activities into less dangerous activities. See Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts* (1961), 70 *Yale L.J.* 499 and T. G. Ison, *The Forensic Lottery* (1967), pp. 37-41.

⁵¹ *Carter Report, op. cit.*, footnote 1, Vol. 3, p. 53.

was such a valuable concession that more stringent restrictions were warranted. The *Report* took the view that as the justification for such tax concessions was primarily social "the value of such benefits should be designed primarily for the low and middle income groups where encouragement of saving is more socially desirable".⁵² The recommendation made by the *Carter Report* was that instead of a maximum annual limit for the deductibility of contributions to a registered plan, the deductibility should be expressed in terms of a maximum pension benefit payable at age sixty-five. It was proposed that the contribution by the individual and by the employer, if there was one, should be deductible in computing income subject to tax only so long as the retirement benefits from all registered plans other than the Canada Pension Plan did not exceed the equivalent of a single life annuity of \$12,000.00 per year, payable at age sixty-five with a ten year guarantee, calculated on the basis of a standard mortality table and a stipulated rate of return for future years.⁵³

A great virtue in a benefit limit as opposed to an annual limit is that it provides greater temporal equity. It provides fairer treatment between the late saver and the early saver. This is important since it is only in recent years that there has been the burgeoning of pension plans even though tax inducement for them was first introduced into the tax system in 1919.⁵⁴ With regard to self-employed persons, no tax deferral was available to assist them in making provision for their retirement until 1957, when the registered retirement savings plan was first introduced.⁵⁵ There are thus many older persons who have had little opportunity to take advantage of the tax deferral available through registered pension plans or registered retirement savings plans. These older individuals would be assisted by the adoption of a benefit limit as opposed to the existing annual limit. The budget of May 25th, 1976, proposed to increase the maximum amounts deductible for contributions to registered pension plans and registered retirement

⁵² *Ibid.*, p. 420.

⁵³ *Ibid.*, pp. 455-456.

⁵⁴ An Act to amend the Income War Tax Act, 1917, S.C., 1919, c. 55, s. 2 added the subsection 3(7): "Any part of the remuneration of a taxpayer retained by his employer in connection with an employee's superannuation or pension fund or plan shall be allowed as an exemption or deduction from the income of the taxpayer for income tax purposes, and any payment to an employee out of such fund or plan shall be included as taxable income of the employee."

⁵⁵ An Act to amend the Income Tax Act, S.C., 1957, c. 29, s. 17 which added s. 79B to the Act.

savings plans from \$2,500.00 to \$3,500.00 in regard to the employee and employer and from \$4,000.00 to \$5,500.00 in regard to the self-employed person.⁵⁶ This does nothing to redress the fact that older taxpayers have in general obtained comparatively little advantage from tax deferral to assist them to save for retirement. The proposed increased annual limits represent a further departure from taxation based on ability to pay since many taxpayers will not be able to utilize the full amount of such large exclusions.⁵⁷

⁵⁶ H. of C. Deb., May 25th, 1976, p. 13832.

⁵⁷ It could also be argued that these larger annual exclusions from income are an indirect part of the tendency in recent years to reduce the taxation on wealth. Consider the self-employed person earning \$27,500.00. He qualifies to make the maximum deduction available to a registered retirement savings plan of \$5,500.00. Yet it seems unlikely that a person who has earned income of \$27,500.00 and no other source of income and little wealth will be able to afford to contribute \$5,500.00 to a registered retirement savings plan. However, the person with \$27,500.00 of earned income and with investment income or some wealth will be better able to divert \$5,500.00 into a registered retirement savings plan. Also being in a higher marginal tax bracket, the tax savings will be greater.

Another disturbing feature of the tendency to simply increase the annual limits on amounts deductible to registered pension and retirement savings plans is that it represents a drift towards an expenditure tax and away from an income tax. Undoubtedly, there is something to be said for a progressive expenditure tax. It may be more rational to assess tax liability on the basis of what one takes out of the economy in the form of consumption rather than on the basis of what one contributes to the economy as measured by income. Nicholas Kaldor, in his book, *An Expenditure Tax* (1955), at p. 53 states: "An inhabitant from Mars . . . would surely be puzzled to discover that each individual's contribution to the finance of socially provided benefits depends not on the sum of benefits he receives from the community but on his personal contribution to the wealth of the others. It is only by spending, not by earning or saving, that an individual imposes a burden on the rest of the community in attaining his own ends."

It has recently received support from J. Rawls in his book, *A Theory of Justice* (1971), p. 278.

To the extent that annual limits are raised, more taxpayers' total savings become equivalent to their contribution to a registered pension plan or a registered retirement savings plan (R.R.S.P.) and therefore the tax which is nominally on income, comes to resemble a tax on expenditure. It does not seem legitimate to argue that the proposed increased limits have been adopted just to compensate for inflation. The limits were \$1,500.00 and \$2,500.00 in 1971 and in 1972, \$2,500.00 and \$4,000.00. The proposed limits of \$3,500.00 and \$5,500.00 represent a 233 $\frac{1}{3}$ % increase and a 220% increase respectively over the 1971 levels. Inflation has not galloped as rapidly as all that. The Carter Report rejected consumption as a tax base even when a progressive tax was applied to this base. Thus we should not simply drift from an income tax to an expenditure tax without consciously deciding that this is the direction which should be taken. This is

The Carter *Report* did not appear to formulate the benefit limit to determine the deductibility of a contribution in the calculation of income subject to tax primarily on the basis of temporal equity. The benefit limit seems to have been advocated in order to achieve horizontal and vertical equity, without any emphasis on the greater fairness it would achieve between the late and the earlier savers for retirement. For instance, the Carter *Report* criticized annual dollar limits and limits based on a percentage of earned income as unsatisfactory "because it does not adequately take into consideration employer contributions, so that the limitation is unevenly applied to different persons".⁵⁸ Another defect which the *Report* noted was that the annual deductibility limit and the exemption of investment income in registered plans from tax "confers a relatively greater benefit, in the form of tax deferment on investment income, on those plans that earn a high rate of income".⁵⁹ The Commons committee which studied the *White Paper* recommended that "the switch to the benefit limit be carried out as expeditiously as possible".⁶⁰ One of the reasons given was that the benefit limit "could be of great assistance to those with fluctuating incomes and form an additional averaging device . . .".⁶¹ Thus a reason for the Commons committee advocating that the benefit limit be adopted did relate to temporal equity. It, however, directed its attention to the continuing temporal equity problem which arises because some taxpayers have fluctuating income and some have more stable income. It did not consider the discreet and, in the very long run, transitory equity problem which arises because many older employees have only recently become members of registered pension plans and self employed persons have only since 1957 had the opportunity of tax deferral for retirement made available to them through registered retirement savings plans.

particularly the case when it is recalled that contributions to these registered plans do not necessarily represent net savings. Further drift towards a hybrid, combining characteristics of an income and expenditure tax, should perhaps be resisted until it is ascertained that it really is an improved species of tax. It might also be questioned whether interest on money borrowed which is contributed to a R.R.S.P. should be deductible from income. An argument could be made that R.R.S.P.'s are intended to encourage net saving for retirement and not to encourage borrowing for retirement.

⁵⁸ Carter Report, *op. cit.*, footnote 1, Vol. 3, p. 431.

⁵⁹ *Ibid.*, p. 432.

⁶⁰ *Op cit.*, footnote 24, p. 22.

⁶¹ *Ibid.*

The benefit limit for the determination of the deductibility of a contribution in computing income has much to recommend it as compared with an annual exemption limit. However, the benefit limit does present formidable administrative problems. It seems probable that these administrative problems could be solved. The fact that these problems have not even been tackled is perhaps in large measure due to the low benefit limit proposed. Even persons who regarded a benefit limit as the appropriate way to circumscribe the amount of tax deferral which should be permitted to assist in retirement saving have been critical of the limit of a single life annuity of \$12,000.00 per year, payable at age sixty-five with a ten year guarantee.⁶² The rampant inflation which has occurred in the ten years that has elapsed since the release of the *Carter Report* has made the proposed benefit limit ludicrously low since no provision was made for indexing of the limit. With the acceptance of indexing of personal exemptions and tax brackets, the way has perhaps been paved for the introduction of a benefit limit which would be adjusted annually in response to changes in the consumer price index. A realistic benefit limit which would be adjusted annually for changes in the consumer price index should be introduced to control the amount of tax deferral. Such a benefit limit would be far superior on equity grounds, particularly when the temporal equity aspect is considered, to an annual exemption limit which is sporadically increased.⁶³

V. *An Assessment of Two Recent Tax Incentives from the Perspective of Temporal Equity.*

a) *The Registered Home Ownership Savings Plan.*

The introduction of the registered home ownership savings plan is an example of a new incentive which is accompanied by

⁶² One of these is R.M. Clark. See Report of Proceedings of the Nineteenth Tax Conference of the Canadian Tax Foundation (1967), pp. 278-286.

⁶³ E. J. Benson, *Proposals for Tax Reform* (1969), pp. 21 and 22: "In principle, the limits on what may be put into such tax-free savings funds by or on behalf of an individual can most fairly be established in terms of the benefit the fund can be expected to provide on retirement. This would equate the position of late savers with that of regular savers. . . . While it is difficult to work out, the government believes in principle that such a system should be established. Unfortunately it is estimated that removal of the contribution limits would be quite expensive, and revenue considerations prohibit a switch at this time." In view of the increase in the annual limits in 1972 and those proposed in 1976, the loss of revenue argument appears to be simply an excuse for inactivity.

the creation of some temporal inequity.⁶⁴ A person who already owns his or her own housing unit will not be able to take advantage of being able to save the maximum of \$10,000.00 in amounts of \$1,000.00 per year.⁶⁵ Since it is a plan which is designed to assist persons to acquire their own homes, obviously persons who own their own home should not receive any benefit. However, it must be conceded that there is temporal inequity between the person who has just recently purchased a home and a person who purchases a home ten years after the introduction of the plan in 1974 and who has availed himself of the advantage of depositing \$1,000.00 each year for ten years and has thus been able to deduct a total of \$10,000.00 from his income subject to tax. This transitory equity problem is an inevitable consequence of introducing such an incentive plan.

There are, however, aspects of this incentive plan that can be validly criticized. There is not simply the inevitable discrimination between persons who own their own homes and persons who do not. There is discrimination which could be described as tantamount to discrimination on the basis of marital status. A single person who owns a house cannot take advantage of the plan unless that person disposes of the home and lives in a rented accommodation and in order to take maximum advantage the person would have to live in rented accommodation for a minimum of ten years. A married couple who already owned their home in joint tenancy could have the ownership of the property transferred solely to one of the spouses and the other spouse could take advantage of the maximum tax free saving under the plan. That spouse could then use the proceeds of the plan to purchase the house from the spouse to whom sole ownership of the house had been originally transferred. The vendor-spouse, no longer having ownership of residential property could then save \$10,000.00 tax free in a plan and then could use the proceeds to reacquire joint ownership in the house. Such manipulation is not available to the single person. Thus for married persons who are prepared to engage in this type of manoeuvre, the temporal equity problem to which attention was earlier drawn does not exist. However, the plan was surely not intended to benefit married persons who

⁶⁴ An Act to amend the statute law relating to income tax, S.C., 1974-75, c. 26, s. 100 which added s. 146.2 applicable to 1974 and subsequent years.

⁶⁵ The income of the plan is also not subject to tax. Assuming a rate of return of eight per cent, the amount of an annuity of \$1,000.00 per year for ten years is \$14,487.00. Thus an additional \$4,487.00 is shielded from taxation.

already own a home. There is something seriously wrong with the structuring of a home ownership incentive programme which encourages married couples to engage in a ping-pong game in regard to title to a residential property. It is also relevant to recognize that the higher the income of the spouses the greater the tax saving to be derived from the title ping-pong.

The plan should be restricted to a person who has never owned a residential property and who is not married to a person who owns residential property. In this way, some of the gimmickry of the present plan could be eliminated. It does not eliminate the basic objection to all such deduction schemes, which is that the greatest tax advantage accrues to the persons who pay tax at the highest marginal tax rate. These are the persons who require either no assistance or the least assistance. It may not be unfair to describe the plan as a gimmickry upside down subsidy which should be eschewed in the formulation of rational tax policy.⁶⁶ If more emphasis were placed on temporal equity, it may be that similar poorly structured incentives would be rejected. Attention directed towards temporal equity might also work against further tax complication. Tax complication redounds to the benefit of the sophisticated taxpayer or the taxpayer who is able to afford tax planning. These are likely to be middle or upper income bracket taxpayers and if this is the group whom it is desired to benefit, the benefit should take the form of a simple reduction in tax rates, rather than encumbering the Income Tax Act with further complicating embellishments.

b) *The Multiple-Unit Residential Incentive.*

Another recent incentive to encourage the construction of rental accommodation was announced by the Minister of Finance in his budget of November 18th, 1974. Mr. Turner stated:

I am particularly anxious to provide a quick and strong incentive to the construction of new rental housing units. I therefore propose to relax

⁶⁶ Another defect is that even if you purchase a home, you do not have to use the funds in a plan. You can no longer make contributions to your plan but it can go into a state of suspension. See Information Circular 75-18R, Dec. 30th, 1975, paragraph 15(b) which states: "A beneficiary who has acquired and contributed to a RHOSP for one or more years may find that in a subsequent year he is no longer eligible to contribute because he has acquired a dwelling place in Canada, by inheritance or otherwise. Nevertheless the beneficiary is not required to terminate the RHOSP and to apply the funds to the purchase of the dwelling place and may resume contributions in a subsequent year if he again becomes eligible to contribute." One might also question whether the tax free roll out should have extended to the purchase of home furnishings in addition to the purchase of a house.

for a period the rule whereby capital cost allowances on rental construction could not be charged against income from other sources.

Specifically, in respect of new, multiple-unit residential buildings for rent, started between tonight and December 31, 1975, the capital cost allowance rule will not apply. This means that an owner of an eligible rental unit will be permitted to deduct capital cost allowance against any source of income at any time. I am confident that this measure will attract a significant amount of private equity capital into the construction of new rental housing.⁶⁷

The Order in Council amending the regulations was not made until April 8th, 1975, and was published in the *Canada Gazette* on April 23rd, 1975.⁶⁸ After the provision of details about the capital cost allowance incentive, there was only eight months in which to take advantage of the incentive. Since the time necessary for land assembly, necessary planning and arrangements for financing for any substantial rental construction may be in the order of two to three years, the ineffectiveness of this incentive is patently obvious. Yet all owners of multiple-unit residential buildings for which footings were commenced after November 18th, 1974, and before January 1st, 1976, were freed from the restriction introduced in 1972 that capital cost allowance could not produce a loss from rental buildings utilizable against other forms of income.⁶⁹ As a result of the long lead time necessary in regard to the construction of most apartment buildings, it would appear that the Minister's confidence that the measure would attract "a significant amount of private equity capital into the construction of new rental housing" was almost totally misplaced. The substantial benefit which some taxpayers may reap from the measure represents in most instances a windfall gain in regard to projects which were in advanced planning stages but for which footings had not been laid by November 18th, 1974. The benefits largely accrued to taxpayers who were proceeding with plans which were in such an advanced stage that cancellation was improbable, instead of flowing to taxpayers who had deliberately responded to the incentive offered by the government to build apartment buildings which would not otherwise have been undertaken. To the extent that the tax subsidy accrued to persons whose plans were uninfluenced by the incentive measure, the tax revenue foregone represented a total loss to the government with no compensating gain to the

⁶⁷ H. of C. Deb., Nov. 18th, 1974, Vol. II, p. 1426.

⁶⁸ S.O.R./75-201, Can. Gaz., Part II, Vol. 109, pp. 667-669.

⁶⁹ Income Tax Regulations 1100(11). Subsection 12 provided substantial exceptions to the general rule that losses produced by capital cost allowance in regard to rental property could not produce a loss which was deductible from other forms of income.

economy in the form of additional rental accommodation. In addition, viewed from the aspect of the distribution of income, it was undoubtedly a very regressive subsidy.

The government perhaps recognizing the inefficacy of a measure intended to stimulate the construction of rental accommodation which was of such short duration, on February 3rd, 1976, passed an Order in Council by which it extended the incentive from January 1st, 1976, to January 1st, 1978.⁷⁰ One would like to be charitable and say that the government had benefited from its earlier mistake but it more closely resembles repetition of error. The amendment to the regulations extending the incentive, still only provided twenty-two full months in which to undertake any necessary land assembly, to obtain architectural plans, to receive any necessary planning board, council or municipal board approval, to arrange financing and to conclude a contract with a builder. The tax subsidy may to a considerable extent still redound to the advantage of taxpayers who have already committed themselves to the erection of an apartment block rather than serving as a reward for undertaking a project which would not otherwise have been launched. There can be no doubt that the incentive measure announced in the November 18th, 1974, budget which was to expire on January 1st, 1976, and which was tardily extended on February 3rd, 1976, to January 1st, 1978, would have been much more effectual if when it was introduced it had initially applied to all multiple-unit residential units commenced after budget day and before 1978.

My objective is not, however, to criticize tax policy but to illustrate how an awareness about temporal equity may assist in the formulation of better tax policy. It is difficult to justify treating a taxpayer who commences the footings for an apartment block on November 18th, 1974, substantially differently than one who commences the footings on November 19th, 1974. Yet the measure introduced by the Minister of Finance in his budget of November 18th, 1974, did just that. The incentive measure introduced a significant amount of temporal inequity into the tax structure. If more attention had been paid to the concept of temporal equity, such an inefficient incentive would have been rejected.

VI. *Conclusion.*

An attempt has been made to assert the importance of temporal equity in the formulation of tax policy. It is submitted that one

⁷⁰ S.O.R./76-99, Can. Gaz., Part II, Vol. 110, p. 450.

of the most serious errors in tax policy was the abandoning of the estate and gift tax field by the federal government on December 31st, 1971. This created enormous temporal inequity between beneficiaries of persons who died prior to that date and beneficiaries of persons who died on or after January 1st, 1972 which was only partially compensated by the provinces.⁷¹ Professor Richard Bird vigorously criticized the vacating of the estate and gift tax field by the federal government. He stated: "On moral, social and economic grounds, for the good of this country, estate taxes should be raised on large estates, not reduced."⁷² To this criticism, one can add that concern for temporal equity would have militated at the very least in favour of the continuation of the estate and gift taxation by the federal government. However, the one half inclusion of capital gains in the income tax base by making wealth accumulation more difficult provides a strong argument for placing more emphasis on wealth taxation unless one is in favour of protecting existing accumulations of wealth and of reducing upward economic mobility.

A recognition of the importance of the temporal aspect of tax equity might have deterred the introduction of some of the more dubious tax incentive measures, such as the multiple-unit residential building incentive. The building incentive should probably have been rejected on the basis that the benefit accruing to the economy was not commensurate with the tax revenue deferred. However, if this factor was not decisive, consideration of the temporal inequity involved should have delivered the *coup de grâce* to his particular incentive.

It has also been argued that recognition of the temporal dimension of tax equity should have an important impact on the way in which a tax system is designed. For instance, if it is decided that the taxation of wealth should be accorded greater

⁷¹ As noted in footnote 22, *supra*, the greatest amount of temporal inequity to the extent of seventy-five per cent occurred in Alberta on April 1st, 1967, when The Estate Tax Rebate Act became effective and twenty-five per cent on January 1st, 1972. In Saskatchewan, there was a period of temporal inequity between April 1st, 1969, when The Estate Rebate Act took effect and January 1st, 1972, when The Succession Duty Act (Manitoba) became operative. Thus in the case of Saskatchewan the temporal inequity between beneficiaries of persons who died on or before March 31st, 1969, and beneficiaries of those who died on or after January 1st, 1972, was actually reduced. The temporal inequity centred on January 1st, 1972, for Prince Edward Island, January 1st, 1974, for New Brunswick, April 1st, 1974, for Nova Scotia and April 9th, 1974, for Newfoundland.

⁷² The Case for Taxing Personal Wealth, Report of Proceedings of the Twenty-Third Tax Conference, Canadian Tax Foundation (1971), p. 24.

emphasis in our tax system,⁷³ there are a number of solutions.⁷⁴ It could be done by imposing a simple inheritance tax or its much more sophisticated counterpart, a cumulative lifetime accessions tax.⁷⁵ It might also be accomplished by enacting a simple estate tax⁷⁶ or its more sophisticated counterpart, a cumulative lifetime donor's tax.⁷⁷ Another solution is that proposed by the *Carter Report* that gifts and inheritances should form part of the income tax base of the recipient. Instead of

⁷³ One point which deserves clarification is that, in my view, the deemed realization on death or on the making of a gift for the purpose of levying income tax in relation to the capital gain does not represent wealth transfer taxation. If one accepts the Haig-Simons definition of income, the appreciation of capital assets represents income as it occurs. It is not taxed at that time simply because of the administrative problems. Thus the deemed realization on death or the making of a gift simply ends the tax deferral in regard to income which has not been taxed only because of the problem of annual valuations.

⁷⁴ For discussion about the various types of death duties see Bale, *Whither Death Duties*, [1974] *Pub. L.* 121.

⁷⁵ A cumulative lifetime accessions tax was suggested by Henry Simons in *Personal Income Taxation* (1938), pp. 143-145 but not developed in any detail. It was developed in detail by Harry Rudick in *A Proposal for an Accessions Tax* (1945), 1 *Tax L. Rev.* 25 and later in *What Alternative to the Estate and Gift Taxes?* (1950), 38 *Cal. L. Rev.* 150 in a symposium introduced by Stanley S. Surrey, *An Introduction to Revision of the Federal Estate and Gift Taxes* (1950), 38 *Cal. L. Rev.* 1. A cumulative lifetime accessions tax was in force in Japan from 1949 to 1952 as a result of recommendations contained in *Report on Japanese Taxation by the Shoup Mission* (Tokyo, 1949), Vol. 2, pp. 143-155. For more recent discussion see Richard D. Kirshberg, *The Accessions Tax: Administrative Bramble-bush or Instrument of Social Policy?* (1966), 14 *U.C.L.A. L. Rev.* 135 and William D. Andrews, *The Accessions Tax Proposals* (1967), 22 *Tax L. Rev.* 589. Interest in a cumulative lifetime accessions tax has also developed in Britain, see J. E. Meade, *Efficiency, Equality and the Ownership of Property* (1964); Oliver Stutchbury, *The Case for Capital Taxes* (1968); C. T. Sandford, *Taxing Inheritance and Capital Gains* (1967) and *Taxing Personal Wealth* (1971) and A. B. Atkinson, *Unequal Shares, Wealth in Britain* (1972).

A very sophisticated tax, a "Bequeathing Power Succession Tax" was proposed by W. Vickrey in *Agenda For Progressive Taxation* (1947), pp. 224-248. Its function was to impose the same tax burden "on the transfer of a given sum from one individual to another regardless of the number of steps or channels through which the transfer is effected, and as nearly as may be regardless of the time of the transfer", p. 224.

⁷⁶ By virtue of s. 92(2) of *The British America Act, 1867*, 30 & 31 *Vict.*, c. 3 (U.K.), the provinces would not be able to impose a simple estate tax.

⁷⁷ The *Finance Act 1975* of the United Kingdom, c. 7, replaced estate duty with a capital transfer tax which is basically a cumulative lifetime donor's tax.

utilizing some from of wealth transfer tax, a net wealth tax might be imposed.⁷⁸ In jurisdictions in which wealth transfer taxation has been abolished, concern about temporal equity would militate in favour of the imposition of an annual net wealth since this would involve much less temporal inequity than the imposition of any form of wealth transfer taxation or the inclusion of the gift or inheritance in the income tax base of the recipient.⁷⁹

The proposition has also been advanced that the concept of temporal equity makes a meaningful contribution to the determination of whether there should be an annual limit or a benefit limit to the amount of tax deferral which is permitted in the interest of assisting persons to save for their retirement. The benefit limit is far more equitable between the late saver and the early saver. In view of the relatively recent introduction of the registered retirement savings plan, the benefit limit would be far more equitable as between different generations.

A note of caution is in order about temporal equity. There are many instances in which temporal equity has in the past received no attention or too little attention. However, it is certainly possible to accord too much importance to temporal equity. A rigid adherence to the principle that tax payers in the same circumstances but distinguishable only by separation in the temporal dimension should pay the same tax would prevent any tax reform.⁸⁰ Thus a tax proposal which will make the income

⁷⁸ Cutt, *A Net Wealth Tax for Canada* (1969), 17 Can. Tax J. 298; *Wealth Tax, op. cit.*, footnote 44; J. S. Fleming and I. M. D. Little, *Why We Need a Wealth Tax* (1974); C. T. Sandford, J. R. M. Willis and D. J. Ironside, *An Annual Wealth Tax* (1975).

⁷⁹ Temporal inequity would, however, only be one factor to be taken into account. The administrative problems involved in a net wealth tax might be so great that some effective form of wealth transfer taxation might be the best compromise.

⁸⁰ Only after submission of this text did the article of Martin Feldstein entitled, *Compensation in Tax Reform* (1976), 29 Nat. Tax J. 123 come to my attention. At p. 128 he states: "The principle of horizontal equity is not a mere abstraction of academic theory but a fundamental belief that is widely held and strongly felt. Many otherwise desirable tax reforms may never be enacted because doing so would violate this injunction that government action should not treat equals unequally." Mr. Feldstein's conception of horizontal equity thus clearly encompasses the temporal dimension. I have indicated the danger to tax reform when the concept of temporal equity receives unwarranted emphasis. Mr. Feldstein's article clearly exemplifies my concern. At p. 125, he states: "A change in the individual income tax treatment of some form of capital income, e.g., the taxation of municipal bond interest or the full taxation of realized capital gains, requires compensation of those individuals who own the

tax base more closely reflect the Haig-Simons definition of income should certainly not be rejected simply because it will cause some temporal inequity.⁸¹ Some temporal inequity is a price which must be paid in achieving a more equitable distribution of tax burdens. Temporal inequities involved in tax proposals which are unrelated to a more accurate definition of income but are simply incentive measures should weigh more heavily in a decision about the proposal. Recognition of the concept of

affected assets." I find it impossible to accept that tax reform should be circumscribed by the requirement of compensation for those affected by it, even assuming a feasible mode of compensation could be devised. Mr. Feldstein's position seems to be based on the premise that taxpayers have a vested property interest in the preferential treatment that is currently accorded by our taxing statutes to certain forms of economic gain. This is a premise which I can not accept. He also states that even over compensation is preferable for it "eliminates any suspicion that the reform is being used as a substitute for changes in progressivity..." *Ibid.*, at p. 127. In my opinion, the essence of fundamental tax reform is that it does change the progressiveness of the tax and is undertaken for the very purpose of making the nominally progressive rate structure truly progressive. For instance, when our new Income Tax Act brought one-half of realized capital gains into the income tax base, it increased the progressiveness of the income tax, with income determined in accordance with the Haig-Simons definition. This reform was implemented for the very purpose of increasing progressiveness of the income tax. To advocate that the owners of capital assets should be compensated because one-half the gain is now included in the income tax base appears to frustrate the whole thrust of the reform. My conclusion is that no compensation should be paid. In addition, fairness to younger generations who have not had the opportunity to accumulate capital assets without having to pay tax when a capital asset is sold at a gain suggests that there should be negative compensation in the form of greater emphasis on wealth taxation. Perhaps Mr. Feldstein's principle of compensation for tax reform may be relevant with regard to municipal bonds in the United States which have been issued on the understanding that such interest is not taxable. I find it difficult to accept the general conclusion that: "When compensation is feasible, as it generally would be for reforms affecting capital income, there is much to recommend it." *Ibid.*, at p. 128. I believe the principle of compensation would frustrate much tax reform. Mr. Feldstein does state that in the area of tax reforms involving labour income compensation is impossible and suggests that the most appropriate accommodation of horizontal equity and economic efficiency is through the enactment of postponed tax changes.

⁸¹ I do not mean to imply that every proposed change which accords with the Haig-Simons definition of income should be accepted simply for that reason. If tax reform had come closer to implementing a comprehensive income tax base, I would have no objections to clause 56(1)(n) which includes in income "a scholarship, fellowship or bursary, or a prize for achievement in a field of endeavour ordinarily carried on by the taxpayer" to the extent that it exceeds \$500.00. However, it seems peculiar to say the least, that, for example, a Nobel prize winner is

temporal equity should assist in the formulation of better tax policy.

taxable and yet the winner of a lottery is not. There appears to be no reason why gambling gains should not be included in income. Gambling losses should probably be regarded as a personal entertainment expense and therefore there should be some limitation on their deductibility. The solution proposed by Carter was that gambling gains should be fully included in income but that gambling losses could only be deducted from gambling gains. I find the exclusion of gambling gains very galling particularly when the government exploits this exclusion to raise government revenue through lotteries. A lottery is a form of taxation which bears no relationship to capacity to pay and is generally regarded as highly regressive as well as very costly to administer. The fact that it is a voluntary tax may partially excuse its use by the government. However, to provide a tax loophole to make such an irrational but voluntary tax more attractive should not be condoned. Many tax theorists advocate taxing windfall gains more heavily than other forms of income. There is certainly no justification for the complete exclusion of gambling gains.