

*PRELIMINARY DRAFT: Please do not cite without permission of the authors*

## **The Taxation of Strike Pay**

Benjamin Alarie & Matthew Sudak  
University of Toronto Faculty of Law

Date of Draft: June 18, 2005

## TABLE OF CONTENTS

<b>I. INTRODUCTION</b>	<b>- 2 -</b>
<b>II. CANADIAN STRIKE PAY TAX EXPENDITURES</b>	<b>- 4 -</b>
<b>III. CANADIAN AND COMPARATIVE TAX TREATMENT OF UNION DUES, LABOUR ORGANIZATIONS, AND STRIKE PAY</b>	<b>- 11 -</b>
A. Canada	- 12 -
B. United States	- 21 -
C. United Kingdom	- 23 -
D. Australia	- 25 -
<b>IV. EFFICIENCY, EQUITY, AND SOCIAL WELFARE CONSIDERATIONS</b>	<b>- 28 -</b>
A. Unions and Strikes	- 30 -
B. The Power of and Demand for Unions	- 40 -
<b>V. CONCLUSION</b>	<b>- 44 -</b>

## I. Introduction

In New York City on September 15, 2004, Gary Bettman, Commissioner of the National Hockey League (NHL), announced officially that the league would be locking-out its players and would indefinitely delay the start of the 2004-05 season due to the failure to negotiate a new collective bargaining agreement with the NHL Players' Association (NHLPA). The lockout continued into 2005, and the entire 2004-05 season—including the Stanley Cup playoffs—was cancelled for the first time in the history of the league on February 16, 2005.<sup>1</sup> At 275 days and counting as of June 17, 2005, the current NHL lockout is the longest-running interruption in the modern history of major professional sports in North America and is rivaled only by two other similar disputes.<sup>2</sup> There is no evidence to suggest that in either of these other professional sports labour disputes strike pay was paid to players (the term “strike pay” is used herein to refer generically to both strike and lockout pay).<sup>3</sup>

The current NHL lockout is a curiosity as probably being the sole labour dispute in the history of North American professional sports in which players have received strike pay. It is particularly interesting from a tax perspective because it has probably engendered the greatest

---

<sup>1</sup> Dave Fay, “Game off; None and Done for Lost Season” *The Washington Times*, February 17, 2005.

<sup>2</sup> The first, the Major League Baseball strike of 1994-95, lasted a total of 232 days from August 12, 1994 to March 31, 1995 and resulted in the cancellation of the 1994 World Series; see Robert F. Burk, *Much More Than a Game: Players, Owners, and American Baseball since 1921* (University of North Carolina Press, 2001) at 288-293. The second, the National Basketball Association's 1998-99 lockout, lasted 202 days, but did not result in the cancellation of the NBA playoffs; see Paul D. Staudohar “Labor Relations in Basketball: The Lockout of 1998-99” (1999) 122(4) *Monthly Labor Review* 3 at 3. The National Football League, the other major North American professional sports league, does not have a history of lengthy labour disputes, with 1982 witnessing the longest interruption of regular season play, 57 days, from September 20 to November 17, 1982; see Dennis Coates and Brad R. Humphreys “The Economic Consequences of Professional Sports Strikes and Lockouts” (2001) 67(3) *Southern Economic Journal* 737 at 738.

<sup>3</sup> It is difficult to determine with certainty that strike pay was not paid in any of these earlier disputes, though searches have yielded no reference to any having been paid. In the NFL labour disputes of 1982 and 1987, email correspondence with Michael Duberstein of the NFL Players' Association has confirmed that there was no strike pay paid.

concentration of strike pay in the history of Canadian organized labour. Strike pay in Canadian labour disputes is usually rather modest, typically ranging up to \$250 per week.<sup>4</sup> In November 2004, however, the NHLPA announced that it would be paying a monthly stipend of \$10,000 US to each of its 730-odd members for November and December 2004—a rate about 15 times higher than conventional strike pay—with subsequent payments planned on a two-year schedule ranging from \$5,000 to \$10,000 US per month for the duration of the lockout.

In the wake of the stipend announcement, the NHLPA advised its players that those players subject to income tax in the U.S. would have to report the monthly stipends as income for tax purposes, but that players resident in Canada would not have to report the stipends as income to the Canada Revenue Agency (CRA). The differing tax policy between Canada and the U.S. in this regard is arresting. Strike pay has long been treated by Canadian revenue authorities as not being taxable. This view was explicitly upheld by the Supreme Court of Canada in 1991 in *Canada v. Fries*,<sup>5</sup> where the Court decided that strike pay was not “income from a source” within the meaning of paragraph 3(a) of the *Income Tax Act (ITA)*.<sup>6</sup> By way of contrast, and consistently with the more inclusive approach to defining income that predominates in the U.S.,<sup>7</sup> strike pay is subject to tax under the broad definition of income of § 61 of the *Internal Revenue Code (IRC)*.<sup>8</sup>

This Article aims to examine in detail this intriguing difference in tax policy between Canada and the U.S. In the process, it canvasses the attitude of some other selected countries to

---

<sup>4</sup> See the discussion in Part II, *infra*.

<sup>5</sup> [1990] 2 C.T.C. 439, (1990) 90 D.T.C. 6662 (S.C.C.), rev’g [1989] 1 C.T.C. 471, (1989) 89 D.T.C. 5240 (F.C.A.).

<sup>6</sup> R.S.C. 1985, c. 1 (5th Supp.)

<sup>7</sup> firmly established in 1955 by the U.S Supreme Court in *Commissioner of Internal Revenue v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). Warren C.J. remarked at 429-430: “Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted.”

<sup>8</sup> 26 *United States Code Service* § 61.

similar issues, maps out what can be inferred about the likely efficiency and equity consequences, and provides a tentative explanatory account of the sharply differing Canadian and American approaches. To this end the Article proceeds as follows. Part II outlines the probable fiscal effects of the Canadian strike pay exemption. Part III examines the tax treatment accorded to strike pay in Canada, the U.S. and several other jurisdictions, in the process counter-intuitively demonstrating that it is the U.S., and not Canada, which is an outlier in policy terms. Part IV draws on the findings of the labour economics and industrial relations literatures to analyze the effects associated with exempting strike pay from income tax, concluding that despite some as yet unresolved empirical and theoretical issues, the inefficiencies probably outweigh any offsetting gains, though to a small extent and with some redistribution of returns from capital to labour. Part V concludes with some thoughts seeking to account for the differing tax policy outcomes manifested in Canada and the U.S., with reference to both political economy and status-quo bias, with the ultimate aim of reconciling the economic analysis of Part IV with the actual North American and international practice outlined in Part III.

## **II. Canadian Strike Pay Tax Expenditures**

A natural issue at the outset is to delineate the magnitude of the tax expenditures associated with the Canadian strike pay exemption, both specifically in the context of the current NHL lockout and more generally in Canadian fiscal affairs. With regard to the NHL lockout, the NHLPA's activities are private and publicly available information necessarily piecemeal; however, it is possible to get some sense of the gravity of the tax break enjoyed by Canadian-resident NHL players during the lockout by making some (more or less reasonable) assumptions. Six of the NHL's 30 teams operate in Canadian cities: Vancouver, Calgary, Edmonton, Toronto,

Ottawa, and Montreal. If one assumes that players who play for teams located in Canada are resident for tax purposes in Canada, then approximately 150 of the 730-odd NHL players could reasonably be considered Canadian residents. Of course, this is not an entirely accurate assumption. Various players who might otherwise be Canadian residents during an ordinary season, living and playing for NHL teams in Canada, may have been residing in Europe or elsewhere for much of the time preceding or during (and eventually potentially following) the lockout. On the other hand, the number of players departing from Canada might be offset to some extent by those returning from U.S. teams to reside in Canada, since a significant proportion of NHL players are Canadian citizens. Some additional assumptions suggest that from November 2004 to June 2005 approximately \$12.2 million in strike pay (2 months at \$10,000 per month plus 6 months at \$7,500 per month x 150 players x \$1.25 CDN/US) may have been received tax-free in Canada—implying tax expenditures relating to the non-taxation of the payments to NHL players of roughly \$6 million.

Of course, most of the strike pay received by NHL players in the current lockout is anomalous. Strike pay is generally concerned with providing workers and their families with day-to-day sustenance over the course of a labour dispute. Strike pay is not usually (or is perhaps only crudely and imperfectly) concerned with income replacement as such. For example, the guidelines for payments to members of the Canadian Union of Public Employees (CUPE) from the National Strike Fund (individual locals may have additional strike pay guidelines) provide as follows: (i) payments begin on the 10<sup>th</sup> day of a strike (including holidays and weekends); (ii) a “bonus” payment of \$80 is given when strikes lasting more than 10 days are settled; (iii) daily payment amounts are \$40, to a weekly maximum of \$200; (iv) striking workers must perform assigned strike duties to be eligible for the strike pay; and (v) CUPE will

top-up any group life or medical insurance premiums not covered by the employer as a result of the strike.<sup>9</sup> In late 2004 the Communications, Energy and Paperworkers Union of Canada claimed that its strike pay policy was the most generous in Canada, providing for payments of \$250 per week, though this high rate begins only with the fourth week of a labour dispute.<sup>10</sup>

With regard to the more general question of strike pay tax expenditures in Canada, the latest data available from the Government of Canada's series of tax expenditures reports show that in 1992 the strike pay exemption resulted in foregone revenues of an estimated \$9 million.<sup>11</sup> These figures were calculated by the Department of Finance with reference to Statistics Canada's annual reports on Part II of the *Corporations and Labour Unions Return Act (CALURA)*.<sup>12</sup> Unfortunately, figures more current than 1992 are unavailable and earlier official estimates are only intermittently available. Moreover, Statistics Canada stopped collecting the *CALURA* information series in 1995. From 1997 onwards Statistics Canada has collected information similar to that collected under Part II of *CALURA* using a redesigned monthly Labour Force Survey.<sup>13</sup> However, the 1997 redesign of the Labour Force Survey does not collect strike pay information, and apparently does not assemble related data that would allow the Department of Finance to come up with reliable strike pay tax expenditure estimates. As a result, there is no official source for Canadian strike pay tax expenditure data post-1992.

---

<sup>9</sup> All information from the CUPE website, "Support to Members on Strike" (September 23, 2003), available at <http://cupe.ca/www/nationalstrikefundcampaigns/5977> (accessed April 17, 2005).

<sup>10</sup> See CEP National Union, "Information for All CEP Members" (accessed May 16, 2005), available online at: <http://www.cep1129.ca/cepNews/Dues%20Increase.htm>; and CEP National Union, "Policy 614 CEP Defense Fund Rules and Strike Authorization Procedures" (accessed May 19, 2005), available online at: [http://www.cep.ca/policies/policy\\_614\\_e.pdf](http://www.cep.ca/policies/policy_614_e.pdf) at para. 7.3.

<sup>11</sup> Department of Finance, *Government of Canada Tax Expenditures 1995* (Canada, 1996) at 24.

<sup>12</sup> *Ibid.* at 52.

Table 1: Days Lost Due to Labour Disputes and Strike Pay Tax Expenditures

<b>Year</b>	<b>Days Lost Due to Labour Disputes (in millions)</b>	<b>Strike Pay Tax Expenditures (in millions of dollars)</b>
1979	7.83	6
1980	8.98	7
1981	8.88	8
1982	5.80	5
1983	4.44	4
...	...	...
1988	4.90	7
1989	3.70	13
1990	5.08	18
1991	2.52	12
1992	2.11	9

**Sources:** Data on days lost from the International Labour Organization Laborsta Database, Table 9C, ISIC Rev. II (laborsta.ilo.org); tax loss figures from Department of Finance (Government of Canada) calculations: 1979-83, Department of Finance, Account of the Cost of Selective Tax Measures (Canada, August 1985) at 42; 1988-89, Department of Finance, Government of Canada Personal Income Tax Expenditures (Canada, December 1992) at 11; 1989-91, Department of Finance, Personal and Corporate Income Tax Expenditures (Canada, December 1993) at 15; 1992, Department of Finance, Government of Canada Tax Expenditures 1995 (Canada, 1996) at 24.

According to the Yearbook of Labour Statistics, compiled by the International Labour Office and cited by Statistics Canada, Canada witnessed a total of 379 strikes or lockouts in 2001, involving a total of almost 224,000 workers. These interruptions accounted for a cumulative loss of 2.11 million workdays.<sup>14</sup> These figures, however, underestimate the actual number of work stoppages and workers involved because only stoppages lasting for ten workdays or longer are included. In the U.S., 1.1 million workdays were recorded as being lost

---

<sup>13</sup> The Labour Force Survey has been in use since 1945, and has been conducted monthly since 1952. See Statistics Canada, "History of the Labour Force Survey before November 2000" [http://www.statcan.ca/english/sdds/document/3701\\_D7\\_T9\\_V1\\_E.pdf](http://www.statcan.ca/english/sdds/document/3701_D7_T9_V1_E.pdf).

in 2001, though only stoppages involving more than 1000 workers were counted. By way of comparison, and with various caveats, in the same year Japan lost 29,000 workdays; the U.K., 500,000; Australia, 400,000; and New Zealand, 54,000.<sup>15</sup> The reported frequency and duration of labour disputes varies significantly by country, partly for methodological reasons surrounding the way the data are collected, but probably also for more fundamental social, cultural and economic reasons.<sup>16</sup> It should be noted, however, that recent empirical work suggests that there is considerable interdependence in strike activity that cuts across social, cultural and economic factors to some extent, at least among OECD countries.<sup>17</sup>

Tax expenditure estimates, as calculated by the Department of Finance, are presented in Table 1 for the years official government figures are available.<sup>18</sup> It is interesting to note the dramatic surge in average tax expenditures from the 1979-83 period to the 1988-92 period (estimates were not issued by the Department of Finance between 1984-87), especially in light of the apparent waning in days lost due to labour disputes. There is no single obvious explanation for the jump, although changes in the way the Department of Finance estimated the strike pay tax expenditures—due to changes in tax rates, tax brackets and average wages of unionized workers—may be a factor,<sup>19</sup> as would increasing nominal levels of strike pay during labour

---

<sup>14</sup> International Labour Office, *Yearbook of Labour Statistics* (2003); available through Statistics Canada online at: (<http://www40.statcan.ca/101/cst01/labor30a.htm> (accessed May 28, 2005); complete statistics available through the International Labour Organization Laboursta Database ([laboursta.ilo.org](http://laboursta.ilo.org)).

<sup>15</sup> *Ibid.*

<sup>16</sup> These reasons are important and have garnered significant attention in the industrial relations literature, but are beyond the scope of this paper.

<sup>17</sup> See L.J. Perry and Patrick J. Wilson, “An Analysis of International Linkages in Strike Activity” (2003) 11(2) *International Journal of Employment Studies* 47.

<sup>18</sup> Special thanks to a source at the Department of Finance who was instrumental in tracking down some of the more dated reports, and who wished to remain anonymous.

<sup>19</sup> This is based on speculation only, since a detailed record of how the Department of Finance arrived at its calculations has proved to be unobtainable.

disputes, which would be consistent with what clearly is in retrospect the relatively high levels of inflation predominating throughout the late 1970s and early 1980s.

A straightforward way to operationalize the above strike and lockout activity information, given the unavailability of official tax expenditure figures since 1992, is to calculate an average tax expenditure per lost work day using the official pre-1993 estimates, and to then use this per day amount to estimate the missing, more recent, annual tax expenditure figures. Of course, this approach is insensitive to a variety of relevant factors, most importantly the influence of inflation. A straight averaging of tax expenditure per lost work day over the ten years for which estimates are available suggests that each day is associated with tax expenditures of \$2.17. However, this result is biased downward because of the low tax expenditures per day during the 1979-83 period, during which the average was \$0.84. By contrast, the 1988-92 figures are all well above one dollar per day, with a peak per day tax expenditure of \$4.77 in 1991, for an average of \$3.50. Greater emphasis should be placed on the later numbers since they are more applicable to current economic circumstances, probably more consistent with contemporary union and management practices and negotiation techniques, and have been derived under more comparable tax brackets, tax rates and price and wage levels.

The per day tax expenditure figures can be matched with more recent information on days lost due to strikes and lockouts to generate estimates of more current tax expenditures. Table 2 summarizes these data, and provides estimates of the missing tax expenditure figures using three different sets of assumptions. The second column begins with an estimate using the straight average figure of \$2.17 per day. The third column uses only the \$3.50 average derived from 1988-92 data. The fourth and final column weights the 1979-83 figures above at 30 percent, giving 70 percent weight to the more recent data. Taken together, the calculations

suggest that the tax expenditures associated with strike pay have, from 1993 to 2003, amounted to between \$55 and \$88 million in nominal terms. Actual tax expenditures would probably tend toward the higher end of this range (and perhaps extend higher), not least because these estimates ignore entirely the role of increasing prices from 1979 to 2003, during which time the Consumer Price Index rose from 47.6 to 122.3—an increase of 157 per cent.<sup>20</sup>

Table 2: Estimate of Strike Pay Tax Expenditures

	<b>Days Lost Due to Strikes and Lockouts (M)</b>	<b>Estimated Tax Expenditures (M)</b>		
		<i>1. Straight Average</i>	<i>2. Based on 1988-92 average</i>	<i>3. Weighted 30/70 average</i>
1993	1.52	3.30	5.32	4.10
1994	1.61	3.49	5.63	4.35
1995	1.58	3.44	5.55	4.28
1996	3.35	7.28	11.75	9.07
1997	3.61	7.85	12.65	9.77
1998	2.44	5.30	8.55	6.60
1999	2.45	5.32	8.57	6.62
2000	1.66	3.61	5.82	4.50
2001	2.20	4.78	7.71	5.95
2002	3.03	6.59	10.63	8.21
2003	1.74	<u>3.77</u>	<u>6.09</u>	<u>4.70</u>
	<u>Total</u>	54.73	88.26	68.15

Sources: Data on days lost from the International Labour Organization Laborsta Database, Table 9C, ISIC Rev. III (laborsta.ilo.org); authors' calculations for remaining figures based on Table 1, *supra*.

Retrospectively, then, it is clear that the fiscal effects associated with the non-taxation of strike pay have not been insignificant, though they have been far from overwhelming, especially in a fiscal context in which the federal government is growing accustomed to running annual

<sup>20</sup> See Statistics Canada, “Consumer Price Index, historical summary” accessed June 14, 2005, available online at: <http://www40.statcan.ca/101/cst01/econ46.htm>. The CPI figures are normalized such that the 1992 price level is

multi-billion dollar surpluses.<sup>21</sup> Prospectively, if one assumes that the strike pay exemption will continue into the future indefinitely, that the tax expenditures will continue to be roughly \$9 million per year in real terms, and that a reasonable discount rate is equal to the present yield on one year Government of Canada treasury bills, which is 2.75 per cent,<sup>22</sup> then the net present value of the future stream of strike pay tax expenditures is approximately \$327 million. Notwithstanding the size of this sum, however, it may well be that in the case of strike pay the indirect consequences relating to the perceived fairness and legitimacy of the Canadian income tax system (and therefore compliance with the various filing, reporting, and remittance requirements of the *ITA*) are more important than the relatively modest (though again, not insignificant) tax expenditures associated with not taxing strike pay.<sup>23</sup>

### **III. Canadian and Comparative Tax Treatment of Union Dues, Labour Organizations, and Strike Pay**

Although at first glance it might seem that the issue of the income tax treatment of strike pay would be a binary question; that is, “Is strike pay subject to tax or not?” However, to get a complete picture of the tax treatment of strike pay, it is necessary to consider the context in which strike pay is actually paid, and take into account all the relevant circumstances leading up to its payment. As such, there are actually three distinct levels of analysis that are salient to

---

equal to 100.

<sup>21</sup> In 2003-04 the Federal government enjoyed a \$9.1 billion surplus. In 1997-98, the surplus amounted to \$3.8 billion; 1998-99, \$3.1 billion; 1999-00, \$12.7 billion; 2000-01, \$18.1 billion; 2001-02, \$8.9 billion; and 2002-03, the surplus was \$7 billion. See Department of Finance, *Annual Financial Report of the Government of Canada Fiscal Year 2003-2004*, accessed June 14, 2005, available online: <http://www.fin.gc.ca/afr/2004/AFR2004-e.pdf>, at 10.

<sup>22</sup> As of June 10, 2005, one year Government of Canada treasury bills sold at a discount to yield 2.75 per cent. See Bank of Canada, “Rates and Statistics-Money Market Yields” accessed June 14, 2005, <http://www.bankofcanada.ca/en/rates/monmrt.html>.

<sup>23</sup> See, for example, V. Trivedi, M. Shehata, and S. Mestelman, “Attitudes, Incentives, and Tax Compliance” (2005) 53(1) *Canadian Tax Journal* 29. The authors report, at p. 60, that “Like other researchers, we found that economic variables did not go very far in explaining tax compliance behaviour.” More important for compliance were various psychological factors, which include perceived fairness of the income tax.

setting out the tax treatment of payments from labour organizations to their members during labour disputes. At the first level of analysis is the issue of the deductibility of membership fees or union dues paid to labour organizations. At the second level, the tax status and treatment of the various activities of the labour organization itself, most especially the aggregation, accumulation and investment of funds held in reserve for use during potential labour disputes, is relevant. The final level of analysis is concerned with payments made by labour organizations for the support of workers who have been locked-out or are on strike—i.e. the tax consequences to the recipient of strike pay. Each of these three aspects of the strike pay context will be considered for Canada, the United States, the U.K. and Australia.

### ***A. Canada***

In Canada, generally speaking, union dues paid by an officer or an employee to an eligible union are deductible from a taxpayer's income from office or employment unless the payments can be more accurately considered to be payments made for some non-union purpose, such as to establish or support a superannuation fund, for the provision of insurance, or for any purpose not related to the union's ordinary operating expenses.<sup>24</sup> Union dues paid to an eligible trade union are not deductible if the officer or employee has been (or will be) reimbursed by his or her employer for the fees<sup>25</sup> or if the fees constitute an initiation fee associated with joining the union rather than annual dues necessary to maintain membership.<sup>26</sup> Subparagraphs 8(1)(i)(iv) and 8(1)(i)(v), and subsection 8(5) of the *ITA* secure this result by providing as follows:

8. (1) In computing a taxpayer's income for a taxation year from an office or employment, there may be deducted such of the following amounts as are

---

<sup>24</sup> Revenue Canada, Interpretation Bulletin IT-103R, (November 4, 1988) at para. 2.

<sup>25</sup> *Ibid.*, at para. 3.

<sup>26</sup> See *Burke v. The Queen*, 76 D.T.C. 6075 (F.C.T.D.).

wholly applicable to that source or such part of the following amounts as may reasonably be regarded as applicable thereto

[...]

(i) amounts paid by the taxpayer in the year as

[...]

(iv) annual dues to maintain membership in a trade union as defined

(A) by section 3 of the Canada Labour Code, or

(B) in any provincial statute providing for the investigation, conciliation or settlement of industrial disputes,

or to maintain membership in an association of public servants the primary object of which is to promote the improvement of the members' conditions of employment or work,

(v) annual dues that were, pursuant to the provisions of a collective agreement, retained by the taxpayer's employer from the taxpayer's remuneration and paid to a trade union or association designated in subparagraph 8(1)(i)(iv) of which the taxpayer was not a member,

[...]

(5) Notwithstanding subparagraphs 8(1)(i)(i), 8(1)(i)(iv), 8(1)(i)(vi) and 8(1)(i)(vii), dues are not deductible under those subparagraphs in computing a taxpayer's income from an office or employment to the extent that they are, in effect, levied

(a) for or under a superannuation fund or plan;

(b) for or under a fund or plan for annuities, insurance (other than professional or malpractice liability insurance that is necessary to maintain a professional status recognized by statute) or similar benefits; or

(c) for any other purpose not directly related to the ordinary operating expenses of the committee or similar body, association, board or trade union, as the case may be.

In order to be considered a "trade union" within the meaning of clause 8(1)(i)(iv), an organization must satisfy the definition of "trade union" in section 3 of the *Canada Labour Code*<sup>27</sup> (CLC) or the definition in any provincial labour relations legislation. Section 3 of the

---

<sup>27</sup> *Canada Labour Code*, R.S. 1985, c. L-2.

*CLC* defines “trade union” as “any organization of employees, or any branch or local thereof, the purposes of which include the regulation of relations between employers and employees.”<sup>28</sup> Substantially similar definitions of “union” and/or “trade union” can be found in the various provincial *Acts* addressing labour relations.<sup>29</sup>

With regard to the requirement that the dues paid to the union be “annual dues,” Canadian courts have analyzed the meaning of “annual dues” on a number of occasions. The basic findings can be relatively quickly surveyed. In *Burke v. The Queen*,<sup>30</sup> a taxpayer paid dues to his union and attempted to deduct the amount of the dues paid. The Minister disallowed the taxpayer’s deduction on the basis that the union dues were not paid to cover the operating expenses of the union, but rather to finance Old Age and Mortuary Benefits which were to be provided to the taxpayer pursuant to the union’s constitution. The court held that although the dues passed the test of being “annual” in the sense that they would be “recurring” or “yearly” as opposed to a once-and-for-all initiation-type fee, the payments were not deductible to the extent they were levied in order to finance the Old Age and Mortuary Benefits, any deduction for which is expressly precluded by paragraph 8(5)(b) of the *ITA*.<sup>31</sup>

In *Lucas v. M.N.R.*,<sup>32</sup> a teachers’ union had increased its annual dues from \$267 per year to \$867 per year (i.e. by \$50 per month) to help defray the elevated costs associated with some of the union’s membership being out of work due to an extended labour dispute. At trial, Goetz

---

<sup>28</sup> *Ibid.*

<sup>29</sup> For example, Subsection 1(1) of the Ontario *Labour Relations Act, 1995*, 1995, c. 1, Sch. A, defines “trade union” as “an organization of employees formed for purposes that include the regulation of relations between employees and employers and includes a provincial, national, or international trade union, a certified council of trade unions and a designated or certified employee bargaining agency.” Similarly, paragraph 1(x) of Alberta’s *Labour Relations Code*, R.S.A. 2000, c. L-1, defines “trade union” as “an organization of employees that has a written constitution, rules or bylaws and has as one of its objects the regulation of relations between employers and employees.”

<sup>30</sup> 76 D.T.C. 6075 (F.C.T.D.)

<sup>31</sup> *Ibid.* at 6082.

<sup>32</sup> 84 D.T.C. 1628 (T.C.C.).

T.C.J. at the Tax Court of Canada held that the increase in the union’s “annual dues” in order to finance strike pay of other members was not deductible, since it essentially amounted to a special levy to support the strike, and was therefore not going to be “recurring” or “yearly” in the sense suggested by the use of word “annual” in the term “annual dues.”<sup>33</sup> Lucas appealed to the Federal Court—Trial Division.<sup>34</sup> The appeal was allowed by Cullen J., who held that the use of the term “annual” did not necessarily require an amount to be “recurring” or “yearly,” but also referred to dues paid during a particular taxation year.<sup>35</sup>

The more recent case of *Hummel v. Canada*<sup>36</sup> also addressed the proper understanding of the term “annual dues.” *Hummel* involved a number of principals and vice-principals who were members of the Ontario Secondary Schools Teachers Federation (OSSTF), but were required to report to work during normal school hours regardless of any strike action taken by other teachers in the bargaining unit. In order to have principals and vice-principals participate in the economic hardship associated with the strike, the OSSTF required them to remit 0.1 per cent of their gross annual salary to the union for each day of the strike. For the 1990 taxation year, the taxpayer attempted to deduct the amount so paid, a total of \$2,255.70, as annual dues. The court denied the taxpayer’s deduction, in part, on the basis that the payment was actually a strike fund levy and therefore not within the meaning of the term “annual dues.”<sup>37</sup>

Moving on to the second stage of the analysis, issues surrounding the tax treatment of a union’s investment activities, unions are generally considered to be exempt organizations under paragraph 149(1)(k) of the *ITA*:

---

<sup>33</sup> *Ibid.* at 1633.

<sup>34</sup> 87 D.T.C. 5277 (F.C.T.D.).

<sup>35</sup> *Ibid.* at 5279.

<sup>36</sup> [1996] T.C.J. No. 1762 (Q.L.).

<sup>37</sup> *Ibid.* at para. 10.

149. (1) No tax is payable under this Part on the taxable income of a person for a period when that person was  
[...]  
(k) a labour organization or society or a benevolent or fraternal benefit society or order

Ostensibly similar in motivation to the general deductibility of union dues on the part of officers and employees, paragraph 149(1)(k) provides that amounts received by a union *qua* labour organization will not be taxable. The CRA has held that labour organizations do not have to file for status or register in any particular way in order to be exempt under paragraph 149(1)(k), that is, the provision is self-assessing, though the agency has also stated in a Technical Interpretation issued on September 10, 2001, that whether a particular entity constitutes a labour organization in any given year is a question of fact that needs to be determined from year to year based on entity's activities.<sup>38</sup> Relevant though not dispositive in the view of the CRA is the list of organizations contained in the Directory of Labour Organizations maintained by Human Resources Development Canada (HRDC).<sup>39</sup> Ultimately, the distinction between the paragraph 8(1)(iv) test and the 149(1)(k) test is unlikely to be material. In practice, if a labour organization satisfies the paragraph 8(1)(iv) hurdle, then by self-assessment it is likely it will also pass the test contemplated in paragraph 149(1)(k).

If this second stage were as far as the advantages went, the relevant provisions would already provide two important tax preferences to unions and unionized workers. First, the deductibility of contributions subsequently used to fund strike pay (and any investment income earned on these funds by the union) constitutes a benefit in itself in the form of a deferral of

---

<sup>38</sup> Canada Revenue Agency, "2001-009077: Technical Interpretation Request: Labour Unions", issued September 10, 2001.

<sup>39</sup> See Human Resources Development Canada, "Directory of Labour Organizations" (accessed May 12, 2005) [http://www110.hrdc-drhc.gc.ca/millieudetravail\\_workplace/ot\\_lo/index.cfm/doc/english](http://www110.hrdc-drhc.gc.ca/millieudetravail_workplace/ot_lo/index.cfm/doc/english). The NHLPA is listed as a labour organization by HRDC.

income tax liability. Second, the free pooling and redistribution of such contributions within the strike fund of the union provides a ready-made facility to split income among union members. However, the tax advantages extend also to the third level of analysis—the treatment of strike pay.

On May 5, 1989, in a judgment that would ultimately be overturned by the Supreme Court of Canada, the Federal Court of Appeal in *Fries*<sup>40</sup> held that \$880.80 received by Wally Fries in strike pay from the Saskatchewan Government Employees' Union was taxable “income from a source” under paragraph 3(a) of the *ITA*, and therefore should have been reported as income by Fries. Fries applied for leave to appeal to the Supreme Court of Canada. Leave was granted, and the appeal heard on November 1, 1990. The Supreme Court of Canada unanimously allowed Fries's appeal, reversing the judgment of the Federal Court of Appeal. Sopinka J. rendered the Court's reasons from the bench:

We are not satisfied that the payments by way of strike pay in this case come within the definition of “income ... from a source” within the meaning of s. 3 of the Income Tax Act, S.C. 1970-71-72, c. 63. In these circumstances the benefit of the doubt must go to the taxpayers. The appeal is therefore allowed and the decision of the Tax Review Board is restored. The appellant is to have his costs throughout.<sup>41</sup>

The judgment of the Supreme Court of Canada in the case has been criticized for its brevity and the reluctance of the Court to analyze the proper approach to construing paragraph 3(a) of the *ITA*. For one, Vern Krishna remarks that, “the Supreme Court bypassed the fundamental issue: should section 3 be read expansively on a global, or narrowly on a scheduler, basis.”<sup>42</sup> Similarly, Peter Hogg, Joanne Magee, and Jinyan Li state, “In a surprisingly brief judgment on an issue of

---

<sup>40</sup> *Fries* (FCA), *supra*, note 5.

<sup>41</sup> *Fries* (SCC), *ibid.*

<sup>42</sup> Vern Krishna, *The Fundamentals of Canadian Income Tax*, 8<sup>th</sup> ed. (Thomson Carswell, 2004)

fundamental importance, the Court did not analyze whether strike pay had the character of income and the fact that a union had an obligation to make payments to its members on strike.”<sup>43</sup>

In our view, it is indeed unfortunate that the Court did not provide a detailed analysis of the reference to “income from a source” in paragraph 3(a) of the *ITA*. Not only did the Court bypass an opportunity to engage with the appropriate interpretation of section 3, it also failed to engage meaningfully the analysis of the Federal Court of Appeal, whereby the taxpayer’s argument that the \$880.80 payment was merely a return of income was disallowed on the basis that the funds were held in a common fund, a ruling which highlights the income-splitting possibilities that exempting strike pay facilitates. In addition, the relevance (if any) of the some more straightforward objections to the characterization of strike pay as not income from a source on the basis that contributions in the form of union dues had already benefited from deductibility and that investment returns had been exempted from income would have been welcome. Indeed, by not providing substantial reasons, the Court appears to have ignored the cautionary words of importance placed on the case by Urie J. at the Federal Court of Appeal, who wrote:

The parties hereto have agreed that, despite the small amount involved, this appeal is an important one since it is a test case for a substantial number of other potential appellants whose appeals from assessments of income tax arising from largely similar facts, depend on the outcome of the appeal.<sup>44</sup>

As discussed above, an estimate of the prospective net present value of the tax expenditures associated with strike pay is \$327 million, which suggests that Urie J. was quite right to consider *Fries* an important test case. The decision is all the more lamentable given its cursory analysis and problematic return to bygone methods of statutory interpretation. According to Professor David Duff:

---

<sup>43</sup> Peter Hogg, Joanne Magee, and Jinyan Li, *Principles of Canadian Income Tax Law*, 4<sup>th</sup> ed. (Carswell, 2002) at 86.

<sup>44</sup> *Fries* (FCA), *supra* note 5 at para. 1.

While statutory interpretation cannot proceed without background norms and assumptions, these norms and assumptions should reflect the values of the society of which they are a part, not those of a bygone era. For this reason, a residual presumption in favour of the taxpayer, a lingering legacy of strict construction, is perhaps less convincing than a residual presumption in favour of political accountability and democratic decision making. [...] In *Fries v. The Queen*, [...] where the taxpayer argued successfully that strike pay was not income from an unspecified source within the meaning of paragraph 3(a) of the Act, such a presumption would have favoured the Crown, requiring labour unions and their members to justify a special exemption for strike pay notwithstanding that union dues are deductible in computing a taxpayer's employment income and the investment income that accumulates in a union's strike fund is tax-exempt.<sup>45</sup> [Citations omitted.]

Thus, the decision also represents in some sense a repudiation of the so-called modern approach to the interpretation of the *ITA*, explicitly adopted in the judgment of the Supreme Court of Canada in *Stuart Investments Ltd. v. The Queen*,<sup>46</sup> in favour of a strict approach whereby failure to enumerate a source of income within the *ITA* leads to essentially default judgment in favour of the taxpayer.

Whatever its limitations in terms of the apparent depth of analysis, rigour of expression, and suspect statutory interpretation, the judgment of the Supreme Court of Canada in *Fries*, it should be noted, did not actually change established administrative practice. Prior to the judgment in *Fries*, the administrative position of Revenue Canada, as set out in Interpretation Bulletin IT-334R dated July 30, 1982, had been to not consider strike pay to be income to recipients (unless it had been received from the union *qua* contractual remuneration for services rather than strike pay *per se*).

#### Payments Received by Union Members

3. Financial assistance paid by a union to its members during the course of a strike is not necessarily income of the member for the purposes of the Act. Such amounts, when received by a member, will be taxable if they are received as a

---

<sup>45</sup> David G. Duff, "Interpreting the Income Tax Act—Part 2: Toward a Pragmatic Approach" (1999) 47(4) *Canadian Tax Journal* 741 at 784.

<sup>46</sup> [1984] 1 S.C.R. 536.

consequence of the member being an employee of the union. Where union members receive funds that originated, or will originate, from the operation of a business by the union, the amounts will be treated as income subject to tax regardless of whether or not the receiving members participated in the business activity. Similarly, any amounts are taxable which are received by a taxpayer who is employed by or a consultant to a union, either permanently or as a member of a temporary committee, or who has withdrawn his services from his employer and has agreed to provide services, pursuant to an employment contract, to the union.<sup>47</sup>

It bears noting that interpretation bulletins are not—and do not purport to be—dispositive with regard to legal issues. Interpretation bulletins rather attempt to outline the CRA’s interpretation of the law, which is not binding, of course, on the courts. Interpretation bulletins are not even binding on the Minister.

On February 21, 1991, Interpretation Bulletin IT-334R was revised and reissued as IT-334R2 in the wake of the Supreme Court’s decision in *Fries*, with little change to administrative practice:

Union Members Assistance

12. A member of a union who is on strike or locked out need not include in income payments of the type commonly referred to as “strike pay” that are received from his or her union, even if the member performs picketing duties as a requirement of membership. In the decision of the Supreme Court of Canada in *Wally Fries v. The Queen*, (1990) 2 CTC 439, 90 DTC 6662, payments by way of strike pay were held not to be “income from a source”. On the other hand, payments made by a union to its members for services performed during the course of a strike are included in income if the member is employed by or is a consultant to the union whether permanently, as a member of a temporary committee or in some other capacity. Regular salary, wages and benefits received by employees of unions are subject to tax in the usual manner.

IT-334R2 is still current insofar as the CRA is concerned, and is now correct as a legal matter, pending something further from Parliament or from the Supreme Court of Canada to disturb the judgment of the Court in *Fries*.

---

<sup>47</sup> As quoted by the Federal Court of Appeal’s judgment in *Fries*, supra note 5.

## ***B. United States***

The *IRC* allows for the deductibility of union dues as a miscellaneous itemized deduction pursuant to § 67.<sup>48</sup> However, to take the deduction taxpayers have to itemize their deductions instead of taking the standard deduction, and ordinarily only miscellaneous deductions cumulatively exceeding 2 per cent of adjusted gross income may be taken, although there are some types of miscellaneous deductions that are not subject to the 2 per cent rule. Thus, for many taxpayers who pay union dues but take the standard deduction instead of itemizing their deductions, then, there is no explicit allowance made for the deductibility of union dues. This is an important caveat in the deductibility of union dues in the U.S. since a significant proportion, perhaps a majority, of unionized workers make only the standard deduction.

Labour organizations are considered to be tax exempt by virtue of § 501(c)(5) of the *IRC*.<sup>49</sup> According to the IRS, to be a labour organization for the purposes of § 501(c)(5), a particular entity has to be: (i) an association of workers; (ii) who have combined to protect or promote the interests of the members; (iii) by bargaining collectively with their employers; (iv) to secure better working conditions, wages, and similar benefits. A special purpose labour organization not controlled by private individuals<sup>50</sup> and created with the purpose of operating a strike or lockout fund has been held by the IRS in Revenue Ruling 67-7, 1967-1 C.B. 137 to satisfy the four-prongs of this test, since strike pay provided directly to members furthers a “union’s primary purpose of representing its members in matters of wages, hours of labor,

---

<sup>48</sup> 26 *United States Code Service* § 67.

<sup>49</sup> 26 *United States Code Service* § 501(c)(5). For an extended treatment of the § 501(c)(5), see John Francis Reilly, Carter C. Hull, and Barbara A. Braig Allen, *IRC 501(c)(5) Organizations: Exempt Organizations-Technical Instruction Program-for FY 2003*, accessed June 15, 2005, available online at: <http://www.irs.gov/pub/irs-tege/eotopicj03.pdf>.

<sup>50</sup> For details, see Revenue Ruling 76-420, 1976-2 C.B. 153.

working conditions, and economic benefits.”<sup>51</sup> Although any income accruing to labour organization is generally considered tax exempt, § 501(c)(5) entities must still report and remit taxes on “unrelated business income” to the IRS. In keeping with a § 501(c)(5) entity’s tax exempt status, investment income generated by the labour organization and used to support its ends is generally non-taxable.

The definition of gross income in § 61(a) of the *IRC* states that “Except as otherwise provided in this subtitle, gross income means all income from whatever source derived...”<sup>52</sup> The provision then lists examples of specific amounts included in gross income, refers to §§ 71 and following as provisions detailing specific inclusions, and refers to §§ 101 and following as provisions detailing specific exclusions. Strike pay is not explicitly mentioned anywhere in the *IRC*. However, the broad interpretation given to the phrase “gross income means all income from whatever source derived” by the U.S. Supreme Court in cases like *Glenshaw Glass*,<sup>53</sup> has been picked up by lower courts to include strike and lockout benefits. The primary taxpayer argument in the reported American case law on strike pay tends to be that the strike pay was gratuitous, a gift,<sup>54</sup> and should be excluded from gross income, therefore, on the basis of § 102(1) of the *IRC*,<sup>55</sup> the provision which expressly excludes gifts and inheritances from gross income. Since the issue of whether a particular transfer of property is a question of fact and turns on whether the transferor was motivated to act out of “detached and disinterested generosity,” it is

---

<sup>51</sup> Reilly *et al.*, *supra* note 49 at 24.

<sup>52</sup> *IRC*, *supra* note 8.

<sup>53</sup> *Supra* note **Error! Bookmark not defined.**

<sup>54</sup> The U.S. Supreme Court addressed the definition of gift in *Commissioner v. Duberstein*, 363 U.S. 276 (1960).

<sup>55</sup> 26 *United States Code Service* § 102.

perhaps not surprising that some courts have characterized strike pay as gifts in certain circumstances.<sup>56</sup>

However, it is more commonly concluded that strike pay is not a gift, and is taxable as gross income.<sup>57</sup> The Tax Court enunciated six relevant factors in the 1975 case of *Colwell v. Commissioner*<sup>58</sup> for determining whether strike pay would be considered a gift. These factors include (i) whether there was a moral or legal obligation to make the payments; (ii) whether the payments were made upon a consideration of the recipient's financial need; (iii) whether the benefits would continue during the strike if the recipient worked elsewhere; (iv) whether the recipient was a member of the striking union; (v) whether the payments required the recipient to perform any strike duties such as picketing, or to what extent the recipient was under a moral obligation to picket; and (vi) whether there were any restrictions, such as whether the benefits were restricted to basic necessities, or whether the recipient had unfettered control over use of the funds.<sup>59</sup>

### ***C. United Kingdom***

In the U.K., annual subscription fees to trade unions are deductible from employment income under s. 344 of the *Income Tax (Earnings and Pensions) Act, 2003 (ITEPA)*.<sup>60</sup>

---

<sup>56</sup> The most prominent of the cases holding that strike pay amounted to a gift was rendered by the U.S. Supreme Court in *United States v. Kaiser*, 363 U.S. 299 (1960). It should be noted that the Court in *Kaiser* was constrained by the jury's finding at trial that the assistance was rendered to a class of persons in the community in economic need and that the strike pay was motivated primarily by generosity or charity. Another case which decided that strike pay was a gift under the test articulated in *Duberstein* was the decision of the North Carolina Supreme Court in *Stone v. Lynch*, 312 N.C. 739, 325 S.E.2d 230 (1985) (concluding that the strike pay in that case was properly considered a gift for the purposes of North Carolina income taxation).

<sup>57</sup> See, for example, *Osborne v. Commissioner*, T.C. Memo 1995-71 (U.S.T.C. 1995).

<sup>58</sup> 64 T.C. 584 (1975).

<sup>59</sup> As described in *Osbourne*, *supra* note 57 at 23-24.

<sup>60</sup> See HM Revenue & Customs, "EIM32900 - Other expenses: professional fees and subscriptions: annual subscriptions to approved bodies" accessed June 16, 2005, available online at: <http://www.hmrc.gov.uk/manuals/eimanual/EIM32900.htm>.

#### 344. Deduction for annual subscriptions

(1) A deduction from earnings from an employment is allowed for an amount paid in respect of an annual subscription if-

(a) it is paid to a body of persons approved under this section, and

(b) the activities of the body which are directed to one or more of the objects within subsection (2) are of direct benefit to, or concern the profession practised in, the performance of the duties of the employment.

(2) The objects are-

(a) the advancement or dissemination of knowledge (whether generally or among persons belonging to the same or similar professions or occupying the same or similar positions),

(b) the maintenance or improvement of standards of conduct and competence among the members of a profession,

(c) the provision of indemnity or protection to members of a profession against claims in respect of liabilities incurred by them in the exercise of their profession.

A current list of approved organizations is maintained by Inland Revenue and available for public perusal on the Internet.<sup>61</sup>

Trade unions and employees' associations have historically been explicitly exempt from income taxation by, *inter alia*, s. 467 of the *Income and Corporation Taxes Act, 1988 (ICTA)*. However, trade unions are generally considered to be companies for the purposes of the corporate tax.<sup>62</sup> Under certain conditions, registered trade unions can claim relief from corporate tax in respect of certain non-trading income and chargeable gains used to make provident benefits available to members.<sup>63</sup> Registered trade unions are listed pursuant to the *Trade Union*

---

<sup>61</sup> The list is available for download from HM Revenue & Customs at <http://www.hmrc.gov.uk/list3/list3.pdf>.

<sup>62</sup> HM Revenue & Customs, "CT4710—Trade Unions" accessed June 16, 2005, available online at: <http://www.hmrc.gov.uk/manuals/ct123manual/ct4710.htm>

<sup>63</sup> HM Revenue & Customs, "CT4711—Trade unions: provident benefits - title to and extent of relief" accessed June 16, 2005, available online at: <http://www.hmrc.gov.uk/manuals/ct123manual/ct4711.htm>.

*and Labour Relations Consolidation Act 1992* or the *Industrial Relations (Northern Ireland) Order 1992*.<sup>64</sup> In practice, most trade unions are registered under one of these acts.

Strike pay is not subject to tax in the U.K. According to HM Revenue & Customs, s. 19(1) of *ICTA* did not extend to include strike pay in income. “Some Trade Unions make payments to members who are on strike. Such payments are not emoluments from the employment and are not taxable.”<sup>65</sup> The *ICTA* has since been superseded by *ITEPA*, though with no substantive changes to the law regarding the taxation of strike pay.

#### ***D. Australia***

The Australian approach to the deductibility of union dues and the taxation of strike pay has been recently addressed in two taxation rulings issued on April 24, 2002 by the Australian Taxation Office (ATO). The first of these rulings, TR 2002/7, deals with the deductibility of payments by union members to strike funds.<sup>66</sup> The second, TR 2002/8, addresses whether payments received by workers during a labour dispute from strike funds are assessable to tax.<sup>67</sup> With regard to the deductibility of contributions to strike funds, in TR 2002/7 the ATO has drawn a distinction between ordinary union membership fees, which are generally deductible, and special strike fund levies, which are not deductible since, in the opinion expressed by the ATO, such expenditures are not incurred in order to gain or produce assessable income. The ATO states, “A payment of a levy to a strike fund will only be incurred in gaining or producing the contributor’s assessable income where the strike fund is used to maintain or improve the

---

<sup>64</sup> See *CT4710*, *supra* note 62.

<sup>65</sup> HM Revenue & Customs, “SE06500 - Emoluments of employees and office holders: strike pay from Trade Unions” accessed June 16, 2005, available online at <http://www.hmrc.gov.uk/manuals/senew/SE06500.htm>.

<sup>66</sup> Commissioner of Taxation, Australian Tax Office, Taxation Ruling 2002/7, April 24, 2002.

<sup>67</sup> Commissioner of Taxation, Australian Tax Office, Taxation Ruling 2002/8, April 24, 2002.

contributor's pay.”<sup>68</sup> This seems a dubious justification of the denial of deductibility of contributions to strike funds, however, since the reason unions maintain such funds is to provide support to union members during labour disputes and hence increase the union's bargaining power and thereby improve the terms—including salaries and wages—under which union members are employed. But the ATO maintains in a footnote in TR 2002/7 that contributions to strike funds are not deductible on the basis that, “We have been advised by a leading trade union that strike funds are not established for [the] purpose [of maintaining or improving the contributor's pay].”<sup>69</sup>

Trade unions located in Australia that operate principally in Australia are considered to be tax-exempt organizations in Australia. However, the tax exemption does not apply to investment income earned by an otherwise tax-exempt trade union from any superannuation, life insurance, or accident and disability insurance business it carries on.<sup>70</sup>

One potential explanation for the strained reasoning in TR 2002/7 regarding the denial of the deductibility of contributions to strike funds is provided in TR 2002/8. The ATO takes the position that payments from strike funds to union members during labour disputes are not assessable income, which is consistent with no deduction being allowed for contributions to the fund. Without referencing the non-deductibility of the contributions, however, the ATO purports to base its position on its asserted understanding that the usual practice is for union members who suffering from financial hardship during labour disputes to receive one-off voluntary payments from the union. That is, because union members have no right or entitlement to the

---

<sup>68</sup> TR 2002/7, *supra* note 66 at para. 8.

<sup>69</sup> *Ibid.* at note 2.

<sup>70</sup> Australian Taxation Office, “Is your organisation exempt from income tax?- Income tax guide for non-profit organizations”, accessed June 12, 2005, available online at: [http://www.ato.gov.au/nonprofit/content.asp?doc=/Content/34269.htm&page=1#P338\\_26742](http://www.ato.gov.au/nonprofit/content.asp?doc=/Content/34269.htm&page=1#P338_26742)

payment, and because it is made on the basis of financial hardship, it does not satisfy the ordinary tests regarding what constitutes income. In the ATO's opinion, striking or locked-out union members will generally have "no expectation of receiving regular, fixed payments from the strike fund."<sup>71</sup> However, if for some reason a member does have "an expectation of receiving regular, fixed payments from the strike fund, and is accordingly able to rely on the payments for his or her regular expenditure, the payments will be assessable income."<sup>72</sup>

With respect, the ATO seems to have reached a defensible policy, although for ill-articulated—even incoherent and palpably falsifiable—reasons. The position is defensible for policy purposes because deductions for contributions to a strike fund are not allowed, meaning strike funds will be composed of after-tax dollars, and when money is paid out from a strike fund it will not be assessable, which is consistent with the idea that the fund is composed of after-tax dollars.

To summarize, Canada has probably the most tax-payer friendly approach, with tax advantages at all three levels of analysis, leading to a simple pass-through tax avoidance vehicle. The U.S. has the most aggressive approach, with contributions to unions not being deductible by taxpayers who do not itemize their deductions (although one might argue such taxpayers do not itemize because it is more advantageous to them to take the standard deduction), and with strike pay being typically considered to be includible in gross income. The U.K. and Australia adopt intermediate positions. The U.K. allows deductions for contributions to certain listed entities, taxes but provides some relief for investment income earned by trade unions, and does not include strike pay in income. Australia does not allow a deduction for targeted contributions to strike funds, but does allow annual dues to be deducted from income, and does not generally tax

---

<sup>71</sup> TR 2002/8, *supra* note 67 at para. 6.

strike pay, although by the reasoning articulated by the Australian Taxation Office, would probably consider payments such as the stipends issued by the NHLPA to be income. Thus, among the four countries examined, it is Canada alone which exhibits this troublesome multiple non-taxation problem with regard to strike pay. Part IV examines the likely consequences of this multiple non-taxation.

#### **IV. Efficiency, Equity, and Social Welfare Considerations**

The economic approach to studying labour markets begins and ends with an analysis of the demand and supply of labour.<sup>73</sup> A neoclassical economic perspective suggests that equilibrium wage and employment outcomes are derived from the simultaneous optimizing behavior of demanders (employers) and suppliers (employees) of labour, within given legal, economic and social contexts.<sup>74</sup> Moving from the more abstract neoclassical view to a more realistic approach, there are competing visions of how labour markets actually function, with a range of bells and whistles such as information asymmetries, segmented markets, institutional features such as discrimination, and irrational behavior often being added to the neoclassical approach. Despite the complexity of these models, our goals are relatively modest. Our first goal is to identify what economic effects might conceivably arise from the non-taxability of strike pay. Our second objective is to consider the strength of the theoretical or empirical reasons for supporting or rejecting Canada's tax policy on account of these likely effects.

---

<sup>72</sup> *Ibid.* at para. 7.

<sup>73</sup> Ronald G. Ehrenberg and Robert S. Smith, *Modern Labour Economics*, 6<sup>th</sup> ed. (New York: Addison-Wesley, 1997), at 36.

<sup>74</sup> Other views emphasize differing aspects. For instance, segmented labour market theory, while still relying on the analytical tools of the standard neoclassical approach, deals with the fact that the labour market is composed of both competing and non-competing groups, with various social and institutional factors precluding competition over wages (see Dwayne Benjamin *et al*, *Labour Market Economics*, 4<sup>th</sup> ed. (Toronto: McGraw-Hill Ryerson, 1998) at 9.)

It is reasonably clear that non-taxation of strike pay is advantageous for organized labour and will have at least some marginal labour market effects. The precise magnitude and nature of the effects and the associated social welfare consequences, however, are open to debate. There are several relatively evident immediate effects of the non-taxability of strike pay. The cost to the union of providing a particular level of support to striking workers will decrease, implying that policies which either increase payouts or maintain payouts for longer periods will be possible. The ultimate effect of this, assuming that unions choose to pursue one of the above policies, is not only to decrease the costs of maintaining a strike to the union *qua* organization, but also to decrease the costs of a labour dispute to union members. On the front end, because the exemption decreases the funds needed to provide a given level of support to union members, unions have the option of collecting dues at a lower rate, or, for a given level of dues collected, will see the value of their financial assets increase (since use of those assets during a strike is not taxed) and be able to maintain strike benefits for a longer period of time. The ultimate effect of what is essentially a tax subsidy to organized labour ought to be a relative increase in their bargaining power vis-à-vis management, and an augmented ability to meet their bargaining objectives. In this context, then, the central questions are how the non-taxation of strike pay will alter strike incidence and duration and whether the policy is likely to have any broader social welfare implications (such as adverse affects on efficiency in production, dynamic effects with respect to economic growth, or affecting the distribution of income or wealth).

## ***A. Unions and Strikes***

The primary objective of unions is generally identified as the promotion of the welfare of union members, in both a pecuniary and non-pecuniary sense.<sup>75</sup> This involves pursuing redistribution of gains from a business venture away from other stakeholders, such as management and shareholders, in favour of union members (although arguably these relationships can be quite complex).<sup>76</sup> A non-exhaustive list of objectives pursued by unions includes maximizing wages, maintaining or increasing employment rates, pursuing employment security, benefit programs, and securing better working conditions.<sup>77</sup> Unions generally advance these interests by negotiating and operating under labour-management agreements, and by limiting the supply of labour. The limitation of the supply of labour, traditionally practiced by craft unions and professional associations, is of limited concern in the present context. On the other hand, negotiation of collective agreements—and particularly the role of strikes in the negotiation process—is central.

---

<sup>75</sup> Dwayne Benjamin *et al*, *Labour Market Economics*, 4<sup>th</sup> ed. (Toronto: McGraw-Hill Ryerson, 1998) at 487. Other secondary objectives have also been identified, most notably relating to the contention that unions have historically driven improvements in wages and working conditions for workers throughout the economy (that is, outside of their specific membership base).

<sup>76</sup> For instance, it is not entirely uncontroversial that shareholder wealth is necessarily depressed by union presence. Although Addison and Hirsch, and separately Peter Kuhn, summarize the literature as generally demonstrating a negative union effect on firm profits, at least one Canadian study by Martinello, Hanrahan, Kushner and Masse suggests no such effect. Most of the other studies are of the US labour market, suggesting the Canadian experience may be different. See Peter Kuhn, “Unions and the economy: what we know, what we should know” (1998) 31 *Canadian Journal of Economics* 1032 at 1039; J. Addison and B. Hirsch, “Union effects on productivity, profits and growth: has the long run arrived?” (1989) 7 *Journal of Labour Economics* 72 at 83-95.; F. Martinello *et al*. “Union certification in Ontario: Its effect on the value of the firm” (1995) 28 *CJE* 1077-95; see also Dwayne Benjamin *et al*, *Labour Market Economics*, 4th ed. (Toronto: McGraw-Hill Ryerson, 1998) at 497 for summary of Martinello’s study.

<sup>77</sup> See *supra* note 75 at 312.

Strikes are commonly defined as “a temporary stoppage of work by a group of employees in order to express a grievance or enforce a demand.”<sup>78</sup> While there is no consensus theory providing a complete functional explanation of why strikes occur, it is generally accepted that “regardless of whether a strike is ultimately effective, its viability is essential to union bargaining leverage.”<sup>79</sup> Generally, “unions are able to win management concessions at the bargaining table because of the unions’ ability to impose costs on management.”<sup>80</sup> The ultimate cost is a complete shutdown in production, and while strike action is relatively infrequent, “the *threat* of a strike hangs over virtually every bargaining situation.”<sup>81</sup> Consequently, the ability to orchestrate strike action, or to threaten strikes credibly, is fundamental to determining the bargaining power of labour unions. Lockouts, representing a work stoppage initiated not by labour but by management, illustrate the importance of relative bargaining power. Generally, management will use the lockout option if it feels the costs of the lockout (if any) are less than the discounted present value of any concessions it may obtain at the bargaining table. In the context of the current NHL lockout, the claims by the league that its teams have been losing money and that therefore the lockout is actually financially advantageous for the team owners have been supported by the unwillingness of the league to make concessions or to settle the dispute in a timely fashion. The opportunity costs borne by the players have probably been more significant,

---

<sup>78</sup> John Ignatius Griffin, *Strikes: A Study in Quantitative Economics* (New York: Columbia University Press, 1939) at 20, quoting from F. Peterson, “Methods Used in Strike Statistics” (1937) 197 *Journal of the American Statistical Association* 91.

<sup>79</sup> Marick F. Masters, “Union Wealth: The Bargaining Power Implications” (1997) 28 *Journal of Labour Research* at 101.

<sup>80</sup> *Supra* note 73 at 495.

<sup>81</sup> *Ibid.*

and among most commentators there is a consensus that the players have made more important concessions than the owners.<sup>82</sup>

The theory of strikes, however, is more complicated than these general comments suggest. Bruce E. Kaufman provides a helpful though now somewhat dated overview (1992) of the various strike theories and assessment of the available empirical support, and the following discussion draws liberally from his insights.<sup>83</sup> While there are behavioural and political explanations for strikes, and various macroeconomic considerations, we confine our analysis primary to a more limited subset of economic theories which are most likely to be implicated by a policy that changes the relative economic costs of strike activity, and is decidedly “economic” in nature.

The first rigorous modern treatment of why strikes occur comes from John Hicks.<sup>84</sup> Hicks postulated early that strikes occur as a result of faulty assessments of costs and benefits by both sides—that is, strikes are mistakes. The intuition is relatively simple: if strikes are costly to labour and management (as they generally are), any final agreement is inefficient since both sides would have been better agreeing to the settlement and not incurring the strike costs. In this model, strikes result either from imperfect information, or as Hicks suggested, out of a possible need to use the strike weapon to establish credibility.<sup>85</sup> At settlement, the union’s bargaining position, represented by a downward sloping resistance curve, intersects with management’s

---

<sup>82</sup> For example, Joe Lapointe and Maria Newman, “N.H.L. Commissioner Cancels Rest of Season” *New York Times*, February 16, 2005, in referring to the last-ditch offers leading up to the cancellation of the season, remarked that “The union made the greater concession by agreeing to a salary cap. The league’s major concession was to drop its demand for a fixed compensation formula in which a team’s salaries could not exceed 55 percent of revenue.”

<sup>83</sup> Bruce E. Kaufman, “Research on Strike Models and Outcomes in the 1980s: Accomplishments and Shortcomings” in David Lewin, *et al*, eds., *Research Frontiers in Industrial Relations and Human Resources* (Madison, WI: Industrial Relations Research Associations, 1992) 77.

<sup>84</sup> John R. Hicks, *The Theory of Wages* (London: MacMillan, 1932), and John R. Hicks, *The Theory of Wages*, 2<sup>nd</sup> ed. (New York: St. Martin’s Press, 1966), specifically see 136-157.

upward sloping concession curve—the relative starting positions and slopes of these curves are representative of the bargaining power and initial demands of the two sides. Kaufman notes that “Hicks’s theory has come to dominate economic theorizing on strikes.”<sup>86</sup>

A multitude of other economic models have been suggested, however, to explain strike behavior. Two are closely related to Hicks’ proposition. *Imperfect information models*, as outlined by Mauro<sup>87</sup> and by Kaufman,<sup>88</sup> maintain the general concession and resistance curve architecture from Hicks, but are more explicit in addressing the benefits of strikes, and suggest that each party in the dispute emphasizes different variables, leading to divergent (and erroneous) estimations of the relevant bargaining positions.<sup>89</sup> *Information uncertainty models* place emphasis on the amount of information required to determine relative bargaining positions, and the uncertainty associated with the relevant variables.<sup>90</sup> In *asymmetric information models*, a type of model which departs from Hicks’ analytical framework, unions use strikes as a method to differentiate firms based on their level of profitability. Since all firms would like to signal to unions that they are not highly profitable (in contrast to what may be desirable market signals), unions differentiate between the firms by forcing them to choose between labour concessions and strikes on the theory that firms that are highly profitable are likely to be more willing to make such concessions, both since they are in a better position to finance any union demands, and because their opportunity cost of strike may be higher (although this will not always be the case). Of course, employers may also use this model to determine the flexibility on the part of

---

<sup>85</sup> Other explanations are also possible. Hicks himself suggested that divergence between the unions and union members estimates of possible concessions may drive strikes, while other commentators have suggested

<sup>86</sup> *Supra* note 83 at 82.

<sup>87</sup> Martin J. Mauro, “Strikes as a Result of Imperfect Information” (1982) 35 *Industrial and Labor Relations Review* 522-38.

<sup>88</sup> Bruce E. Kaufman, “Bargaining Theory, Inflation, and Cyclical Strike Activity in Manufacturing” (1981) 34 *Industrial and Labor Relations Review* 333-55.

<sup>89</sup> See *supra* note 83 at 83.

labour to lower wages. The *joint cost model* of strikes, elaborated by in the early 1980s by Kennan,<sup>91</sup> and separately by Neumann and Reder,<sup>92</sup> suggests that the greater the joint costs of a strike, the greater the incentive to compromise to avoid the expenses associated with a work interruption.

The exemption of strike pay from income tax is unlikely to have any effect on the information available to firms or unions. The exemption is transparent, in that both parties are aware of it (or ought to be), and quantifiable, in that the financial burden relieved by the policy can be readily measured, or estimated. This suggests that in a world where strikes are caused by information imperfections, exempting strike pay from taxation is in all likelihood neutral.

Both the asymmetric information model and the joint costs model “predict that strike activity will be reduced when strikes are costly.”<sup>93</sup> In the former, strike cost is relevant because firms and unions will opt to use work interruptions to get desired wage concessions when the costs are low—that is, overcoming the asymmetry of information by strike action is more likely when that action is less costly relative to other mechanisms. The joint cost model expands this analysis, shifting the focus away from asymmetric information. If the cost of a strike is increased only for one of the parties, that party will be forced to offer a bribe, in the form of concessions, if it wants to reduce the likelihood or duration of a strike. For instance, if management strike costs increase, *ceteris paribus*, the employer has greater incentive to avoid a strike, and to make the strike shorter. Not only are the actual costs of a lockout or a strike higher

---

<sup>90</sup> *Ibid.* at 85.

<sup>91</sup> John Kennan, “Pareto Optimality and the Economics of Strike Duration” (1980) 1 *Journal of Labor Research* 77-94. See also John Kennan, “The Economics of Strikes” in Orley Ashenfelter and Richard Layard, eds., *Handbook of Labor Economics*, vol. 2 (New York: Elsevier Science Publishers, 1986).

<sup>92</sup> Melvin W. Reder, and George R. Neumann “Conflict and Contract: The Case of Strikes,” (1980) 88:5 *Journal of Political Economy* 867-86.

<sup>93</sup> Morley Gunderson, Allen Ponak and Daphne G. Taras, *Union-Management Relations in Canada*, 4<sup>th</sup> ed. (Toronto: Addison Wesley Longman, 2001) at 331.

in an absolute sense, but the increase in costs also makes other resolution options (e.g. arbitration or concession) look like a better means of achieving a particular result. In our specific case, the non-taxation of strike pay affects directly the costs of only one party: the union. It lowers union strike costs, suggesting that for the union a strike (or calling management's bluff on a lockout) may be a more viable negotiating tactic. Gunderson *et al.* write that "if a certain factor or variable increases the cost to only one of the parties...incidence and duration are reduced even though the cost of strikes is higher for one party, since the cost to that party is a component of the total cost to both parties."<sup>94</sup> Of course, the converse will also hold.

In one of the few works to consider the issue of strike pay directly, Laszlo Goerke developed a theoretical model indicating that the availability of strike pay will generally increase the incidence of strikes.<sup>95</sup> Consistent with the joint costs analysis above, Goerke argues that any income substitute for employees, provided by unions, will "facilitate labour disputes."<sup>96</sup> An important nuance in his model is that where unions provide no other services except for strike pay, and the union's strike fund is required to break even at the end of the bargaining period, membership fees paid to unions will equal disbursements, implying that strike pay will be relatively neutral.<sup>97</sup> In the case where income taxes specifically allow membership fees as a deduction from taxable income, and union members could receive those funds back tax-free, there would be a significant tax incentive and deferral advantage to implementing and growing a

---

<sup>94</sup> *Supra* note 93 at 331.

<sup>95</sup> Laszlo Groerke, "Strike Pay and Employers' Strike Insurance" (2000) 51:3 *Metroeconomica* 284-303.

<sup>96</sup> *Ibid.* at 298.

<sup>97</sup> See specifically *ibid.* at 296. Although some cost would likely be involved because the income smoothing provided through strike pay is unlikely to perfectly mirror self-insurance elected by the taxpayer.

strike fund. Goerke himself notes in concluding his paper that empirical research is required, but notably lacking.<sup>98</sup>

It would be erroneous therefore to conclude that strikes are necessarily more likely, and that this is the end of the story. There are two primary complications. First, more nuanced versions of the model may open the door to alternative outcomes in terms of strike incidence and duration. Second, the empirical evidence surrounding the joint strike cost model is mixed. To see these issues more clearly, consider a period in which strike pay is taxable, following which the current tax exemption for strike pay is first introduced. Unions might react by increasing their reliance on strikes, since these are now less costly in net terms, and unions may be able to sustain strikes longer. Consequently, the union might be in a position to demand more from management. However, given that the employer is aware of this change in relative bargaining position, the employer might be expected to moderate its demands. In the case where information about concession and resistance curves is imperfect, it is possible that the employer may in a sense over-compensate the union for their newfound bargaining power. This might suggest that a removal of the strike pay exemption would merely redistribute wealth between the two parties—that is, unions would receive a smaller part of the pie—but that the decreased preference for strikes for unions may be compensated for by an increased preference on the part of employers.

Ultimately, therefore, the whole discussion of the joint cost theory must necessarily be couched in uncertain terms on account of the mixed empirical evidence. Reder and Neumann<sup>99</sup> in the study mentioned earlier did find a significant inverse relationship between strike costs and strike duration, but subsequent studies in a similar vein, such as that by Cousineau and

---

<sup>98</sup> *Ibid.* at 299.

Lacroix,<sup>100</sup> were unable to replicate the results. Consistently with Reder and Neumann's findings, Hutchens, Lipsey, and Stern in a series of studies have found a positive correlation between strike activity and the availability of government unemployment insurance programs (which would presumably decrease strike costs).<sup>101</sup> Although it is unclear whether the studies' findings are directly transplantable to the situation where it is the unions themselves providing what amounts to low-level employment insurance benefits, the actual economic effects on unions and union members under both plans are similar, especially when the non-taxation of strike pay is regarded as a *de facto* subsidy. It is of some significance in this regard that under the *ITA* Employment Insurance benefits are taxed as income. Unfortunately, similar attempts to find a comparable relationship by a number of researchers, most notably Maki,<sup>102</sup> Ahmed,<sup>103</sup> and Ingram, Metclaf and Wadsworth,<sup>104</sup> have failed to do so.

The *ex ante* strategic effects of the non-taxability of strike pay are not limited to possible decreased disincentives for unions to initiate strike action and increased union bargaining power. Several other interesting effects may also be present. The fact that unions are more likely to, *ceteris paribus*, favour strike action where the costs of striking decrease, derives from an implicit increase in the value of their financial assets. Strike pay is paid from union assets, and if those assets are large, this suggests a union can more credibly commit to a strike. Effective threats

---

<sup>99</sup> *Supra* note 92.

<sup>100</sup> Jean-Michel Cousineau and Robert Lacroix, "Imperfect Information and Strikes: An Analysis of Canadian Experience, 1967-82" (1986) 39(3) *Industrial and Labor Relations Review* 377.

<sup>101</sup> Hutchens R., Lipsky, D., Stern R. (1989) *Strikers and Subsidies: The Influence of Government Transfer Programs on Strike Activity*, (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 1989); Hutchens R., Lipsky, D., Stern R. (1992) "Unemployment insurance and strikes", *Journal of Labour Research*, 13, pp. 337-354.

<sup>102</sup> Maki, D. R. (1986), "The Effect of the Cost of Strike Activity on the Volume of Strike Activity," *Industrial and Labor Relations Review*, 39(4), 552-63.

<sup>103</sup> Ahmed, Syed M. (1989), "The effects of the Joint Cost of Strikes in Canadian Manufacturing Industries—A Test of the Reder-Neumann-Kennan Theory," *Applied Economics*, 21, 1353-1367.

<sup>104</sup> Ingram, Peter, David Metcalf, and Jonathan Wadsworth (1993), "Strike Incidence in British Manufacturing in the 1980s," *Industrial and Labor Relations Review*, 46(4), 704-17.

require demonstrations or reassertions of credibility from time to time; this might lead to credibility-motivated strikes on the part of unions.<sup>105</sup> The non-taxability of strike pay has an analogous effect to an expansion in a union's financial assets devoted to financing a strike: unions can elicit the same level of credible threat with a smaller amount of financial assets. This creates two possibilities for unions, both favorable. They can either collect less revenues than they otherwise would have from their membership, thereby decreasing the costs to employees of unionization, or they can retain the same revenue stream they would have had absent the tax exemption on the disbursement end and thereby increase their financial holdings, either extending the length of strike and depth of benefits they can provide during a work stoppage, or freeing-up capital to use for other endeavours. It is well-established that large strike funds (relative to expected strike costs) are vital to establishing credibility with employers regarding strike action, and are of course necessary to actually sustain prolonged strike action.<sup>106</sup> This wealth analysis correlates with our earlier discussion which suggested that because of employer responses to policies decreasing strike costs for unions, the ultimate effect on strikes is ambiguous: if employers believe the strike threat to be more credible because the union has greater financial assets, their behaviour may in fact work to avoid such a strike.

One aspect of this discussion that has not been sufficiently highlighted is the general effect of strikes and lockouts on social welfare, and what policy responses may minimize adverse social effects. Specifically, most of the negotiations between unions and management focus on how to split producer surplus. Yet consumer surplus is also clearly affected, especially during a strike and also often as a result of any settlement between unions and employers. Strikes impose

---

<sup>105</sup> *Supra* note 73 at 499; Richard Walton and Robert McKersie, *A Behavioral Theory of Labour Negotiations*, 2<sup>nd</sup> ed. (New York: ILR Press, 1991).

costs on the disputing parties, reducing the amount of producer surplus that can be negotiated over, but they also reduce consumer surplus. Consider for instance the high costs of disputes relating to public transit (the prospect of a transit strike in a metropolitan centre imposes enormous costs of consumers of transit services), but these concerns do not often have a seat at the table, except in the context of back-to-work legislation that forces an end to labour interruptions in situations in which the negative externalities are particularly severe.<sup>107</sup> However, most labour interruptions are not ended by the use of back-to-work legislation. This suggests that the social costs of labour disputes are rarely, if ever, fully internalized by the parties directly involved. Besides legislating a return to work, another possible policy response might be to increase the cost of strikes to both parties by forcing them to internalize the costs imposed on others by the labour interruption, thereby indirectly prodding them to reach settlement earlier. However, the tax treatment of strike pay suggests that it is possible that exactly the opposite is happening. The tax advantages realized by labour organizations are mirrored by tax advantages realized by employers, however, where, for instance, bargaining costs and expenditures on replacement workers are generally deductible as income-earning expenses. In light of the externalities associated with labour interruptions, we suggest that both sets of exemptions perhaps need to be reconsidered, although our focus here is on the union side of the equation. One corollary of the admission that both sides may benefit equally from direct or indirect support for strikes or lockouts is that if advantages to both parties were removed in tandem, it is possible

---

<sup>106</sup> See for instance Marick F. Masters, "Union Wealth: The Bargaining Power Implications" (1997) 28 *Journal of Labour Research* 91-109 at 92.

<sup>107</sup> According to the Canadian Library of Parliament, the first Canadian back-to-work legislation was in 1950, with approximately 30 federal actions since that time. ("Federal Back to Work Legislation" 2004, Library of Parliament, available online at <http://www.parl.gc.ca/information/about/process/info/back.asp?lang=E>, accessed June 13, 2005). For one of the few works dealing with Canadian back-to-work legislation specifically, see Adam Robert and William Price, *Back-to-work Legislation: An analysis of the federal and Ontario governments' increased propensity to end strikes by ad hoc laws, 1950-78* (Ottawa: National Library of Canada, 1981).

that some of the concerns regarding relative bargaining power would be vitiated. Increasing the costs of work stoppages should, in principle, provide greater incentives to reach a negotiated settlement.

### ***B. The Power of and Demand for Unions***

Another possible effect of the deductibility of union dues, the non-taxation of labour organizations, and the non-taxability of strike pay more generally is to augment the demand for unions. Although traditionally labour markets are seen as a demand and supply relation between employees and employers, similar considerations play out between workers (i.e. either potential or actual union members) and unions. The costs of unionizing will be evaluated in relation to the benefits a union is likely to provide. The deductibility of union dues decreases the costs of belonging to a union. Similarly, the general non-taxation of union investment activities and, moreover, the exemption of strike pay suggests that the private benefits from union membership will be higher, *ceteris paribus*. This implicates another aspect for analysis: ought we to care that the strike pay exemption is likely to redistribute income towards union members, and that the demand for unions might increase? Whether a tax policy that increas Tw[(t activities)4.6( )]TJ=19.695

might say typically, two-handed on the question.<sup>108</sup> Whatever the broader effects of increasing union power may be, certainly the degree to which the relevant tax policies will drive them is most likely small. The effects are not only indirect, but it is probably also a stretch to suggest that the non-taxation of strike pay is apt to generate a significant increase in the demand for unionization, or dramatically increase the bargaining power of labour organizations.

Some of the concerns regarding expanding the appeal and effectiveness of unions include potential negative effects on shareholder value, employment levels, non-union wages, and total factor productivity. Peter Kuhn has recently (1998) canvassed the literature regarding the broader impacts of unions on the economy, outlining “what we know.”<sup>109</sup> Kuhn found that on average Canadian workers covered by collective agreements earn 15 percent more than those not covered.<sup>110</sup> Unions compress wage differentials among their members, and are likely to reduce overall wage inequality for men, but not for women (since it is predominantly highly paid women who tend to be unionized in Canada, and their wages are further raised by unions).<sup>111</sup> Unions reduce profits, decreasing shareholder wealth, although this effect generally is pegged at around 3 per cent, and there is no evidence that unions actually drive firms out of business.<sup>112</sup> Kuhn goes on to argue that although standard microeconomic theory suggests unions reduce employment, the theoretical case is in fact ambiguous<sup>113</sup> and there is little empirical evidence to

---

<sup>108</sup> *The Economist* credits the following plea to Harry Truman: “Give me a one-handed economist...all my economists say, ‘on the one hand...on the other.’” See “The one-handed economist” *The Economist* (November 13, 2003).

<sup>109</sup> Peter Kuhn, “Unions and the economy: what we know, what we should know” (1998) 31 *Canadian Journal of Economics* 1032.

<sup>110</sup> *Ibid.* at 1036-8.

<sup>111</sup> *Ibid.* at 1038-9.

<sup>112</sup> *Ibid.* at 1039.

<sup>113</sup> Because unions may negotiate for higher employment levels, not merely higher wages, and because unions can assign variable wages levels to its members, thus becoming a “discriminating monopoly.” See *ibid.* at 1042.

support the standard theories.<sup>114</sup> Further, allocative inefficiencies (caused by the wage wedge) and strikes are, argues Kuhn, unlikely to cost more than a quarter of a percentage point of GDP.<sup>115</sup> The theory is ambiguous regarding union effect on productivity, while “a fair summary of the industry studies is that most estimates are positive, with negative effects largely confined to industries and periods known for their conflictual union-management relations.”<sup>116</sup> As Benjamin, *et al.*, note in their broader (and more recent) review of the literature that “evidence on the average economy-wide impact is inconclusive.”<sup>117</sup> The authors also suggest that effects on profitability are ambiguous, but that generally investment correlates negatively with unionization, a sentiment echoed by Kuhn.

One implication of the uncertainty surrounding the effects of the non-taxation of strike pay is that the complexity of the issue may call for legislative action by elected officials capable, ideally, of a more sensitive analysis regarding the social welfare implications of such a policy. Specific consideration should be given to the general presumption against double-taxation and, equally, the double non-taxation of income, the latter of which the deductibility of union dues, combined with the non-taxability of labour organizations and strike pay violates. Double taxation is seen as undesirable for reasons of efficiency and fairness, and legislative mechanisms, such as the integration of corporate and personal tax through the dividend tax credit, are designed to limit the possibility of double taxation. Similarly, although the strike pay context does not bear this out, there is generally in the *ITA* a presumption against the double (or multiple) non-taxation of income.

---

<sup>114</sup> *Ibid.* at 1040-4.

<sup>115</sup> *Ibid.* at 1044-6.

<sup>116</sup> *Ibid.* at 1048.

<sup>117</sup> Dwayne Benjamin, Morley Gunderson and W. Craig Riddell, *Labour Market Economics*, 5<sup>th</sup> ed. (Toronto: McGraw-Hill Ryerson, 2002) at 495.

Another implication has to do with the fiscal costs of the policy, which while small are not insignificant. We argue that where a policy has undefined economic welfare benefits, is not readily defensible on some clearly identified grounds of social justice, and is likely associated with at least some quantifiable economic losses (such as in the case of investment), this militates in favor of discontinuing the practice. Were the policy revenue-neutral and distributionally neutral in the sense that it did not decrease tax revenues *and* did not redistribute them in a manner not envisaged within the general fairness framework of the *ITA*, then it might be unobjectionable. This is not the case, which suggests that at least on economic grounds the time may have come to reexamine the non-taxation of strike pay in Canada. To our general surprise, however, the Canadian experience is not unique, at least to the extent that the tax systems in most developed countries offer tax advantages (albeit of varying generosity). Despite significant rhetoric on both sides of the union debate, both theory and evidence on the major social welfare aspects of unionization remain largely ambiguous, although we can say that they likely decrease profits and shareholder wealth, create small allocative inefficiencies and opportunity costs, and depress investment. The relatively uncertain but small magnitude of these deleterious consequences, when added to the indirect nature of the effect arising from the non-taxation of strike pay, makes it difficult to formulate too strong an objection to the implicated tax policy. To the degree that a conclusion can be reached, it appears that there are more economic reasons to be wary of the exemption than to embrace it, and compelling policy reasons would have to be presented to override this skepticism. For some, the redistributive effects, which we have noted are themselves not entirely clear, will be sufficient justification. We are inclined to be less accepting, especially since the equality values espoused by advocates of this redistribution are the same ones that, at least in the case of the NHL strike, are violated in the context of the *ITA* by

the exemption. It is also unclear why the social desire for redistribution cannot be readily achieved through the more explicit mechanisms of the *ITA* itself, such as by increasing the basic exemption.

## **V. Conclusion**

The tax treatment of union dues, labour organizations, and strike pay in Canada is troubling since it provides a mechanism through which employment income can flow through to taxpayers while avoiding all tax liability. The recent NHL labour dispute has brought this situation to the forefront with the aggressive use of this tax-free flow-through mechanism to spinout from \$5,000 to \$10,000 US monthly to players, resulting—so far—in approximately \$6 million in foregone tax revenues. The differential tax treatment of strike pay in the Canada and the U.S. raises a host of issues surrounding the ontology and potential justification of the divergence in tax policy.

The lessons from the labour economics literature give rise to a puzzle when examined from a comparative perspective. Despite the prospect of uncertain effects on strikes, and small but negative welfare effects suspected on the economic side resulting from the non-taxation of strike pay, the international practice tends to be more aligned with Canada's approach than the American approach. Few (if any) jurisdictions follow the lead of the U.S. and treat strike pay as taxable income. Australia partly mirrors the American approach in that it taxes strike pay that is received on a predictable, periodic basis as income; however, Australia does not consider lump sum union member assistance payments to be taxable income. Other jurisdictions, such as the U.K., adopt positions similar to Canada's and do not consider strike pay income for tax purposes, regardless of whether it is received in a lump sum or periodically.

There are two complementary candidate explanations for the puzzling finding that the American treatment of strike pay is anomalous and not Canada's. The first is a political economy explanation, suggesting that the political cost of taxing strike pay—i.e. perhaps alienating and losing the support of organized labour—is typically perceived to be too steep to justify meddling with the *status quo* first established by the original administrative stance adopted by what was then Revenue Canada, and also that reached by the Supreme Court of Canada post-*Fries*. This may help to partly explain both the Canadian and the American experience, since the U.S. has typically employed a much more inclusive understanding of “income” under the *IRC*. And perhaps the stakes are so low that a change to exempting strike pay under the *IRC* would not mobilize much political support. A second potential explanation draws upon the observation that the efficiency costs of unionization are low but the equity gains—i.e. the return to labour versus the return to capital—may be thought to be sufficiently desirable to outweigh the efficiency losses. Whatever the likely explanation, the non-taxation of strike pay continues to puzzle. Perhaps the observation that the net present value of the exemption is in the neighbourhood of \$327 million will be sufficient to overcome the lack of political will, though given the recent seven year string of multi-billion dollar Federal surpluses, and the precarious political situation in Ottawa, we remain skeptical.