Rethinking the Concept of Income in Tax Law and Policy

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I. Introduction

> *Income is the money-value of the net accretion to one's economic position between two points of time.*
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> Robert Murray Haig, "The Concept of Income – Economic and Legal Aspects," in R.M. Haig, *The Federal Income Tax*, (New York: Columbia University Press, 1921) 1-28 at p. 27.

> Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and the end of the period in question.
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> Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy*, (Chicago: University of Chicago Press, 1938) at p. 50.

For the better part of a hundred years now, the "Haig-Simons" definition of income has served as a touchstone for normative debates in North American tax law and policy.[1] In the United States, the definition has been central to the concept of tax expenditures,[2] and has influenced base-broadening efforts such as the Tax Reform Act of 1986.[3] In Canada, the Haig-Simons definition was the intellectual inspiration for the

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[1] See, e.g., Boris I. Bittker, "A 'Comprehensive Tax Base' as a Goal of Tax Reform," 80 *Harv. L. Rev.* 925 (1967) at 925 (stating that the concept "has come to be the major organizing concept in most serious discussions of our federal income tax structure"). The concept has a German antecedent in the work of George van Schanz, "Der Einkummensbegriff und die Einkommensteuergesetz,"13 *Finanz-Archiv* no. 1, 1-87 (1896). For this reason, references are often made to the Schanz-Haig-Simons definition of income. For a discussion of Schanz and other early German scholars on the concept of income, see Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy*, (Chicago: University of Chicago Press, 1938) at 60-79.

[2] See, e.g., Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures*, (Cambridge: Harvard University Press, 1985) at 3-4 (explaining that "[t]ax expenditure analysis is based on the concept of a normative tax of the type under consideration" and that analysis of income tax expenditures in the U.S. is 'based on the Schanz-Haig-Simons (S-H-S) economic definition of income").

[3] See, e.g., C. Eugene Steuerle, *Contemporary U.S. Tax Policy*, (Washington, D.C.: The Urban Institute, 2004) at 113-14 (discussing the "prelude" to tax reform in 1986) and 240 (describing the agenda of "traditional tax reformers").

Royal Commission on Taxation (Carter Commission), which favoured a "comprehensive tax base" defined as "the sum of the market value of

goods and services consumed or given away in a taxation year by the tax unit, plus the annual change in the market value of the assets held by the unit."[4] In both countries, tax scholars routinely refer to the Haig-Simons definition as the normative standard for income taxation – not only to evaluate existing income tax rules and advocate specific reforms,[5] but also to criticize the taxation of income and advocate alternatives like consumption taxation.[6]

Notwithstanding this apparent prominence in policy and theory, however, existing income taxes in the United States and Canada have consistently departed from the Haig-

[4] Royal Commission on Taxation (Carter Commission), *Report*, (Ottawa: Queen's Printer, 1966), Vol. 3 at 39.

[5] See, e.g., William A. Klein, "An Enigma in the Federal Income Tax Act: The Meaning of the Word 'Gift'," 48 *Minn. L. Rev.* 215 (1963) (criticizing the exclusion of gifts and inheritances from gross income under the Internal Revenue Code); Joseph M. Dodge, "Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income," 91 *Harv. L. Rev.* 1177 (1978) (arguing that gifts and bequests should be subject to tax as income to the recipient, rather than under separate wealth transfer taxes); Donald B. Marsh, "The Taxation of Imputed Income," 58 *Pol. Sc. Q.* 514 (1943) (arguing that the imputed rental value of owner-occupied housing should be included in taxable income); Nancy C. Staudt, "Taxing Housework," 84 *Geo. L.J.* 1571 (1996) (arguing that the income tax should included the imputed value of household services); Kim Brooks, "Delimiting the Concept of Income: Taxation of In-Kind Benefits," 49 *McGill L.J.* 255 (2004) (defending market-value as the appropriate basis for valuing in-kind benefits); David Shakow, "Taxation without Realization: A Proposal for Accrual Taxation," 134 *U. Pa. L. Rev.* 1111 (1986) (recommending the taxation of unrealized gains); Mary Louise Fellows, "A Comprehensive Attack on Tax Deferral," 88 *Mich. L. Rev.* 722 (1990) (proposing a "time-adjusted-realization-event tax" or "TARET" as a solution to the opportunities for tax deferral created by the realization criterion); Stephen B. Land, "Defeating Deferral: A Proposal for Retrospective Taxation," 52 *Tax L. Rev.* 45 (1998) (proposing a form of "retrospective taxation" which preserves the realization requirement but adjusts the tax to offset the benefit of deferral); and David A. Weisbach, "A Partial Mark-to-Market System," 53 *Tax L. Rev.* 95 (2000) (proposing a system of mark-to-market taxation for most liquid assets such as financial products and commodities, while leaving hard-to-value assets like real estate or small businesses subject to tax on a realization basis).

[6] See, e.g., William D. Andrews, "A Consumption-Type or Cash Flow Personal Income Tax," 87 *Harv. L. Rev.* 1113 (1974) (identifying various complexities in the pursuit of the ideal suggested by the Haig-Simons definition of income and proposing personal consumption taxation as an alternative ideal); William D. Andrews, "The Achilles' Heel of the Comprehensive Income Tax" in Charles E. Walker and Mark A. Bloomfield, eds., *New Directions in Federal Tax Policy for the 1980s*, (Cambridge, MA: Ballinger Publishing, 1983) 278 (emphasizing deficiencies resulting from reliance on realization as a criterion for assessing tax under most real-world income taxes); and Edward J. McCaffery, "Tax Policy Under a Hybrid Income-Consumption Tax," 70 *Texas L. Rev.* 1145 (1992) (arguing that the existing income tax in the U.S. represents a hybrid version of the Haig-Simons ideal and the personal consumption tax ideal).

Simons concept in at least three crucial respects – excluding “imputed income” from leisure, services, and durable goods,[7] excluding gifts and inheritances,[8] and recognizing gains and losses for the most part only when they are realized through a sale or other disposition and not as they accrue from one period to the next.[9]

Although these departures from the Haig-Simons ideal are usually explained as necessary compromises resulting from the practical challenge of valuing these types of “income” and collecting tax on amounts that are not received in monetary form,[10] they might also be justified on normative grounds. If so, it follows that one should also question the Haig-Simons definition as a normative ideal for the taxation of personal income. Indeed, this paper argues, the underlying rationales for this concept of income fail to provide a convincing foundation for the taxation of personal income. For this reason, it is perhaps not surprising that the income tax has diminishing support among tax scholars and the general public. As this paper also argues, however, the deficiencies of the Haig-Simons definition point to a more attractive concept of income based on participation in the market economy that might attract greater scholarly and popular

[7] Although neither country seeks to tax imputed income, Wisconsin’s state income tax required taxpayers to include the estimated rental value of owner-occupied residences between 1911 and 1917. See Thomas Chancellor, “Imputed Income and the Ideal Income Tax,” 47 *Oregon L. Rev.* 561 at 563, n. 6.

[8] In the United States, see I.R.C., s. 102(a) (excluding from gross income “the value of property acquired by gift, bequest, devise, or inheritance”). In Canada, gifts and inheritances are excluded not by statute, but by judicial decisions concluding that the source concept of income on which the Canadian income tax is based does not include transfers of property. See, e.g., *Bellingham v. The Queen*, [1996] 1 C.T.C. 187, 96 D.T.C. 6075 (F.C.A.).

[9] For the United States, see *Eisner v. Macomber*, 252 U.S. 189 (1919). For Canada, see *Friedberg v. Canada*, [1993] 2 C.T.C. 306, 93 D.T.C. 5507 (S.C.C.).

[10] See, e.g., Tim Edgar, “The Concept of Taxable Consumption and the Deductibility of Expenses Under an Ideal Personal Income Tax Base,” in Richard Krever, ed., *Tax Conversations: A Guide to the Key Issues in the Tax Reform Debate*, (The Hague: Kluwer Law International, 1997) 293 at 303 (explaining that the “economic utility” of leisure time and the imputed income from services and consumer durables “cannot be readily converted into money that can be appropriated by government”); and Fellows, *supra* note 5 at 724: “Requiring a realization event before assessing a tax, as the Code does, avoids the difficult administrative problems of determining the value of property by hypothesizing a market event. Additionally, such a requirement prevents the possibility that the taxpayer will be forced to liquidate an investment or borrow to pay any tax due.”

support. As a result, the aim of this paper is not to challenge the taxation of personal income but to defend it.

The argument proceeds as follows. Part II reviews the Haig-Simons definition of income, explaining the underlying rationales for the specific definitions that each of Haig and Simons advance, and the implications of each definition for the taxation of specific items. Part III questions the extent to which either argument provides a secure foundation for the taxation of personal income. Part IV advances an alternative conception of income based on participation in the market economy, and explains how this alternative conception would deal with the taxation of imputed income, gifts and inheritances, unrealized gains and losses, and other items. Part V summarizes the argument and offers concluding observations.

II. The Haig-Simons Concept of Income

Although the definitions of income advanced by Haig and Simons are sufficiently similar to be characterized as a single "Haig-Simons" definition,[11] the underlying rationale for the definition advanced by each author differs noticeably. For this reason, it is useful to consider these rationales first, before turning to the implications of each definition for the inclusion of specific items in taxable income.

A. Underlying Rationales and Specific Definitions

In general, one might expect that a definition of income for the purpose of an income tax would relate to the underlying purpose of the tax. While an obvious purpose

[11] Simons himself characterized Haig's conception as "[s]imilar in content," noting however that "Haig does not go far to describe its content in relation to particular problems of income determination" and observing that the definition "literally construed, would exclude consumption – which he clearly does not himself intend." Simons, *supra* note 1 at 61-61.

of most taxes is to raise revenue to finance public goods and services, taxes may also be designed to redistribute economic resources, or to regulate economic activity.[12] Where a tax serves redistributive goals, moreover, its design should presumably relate to the conception of distributive justice that underlies the redistributive scheme.[13] In order to evaluate the definitions of income that Haig and Simons propose, therefore, one should consider not only the definition itself and its implications for the inclusion of specific items, but also the purpose or purposes that each attributes to the taxation of personal income.

1. Haig

Surprisingly, Haig provides no apparent rationale for the existence of an income tax, taking as given the Sixteenth Amendment to the U.S. Constitution granting Congress the power to tax "incomes, from whatever source derived," and the fact that "under this grant of authority, Congress has for eight years past, collected taxes upon what it has been pleased to term income."[14] Explaining that neither Congress nor the courts have managed to formulate a clear and all-encompassing definition of income,[15] the task that Haig sets for himself is not to justify the income tax,[16] but rather to examine "the content" of the term income "from the point of view of the economics of the problem and

[12] See, e.g., Reuven Avi-Yonah, "The Three Goals of Taxation" Working Paper (2006).
[13] See generally Liam Murphy and Thomas Nagel, *The Myth of Ownership*, (Oxford: Oxford University Press, 2002).
[14] Robert Murray Haig, "The Concept of Income – Economic and Legal Aspects," in Richard A. Musgrave and Carl S. Shoup, *Readings in the Economics of Taxation*, (Homewood, Illinois: Richard D. Irwin, Inc., 1959) at 54.
[15] *Ibid*. (adding that "judicial decisions that had been handed down during the first years of the U.S. income tax "appear to be leading toward a definition of income so narrow and artificial as to bring about results which from the economic point of view are certainly eccentric and in certain cases little less than absurd").
[16] See, e.g., *ibid*. at 58-59, where Haig discusses the choice between a "pure consumption tax" and an income tax, explaining only that the latter option "has been the one generally adopted as the definition of income in modern income tax acts."

from the point of view of the practice elsewhere."[17] More generally, he maintains, "[t]he approach here taken is … one of fundamental economics and equity."[18]

Insisting that "the concept of income … is essentially an economic concept,"[19] Haig begins by defining income in terms of welfare or utility – observing that "[m]odern economic analysis recognizes that fundamentally income is a flow of satisfactions, of intangible psychological experiences."[20] Thus, he explains:

> If one receives a dollar he receives something which he ordinarily can and does spend – perhaps for a dinner. Is his income the dollar, or is it the dinner which he buys with the dollar, or is it, at bottom, the satisfaction of his wants which he derives from eating the dinner – the comfort and the sustenance it yields to him? If one spends his dollar for something more durable than a dinner – say a book or a pipe – is his true income the book or the pipe, or the series of satisfactions or "usances" arising from reading the book or smoking the pipe? There is no doubt as to the answer to these questions. A man strives for the satisfaction of his wants and desires and not for objects for their own sake.[21]

In support of this proposition, Haig quotes several contemporary economists, each of whom had defined income in terms of utility or benefits over a period of time.[22]

Notwithstanding these references to "intangible psychological experiences" and "the satisfaction of wants", however, Haig also emphasizes that utility alone cannot be the basis for economic analysis, which requires "something more definite and more

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[17] *Ibid*. at 54.
[18] *Ibid*.
[19] *Ibid*. at 66.
[20] *Ibid*. at 55.
[21] *Ibid*.
[22] *Ibid*. at 56-57, citing Taussig, *Principles of Economics*, Vol. X (1916), p. 134 ("all income consists in the utilities or satisfactions created"); Irving Fisher, *Elementary Principles of Economics*, (1911), p. 34 ("A flow of benefits during a period of time is called income"); Ely, *Outlines of Economics*, (1908), p. 98 ("income … has reference to the satisfaction we derive from the use of material things or personal services during a period of time"); and Seligman, *Principles of Economics*, (1914), p. 16 ("We desire things at bottom because of their utility. They can impart this utility only in the shape of a succession of pleasurable sensations. These sensations are our true income.").

homogeneous."[23] As a result, he continues, "[t]he usances and satisfactions and the goods and services supplying them which are of significance to the economist in his analysis are those which are susceptible of evaluation in terms of money."[24] More importantly, he explains, in order to define income for tax purposes:

> It is necessary as a practical proposition to disregard the intangible psychological factors and have regard either for the money-worth of the goods and services utilized during a given period or for the money itself received during the period supplemented by the money-worth of such goods and services as are received directly without a money transaction.[25]

While a tax on "the money-worth of the goods and services utilized during a given period" defines what Haig calls a "pure consumption tax",[26] a tax on money received during the period and "the money-worth of such goods and services as are received directly without a money transaction" reflects Haig's general understanding of "the definition of income in modern income tax acts."[27] Under this conception, he explains, "income becomes the increase or accretion in one's power to satisfy his wants in a given period in so far as that power consists of (a) money itself, or (b) anything susceptible of valuation in terms of money."[28] Stated more simply, he adds, "[i]ncome is

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[23] Haig, "Concept of Income" *supra* note 14 at 56 (explaining that "psychic satisfactions" are difficult to quantify for even a single individual and "impossible … to compare" between persons).
[24] *Ibid*. at 56-57 (explaining that "[w]hen one can express his wants and satisfactions in terms of dollars and cents he can use a language which other men can understand and which means something to the economic community generally").
[25] *Ibid*. at 58.
[26] *Ibid*. at 58 (adding that this ignores "an evaluation of the satisfactions arising from the consciousness of a saved surplus" which he dismisses as "obviously an impracticable procedure"). Subsequent analysis has referred to this kind of tax as a "personal expenditure tax" or "personal consumption tax" in order to distinguish it from retail sales taxes and value-added taxes that also apply to consumption but do so on a transaction-by-transaction basis. See, e.g., Nicholas Kaldor, *An Expenditure Tax*, (London: George Allen & Unwin Ltd., 1955); and Andrews, "A Consumption-Type or Cash Flow Personal Income Tax" *supra* note 6.
[27] Haig, "The Concept of Income" *supra* note 14 at 59.
[28] *Ibid*.

the *money value of the net accretion to one's economic power between two points of time*."[29]

2. Simons

Unlike Haig, Simons is both a vocal advocate of personal income taxation and explicit about the primary purpose for which he thinks the tax should exist. Writing toward the end of the Great Depression, Simons argues that the United States should greatly increase its share of government revenues from the personal income tax,[30] and should do so primarily for the purpose of "mitigating economic inequality."[31] Insisting that "taxation must be conceived as an instrumentality for altering or correcting the distribution of wealth and income,"[32] Simons contends "not merely that progressive taxation is a sound and promising method for mitigating inequality but that it is the only sound and promising method which has been seriously proposed."[33] As a result, although his analysis is directed primarily at the concept of income and its implications for the inclusion of specific items, his rationale for personal income taxation has implications for tax rates as well as the tax base to which these rates are applied.

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[29] *Ibid*.
[30] Simons, *supra* note 1 at 39-40 (suggesting that this share be increased from the roughly 10 percent that it represented at the time to "a point where it would cover considerably more than half of total governmental expenditures"). In Canada and the United States, Simons' objective was achieved in remarkably short order, as the personal income tax was transformed during the Second World War from a tax that applied only to very high income earners, to a mass tax that was broadly applicable to large segments of the population. In Canada, the share of federal government revenue from the personal income tax increased from 9.9 percent in 1939 to approximately on-third in 1945, and currently accounts for roughly 45 percent of total revenues. [Add references and U.S. figures].
[31] Simons, *supra* note 1 at 41.
[32] *Ibid*. at 15. See also *ibid*. at 1 ("Taxation is a proper means for mitigating inequality.") and 41 ("Income taxation is broadly an instrument of economic control, a means of mitigating economic inequality.").
[33] *Ibid*. at vii (criticizing Republican "subsidies in the form of protective-tariff duties" and Democratic "restraints upon internal trade" and adding that 'in the name of justice (fair wages, fair prices, parity prices, and other derivatives of the medieval conception), we are perverting and destroying the free enterprise, free markets, and competitive free trade which are essential to representative government and to orderly political life on a vast national scale").

With respect to the definition of income, Simons begins by assuming that "moderation of inequality is an important objective of policy" and that "income taxes [are] devices for effecting it."[34] In this respect, he maintains, "[t]he development of income taxes may be viewed as a response to increasingly insistent and articulate demands for a more equitable apportionment of tax burdens."[35] In addition, he suggests, "[s]ince it is widely agreed that income is a good tax base, its meaning may be sought by inquiring what definition would provide the basis for the most nearly equitable levies."[36] As a result, he concludes, "the task of describing, delimiting, and defining closely the actual tax base … may be dealt with largely in the light of considerations of justice."[37]

Notwithstanding this reference to "considerations of justice", however, Simons devotes little attention to the conception of distributive justice on which his definition of income is ultimately based. With respect to economic inequality, for example, the Preface to *Personal Income Taxation* simply declares that "[n]owadays ... there is no issue as to the need for a lesser concentration of wealth and income."[38] Elsewhere, Simons suggests that "there is a presumption in favor of equality and that the burden of proof rests with him who would depart from it."[39] In this respect, he emphasizes that it is appropriate to "deny … any justification for prevailing inequality in terms of personal desert."[40] More generally, he maintains:

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[34] *Ibid*. at 41.
[35] *Ibid*. (assign that "[t]hese taxes are the outstanding contribution of popular government and liberal political philosophy to modern fiscal practice").
[36] *Ibid*. at 42. See also *ibid*, at 30 (explaining that "[a]n ideal income tax should involve a minimum of obvious inequity"). For a useful analysis of the role that equity or fairness plays in Simons' conception of income, see Victor Thuronyi, "The Concept of Income," 46 *Tax Law Rev*. 45 (1990).
[37] *Ibid*. at 41.
[38] *Ibid*. at vi.
[39] *Ibid*. at 17.
[40] *Ibid*. at 18.

> The case for drastic progression in taxation must be rested on the case against inequality – on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely.[41]

For the purposes of his analysis, however, Simons assumes that this case has been made.

Returning to the definition of income, therefore, Simons' ultimate objective is to promote an "equitable apportionment of tax burdens" in order to mitigate economic inequality.[42] For this purpose, he explains (in sharp contrast to Haig's initial conception of income as a "flow of satisfactions"), personal income should be conceived as "a purely acquisitive concept having to do with the possession and exercise of rights … not with sensations, services or goods …."[43] On this basis, he suggests, "[p]ersonal income connotes, broadly, the exercise of control over the use of society's scarce resources."[44] Since the concept of income implies measurement over a specific period of time, however, Simons also emphasizes that personal income measures "the results of individual participation in economic relations *for an assigned interval* and without regard for anything which happened before the beginning of that … interval or for what may happen in subsequent periods."[45] Thus, he maintains, the calculation of personal income requires an estimate: "(a) of the amount by which the value of the person's store of property rights would have increased, as between the beginning and the end of the period,

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[41] *Ibid*. at 18-19.

[42] In this respect, Simons approach to the definition of income includes not only the idea of "horizontal equity" according to which similarly situated taxpayers should pay similar taxes, but also the concept of "vertical equity" according to which persons with greater economic resources should pay proportionately larger taxes. See *ibid*. at 30 ("tax burdens should bear similarly upon persons whom we regard as in substantially similar circumstances, and differently where circumstances differ"). For more recent explanations of horizontal and vertical equity, see R.A. Musgrave and R,M, Bird, *Public Finance in Theory and Practice*, 1st Can. Ed. (Toronto: McGraw Hill Ryerson, 1987) at 214; and R.W. Boadway and H.M. Kitchen, *Canadian Tax Policy*, 3rd ed. (Toronto: Canadian Tax Foundation, 1999) at 53-73.

[43] Simons, *supra* note 1 at 49.

[44] *Ibid*.

[45] *Ibid*. at 50.

if he had consumed (destroyed) nothing, or (b) the value of rights which he might have exercised in consumption, without altering the value of his store of rights."[46] As a result, he concludes: "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and the end of the period in question."[47]

B. Implications for Inclusions in Income

Notwithstanding the very different foundations on which Haig and Simons base their definitions of income, the implications of each for the inclusion of specific items in taxable income are strikingly similar. Of particular significance for the design of the income tax are the treatment of imputed income, gifts and inheritances, and unrealized gains and losses.

1. Imputed Income

For Haig, the inclusion of imputed income in an ideal income tax follows logically from the underlying "economic concept" of income as a "flow of satisfactions" or "intangible psychological experiences."[48] If "true income" comprises "the flow of economic 'usances' and satisfactions expressed in terms of money,"[49] it should not matter for an ideal income tax whether these satisfactions are derived from market exchanges or non-market activities,[50] nor whether they result from self-performed services, the use of durable consumer goods, or the enjoyment of leisure. In each case, Haig contends, "[f]rom the point of view of equity it is theoretically important that all goods and services

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[46] *Ibid*. at 49.
[47] *Ibid*. at 50.
[48] Haig, "Concept of Income" *supra* note 14 at 55.
[49] *Ibid*. at 59.
[50] *Ibid*. at 58 (explaining that "the goods and services which are of significance" to an income tax must be "susceptible of evaluation in terms of money" but need not "actually have passed through the process of a sale").

received without payment should be accounted for in case it is possible to value them in terms of money."[51]

For this reason, Haig is clear that imputed income from self-performed services should be included in taxable income. Considering "the fire-wood the farmer cuts from his wood lot or the vegetables for his table which he gathers from his garden," he remarks that "the fact that one man buys his firewood or his vegetables, rather than receives them without the formality of a money sale, should not operate so as to increase the weight of his income tax."[52] Elsewhere, he quotes with approval Alfred Marshall's conclusion that:

> … a woman who makes her own clothes, or a man who digs in his own garden or repairs his own house, is earning income just as would the dressmaker, gardener, or carpenter who might be hired to do the work.[53]

On this basis, contemporary tax scholars have argued that imputed income from household services should either be directly included in taxable income,[54] or otherwise recognized for tax purposes through deductions for child care expenses or secondary earners,[55] or the application of progressive rates to individual taxpayers.[56]

In addition to imputed income from self-performed services, Haig's ideal income tax would also include "the income one really receives when he lives in the house he himself owns".[57] In practice, however, Haig suggests that "it may be futile and silly, from an administrative point of view, to attempt to include in the income tax return a money

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[51] *Ibid*.
[52] *Ibid*.
[53] *Ibid*. at 56, citing Alfred Marshall, *Economics of Industry*, (1901), p. 51.
[54] See, e.g., Staudt, "Taxing Housework" *supra* note 5.
[55] See, e.g., Edward J. McCaffery, *Taxing Women*, (Chicago: University of Chicago Press, 1997) at 120-26 (arguing, among other things at 122, that: "A failure to tax imputed income is a failure to tax income. It is a failure to have an income tax.").
[56] See, e.g., P.W. Hogg, J.E. Magee, and T. Cook, *Principles of Canadian Income Tax Law*, 3rd ed. (Toronto: Carswell, 1999) at 97 (suggesting that "[t]he present higher tax on the one-job family could be defended as an indirect recognition of that family's higher imputed income from unpaid services"). See also Boadway and Kitchen, *Canadian Tax Policy*, *supra* note 42 at 171-73.
[57] Haig, "Concept of Income" *supra* note 14 at 72.

estimate of the income which the man receives when he lives in his own house."[58] On the other hand, he emphasizes, "[s]uch real income should certainly be taxed if it is practicable to evaluate it."[59] As a result, he concludes

> … one might urge that no tax be placed on the services which one actually enjoys when one lives in his own home rather than a rented one. But … that recommendation should not be supported by the assertion that this item is not income. It is income whenever it is susceptible of evaluation in terms of money.[60]

In practice, several European countries require taxpayers to include the estimated rental value of owner-occupied residences in computing taxable income.[61]

Curiously, Haig does not consider the value of leisure as another inclusion in an ideal income tax, although this would be consistent with his economic concept of "true income" and is also susceptible of valuation in terms of money if one were to impute to each hour of leisure the income that one might otherwise be able to obtain. Perhaps the practical challenges to the implementation of this kind of tax led Haig to dismiss it without consideration. Alternatively, perhaps, he was influenced by the implications that taxation of leisure time might have for individual liberty. Indeed, some conception of individual autonomy seems to underlie his conclusion that tax burdens should not differ according to different capacities for pleasure.[62] Whether any attention to individual liberty is consistent with his theoretical framework, however, is doubtful.

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[58] *Ibid*. at 65.
[59] *Ibid*. at 72-73.
[60] *Ibid*. at 65.
[61] [need proper cite, but Edgar refers to the Netherlands and Sweden] As stated at *supra* note 7, the State of Wisconsin required taxpayers to include the estimated rental value of owner-occupied residences from 1911 to 1917.
[62] Haig, "Concept of Income" *supra* note 14 at 57 (observing that "two persons who receive precisely equal amounts of goods and services may derive therefrom very unequal 'usances' and satisfactions" but dismissing the idea that equal taxation would result in "theoretical injustice" on the basis that no one "would seriously defend the proposition that taxes should be apportioned according to capacity for

Like Haig, Simons would also include imputed income in an ideal income tax – not on the utilitarian basis that self-performed services, leisure and durable consumer goods produce "economic 'usances' and satisfactions expressed in terms of money,"[63] but on the grounds that the exercise of these rights constitutes "control over the use of society's scarce resources"[64] and consumption under his definition of income. As a result, he contends, "[i]f a man raises vegetables in his garden, it seems clearly appropriate to include the value of the product in measuring his income."[65] Similarly, he suggests, "[m]ost economists recognize housewives' services as an important item of income."[66] In addition, he continues, "leisure itself is a major item of consumption … income per hour of [which] … might well be imputed to persons according to what they might earn per hour if otherwise engaged."[67] Furthermore, he maintains, "when property is employed directly in consumption uses, there is the strongest case for recognizing an addition to taxable income."[68]

In practice, however, Simons is reluctant to include all of these items in taxable income. With respect to self-employed services, in fact, he questions the extent to which various activities can be characterized as "economic activity" that is properly subject to redistributive taxation.[69] Although the value of vegetables grown in a private garden "seems clearly appropriate" to him as an addition to taxable income,[70] for example, he is

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appreciation rather than according to the capacity to command the goods and services which are appreciated").

[63] *Ibid*. at 59.
[64] Simons, *Personal Income Taxation*, *supra* note 1 at 49.
[65] *Ibid*. at 51-52.
[66] *Ibid*. at 52.
[67] *Ibid*. at 52.
[68] *Ibid*. at 112.
[69] *Ibid*. at 51.
[70] *Ibid*. at 52.

“less clear” about “flowers and shrubs”.[71] Nonetheless, he concludes, if a man shaves himself, “it is difficult to argue that the value of the shaves must also be accounted for.”[72] Continuing with this line of reasoning, he asks:

> Do families have larger incomes because parents give competent instruction to children instead of paying for institutionalized training? Does a doctor or an apothecary have relatively large income in the years when his family requires and receives an extraordinary amount of his own professional services?[73]

Instead of answering these “unanswerable” questions,[74] Simons shift to more practical considerations, the most significant of which relates to his stated purpose of the income tax to mitigate economic inequality. Arguing that income from self-performed services “bulks large only in the case of classes exempt from tax or subject to only the lowest rates,”[75] he concludes that “to ignore ‘earned income in kind’ serves, on the whole, merely to increase both the real exemptions and the real degree of progression; i.e., it leads to a true progression somewhat steeper than that revealed in the nominal rates.”[76] In addition, he notes, the exclusion of imputed income from household services does not create significant opportunities for tax avoidance, given “the premium on specialization.”[77] As a result, he maintains, “considerations of justice, not to mention those of administration, argue here for a rather narrow definition of taxable income.”[78] On the other hand, he adds, “[i]f it is not equitable to exclude such items entirely,” they

[71] *Ibid*.
[72] *Ibid*.
[73] *Ibid*.
[74] *Ibid*. at 51.
[75] *Ibid*. at 113.
[76] *Ibid*.
[77] *Ibid*. (observing that “[o]ne cannot go far toward making one’s family an autonomous economy without severe penalty”).
[78] *Ibid*. at 112.

may be recognized through a special exemption for "the 'earned income' of a wife."[79] For similar reasons, as indicated earlier, contemporary tax scholars have suggested a deduction for secondary earners.[80]

As with imputed income from self-performed services, Simons also rejects the inclusion of imputed income from leisure in any real world income tax. Emphasizing that "it is one thing to note that such a procedure is appropriate in principle and quite another to propose that it be applied,"[81] he suggests that the exclusion of imputed income from leisure may "substantially offset, for comparative purposes (for measurement of relative incomes)" the exclusion of imputed income from self-performed services.[82] On the not unreasonable assumption that households with significant imputed income from self-performed services are apt to have little imputed income from leisure and *vice versa*, therefore, Simons is content to exclude both types of imputed income. Crucially, however, given his emphasis on the redistributive purpose of the income tax, Simons is careful to add that "it is important that these elements of income vary with considerable regularity, from one income class to the next, along the income scale."[83]

The goal of redistributive taxation also underlies Simons' approach to imputed income from consumer durables, the most important of which is owner-occupied housing. Explaining that "[i]ncome from consumers' capital is often a large part of total income for individuals in the upper brackets,"[84] Simons argues that its exclusion would "introduce a bias inconsistent with the system of progression and to differentiate

[79] *Ibid*. at 111.
[80] *Supra* note 55.
[81] Simons, *Personal Income Taxation*, *supra* note 1 at 52.
[82] *Ibid*.
[83] *Ibid*. at 53.
[84] *Ibid*. at 113-14.

flagrantly among persons of really similar financial circumstances."[85] In addition, he maintains, the exclusion of imputed income from consumer durables would furnish "an attractive and easy means of evasion" since other income-producing investments could be liquidated "and the proceeds used to obtain property for consumption use."[86] On these grounds, therefore, Simons recommends an imputed income inclusion for owner-occupied housing based on assessed values for municipal taxation,[87] an additional inclusion for the "rental values of furniture" based on "some multiple" of rent and home value,[88] and "special provisions with respect to such things as yachts, art collections, automobiles, and other more durable articles" with "the appropriate additions to taxable income … determined on the basis of capital values."[89] While some European countries include the estimated rental value of owner-occupied residences in taxable income,[90] the inclusion of imputed income for other consumer durables does not appear to have been implemented in practice.

2. Gifts and Inheritances

As with the inclusion of imputed income, the inclusion of gifts and inheritances in taxable income follows logically from the income definitions that Haig and Simons propose. To the extent that these receipts "increase the economic strength of the recipient," Haig concludes, they are income "[u]nder the terms of the definition."[91] Other than this conclusion, his brief comments on the question are limited to the suggestion that

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[85] *Ibid*. at 114.
[86] *Ibid*.
[87] *Ibid*. at 117-18.
[88] *Ibid*. at 121.
[89] *Ibid*. at 122.
[90] *Supra* note 61.
[91] Haig, "Concept of Income" *supra* note 14 at 74.

"family gifts" might be ignored "on the ground of the essential unity of the family,"[92] and the proposition that charitable gifts are properly included in the income of the donor (i.e., not deductible) since "the man who makes [such] a gift … deliberately chooses that way of spending his money because it yields him a greater satisfaction than some alternative use."[93]

Simons' analysis of "gratuitous receipts" is much more extensive, comprising an entire chapter of *Personal Income Taxation* which contains a detailed discussion of different types of taxes on the transfer of wealth.[94] Like Haig, Simons begins by stating that gifts are properly included under the definition of income which he affirms.[95] Since gratuitous receipts contribute to the recipient's "store of property rights" during the period in which they are received, it follows from his definition that these receipts should be included in computing taxable income on the same basis as any other kind of receipt.[96] In addition, he suggests, gifts and earnings are essentially similar,[97] and distinctions based on the intentions of second parties are difficult to administer.[98] As a result, he

[92] *Ibid*.

[93] *Ibid*. at 74-75. Simons makes a similar argument, characterizing charitable contributions as taxable consumption, see Simons, *Personal Income Taxation*, *supra* note 1 at 57-58 and 139-40. Notwithstanding this conclusion, Haig appears to accept the idea of a charitable contributions deduction "[o]n the ground of public policy." *Ibid*. at 74.

[94] Simons, *Personal Income Taxation*, *supra* note 1, chapter VI at 125-47.

[95] *Ibid*. at 125 ("The definition of income which we have proposed … would bring all these items of receipts into calculation.").

[96] *Ibid*. at 130 ("That the definition of taxable income as the algebraic sum of consumption and accumulation affords the best available basis for personal taxation is the central thesis of our whole discussion; and the argument must be appraised as a whole. The inclusion of gratuitous receipts is here proposed as part of a whole scheme of income-tax procedure – as a part consistent with, and complementary to, the other parts, defined by the proposals of other chapters.").

[97] *Ibid*. at 134-35 ("Gifts are very much like earnings, and earnings are often quite like gifts. The whole return from property is, in a sense, a gift from the community. Where money is earned by common labor, the distinction may be fairly clear; but many remunerative employments only require people's doing what they would quite enjoy doing without compensation.").

[98] *Ibid*. at 56-57 (arguing that there is "no objective test" to distinguish gifts from exchanges, and that "the income concept will … be … more precise and definite" if the distinction is avoided).

concludes, fairness and administrative simplicity favor the inclusion of gifts and inheritances in taxable income.[99]

Notwithstanding this conclusion, however, Simons also emphasizes that "[i]t would obviously be folly for an income tax to try to reach all gifts."[100] Considerations of administrative simplicity, for example, make it "unthinkable that taxpayers should be obliged to account in their returns for the value of all dinners and entertainments which they enjoy as guests."[101] Likewise, he argues, while a perfect income tax would "include all gifts or inheritances in the form of special training, education, and social position" that children receive from their parents,[102] these transfers "must largely be disregarded for taxation purposes" because they "assume … no definite or measurable form".[103] Nonetheless, he concludes, "all receipts in the form of real estate and investment assets should be included" as well as "major items of consumer capital, such as yachts, motorcars, and valuable art objects," together with "a miscellaneous category or catch-all provision" adding "all other gifts of property" other than "trifles" with "a small annual exemption (say $200)."[104]

With respect to wealth transfer taxes, Simons is especially critical of the estate-tax form, which applies to the aggregate net value of each estate irrespective of its distribution among different beneficiaries. Although acknowledging that "they do mitigate inequality by modifying, however unsystematically and inelegantly, one phase of existing property rights," he also emphasizes that "they cannot pretend to fairness

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[99] *Ibid*. at 134-35.
[100] *Ibid*. at 135.
[101] *Ibid*.
[102] *Ibid*. at 141 (emphasizing that these transfers constitute "a major kind of inheritance, especially in middle-class families").
[103] *Ibid*. at 142.
[104] *Ibid*. at 136.

among persons."[105] While the inheritance-tax form is better, he continues, since it applies to amounts received by each beneficiary, these taxes are also deficient since they "take no account of the prior circumstances of the beneficiary" and "are levied progressively not according to the total of property inherited but according to the size of each transfer separately."[106] Better yet, he suggests, would be a lifetime accessions tax "covering all gifts and inheritances, giving each beneficiary a once-and-for-all exemption, and taxing him with respect to each receipt according to the total previously received."[107] Nonetheless, he concludes, although taxation on this basis "might come to make some sense," even an accessions tax is "very unattractive" compared to the inclusion of gifts and inheritances in taxable income, since it ignores other receipts that a beneficiary may receive from other sources.[108]

As a result, Simons proposes, "the inclusion of gratuitous receipts under the income tax might call for drastic change in our existing death duties and gift taxes."[109] More specifically, he maintains:

> The rates under these levies, if appropriate before the receipts in question were reached as income, would certainly be inappropriate afterward; indeed, a case might be made for the entire repeal of the old levies.[110]

Notwithstanding this passage, however, Simons rejects the case for repealing these levies, arguing that a separate tax on the transfer of wealth is necessary to supplement the

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[105] *Ibid*. at 131.
[106] *Ibid*.
[107] *Ibid*. at 133.
[108] *Ibid*. (arguing that "we should then have a separate personal levy, progressive according to the total of those particular receipts which (for purposes of justice) an irrelevant legal criterion establishes to be gifts, inheritances and bequests" and commenting that "[t]o provide appropriate company for it in the tax system, we should have a progressive personal tax with respect to wages and salaries, another with respect to ground rents, another with respect to interest, dividends, and business profits, another with respect to capital gains, etc.!").
[109] *Ibid*. at 128.
[110] *Ibid*. at 129.

taxation of gifts and inheritances under the income tax, since the latter "would impose relatively inadequate total taxes with respect to large transfers which were carried out very gradually."[111] For this purpose, he suggests:

> The appropriate arrangements … would take the form of a cumulative personal tax on beneficiaries with respect to gifts, inheritances and bequests …, with a credit for all amounts paid as personal income by virtue of the inclusion of such receipts – i.e., with a credit for the difference between what one's income-tax payments actually were and what they would have been without the receipt in question.[112]

The effect of this arrangement would be to levy income tax on the gift or inheritance in the year of receipt and a supplementary accessions tax if and when aggregate amounts received as gifts and inheritances exceed a threshold at which the supplementary tax imposed is greater than the cumulative credits for income taxes paid. Its purpose, Simons declares, is to control inheritance.[113]

Notwithstanding the Haig-Simons definition, neither the United States nor Canada has ever included gifts and inheritances in taxable income.[114] Although the Canadian Royal Commission on Taxation recommended this reform in its 1966 Report,[115] the government rejected this recommendation shortly after the Report was released. When the government subsequently acted on the Report's recommendation to tax capital gains at death, moreover, it repealed the federal gift and estate taxes.[116] More recently, the federal government in the United States has moved to phase out its gift and estate taxes

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[111] *Ibid*. at 143-44.
[112] *Ibid*. at 144.
[113] *Ibid*. at 146.
[114] See *supra* note 8.
[115] Royal Commission on Taxation, *supra* note 4 [need precise cite]. In contrast to Simons' proposal for a supplementary wealth transfer tax, the Commission recommended that separate gift and estate taxes should be repealed if gifts and inheritances were included in taxable income.
[116] See David G. Duff, "The Abolition of Wealth Transfer Taxes in Canada," in John Tiley, ed., *Studies in the History of Tax Law*, 2nd ed (Oxford: Hart Publishing, 2006) (forthcoming).

by 2010, though the prospects for total repeal remain uncertain.[117] As a result, tax policy developments in this area have departed significantly from what Haig and Simons in particular proposed.

3. Unrealized Gains and Losses

A third important implication of the Haig-Simons definition of income is that gains and losses in the value of property owned by a taxpayer are properly recognized for tax purposes over the period during which they accrue, whether or not these gains or losses are actually realized through a sale or other disposition. If income is defined, as Haig proposes, as "the money value of the net accretion to one's economic power between two points of time,"[118] it should not matter whether that economic power is converted into cash or some other form or not. As a result, Haig insists, "[t]o achieve exact justice the increased economic strength … must be measured *period for period*."[119] Nor if income is defined, as Simons proposes, as "the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of rights between the beginning and the end of the period in question,"[120] should it matter whether changes in the value of property rights occur with or without a sale or other disposition. For this reason, Simons clearly assumes that an ideal income tax would recognize gains and losses not only when they are realized but also as they accrue.

Notwithstanding these initial conclusions, however, both Haig and Simons acknowledge a central for the realization criterion as a practical imperative. Observing that "it may be impracticable as an accounting proposition, to reflect the varying worth of

[117] See, e.g., Michael Graetz and Ian Shapiro, *Death by a Thousand Cuts: The Fight over Taxing Inherited Wealth*, (Princeton: Princeton University Press, 2005).
[118] Haig, "Concept of Income" *supra* note 14 at 59.
[119] *Ibid*. at 62. See generally *ibid*. at 60-66.
[120] Simons, *Personal Income Taxation*, *supra* note 1 at 50.

assets on the balance sheet," for example, Haig concludes that "[i]f the difficulties of complete periodical revaluations are so great as to make it impracticable to tax appreciations as they accrue, they ought not to be taxed."[121] Similarly, Simons declares, while accrual taxation "is possible in the case of actively traded securities …, the realization criterion must be accepted as a practical necessity" in other circumstances.[122] Nonetheless, Haig emphasizes:

> … one might urge that no tax be placed on a gain arising from the appreciation of a fixed asset until it is actually sold. But the recommendation should not be urged on the ground that the appreciation is not income until it is sold. The economic fact is that the owner of that asset comes into possession of economic income whenever the increase in the value of that asset is sufficient in amount and definite enough in character to be susceptible of precise evaluation in terms of money.[123]

On the basis that income is properly recognized as gains accrue and subject to an unintended "tax preference" when tax is deferred until gains are realized, several tax scholars have proposed various arrangements whereby the tax otherwise applicable to realized gains would be increased in order to offset the economic advantage attributable to the deferral of tax.[124] Haig himself anticipates these proposals, suggesting that a "scheme of arbitrary apportionment of the gain over the period of accrual would be infinitely superior to the present practice" of unadjusted taxation on a realization basis.[125] Surprisingly, given the economics of deferral, Simons considers the realization criterion "relatively unobjectionable in principle where it results only in postponement of assessment."[126] Where property that has appreciated in value is transferred by gift,

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[121] Haig, "Concept of Income" *supra* note 14 at 65.
[122] Simons, *Personal Income Taxation*, *supra* note 1 at 153.
[123] Haig, "Concept of Income" *supra* note 14 at 65.
[124] See, e.g., Fellows, "A Comprehensive Attack on Tax Deferral" *supra* note 5; and Land, "Defeating Deferral: A proposal for Retrospective Taxation" *supra* note 5.
[125] Haig, "Concept of Income" *supra* note 14 at 73.
[126] Simons, *Personal Income Taxation*, *supra* note 1 at 162.

inheritance or bequest, however, he denounces the "almost unlimited opportunities for avoidance" that result from the failure to collect tax on accrued gains.[127] Of particular concern in this respect is the "step-up-of-basis" approach currently employed in the United States, whereby accrued gains are not taxed to the estate, while beneficiaries calculate subsequent gains and losses on the basis of the value of the property when they acquired it.[128] Although the obvious advantage of non-taxation in this circumstance might be prevented by the carryover of the donor's cost to the donee, as has been proposed in the United States,[129] Simons criticizes this solution on the grounds that the assessment of tax on gains prior to the donee's acquisition of property "finds support in no considerations of equity as among donees or as between donees and other persons."[130] Instead, he suggests, estates should be taxed "just as though all property in the estate were disposed of at the fair market value as of the date of transfer to the beneficiary."[131] As well, he advises, "[e]very transfer of property by gift should be treated as a realization, at the fair market value as of the date of transfer, by the donee."[132]

In Canada, where the Haig-Simons definition had a major influence on the Royal Commission on Taxation, the 1966 Report of the Commission endorsed Simons' proposals in this respect, recommending that accrued gains should be subject to income tax when property is transferred by gift or at death. Acting on this recommendation, the federal government introduced provisions to this effect in 1972. Since then, property that is transferred by way of gift *inter vivos* and capital property that is transferred at death are

[127] *Ibid*.
[128] [need cite to Internal Revenue Code]
[129] [cite Graetz article, Dodge article, and recent legislative initiatives]
[130] Simons, *Personal Income Taxation*, *supra* note 1 at 163.
[131] *Ibid*. at 165.
[132] *Ibid*. at 166.

deemed to have been disposed for proceeds equal to their fair market value at that time and deemed to have been acquired by the donee at a cost equal to this fair market value.[133] As mentioned earlier, however, the political tradeoff for the implementation of these deemed dispositions was the repeal of separate federal taxes on gifts and estates.[134] Whether Simons would have approved of this political price is highly doubtful.[135]

III. Haig, Simons, and the Taxation of Income

The remainder of the paper remains very much a work in progress. For the purpose of discussion, however, this part will make the following main arguments:

1. Haig's underlying conception of income as a flow of satisfactions is really more compatible with a personal consumption tax than a personal income tax. According to Haig: "when one abandons 'usances' and satisfactions and substitutes the goods and services yielding these satisfactions, he is taking a step away from the fundamentals."[136] More importantly, he argues, when one "substitutes money received during the period in place of goods and services used," as is the case with most income tax laws, "he has really moved a very appreciable distance from the fundamental conception, for not only does everyone receive goods and services of greater or less amount without buying them with money, but also everyone is, in effect considered to be in receipt of his income when he gets the money with which to buy the goods and services which will yield the usances and satisfactions which go to make up his true income."[137] Although Haig himself is not concerned by the apparent inequity that might result within this framework when a

[133] See subsections 69(1) and 70(1) of the Canadian *Income tax Act*, R.S.C. 1985, c. 1 [as amended].
[134] *Supra* note 116 and accompanying text.
[135] [cite Doug Hartle]
[136] Haig, "Concept of Income" *supra* note 14 at 57.
[137] *Ibid*.

person is taxed on income that is not immediately used to acquire goods and services that produce "'usances' and satisfactions,"[138] it has been central to arguments by consumption tax advocates that the income tax results in the double taxation of saved income.[139]

2. As Haig provides no justification for the existence of an income tax, it is difficult to understand the purpose that his proposed definition is intended to serve. To the extent that the definition advances a utilitarian conception of distributive justice, I will draw on Ronald Dworkin (among others) to argue that this conception is not compatible with the values of a liberal society. To the extent that the definition is intended to advance a more narrow conception of tax fairness or tax equity, the definition (and hence personal consumption taxation or broad-based retail sales and value-added taxes) may have merit as a criterion for financing public goods and services in a manner that reflects the price that taxpayers would be willing to pay for these goods and services (which is apt to correspond to the marginal utility from private consumption)..

3. Simon's initial conception of personal income as "broadly, the exercise of control over the use of society's scarce resources"[140] is really more compatible with an annual wealth tax than with an income tax. Only after articulating this initial definition does Simons introduce the element of periodicity that converts what would otherwise be a wealth tax into an income tax.[141]

4. Although communitarians often advocate annual wealth taxes in order reduce economic inequality,[142] its compatibility with the values of a liberal society is

[138] *Ibid*. at 58 ("No great harm is done if the person who postpones spending his money is taxed upon it when he receives it rather than when he spends it.").
[139] [cite John Stuart Mill, William Andrews, Ed McCaffery, Bankman and Weisbach]
[140] Simons, *Personal Income Taxation*, *supra* note 1 at 49.
[141] See *supra* notes 42-47 and accompanying text.
[142] See, e.g., Avi-Yonah, "The Three Goals of Taxation" *supra* note 12.

uncertain.[143] To the extent that differences in personal wealth reflect different decisions about saving and spending, they are precisely the sort of differences that a liberal society generally respects. Although a liberal society may have legitimate concerns about the distribution of economic resources (among other reasons, because of the impact that extreme inequality can have on democratic institutions), the redistributive instruments that it employs for this purpose should be compatible with the respect that it accords to individual choice and autonomy.

5. To the extent that Simons' argument for a redistributive personal income tax is premised on the assumption that progressive taxation is "the only sound and promising method" for mitigating inequality,[144] the history of postwar spending programs (especially public health and education) and transfer payments (public pensions,. unemployment insurance, and social assistance) is difficult to ignore. Given the experience with these programs, which have arguably done more to mitigate economic inequality than any tax,[145] it is not at all clear why a socially and fiscally responsible government would not design its redistributive policy to raise a targeted amount of revenue with the least economic cost, using these revenues to mitigate economic inequality through spending and transfer programs. This, of course, is the argument that op0timal tax theory has advanced.[146]

6. As a result, the arguments that underlie the Haig-Simons definition of income fail to provide a convincing foundation for the taxation of personal income. Nor, I believe do the implications of each definition which would, in principle, include in taxable

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143 [cite Rakowski]
144 Simons, *Personal Income Taxation*, *supra* note 1 at vii.
145 [cite Zolt and Bird]
146 [cite, e.g., Bankman and Griffith on progressive tax rates]

income imputed income from leisure, self-performed services and the use of consumer durables, the value of gifts and inheritance above a very small annual exemption, and all gains regardless of whether they have been realized. Although it is impossible in this brief form to fully sketch out my arguments to this effect, I will argue: (1) that the inclusion of imputed income from leisure, self-performed services and the use of consumer durables contradicts values of individual autonomy that are central to a liberal society;[147] (2) that the inclusion of gifts and inheritances in an annual income tax disregards the special character of these receipts which, as I have argued elsewhere,[148] should be subject to a separate lifetime accessions tax which would exempt moderate sums from any tax and apply higher rates than the income tax to substantial transfers of wealth;[149] and (3) that the inclusion of unrealized gains in all circumstances would also undermine liberal values of individual autonomy, requiring persons to pay tax on increases in the value of items (e.g., a personal residence or a work of art) that they hold for their use value simply because their exchange value has increased.[150]

IV. Toward a Market-Based Conception of Income

In this section, I propose to build upon the critique of the previous section, by advancing a positive conception of income based on participation in the market economy. This conception should reflect an underlying conception of distributive justice consistent with the values of a liberal society and should be compatible with moral intuitions

[147] [cite Kelman and others; need to address arguments advanced by Shaviro and Stark]
[148] David G. Duff, "Taxing Inherited Wealth: A Philosophical Argument," *Canadian Journal of Law and Jurisprudence* 1 (1993).
[149] Interestingly, Simons himself seems to share this view, given his recommendation for a supplementary levy on inherited wealth in the form of a lifetime accessions tax. See *supra* note 109-13 and accompanying text..
[150] [explain by reference to Aristotle, *The Politics*]

regarding the scope of appropriate inclusions. With respect to the former, I believe, the centrality of markets to modern economic life, the inherently social nature of market interactions, the element of fortuity to market outcomes, and the widely divergent results that markets produce combine to justify an income tax designed to mitigate not economic inequality per se, but inequalities resulting from the market economy. With respect to the latter, moreover, a conception of income based on participation in the market economy would disregard imputed income from leisure, self-performed services and the use of consumer durables, the transfer of accumulated wealth by way of gift or at death (recognizing that these receipts should be subject to a separate tax on the transfer of wealth), and the taxation of unrealized gains on items that are valued for their use rather than their exchangeability. As in any area of law, there will always be difficult borderline issues to decide, but we should at least try to draw these lines for the right reasons.