HOW SHOULD GIFTS BE TREATED UNDER THE FEDERAL INCOME TAX?

David Hasen[*]

2018 MICH. ST. L. REV. 81

ABSTRACT

No consensus exists regarding the proper income tax treatment of gifts. Some commentators believe the tax should fall on the donor only; others believe it should fall on the donee only; and still others believe it should fall on both the donor and the donee.

Although much of the disagreement appears to center on the proper definition of "income," this Article argues that the problem lies elsewhere. There is no readily identifiable, correct definition of "income," which means that most arguments tying the income tax treatment of gifts to the income concept tend to be definitional and, for that reason, circular. In fact, what motivates most theories about the proper income tax regime for gifts is a prior view about the nature and purpose of government coupled with a theory of how the tax system should best promote that view. Commentators debating the rules for the income taxation of gifts rarely argue explicitly about their prior views, however, and it is not clear whether, if they did, they would be able to resolve their differences. Accordingly, the debate over the proper income taxation of gifts is in some measure a pseudo-debate.

Problems with efforts to derive normative propositions about taxation from the definition of the tax base are not unique to the gift case; they extend to other debates as well. The analysis therefore has relevance to normative tax scholarship more generally.

TABLE OF CONTENTS

* Professor of Law, University of Florida Levin College of Law. Thanks to Brian Galle and Doug Kahn for comments on earlier drafts, and to the editors of the *Michigan State Law Review*. The University of Florida provided principal research support. I remain solely responsible for any errors.

INTRODUCTION

It is perhaps surprising that no consensus exists regarding the proper income tax treatment of the following transaction: *A* makes a cash gift to *B*.[1] Since the inception of the modern income tax, the rule has been that *A* is taxed (by means of the denial of a deduction for the gift), while *B* is not,[2] but tax scholars frequently have

---

1. A related set of issues concerns whether a transfer for less than full consideration is a gift in certain borderline situations, such as non-obligatory transfers from service recipients to service providers. This set of issues has also generated a large body of case law and scholarship, but it is not the focus of the present discussion, which assumes the transfer is unambiguously a gift and asks what the income tax regime for such a transfer should be. For commentary and authority on the issue of what does or should constitute a gift, see Douglas A. Kahn, *The Taxation of a Gift or Inheritance from an Employer*, 64 TAX LAW. 273, 273-74 (2011), and authorities cited therein; William A. Klein, *An Enigma in the Federal Income Tax: The Meaning of the Word "Gift,"* 48 MINN. L. REV. 215, 215-23 (1963), and authorities cited therein.

2. 26 U.S.C. § 102(a) (2012). (Henceforth, all statutory citations are to Title 26 of the U.S. Code, the "Internal Revenue Code of 1986" as amended.) A largely opposite regime applies to built-in gain or loss on gifted property: The donor is not taxed on the gain, but the donee is, albeit not until the property is disposed of in a taxable transaction. *See* § 1015(a)(1) (carryover basis to donee for appreciated gifts); § 1001(a) (gain (loss) realized equals the difference between the amount realized (seller's adjusted basis) and the seller's adjusted basis (amount realized)). The special features for taxation of built-in-gain seem to relate to practical questions about the optimal taxpayer given that Congress has chosen to tax just one party; they do not seem to relate to a different normative theory about who should bear the tax in the case of such gain.

A separate gift tax applies to donors on certain gifts, but the gift tax is a part of the federal transfer tax regime, which comprises the estate tax, the "generation-skipping tax," and the gift tax, not of the income tax. *See* § 2501; *see generally* §§ 2101-2664. In addition, the income tax provides a deduction for certain charitable gifts, but for policy reasons not entirely related to the concept of the disagreed about whether that is the right rule. Some believe it is,[3] others have argued it is backwards,[4] and still others have said it goes only halfway: Donors should not enjoy a deduction for gifts they make, but donees should be taxed on gifts they receive.[5]

Disagreement among proponents of the various views often has centered on the meaning of the term "income,"[6] but the long history of contention over the question suggests the problem lies elsewhere. This Article argues that the disagreement is properly traceable to conflicting and to some extent irresolvable philosophical commitments that proponents of the various positions have adopted; it does not have to do with determining the correct definition of "income," an enterprise that is probably doomed to failure anyway. The argument implies that disagreements over the income concept as it relates to gifts tend to be semantic. Stated otherwise, the debate has in some measure operated at the level of competing tautologies.

As an example, if one believes income to be a proxy for well-being or utility (sometimes generally referred to in this Article as "welfare"), taxation of both parties could follow, as could relatively lighter taxation for gifts, depending on the extent of the government's interest in using tax rules to promote certain behavior

---

proper measurement of income. *See* § 170. *See generally* John D. Colombo, *The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 659, 659 n.11 (2001). This Article addresses neither the transfer taxes applicable to certain gifts nor the policies that underlie the deduction under section 170.

3. *See, e.g.*, Douglas A. Kahn & Jeffrey H. Kahn, *"Gifts, Gafts, and Gefts"—The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 483 (2003).

4. William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 348 (1972).

5. Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177, 1179 (1978); Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 28 (1992); Lawrence Zelenak, *Commentary: The Reasons for a Consumption Tax and the Tax Treatment of Gifts and Bequests*, 51 TAX L. REV. 601, 601 (1996). As far as I am aware, no one has explicitly argued for the fourth possibility: deduction to donor and exclusion for donee, but welfare-type arguments could support such a regime or something similar, such as reduced rates on gifts. *See infra* notes 12-15 and accompanying text.

6. *See, e.g.*, Dodge, *supra* note 5, at 1182-83 (treating as income the taxpayer's ability, relative to other taxpayers, to pay for public goods); *see* Kahn & Kahn, *supra* note 3, at 454 (treating as income the taxpayer's right to determine the preclusive use of resources produced through economic activity); Kornhauser, *supra* note 5, at 32 (treating as income the right to affect consumption).

as well as on the actual facts of the case. Conversely, if one begins with a definition of income that limits it to something like command over resources or ability, where "ability" means capacity in resources the government itself can use, taxation of just one of the parties to the transaction likely would follow, albeit with disagreement over whom. Those who identify income with resources produced through economic activity generally consider the donor to be the proper taxpayer,[7] while those who identify income with ownership of a portion of such resources generally consider the donee to be the proper taxpayer.[8] (An intermediate rule that taxes both parties to the same total extent but only on a share of the total gift also is possible.) In either case, however, there is no way to adjudicate between the two positions without also engaging the question of whether one ought to consider income a proxy for welfare, or a concept reflecting a measure of control over usable resources, or as implementing some other ideal. In short, nothing will be settled by trying to derive the correct tax rule for gifts from the definition of "income" without also having informed that definition by means of a theory of social and political obligation.

Two of this Article's ambitions are to show how the debates as they have evolved relate to the more foundational philosophical questions described above and to clarify the implications of several of the various views for the income taxation of gifts. I do not take a position on which view is correct. Instead, I conclude that any of a number of possible regimes, including the regime in effect, are equally reasonable, depending on what one takes to be the purpose of the tax system. What I hope to show is that much of the apparent disagreement about the proper taxation of gifts is really disagreement over other issues that is likely not resolvable and that, at all events, has generally not been engaged by commentators in the debate over the income tax treatment of gifts. A further point is that coherence in normative orientation can make for what might seem to be strange bedfellows. For example, the idea that the income tax should be progressive may entail that psychic benefits or welfare also be part of the "income" tax base (at least setting aside administrative and other practical considerations), a position that many commentators who defend progressivity reject.[9]

---

7. *See, e.g.*, Kahn & Kahn, *supra* note 3, at 452.
8. *See, e.g.*, Andrews, *supra* note 4, at 348.
9. As an example, Henry Simons, widely acknowledged as the progenitor of the modern concept of income, defined it in terms of economic power, not utility.

A final ambition is to suggest that the type of problem discussed here is not unique to the question of how the income tax should apply to gifts. Like any tax base, the income base reflects an effort to operationalize a prior set of normative commitments; it does not, by itself, function as a final normative authority. Scholars should be aware of the limited serviceability of tax base concepts as guideposts to tax rules when they seek answers to foundational normative questions. The base serves as a heuristic, not as an Archimedean point.[10] Therefore it often will not be possible to settle normative tax questions through analysis of the principles that determine what is in or out of the base.

SCHOLARLY APPROACHES TO THE INCOME TAXATION OF GIFTS

Three broad philosophical orientations dominate the current literature on theories of social and political cooperation: welfarist-type theories, under which some social good is sought to be maximized without regard to any particular individual's superior entitlement to anyone else's;[11] libertarian or quasi-libertarian theories, under which government is viewed solely as providing otherwise unavailable benefits to individuals who owe few or no duties to each other beyond those established through voluntary agreement;[12] and, for lack of a better term, fairness-based theories, under which some principle of resource distribution in accordance with merit or desert both alters the allocation of resources that results from private voluntary activity and is subject to significant

---

See infra notes 22-24 and accompanying text. *See also* Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?*, 89 YALE L.J. 1081, 1096-97 (1980) ("The respect accorded noneconomic differences by our political system . . . arguably [] derives from fundamental views about the primacy of persons over things, views that assume it is possible to treat people as distinct from their product, whether consumed or not, a distinction that would not obtain under the broader utilitarian view of distributive justice.").

10. In a well-known article, Boris Bittker developed the related idea that the concept of income is incapable of providing a rule for what counts as an acceptable versus an unacceptable departure from a comprehensive income tax base. *See generally* Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967). The argument here extends Bittker's by noting that a problem with comprehensive bases (be they income, consumption, or something else) is that they reflect intermediate judgments about how to allocate and distribute tax burdens, not final ones.

11. The main historical antecedent is the utilitarianism of Bentham.

12. *See, e.g.*, ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 297 (1974).

limitations.[13] Each approach might provide a different justification for income as a tax base and, by extension, a different rule for the proper income taxation of gifts because each position implies a different view about the purpose of an income tax and, consequently, about the meaning of "income" itself.

Of primary significance, most,[14] but not all,[15] commentators in the tax literature do not explicitly associate themselves with any of these approaches. Instead, they proceed to define "income" in some way and then to argue for a regime for gifts on the basis of the definition. In order to highlight the conceptual problems with this way of proceeding, the discussion below is organized much as the literature has organized itself. It asks first whether the gift is income to both the donor and the donee or to just one of them. It then asks, in the case where the answer to the first question is that the gift is income to just one party, which party. The main conclusion of these inquiries is that the definition of income itself is somewhat arbitrary, for the reasons described above. A secondary conclusion is that some common intuitions about what an income tax should and should not require or permit are in some measure inconsistent with each other even though they often are found together.

A. Double Taxation

Proponents of double taxation can be found in each of the three camps just described. The argument of this Section is that welfare-based and fairness-based views may support double taxation under certain assumptions, while a libertarian-type view, sometimes referred to as a "real asset" or "classical income" base, does not.

1. *Welfarist Views*

The idea that tax burdens should be allocated so as to maximize overall utility or some other aggregately determined quantity has a

---

13. John Rawls was the most prominent contemporary proponent of such a view. *See generally* JOHN RAWLS, A THEORY OF JUSTICE (1971).

14. *See, e.g.*, Dodge, *supra* note 5, at 1185 (explaining "income" means the relative capacity of the taxpaying unit to contribute to the public sector); Kornhauser, *supra* note 5, at 32-37 (explaining "income" means the ability to pay as measured by economic power to consume or dispose of wealth).

15. *See generally* Louis Kaplow, *Tax Policy and Gifts*, 88 AM. ECON. REV. 283 (1998) (adopting an explicitly welfarist approach to the tax policy for gifts).

long pedigree.[16] Against an assumed backdrop of free market exchange, the principle for taxation generally would be to assign burdens so that the loss in welfare, or utility, from taxpaying is minimized.[17] If the customary assumption of the declining marginal utility of resources also is made, then a principle of disutility minimization generally would result in some scheme of progressive taxation, more or less regardless of the actual base, assuming the base is measured in real resources and not in utility itself. Progressivity follows because the declining marginal utility of actual resources means that the amount of utility the taxpayer derives from enjoying more of the explicit base—be it consumption in the case of a consumption base, income in the case of an income base, and so forth—declines with each additional unit of the resource made available to the taxpayer. Because individuals get more utility out of the first dollar earned (income) or spent (consumption) than out of the millionth, it makes sense to take a larger portion of the millionth than of the first, setting aside incentive effects of the tax. In point of fact, under a social welfare function that values all utility equally and assumes utility corresponds to wealth, the only limitation on equalizing all incomes would be the incentive effects of taxation at 100% for all income in excess of the mean income.[18]

Under a welfarist view of this kind, the actual tax base—say, accessions to wealth or amounts expended on consumption—represents merely an approximation of what we want to tax. That is, because it is not possible to observe or tax welfare directly, a proxy is needed. Consequently, when a straightforward application of the base to a particular situation characteristically results in a substantial departure from what the system attempts to approximate with the base, a case is made for departing from the base, resulting in what may appear to be either double taxation or failure to tax. The typical gift represents such a situation. The giving of a gift, because it is by nature a voluntary act, must be understood to generate some benefit to the donor at least equal to the welfare (or to the utility, psychic

16. For an overview of utilitarian theories of taxation and problems with implementing a tax based on utility, see Carolyn C. Jones, *Treatment of Gratuitous Transfers: Unraveling the Case for a Consumption Tax*, 29 ST. LOUIS U. L.J. 1155, 1162-67 (1985).

17. See Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 455-61 (1952), for a discussion of the related “equal sacrifice” principle under which tax burdens are assessed based on utility.

18. *See id.* at 467-68.

benefit, etc.) to the donor of what is surrendered; otherwise the gift would not be made. In the meantime, the donee must be understood to enjoy a benefit at least equal to the benefit he or she would enjoy had the value of the amount received been earned. Indeed, it is likely greater inasmuch as the (typical) disutility of work is avoided. Thus, apparent double taxation follows if the donee is taxed on after-tax dollars received from the donor, assuming the donor receives no offsetting deduction. Yet because the relevant criterion is posited to be welfare or some other psychic characteristic and not money, no double tax actually would arise, assuming the true objective is to tax welfare and not its proxy. Barring administrative concerns, and setting aside incentive effects, the proper rule would require donees to report gifts as taxable income while continuing to deny a deduction to donors.[19]

The preceding analysis is incomplete because it does not take into account incentive effects of the tax rule, as most utility views would.[20] If the donee is taxed, the donee's tax liability may make enough of a difference to the donor's utility to cause the donor not to make the gift. For example, suppose that, prior to accounting for the donee's tax liability, the donor derives $125 of utility from a $100 gift to the donee and that all of the donor's alternative uses of the $100 consist of consumption purchases from which she would derive no more than $100 in psychic benefit. If the donee's marginal bracket exceeds 20%, and assuming the donor's utility from the gift varies directly with the amount of the donee's after-tax income, the donor will not make the gift because an after-tax gift to the donee of less than $80 will produce less than $100 of utility to the donor. The tax results in a total loss in social welfare of at least $100 (measured in the donor's terms) from failure of the gift. Thus, under this approach, relatively lighter taxation of donors, and possibly even a net subsidy, would be appropriate because the total utility from the gift is roughly twice the total utility from the donor's own consumption.[21]

19. See JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY, Book V, Ch. 2, § 5 (1885), for an early statement of this view as applied to inheritances.

20. *See* Kaplow, *supra* note 15, at 283. Kaplow provides an example of an approach that focuses on the incentive effects on utility of taxing gifts. *Id.*

21. *See id.* at 284-85.

2. *Classical Income View*

The main alternative to the view that income functions as a proxy for welfare is the classical view of income developed over the course of the first half of the twentieth century by Robert Haig, Georg Schanz, and later, Henry Simons.[22] Under the now-familiar "Haig-Simons" definition, personal income is "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 end of the period in question."[23] In essence, personal income is the increase in the market value of the taxpayer's economic rights during the accounting period, recognizing that rights cashed out in consumption are income nonetheless. In theory, this definition reflects the concept of "ability to pay," where ability is understood in terms of real goods or services in principle available to pay for government, regardless of whether the taxpayer has voluntarily transformed some of those rights into consumption benefits.[24] This classical view, sometimes referred to herein as the real asset view, though neither strictly implying nor strictly implied by libertarian social theory, does have significant affinities with such a theory. If, for example, one considers the primary purpose of taxation to be to pay for public goods and that the extent of enjoyment of public goods roughly corresponds to the material resources one is able to obtain through markets that are established and protected through the provision of public goods, then the real asset view of taxation would seem to follow.[25]

Depending upon one's approach to the status of consumption items as a proxy for income, the classical definition may seem to support taxation of either: (a) one of, but not both, the donee and the donor, or (b) both the donee and the donor (by means of taxing the donee and denying the donor a deduction).[26] Here I argue that the

---

22. *See* Bittker, *supra* note 10, at 932; Carl S. Shoup, *The Schanz Concept of Income and the United States Federal Income Tax*, 42 FINANZARCHIV 433, 434 (1984).

23. *See* HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938).

24. See Kahn & Kahn, *supra* note 3, at 452-54, for a development of this point.

25. F.A. Hayek is an exemplar of this view. *See generally* F.A. HAYEK, THE CONSTITUTION OF LIBERTY 307 (1960).

26. As far as I am aware, no one in the classical income camp regards as reasonable the fourth possibility—deduction to donor and exclusion for donee—since it would eliminate the resources that gifts consist of from the tax base.

classical income view logically supports single taxation only. Those who argue for double taxation under the classical view in fact revert to either a welfarist approach or a fairness-based one (discussed below). In Section B, I argue further that, apart from reasons unrelated to the concept of income, under the classical or real asset view the single tax properly should fall on the donee if one has decided that income is a measure of ability in resources possessed (an accessions tax), but on the donor if it is a measure of resources produced (an accumulations tax).

The claim has often been advanced that the classical view supports double taxation of gifts.[27] Double taxation rests on the intuitive idea, already explored, that the donee has experienced an increase in wealth by reason of the gift,[28] while the donor is in a position no different from the purchaser of a consumption item who enjoys no deduction by reason of the consumption.[29] As regards the donee, the fact that the increase in wealth comes by way of gift rather than the donee's own labor seems, if anything, to strengthen the case for donee taxation. Under an accessions income tax, the focus is on the extent to which the taxpayer has been enriched during the accounting period, not on whether the enrichment involved the creation of wealth;[30] the fact that the wealth received was not the product of as yet-untaxed economic activity is not relevant.[31] Further, earning income typically requires bearing psychic costs—the disutility of work—while receipt of a gift does not.[32] Although we do

---

27. *See, e.g.*, SIMONS, *supra* note 23, at 125; Dodge, *supra* note 5, at 1185-86; Kornhauser, *supra* note 5, at 28.

28. *See* Dodge, *supra* note 5, at 1177; *see also* Klein, *supra* note 1, at 226.

29. *See* SIMONS, *supra* note 23, at 128. More recently it has been advocated in various forms by Joseph Dodge and Marjorie Kornhauser. *See* Dodge, *supra* note 5, at 1185-86; Kornhauser, *supra* note 5, at 28. I review their arguments below.

30. *See* Dodge, *supra* note 5, at 1185.

31. *See* Comm'r v. Glenshaw Glass, 348 U.S. 426, 431 (1955). In *Eisner v. Macomber*, 252 U.S. 189 (1920), an early income tax case, the Court had defined "income" as "'the gain derived from capital, from labor, or from both combined.'" *Id.* at 415 (quoting Stratton's Independence, Ltd. v. Howbert, 231 U.S. 399, 415 (1913), which was a case dealing with the pre-Sixteenth Amendment corporate tax). In *Glenshaw Glass*, the Court stated that the earlier definition had not been intended to limit the concept of income to amounts the taxpayer so produced but rather that, under the income tax, income included amounts "clearly realized" whether or not the product of the individual's productive labor or capital. 348 U.S. at 431. On this basis, the Court held that punitive and exemplary damages the taxpayer received were includible in income. *Id.*

32. See Klein, *supra* note 1, at 227, for a discussion of this point and related legislative history.

not generally provide a deduction for psychic costs, it nonetheless seems that if we are willing to tax the earner on the full value of wages even in light of the psychic costs she must bear, then the donee is at least as worthy of bearing the full tax associated with the same wealth increase when the donee incurred no psychic detriment to obtain the wealth.

As regards the donor, the psychological parallelism between the use of income for purchase and its use as a gift suggests that no deduction should be available. In both cases, the person parting with the wealth does so voluntarily, and consequently it seems that what is received "in exchange"—namely, the psychic benefit—must be of at least equal value to what is surrendered, for otherwise the transaction would not take place. As in a purchase transaction, the donor has merely swapped physical wealth for psychic wealth or, what seems the same, has generated the corresponding benefit through spending. Indeed, a number of commentators view the equivalence between the consumer's benefit from consumption and the donor's from giving as bordering on self-evident. Professor Joseph Dodge, for example, states in an influential 1978 article: "[T]he donor's voluntary transfer of the gift itself indicates the donor's ability to pay."[33]

The difficulty with this argument is that appeal to the analogy between the psychic income from consumption and that from giving appears to be question-begging, while the reasoning that independently would support identical treatment of the two transactions under a real asset view is suspect. As regards the analogy, it simply does not follow from the fact that preclusive consumption and voluntary giving both generate psychic benefits that the donor has "income" in both cases. Rather the very question is whether one should consider psychic benefits to be income.

As regards the reasoning, consider that after the gift, the donor plainly has fewer resources than before. Therefore the gift can be said not to affect the donor's ability to pay only if one has decided that something other than the psychic benefit resulting from the gift contributes to the donor's income—that is, to her ability to pay—by at least as much as the amount given has reduced it. It is, however, unclear what that something would be.

The most natural objection to this argument is that it appears to prove too much. If for tax purposes we are unwilling to treat as the

33. Dodge, *supra* note 5, at 1186. *See also* Kornhauser, *supra* note 5, at 37-38.

equivalent of wealth the psychic benefit the taxpayer receives by voluntarily parting with the gift, why are we willing to assert the equivalence in the case of the conversion of wealth into a consumption experience in (or following) a market transaction? After all, no one disputes that the concept of ability to pay properly includes the market value of rights consumed during the period. If it does, do we not, after all, have a basis for concluding that the psychic benefit from personal consumption is what justifies denial of a deduction for that consumption? What, in short, is the difference between the purchase of a psychic benefit realized in consumption and its derivation from a mere transfer to another by gift that warrants retention of the first but not the second in the tax base? In both cases, the taxpayer is left without the wealth but with a psychic benefit obtained by its disposition.

However intuitive the objection may appear, it fails because it presupposes that the reason for including purchased consumption items in the base is the equivalence of the psychic value to the taxpayer of the thing purchased with the wealth used to purchase it. In fact, circumstances besides psychic benefits support the inclusion of the value of consumed items in a real income base, among them that the consumption reflects the direction of real assets to the consumer for his preclusive use.[34] When *Moviegoer* purchases a movie ticket, the movie-watching experience goes to *Moviegoer* and not to someone else. Preclusive use is not so much destruction as it is transformation into a subjective flow of services that are now internal to the consumer; it is of no consequence that the consumer received psychic value from the flow that (typically) is at least roughly equal to its fair market value. Indeed, the tax is the same on the consumer regardless of how much she values the psychic flow. In short, it is not the psychic benefit that justifies denial of a deduction on consumption but the fact that the consumer no less "has" the thing consumed by virtue of the consumption than she did before, when she owned it. Thus, contrary to the suggestion above, and unlike in the gift case, the consumer of a good or service is not without the item when she consumes it; she merely has it in a different form.

One might reply that the above argument is inconsistent with the treatment of business outlays, which generally are recoverable

34. Kahn & Kahn, *supra* note 3, at 461, address this argument as well, though their opposition to double taxation rests on a view different from the one developed below.

for tax purposes,[35] apparently precisely because, unlike personal outlays, they do not provide a psychic benefit. But this reply too is mistaken. To be sure, as a general matter, some sort of cost recovery (typically either immediate deduction, or capitalization[36] coupled with depreciation or amortization[37]) is available for business outlays but not for personal ones.[38] Moreover, it is generally true that business outlays, unlike personal ones, do not supply a psychic benefit.[39] However, the reason cost recovery for business outlays is available has nothing to do with the absence of psychic benefits; rather, it has to do with the timing of the benefits that are expected to be realized from the outlay. For one thing, a business outlay does not represent a loss to the taxpayer.[40] It is, after all, voluntary. Therefore the expected benefits from the outlay must at least equal those that would be gained on an alternative personal outlay; otherwise the taxpayer would not make it. Under the theory advanced by those who view psychic benefits as income, it would seem no deduction at all under a psychic benefits theory should be available for business outlays.

More to the point, the difference between the two types of expenditure is merely one of timing. A business outlay is an investment in anticipated future income.[41] As contrasted with a personal outlay, the use of a good or service for business purposes constitutes its transformation into something else that will be separately accounted for as an income item later on.[42] In short, cost

---

35. *See, e.g.*, I.R.C. §§ 162(a) (2012) (deduction for "ordinary and necessary" business expenses); 167(a) (depreciation deduction for capital assets used in a trade or business or for the production of income); 212(1) (deduction for expenses incurred in the production of income). In the discussion in the text, the terms "business expenses" and "business outlays" include outlays for the production of income.

36. *See* § 263(a).

37. *See, e.g.*, §§ 167 (depreciation of tangible property); 193 (amortization of certain intangible assets).

38. *See* § 262(a) ("Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.").

39. *See* Charlotte Crane, *Liabilities and the Need to Keep the Income Tax Base Closed*, 25 VA. TAX REV. 31, 44-45 (2005).

40. David Hasen, *The Tax Treatment of Advance Receipts*, 61 TAX L. REV. 395, 434 n.178 (2008) (discussing the principles of business cost recovery).

41. *See* Crane, *supra* note 39, at 44-45 (observing that amounts spent in business do not generate a loss but, instead, that "value [spent to produce income] is replaced by income earned in the normal course of the taxpayer's business"); *see also* David Hasen, *supra* note 40, at 434 n.178.

42. *See* Crane, *supra* note 39, at 44-45; Hasen, *supra* note 40, at 434 n.178.

recovery for business outlays reflects an accounting convention, not a view about the absence of psychic benefits.

To see this point, consider the case of equipment used to produce inventory. From a business perspective, the equipment is effectively transformed into the inventory over time. When the inventory is sold, the consumed equipment is recovered in the sale. Where cost recovery for the equipment is allowed, the cost of goods sold does not include the apportionable cost of the equipment, precisely because it has already been recovered.[43] However, one could equally deny the cost recovery deduction for the equipment and instead add its cost to the cost of the inventory (thereby reducing income realized on its sale) to get an accurate measure of the taxpayer's income. Indeed, this regime does apply to certain taxpayers in certain cases.[44] Under it, there is no deduction for business outlays because, as always, there is no loss, and because the taxpayer still "has" the item expended; it is embodied in the good or service that the taxpayer sells. Here, there would be no deduction even though there is no psychic benefit.

The point for present purposes is that personal consumption does not differ from business consumption in that both consist of the use of one thing to affect the properties of another—the equipment to make the widget; the hamburger to sustain the eater. The two are the same just in the sense that the properties of what is consumed have a particular effect on or embodiment in something else and do not reflect a loss of the taxpayer. The difference in the personal setting is that the properties are embodied immediately in something the taxpayer seeks for her own benefit as an end rather than for the purpose of realizing income in the future, but this truth does not affect the basic point that the reason the taxpayer is not worse off (under a real asset view) by reason of the consumption—whether business or personal—is not that she has a psychic benefit but that she has simply changed the asset from one form to another of equivalent real (not psychic) worth. Further, whether the end generates a psychic benefit of equivalent value to the cost of the thing consumed or not is beside the point; it does not alter the fact that the thing is transformed into, as it were, a property of the consumer—that is, it affects her person just through its

43. *See, e.g.*, Gardiner v. United States, 391 F. Supp. 1202, 1207-08 (D. Utah 1975), *aff'd*, 536 F.2d 903 (10th Cir. 1976).

44. *See* § 263A (discussing the capitalization and inclusion of costs of inventory of certain expenses).

transformation, but the tax reaches the thing or what it is turned into, just as in the case of a business outlay. Or, stated in the converse, the tax does not fail to apply merely because the physical wealth has changed its form but not its value.

Contrast this internalization or transformation that takes place in consumption with the benefit that *Donor* receives on making a gift. In a gift, no resources are directed to the donor or internalized by her, and the consumed item has no effect on her. The proper analogy in the exchange case to the *Donor*'s enjoyment of the gift therefore would not be to the consumer but to the provider of the consumed good or service. The analogy is not to *Moviegoer*'s enjoyment of a purchased movie-watching experience, but to *Cinema*'s psychic benefit (if any) derived from selling the movie-watching experience to *Moviegoer*. More generally, it is to the enjoyment, if any, that one derives from work. Like *Donor*'s enjoyment of *Donee*'s enrichment, *Cinema*'s would be derived apart from the direction to or destruction of resources for the benefit of *Cinema*. A person who likes his or her job is not said to have income from liking it unless income is understood to include psychic benefits. But this, of course, is just the point: Under a real asset view, income does not include psychic benefits. Moreover, if it did, it seems a deduction ought to be available for the psychic detriment associated with the more typical pain of earning income. It is generally taken as axiomatic, however, that the pain or "disutility" of earning income should not offset the income itself under a true Haig-Simons base.[45]

One might counter that the psychic benefit to *Donor* can be distinguished from the utility or, more often, disutility, from work in that *Donor*'s psychic benefit is a sine qua non of the gift, while *Cinema*'s is not of the sale. *Cinema*'s ticket sale to *Moviegoer* will occur whether or not *Cinema* enjoys providing the movie-going experience. But the significance of motivation for the psychic benefit to the tax treatment is murky. All that the observation establishes is that, if we were to tax on the basis of psychic benefits received, we could be confident that the donor's benefit at least equaled the value of the gift given. This argument presupposes that the reason psychic benefits and detriments are left out of the base is not that psychic effects do not count as income (or loss) but that it is too difficult to

---

45. *See* John K. McNulty, *Flat Tax, Consumption Tax, Consumption-Type Income Tax Proposals in the United States: A Tax Policy Discussion of Fundamental Tax Reform*, 88 CAL. L. REV. 2095, 2164 n.234 (2000).

quantify them, a difficulty absent in the gift case. If, however, that were the case, one would think some method of approximating them would be in order given the very real psychic benefits and detriments that many activities predictably entail. For example, for most people, work imposes substantial psychic costs. Why not incorporate some estimate of these costs into the tax base if we aim to measure income accurately and believe it to consist of psychic benefits? Further, why not tax income that is not accompanied with psychic costs, such as windfalls, more heavily than wage income?

One can summarize the argument of this section as follows: The fact that material resources are produced or obtained for the purpose of generating psychic satisfactions—in other words, the fact that consumption of physical resources is in a sense an intermediate rather than an ultimate value—does not imply that psychic satisfactions are the object of the tax. In fact, the point of distinguishing psychic satisfactions from income, if one is so inclined, is to insist that income is not reducible to psychic benefits. Income may be produced in order to realize psychic benefits, but it need not be considered the same thing. Again, the point is not that there is something in principle wrong with understanding income as a proxy for psychic benefits or "welfare" however construed, but rather that if one wishes to distinguish income from welfare, then one ought not justify the tax on consumption on the basis of the equivalence of the monetary value of psychic benefits derived from consumption and the thing (or service) consumed. Rather, the tax on consumption (as part of the definition of income as consumption plus change in wealth) follows from the fact that the income realized to finance the consumption is still "with" the taxpayer after consumption, not because of the psychic benefits but because the physical transformation of the real thing into a property of the taxpayer does not imply that the taxpayer no longer has the benefit of the thing transformed.

3. *Fairness Views*

A third strand of views considers taxation as a way to implement a principle of fairness.[46] Here the objective is not to

46. RAWLS, *supra* note 13, at 246-47 (explaining that John Rawls is the preeminent modern advocate of the idea of justice as fairness). Although Rawls voiced support for consumption taxation in *A Theory of Justice*, he also qualified the support as applicable to something akin to a first-best world and suggested that income taxation might be appropriate under actual historical circumstances. *See id.*;

allocate tax burdens in order to maximize some aggregate quantity, such as total welfare or utility, nor is it simply to finance government through available resources wherever they may be found.[47] Rather the objective is to allocate burdens in accordance with some principle of fair distribution, such as equality of opportunity or result, or respect for persons, and to do so based on relevant attributes of those who bear the burdens.[48] As an example, Ronald Dworkin argues for a principle of fair equality of resources, where equality is measured with respect to otherwise arbitrarily distributed endowments.[49] The idea is to eliminate the disparities in resources that result from these distributions but not those that result from individual choices. Under Dworkin's view, an income tax might implement such a distributive principle, and progressivity might be a feature of the tax.[50] As another example, John Rawls, though he voiced an abstract preference for an expenditure tax (i.e., a cash-flow consumption tax), acknowledged that in certain circumstances income taxation and indeed progressive income taxation could be an appropriate way to implement what he calls the difference principle, which requires that social institutions be structured to the advantage of the least-advantaged social group.[51]

In some respects, fairness views occupy a kind of middle ground between the welfarist and real asset views. On one hand, the rejection of market outcomes as necessarily determinative of the allocation of resources implies that societal goods are subject to more-centralized control than they are under libertarian theories: Government transfers may adjust market outcomes, as under welfarist theories. On the other hand, fairness views generally seek to redistribute resources based on some notion of individual merit or desert rather than with regard solely to what maximizes some desired end, such as utility. Under a fairness theory, not all social wealth is in principle available for government transfer simply because a different distribution or allocation would better maximize the total

---

see also JOHN RAWLS, JUSTICE AS FAIRNESS: A RESTATEMENT 160-61 (1985) (noting that proportional taxation might be applied if institutions otherwise satisfy the principles of justice).

47. *See* RAWLS, *supra* note 46, at 160-61.

48. *See id.* (explaining the way taxation can be used to implement a standard of fairness).

49. Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 PHIL. & PUB. AFF. 283, 307 (1981); *see also* ERIC RAKOWSKI, EQUAL JUSTICE 99 (1991) (adopting an approach similar to Dworkin's).

50. *See* Dworkin, *supra* note 49, at 325-26.

51. RAWLS, *supra* note 13, at 266.

pie.[52] In this respect, fairness theories resemble libertarian theories, with the difference that fairness-based views do not assume that market outcomes typically accord with merit or desert.

Corresponding to this intermediate position, whether any given fairness view authorizes double taxation of gifts depends on what it considers and does not consider to be available under a tax-and-transfer scheme to ensure a fair distribution of resources. For instance, consider the principle of guaranteeing substantive equality of opportunity. Under a strong version of this principle, each individual is entitled to some standard initial bundle of goods or opportunities, perhaps compensated to account for relatively fewer or greater benefits afforded by birth or social position, but not to more.[53] Under a weaker version of the principle, the government might ensure a baseline but not require equality of initial resources.[54] Now suppose in either case that the financing scheme for the guarantee is some amount of redistribution through taxation. The question is whether or not an individual's resources deemed available to fund the bundle include both amounts given (in the case of donors) and amounts received (in the case of donees). If the idea is that one should pay according to his or her welfare as provisionally evidenced by material resources rather than according to the resources themselves, it seems double taxation of gifts is appropriate since the donor's welfare includes the welfare produced through the gift and the donee has resources from the gift; the notion would be that the gift does not reduce donor welfare for the reasons already explored. If the idea is that one should pay according to material resources one holds, then it seems only a single level of tax should apply, and, for reasons developed below, it seems the tax ought not be progressive, and the liability should fall on the donee, not the donor. In short, as under the views already discussed, what counts as income for purposes of taxing gifts depends on which principle the income tax is thought to implement.

---

52. *See, e.g.*, *id.* at 28 ("[T]he rights secured by justice are not subject to political bargaining or to the calculus of social interests."); *see also* Dworkin, *supra* note 49, at 335-36 (arguing that society has no duty to maximize the utility of people who happen to have expensive tastes).

53. See generally Richard J. Arneson, *Against Rawlsian Equality of Opportunity*, 93 PHIL. STUD. 77 (1999) for a discussion of the principle of substantive equality of opportunity.

54. Rawls's difference principle is one example. Under the principle, social institutions must be arranged to the advantage of the least-advantaged group, but there is no requirement that more-advantaged groups be placed on the same footing as less-advantaged ones. *See* RAWLS, *supra* note 46, at 42-43.

Examples could be multiplied, but the logic is straightforward. A fairness view looks to some principle of merit or desert to inform the distribution of societal resources and burdens. If the view effectuates its desired distribution in whole or part through an income tax, the income tax treatment of gifts will depend on what is considered to be a resource subject to governmental control for this purpose.

4. *Notable Double-Tax Views*

The preceding three Subsections discussed in general terms the relationships between prominent theories of social and political organization and the associated concepts of income that would, in turn, inform the question of how to treat gifts under the income tax. The idea was to show how these theories do or do not support double taxation of gifts. This Subsection reviews two influential arguments for the double taxation of gifts. Here the object is to show how attempts to derive a rule for the taxation of gifts based on a definition of income—how, that is, efforts that proceed in the reverse direction—tend to founder.

a. Dodge's "Income in the Tax Sense"

In a 1978 article,[55] Dodge argued for double taxation of gifts on the basis that the donee clearly enjoys what he called "income in the tax sense," while the voluntary nature of the transfer makes the donor's position no different from that of a purchaser of a consumption item.[56]

For Dodge, income in the tax sense "describe[s] the measurement of the taxable unit's capacity to contribute to the public sector relative to other taxable units."[57] It is to be distinguished from income in the "economic sense," which refers to the creation of wealth and may be taken as an expression as well of early legal formulations of the income concept.[58] Perhaps the most well-known

55. *See generally* Dodge, *supra* note 5.

56. Dodge, *supra* note 5 at 1185-86 ("[T]he donor's voluntary transfer of the gift itself indicates the donor's ability to pay."). In a later article, Dodge argued that the same principle applies to a consumption tax. *See generally* Joseph M. Dodge, *Taxing Gratuitous Transfers Under a Consumption Tax*, 51 TAX L. REV. 529 (1996).

57. *See* Dodge, *supra* note 5, at 1185.

58. *Id.*

such legal formulation appears in *Doyle v. Mitchell Bros., Co.*, in which the U.S. Supreme Court said that income results from the activity of capital, labor, or the two combined.[59] As Dodge rightly notes, such a definition will not do for a concept of "personal" rather than aggregate (national) income if the object of the definition is to set forth a criterion according to which one can measure a given taxpaying unit's relative capacity to bear the costs of public sector finance (and presumably redistribution if desired).[60] Whether the taxpaying unit comes by the item through a zero-sum transfer (e.g., a gift) or by creating it, the material capacity of the taxpayer to bear the costs of government is increased to the same extent.[61] Dodge is correct that under an "income in the tax sense" standard, the donee's ability to pay has increased and, absent some overriding policy consideration,[62] ought to be viewed as taxable on the gift.[63]

As for the donor, the question whether a deduction ought to be available depends solely on that person's ability to bear those same costs. According to Dodge, no deduction is appropriate for the now-familiar reason that in the transfer the donor merely exchanges the physical asset for a psychic benefit of equal value, in effect "consuming" the gift.[64] As explained previously, however, under a real asset definition of income, the reason consumption items are not deducted from the income tax base is that they represent the conversion of physical assets (or services) into a property of the taxpayer, not that they generate a psychic benefit of equivalent economic value.[65]

It follows that Dodge's argument for double taxation of gifts is correct only if income in the tax sense includes psychic income. Although Dodge does not explicitly address the question, his conceptualization of income as ability to pay suggests he does not so understand it. He argues, for example, that a deduction for the donor is inappropriate because "the making of a gift represents the

---

59. 247 U.S. 179, 185 (1918).

60. *See* Dodge, *supra* note 5, at 1185.

61. *See id.* at 1186.

62. Among possible such considerations are the administrative difficulty of identifying gifts, the incentive effects on gift-giving of taxing the donee, and the fact that making the donee aware of the value of a gift may vitiate or even nullify the purpose of the gift.

63. *See* Dodge, *supra* note 5, at 1186.

64. *See id.* at 1186-87.

65. *See* Kahn & Kahn, *supra* note 3, at 454-55 (sharing a similar view about the purpose of the tax under the real asset view).

voluntary exercise of the donor's economic power."[66] The use of the term "economic power" suggests that Dodge means to focus on real assets or what he takes to be their substitutes—namely, the enjoyment derived from consuming or gifting them—as a definition of the base, but for the reasons already provided, grouping these together supposes that psychic benefits are part of the base too. Perhaps more importantly, if Dodge means that psychic benefits are to be included in the base, it becomes unclear why the base is limited to economic accumulations and the psychic benefits that come from disposing of them, whether by consumption or by gift. It rather seems that other psychic benefits and detriments ought to be included as well, such as the utility or disutility from one's work, or the enjoyment (or not) of one's family, or of prestige. Dodge does not suggest, however, an expansion of the income concept to include such benefits and detriments.

b. Kornhauser's "Power to Control Scarce Resources"

Professor Marjorie Kornhauser likewise claims that the Haig-Simons definition of income properly understood supports double taxation of gifts, though on a slightly different basis from Dodge. Kornhauser argues that the income concept includes not just, or even so much, the right to consume resources but the power to determine who consumes them—the "power to affect consumption."[67] Specifically, Kornhauser observes that Simons's definition embraces both consumption and accessions to wealth, and she argues that accessions differ from consumption not just in that they represent potential rather than actual preclusive use by the taxpayer but also in that they carry with them the power to determine the identity of the preclusive user.[68] In this sense, the term "income" as Simons employs it primarily identifies powers, not their exercise. Income consists of accessions to the powers to direct resources and to use them (consumption or preclusive use).[69] It is these powers, in turn, that determine the taxpayer's "ability to pay," the touchstone for Kornhauser of the income concept.[70] A tax on income therefore is a tax on the increase in powers.

---

66. *See* Dodge, *supra* note 5, at 1186.
67. Kornhauser, *supra* note 5, at 32.
68. *See id.*
69. *See id.*
70. *See id.*

Kornhauser is probably correct that this was Simons's view. As previously noted, Simons believed the double tax regime was appropriate for gifts, and Simons also viewed income as primarily power over economic resources, not as their use.[71] The donor plainly exercises power over the gifted property, suggesting that Simons considered the exercise of the power through the gifting of it to be the same as the exercise of the power through its consumption—neither represents a deductible outlay. Meanwhile, after the gift has been made, the donee enjoys the same powers to consume and to give as the donor enjoyed, suggesting that inclusion is appropriate for her as well.

Kornhauser's focus on powers also may appear to support treating the double-tax view as consistent with the real asset theory of income taxation, since the concept of ability to pay she adopts does not explicitly rest on psychic benefits or utility. In fact, however, Kornhauser's position amounts to either a restatement of a welfarist view or simply a stipulative definition of income; it does not authorize double taxation under the real asset view. To begin with, note that it is not obvious why, if income consists in part in the accession to the power to determine who consumes, the transfer of that power is not negative income. If the claim is that income does not result from utility but because the receipt of the power increases the taxpayer's ability understood in some other sense, then what is that other sense, such that the ability is not diminished on the transfer to another of the power to consume, since the power is now lost? The idea seems to be the by-now familiar one that exercise of the power to determine who consumes is analogous to the exercise of the consumption power, for which no deduction is available.

As developed above, however, ordinary consumption does not result in the loss of the thing consumed so much as its transformation, and this is why, on the real asset view, no deduction for consumption is allowed. Indeed, it is not so much that later consumption does not vitiate income but that the very point of treating accession to the power to consume as income is that the wealth will be consumed. By contrast, the power to determine the identity of the consumer has value only because, or at any rate primarily because, of the prospect of consumption itself.[72] If gifts

71. *See* SIMONS, *supra* note 23, at 49; Kornhauser, *supra* note 5, at 32 n.117.

72. See Daniel N. Shaviro, *Replacing the Income Tax with a Progressive Consumption Tax*, 102 TAX NOTES 91, 103-06 (2004), for a discussion of this point.

were outlawed, goods and services would still have value, but if the consumption of goods and services were outlawed, the making of gifts would not. The observation indicates that the value of the power to determine the identity of the consumer derives from the more basic value of consumption itself. That value is just the benefit that redounds to the consumer by the act of consumption.

Thus it is not surprising that in some cases, events following the accession to the power to consume are thought to justify a deduction of previously received income, even under the real asset view. Most theorists probably would agree that the conceptually correct treatment of an uninsurable casualty loss under the real asset view is a deduction.[73] Presumably the reason is that the taxpayer has lost the value of the wealth. She has never been able to make good, through consumption, the value of its receipt. If this is correct, the question becomes whether different treatment is appropriate when, in the case of a gift, the taxpayer also parts with that very same power. Of course the gift is voluntary, but that explains merely how the value comes to be transmitted (there is utility derived of at least equivalent value to the gift). But since the real asset view takes no account of utility in determining what counts as income, it becomes unclear why different treatment of the donor and the victim of the casualty loss would be appropriate. What, besides utility, does the donor obtain in the gift that offsets what is removed from her control by the gift? At least in a pure gift, where the object is not to influence the donee (or for that matter someone else) in the donor's favor, the donor receives nothing from the donee apart from the psychic benefit. The donor does not enjoy the benefit of the wealth, just as in the case of a casualty loss. The difference is that, unlike in the case of a casualty loss, someone else does enjoy the benefit. But

---

As developed later in this Subsection, there may be value in simply holding wealth, which value may in fact be captured under an inclusion–deduction regime for gifts.

73. *See generally* Richard A. Epstein, *The Consumption and Loss of Personal Property Under the Internal Revenue Code*, 23 STAN. L. REV. 454 (1971) (arguing generally that a deduction for a casualty is generally correct because it reduces the value of the taxpayer's store of rights). Until 2018, a deduction was available for personal casualty losses sustained by the taxpayer, subject to a number of limitations enacted mostly for administrative reasons. *See* 26 U.S.C. §§ 165(c)(3) (2012) (permitting the deduction), 165(h) (limiting the deduction to $100 per casualty per taxpayer and generally only to the extent that all such losses (to the extent in excess of $100 per casualty per taxpayer) exceeded of 10% of the taxpayer's adjusted gross income for the year). Congress suspended the deduction, with a few exceptions, for the years 2018-25. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 11044(a), 131 Stat. 2054, 2087 (2017).

that person would be taxed under a real asset view that focuses on ability to pay. One also could formulate the point as follows: There is no obvious reason why a voluntary reduction in ability to pay is not possible. Its being voluntary would defeat the claim that the taxpayer's ability to pay has been reduced only if what made it voluntary, namely, the psychic benefit, is part of the tax base.

All of this said, there is an aspect of Kornhauser's analysis that does seem to suggest that the power to determine who consumes wealth has value beyond the utility it affords the taxpayer. As she notes, in controlling the potential disposition of economic resources, the owner also exercises some control over others because resources are scarce.[74] If it matters to *B* whether *A* may benefit *B* in some way (through gift or otherwise) with her resources, then *A* may exercise some control over *B*, even if *A* ultimately does not benefit *B* at all. Indeed, it could matter to *B* even if the only prospect in view is that *A* may enter into a lucrative contract with *B* or exercise her wealth-derived influence in favor of *B* in some other way. In other words, possession of wealth confers a valuable power because the possession can affect the behavior of others in favor of the owner. Further, this power seems to be "real" in a way that the psychic benefit from giving (or consuming, for that matter) is not. It is not specifically the power to determine who consumes but more generally the power that comes with control over others through one's own control over scarce resources.

Perhaps ironically, it seems that an inclusion–deduction regime for gifts would precisely tax this very power because it seems to be embodied in the discounted value of a deferred deduction for the gift. If the taxpayer accedes to wealth in the first period and gifts it in a later period, the inclusion–deduction regime will require immediate inclusion and a later deduction of lesser economic value than if the gift were made immediately. Suppose, for example, that the donor earns $100 in Year 1 and gives the donee $100 one year later, together with the interest that is earned on the after-tax amount. Assume further that the tax rate is a flat 20% and the discount rate is 10%. The donor therefore pays $20 of tax in Year 1, leaving $80. In Year 2, the donor transfers $108 to the donee, of which $80 reflects the after-tax amount from Year 1, $20 is the tax benefit of the $100 deduction, and $8 reflects the interest earned during Year 1 that is neither included nor deducted by the donor. (This treatment of the interest is equivalent to the donor's including the $8, paying the tax

74. *See* Kornhauser, *supra* note 5, at 32.

on it, and then immediately giving the $8 and receiving an $8 deduction, canceling the tax.) The donee has $108 of income. The overall effect to the donor is that she pays $20 in taxes in Year 1 and receives $20 back in Year 2. The donor ends up paying tax on the time value of holding the $100 for a year because the Year 1 value of the $20 tax reduction in Year 2 is just $18.18,[75] resulting in a net real tax liability of $1.82 (in Year 1 dollars). In effect, the donor is taxed on the power to determine the identity of the consumer for the term during which she exercises the power.

In fact, taxation of the power to affect others really seems to be exemplified in the difference between an inclusion–deduction income tax regime and a cash-flow consumption tax as the two apply to gifts.[76] Consider again the preceding example, but under a cash-flow consumption tax (as understood under the real asset view). The donor would both include and immediately deduct the $100 on investment in Year 1. The $100 would earn $10 of interest during the year (not $8), and, taking the tax to apply only to actual preclusive use, would result in a non-taxed net transfer to the donee one year later of $110 rather than $108. As contrasted with the income tax version of the example, here no tax arises on the power to determine the identity of the consumer. The income tax includes an additional $1.82 in its base—the Year 1 dollar equivalent of the additional $2 transferred to the donee in Year 2. Thus, the income tax and the consumption tax differ just in that the latter reaches only consumption while the former reaches the power to affect consumption as well as consumption itself.

B. Single Taxation

As stated previously, a number of commentators have argued that the income concept supports taxation of just one of the parties to the gift—either the donee or the donor. This Section examines the idea of income as supporting single taxation.

An explicitly welfarist conception of income would support taxation of both the donor and the donee if the goal were simply to tax utility, without regard to the incentive effects of the tax itself.[77] For the reasons discussed in Section A, the grounds for concluding

---

75. That is, $18.18 grows in one year at 10% to $20.

76. As against the point made above, one can argue that the power is taxed even under a consumption tax because the exercise of the power ultimately yields consumed benefits to the donor. *See* Shaviro, *supra* note 72, at 103-06.

77. *See supra* Section A.

that the donor enjoys utility from the gift at least equal to its fair market value are overwhelming, while it seems reasonable to conclude, to a first approximation, that the donee enjoys utility equal to the fair market value of the gift given—certainly at least equal to face value in the case of a cash gift.

If, however, one considers the tax on gifts in light of the incentive consequences of the tax and with a view to maximizing welfare, one might reach a different conclusion. As also explained previously, a distinctive feature of many gifts is that they produce utility in a way that is not commensurate with resources consumed.[78] In the simplest case, if *A* gives *B* $100 in cash, *A* enjoys at least $100 of utility, and so does *B*; if *A* instead consumes the money, only *A* derives utility.[79] A tax on gifts that reduces the after-tax value to the donee of the gift below the donor's after-tax own-consumption value can result in failure of the gift and thereby in reduction of total utility by approximately the full (pre-tax) amount of the gift.[80] Thus there may be good grounds under a welfarist view for taxing gifts quite lightly or even for subsidizing them. In any case, however, whether one settles on single taxation or double but light taxation (or even single taxation at a reduced rate or a subsidy), the question of how heavy the burden should be is an empirical one under a welfarist analysis because it depends on the elasticity of gifts to taxes. It is also one of policy because it depends as well on one's view about the role of the tax system—whether it is to be part of a larger governmental program of maximizing utility or, more modestly, simply to withdraw private resources in a way that minimizes the disutility from doing so, assuming the pre-tax world operates as a baseline. Addressing these questions is beyond the scope of this Article. The point is that welfarist views have an ambiguous relationship to the tax on gifts.

The discussion below accordingly focuses on the single tax theory as applied to the classical income and fairness views of taxation. The general question is whether these views support

---

78. *See supra* Section A.

79. The discussion in the example ignores consumer surplus or the fact that an individual may value what is purchased or given more than its fair market value (face amount in the case of cash). *See* Henry E. Smith, *Intermediate Filing in Household Taxation*, 72 S. CAL. L. REV. 145, 157, n.32 (1998) (defining consumer surplus).

80. See Kaplow, *supra* note 15, at 284, for an exploration of the problem.

taxation of the donee or the donor.[81] I argue that there is no uniquely correct answer, just as in the case of the question whether a single or a double tax should apply to gifts; rather, one's answer depends on a prior and for the most part unreviewable decision about the purpose of taxation. Again, it is unreviewable in the sense that it depends on one's view about the nature and purpose of government, a topic that typically falls outside of most scholarly analyses of the income taxation of gifts.

1. *Donee Taxation*

Professor Andrews suggests, albeit with some reservation, that a real asset income tax would tax the donee and not the donor, at least in the absence of other, more pragmatic policy considerations.[82] The theory is straightforward. The donee is the one who takes a portion of the pool out of which government spending will be financed.[83] Treating the assets consumed as the stock out of which government spending occurs, the tax simply reaches a portion of that pool.[84] Concomitantly, the donor lacks the resources once the gift is made; hence the tax should fall on the donee (by means of an inclusion–deduction regime) if one considers the base of the tax to be ability to pay as determined by the resources the taxpayer controls.

The principle for donee taxation under a real asset view seems straightforward enough in the case of a flat tax but more problematic if the tax is progressive, as most national income taxes are.[85] As

81. Another theoretically possible outcome is "single" taxation divided between donor and donee. Such a tax would be single in the sense that it would not exceed, in total, the tax either party would pay if that party had earned the gifted amount. This possibility does not seem to be a live option under a pure version of the classical income view, since that view tracks resources. As noted below, however, the economic (rather than legal) incidence of the tax may be divided between the donor and the donee in many cases. *See infra* note 94 and accompanying text.

82. *See* Andrews, *supra* note 4, at 348 ("Ideally, perhaps, the tax should be on the donee rather than the donor."). Other considerations include the administrative problem of tracking gifts and the fact that reporting the value of gifts to donees may be inappropriate in some cases.

83. *See id.*

84. Kahn & Kahn develop this theory at some length in the course of their defense of donor-only taxation, which I discuss below. *See* Kahn & Kahn, *supra* note 3, at 454-55.

85. The Organisation for Economic Cooperation and Development reports that, as of 2016, 31 of 35 of its members (the Czech Republic, Estonia, Latvia and Hungary excepted) levied a personal income tax that features a progressive rate

noted, a common and plausible justification for progressive taxation is that higher-income individuals suffer less from bearing the same proportion of the costs of government than do lower-income individuals under the assumption of the declining marginal utility of money.[86] If the assumption is correct, a high- and a low-income person may bear equal psychic burdens from taxes even if the tax rate on the high-income person is higher than the rate on the low-income person.

Whatever its merits, when applied to the common gift case in which the donor is in a higher tax bracket than the donee, a deduction–inclusion regime for gifts seems to justify tax avoidance. If the objects of their bounty are in lower tax brackets, then through gifts donors can electively reduce the combined tax burden of the donor and donee and subvert the progressive rate structure.[87] The result seems to be problematic for the version of the real asset view that would seek to tax the donee only.[88] Indeed, the Supreme Court expressly disallowed this method of tax reduction in a similar setting in the early case of *Lucas v. Earl*, where the Court held that the taxpayer's contractual assignment of one-half of his income to his wife was ineffective to prevent the income from being taxed to him rather than her, even though the assignment seems not to have been tax-motivated.[89]

In order to see why the prospect of joint donor-donee reduction does not defeat the donee-only tax view, it is important to keep in mind the basis for concern with this kind of elective tax reduction. It may be true that a deduction/inclusion regime for gifts would subvert the progressive structure of the tax, but the question is whether a progressive rate structure is consistent with the real asset theory of income in the first place, not with whether donee-only taxation should be disallowed under a progressive structure.[90]

---

structure. *See Table I.1: Central Government Personal Income Tax Rates and Thresholds*, OECD.STAT, https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_I1 [https://perma.cc/X4LX-7JNJ] (last visited Feb. 19, 2018).

86. *See* Blum & Kalven, *supra* note 17, at 472.

87. *See* Kahn & Kahn, *supra* note 3, at 474.

88. *See id.* at 475 (arguing that this problem makes a deduction–inclusion regime unworkable under a progressive rate structure).

89. 281 U.S. 111 (1930). The parties entered into the contract in 1901, some twelve years before passage of the Sixteenth Amendment. *Id.* at 113. Joint filing was unavailable for the years in issue.

90. *See* Kahn & Kahn, *supra* note 3, at 474-75. Kahn & Kahn note the adverse incentives that a deduction–inclusion regime creates under a progressive tax

If it is not, then all that follows is that some other principle or principles dictate denial of a deduction, in whole or part, to the donor, not that the real asset view supports donor taxation after all.

Many arguments might be advanced to support a progressive rate structure,[91] but what they have in common is the idea that accessions are a proxy for the thing we wish to tax, rather than the thing itself.[92] If that were not the case, if accessions were the very thing we wanted to tax, then a flat tax would be appropriate, perhaps by definition. In that case, the transfer of resources from *A* to *B* would not reflect the retention or creation by *A* of anything that one would believe should be in the tax base, and the shift in tax liability would be unobjectionable. By contrast, under a progressive structure, we know that accessions are not the very thing we wish to tax because the amount of tax due depends on something other than change in wealth: The quality of the income that makes it attractive to tax varies with its quantity. Thus there is something about the quantity that affects its quality, and it is that quality, and not the income, that is the thing we wish to tax.

What is the quality? As indicated above, the most commonly offered justification for progressive taxation is the declining marginal utility of money or the idea that equal sacrifice demands larger proportional dollar sacrifices from the better-off.[93] Another possible justification is that progressive rates represent a compromise between ensuring equal material welfare for each individual and maintaining adequate incentives for higher wage-rate persons to continue working and for wealthier taxpayers to save.[94] Under this view, rates should be progressive as long as the loss in total welfare due to declining work and saving incentives is less than the gain in welfare from redistributing societal resources, which is done (in part) by means of a progressive tax.[95] Yet a third possible view is that

---

and conclude that the tax should be on the donor for that reason (among others). *Id.* at 474.

91. *See* Blum & Kalven, *supra* note 17, at 452-86 (discussing arguments for and against progressivity in income taxation).

92. Deborah L. Paul, *The Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?*, 76 N.C. L. REV. 151, 163 (1997).

93. *See* Blum & Kalven, *supra* note 17, at 457.

94. Identifying the tax schedule that maximizes welfare given the disincentive that taxes create to supply additional labor and the fact that wage rate is generally unobservable is the main subject of the optimal tax literature. *See* James A. Mirrlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 REV. ECON. STUD. 175, 179 (1971).

95. *See id.* at 175.

wealth concentration in relatively few hands constitutes a power that ought to be taxed (as previously discussed). Whatever the justification, it seems the shifting of tax liability from donor to donee is inconsistent with the principle of progression in rates. Nevertheless, the untoward avoidance aspect of shifting the tax derives from the fact that progression seeks to tax something other than economic power itself, and that thing goes untaxed in the gift case. It does not derive from an asserted inconsistency of donee-only taxation with the real asset view.

As an illustration, consider the case in which the principle of equal proportional sacrifice underlies progression in rates. The idea is that each person should pay the same percentage of her total psychic welfare or utility to fund the government, and the psychic cost is thought to be a declining function of market resources.[96] (Or, in a more refined version, what is to be equally shared is the proportion of psychic welfare derived from government-provided services.) At this point, the relevance of utility or psychic welfare to the proper tax treatment of gifts becomes explicit. The high-bracket donor plainly derives utility or psychic benefit from the gift at least equal to its market value to her. We therefore know that her total utility after the gift is at least equal to what it was beforehand, so that (at least) the same higher rate should apply after the gift as before. In contrast to a real asset tax base, the base here is welfare as determined by, but not the same as, market resources. Therefore it makes sense to levy some tax on the donor even if the donee also is taxed: She has as much utility as before, and the principle of the tax is in fact utility (or, more accurately, relative disutility). The basis for taxing the donor is that progression indicates that at least a criterion of tax liability is welfare; the very thing we wish to tax is not control over material resources. Thus, progressivity in rates seems to point to some theory of income as psychic benefit that may support taxation of both donor and donee, which is the effect of progression on the (higher-bracket) donor. Note that this may in fact be a version of the regime we have, which nominally taxes the donor only. In particular, under the current regime, if the donor adjusts the size of the gift by the deduction that would be made available under explicit donee

96. *See* Blum & Kalven, *supra* note 17, at 472-80 (discussing and criticizing the equal sacrifice principle—the issue here is not its cogency but what follows for the taxation of gifts if it applies).

taxation, the donee in effect bears the tax at the donor's marginal rate.[97]

2. *Donor Taxation*

Professors Douglas Kahn and Jeffrey Kahn (Kahn & Kahn) argue for a single, donor-level tax (through non-deduction for the gift) under a version of the real asset view.[98] This Subsection uses their analysis to highlight that the choice of taxpayer, like the question of whether the tax is single or double, ultimately depends on a prior decision about what one thinks should be in the base and what one thinks should not.

Kahn & Kahn tie the tax on the donor to their conception of the specific nature of an income tax as opposed to a consumption tax.[99] According to them, whereas a consumption base reaches preclusive personal use, "the payment of an income tax purchases the right to have the taxed income used by the taxpayer, or by someone else of the taxpayer's choosing, to acquire and consume societal goods or services."[100]

As contrasted with a consumption tax, which they agree would support taxation of the donee but not of the donor, an income tax reaches accumulated income and for this reason requires taxation of the donor only. According to Kahn & Kahn, the reason that a tax on accumulated income confers rights both to consume and to determine who consumes goods is that the Haig-Simons definition of income "subsumes an assumption that the accumulated wealth will be spent on consumption in some future year and that the amount of the income currently accumulated provides a fair approximation of the present value of the future consumption."[101] Accordingly, income is taxed on accumulation because it

> represents the present value of the consumption that presumably will take place at some future date. In other words, an income tax differs from a consumption tax in that the income tax imposes a tax currently on the

97. As an example, suppose the donor is in the 30% bracket and the donee in the 10% bracket. If the donor would give $100 under a deduction/inclusion regime but gives $70 instead, the donee effectively pays an extra $20 tax.

98. *See* Kahn & Kahn, *supra* note 3, at 465-66.

99. *Id.* at 460.

100. *See id.* at 444.

101. *See id.* at 459.

> present value of future consumption instead of waiting until the future consumption takes place and taxing it then.[102]

In effect, Kahn & Kahn's idea is that an income tax is a prepaid tax on resources (relative to the time of consumption), and therefore once the tax is paid, the associated consumption is covered, whether it is by the earner or by someone of the earner's choosing, and whether it takes place immediately or later on.[103] A consumption tax, by contrast, occurs on consumption itself.

Kahn & Kahn acknowledge that one could take the opposing position under an income tax that donee taxation is preferable to donor taxation.[104] The basis for doing so would be that donee taxation would more accurately measure the affected individuals' relative ability to bear the costs of government.[105] Their point, however, is that because both positions further values that Congress might want to promote under an income tax, Congress reasonably can choose either one given that they conflict.[106] Nevertheless, if their claim is to be more than a purely descriptive one about how the income tax can (and in fact does) apply to gifts, the position Kahn & Kahn advocate must be grounded in some normative theory. It must do more than describe the operation of the tax (or of a possible one). Perhaps more to the point, their argument still raises the question whether there is an internal logic to the economic accumulation theory such that taxing the donor but not the donee rests on more than a simple decision to define "income" such that only the donor has it.

Kahn & Kahn's argument in support of donor taxation appears to relate to what they regard as the conceptual source of an income tax.[107] In a simpler economy, they note, the government would not need to tax individuals on their money income; instead, it could simply take a portion of wealth that is produced at the source, since actually produced resources are what the government ultimately uses in its activity.[108] This would be a simple form of income taxation and would, according to Kahn & Kahn, furnish the government with

---

102. *Id.* at 455.

103. *See id.* at 453-54 ("The taxation of income is effectively a tax on current consumption plus a tax on future consumption that will be enjoyed by the taxpayer or by someone else.").

104. *See id.* at 443.

105. *See id.* at 468.

106. *See id.*

107. *See id.* at 443.

108. *See id.* at 454.

necessary resources so that no further taxation on income or consumption would be necessary.[109] Gifts under such a regime would be taxable to the donor—in that the government would take its cut up front, before any gift were made—but not to the donee—in that the government's tax role would be complete upon taxation at source.[110]

Kahn & Kahn then observe that in a more complex economy, taxation at the source is not feasible, and, as a consequence, the government must institute a personal income tax along the lines of the tax we currently have.[111] Nevertheless, the essence of the two taxes is assertedly the same: a tax on accumulation—that is, when wealth is produced—with no further tax where no additional wealth is created—or at least with no further tax when the accession comes by means of gift rather than through some other mechanism. Therefore, since the first tax would be a true income tax and would be completed when the resource was produced, so should the income tax that we actually have. By contrast, a tax on wealth imposed at the time of preclusive use is a consumption tax and, indeed, expresses the difference, in their view, between the two bases.[112]

There are at least two difficulties with this argument, both of which boil down to the fact that their definition of income, like those examined before, appears to be stipulative. It is true that if the term "income" means economic accumulation, or perhaps more broadly receipts derived from economic activity, then a tax on the donor but not the donee is in order, as there is no accumulation or even ancillary economic production in a gift; material wealth is merely shifted for no commercial purpose. Kahn & Kahn, however, do not offer a conceptual argument for their definition. The observation about the nature of a simple income tax as a tax paid at the source in kind is merely descriptive of a possible tax. It does not demonstrate that such a tax is essentially a tax on income or even that it is more essentially an income tax than is an accessions tax. Instead, it is at most a thought experiment about a possible simple form of income taxation that implements a tax-on-accumulation principle. The question, however, is why the tax should implement that principle rather than an accessions principle (or some other principle). Thus one could equally say that an income tax is in essence an accessions tax, regardless of the reason for the accession, so that a pure version

109. *See id.*
110. *See id.*
111. *See id.*
112. *See id.* at 453.

of the tax would apply at the source (accumulation being an instance of accession) but also provide a deduction (and inclusion) on transfer (a gift being an instance of de-accession for the donor and accession for the donee). The only difference is that the second version is harder to administer—a difference that does not appear to serve as a basis for concluding the first version is normatively correct (rather than just administratively simpler). Extending the point, one might equally say that the difficulty arises not with the more complex economy, in which money rather than accumulation at the source is taxed, but with the more rudimentary administrative apparatus in the simple economy, in which it is not feasible to keep track of de-accessions. Neither observation by itself, however, says which version (if either) is normatively correct.

Kahn & Kahn's second argument relates to their assertion that an income tax, but not a consumption tax, reaches the present value of future consumption.[113] This is an accurate description of the tax if no deduction is provided on a gift, but that is precisely the question—whether a deduction should be provided on a gift. Why, then, is the description somehow correct as applied to gifts? The answer seems to be that at least a cash-flow version of a consumption tax applies on actual consumption, whereas an income tax does not await consumption; it reaches accumulation regardless of whether consumption occurs at the time of accumulation or later. Nevertheless, it would only follow that there should be no shifting of the income tax to the donee on a gift if the gift were itself a form of consumption; otherwise, the fact of tax on accumulation of amounts only later consumed has literally no implication for the tax treatment of the gift. Kahn & Kahn themselves, however, state just the opposite about the nature of gifts: They assert (correctly, in my view) that a gift is not a form of consumption.[114] Instead, they agree with Professor Alvin Warren's definition of consumption as "the ultimate use or destruction of economic resources."[115] Once they concede that making a gift is not an act of consumption, the fact that an income tax reaches deferred consumption on prior accumulation has no bearing on the tax treatment of gifts.[116] At that point, it becomes

113. *See id.* at 455.

114. See *id.* at 461.

115. *Id.* at 453 (internal quotation marks omitted) (quoting Warren, *supra* note 9, at 1084).

116. *See id.* at 462 ("[W]hen X makes a gift to his son, X has not consumed any of society's resources by making that transfer."). In another article, Professor Douglas Kahn states that the enjoyment a donor derives from a gift does not count

unclear why an income tax should be defined as one that applies on accumulation rather than on accession. There is no reason why an income tax could not be defined as a tax that applies to the present value of future consumption by the person who consumes the wealth, rather than by the one who first accumulates it. Under the former definition, a true income tax would provide a deduction to the donor and inclusion by the donee.[117]

The point of these observations is not to defend an accessions tax as somehow a "true" income tax under the real asset view. Rather it is to show that a preference for an accumulations base or for an accessions base, if not itself grounded in some normative theory, is just that: a preference that has no normative force. As noted, Kahn & Kahn claim their argument is merely that either definition could serve for an income tax and not that the tax ought to be on accumulations. But it seems they also intend their argument to be more than merely a claim that one could define income as accumulation rather than as accession. Instead it seems they consider the income tax concept to differ from the consumption tax concept just in that the income tax concept is a form of prepaid tax on consumption.

CONCLUSION

How should gifts be treated under an income tax? The main point of this Article is that the answer must be: "It depends." Specifically, it depends on one's view of the nature of social organization and, consequently, about the role (if any) of an income tax in supporting any particular such view. Secondly, it depends on the consistent application of whatever principles follow for an income tax from whatever view one does have.

If, as is often the case, the first topic is not engaged, one can derive no final answer to the question of the proper treatment of gifts under the tax. The most one can realistically hope for is consistency between the proponent's normative first principles and the associated

---

as consumption. Douglas A. Kahn, *The Taxation of a Gift or Inheritance from an Employer*, 64 TAX L. 273, 277 (2011). "The psychic pleasures that a donor acquires from making a gift do not involve the consumption of any item or service because no societal good or service has been used up." *Id.*

117. A further point that Kahn & Kahn make relates to the fact that a tax on the donee subverts progressivity. *See* Kahn & Kahn, *supra* note 3, at 474. This issue is addressed in the previous Subsection. *See supra* notes 82-97 and accompanying text.

rules for the income taxation of gifts. For instance, if one adopts a real asset view of income taxation, it seems that the proper rule for gifts is a single tax, while a welfarist approach would seem to favor a rule that might tax one or both parties, or might more lightly tax gifts than other transactions, based on a study of the actual incentive effects that various possible regimes create and their effects on total welfare. Within the single-tax view, it would appear that an accumulation view of the income tax, namely that it is a tax on productive economic activity, would support donor-only taxation, while an accessions view of the tax would support donee-only taxation. Neither version of the real asset view seems to support progressivity in taxation, since each of them seems to subscribe to the idea that income is the thing we wish to tax.

A second implication of the analysis is that consistency in application of whatever principle one favors may have unexpected consequences. If one believes, for example, that the tax system ought to be progressive, one may find it hard to make a principled case for omitting from consideration the welfare effects of a whole array of tax rules on the basis that welfare effects involve psychic rather than real income or loss. By its nature, progressivity seems to rely on the propriety of taxing psychic benefits. Thus it could be hard to insist on, for example, a double-tax regime for gifts while also maintaining the idea that the income tax generally ought to be based on ownership of material resources, or that no account should be made for the psychic cost of producing income. While there might be administrative or other grounds for limiting the tax so as not to include psychic costs or benefits, the substantive policy basis for doing so would need some explication.

A third implication is that the same lesson drawn here for the question of how to tax gifts applies to other debates that veer into questions of basic social policy. An effort to tax "income" will not dictate whether, for example, allocating tax burdens by income is finally fair or not because the concept of income does not adequately specify what, in the final analysis, would be relevant for determining what counts as fair. Rather a conception of fairness, together with other more practical considerations, shapes what should and should not count as income. The same goes for the use of consumption, wealth, or other bases as normative principles. These concepts may be enormously helpful in answering practical questions within the framework of already-accepted principles, but they will not tell us whether those already-accepted principles are correct.