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ARTICLES

IT'S NOT A RULE: A BETTER WAY TO UNDERSTAND THE DEFINITION OF INCOME

Alice G. Abreu
Richard K. Greenstein

UNIVERSITY OF FLORIDA COLLEGE OF LAW

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IT'S NOT A RULE: A BETTER WAY TO UNDERSTAND THE DEFINITION OF INCOME

by

Alice G. Abreu[*]
Richard K. Greenstein[*]

I. INTRODUCTION

In a recent article, Professor Douglas Kahn explores a particular dissonance between the positive and very broad definition of income that includes all realized accessions to wealth, and what the government can, and

* Alice G. Abreu is James E. Beasley Professor of Law, and Richard K. Greenstein is Professor of Law at Temple University's Beasley School of Law. We are grateful for the very detailed and thoughtful comments offered by our Temple colleagues, Jane Baron, Greg Mandel, and Andrea Monroe, and we also thank Professor Douglas Kahn of the University of Michigan School of Law for writing an article that inspired a close read and this response. We could not have completed this project without our exemplary research assistant, Ashley Rivera, Temple 2013, who took tax as an elective in her first year of law school and whose love of the subject, dedication, reliability, attention to detail, and professionalism will be missed when she graduates. A summer research stipend from Temple also assisted our work. All errors, omissions and deficiencies remain ours.

actually does attempt to tax.[1] At the beginning of his article, Professor Kahn summarizes the problem he seeks to resolve:

> When cash is received for services, it typically will constitute gross income to the recipient. But what if the payments are made in a noncommercial setting such as the payment by a parent to a child for mowing the lawn or performing household chores? As discussed later in this Essay, there are reasons to conclude that such payments do not constitute income. The problem of how to treat receipts from a noncommercial activity frequently arises in the context of an exchange of services. A similar problem arises when services are provided by several persons pursuant to a pooling of labor to accomplish a common noncommercial goal.[2]

Professor Kahn then offers two limiting principles, which he posits operate as exclusions, thus eradicating the gap. Specifically, he suggests that the apparent dissonance vanishes if we understand that "the income tax operates only on commercial transactions"[3] and, as a corollary, that "joint efforts should not be treated as an exchange of services but rather as a jointly conducted activity,"[4] which does not produce income "[w]hen the common goal has no business connection."[5] For Professor Kahn, these two principles explain why a number of items that would seem to come within the broad positive definition of income are not in fact subject to tax despite the absence of a statutory exclusion. We will refer to these principles collectively as the "commercial/noncommercial distinction" or the "commercial/ noncommercial rule."

We understand the deep dissatisfaction with the positive definition of income that led Professor Kahn to develop the commercial/noncommercial distinction he explores in his article. Indeed, we have shared it, as have others before us, including Professors Zelenak and McMahon, who struggled to provide a theoretical justification for not treating as income the value of a

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1. *See generally* Douglas A. Kahn, *Exclusion from Income of Compensation for Services and Pooling of Labor Occurring in a Noncommercial Setting*, 11 FLA. TAX REV. 683 (2011) [hereinafter Kahn, *Exclusion from Income*]. In Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955), the Supreme Court defined income as "undeniable accessions to wealth, and over which the taxpayers have complete dominion."

2. Kahn, *Exclusion from Income*, *supra* note 1, at 683 (footnote omitted).

3. *Id.* at 686.

4. *Id.* at 691.

5. *Id.* Although it is unclear, there may be an additional corollary principle having to do with whether the services exchanged are "similar." *See infra* Part II.C.1.

record-breaking baseball caught by a lucky fan at a game.[6] That same desire for theoretical tidiness prompted scholars years ago to search for a Comprehensive Tax Base ("CTB").[7]

In our earlier article, *Defining Income*, we argued that the desire for theoretical precision has led to a long tradition of interpreting the definition of income — whether in the Haig-Simons or *Glenshaw Glass*[8] formulation — as a rule.[9] We proposed as an alternative that the definition of income be thought of as a standard — specifically, that questions about whether a particular accession to wealth constituted income be answered by employing an all-things-considered inquiry based on the values relevant to federal income tax. Our claim was that treating income as a standard effectively addressed the puzzling gap between what the broad definition that *Glenshaw Glass* would seem to include in the tax base and what is actually included. Child support, government welfare payments, and many other categories of "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion"[10] are routinely excluded from income, despite the absence of any statutory basis for their exclusion. To account for this, we began to explore the role of values — particularly non-economic values — in determining the contours of the tax law. We posited that

> what explains the inconsistency . . . is that economics — at least Haig-Simons economics — is not everything. Although the *Glenshaw Glass* definition of income is largely consistent with the Haig-Simons definition, and thus with economics, it fails to take into account other values that count for the people who are subject to the tax and must buy into it, at least to some degree, for the tax to be administrable.[11]

6. *See* Lawrence A. Zelenak & Martin J. McMahon, Jr., *Taxing Baseballs and Other Found Property*, 84 TAX NOTES 1299 (Aug. 30, 1999) [hereinafter Zelenack & McMahon, *Taxing Baseballs*]. Professor Dodge also addressed this issue, but came to a different conclusion. *See* Joseph M. Dodge, *Accessions to Wealth, Realization of Gross Income, and Dominion and Control: Applying the "Claim of Right Doctrine" to Found Objects, Including Record-Setting Baseballs*, 4 FLA. TAX REV. 685, 691 (2000) [hereinafter Dodge, *Accessions to Wealth*].

7. *See, e.g.*, Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 Harv. L. REV. 925 (1967) [hereinafter Bittker, *CTB as a Goal*].

8. Commissioner v. Glenshaw Glass Co. 348 U.S. 426 (1955).

9. Alice G. Abreu & Richard K. Greenstein, *Defining Income*, 11 FLA. TAX REV. 295 (2011) [hereinafter Abreu & Greenstein, *Defining Income*].

10. *Glenshaw Glass*, 348 U.S. at 431.

11. Abreu & Greenstein, *Defining Income, supra* note 9, at 299 (footnotes omitted).

Accordingly, we proposed "that the definition of income be acknowledged to be a standard that should be interpreted in light of the values — including noneconomic values — that animate the field of income taxation."[12]

In proposing that income be understood as a standard, we were returning to an approach that characterized the early days of federal income tax scholarship. Writing in the mid-1950s, Professors Stanley Surrey and William Warren understood the importance of values and therefore urged that foundational concepts such as income be defined by reference to standards.[13] Standards are inherently flexible and allow for consideration of various factors with multiple, and possibly conflicting values. As Surrey and Warren explained:

> In the income tax, as in other complex legislation, the need is for a standard which will project our present aims into the future and serve as the vehicle for solving the unforeseen cases as they arise. The legislative function is not denied or thwarted when other branches of the Government are relied upon by Congress to perform substantial tasks in the application of statutes. Administration and judicial interpretation are necessary parts of the overall process of legislation. The income tax is no exception.[14]

Surrey and Warren's call for the acceptance of standards and for not treating tax law as exceptional went unheeded despite having been contained in an otherwise influential American Law Institute study which appeared in a

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12. *Id.* at 346.

13. *See* Stanley S. Surrey & William C. Warren, *The Income Tax Project of the American Law Institute: Gross Income, Deductions, Accounting, Gains and Losses, Cancellation of Indebtedness*, 66 HARV. L. REV. 761, 771–72 (1953) [hereinafter Surrey & Warren, *Tax Project*]. The Supreme Court also understood the importance of values, noting in *Duberstein* that

> [t]he nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each, confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact.

Commissioner v. Duberstein, 363 U.S. 278, 289 (1960). The *Duberstein* Court took its cue from Justice Cardozo, quoting his observation that "[t]he standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." *Id*. at 288 n.9 (quoting Welch v. Helvering, 290 U.S. 111, 115 (1933)).

14. Surrey & Warren, *Tax Project*, *supra* note 13, at 775.

leading scholarly publication, the *Harvard Law Review*. Another scholar of like stature, Professor Boris Bittker, echoed Surrey and Warren's recognition of the central role of values in tax law when he opposed the call for a CTB (a tax system free of loopholes and base erosions and, by necessary implication, free of any role for non-economic values) on the ground that a "neutral, scientific measure of . . . income is a mirage."[15] However, Bittker's views were roundly criticized by very prominent scholars from both economics and law, who accused him of misunderstanding Haig-Simons, adopting an "untenable position," and doing no more than "suggesting ad hoc settlements."[16]

To his enduring credit, Bittker remained undaunted, choosing instead to use his rapier wit to mock the Comprehensive Tax Base as "an encompassing verity" and asserting that failure to find that verity would not produce the "'dank, miasmic, myxomycetous sump' that [his detractors] would probably like to call 'Bittker's Quagmire.'"[17] Despite also being a formidable technician who wrote several treatises and casebooks — including *Federal Income Taxation of Corporations and Shareholders*, a tome of near-Biblical authority coauthored with James S. Eustice, Bittker advocated a nuanced, multifaceted analysis and interpretation of tax law.[18] In his detractor's quagmire he saw a boundless fertility.

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15. Bittker, *CTB as a Goal*, *supra* note 7, at 925. Like Bittker, Professor Ernest Brown — also a noted and influential scholar — embraced a view of the income tax where standards that were influenced by values play a substantial role. *See* Ernest J. Brown, *The Growing "Common Law" of Taxation*, 34 S. CAL. L. REV. 235, 239–40 (1961).

16. *See, e.g.*, Charles O. Galvin, *More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR*, 81 HARV. L. REV. 1016, 1019 (1968) [hereinafter Galvin, *More on Bittker*] (accusing Professor Bittker of doing no more than suggesting "ad hoc settlements"); Richard A. Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44, 45 (1967); Joseph A. Pechman, *Comprehensive Income Taxation: A Comment*, 81 HARV. L. REV. 63, 65 (1967) (accusing Professor Bittker of misunderstanding Haig-Simons).

17. Boris I. Bittker, *Comprehensive Income Taxation: A Response*, 81 HARV. L. REV. 1032, 1041 (1968) [hereinafter Bittker, *CTB Response*] (quoting Galvin, *More on Bittker*, *supra* note 16, at 1019).

18. Perhaps this is attributable at least in part to Professor Bittker's profound interest in constitutional law, a field in which the role of values is patent. After taking emeritus status, Bittker's scholarly production turned to constitutional law. *C.f.* BORIS I. BITTKER & BRANNON DENNING, BITTKER ON THE REGULATION OF INTERSTATE AND FOREIGN COMMERCE (1999); Boris I. Bittker, *Constitutional Limits on the Taxing Power of the Federal Government*, 41 TAX LAW. 3 (1987); Boris I. Bittker, *The Bicentennial of the Jurisprudence of Original Intent*: *The Recent Past*, 77 CALIF. L. REV. 235 (1989); Boris I. Bittker, *The World War II German Saboteurs' Case and Writs of Certiorari Before Judgment by the Court of Appeals: A Tale of* Nunc Pro Tunc *Jurisdiction*, 14 Const. Comment. 431 (1997).

However, the standard-based approach recommended by Surrey, Warren, and Bittker has been supplanted by, as we have said, a tradition of thinking about tax law, generally, and income, particularly, in terms of rules.[19] The approach that Professor Kahn takes in his article lies squarely in this tradition. He sees the commercial/noncommercial distinction as signaling a rule,[20] namely "that the income tax applies only to commercial activities and that income produced from noncommercial activities is not taxable."[21]

In this Article we propose a thought experiment: What if we were to think about the problems Professor Kahn poses from the perspective of income-as-standard? Doing so will allow us to explore the utility of such an approach in a concrete way. Professor Kahn develops the commercial/noncommercial distinction by working through a series of interesting hypothetical scenarios, and we use these scenarios as the foundation of our thought experiment. In Part II, which follows this Introduction, we examine those scenarios using the income-as-standard approach. In Part III we compare the application of rule-based and standard-based approaches to the general issue raised by Professor Kahn and, having concretely contrasted the two approaches, return to the conclusion we reached in *Defining Income*: standards have important virtues that make them superior to rules for resolving some fundamental questions in federal income tax law. We conclude in Part IV by summarizing the virtues of regarding the definition of income as a standard and pointing toward future scholarship that will apply a standard-based framework to other fundamental questions in tax law. Our exploration of the definition of income has shown us that contemporary tax analysis often assumes that all tax formulations are rules. We believe that while many are, income is not.

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19. In many ways this is not surprising given the widely acknowledged advantages of rules as providers of clarity and certainty. *See generally* Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983); Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992); Cass R. Sunstein, *Problems with Rules*, 83 CALIF. L. REV. 953 (1995). Nevertheless, some contemporary scholars are once again looking to standards to explain and understand particularly thorny problems. *See, e.g.*, Steven A. Dean, *Neither Rules nor Standards*, 87 NOTRE DAME L. REV. 537 (2011) (providing a critique of efforts to replace standards with rules in the international tax regime); THE DELICATE BALANCE: TAX, DISCRETION AND THE LAW (Chris Evans et al. eds., 2011).

20. Indeed, Professor Kahn explicitly identifies what he is doing as developing a "proposed rule excluding income from noncommercial activity." Kahn, *Exclusion from Income*, *supra* note 1, at 697.

21. *Id.* at 686.

II. APPLYING AN INCOME-AS-STANDARD APPROACH

To explore the problem of compensation for, and exchange of, services in "noncommercial" settings, Professor Kahn examines seven hypothetical scenarios, along with some variations on a couple of these settings. In addition to the scenarios, Professor Kahn examines barter clubs for child care, cooperative nursery schools, and cooperative home schooling.

In this Part we examine these various situations from the perspective of income-as-standard. This endeavor requires an all-things-considered analysis informed by the relevant tax values. Thus, the first order of business is to identify those values: the things we care about when deciding whether an accession to wealth should be treated as income. Professor Kahn's article is very helpful in this endeavor, as he identifies various "policies" that support his conclusions regarding when compensation for services, exchanges of services, and pooling of labor should and should not count as income. For instance, focusing on exchanges of services within a "marital community," he identifies the importance of administrability:

> One consideration is that taxing an exchange of services performed in a marital community would pose huge administrative difficulties, and avoidance of that administrative burden is likely one factor in the decision not to impose a tax. In addition to difficult valuation issues, it would not be easy to discover the events where one spouse performed a service for the other; and many of the services performed will be of a highly personal nature.[22]

Another important consideration identified by Professor Kahn is privacy:

> A tax regime that would require the discovery of services performed within the marital community would constitute an invasion of privacy and an intrusion into an individual's private noncommercial life, and that would be unacceptable in a free society. Even when identification and valuation of marital services does not pose a problem, the value of these services nevertheless will be excluded from income. The personal private lives of individuals should not be subjected to disclosure by the government unless there is a compelling public reason to require it.[23]

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22. *Id*. at 687.
23. *Id.* at 687–88.

In addition to administrability and privacy, Professor Kahn worries about creating undesirable incentives that undermine private improvement of living standards:

> Not taxing services performed in a family setting is analogous to not taxing imputed income from the services one performs for himself. An individual is not taxed on the wealth produced by cooking his own meal, shaving himself, mowing his own lawn, building a bookcase for his own use, etc. . . . A tax on such imputed income would pose difficult valuation and identification problems and would constitute an invasion of privacy and an intrusion into an individual's private life. Moreover, it would be undesirable to have the tax law deter an individual from using his own labor to improve his household, himself, or his family. If such imputed income were taxable, an individual might choose not to shave or have his wife cut his hair or make household improvements and repairs. That is not to say that a person would necessarily refrain from such actions, but the imposition of a tax liability would be a factor to be weighed in determining whether the net benefit to be gained is worth the effort. While there is no statutory provision excluding imputed income from taxation, it is excluded under the common law.
>
> For some limited purposes (but certainly not for all purposes) members of a family are treated as a single unit. Therefore, services performed for the family by an individual member can be seen as services performed by the family unit for its own benefit and thus excluded from tax as imputed income.[24]

This concern about incentives to promote improved well-being leads Professor Kahn to identify the importance of social cooperation: "As a matter of societal policy, the tax law should not operate to deter the formation of cooperative ventures in which people pool their labor for a common personal goal."[25]

We agree with Professor Kahn's assessment of the importance of administrability, privacy, and social cooperation as social policies and believe that by invoking them, he is identifying what we refer to as values. His article begins to create a taxonomy of relevant values, and in doing so,

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24. *Id.* at 688–89 (footnote omitted).
25. *Id.* at 693.

he has helped us to refine our own thinking. We fully agree with Professor Kahn that the values he identifies are important and must be considered when deciding what to include in the tax base. We differ with respect to where our respect for those values takes us.

For each of the scenarios and variations, Professor Kahn's analysis requires a determination of whether the setting is commercial or noncommercial. Our thought experiment requires instead that we treat the definition of income as a standard, the application of which depends on the relevant values. In this case the values are those which Professor Kahn identifies — administrability, privacy, improvement of living standards, and cooperation — along with others that are implied in his discussions of specific scenarios. When we do that, the important facts in the scenarios, now illuminated by the values, become apparent.

But the income-as-standard analysis that we advocate in *Defining Income*, and which our thought experiment applies here, does not stop with an identification of the relevant values. Identification cannot suffice when some of the relevant values collide with other relevant values. Indeed, it is precisely because of such collisions that a standard-like, rather than a rule-like formulation is apt in defining income.[26] Colliding values require choosing which values will prevail in any given case, and as we will discuss in Part III, that is something that can only be accomplished by deploying a standard.

Professor Kahn's scenarios are especially helpful in illustrating this collision of values, so we turn to them now as we pursue our thought experiment to illustrate the operation the income-as-standard approach. For ease of identification and recollection, we will refer to the scenarios by the roles that their protagonists play.

A. The Doctor and the Lawyer

Professor Kahn begins his analysis by describing an example of an exchange of services which he believes — and we agree — produces income for both parties. The exchange that so clearly produces income is that described in the first iteration of the first scenario, which involves a doctor (the Doctor) and a lawyer (the Lawyer). If the Doctor performs surgery for the Lawyer in explicit exchange for her representing him in a divorce, both have income in the amount of the fair market value of their services, which are presumably equal under these circumstances. An explicit, bargained-for exchange of services like this constitutes income because the regulations provide that "if a taxpayer receives services from another as payment for

26. *See generally* Abreu & Greenstein, *Defining Income*, *supra* note 9, at 321–44 (exploring the concept of aptness more fully).

services rendered by the taxpayer, each party will realize gross income equal to the value of the services received from the other."[27]

This first scenario is an easy case because both an income-as-rule and an income-as-standard analysis produce the same result. If the definition of income articulated by the Supreme Court in *Glenshaw Glass* — that gross income is all "accessions to wealth, clearly realized, over which the taxpayers have complete dominion"[28] — is a rule, both the Doctor and the Lawyer have income. The receipt of legal services and surgery, respectively, without a diminution in resources to pay therefor, has made each better off. The transaction described is equivalent to one where the Lawyer pays the Doctor for his services in cash and the Doctor takes that cash and uses it to pay the Lawyer; neither the Lawyer nor the Doctor has any more or less cash as a result of the two transactions, and each has received services from the other. However, both the Doctor and the Lawyer have realized accessions to their respective wealth when they receive cash in exchange for the services they perform, and the fact that they use that cash to pay for a service does not remove the realization of income upon receipt. When a transaction in which cash is paid is economically the same as one in which no cash is exchanged, a view of income-as-rule must tax both transactions equally.

A view of income-as-standard produces the same result. The value of horizontal equity supports taxation of both the Doctor and the Lawyer because it supports taxing economically equivalent transactions equivalently. While other values, such as administrability, might point to a different conclusion and create a potential collision of values in this case, the administrability problems are relatively minor. Ascertaining the value of the services exchanged is not difficult since there is an active market for both. Other important values, such as privacy, do not pose grave concerns because of the public nature of the services. Neither the receipt of surgery nor of legal representation in a divorce proceeding are private events. Both the Doctor and the Lawyer would probably have paid for the services elsewhere if the exchange had not been possible, so social cooperation is not diminished. Horizontal equity requires taxing a bargained-for exchange that produces the same result as an arms-length transaction between strangers for cash in the same way in which the cash transaction would have been taxed; in the absence of strong countervailing values, it carries the day.[29] Most cases

27. Kahn, *Exclusion from Income*, *supra* note 1, at 683 (citing Reg. § 1.61-2(d)(1)).

28. *Glenshaw Glass*, 348 U.S. at 431.

29. Horizontal equity, which is largely an economic value because it seeks to tax economically equivalent transactions equivalently (it is also a specific instance of the value of justice), outweighs administrability in this case as well as in many others in which the principal value pushing against taxation is administrability. We note, however, that when administrability is joined by other, noneconomic values,

involving bargained-for exchanges are of this sort, and the income-as-rule and the income-as-standard approaches produce identical results. Since the income-as-rule approach is both much easier to apply and consistent with the tax-as-rules reflex, it is hardly surprising that income is so often thought to be a rule. The possibility that prompts our thought experiment — that income might actually be more effectively analyzed as a standard — does not appear until we encounter more difficult cases. Quite usefully, Professor Kahn's scenarios provide us with such cases.

The first variation of the Doctor/Lawyer scenario is also easy. In that variation the Doctor and the Lawyer have been friends since childhood. The Lawyer retains the Doctor's services, but, after the Doctor performs the surgery, he tells the Lawyer that he won't charge her because of their friendship. In this case, both the income-as-rule and the income-as-standard approaches again produce the same result again. The Lawyer would not have income because the Doctor has made the Lawyer a gift and section 102 excludes gifts from income.[30] Under an income-as-standard approach, the values of encouraging and respecting kindness and cooperation among friends, as well as the privacy of those personal relations, would suggest non-

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like cooperation, privacy, education, or even a love of baseball, the strength of the other values often tips the balance, and non-taxation is the result. This observation explains Professors Zelenak and McMahon's suggestion that for tax purposes, income is paradigmatically about cash; that noncash transactions (e.g., bartering) are taxed when necessary to prevent "wholesale tax avoidance," but that "nontax benefits . . . that involve no transaction" should not be taxed. Zelenak & McMahon, *Taxing Baseballs*, supra note 6, at 1304–05 (emphasis removed). We see their point about taxing certain nontax transactions to be the preservation of horizontal equity and their suggestion as saying that in those cases where horizontal equity meets only administrability, horizontal equity should triumph. But where administrability has other allies (as in the case of imputed income, the caught baseball, big game trophies, or caught fish), horizontal equity should not necessarily carry the day. As we note in the text, it seems to us that Professor Kahn's commercial/noncommercial distinction proceeds from the same intuition regarding the power of other, noneconomic values. The situations that he labels "commercial" implicate principally the economic value of horizontal equity; thus administrability takes a back seat to horizontal equity and taxation ensues. In the situations he labels "noncommercial," other values are prominent, and they tip the scale to non-taxation. In the two situations in which we disagree with Professor Kahn, the difference may be in the weight each of us places on the noneconomic values involved. It appears to us that in proposing the noncommercial exclusion, Professor Kahn is implicitly agreeing with one of our conclusions in *Defining Income*: "[e]conomics is not everything." Abreu & Greenstein, *Defining Income*, *supra* note 9, at 299, 348.

30. I.R.C. § 102(a).

taxation to the Lawyer. Under that view, section 102 simply serves to make the importance of those values patent and to make the conclusion explicit.[31]

The difficult variation is the next one. In that variation the Doctor also gratuitously performs the Lawyer's surgery but several years thereafter, the Doctor finds that he needs a divorce lawyer and asks the Lawyer to represent him. The Lawyer does so and wants to charge the Doctor but decides not to because the Doctor had not charged her for the surgery. In explaining his conclusion that the Doctor has income in this situation, Professor Kahn reasons that since the Lawyer did not refrain from charging out of "detached and disinterested generosity" as required by the Supreme Court to find a gift, the Doctor should have income.[32] In other words, Professor Kahn finds income and can conclude that there is no income only if the gift exclusion applies.

An income-as-standard approach suggests a different result. The same values that resulted in no income to the Lawyer in the previous variation of this scenario (the clear gift) would apply here. The values of encouraging and respecting kindness and cooperation among friends, as well as the privacy of those personal relations, suggest non-taxation to the Doctor. Additionally, in this case there is the additional value of preventing intrusion into an individual's thoughts, coupled with the administrative impossibility of so doing in most cases. Absent the knowledge of the Lawyer's secret desire to charge, this scenario would look just like the prior one. Under an income-as-standard approach, the value of personal privacy would preclude consideration of that desire, and the result would be the same as it would be without the secret desire.

This standard-based approach is supported by the Supreme Court's decision in *Duberstein.* When it announced the "detached and disinterested generosity" test, the Supreme Court quite clearly and explicitly stated that the existence of detached and disinterested generosity was to be determined objectively.[33] Justice Brennan, writing for the Court, asserted that it was "plain that the donor's characterization of his action is not determinative — that there must be an objective inquiry as to whether what is called a gift amounts to it in reality."[34] Based on this language, the question is not simply whether the Lawyer would have liked to charge the Doctor for her services in the absence of other considerations. *Duberstein* could easily be read to require that the question of the Lawyer's intent "must be based ultimately on

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31. Just as in the case of section 501(c)(3), the statutory exclusion confirms the importance of the value, but the exclusion is a structural part of the tax system — not a tax expenditure.

32. Kahn, *Exclusion from Income*, *supra* note 1, at 685 (quoting Commissioner v. Duberstein, 363 U.S. 278, 285 (1960)).

33. Commissioner v. Duberstein, 363 U.S. 278, 286 (1960).

34. *Id*.

the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case."[35] As the Court acknowledged in *Duberstein*, "[t]he nontechnical nature of the *statutory standard*, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each, combine to require a consideration of multiple factors."[36]

Although Professor Kahn acknowledges that "[t]here is a substantial question as to whether the moral constraint that prevented [the Lawyer] from charging [the Doctor] precludes gift treatment," he concludes that it does because "[h]er transfer was not motivated by affection or a concern for [the Doctor]."[37] However, extending our thought experiment and treating the *definition of a gift* as a standard, a trier of fact could reasonably conclude that although the Lawyer might have wanted to charge the Doctor, her decision not to charge meant that she put her friendship with him above her desire for additional money. Whether characterized as a "moral constraint" or "affection or a concern for the doctor," some aspect of the value the Lawyer placed on her relationship with the Doctor caused her to decide not to charge him. A trier of fact could justifiably conclude that the Lawyer's legal services were given out of "detached and disinterested generosity" and were, therefore, a gift.

Extending the thought experiment that contrasts the rule-based and standard-based approaches to the Supreme Court's definition of a gift as proceeding from the donor's "detached and disinterested generosity" highlights the differences between the two approaches. Rules narrow the factual focus of analysis, and in this case cause a focus on only one fact (the Lawyer's desire to charge the Doctor), resulting in a finding that the rule is unsatisfied, which leads to the conclusion that there is no gift. The standard-based approach is different. If the detached and disinterested generosity requirement sets forth a standard to be informed by an all-things-considered analysis, the inquiry involves consideration of the value that the Lawyer places on her relationship with the Doctor, and perhaps with others, who might think badly of her if she charges the Doctor, and the value she places on compliance with social mores or reciprocity. In other words, a standard-based approach requires consideration of what the Lawyer actually did, rather than what she might have wanted to do if no other factors were considered. That broader consideration can quite easily lead to the conclusion that the standard is satisfied. Affection for the Doctor and a desire to preserve his friendship triumphed over competing values, such as the desire for money. The importance of respecting the values that caused the

35. *Id.* at 289.
36. *Id.* (emphasis added).
37. Kahn, *Exclusion from Income*, *supra* note 1, at 685 n.4.

Lawyer's decision, as well as the values of administrability and privacy, supports a conclusion of non-taxation.

Such a nuanced, multifaceted analysis might be precisely what the *Duberstein* Court intended when it referred to the "nontechnical nature of the statutory standard,"[38] and what led it to reject the Government's request to adopt a single-factor, rule-like test under which gifts would "be defined as transfers of property made for personal as distinguished from business reasons."[39]

An odd consequence of the rule-based analysis is that the Doctor's surgery is excluded from income as a gift to the Lawyer, but the Lawyer's legal representation is gross income to the Doctor. If instead the Lawyer's action is treated as a gift, as it would be under a standard-based analysis, there is no asymmetry. But eliminating asymmetry is not our goal, and our desire to explore the application of a standard-based analysis is broader than a critique of an interpretation of the *Duberstein* test as a rule. An income-as-standard analysis reveals that neither the Doctor nor the Lawyer has income when the definition of income is analyzed as a multifaceted standard informed by multiple values, including the values of friendship, affection, reciprocity, privacy, and the mores of social interaction that suggest that friends do things for one another even when they would prefer not to. Later, we'll discuss why we think this analysis is the better one.

B. The Father and Son

In the first variation in this scenario, a father (the Father) pays his son (the Son) a $20 weekly allowance while the Son "performs chores as his share of household responsibilities."[40] In this variation, the allowance can be characterized as a gift and not taxable, presumably because of the lack of explicit connection between the allowance and the chores. In the second variation the Father pays his Son $20 in specific return for the Son's performance of chores because the Father wants "to instill work habits in [his son] for earning his living later in life."[41] In this variation there does not appear to be a gift because the payment of $20 explicitly exchanged for the performance of chores cannot be characterized as proceeding from detached and disinterested generosity. It is in this variation that Professor Kahn develops the commercial/non-commercial distinction that his article advocates. He takes the position that although it is not a gift, this payment should be excluded from income because the transaction occurs in a noncommercial zone. This approach takes a rule — the definition of income

38. *Duberstein*, 363 U.S. at 289.
39. *Id.* at 284 n.6.
40. Kahn, *Exclusion from Income*, *supra* note 1, at 689.
41. *Id*.

— and creates another rule — the noncommercial zone exclusion — to arrive at what we agree is the correct result of no income.

An income-as-standard analysis arrives at the same conclusion in this case but does so by a different path. That path does not involve applying a rule and then creating another rule, which operates as an exception, but rather involves only applying a standard. As before, applying the standard requires a consideration of the relevant values. Those values include horizontal equity, which would point toward taxation because it requires that all individuals who receive compensation for services be treated alike; thus, if the chore is mowing the lawn and a landscaper who receives $20 for mowing the lawn has income, then the child who receives a similar amount for performing the same service should have income as well. But in this case, unlike in the case of the landscaper, there are competing values. Those competing values include the value of family and the value of the parent's freedom to raise his child by demonstrating the rewards of industry, as well as the privacy that should attend intra-family transactions, the kind of social cooperation that families generally represent, and the difficulty of administering a different conclusion. The strength of the competing values supports a no-income result.

This scenario is particularly helpful in illustrating the differences in the two approaches because it reveals that both approaches rely on the importance of values other than horizontal equity. The difference is not whether the approaches involve a consideration of values, but is what analytical role the consideration of values plays. Professor Kahn's application of the rule-based approach makes it clear that the commercial/noncommercial rule was crafted in response to the same values we employ in our standard-based approach. In the standard-based approach, no additional category is created and nothing else needs to be defined. We believe that the transparency of the standard-based approach, with its direct resort to a consideration of values (as opposed to considering values only as a step in the creation of another rule which must itself be construed), makes it an attractive alternative.

C. *Pooling Labor: Joint Activities and Common Goals*

1. *The Roommates, the Urban Gardeners, and the Young Parents: Dividing Responsibilities*

A number of the scenarios Professor Kahn analyzes involve situations where services are exchanged in pursuit of a common goal. These goals involve housekeeping in shared living quarters, reciprocal tending of gardens, and reciprocal caring for children in their parent's absence (i.e. babysitting). In the first of these scenarios, two roommates (the Roommates) divide household chores. The income-as-rule approach, now supplemented by the noncommercial zone exception, produces the conclusion that the exchange of services between the Roommates is not income to either of the Roommates. However, in this case, Professor Kahn describes a "corollary principle" to the noncommercial zone exception — that an exchange of services should not produce income if the exchange occurs in pursuit of a common goal.

In another scenario, two individuals who live separately in Manhattan each want to have a vegetable garden (the Gardners), a goal they accomplish by purchasing neighboring plots of land on Long Island, planting their gardens, and then agreeing that each will travel to the plots twice a week to tend to both gardens rather than four times a week to each tend to his own garden. The income-as-rule approach, now supplemented by the noncommercial zone exception and the corollary principle of the common goal, produces the conclusion that the exchange of services between the Gardeners is not income to either.[42]

Yet another scenario involves two couples (the Parents), each of whom have young children. When one couple needs a babysitter on short notice, the other couple agrees to provide that service, and in return, the first couple agrees to care for the other couple's son. Again, the income-as-rule approach, supplemented by the noncommercial zone exception and the corollary principle of the common goal, produces the conclusion that the exchange of babysitting services between the Parents is not income to either couple. In this case, however, there is a further rule-like refinement that produces a "joint activity exception."[43] Reaching a no-income approach in this scenario under an income-as-rule approach, thus, requires the application of one rule, one exception, and one corollary principle which in turn produces yet another exception.

All three of these scenarios can be seen as examples of what Professor Kahn calls "pooled labor."[44] He explains that "[s]everal persons can join together to pool their labor to accomplish a common goal" and

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42. *Id.* at 693.

43. *Id.* at 694. We confess that it is a bit difficult to ascertain the parameters of the "common goal" and the "joint activity." In discussing the Gardeners scenario, Professor Kahn states that the Gardeners "should be treated as pooling their labor to accomplish a common goal," *id.* at 693, but later, in discussing the Parents scenario, he states that "exchange of services comes within the joint activity exception described above in connection with the tending of the vegetable gardens. The Parents are tending children instead of vegetables, but the same principle applies." *Id.* at 694. The two concepts — common goal and joint activity — are obviously related, but the references to a "corollary principle" of a common goal and the "joint activity exception," which later is applied to the same situation first governed by the common goal corollary principle, make the nature of the relationship between them somewhat opaque.

44. *Id*. at 691.

concludes: "When the common goal has no business connection, the exclusion of joint activity services from income can be seen as a corollary to the proposed principle that income arising out of a noncommercial activity is not taxable."[45] This in turn requires a test "for determining what constitutes a 'common goal.'"[46] In setting out that test, Professor Kahn follows the kind of all-things-considered approach characteristic of a standard. In his words:

> The common goal must be the product of a single activity that is regarded as such by the public. The services involved must be so related that they are commonly regarded as in furtherance of that activity. The limitation on the breadth of a common goal rests on a common sense approach to whether the public would consider that goal to be the purpose of conducting an activity as contrasted to stretching the concept to incorporate the services in question. The limitation of the concept rests on a factual issue as to what is commonly regarded as a single activity.[47]

Although the development of this "common goal" formulation started from a construction of income-as-rule, it appears to us that the formulation itself (as explained in the foregoing paragraph) differs little from an income-as-standard approach that openly relies on values, and Justice Cardozo's exhortation that 'life in all its fullness' must provide the answer. Values seem to guide the "common goal" analysis because, as professor Kahn explains:

> As a matter of societal policy, the tax law should not operate to deter the formation of cooperative ventures in which people pool their labor for a common personal goal. The tax law expressly provides for such pooling of labor and property for business purposes in its rules for dealing with partnerships. The partners' exchange of services does not cause them to recognize income. The same treatment

45. *Id*. Consistent with our analysis, while we agree with Professor Kahn that the joint efforts of individuals who pool their labor to accomplish a common goal — which occurs in nearly all business activities that involve multiple individuals, whether organized as partnerships or corporations — do not generate income, we do not agree that this conclusion proceeds from an "exclusion of joint activity services from income." *Id*. Our claim is that the pooling, or exchange, does not produce income. and hence nothing needs to be excluded.

46. *Id.* at 691.

47. *Id.* at 692.

> should be accorded to the pooling of labor in a joint activity that is not connected with a business.[48]

Invocation of business partnerships strongly suggests that in the construction of the common goal the relevant point is not whether the activity is commercial or noncommercial (because business partnerships are obviously commercial), and yet the existence of a common goal precludes a finding of income for the partners who benefit from each other's services.[49] It seems that the value of fostering cooperation guides the creation of the common goal principle.

The value of cooperation is also central to the conclusion that follows from application of the income-as-standard approach. Under that approach cooperation is a value to be considered along with other values in determining whether something should be treated as income. The income-as-standard approach dispenses with the devices of "noncommercial zone[s]," "common goals," and "joint activities." Instead, it directly considers the various values at stake. The income-as-standard approach produces the same result as the income-as-rule approach without resort to exceptions and corollary principles.

In the scenario involving the Roommates the relevant values emerge from the discussion that produces the common goal principle. Hence, administrability strongly suggests non-taxation since, as Professor Kahn points out, the difficulties in both discovering and valuing a bartered exchange of services in a domestic cohabitation context would be enormous.[50] Privacy and the correlative concern with intrusiveness are also considerations, although their strength may have to do with the precise nature of the Roommates' relationship. Finally, the value of social cooperation — what Professor Kahn describes as "the formation of cooperative ventures in which people pool their labor for a common personal goal"[51] — is directly relevant. Here, the Roommates cooperate to improve their well-being by maintaining a clean and orderly household. Against these considerations are different tax-related values: revenue raising and horizontal equity (someone providing household cleaning services as a business would have income when paid for those services). Under an income-as-standard approach we believe that the values of cooperation, privacy, and administrability, all of which point to the conclusion of no income, push against the values that point to a different conclusion and hence account for the no-income result.

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48. *Id.* at 693 (footnotes omitted).
49. *Id.*
50. *See id.* at 687.
51. *Id*. at 693.

In the case of the Gardeners and the Parents, healthy eating and the care of children, like the Roommates' maintenance of a functional household, are social goods, and as Professor Kahn himself argues, the tax law should not discourage the kind of social cooperation necessary to produce such goods. Moreover, informal arrangements like these among neighbors, friends, and relatives cannot be easily identified and evaluated without an objectionable degree of government intrusion, implicating both administrability and privacy concerns. As with the Roommates, the values that suggest non-taxation are countered by concerns for revenue raising and horizontal equity given that vendors of gardening and child care services would have gross income if paid for their work. Application of income-as-standard requires directly deciding which values should be preferred in this context.

In all three of these scenarios there is likely widespread agreement that the sharing of household chores or gardening or child-care services among friends or acquaintances should not generate gross income. If pressed, those holding this view would likely explain their conclusion by invoking values; the values invoked would include privacy, social cooperation, well-being, administrability, and horizontal equity; and the widely shared conclusion would be that these various values taken together favor non-taxation. Both the income-as-rule and the income-as-standard approaches produce that result. For us, the question is which one does so most directly and transparently.

2. *Child Care, Nursery School, and Home School*

In his article, Professor Kahn also examines the existence of income in the case of larger-membership barter clubs for child care, cooperative nursery schools, and cooperative home schooling. In general, barter clubs, which individuals join to exchange disparate services and for which points are earned or spent, will generate gross income.[52] However, Professor Kahn distinguishes cooperative barter clubs organized by parents for child care and concludes that such clubs do not produce income to the members who receive child-care services.

Professor Kahn cites two reasons in support of this conclusion. One, mentioned in passing, is that the paradigmatic barter club is a "commercial

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52. As Professor Kahn points out, the Service has issued several rulings on the income tax consequences of barter clubs and their attendant information reporting obligations, all of which make clear that transactions occurring within such clubs produce the same tax consequences as regular marketplace exchanges involving cash. Kahn, *Exclusion from Income*, *supra* note 1, at 691 and accompanying text; *see also* Rev. Rul. 85-101, 1985-2 C.B. 301; Rev. Rul. 83-163, 1983-2 C.B. 26; Rev. Rul. 80-52, 1980-1 C.B. 100; Rev. Rul. 79-24, 1979-1 C.B. 60.

enterprise from which a proprietor derives a profit."[53] It seems that applying an income-as-rule approach, as limited by the noncommercial exception, produces this result. The second reason for distinguishing cooperative barter clubs for child care from others is this:

> A significant difference between the child-care barter clubs and other barter clubs is that the services that are obtained through the club are all of the same type and serve the same function. The only service obtained is babysitting for a young child. In other types of clubs, a member might choose to get legal services from another member or he could choose to obtain an entirely different type of service. Consequently, in contrast to other barter clubs, a child-care barter club can be seen to be a cooperative joint venture to engage in a single activity — that is, the tending to young children.[54]

Applying an income-as-rule approach as limited by the noncommercial exception produces a similar result in the case of cooperative nursery schools and cooperative home schooling. Professor Kahn "concludes that the cooperative nursery does not constitute a taxable exchange of services but rather is a pooling of labor to accomplish a common goal."[55] In the case of cooperative home schooling, no income is generated because "[t]he parents pool their services to achieve the common goal of educating their children."[56]

The same analysis extends to the exchange of teaching services involving just two different subjects, which Professor Kahn describes in a scenario involving teachers (the Teachers). In that scenario one Teacher teaches Latin to the child of another Teacher who teaches French to the first Teacher's child.[57] Applying the income-as-rule approach limited by the noncommercial zone exception, further enhanced by the common goal corollary principle and the common goal exception, leads to the conclusion that this exchange does not result in income to either of the Teachers. Under this approach, "[t]he common goal could be to teach a foreign language or more broadly to educate the children. In [Professor Kahn's] view, neither goal is too broad to serve for this purpose; and so the exchange is not taxable."[58]

53. Kahn, *Exclusion from Income*, *supra* note 1, at 695.
54. *Id.*
55. *Id.* at 696.
56. *Id.*
57. *Id*.
58. *Id.*

The income-as-standard approach operates differently, although it produces the same result. Rather than ask whether the setting is "commercial" or the services exchanged by the members of the child-care barter club are "all of the same type" or serve a "common goal," that approach asks what is valued in this type of setting. The answer is that social cooperation to care for and educate children is an important value, as is education,[59] and public outrage would likely accompany any effort to tax the

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59. That education is a relevant tax value is easily demonstrated by considering that section 501(c)(3) exempts revenue received by nonprofit educational organizations from federal income taxation. As the staff of the congressional Joint Committee on Taxation ("Joint Committee") has consistently made clear, the tax exemption for these organizations is not a tax expenditure. *See, e.g.*, STAFF OF JOINT COMM. ON TAXATION, 112TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2011–2015, at 9–10 (Comm. Print 2012) [hereinafter JOINT COMM. ON TAXATION, 2011–2015 TAX EXPENDITURES]. Prior Joint Committee Reports and other government estimates consistently reach the same result. *See, e.g.*, OFFICE OF MGMT. & BUDGET, SPECIAL ANALYSES, BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 1976, at 108 (1975). Although it is beyond the scope of our current effort to discuss it further, there is a rich literature on the nature of the exemption for certain organizations and a number of theoretical bases on which to support it, but the conception of the exemption as structural and not as a tax expenditure has been consistent. *See, e.g.*, Boris I. Bittker and George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 304–05 (1976) (analyzing the genesis of the exemption and arguing that the failure to treat the exemption as a tax expenditure "can properly be regarded as [a] routine aspect[] of the income tax structure rather than as [a] digression[] from an as yet undefined comprehensive tax base"); Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 585–86 (1998) (analyzing whether the tax exemption for charities "is, on the one hand, a 'subsidy' or, on the other, an acknowledgement that charitable activity falls outside the 'right' tax base" and suggesting a "sovereignty" view that both explains the non-taxation of charitable organizations while also accounting for the form of executing the nontaxation (exemption rather than direct subsidy). *See generally* Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B. C. L. REV. 501 (1990) (examining the role of altruism in the rationale for the tax exemption of nonprofit organizations as a supplement to traditional economic analysis). That is, the exemption is a structural part of the system, it is not a subsidy, and revenue received by 501(c)(3) educational organizations is not income at all — precisely the result that an income-as-standard analysis produces. As the Joint Committee on Taxation explains,

> The legislative history of the Budget Act indicates that tax expenditures are to be defined with reference to a normal income tax structure (referred to here as "normal income tax law"). The determination of whether a provision is a tax expenditure is made on the basis of a broad concept of income that is larger in scope than "income" as defined under general U.S. income tax

Teachers for teaching each other's children. Hence, the values of administrability, which requires some degree of acceptance by those being taxed, social cooperation, and education suggest non-taxation in this case.

Interestingly, the income-as-standard and the income-as-rule approaches produce the same results in the child-care barter club, cooperative nursery school, and cooperative home schooling contexts. As before, the difference is in the directness and transparency of the analysis. We believe the income-as-standard approach provides a more direct route. Both approaches are rooted in the same concern for respecting and promoting the values of cooperation, administrability, and education, but the income-as-standard approach exposes those values directly, whereas the income-as-rule approach requires the creation of exceptions, corollary principles, and further exceptions to reach the result.

3. The Handy Shoe Salesman and the Chess Master Professor

Following the joint activity discussion Professor Kahn proceeds to consider what he labels "Non-Marital Exchange of Services Not Connected With a Trade or Business" and offers a scenario in which a shoe salesman (the Salesman), who is handy with home repairs, and a college professor with a master's ranking in chess (the Professor), but no talent for home repairs, exchange services. Thus, when a window in the Professor's house is broken by a storm, the Salesman offers to fix it. The Professor accepts the Salesman's offer and suggests that he give chess lessons to the Salesman's daughter in return. The income-as-rule approach produces income even though neither the Professor nor the Salesman is providing services connected with their businesses. Professor Kahn explains that "the exchange of services can be seen as occurring in a commercial zone" because the Professor and the Salesman each could have charged for their services.[60] He then concludes that there is no common goal, and the transaction cannot be characterized as a pooling of services. Consequently, "a proper application of the tax law would tax the exchange."[61]

In this scenario the income-as-standard approach would produce a different result, and the reason for that is contained in an aside offered by Professor Kahn:

> principles. The Joint Committee staff has used its judgment in distinguishing between those income tax provisions (and regulations) that can be viewed as a part of normal income tax law and those special provisions that result in tax expenditures.

JOINT COMM. ON TAXATION, 2011–2015 TAX EXPENDITURES, *supra*, at 3.

60. Kahn, *Exclusion from Income*, *supra* note 1, at 694.

61. *Id*.

> Given the isolated aspect of this exchange (i.e., it was not part of a pattern of exchanging services), the administrative costs of taxing it are such that the government might be better advised to ignore it. Nevertheless, *a proper* application of the tax law would tax the exchange. The exchanged services were not provided to achieve a common goal. It just may not be worth the government's effort to enforce the tax.[62]

Substituting the words "an income-as-rule" for "a proper" in the foregoing paragraph explains the difference. An income-as-standard approach produces precisely the result Professor Kahn prefers without resort to either exceptions or corollary principles and avoids the assertion of apparent impropriety.[63] Although the income-as-standard approach would result in the same counsel to the government, the difference is that counsel based on an income-as-standard approach produces a result of no-income, not just non-enforcement.

In suggesting non-enforcement, Professor Kahn is not alone. Courts have recognized the administrative agency's ability to deploy its resources as it deems appropriate and have relied on that power to explain the IRS's position that unsolicited samples are not income unless a taxpayer attempts to claim a deduction for donating them to charity.[64] But that reasoning

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62. *Id.* (emphasis added).

63. We should add that it is not clear that considerations of horizontal equity press in favor of finding income in the scenario involving the Salesman and the Professor. Here, a useful comparison is the first version of the Doctor/Lawyer exchange of services in the first scenario examined. *See supra* Part II.A. As Professor Kahn sets up the facts, the Lawyer needed surgery and the Doctor needed a divorce lawyer. Each would have purchased the services on the open market if the other had not offered to provide them. The value of horizontal equity requires that transactions that would have taken place on the open market through the exchange of money for services be taxed similarly even when no money changes hands. However, in the scenario involving the Salesman and the Professor there is no certainty that either of those transactions would have taken place in the marketplace. The Salesman may not have been willing to pay (with after-tax dollars) for his daughter to take chess lessons from a master, or at all, and the Professor may have been happy attempting the repair himself, simply tacking a piece of wood to the broken window, or otherwise making do. The exchange is not a clear substitute for a market transaction (which the value of horizontal equity requires us to tax), and that allows other values, like the values of cooperation and administrability, to carry the day.

64. *See* Haverly v. United States, 513 F.2d 224, 227 (1975), discussed in *Defining Income*, *supra* note 9, where we quoted the court's observation that

> [t]he Internal Revenue Service has apparently made an administrative decision to be concerned with the taxation of

implicates a concept akin to prosecutorial discretion, which assumes that an item is income (or a crime) although the relevant administrator has decided not to assert that position. We believe that an interpretation which posits that an administrative agency can use its discretion to interpret a standard and, in this case, to interpret the bare receipt of an unsolicited sample as not constituting income under that standard, offers a more satisfactory explanation of the agency's observed decision.

III. INCOME-AS-RULE OR INCOME-AS-STANDARD

What has our thought experiment demonstrated? One thing it has shown is that the standard-based approach supports the same results as a rule-based approach in most of the cases that Professor Kahn considers in his article. In addition, a standard-based approach explains why those results seem appropriate by revealing how the relevant tax values apply to the various sets of facts. Usually, that would not be enough to recommend income-as-standard over income-as-rule. But in this case there is more.

Among the presumed advantages of rules over standards is that they are more efficient and promise predictability, certainty, uniformity, and administrability.[65] These advantages should be realized if the rule is determinate in the great run of cases; if it is, it makes sense to reach predictable results through the efficient application of that rule and not worry about the underlying reasons. The situations at the margins can be addressed as they arise. In the case of the definition of income, though, it turns out that treating the definition of income as a rule actually leads to a high degree of indeterminacy, not just indeterminacy at the margins. Professor Kahn's commercial/noncommercial distinction offers a good illustration.

In Professor Kahn's formulation, the rule is that "the income tax applies only to commercial activities and . . . income produced from noncommercial activities is not taxable."[66] For this rule to have the predictive power associated with rules, the meaning of "commercial" and "noncommercial" must be reasonably clear. But consider Professor Kahn's central examples of what he classifies as noncommercial activities in which exchanges should not produce income. Those examples involve the Father and the Son, and the Roommates.

In both cases, Professor Kahn concludes that the exchanges of money for services (in the case of the Father and the Son), and of pure

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unsolicited samples only when failure to tax those samples would provide taxpayers with double tax benefits. It is not for the courts to quarrel with an agency's rational allocation of its administrative resources.

65. *See supra* note 18.

66. Kahn, *Exclusion from Income*, *supra* note 1, at 686.

services (in the case of the Roommates), is not income to either of them because the exchange occurs within a noncommercial zone. The problem is articulating what makes the zone noncommercial. It cannot be that there is no money exchanged since no money was exchanged when the Doctor exchanged surgery for legal services, or when the Salesman exchanged repairs for chess lessons, both of which Professor Kahn treats as commercial exchanges that generate income. It cannot be the absence of a quid pro quo since in some scenarios the division is deliberate: one Roommate cooks in exchange for the other's doing the dishes, and the Son does the chores in exchange for the money the Father gives him, making precisely the association that the Father seeks to underscore.[67] It cannot be because the services were not sold for a profit since any compensation for labor by definition produces a profit.[68] It cannot be because the services were not

67. Professor Kahn acknowledges that the noncommercial determination is not affected by the existence of explicit bargaining, citing the example of a couple who deliberately divide chores so that they are equivalently distributed and no one is receiving a bargain or undue burden, concluding that even in such an extreme example the zone remains noncommercial. *Id.* at 687.

68. The tax system does not assign any basis to human capital, which is why the exchange of human capital for money — working for a salary — always produces income in the full amount of the compensation received. The D.C. Circuit faced the issue of human capital in Murphy v. I.R.S., 460 F.3d 79, 88 (D.C. Cir. 2006), finding that compensation for harm caused to an individual's reputation and emotional well-being must be included in income unless a taxpayer's basis in such human capital exceeds the amount received. Much to the chagrin of the tax community and its contrary general consensus, the decision implied that it would be possible to have basis in human capital. *See* Joseph M. Dodge, Murphy *and the Sixteenth Amendment in Relation to the Taxation of Non-Excludable Personal Injury Awards*, 8 FLA. TAX REV. 369, 420 (2007) ("Human capital simply does not possess basis as a matter of Law."); Deborah A. Geier Murphy *and the Evolustion of 'Basis,'* 113 TAX NOTES 576, 582 (Nov. 6, 2006) ("Because Murphy had no basis in her human capital, the entirety of the cash she received was gross income . . . ."); Allen Kenney, Murphy *a Boon for Protesters, Critics Say*, 112 TAX NOTES 832, 832 (Sept. 4, 2006) ("[Critics] expressed concern that the decision could be read as a validation of the popular antitax argument that wages paid for an individual's labor are not taxable"); Lee A. Sheppard, Murphy's *Law: Tax Provision Declared Unconstitutional*, 112 TAX NOTES 825, 830 (Sept. 4, 2006) ("Human capital is taxable"); Sheryl Stratton, *Experts Ponder* Murphy *Decision's Many Flaws*, 112 TAX NOTES 822, 823 (Sept. 4, 2006) ("[U]ntil this opinion, it has been widely accepted that taxpayers have no basis in their labor . . . ."). Bowing to the scathing criticism, the opinion was subsequently vacated and a new one issued in Murphy v. I.R.S., 493 F.3d 170, 184–86 (D.C. Cir. 2007), this time finding that the taxpayer had gross income even if the amounts were characterized as a recovery of human capital. For related analyses of human capital in the context of the cost of education, *see generally* Jennifer J.S. Brooks, *Taxation and Human Capital*, 13 AM. J. TAX POL'Y 189 (1996); David S. Davenport, *Education and Human Capital: Pursuing an*

provided as part of an established business because in the scenario involving the Salesman and the Professor, the services exchanged were not a part of either the Salesman's or the Professor's established business and Professor Kahn nevertheless found that the exchange of window-fixing for chess lessons occurred "in a commercial zone."[69] It also cannot be because each party to the exchange could have charged for his work. Like home repairs and chess lessons, the housekeeping chores exchanged by the Roommates, gardening chores exchanged by the Gardeners, the babysitting exchanged by the Parents, and teaching exchanged by the home schooling language Teachers all involve services for which a commercial market exists.

Since we can point to no aspect of the various transactions that explains why the zones in which they occur are commercial in some cases but not in others, and Professor Kahn offers no definition or explanation of the term, we are drawn to the conclusion that the commercial/noncommercial rule does not help us understand those results. The promise of determinacy offered by the crafting of a rule is unfulfilled.

Our more general point is that no single rule can determine the existence of income across the great run of human activity. Any rule would fail to explain the result in great swaths of human exchanges. Indeed, Professor Kahn's attempt to craft such a rule vividly demonstrates that, as even the commercial/noncommercial distinction is insufficient to explain the result in the various exchanges he posits without the aid of a corollary principle and an additional exception. Our thought experiment thus lends support to the claim we made in *Defining Income*: The definition of income is most aptly analyzed not as a rule but as a standard.

As we have suggested, transparency alone might not suffice to make an income-as-standard superior if the indeterminacy produced by the rule existed only at the margins. And the types of situations addressed in Professor Kahn's scenarios might be thought to lie at the margins. After all, many non-tax scholars might ask: Who really wonders whether a kid has income when his dad pays him to do chores, or whether neighbors who exchange babysitting or gardening or even do disparate things for one another (fix a window, teach chess), have income? Only a tax geek would think that such questions even existed.

But it is precisely because the no-income answer is so obvious to so many people, and so troubling to tax scholars,[70] that the income-as-standard

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Ideal Income Tax and a Sensible Tax Policy, 42 CASE W. RES. L. REV. 793 (1992); Joseph M. Dodge, *Taxing Human Capital Acquisition Costs—Or Why Costs of Higher Education Should Not Be Deducted or Amortized*, 54 OHIO ST. L. J. 927 (1993).

69. Kahn, *Exclusion from Income*, *supra* note 1, at 694.

70. The fact that very highly respected tax scholars are troubled by these issues is evidenced by Professor Kahn's article as well as by the efforts of other

approach is apt. The types of exchanges represented by the scenarios in which Professor Kahn finds no income are the norm in civil society, not the exception. People do things for one another all the time, and they do those things not necessarily out of detached and disinterested generosity but out of social convention and expectation. Observance of norms makes us better off and thus arguably constitutes an accession to our wealth, but it should not be taxed.

The problem for tax scholars is that a tax law that defines income as "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion,"[71] would have to treat such accessions as gross income if that definition were interpreted as a rule. Like the first-year law student who suddenly sees torts everywhere when she takes Torts, the law student first exposed to the concept of income as defined in *Glenshaw Glass* can see income everywhere too. The torts student comes to understand that not every instance of preventable harm represents an actionable tort because she comes to understand that due care, or its converse, negligence, is a standard. The tax student has no similarly clarifying explanation. She assumes that the definition of income is a rule not only because it is framed as a rule but because so much of the tax law is composed of rules. Why would there be a 10,000-plus page statute if not to set forth all the rules? And of course there are many, many rules in tax. But a view of the tax law as consisting exclusively and uniformly of rules creates a situation in which there is no theoretically satisfactory way of arriving at a no-income result in the scenarios in which Professor Kahn arrives at such a result save for the creation of more rules. As we have seen with Professor Kahn's attempt at creating the commercial/non-commercial rule, defining income as a rule only begets more rules or exceptions thereto without necessarily producing more determinacy at the end.[72]

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noted scholars who have addressed similar questions, particularly when they involved home-run breaking baseballs. Zelenak & McMahon, *Taxing Baseballs*, *supra* note 6, at 1300–01; Dodge, *Accessions to Wealth*, *supra* note 6, at 691–92.

71. *Glenshaw Glass*, 348 U.S. at 431.

72. Although this is not the vehicle in which to engage in an extended discussion of tax pedagogy, the one of us who teaches the introductory tax course regularly and has been doing so for over twenty-five years can attest to the illuminating power of even suggesting that the definition of income is a standard. The suggestion has the potential to answer many of the questions tax professors often get when teaching *Glenshaw Glass*, such as why an individual will not have income when a companion pays for an expensive dinner even if the individual clearly understands the expectation, that as a result, sexual advances will not be rebuffed. Indeed, determining whether a formulation is a rule or a standard before proceeding with further analysis can illuminate the application of many fundamental tax concepts. Some are obvious, such as the Supreme Court's definition of capital expenditure in *INDOPCO*. INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 85–87

The disconnect between the very large number of exchanges that would seem to produce income if the definition thereof were a rule and our real world understanding that many of these exchanges do not produce income (and that treating them as such would be unadministrable), led Professor Kahn to attempt an explanation by developing the commercial/noncommercial distinction. Putting aside the technical problem of finding the authority to craft an exception to a rule, income-as-rule is seriously indeterminate. The reason is that rules are determinate when they reflect clear value preferences.[73] But the question of what counts as income in an income tax system implicates an unusually large number and variety of relevant values. Some of these are economic (e.g., efficiency); some are about design of an effective system (e.g., administrability); and some are about the fundamental legal value of justice (e.g., horizontal and vertical equity). Moreover since an income tax system concerns nothing less than the whole of public welfare, all public welfare values — economic and noneconomic alike — are potential candidates for application to questions of income. Finally, there is no consensus that certain values should consistently predominate over others in determining what should be taxed. Indeed, there is little consensus on whether there should be an income tax at all.

In short, there are too many values and too little agreement for a rule like Professor Kahn's to work. Yet because rules seem so desirable in tax, the temptation is to provide determinacy by refining the rule. Professor Kahn does this by qualifying the commercial/noncommercial rule with exceptions and corollary principles. We might even pursue this further by adding a sub-rule that payments or exchanges between cohabitants do not generate income. But that will not do. If someone patronizes a particular store

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(1992). When understood as a standard, the Treasury Department implemented through the promulgation of detailed rules containing safe harbors and rules of convenience designed to foster administrability, Regs. §§ 1.263(a)-4 to -5, the definition loses the apparently constricting force that threatened to make every CEO's salary nondeductible. It also explains the Treasury's position in the Regulations as an administratively driven interpretation thereof and not simply as an illegitimate giveaway to the taxpayer community. *See* Roger Jones & Andrew Roberson, *To What Extent Can Treasury Abandon or Overrule* INDOPCO*?*, 127 TAX NOTES 547, 547–49 (May 3, 2010). Understanding the word 'reorganization' in the predecessor of section 368 as a standard explains not only Gregory v. Helvering, 293 U.S. 465 (1935), and its progeny but also the pervasiveness of judicial doctrines of substance over form more generally. Understanding the section 318 attribution rules as rules that promote administrability explains the Service's (and most courts') stubborn unwillingness to countenance arguments of family hostility. Engaging in the rule/standard determination as part of the analysis of a tax provision can illuminate the application of that provision, but further development of this point must await another day.

73. Abreu & Greenstein, *Defining Income*, *supra* note 9, at 330–31.

primarily because it is owned by her roommate and purchases items for the price charged to the public, those transactions generate gross income. So maybe the rule should be that only transactions among cohabitants for the benefit of the household do not generate gross income. But as the rules regarding income thus become more and more refined to work properly, they become more and more numerous and more and more narrow — sliding inexorably towards the all-things-considered approach of a standard.

On the other hand, the consideration of the relevant values is often easy as a practical matter, as it is in many of the cases reflected in Professor Kahn's scenarios, where the IRS has never attempted to assert the existence of income (the Father paying the Son for chores, the Roommates sharing housekeeping, and the like). When it is more difficult, and the IRS takes a position that does not reflect widely shared values, as it did when a spokesperson suggested that a fan who caught a record-breaking baseball at a game had income, public opinion, Congress, or the courts can correct it. Sometimes the IRS even completely changes its position.[74] But this very fluidity is the law's strength. It reflects values, and as those change, so does the law, if imperfectly and sometimes belatedly but, at its best, in a way that reflects changing societal values.

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74. A recent example is the Service's change of position on the application of a two-year statute of limitations to claims for equitable relief in innocent spouse cases, which came despite victories in two federal courts of appeal following congressional communication with the Commissioner. *See* SEN. MAX BAUCUS ET AL., SENATORS REQUEST WITHDRAWAL OF EQUITABLE INNOCENT SPOUSE RELIEF LIMITATIONS PERIOD, 2011 TNT 75–27 (Apr. 19, 2011); Rep. Fortney Pete Stark et al., *Representatives Request Withdrawal of Equitable Innocent Spouse Relief Limitations Period*, 2011 TNT 75–28 (Apr. 19, 2011). *See also* Douglas H. Shulman, *Shulman Says IRS Is Reviewing Innocent Spouse Relief Rules*, 2011 TNT 86–34 (May 4, 2011); David van den Berg, *IRS Gives In on Innocent Spouse*, 134 TAX NOTES 38 (Jan. 2, 2012). In Notice 2011-70, 2011-32 I.R.B. 135 (July 25, 2011), the Service announced that despite its victories in the courts of appeals, the section 6015 regulations would be revised so that the two-year limitations period no longer applied to claims for equitable relief. In addition, the Notice provided generous transition relief, specifying that pending requests for equitable relief would be considered if submitted after the two-year period, requests that were denied solely because of failure to comply with the two-year period and that were not litigated would be treated as claims for refund, any such requests that were in litigation would be the subject of action consistent with the Notice without further action on the taxpayer's part, and in cases where the litigation had been final the IRS would cease further collection action. The only way the IRS's change of heart could have been more complete is if it had offered refunds of any taxes collected from individuals who had sought equitable relief, but it is impossible to know whether any such taxes were ever collected and thus whether any refunds could even have been possible.

IV. CONCLUSION

Professor Kahn's article makes an important contribution to the understanding of the definition of income by explicitly identifying some of the values that should animate it. The scenarios he uses to explore the contours of the definition of income allow useful comparisons and contrasts; working with these scenarios has helped us refine the ideas about the definition of income that we first proposed in *Defining Income*.

In *Defining Income*, we demonstrated that numerous results, like the non-taxation of support, the value of dinners and other entertainment provided to clients by lawyers and other professionals, travel provided by a prospective employer to a prospective employee or investor, record-breaking baseballs caught by fans or fish caught by amateurs and professionals alike, or even big game trophies collected by hunters and donated to charity, were best explained by an analysis that treats the definition of income as a standard, the application of which is informed by multiple values. Working with Professor Kahn's scenarios has reinforced our conclusion that the traditional difficulty of reconciling the definition of income with such results stems from the unexamined assumption that the definition of income is to be interpreted as a rule. Once we consider the possibility that the definition of income is not a rule but a standard, both the source of the difficulty and its resolution become clear. Analyzing the definition of income as a standard illuminates the treatment of the vast majority of exchanges that occur in human interaction. Those exchanges create wealth but implicate important non-economic values too vast and varied for any rule to capture. A standard, however, is apt.

In the case of pornography, Justice Stewart famously acknowledged the futility of creating a rule or even a highly articulated standard and refused to attempt it. Instead he captured the essence of the concept by simply asserting that he knew it when he saw it.[75] In the case of income the Supreme

75. In Jacobellis v. Ohio, 378 U.S. 184 (1964), the Court used the formulation it had developed in Roth v. United States, 354 U.S. 476, 489 (1957), "whether to the average person, applying contemporary community standards, the dominant theme of the material taken as a whole appeals to prurient interest," acknowledging it to be a standard. *Id*. at 191. Concurring in *Jacobellis,* however, Justice Stewart acknowledged the difficulty of "trying to define what may be indefinable," and wished to go no further than stating that criminal laws could only constitutionally proscribe pornography and "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that." *Id.* at 197. The reception to Justice Stewart's most prominent observation has been mixed. For a

Court has not been so candid about the difficulty of the definitional task. But at their core, the definitions of both income and pornography are best analyzed as standards, informed, as standards must be, by contemporary values. Acknowledging that the definition of income is best interpreted as a standard does not render it lawless any more than any legal formulation that is interpreted as a standard is lawless. Neither does such acknowledgment deny that many tax formulations are rules. There are many, many rules in tax, but that does not mean that every tax formulation must be interpreted as a rule. Section 61 suggests as much by defining income by reference to itself.[76]

An income-as-standard approach has the advantage of being more satisfying than an income-as-rule approach because it provides a theoretical explanation for the observed definition of income, which excludes myriad wealth-enhancing accessions taxpayers receive every day, and does so directly, without resort to exceptions that need to be defined and further qualified. Because the number of exchanges that would inappropriately produce gross income if the definition of income were a rule is so vast, it is important to articulate the theoretical basis for their non-inclusion. That is what Professor Kahn was trying to do in his article. We hope to have shown that an income-as-standard approach achieves that objective transparently and efficiently, invoking directly the values that the judgments of non-inclusion reflect. An income-as-standard approach provides the theoretical space for engaging in the nuanced consideration required in an area as value-laden as the income tax.[77]

The benefits that flow from the income-as-standard approach remind us that all law —whether formulated as rules, standards, or hybrids — is animated by values and that the road to resolving seemingly intractable legal puzzles sometimes begins with recalling those values. In the case of income in tax law, the relevant values include the familiar concerns of equity, efficiency, and administrability, but go on to embrace a host of often contestable economic and noneconomic social welfare values. With so much

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discussion of and response to Justice Stewart's critics, *see* Paul Gewirtz, *On "I Know It When I See It,"* 105 YALE L.J. 1023 (1996).

76. Section 61 defines gross income as "all income from whatever source derived," thereby unhelpfully defining gross income as income. Although the provision does include an illustrative list, it is explicit in stating that gross income includes, but is "not limited to" those items. If the definition of income were a rule, it would be reasonable for the statute to define it, but saying that gross income is income does not define income. For the United States Supreme Court's efforts to define income in *Glenshaw Glass*, see *supra* note 1 and accompanying text.

77. As Professor Boris Bittker observed long ago, "When we turn to the field of income taxation . . . we do not begin with a consensus on the meaning of income, but with a myriad of arguments about what should be taxed, when and to whom." Bittker, *CTB as a Goal*, *supra* note 7, at 985.

at stake it seems especially important to remember Bittker's warning a half century ago that a "neutral, scientific measure of . . . income is a mirage"[78] and to revive Surrey and Warren's call "for a standard which will project our present aims into the future and serve as the vehicle for solving the unforeseen cases as they arise."[79]

In the decades since Bittker, Surrey, and Warren offered those observations the income tax has grown into a daunting array of complex statutory provisions with not only sections, subsections, paragraphs, and subparagraphs, but complex, detailed regulations, and a mind-numbing number of revenue rulings, revenue procedures, notices, directives, forms, schedules, instructions, and publications.[80] It is not surprising that in the unrelenting deluge of apparent commandments many tax scholars and other professionals have come to assume that all of the tax law is composed of rules. Our broad claim is that it is not, and our specific claim is that the definition of income is not a rule. In future work we expect to develop our broad claim, but Professor Kahn's article has provided us with an opportunity to test our specific claim, and we believe the test has made our claim stronger. The definition of income is not a rule; it is a standard, and that explains what is taxed and what is not.

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78. *Id.* at 925 (article abstract). Professor Bittker also observed pointedly that "[a] truly 'comprehensive' base . . . would be a disaster." *Id.* at 982.

79. Surrey & Warren, *Tax Project*, *supra* note 13, at 775.

80. The growth in the Code alone is notable. For example, the CCH Standard Federal Tax Reporter weighed in at a hefty 73,608 pages of tax law in 2012 — approximately 13,000 more pages than in 2004. *Federal Tax Law Keeps Piling Up*, CCH INC. (2012), http://www.cch.com/wbot2012/WBOT_TaxLawPileUp_(23)_f.pdf. While this calculation includes more than income tax laws, it nonetheless illustrates the growth in the number of formulations that are easily assumed to be rules because they are contained in a highly articulated statute. In addition, the growth in population, the economy, and technology, have led to significant automation of the tax collection process, and that requires rules, for it is much easier for a machine to determine compliance with a rule than with a standard. For an examination of the effect of using technology in tax administration, *see* 2 NATIONAL TAXPAYER ADVOCATE, *From Tax Collector to Fiscal Automation: Demographic History of Federal Income Tax Administration*, ANNUAL REPORT TO CONGRESS**,** http://www.irs.gov/pub/irs-utl/irs_tas_arc_2011_vol_2.pdf.