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Johnny Rex Buckles
University of Houston Law Center, buckles@central.uh.edu

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The Community Income Theory of the Charitable Contributions Deduction

JOHNNY REX BUCKLES*

The charitable contributions deduction, a longstanding yet controversial feature of the Internal Revenue Code, has been justified under subsidy theories and tax-base theories. Focusing on the latter, this Article presents and explains a new tax-base theory in support of the charitable contributions deduction—the community income theory. This theory posits that some income, designated as "community income," is properly excluded from the personal income tax base because it is more naturally attributed to the community than to the individual members of the community. Adopting the presumption that the community generally should be treated as a tax-exempt entity, this Article argues that both the charity income tax exemption and the charitable contributions deduction may be defended on the basis that they reflect the theoretically correct taxation of community income.

INTRODUCTION

Since 1917,1 Congress has permitted taxpayers to deduct gifts to educational, religious, and other charitable organizations in calculating their taxable income for federal income tax purposes.2 Notwithstanding its longevity, this charitable contributions deduction has been a controversial feature of federal income tax statutory law for decades. The deduction has been criticized as inequitable,3 inefficient,4

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2. See I.R.C. § 170(a)(1) (2003) (authorizing a deduction in computing an individual taxpayer’s income for contributions or gifts to entities described in subsection (c)); id. § 170(c) (describing donees to which deductible contributions may be made).


4. See, e.g., McDaniel, supra note 3, at 383–89; Rabin, supra note 1, at 918–20. One argument based on efficiency is that the government’s foregone tax revenue exceeds the increase (if any) in charitable contributions resulting from the deduction. See McDaniel, supra note 3, at 383–89. However, some studies indicate that the charitable contributions deduction is actually efficient in the sense that contributions induced by the deduction exceed revenue losses. See, e.g., Martin Feldstein, The Income Tax and Charitable Contributions: Part I—Aggregate and Distributional Effects, 28 Nat’l Tax J. 81 (1975). The numerous studies that have been
politically suspect as a tax expenditure, and, in general, fundamentally inconsistent with a comprehensive income tax base. Yet, even as academicians have frontally assaulted the deduction, it has seldom been forced to retreat. Indeed, recently proposed legislation would permit a charitable contributions deduction by taxpayers who do not itemize deductions. Such a change in existing law would plainly expand the deduction. One wonders how the deduction has fared so well in the face of its objectors.

The tenacity of the deduction is not attributable to any rhetorical deficiencies in its critics. Each of the major objections to the charitable contributions deduction has persuasive appeal, and each is easily illustrated and comprehended. Consider Taxpayer A, who is in a 40% marginal income tax bracket and who earns $500,000 annually. Taxpayer A donates $100,000 to the symphony. She lives next door to Taxpayer B, who is in a 10% income tax bracket and who earns $20,000 annually. Taxpayer A

conducted to date apparently have not decisively resolved the issue of the absolute dollar efficiency of the charitable contributions deduction. See generally CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 49-63 (1985) (summarizing numerous studies and concluding that they generally support a finding that the price elasticity of charitable giving is at least one); John D. Colombo, The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption, 36 WAKE FOREST L. REV. 657, 683–84 (2001) (briefly discussing various studies).

A separate, and more difficult, question is whether the deduction is economically efficient (i.e., whether the benefits from contributions resulting from the deduction exceed the benefits lost from foregone government revenue). Some have questioned whether the deduction is economically efficient. See, e.g., Ellen P. Aprill, Churches, Politics, and the Charitable Contribution Deduction, 42 B.C. L. REV. 843, 864–67 (2001). Even if the deduction is efficient in terms of absolute dollars, it may not be economically efficient. See Mark P. Gergen, The Case for a Charitable Contributions Deduction, 74 VA. L. REV. 1393, 1404–05 (1988).


6. See infra text accompanying notes 60–73.


8. “Itemized” deductions are, in general, those which are allowed in computing a taxpayer’s taxable income, other than deductions specifically treated as allowable in arriving at “adjusted gross income.” See I.R.C. § 63(d) (2003). A taxpayer elects to itemize deductions. See id. § 63(e)(1). A taxpayer who does not itemize is entitled to claim a statutorily specified “standard deduction.” See id. § 63(b).

donates $4000 to a local homeless shelter. If we assume that, but for the charitable contributions deduction, the federal government would be entitled to tax revenues equal to the sum of the product of each taxpayer’s income (for the relevant income tax brackets) and the applicable tax rates,\(^\text{10}\) the deduction has an obvious (and unpalatable) effect. It results in the economic equivalent of a $40,000 government grant\(^\text{11}\) to the symphony\(^\text{2}\) and a $400 grant to the homeless shelter.\(^\text{3}\)

Viewed in this manner, the deduction is objectionable on numerous grounds. First, the government has economically extended financial support to the symphony that is one hundred times greater than that extended to the homeless shelter. Yet there is no compelling reason to believe that society is bettered to a greater degree by granting subsidies to the fine arts in excess of those extended to organizations providing basic human services. We know only that the “rich” Taxpayer A has effectively allocated one hundred times more of society’s resources to his favorite charity than has the relatively “poor” Taxpayer B.\(^\text{14}\) Additionally, if people of similar incomes tend to support similar charitable causes, the expectation is that the class of high-income earners will disproportionately (relative to the total number of taxpayers) influence the allocation of charitable dollars.\(^\text{15}\) One may rightly question whether society’s resources

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\(^{10}\) A taxpayer’s total income tax liability is the sum of (1) the products of the rate of tax applicable to each statutory range of taxable income reportable by the taxpayer, and (2) the taxpayer’s income within that range. For example, assume that there are two income tax rates in effect in the case of Taxpayers A and B: 10% for income up to $20,000, and 40% for income in excess of $20,000. Tax receipts attributable to Taxpayer A = 10% x $20,000 + 40% x $480,000 = $194,000. Tax receipts attributable to Taxpayer B = 10% x 20,000 = $2000.

\(^{11}\) See Rabin, supra note 1, at 920 (“In essence, the present system is a type of matching program under which the Government agrees to spend a certain amount (depending on the taxpayer’s top tax bracket) for each dollar contributed to charity.”).

\(^{12}\) After the $100,000 deduction, Taxpayer A’s taxable income is reduced from $500,000 to $400,000. If Taxpayer A’s marginal rate of income tax (i.e., the tax rate applicable to the last dollar of income of the taxpayer) is 40%, the $100,000 reduction in the government’s tax base results in a decrease in tax revenues attributable to the deduction in an amount equal to 40% of $100,000, or $40,000. Thus, by allowing the deduction, the government is economically positioned as though it had taxed all of A’s $500,000 earnings and then distributed a $40,000 grant to the symphony.

\(^{13}\) After the $4000 deduction, Taxpayer B’s taxable income is reduced from $20,000 to $16,000, which gives rise to a tax liability of 10% x $16,000, or $1600. The difference between this income tax liability and that which would exist in the absence of a deduction ($2000, see supra note 10) is $400. Thus, by allowing the deduction, the government is economically positioned as though it had taxed all of B’s $20,000 earnings and then distributed a $400 grant to the homeless shelter.

\(^{14}\) Cf. McDaniel, supra note 3, at 383 (illustrating that the charitable contributions deduction effectively requires government to expend more funds to induce charitable gifts from high-income taxpayers).

\(^{15}\) See Aprill, supra note 4, at 868 (stating that the charitable contributions deduction “favors the charitable activities favored by the wealthy”); Charles T. Clotfelter, Tax-Induced Distortions in the Voluntary Sector, 39 CASE W. RES. L. REV. 663, 685 (1989) (“Charities favored by the rich simply receive more favorable rates of subsidy through the itemized deduction than those favored by the poor.”); Todd Izzo, Comment, A Full Spectrum of Light: Rethinking the Charitable Contribution Deduction, 141 U. PA. L. REV. 2371, 2373–75 (1993) (arguing that the charitable contributions deduction allows high-income taxpayers to decide
should be allocated by means of the preferences of those with high incomes, rather than through normal political processes. Moreover, even if the rich as a class proportionately contribute to the same charitable donees as the less well-to-do (a counterfactual assumption),\footnote{16} the “indirect federal grants” to charities resulting from the charitable contributions deduction are not overseen by congressional committees with special expertise in the fields of import to charitable organizations (such as education, social services, science, health care, and the arts).\footnote{17} Furthermore, even apart from these considerations, in a progressive system of tax rates, the value of the charitable contributions deduction is greater (in nominal dollars) to high-income taxpayers than to low-income taxpayers. Accordingly, some argue that the distribution of the benefit of the deduction is regressive.\footnote{18}

Additional objections may be raised against the charitable contributions deduction if Taxpayer A is compared not with Taxpayer B but with Taxpayer C, who earns the same amount of gross income as Taxpayer A and who expends $100,000 in nondeductible outlays (for items such as personal travel and entertainment, extravagant meals at five-star restaurants, and numerous hand-tailored suits). Presumably, the argument goes, Taxpayer C is neither better nor worse off than Taxpayer A. When Taxpayer A donated her $100,000 to the symphony, she must have received at least $100,000 worth of satisfaction from the donation; otherwise, she would not have donated the sum. Further, prior to the outlays, both A and C plainly had the same income, and therefore the same taxpaying capacity. Accordingly, to tax A more favorably than C (by permitting a charitable contributions deduction) violates the principle of horizontal equity.\footnote{19}

\footnote{16. See Aprill, \textit{supra} note 4, at 846, 868–69 (reporting differences in charitable giving patterns between high- and low-income taxpayers); McDaniel, \textit{supra} note 3, at 391 (“\textit{[T]he data show that high income individuals and low income individuals do not give to the same charities.
\textit{}”).

17. \textit{Cf.} Surrey, \textit{Tax Incentives, supra} note 5, at 728 (explaining that tax incentives effectively impose upon the House Ways and Means Committee and the Senate Finance Committee the burden of “acting on substantive matters outside their fields of responsibility simply because the program uses the tax system”).

18. \textit{See, e.g.,} McDaniel, \textit{supra} note 3, at 395; \textit{cf.} Clotfelter, \textit{supra} note 15, at 683–84 (referring to the “upside-down” subsidy effected by the charitable contributions deduction). This assertion is problematic. One argument in favor of a progressive rate structure is based on the theory of the diminishing marginal utility of the dollar. Under this theory, taxing high-income taxpayers at higher marginal rates is arguably appropriate because they value marginal dollars less than low-income taxpayers value them. \textit{See Joseph M. Dodge et al., Federal Income Tax: Doctrine, Structure, and Policy 267–71} (2d ed. 1999) (discussing utilitarian justifications for progressive income taxation based on the theory of the declining marginal utility of the dollar). But if this theory is true, high-income taxpayers should also value deductions based on nominal dollars less than low-income taxpayers value them at the margin.

Finally, when all taxpayers (A, B, and C) are considered together, the existence of the charitable contributions deduction has a notable effect on the aggregate allocation of the income tax burden. When budgeting its revenue needs, the federal government must account for the decrease in revenue resulting from the charitable contributions deduction. Thus, if all else is held constant, the availability of the charitable contributions deduction means that tax rates must be increased to compensate for the diminished income tax base. For example, let us assume that the government in our three-person economy needs $390,000 in tax revenues annually. In the absence of the charitable contributions deduction, the government could impose a 10% rate of tax on income up to $20,000 and a tax rate of 40% on all income above $20,000. However, with the charitable contributions deduction, these same rates would yield total governmental revenues of only $349,600. In order to raise the additional revenue, tax rates must be increased. To simplify matters, let us assume that our lowest tax bracket (10%) remains the same. In order to raise the total federal budget to the desired $390,000, the 40% income tax bracket must be increased to nearly 44.70%. Under the resulting income tax burden, Taxpayer C has an income tax liability that is $44,700 greater than that of Taxpayer A, and which is $22,560 greater than the income tax liability of Taxpayer B.

<table>
<thead>
<tr>
<th>Income</th>
<th>Taxpayer B</th>
<th>Taxpayer A</th>
<th>Taxpayer C</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $20,000 (taxed at 10%)</td>
<td>$2000</td>
<td>$2000</td>
<td>$2000</td>
<td>$6000</td>
</tr>
<tr>
<td>Next $480,000 (taxed at 40%)</td>
<td>$0</td>
<td>$192,000</td>
<td>$194,000</td>
<td>$382,000</td>
</tr>
<tr>
<td>Total Tax Liability</td>
<td>$2000</td>
<td>$194,000</td>
<td>$194,000</td>
<td>$390,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income</th>
<th>Taxpayer B</th>
<th>Taxpayer A</th>
<th>Taxpayer C</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $20,000 (taxed at 10%)</td>
<td>$10% x ($20,000 - $4000) = $1600</td>
<td>$10% x $20,000 = $2000</td>
<td>$10% x $20,000 = $2000</td>
<td>$5600</td>
</tr>
<tr>
<td>Next $480,000 (taxed at 40%)</td>
<td>$0</td>
<td>$192,000</td>
<td>$194,000</td>
<td>$344,000</td>
</tr>
<tr>
<td>Total Tax Liability</td>
<td>$1600</td>
<td>$154,000</td>
<td>$194,000</td>
<td>$349,600</td>
</tr>
</tbody>
</table>

22. This rate is rounded to the nearest hundredth of a percent. The tax burden would be distributed as follows:

<table>
<thead>
<tr>
<th>Income</th>
<th>Taxpayer B</th>
<th>Taxpayer A</th>
<th>Taxpayer C</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $20,000 (taxed at 10%)</td>
<td>$10% x ($20,000 - $4000) = $1600</td>
<td>$10% x $20,000 = $2000</td>
<td>$10% x $20,000 = $2000</td>
<td>$5600</td>
</tr>
<tr>
<td>Next $480,000 (taxed at 44.70%)</td>
<td>$0</td>
<td>$214,560</td>
<td>$216,560</td>
<td>$384,420</td>
</tr>
<tr>
<td>Total Tax Liability</td>
<td>$1600</td>
<td>$171,860</td>
<td>$216,560</td>
<td>$390,020</td>
</tr>
</tbody>
</table>

23. The difference between Taxpayer C’s $216,560 income tax liability and Taxpayer A’s $171,860 income tax liability is $44,700.
liability that Taxpayer C would have had in a world without the charitable contributions deduction. Stated simply, if all else is constant, the deduction for charitable contributions increases the tax burdens of those who choose not to contribute to charity.

These objections to the charitable contributions deduction pose a formidable challenge to its proponents. How, then, has the deduction managed to survive for so long? There seems to be a deeply held conviction in this country that taxpayers who donate to charity generally should not be subject to the same income tax liability as similarly situated taxpayers who do not. But why? Part of the explanation may lie in the basic intuition that charities "deserve" extra support because they do "good work" or, more technically, because they provide goods and services that would be undersupplied by the private market and the government. This notion is the core of the so-called subsidy theories. Another explanation is that the charitable contributions deduction is necessary to ensure that the income tax base is properly calculated. Under this second view, the deduction is allowed precisely because we have enacted a tax on "income," and the concept of income demands (or at least permits) a deduction for charitable contributions. Theories of this second type may be called "tax-base" theories.

This paper argues that the charitable contributions deduction may be defended under one plausible conception of income. My argument has certain elements in common with theories that have been advanced previously, but relies heavily on a theory not yet precisely articulated by advocates of the deduction. Specifically, I argue that this country has appropriately chosen to exempt from taxation what will be termed "community income" in a variety of contexts, and that the charitable contributions deduction may be viewed as one species of several federal income tax exemptions or exclusions of "community income" from taxation.

Part I discusses the meaning and significance of the concept of "income" when analyzing the theoretical justifications for the charitable contributions deduction. It

24. The difference between Taxpayer C's $216,560 income tax liability (after adjusting tax rates to reflect the revenue effect of the charitable contributions deduction) and the $194,000 income tax liability that Taxpayer C would have incurred if there were no charitable contributions deduction allowed is $22,560. Compare the columns for Taxpayer C in the tables set forth in supra notes 20 and 22.

25. Of course, perhaps not all factors should be assumed to be constant under this analysis. One of the primary arguments in favor of the charitable contributions deduction is that donations provide major community benefits. If these benefits relieve the federal government of some of the burdens that it otherwise would be required to bear (such as expenditures for education, scientific research, public improvements, public health, and the relief of poverty), the deduction may reduce the amount of revenues that government must raise in order to provide for the common welfare. Still, it is far from clear that the net public gains attributable to the deduction would exceed the revenue loss from the deduction if tax rates are held constant. One of the most obvious reasons is that the deduction is available for transfers that government would never make (e.g., contributions to churches, other religious organizations, and private foundations), and quantifying the community benefit from these contributions is impossible.

26. A powerful charitable lobby undoubtedly also solidifies the deduction.

27. See, e.g., Colombo, supra note 4, at 682-701 (discussing subsidy theories justifying the charitable contributions deduction and the charity income tax exemption).

28. Accordingly, my theory is a tax-base theory.
explores the uncertain meaning of income, and concludes that existing tax-base theories for and against the deduction fail to resolve the issue of whether the deduction is proper. Part III introduces the concept of community income, and argues that community income is properly excluded from the personal income tax base. Adopting the tentative conclusions of Part III as a working theory (the "community income theory"), Part IV explains how the theory justifies the federal income tax exemption of charitable entities, and arguably justifies the charitable contributions deduction. Part IV also responds briefly to anticipated objections to the community income theory.

I. THE MEANING AND SIGNIFICANCE OF INCOME

A. The Importance of Defining Income

As Professors William Andrews and Stanley Koppelman have convincingly argued elsewhere, a proper conception of "income" is of utmost importance to the debate on the legitimacy of the charitable contributions deduction. Although not everyone has agreed with this proposition, a moment's reflection should resolve any doubt about the matter. Consider the argument that the charitable contributions deduction violates the principle of horizontal equity because two people with equivalent receipts are taxed differently if one chooses to donate liberally to charity (and thereby receive a deduction for doing so), whereas the other, a profligate, chooses to spend every last dollar obtaining nondeductible retail goods and services. The principle of horizontal equity is violated only if the two taxpayers are similarly situated. If a proper concept of income dictates that the taxpayer making charitable contributions has much less income than the profligate, horizontal equity is not violated by taxing the two persons quite differently.

Or consider the argument that the charitable contributions deduction effectively enables upper-income taxpayers to allocate a disproportionately large quantum of public resources to their favorite charities. If the deduction is necessary to reflect income properly, and if the federal government's claim is limited to a percentage of each taxpayer's "income," then donations by the rich do not involve an indirect allocation of "public" money to their pet charitable causes. Public money would be indirectly allocated by taxpayers only if the government has a prior claim on the funds; such is not the case if governmental claims are based solely on taxpayers' income and if charitable donations are not properly included in the income tax base. Similarly, if the charitable contributions deduction reflects the proper computation of income, then it is not a tax expenditure that inappropriately removes indirect federal grants from the normal legislative process. Instead, the deduction, like the deduction for business

31. See, e.g., Joseph A. Pechman, Comprehensive Income Taxation: A Comment, 81 HARV. L. REV. 63, 65-66 (1967) (asserting that the concept of income is neutral regarding "the personal deductions that might be allowed for income tax purposes").
expenses, merely reduces gross receipts to arrive at the tax base the country has chosen—income.\textsuperscript{32} Finally, although the deduction very likely results in an allocation of the tax burden that differs from the allocation that would exist in the absence of the deduction, this is hardly any objection if the deduction inheres in the concept of income. If the resulting allocation of the tax burden is considered undesirable, the solution is to find an alternative (or additional) federal tax base, not to pretend that charitable contributions should be included in the \textit{income} tax base.

In observing the importance of the concept of income, I am not implicitly rejecting subsidy theories supporting the charitable contributions deduction. Even if the deduction is unnecessary to reflect income properly, it arguably may be justified under one or more subsidy theories. However, I believe that subsidy theories bring unique, problematic inquiries to the table, and that many of these inquiries are unnecessary if the deduction can be justified on alternative grounds. Moreover, like Professor Andrews, I expressly utilize certain (though not all) elements of traditional subsidy theories, but I do not believe that tax-base theories that rely in part upon elements of subsidy theories are merely nuanced versions of the latter. Subsidy theories ultimately justify the charitable contributions deduction on the grounds that, on balance, it benefits society. Tax-base theories ultimately justify the charitable contributions deduction on the grounds that it properly reflects the political choice to tax income, regardless of whether this political choice is wise. In so characterizing the two approaches, I am not suggesting that income is self-defining, or that decisions about what constitutes income must be dissociated from tax policy (including judgments of equity and efficiency). I do embrace the notion, however, that income means something, and that analyzing what we do and do not mean by income sheds light upon the justification for the charitable contributions deduction.

\section*{B. The Uncertain Meaning of Income}

Economists,\textsuperscript{33} the courts,\textsuperscript{34} and legal academics\textsuperscript{35} have articulated various concepts of income through the years. Since the movement toward establishing a comprehensive tax base for federal income tax purposes gained national prominence, it can hardly be

\begin{itemize}
\item \textsuperscript{32} Cf. Clotfelter, \textit{supra} note 4, at 279–80 (explaining that tax-base theories justify the charitable contributions deduction as a matter of principle and do not require an explanation of what form a charitable subsidy should take).
\item \textsuperscript{34} See, e.g., Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955) (finding income where the taxpayer clearly realizes accessions to wealth over which she has complete dominion); Eisner v. Macomber, 252 U.S. 189, 207 (1920) (defining income as gain derived from capital, labor, or both combined).
\item \textsuperscript{35} See, e.g., Alvin Warren, \textit{Would a Consumption Tax Be Fairer Than an Income Tax?}, 89 \textit{YALE L.J.} 1081, 1085–88 (1980) (arguing that, in designing a personal income tax system, one must consider not only the Haig-Simons concept of a taxpayer's personal income, but also the aggregate tax base; stating that the aggregate tax base should be the product of society's total private capital and labor during the taxable period); see generally Koppelman, \textit{supra} note 30, at 687–97 (summarizing three major views of personal income advanced by legal academics).
\end{itemize}
doubted that the most widely accepted theoretical construct of income in this country is the Haig-Simons concept. The most commonly cited expression of the concept, advanced by Henry Simons, is as follows: "Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question."

Mathematically, this expression of income may be depicted as follows, which I will designate as Equation 1:

\[
I_p = (W_{ep} - W_{bp}) + C_p
\]

Where

- \(I_p\) = Income for the taxable period
- \(W_{ep}\) = Wealth at the end of the taxable period
- \(W_{bp}\) = Wealth at the beginning of the taxable period; and
- \(C_p\) = The amount of consumption for the taxable period

To state the Haig-Simons concept (verbally and mathematically) is simple. To articulate its precise meaning is not. Especially troublesome in the debate over the propriety of the charitable contributions deduction is the meaning of the term "consumption." On the one hand, Professor Simons' oft-cited work explaining the concept of income manifestly emphasizes consumption exercised through the medium of the market. His very definition of income refers to the "market value" of rights "exercised" in consumption. For Simons, consumption refers not simply to the value of rights exercised, but to the value of rights exercised "in a certain way," namely, in "destruction of economic goods." He asserted that both accumulation (i.e., \((W_{ep} - W_{bp})\)) and consumption (\(C_p\)) "may be estimated in a common unit by appeal to market prices." Simons also saw "no serious difficulty" in measuring consumption, which is determined by reference to the "prices at the time goods and services are actually acquired or consumed." At first blush, Simons' reliance on market prices would suggest that he understood consumption, in its broadest form, to be limited to a taxpayer's enjoyment of goods and services for which market prices are available.

36. See, e.g., Boris I. Bittker, A "Comprehensive Tax Base" as a Goal of Income Tax Reform, 80 HARV. L. REV. 925, 932 (1967) (observing that commentators advocating a comprehensive tax base state or imply that Congress should strive to enact the Haig-Simons concept of income to the extent possible); Musgrave, supra note 3, at 47 (stating that the case for a comprehensive income tax is based upon the definition of income espoused by Henry Simons); Pechman, supra note 31, at 64 ("Even a cursory examination of the literature discloses that the basic concept used or implied in discussions of comprehensive income taxation is the Haig-Simons definition."); Victor Thuronyi, The Concept of Income, 46 TAX L. REV. 45, 46 (1990) (stating that the "income concept that is now widely accepted by analysts" is the Haig-Simons concept). Although Henry Simons' concise articulation of income is the one that is most often cited, it is referred to as the "Haig-Simons" concept to acknowledge the prior work of Robert Haig. See id.


38. Id. at 49–50.
39. Id. at 50.
40. Id. at 55.
Unfortunately for those who esteem clarity, Simons equivocated in his explanation of consumption. Simons' discussion of gratuitous transfers (primarily gifts between individuals) illumines the flexibility with which he understood consumption. Simons expressly rejected the contention that the value of a gift could not be included in the personal income of both the donor and the donee. He cautioned against the assertion that "giving is not a form of consumption for the giver." More pointedly, Simons acknowledged that gifts may be treated as consumption because they are personal expenditures, rather than investment losses or expenses of acquiring income. Further, he observed the "consumption incidents to charity," and he questioned whether a philanthropist who uses all of his vast income to support socially worthy endeavors "should be permitted so much power." In summary, although Simons apparently favored a market-oriented approach to valuing the consumption of goods and services that have a market value, he was willing to expand the concept of consumption to include gratuitous transfers that are not made to acquire income.

Simons' inconsistent exposition of the meaning of consumption has spawned differing schools of thought on the proper conception of income, and its implications for the charitable contributions deduction. One school of thought is ably represented by Professor Andrews, who has defended the charitable contributions deduction under income tax theory and policy. In apparent (or at least facial) agreement with the classic formulation of income by Henry Simons, Professor Andrews begins with the premise that, under an ideal income tax, each taxpayer is taxed on his or her "aggregate personal consumption and accumulation of real goods and services and claims thereto." Andrews argues that if income means consumption plus accumulation, a deduction is proper whenever a taxpayer expends money for anything other than personal consumption or accumulation. Andrews, then, essentially deduces the propriety of a charitable contributions deduction by focusing on the right-hand side of Equation 1. Thus, if \( I_p = (W_{ep} - W_{bp}) + C_p \), because any transfer of funds (whether or not charitable) reduces \( W_{ep} \), charitable contributions will necessarily result in a lower \( I_p \) if such contributions are not included in \( C_p \). The key question, of course, is whether charitable contributions should count as consumption.

41. See id. at 57–58.
42. Id. at 57.
43. See id. at 139–40.
44. Id. at 140. It is unclear to what "consumption incidents" Simons was referring. He mentioned that a person who supports needy relatives is better off than the person of modest means who must "endure the spectacle of their distress." Id. Perhaps Simons was just referring to the utility of giving.
45. Id. at 141.
46. Simons recognized that "some contributions of business firms" are primarily expenses of generating income. Id. at 139.
47. Cf. Andrews, supra note 29, at 312 (stating that the ideal income tax must be "refined to reflect the intrinsic objectives of the tax," and that it is "imperative to consider carefully whether a provision can be defended by reference to intrinsic matters of tax policy before evaluating it as if it were something else").
48. Id. at 313.
49. See id. at 325.
Andrews asserts that taxable personal consumption (Cp) means only the consumption of "divisible, private goods and services," the consumption of which "by one household precludes enjoyment by others."\(^{50}\) Taxable personal consumption therefore does not include a taxpayer's consumption of "collective goods whose enjoyment is non-preclusive," nor does it include the "nonmaterial satisfactions" derived from a taxpayer's mere act of charitable giving.\(^{51}\) This definition of consumption is reminiscent of that portion of Simons' description of consumption that focuses on the procurement of goods and services with a market value. "Nonmaterial satisfactions" from giving (i.e., the utility that one receives from donating to charity)\(^{52}\) are not priced in the market. Moreover, the "collective goods" to which Andrews refers are in the nature of "public" (or "social") goods familiar to students of economics. Under economic theory, the market cannot be expected to produce an efficient quantity of public goods because their benefits are too widely dispersed to be reflected in a unit price that any one consumer is willing to pay.\(^{53}\) For present purposes, the relevant point is that public goods have no market price. Thus, if we take seriously Simon's initial emphasis on consumption as the market price of goods and services enjoyed by a taxpayer, we can see some justification for Andrews's understanding of the meaning of consumption, and why the charitable contributions deduction is proper.\(^{54}\)

Professor Andrews does not advance his case exclusively in these terms, however. He also invokes more commonly cited norms of tax policy to support his view. He does so in the context of discussing two types of charitable entities. First, in the case of contributions to a donee that redistributes donations to the poor, consumption made possible by the funds, or accumulation resulting from receipt of the funds, is shifted from the donor to the impoverished recipients of funds donated to charity. The ultimate distributees should not be taxed at the presumably higher rates of tax to which donors are subject.\(^{55}\) Further, allowing a charitable contributions deduction places the donor in the same position as a similarly situated taxpayer who donates services to a charitable donee; although the volunteer receives no deduction for the value of her contributed services, no taxable income attributable to her services is imputed to her.\(^{56}\)

Andrews further justifies a deduction for contributions made to charitable donees that do not necessarily redistribute wealth to the poor (including institutions which, to

\(^{50}\) Id. at 314–15; cf. Warren, supra note 35, at 1084 ("As used in this Article, 'consumption' means the ultimate use or destruction of economic resources . . . and 'accumulation,' the retention or saving of such resources.").

\(^{51}\) Andrews, supra note 29, at 315.

\(^{52}\) For a discussion of the several forms of utility that may be generated from charitable giving, see Thomas R. Ireland, *The Calculus of Philanthropy*, in *The Economics of Charity: Essays on the Comparative Economics and Ethics of Giving and Selling, with Applications to Blood* 65, 67–75 (1973).

\(^{53}\) See Musgrave & Musgrave, supra note 19, at 54–76 (explaining the theory of social goods).

\(^{54}\) Cf. William J. Tumier, *Personal Deductions and Tax Reform: The High Road and the Low Road*, 31 VILL. L. REV. 1703, 1726 (1986) (stating that if one adopts the view that consumption refers to the destruction of property or services for personal benefit, a charitable donor is not the consumer of her donation).

\(^{55}\) See Andrews, supra note 29, at 347.

\(^{56}\) See id. at 347–48.
some degree, benefit donors). For Andrews, a deduction is proper for contributions to such organizations because they generally produce public goods that are not enjoyed by contributors in proportion to their contributions. Even those who have contributed nothing to the donee may enjoy the organization’s services financed through donations. Andrews reasons that a deduction for a true donation (in contrast to an amount specifically paid in purchase of a good or service) is proper because the value of the benefits provided by the charitable donee to a particular recipient of a common benefit is indeterminate.

Not all students of Henry Simons embrace the justification for the charitable contributions deduction advanced by Professor Andrews. Chief among Andrews’s critics are Professors Mark Kelman and Stanley Koppelman. Kelman understands income to consist “tautologically” of consumption plus savings. Hence, all money that a taxpayer controls or voluntarily disposes of is, by definition, income (unless it is a cost of generating receipts). Similarly, Professor Koppelman understands income to be “[t]he power to consume that is reduced to economic rights and is capable of valuation.” Under this concept of income, what really matters is accretion, which represents the power to consume. Although Professor Simons formulated income as consumption plus accumulation, Professor Koppelman (like Professor Kelman) argues that those two elements should be viewed merely as “the two possible uses of accretions to wealth during the accounting period,” not as “terms to be defined independently.”

What distinguishes nondeductible personal consumption from deductible expenditures is the “current personal benefit” derived by a taxpayer from the transaction. Hence, like Kelman, Koppelman argues that all voluntary expenditures unrelated to income-producing activities constitute taxable consumption. Charitable contributions should not be deductible, according to Koppelman, because “[t]he expenditure of cash or property represents a clear personal benefit to the donor.”

The views of Kelman and Koppelman are consistent with that portion of Simons’s work which treats all outlays unrelated to the production of income as nondeductible consumption. Their understanding of income can also be illustrated mathematically, given certain assumptions. Recall Equation 1: \[ I_p = (W_{ep} - W_{bp}) + C_p. \] Consider the

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57. See id. at 356-70.
58. See id. at 357-61.
59. See id. at 358-59.
61. See Koppelman, supra note 30, at 688-90. Professors Gergen and Colombo are also critical of Andrews’s analysis in several respects. See Colombo, supra note 4, at 679-82; Gergen, supra note 4, at 1414-26.
62. See Kelman, supra note 60, at 834.
63. Koppelman, supra note 30, at 694. See generally SIMONS, supra note 37, at 49 (conceptualizing income as the value of rights that may be exercised in consumption).
64. See Koppelman, supra note 30, at 694.
65. Id. at 694.
66. Id. at 705.
67. See id. at 706.
68. Id. at 707.
expression representing the taxpayer's change in wealth: \((W_e - W_b)\). What causes a taxpayer's wealth at the beginning of the period to differ from that at the end of the period? In general, her wealth can increase because of (i) appreciation in the value of her existing assets (i.e., assets held at the beginning of the period), and (ii) her acquisition of new assets—such as money received as compensation for services. Similarly, wealth may decrease either because the value of the taxpayer's assets has declined, or because the taxpayer has expended some of her wealth.

Thus, a taxpayer's change in wealth may be expressed mathematically as follows:

\[
(W_e - W_b) = \text{Net Increase (or Net Decrease) in Value of Existing Assets} + \text{Receipts} - \text{Outlays}
\]

A taxpayer can make numerous types of outlays. There are strictly personal consumption expenditures, such as amounts spent on popcorn and soda consumed in front of one's home television set. Mathematically, such outlays are depicted herein as \(C_p\). There are also various types of business and investment outlays. I will designate business and investment outlays that have been made primarily to generate income in the current taxable period as \(B_p\). In other words, if it is assumed that all outlays must be either of a business (or investment) nature or in the nature of consumption, such outlays may be described as \((B_p + C_p)\). Hence, a taxpayer's change in wealth for a particular taxable year may be depicted mathematically as follows:

\[
(W_e - W_b) = \text{Net Increase (or Net Decrease) in Value of Existing Assets} + \text{Receipts} - (B_p + C_p)
\]

Through simple mathematical operations, this equation may be reduced to the following, which I will designate as Equation 2:

\[
I_p = C_p - (W_e - W_b)
\]

69. It is unnecessary to designate business and investment expenditures for assets expected to produce benefits over many years, because when such an asset with long-term value is acquired, the purchase of the asset does not initially change the taxpayer's wealth (if it is assumed that the asset was purchased at fair market value).

70. Some expenditures are actually mixed personal and business (or personal and investment) expenditures. Such expenditures must either be allocated in part to consumption and in part to business or investment, or they must be treated de jure as but one type.

71. The equation in the text may be mathematically expressed equivalently as follows:

\[
(W_e - W_b) = \text{Net Increase (or Net Decrease) in Value of Existing Assets} + \text{Receipts} - B_p - C_p.
\]

What does the Haig-Simons concept of income look like mathematically if we express it in a long form equation? All that is necessary is to substitute the right-hand side of the above equation for \((W_e - W_b)\) in Equation 1. Thus, Equation 1, which is \(I_p = (W_e - W_b) + C_p\), is mathematically equivalent to the following: \(I_p = C_p + (W_e - W_b)\). Substituting for \((W_e - W_b)\), we have the following: \(I_p = C_p + \text{Net Increase (or Net Decrease) in Value of Existing Assets} + \text{Receipts} - B_p - C_p\). Rearranging terms, we have \(I_p = C_p - C_p + \text{Net Increase (or Net Decrease) in Value of Existing Assets} + \text{Receipts} - B_p\). Because \((C_p - C_p)\) is zero, we have \(I_p = \text{Net Increase (or Net Decrease) in Value of Existing Assets} + \text{Receipts} - B_p\). Mathematically, of course, \((+ C_p)\) and a \((- C_p)\) cancel each other out to zero only if each term is identical. This equation (for the sake of simplicity) ignores consumption received in kind. Many items of consumption received in kind are often thought to be properly included in a comprehensive income tax base.
Observe that in Equation 2, a deduction for outlays is allowable only for those that are in the nature of business and investment expenses. No deduction is allowed for any other type of payment or transfer. The equation, therefore, generally describes the conception of income advanced by Professors Kelman and Koppelman. At first glance, it also appears to make for a more administratively “tidy” equation; because personal consumption (Cp) does not appear in the equation, there is no need to define it. However, Equation 2 is not quite so simple as it appears, nor is it complete. Many proponents of a comprehensive income tax base (including Simons himself) recognized that various forms of consumption received in kind (but not purchased in a market transaction) should be included in income. Moreover, economic income includes the value of (1) self-provided services and (2) the personal use of taxpayer-owned assets. These are both elements of the consumption component of income. The tax system must determine to what extent such consumption is taxable, notwithstanding that Equation 2 does not on its face depict consumption. Further, defining Bp in Equation 2 is not always easy. The tax system must decide whether expenses of a mixed character (i.e., expenses which serve business or investment purposes and also confer direct personal benefits on taxpayers) are, to some extent, deductible.

Most important for present purposes, the conception of income described in Equation 2 is only as good as its underlying assumptions. As will be recalled, Equation 2 assumes that all outlays must be either of a business (or investment) nature or in the nature of consumption. In other words, the equation reflects an underlying assumption that a taxpayer’s inflows and other enhancements to wealth can be used only for three purposes: accumulation, personal consumption, and the production of more income. If wealth augmentations have been neither saved nor expended in the production of additional income, they must have been “consumed.” This assumption, of course, is the foundation of the arguments of both Kelman and Koppelman, who believe that any transfer (or at least any voluntary transfer) of funds must be treated as consumption.

In analyzing the propriety of the charitable contributions deduction, choosing between the views of Andrews (on the one hand) and Kelman and Koppelman (on the other hand), or choosing yet another view, is no simple enterprise. The cornerstone of

72. Equation 2 is actually somewhat simplified. A more detailed equation would account for increases (or decreases) in the value of assets (other than money) acquired during the period (such as reinvestments of proceeds from the sale of assets held by the taxpayer at the beginning of the period, and changes in the value of assets received in kind during the period). 73. Professor Koppelman appears willing in some circumstances to allow a deduction for state and local taxes, because they are non-voluntary. However, he appears unwilling to allow such a deduction if the benefits received by the taxpayer from the governmental bodies collecting the taxes correspond to the amount of the tax payments. See Koppelman, supra note 30, at 710.

74. See, e.g., SIMONS, supra note 37, at 53.
75. See id. at 110–24.
76. See id. at 54.
77. See Kelman, supra note 60, at 834 (“All money the taxpayer controls or ‘voluntarily’ disposes of must go to either consumption or savings.”) (citation omitted); Koppelman, supra note 30, at 706 (“All voluntary expenditures unrelated to a profit-seeking activity should be considered taxable consumption . . . .”).
Andrews' analysis—that personal consumption includes only private preclusive appropriation of goods and services—is supported not by any overarching theory, but by numerous considerations under income tax theory and policy. Kelman's contrary view—that income tautologically consists of consumption and accumulation—is advanced in similar fashion. Only Professor Koppelman emphasizes and attempts to develop at length an underlying justification for taxing income (individual welfare) as the central rationale for his concept of income. To weigh the various arguments advanced to date for and against the charitable contributions deduction, it is helpful to focus precisely upon what we do, and do not, believe to be the essence of personal income. I turn to this inquiry in the following section.

C. What Income Is (Not?)

An appropriate place to begin an exploration of what is, and is not, the essence of income is the theoretical position of Professor Koppelman. Koppelman finds support for his concept of income—the power to consume that is reduced to economic rights and is capable of valuation—in theories of social welfare, which focus on the welfare of the individual, or on the aggregation of individual welfare. He argues, "Taxation intended to promote individualistic conceptions of welfare should also be based upon individual measures of welfare." If income is selected as the tax base because it is the best measure of economic well being, "it should be interpreted in an individualistic way." An individual taxpayer's "power to consume" is, according to Koppelman, the only major concept of income that "adopts an individualistic measure of welfare." Although not articulated precisely in these terms, Professor Kelman's various arguments appear to be consistent with this position.

Koppelman's linchpin for income (the power to consume as a benchmark of individual welfare) is not without its difficulties. First, income has meaning only as a function of time. The very concept of gain assumes at least two points in time. Koppelman's analysis therefore presents an obvious question: At what time do we determine whether the taxpayer has the power to consume? In the case of a taxpayer whose paycheck is stolen, Koppelman would allow a deduction because of the taxpayer's "economic loss." I agree with Koppelman, but my agreement assumes that the relevant point in time for looking at the taxpayer's power to consume is after the paycheck has been stolen. If we look at the moment that the payment is received, there would be a clear increase in the power to consume. Similarly, consider a taxpayer who begins the taxable period with one asset and ends the period with that same asset. Assume that halfway through the period, the asset doubles in value; however, by the end of the period, the value of the asset declines to its initial value. Has there been income for the period? The Haig-Simons definition of income would answer this

78. See Koppelman, supra note 30, at 697-705.
79. Id. at 703 (citation omitted).
80. Id.
81. Id. at 705.
82. See SIMONS, supra note 37, at 50 ("The relation of the income concept to the specified time interval is fundamental. ... The measurement of income implies allocation of consumption and accumulation to specified periods.").
83. See Koppelman, supra note 30, at 710.
question in the negative \((W_{cp} - W_{bp})\) is zero), and both Professor Koppelman (I presume) and I would agree with this result. But notice that during the middle of the period, the taxpayer plainly experienced an increase in the power to consume. Had the taxpayer sold the asset and purchased personal items with the sales proceeds, no one would question that the taxpayer's income was enhanced. Only by looking to the taxpayer's wealth at the end of the period can we conclude that the taxpayer's "power to consume" did not increase. Likewise, in the case of a taxpayer who makes a charitable contribution during the year, her wealth has obviously decreased by the amount of the contribution. Stated another way, she has no "power to consume" the amount of the contribution as of the end of the taxable period. Only if we look at her "power to consume" prior to making the contribution do we find income.

This much of the analysis is elementary. It is nonetheless an important step because it accentuates that a mere change in the power to consume is not the hallmark of income. Something more is required to render as income a change in the power to consume. What is it? One tempting candidate is the exercise of "control" by a taxpayer. Thus, it could be argued that a taxpayer who makes a charitable contribution exercises "control" over her accretion, and therefore must be treated as having consumed her wealth. The argument would distinguish such a taxpayer from the taxpayer whose wealth fluctuates in value over the taxable period; the latter just "does nothing," rather than exercise control over her wealth.

This "exertion-of-control" test is assuredly not, by itself, a determinant of income. Consider a taxpayer who sells one investment asset and purchases another of equivalent market value. Such a taxpayer has exercised control over her wealth. But if there is no accretion (i.e., if the new asset at the end of the period is valued the same as the original asset as of the beginning of the taxable period), all disciples of Simons would concede that there is no income.\(^4\) On the other hand, if a taxpayer merely "holds" a single asset that increases in value by the end of the period, there is income in the Haig-Simons sense of the term. This is so even if holding an asset is deemed not to constitute the exercise of "control." Even more fundamentally, it is quite sensible to view the mere retention of an asset as a species of control. A taxpayer who "does nothing" is actually doing something—holding the asset. And this is so for every minute of every hour of every day of the taxable period. Thus, a taxpayer who decides to hold his asset that has doubled in value as of the middle of the period has exercised control over the asset at that point in time. Nonetheless, if at the end of the period the asset is once again worth only its value at the beginning of the period, the taxpayer has no income. Finally, consider a taxpayer who sells assets during the middle of the taxable period at a gain, and then incurs a business expense in an amount equal to the gain. The taxpayer has certainly exercised control over his accretion,\(^5\) but all followers of Simons would concede that a deduction for the business expense is proper.

\(^4\) The result of \((W_{cp} - W_{bp})\) is zero, and so, if there is no consumption, income for the period is zero.

\(^5\) Cf. Andrews, supra note 29, at 363 ("[P]eople exercise power over the allocation of resources by making or controlling the making of deductible business expenditures, and the income tax does not reach these acts."); Jeffrey H. Kahn, Personal Deductions—A Tax "Ideal" or Just Another "Deal"?, 2002 L. Rev. Mich. St. U. Det. C.L. 1, 30 (arguing that a taxpayer's control over business expenses does not negate their deductibility).
All that this discussion means is that “control” is not alone a sufficient test of income. It has also been demonstrated that the mere “power to consume” at some point during the period does not necessarily imply the existence of income. What, then, is the essence of income to Kelman and Koppelman? It must be the presence of what Koppelman simply calls “personal benefit.” He refers more than once to the securing of “personal benefit” as consumption, although he does not identify plainly the nature of the personal benefit derived by a donor from her contribution. Professor Kelman is much more explicit on this point. After equating consumption with “using money to obtain satisfaction,” Kelman observes that charitable donors “may obtain utility, some feeling of pleasure or power equal to the utility that other people get from ordinary consumptive spending.” Donors may receive deference or respect from charitable donees, the ultimate individual beneficiaries of charitable operations, or other members of the community. Donors may also receive nothing more than personal gratification from having improved another’s condition. At the other extreme, donors may actually receive the services provided by charitable donees in the normal course of their charitable activities. Kelman believes that “there is no principle which logically distinguishes charitable spending from other forms of spending.”

Thus, there are really three major types of “personal benefit” that donors may receive when donating to charity. One form of benefit is just that “warm, fuzzy feeling” that people receive when they donate. This utility is largely self-generated. Another form of benefit is the expression of gratitude, admiration, and attention that donors receive from any number of people as a result of being generous. A final type of benefit is more concrete; donors benefit from donations to charity (including their own, presumably) when they are members of the class of persons who partake of services.

86. Accordingly, the argument that charitable contributions necessarily constitute personal consumption because they are “discretionary,” see, for example, Aprill, supra note 4, at 870, is unconvincing.
87. See, e.g., Koppelman, supra note 30, at 705 (“[T]he consumption component of income involves the exercise of economic consumption power in a manner intended to produce a current personal benefit. This current personal benefit is what distinguishes nondeductible taxable consumption from deductible expenditures.”); id. at 707 (“The expenditure of cash or property represents a clear personal benefit to the donor.”); id. at 708 (“The principle of consumption as a current personal benefit has been helpful in determining the extent to which mixed personal and profit-seeking items should be taxable.”); id. at 709 (“The principle that taxable consumption arises from an economic expenditure producing a current personal benefit is also useful in evaluating the role of involuntariness.”); id. at 710 (“The very nature of a loss suggests that no personal benefit has been derived.”).
88. Although Koppelman does not precisely identify this purported “clear personal benefit” received by the donor, he does refer to “the personal satisfaction resulting from voluntary expenditures” as a form of personal benefit. Id. at 705. Thus, the benefit presumably is the utility from giving.
89. See Kelman, supra note 60, at 834.
90. Id. at 844.
91. See id. at 845 & n.46.
92. See id.
93. See id. at 857 & n.78.
94. Id. at 857 n.78.
provided by charitable donees. Examples include donors who are patrons of museums, patients in nonprofit hospitals, parents of students in private universities, aficionados of the symphony, and church members. The question is whether the donor who secures one or more of these benefits has received income.\textsuperscript{95}

Let us first consider the utility\textsuperscript{96} that is largely self-generated. Although I am willing to grant that the typical charitable donor probably receives a sense of satisfaction from giving, I am unconvinced that this form of utility necessarily gives rise to income. Numerous activities generate utility, and it is both wholly impractical and theoretically objectionable to tax utility as such. To impose greater tax liabilities on the “happy” than on the “disgruntled,” to take an extreme example, would be absurd, even if we could ascertain degrees of happiness.\textsuperscript{97} Moreover, mere utility generated from wealth and dealings in wealth is not income. Thus, it is surely the case that the miser who hoards his wealth, year after year, receives utility from the mere possession of wealth,\textsuperscript{98} and yet he has no income (under the Haig-Simons concept) if the value of his wealth is static over time. Similarly, the baroness who takes pleasure in amassing holdings in land may very well experience utility when she uses money to acquire more real estate, but she has no income if the land does not appreciate in value. Even business expenses that are fully deductible very likely generate utility analogous to that arising from charitable contributions. Examples include the expenses of the following: compensating a competent worker who says he really needs the job, offering a Christmas bonus that is not part of the agreed-upon salary package, providing bottled water and tasty coffee to employees, purchasing office supplies from a family-owned business that is struggling, buying recyclable paper and plastic products, performing services for which a “discounted” fee is charged because the recipient is of modest means, and advertising in a charitable organization’s newsletter.

Let us consider the second type of benefit received by donors—gratitude, admiration, and attention. Once again, I am not persuaded that this type of benefit implies the existence of income. It is difficult to refute that, in many cultures (including American subcultures), a wealthy person receives attention, and often admiration.\textsuperscript{99} The mere possession of wealth often commands deference, regardless of whether that wealth is increasing. That an opulent person might use his money to benefit others may well draw their attention to him, and if he once earned that wealth through hard work or sharp wits, he may be revered for a lifetime. These benefits are frequently enjoyed by the wealthy, regardless of whether their wealth appreciates. Accordingly, if a person’s wealth amassed in prior years merely maintains its value, she does not have income during the period, notwithstanding that she continues to enjoy these benefits. Moreover, deductions are allowed for business expenses that produce analogous

\textsuperscript{95} For a general critique of egoistic models of giving, see Gergen, \textit{supra} note 4, at 1428–33.

\textsuperscript{96} In general, I agree with Professor Thuronyi’s argument that a taxpayer’s utility is of limited value in forming a proper concept of income. See Thuronyi, \textit{supra} note 36, at 52–53.

\textsuperscript{97} See id. at 53.

\textsuperscript{98} Professor Koppelman also observes that the holding of wealth itself generates utility. See Koppelman, \textit{supra} note 30, at 701–02.

\textsuperscript{99} Admittedly, a wealthy person may also be resented for no reason other than that he is rich. But the same may be said of a charitable donor, who may be resented for giving to one cause instead of others.
benefits for payors. Anyone who has practiced law for more than a few months understands that a major client is highly valued by the law firm. Those who pay large bills are accustomed to cordiality, social and professional introductions, and other benefits extended or facilitated by grateful owners of the firm. A businesswoman who hires a large workforce is likely to be esteemed in the community, as is a company that locates in an economically depressed part of town. Indeed, the world of business and commerce is openly lubricated by this second type of benefit. But the presence of this type of benefit does not negate the deductibility of business expenses, nor does it otherwise directly cause businesspersons to realize income under the Haig-Simons concept.

We are therefore left with the final type of benefit identified by Professor Kelman—the benefit that donors receive from the charitable donees’ use of donations when donors are members of the class of persons who partake of services provided by charitable donees. For example, a church member who donates funds for a new keyboard receives some benefit when he attends worship service and sings praise and worship songs. The charitable contributions deduction is most difficult to justify in such cases of “charitable spending.” It is worth revisiting the contrasting arguments of Professors Andrews and Kelman with respect to this particular case.

As discussed above, Andrews justifies a deduction for contributions made to charitable donees that to some degree benefit donors. His reasons include the following: (1) charitable organizations produce goods and services in the nature of public goods that are not enjoyed by contributors in proportion to their contributions; (2) it is impossible to value the benefits enjoyed by donors as a result of their contributions; (3) even if we could value such benefits, it may be undesirable to tax donors because of the perceived social benefits that flow from the charitable donee’s operations; (4) taxing donations as a proxy for taxing the ultimate beneficiaries of the donee’s operations is problematic because of differences in the applicable tax rates of donors and ultimate beneficiaries, and because of the resulting burden of the income tax borne by charitable services (as opposed to those goods and services consumed by donors through market purchases); (5) that donors had the ex ante power to consume is an insufficient basis for taxing them because the tax system does not, in general, tax power; (6) that the deduction violates “neutrality” is an unpersuasive objection because of indeterminacy in how the income tax affects the totality of consumer choices and because of the inability of an income tax to be neutral comprehensively; and (7) the public (or quasi-public) goods and services produced by a charitable organization and financed through donations are analogous to goods produced and consumed within a household, which are typically not included in computing income.

100. See Andrews, supra note 29, at 356–70.
101. See id. at 356–58.
102. See id. at 358–59.
103. See id. at 359–60.
104. See id. at 360–62.
105. See id. at 362–66.
106. See id. at 366–67.
107. See id. at 367–70.
Arguments (4)-(6) are really just responses to potential objections to the charitable contributions deduction, rather than affirmative justifications, and need not be explored further for present purposes. Argument (3) properly belongs to subsidy theories of the deduction, which argue that the externalities of charity justify a tax preference for contributions. I do not reject subsidy theories in this paper, but neither do I rely upon them. For the purposes of this paper, the most important arguments are (1), (2) and (7).

Arguments (1) and (2) must be considered together.108 Professor Andrews is correct that there is no way to determine precisely the value of charitable activities enjoyed by a donor, and that donations benefit others than the donor. But these observations are not alone sufficient to justify the deduction of donations. As Professor Kelman has argued, "we do not generally assume that spenders get deductions for purchases where price is above cost."109 If we assume that donations secure some benefits for donors who partake of the charity's services (a reasonable assumption), we could, like Kelman,110 conclude that the inability of donors to establish the value of what they actually received should result in disallowance of a deduction. True, this approach may be unfair in particular cases. Thus, the churchgoer with an annual income of $100,000 who donates 10% of her income and attends services every other Sunday is treated as having consumed $10,000 worth of "church services," whereas the tight-fisted churchgoer (even one with the same annual income) who attends services every time the door is opened is treated as having consumed nothing. Moreover, it is doubtful that there is frequently (if ever) a perfect correspondence between benefits received and donations made by a specific donor, and perhaps even rarely an approximate correspondence. But this inequity is at least analogous to the treatment of the taxpayer who pays $10,000 for golf gear, and the taxpayer who buys the same gear on special for $1,000. The former is treated as having consumed $10,000, whereas the latter is treated as having consumed one-tenth as much. Yet both enjoy the same product.

Under Arguments (1) and (2), the case for the charitable contributions deduction is neither clearly superior, nor clearly inferior, to the case against it. Does Professor Andrews' argument (7) tip the scales? The gist of his argument is captured in his own words:

The charitable contribution deduction can be said to rest upon a judgment that certain common goods financed on a voluntary contributory basis for shared use in a community wider than an individual household should be similarly exempted. . . . The charitable contribution deduction represents a judgment that no tax need be collected on what the clerics, teachers, and musicians have produced insofar as it is distributed or made available as a free good for shared use within a reasonably wide community of persons.111

But what is the underlying theory supporting this special treatment of communities? All that Andrews offers is a comparison between charities and government. Government raises tax revenues for the production of public goods that otherwise would not be produced, and therefore "it may well seem counterproductive to lay the

108. Argument (1) is really a foundational premise upon which argument (2) depends.
109. See Kelman, supra note 60, at 857 n.78.
110. See id.
tax on that very kind of activity—production of common goods for shared enjoyment.” Andrews so concludes, notwithstanding that the goods produced by charities may differ from those that the government provides.

These observations do not necessarily make Andrews’ case. Why is it “counterproductive” to tax public goods produced by charities but not those produced by government? If the argument is simply that charities would not produce such goods (or the same quantity of such goods) but for the charitable contributions deduction, then Andrews is doing little more than offering a spin on traditional subsidy theories. He may be right, but the argument is not chiefly one based upon the concept of income.

Thus, Andrews leaves us wanting for an underlying theory that treats “communities” as extensions of the household. What he advances in his final argument (argument (7)) is more of an intuition than a theory. But this does not mean that his intuition is wrong. To the contrary, he may be quite right. In the remainder of this Article, I attempt to do what Andrews did not: provide a theoretical justification for the charitable contributions deduction based upon the proper taxation of charitable communities.

II. THE NON-TAXATION OF COMMUNITY INCOME

In this Part, I argue that the proper taxation of charitable communities is derived from the broader principle of how we do (or, more precisely, do not) tax the income from “communities” more generally. This Part develops the concept of “community income,” explains that community income is not taxed, and discusses the justifications for not taxing community income.

A. Community Income and the Non-Taxation of Community Benefits

The starting point for developing the concept of community income is to observe the nature of public goods produced by government. A pure public good has two characteristics: non-rivalness in consumption and non-excludability. The first characteristic means that one person’s consumption of the good does not impair another’s ability to consume the good. The second characteristic means that private suppliers are unable to exclude potential consumers of the good by requiring them to pay a price for it. Although economists do not agree fully on what goods and services constitute pure public goods, commonly cited examples include national defense, sanitation, public health, space research, the enforcement of contracts, law and order in general, public roads, and environmental protection.

112. Id. at 370.
114. See id.
115. See id.
116. See id. at 181; Cliff Walsh, Public Goods Provision with Price Exclusion: Market Behavior and Market Performance, in RETROSPECTIVES ON PUBLIC FINANCE 205 (Lorraine Eden ed., 1991). Economists have also recognized that other goods supplied by government, such as public assistance and other forms of welfare, may be in the nature of public goods. See, e.g., Henry Aaron & Martin McGuire, Public Goods and Income Distribution, 38 ECONOMETRICA 907, 915–16 & note b (1970).
Because of free-riding, the market will undersupply public goods. The reason is simple. Some people will refuse to pay (or refuse to pay sufficiently) for goods for which no formal charge can be imposed. They will prefer to let others fund the provision of the goods.\textsuperscript{117} For a variety of reasons,\textsuperscript{118} even those who are willing to pay something will not pay enough for the good. Government, therefore, supplies public goods that the market cannot provide.

What is notable for present purposes is the tax treatment of public goods. Taxpayers plainly consume public goods. They breathe clean air, move about freely with the knowledge of police protection, and live healthier lives because of mass immunizations. Moreover, economists have argued that household income really includes not only disposable money income, but also the value of governmentally provided public goods.\textsuperscript{119} Interestingly, however, the Haig-Simons concept of income may properly be understood to exclude the value of governmentally provided public goods consumed by taxpayers.\textsuperscript{120}

Government is not the only institution that supplies public goods (or benefits in the nature of public goods). Some economists classify externalities as public goods.\textsuperscript{121} Privately produced externalities essentially constitute the positive effects of market activity that are not captured by the market in the form of price. Thus, a large company doing business in a small- or mid-sized town produces more value than is reflected in the market price of its products. Such benefits may include a lower crime rate resulting from a substantial, stable workforce; a more educated citizenry attracted to the locality because of job opportunities; additional industries attracted to the region because of the needs of the company and its employees; better health care made possible by the improved local economy; better public schools resulting from better teachers moving to the region; and, more generally, improved government services of all types made possible by a growing population.\textsuperscript{122}

The amenities offered by a locality or region because of the presence of for-profit firms are of considerable value to the community and its members. Moreover, many forms of such externalities (e.g., lower crime rates, happier neighbors, and better governmental services resulting from a strong economy) are "consumed" by taxpayers.

\begin{itemize}
\item \textsuperscript{117} See Gergen, supra note 4, at 1398.
\item \textsuperscript{118} Such reasons include the desire not to be exploited by free-riders, a lack of confidence in successful collective action, and undervaluing collective goods. See id.
\item \textsuperscript{119} See, e.g., Henry Aaron, What is a Comprehensive Tax Base Anyway?, 22 NAT'L TAX J. 543, 543-44 (1969); Thuronyi, supra note 36, at 52 (stating that the Haig-Simons concept of income fails to reflect neo-classical economic theory because it does not tax leisure and public goods). Further, current law does not tax these benefits. See John K. McNulty, Public Policy and Private Charity: A Tax Policy Perspective, 3 VA. TAX REV. 229, 232 (1984). However, some argue that under certain assumptions, the theoretically correct approach is to include in the individual income tax base not only private consumption, but also public consumption (by not allowing a deduction for expenditures on public goods). See, e.g., Louis Kaplow, Fiscal Federalism and the Deductibility of State and Local Taxes under the Federal Income Tax, 82 VA. L. REV. 413, 422 (1996).
\item \textsuperscript{120} See Eden & McMillan, supra note 113, at 181 (describing the views of Carl Shoup).
\item \textsuperscript{121} Economists have observed that larger communities may be able to offer more public services than smaller ones. See, e.g., Eden & McMillan, supra note 113, at 188.
\end{itemize}
who do not make out-of-pocket expenditures directly to secure these benefits. Again, the Haig-Simons concept of income does not require the direct taxation of the consumption of these benefits.

Of course, some regions offer amenities to taxpayers that are not primarily attributable to the activities of government and business. The Rockies offer breathtaking views of majestic peaks and bubbling rivers teeming with trout; coastal states offer serene ocean sunsets (or sunrises) and relaxing beaches; the southern states offer warm days in the winter, and the northern states cool nights in the summer; the heartland offers unspoiled pastures of waving grass hosting countless species of wildlife. Taxpayers who enjoy the beauty of nature in these areas are "consumers" of nature, yet no major attempt is made to isolate the consumption value of experiencing nature and tax it under the Haig-Simons concept of income.

The amenities offered by numerous charitable organizations are of a similar nature to those untaxed benefits offered by government, business, and the natural environment. That is, the activities of charities are often recognized as producing public benefits—benefits that inure primarily to the public at large, rather than primarily to individual taxpayers. The requirements for federal income taxation are consistent with this notion. Specifically, an organization will not qualify for exemption as a charitable entity described in section 501(c)(3) of the Internal Revenue Code ("Code") unless "it serves a public rather than a private interest," nor will it qualify for exemption if its net earnings inure "to the benefit of any private shareholder or individual." Even those charities that provide services to a wide class of persons which includes donors typically provide services in the nature of public goods (as Professor Andrews and others have argued), and therefore can be viewed properly as primarily serving the public.

For the remainder of this article, I will refer to these several untaxed benefits (provided by government, business firms, charitable organizations, and the environment itself) that are enjoyed by taxpaying (and non-taxpaying) members of the community as "community income." Having observed that the Haig-Simons concept of income probably does not require a taxpayer directly to include any portion of community income in her taxable income, I will offer a justification for the non-taxation of community income. Next, I will explain why I believe the principle of not taxing community income is consistent with both the exemption of charities from federal income tax and the charitable contributions deduction.

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123. Cf. Aaron, *supra* note 120, at 544 (stating that the decisions of charities affect the welfare of households).
126. I am not suggesting that this list exhausts the sources of community income. I recognize, for example, that "nice, friendly, like-minded" citizens may be highly valued by most members of the community, and that the value of such citizens may even have an income effect (such as obviating the need to buy an expensive security system or a high fence, or the need to buy one's own recreational toys (instead of borrowing them from a friend)).
B. Why Community Income Is Not Taxed

There are several reasons that community income is not (and/or should not be) included in the tax base. One is the obvious point that it is impossible to value the portion of community income consumed by a taxpayer. 127 No market mechanism exists for determining the value of community income that a consuming taxpayer places on his share of such income. 128

Another reason that community income arguably ought not to be taxed is equitable: that community income is available for consumption does not mean that it is actually consumed (or that it is consumed to a significant degree) by all taxpayers. For example, the agoraphobic does not consume pretty scenery; the political dissident who detests our form of government may abhor a strong national defense; the church donor may dislike the contemporary music played on the keyboard in part financed with her contributions; the card-carrying, rifle-toting member of the NRA may prefer to defend himself, rather than rely on the police; the recluse who sustains himself on the land may not use the public streets and highways; and the citizen who resents administrative regulation may not enjoy a clean environment. 129

Although these arguments based on both feasibility and equity carry some force, I believe that the most persuasive reason for excluding community income from the tax base is distinct from those discussed above. My thesis is that community income ought

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127. Cf. Aaron, supra note 120, at 544–46 (stating that there is no way to value non-private goods and services consumed (but not purchased) by households); Andrews, supra note 29, at 358 (observing the frequent impossibility of valuing benefits provided by a charitable organization to a particular recipient); Bittker, supra note 36, at 938 (observing that the comprehensive tax base presumably excludes the value of various public goods because “there is no feasible way of comparing the taxpayer’s benefits with his payments”).

128. Cf. Aaron, supra note 120, at 545 (“There exists no institutional setting, however, which induces households truthfully to reveal the valuation placed on non-discretionary income.”).

129. This argument may carry more force in the case of community income generated by government (particularly the federal government) than in the case of community income generated by other entities, such as charities. The average individual taxpayer (or small group of taxpayers) has little influence over what community income the national government will provide. A small group of taxpayers also has limited ability to determine the operations of an unrelated business. A small group of taxpayers may, however, have considerable influence on the type of community income that a particular charity produces (particularly if that taxpayer is a large contributor to the charity). Although not all taxpaying donors can influence the operations of a charitable donee, it must be recognized that some do, and the largest donors are among them. Surely some of this influence leads to the production of community income that influential donors desire to consume.

Of course, these observations do not compel the conclusion that donors with clout attempt to influence charities to produce the precise type of community income that such donors wish to consume, or that charitable boards defer shamelessly to the wishes of such donors who make such an attempt. Indeed, the broader the base of a charitable organization’s donors with different preferences, the less likely it is that any single donor or group of donors will cause the charity to produce the precise type of community income that the donor wishes to consume. Nonetheless, it does seem realistic to accept that in the case of some charitable donees, large donors exert meaningful influence over the charities, and consequently, the charities produce community income that those donors consume.
not to be included in the individual income tax base because it is properly attributed not to individual community members, but to the community itself, and the community is not an appropriate object of taxation.

Initially, it is necessary to explain my position that community income should not necessarily be included in the "personal income" tax base. Henry Simons himself argued that "income" has several meanings, and that "personal income" should not be equated with other notions of income. 130 Perhaps most importantly, he insisted that the sum of personal incomes need not equate to national (or social) income. 131 He first observed that, although social income purports to measure "the net results of economic activity in a community during a specified period of time," 132 social income actually eludes meaningful quantification. Prices "are pure relations" that "cannot be summed into meaningful totals." 133 In other words, market prices are of little help in determining the value of all goods produced and services rendered. 134 Unlike social income, the measurement of personal income "implies estimating merely the relative results of individual economic activity during a period of time." 135 Personal income is also rights-based. 136 Whereas social income "implies valuation of a total product," personal income "is a purely acquisitive concept having to do with the possession and exercise of rights." 137

Simons's critique of attempting to relate personal income to social income helps inform the proper treatment of community income. If social income is incapable of meaningful valuation (as Simons asserts), community income is probably equally so. As noted above, because community income consists of public and quasi-public goods, and there is no market for such goods, no single taxpayer's enjoyment of community income carries an objectively determinable price tag. Thus, total community income cannot even be conceived as the summation of market prices paid by individual consumers. Further, it is often the case that the "value" 138 of community income cannot be meaningfully quantified (for income tax purposes) through other means. In the first place, some forms of community income (e.g., externalities and amenities of the natural environment) do not have an ascertainable production cost (which might be assumed to approximate value). Secondly, even where community income has (or arguably has) an identifiable production cost (such as the cost of police protection

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130. See Simons, supra note 37, at 44–49.
131. See id. at 47–49.
132. Id. at 45.
133. Id.
134. See id.
135. Id. at 49 (emphasis in original).
136. Others have observed this feature of Simons' theory of income. See, e.g., Bittker, supra note 36, at 948; Koppelman, supra note 30, at 696.
137. Simons, supra note 37, at 94.
138. Economists derive the "pseudo-demand curve" for a social good by summing the prices that all consumers are willing to pay for a given quantity of the good. See Musgrave & Musgrave, supra note 19, at 58–59. Equilibrium is represented by the intersection of the supply schedule and the pseudo-demand curve. See id. The "price" (the summation of the prices that all consumers are willing to pay) of the social good at equilibrium is thus analogous to the equilibrium market price (i.e., the market value) of a private good. One may think of this equilibrium price as the value of the social good.
procured by government, and the cost of musicians' services purchased by a symphony association), such cost may very well not reflect the value of the income to the community.139 The thrust of this argument, then, is more than that "we would tax a citizen's share of community income if we could reasonably estimate its value to him." Rather, the point is that benefits that have no market value are outside the design of a system that taxes personal income.

Moreover, if Simons is right that personal income looks to the relative positions of taxpayers, including community income in the personal income tax base is problematic. Insofar as community income consists of public goods (and those in the nature of public goods), it is comprised of benefits available (theoretically) to all members of the community. If all members of the community benefit equally from community income, there is no relative difference among community members. In actuality, as argued above, people benefit from community income in varying degrees. The extent to which an individual benefits from community income depends upon numerous factors, such as her health, age, familial status, geographical location, job status, and (more generally) personal appetite for the types of community income readily available to her. The differences among taxpayers on account of these and other factors only render more difficult the task of determining the relative enjoyment of community income among taxpayers. While this point is highly related to the equitable argument raised above, I believe it is conceptually distinct. Here, the point is not simply that it would be unfair to tax people as though they benefit from community income equally (when, in fact, they do not). Rather, the argument is that a tax system designed to apportion the tax burden among persons on the basis of their relative differences in position simply cannot account for the varying degrees to which individuals consume community income.

Finally, it is instructive to focus on Simons's assertion that the concept of personal income deals with "the possession and exercise of rights,"140 and, specifically, those "rights which command prices."141 Taxing community income is inconsistent with a rights-based approach to determining the tax base. In theory, community income is available to everyone. The nature of a public good is that nobody can prevent another person's consumption of the good. Nobody has exclusive rights to community income, or any part of it. If personal income implies the existence of rights that can be

139. This may be so for a variety of reasons. First, charities and government may be less efficient purchasers of goods and services than private consumers, who (by standard assumption) are rational maximizers of utility. Secondly, to the extent that charities and local governments do not coordinate their efforts, they may over-allocate resources to those community needs that they, ex ante (i.e., prior to allocating resources), have identified (correctly) as most pressing. (To illustrate, the darkest corner in the community park receives ninety percent of the "thousand points of light" and ends up looking like a football stadium). Thirdly, the value of some public goods may be so difficult to ascertain (e.g., national defense obtained through advanced nuclear technologies) that we have no real way to know whether the cost of the goods reflects their value. Finally, of course, the process by which consumers theoretically communicate their preferences with respect to social goods—voting—is far from perfect. Elected officials consequently may buy social goods at a cost that does not reflect the value that consumers place on the goods.

140. SIMONS, supra note 37, at 49.

141. Id.
exercised to the exclusion of others, community income ought not to be included in the tax base.

These arguments suggest that no portion of community income should be allocated to individual members of the community. Rather, the community itself may be seen as the true recipient of community income. We may conceptualize the community as a whole as "society" or "the summation of all local communities" (or in some similar fashion).\(^{142}\) For the moment, I believe it is helpful to view the "community" as distinct from its members, as a type of entity. My reasons are easily understood. While individuals benefit from membership in the community, they do not do so uniformly. What is good for the community is not always good for the individual, and vice versa. Moreover, individuals do not control the community as they do their own lives. To the contrary, the community itself (through government, law and order, and social and business customs, for example) exerts a great deal of control over the individual. The individual must often defer to the will of the community. Thus, it is no stretch to think of the community as distinct from its members in some sense.

If the community is conceptualized as a kind of entity, in some sense distinct from its members, it is easier to see why community income is not properly allocable to the members of the community. The community enjoys the totality of community income: national defense; a sound, free infrastructure; clean air, etc. Whereas any certain individual may not consume a per capita share of community income, the community as a whole receives it all. Although no single member of the community can prevent another from enjoying it, the community itself has a great deal of power to restrict the enjoyment of community income. For example, acting through the government, the community can alter the quantity of public goods produced by the state, and highly regulate the activities of businesses that produce externalities. Acting through all three major sectors of the economy (government, business, and nonprofit), the community can alter the enjoyment of all types of community income through ceasing to generate it.

As between the entity of community, and the individual members of the community, the entity of community appears to be the real recipient of community income. Once that point is accepted, one may understand the non-taxation of community income in yet another light. Obviously, it would seem incongruous to include in the personal income tax base income that is properly attributable to an entity, rather than to individuals. But more importantly, one may also embrace the position that the community is not a proper object of taxation. Although I do not intend to develop the argument in detail in this Article, the fundamental notion is that government exists to promote the welfare of the community.\(^{143}\) True, the community consists of (and acts through) individuals, and individuals receive all kinds of protection and other benefits from government (including the recognition and preservation of individual rights), but the government exists not to serve the precise interests of any single person, but the

\(^{142}\) Cf. Bittker, supra note 36, at 938 n.23 (suggesting that society, rather than its members, may be the real recipient of public goods).

\(^{143}\) Cf. JOHN LOCKE, TWO TREATISES OF GOVERNMENT 330–33 (Peter Laslett ed., Cambridge Univ. Press 1988) (1690) (stating that people put on "the bonds of Civil Society" when they unite in a community for comfort, safety, and peace; arguing that those who unite into a community cede to the community’s majority that power which is "necessary to the ends for which they unite into Society").
interests of all persons who comprise the community. The recognition of individual rights, for example, is ultimately an expression of the community’s judgment that its members (and indeed, the members of all society) have dignity and must be treated as such. Thus, to enforce the free expression rights of any single person is to ensure that the community of all persons will enjoy this freedom. Similarly, governmental (or governmentally enforced) restrictions on the activities of individuals and firms (e.g., criminal law, tort law, and environmental regulation) are designed to promote the welfare of the community. Indeed, rights and duties find meaning and expression most plainly in the context of community.

If government ultimately exists for the benefit of the community, it may be maintained that the tax system exists largely for the same purpose. Under this view, the initial presumption may well be that community income ought not to be taxed. The community does not exist to benefit government; rather, government exists to benefit community. Similarly, one may argue that community income should not fund government, but government should produce community income. True, one may counter this line of reasoning by observing that, just as the community does not exist to benefit government, neither do individuals. The response is that it is proper to tax personal income because (or perhaps “when”) individuals appropriate it primarily for their benefit, rather than for the benefit of the community.

Moreover, personal income is taxed (in significant part) to finance the government’s production of community income (which cannot be appropriated by taxpayers to the exclusion of others).

The foregoing conceptualization of community (and the reason for not taxing its income) sketches a theoretical construct that merits further development. Nonetheless, under the analysis set forth above, the concept that community income is properly excluded from the tax base is a plausible working theory. The remainder of this Article adopts this working theory and explains why it justifies the exemption of charitable entities from federal income taxation, and arguably justifies the charitable contributions deduction.

III. THE NON-TAXATION OF COMMUNITY INCOME PRODUCED BY CHARITABLE ORGANIZATIONS

Before explaining why charitable contributions arguably should be deductible under the community income theory, it is first necessary to examine the justification(s) for the federal income tax exemption provided charitable entities under Code § 501(c)(3).

144. Cf. JOHN RAWL, A THEORY OF JUSTICE 4 (rev. ed. 1999) (stating that the principles of social justice “provide a way of assigning rights and duties in the basic institutions of society and they define the appropriate distribution of the benefits and burdens of social cooperation”).
145. Cf. SIMONS, supra note 37, at 51 (analogizing society to a partnership in which individual taxpayers make “withdrawals” in the form of consumption expenditures).
146. I.R.C. § 501 (c)(3) (2003). Code § 501(a) exempts from federal income taxation organizations described in subsection (c). Section 501(c)(3) describes the following organizations:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . . no part of the net earnings of which inures to
This Part briefly places the exemption issue in its historical context of how incorporated entities have been viewed, and then explains how the exemption can be justified under the community income theory. Next, this Article explains that under this theory, the charitable contributions deduction is also arguably justified (for reasons similar to those that justify the charity income tax exemption). Finally, this Part responds to anticipated objections to the deductibility of charitable contributions under the community income theory.

A. Federal Income Tax Exemption of Charities

Numerous theories have been advanced in support of the federal income tax exemption of nonprofit organizations generally, and charitable organizations specifically.\(^{147}\) These theories usually assume that some affirmative justification must be advanced in favor of exempting charities independent of whatever reasons justify taxing business entities. The basic premise is that the burden is on the charitable sector to establish its entitlement to exemption.

A different way of approaching the policy behind the exemption of charities from taxation is to determine whether the underlying justification for taxing business entities, especially corporations,\(^{148}\) applies to charitable organizations. If the rationale for taxing for-profit corporations does not (or at least may not) apply to charitable organizations, and if there is no compelling alternative basis for taxing charitable entities, the presumption probably should be that charitable organizations ought not be taxed on their income.

The traditional view appears to be that, since around the late nineteenth century, Congress has conceived of business corporations as quite distinct from their shareholders, and that the status of a corporation as a separate entity justifies taxation

the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation . . . and which does not participate in, or intervene in . . . any political campaign on behalf of (or in opposition to) any candidate for public office.


148. More precisely, the discussion will focus on the taxation of for-profit corporations that are taxed under Subchapter C (I.R.C. §§ 301-385). Both partnerships, see § 701, and incorporated business firms electing S Corporation status, see I.R.C. §§ 1361-1363, are not subject to the same type of entity taxation as corporations subject to Subchapter C.
However, this traditional view is suspect. Having exhaustively examined the evidence concerning congressional attitudes toward the taxation of corporations in the nineteenth century, Professor Steven Bank has persuasively advanced a contrary historical theory.150 Bank argues that throughout the century preceding the enactment of the modern income tax, policymakers viewed the tax on corporate income “as the economic equivalent of a tax upon the shareholders.”151 Desiring to enact a tax that would reach shareholder wealth, Congress chose the corporate income tax as the most suitable means for doing so.152 Of course, as Bank notes,153 the United States has strayed from its historic justification for taxing corporate income, and now has a system that generally treats the business corporation as a separate taxable entity.

One way of understanding why charitable corporations historically were excluded from federal income taxation is that the rationale for taxing corporations simply did not apply to charitable corporations.155 If Congress favored the corporate income tax because it had the effect of taxing the income of individual investors, the absence of investors in charitable corporations (which, by statute, may not distribute earnings to private shareholders or individuals) would suggest no obvious reason to tax charitable entities. Granted, this argument would lose some of its luster (at least as an historical explanation) if Congress actually thought of incorporated businesses as distinct entities for purposes of taxation when the precursor to § 501(c)(3) was enacted, but Professor Bank’s historical analysis suggests that such was not necessarily the case.

What are the implications if a charitable organization is not viewed as a distinct taxpaying entity? In the case of a business firm taxed as a conduit (such as a partnership), individual members of the firm (partners) are taxed on the firm’s income. Such a system is administrable when the identity of the partners is known or ascertainable. However, often it is unclear what persons should be considered “partners” of a charity. If, as required by current law, a tax-exempt charitable

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151. Id. at 531.

152. See id. at 527–33.

153. See id. at 533–37.

154. Presumably, charitable corporations should be taxed no differently from charitable trusts. If the former were thought to be improper objects of taxation, surely the latter were, as well.

155. There is little additional historical evidence of the precise reasons for exempting charities from taxation immediately following the adoption of the Sixteenth Amendment to the United States Constitution (which authorized Congress to tax incomes). See Bittker & Rahdert, supra note 147, at 301–04. Bittker and Rahdert observe that most of the modern exemptions of charities from income taxation date from the Revenue Act of 1894, and were reenacted in subsequent legislation (including the Revenue Act of 1913, which imposed an income tax following the adoption of the Sixteenth Amendment). See id.

156. See § 501(c)(3).
institution confers primarily a public benefit, ultimately the "public" comprises the analogue of a business firm's partners. Yet it is impossible to assign allocable shares of income to members of the public, except perhaps to those who receive cash or goods and services with a market value from a charity. Consequently, it is plausible that a charitable organization's income should not be subject to taxation if it is conceptualized as a conduit (rather than as an entity).

Perhaps these observations mean no more than that the exemption of charities from federal income taxation can reasonably be considered presumptively correct under the original rationale for taxing corporate income. These observations do not necessarily justify the continued exemption of charities from federal income taxation, for the entity theory of taxing corporate income has developed over time. If the entity theory is now assumed to be credible, the presumption arguably should be against the charity income tax exemption. Resolving whether the entity theory of corporate taxation is sensible is beyond the scope of this Article. Although I recognize difficulties in taxing corporate income under the entity theory, I am willing to assume that others accept the theory. For those persons, it is necessary to offer an affirmative justification for the income tax exemption of charitable corporations.

The charity income tax exemption finds support in the community income theory introduced above. As observed previously, charities primarily produce community income. In theory, charities exist for no reason other than to benefit the community. If the community itself is not a proper object of taxation, it is difficult to justify taxing the very organizations that exist for, and embody, the community. One might even conceptualize charitable entities as agents of the community. The income of an agent that is earned for its principal is properly attributed to the principal, not to the agent. If the principal (the community) is not an appropriate object of taxation (i.e., it is taxable), then the income it earns and distributes would not be taxable.

157. Taxing the recipients of cash (or marketable goods and services) on the value of what they receive (without paying consideration therefore) is not strictly parallel to the taxation of partners of a partnership. The latter are generally taxed not on their actual distributions, but on their share of partnership income (whether or not distributed). See § 702.

158. Cf. Bittker & Rahdert, supra note 147, at 309 (posing the question of whether a charitable organization is best viewed as a conduit between donors and ultimate recipients of the charity's goods and services).

159. For an excellent discussion of why (and how) the income of an entity should be taxed, see Herwig J. Schlunk, I Come Not to Praise the Corporate Income Tax, But to Save It, 56 Tax L. Rev. 329 (2003).

160. I agree with Professor Thuronyi that application of the Haig-Simons concept of income to a corporation poses problems. See Thuronyi, supra note 36, at 77–79. I also observe that Thuronyi is willing to tax corporations not because they are taxable entities in their own right under a true income tax, but because they may serve as a proxy for their shareholders. See id. at 77. Viewing corporations as proxies for shareholders is, of course, consistent with the historical rationale for the taxation of corporate income identified by Professor Bank. See supra note 150.

161. Because it makes little sense to distinguish between incorporated charities and those that are not (i.e., charitable trusts and associations), I will often refer simply to charitable corporations. To restate what may seem obvious, if there is no good reason to tax charitable corporations, other charitable entities also should be exempt from tax.
ultimately a tax-exempt entity), the income earned by the agent (the charity) for the principal is not properly included in the tax base.\textsuperscript{162}

Under this analysis, whether charitable organizations operate in corporate form is irrelevant. An analogy to local governments will help me explain my basis for this assertion. Local governments are not subject to federal income taxation.\textsuperscript{163} The justification for not imposing a federal tax on the income of nonfederal governmental bodies is typically said to rest in notions of comity.\textsuperscript{164} Municipalities are often incorporated, but this fact does not mean that they should be taxed. Similarly, if charitable organizations are not taxable because they embody and represent the nontaxable community, the form in which they operate (whether the corporate form or some other form of entity) is quite beside the point.

This understanding of the charity income tax exemption is distinct from Professor Evelyn Brody's theory of exemption based upon sovereignty, although it has certain similarities to (and complements) her theory. Professor Brody argues that charities historically have been viewed as limited co-sovereigns with the state.\textsuperscript{165} As qualified (rather than absolute) co-sovereigns,\textsuperscript{166} charitable entities generally have been thought not to be proper objects of taxation. The community income theory may help explain why charitable organizations have been treated as co-sovereigns with government. As observed supra, one may understand government as existing for the community. Similarly, charitable entities exist for the community. If, as I have argued above, community income is not properly included in the tax base, it is sensible to exclude

\textsuperscript{162}Viewing a charity as an agent of the community has an analogue in the taxation of married couples. In \textit{Poe v. Seaborn}, 282 U.S. 101 (1930), the Supreme Court considered the proper taxation of income earned by a husband and wife who lived in a community property state. Under state law, all of the income earned by either spouse belonged to the marital community. According to the Court, the husband earned wages as an "agent" for the principal—the marital community. Because the marital community was not recognized as a taxpayer in its own right, each spouse was deemed the beneficial owner of one-half of the income that belonged to the marital community. See \textit{id.} at 111–18. Under the analysis in the text, a charity earns income as an agent for the community, just as each spouse was an agent of the marital community in \textit{Seaborn}. However, unlike the "principal" in \textit{Seaborn}, the community at large may be viewed as a tax-exempt entity in its own right. If so, the income of charitable agents acting on its behalf should not be subject to taxation.

\textsuperscript{163}The position of the Internal Revenue Service is that the income of a state or its political subdivision (such as a municipality) is not subject to federal income taxation. See, e.g., Priv. Ltr. Rul. 88-49-023 (Dec. 9, 1988). Under the Code, gross income excludes "income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof." I.R.C. § 115(1) (2003). However, the Internal Revenue Service maintains that income directly derived by a state or political subdivision is exempt from federal income taxation without regard to section 115. See, e.g., Priv. Ltr. Rul. 89-52-016 (Dec. 29, 1989).


\textsuperscript{165}See Brody, \textit{supra} note 147, at 585–96.

\textsuperscript{166}I use the term "qualified" co-sovereigns because Brody argues that the state treats charities with suspicion, and is unwilling to recognize their co-sovereignty consistently for tax purposes. See, e.g., \textit{id.} at 629.
from the tax base the income of those institutions that represent and embody the community. Both governmental entities and charitable entities do so.

Because the community income theory is grounded on the concept of what we mean by income, it is an example of what Professor Brody calls a "base-defining" theory. Professor Brody has opined that, relative to subsidy theories of the charity tax exemption, "a sovereignty view is easier to see in a base-defining approach." I agree. Although the community income theory was not one of the base-defining theories that Brody had in mind when she made this observation, it is compatible with the sovereignty perspective. The income of charity is generally treated in the same way that the income of government is treated; it is excluded from the tax base. Because the federal government generally has no business taxing community income, it generally ought not tax the agents of the community, be they governmental bodies or charitable entities.

B. The Charitable Contributions Deduction

The preceding explanation of the basis for the charity income tax exemption paves the way for a potential justification for the charitable contributions deduction under the community income theory. As argued above, charitable entities may be conceptualized as agents of the community. Thus, for purposes of the theoretical analysis of the charitable contributions deduction, initially it is helpful to look beyond charities as entities in their own right. If charities may be conceived as agents of the community, we may think of a charitable contribution as a transfer from an individual to the community. The question then becomes whether this transfer should be deductible.

One view would be that the charitable contributions deduction is unnecessary to ensure that community income is not taxed. Under this view, as long as the community is not taxed on its income (consisting of charitable gifts and the value added to such gifts in the form of goods and services produced by charity), it does not matter that the donor is taxed. This view is most sensible if charitable donors are viewed as autonomous actors who are completely independent of the community.

But this is not the only, nor necessarily even the best, way of characterizing donors. It is surely true that donors, as individuals, are economic actors who enter the market and maximize self-interest through purchases and sales of goods and services. But donors are more than profit-maximizing, self-interested islands in the sea of commerce. Donors act in numerous capacities. They are sons and daughters, husbands and wives, parents, mentors, friends, colleagues, customers, counselors, employees, bosses, board members, teachers, and people in other types of relationships too numerous to mention. Sometimes the tax system takes these relationships into account in determining relative tax burdens. For example, although each taxpayer is generally taxed on his or her own income (i.e., the individual is the taxpaying unit), the system provides for special filing.

167. See id. at 585–86.
168. Id. at 586.
169. My argument is not simply that the charitable contributions deduction is a logical corollary to the federal income tax exemption of charities. Some, however, maintain that it is. See, e.g., McNulty, supra note 120, at 233.
status for married couples\textsuperscript{170} and heads of household,\textsuperscript{171} imposes a “kiddie tax” at the parents’ income tax rate on the unearned income of certain minor children,\textsuperscript{172} allows taxpayers to claim dependency exemptions,\textsuperscript{173} includes the medical expenses of a taxpayer’s spouse and dependents under the deduction for medical expenses,\textsuperscript{174} and excludes from taxation receipts of family support.\textsuperscript{175} These provisions reflect the common sense notion that family members often behave toward one another in a way that differs from the way in which they interact with unrelated persons. Our tax system recognizes that membership in a family may require adjustments to the normal rules applicable to our choice of taxing unit—the individual.\textsuperscript{176}

A similar notion may lie at the core of the justification for the charitable contributions deduction. Just as membership in a family commonly alters the normal treatment of individual family members, so may membership in a community alter the normal rules of taxation governing individual members of the community. Specifically, the charitable contributions deduction can be understood to rest on the intuition that when individuals donate to charity, they are acting uniquely as members of a community, for the good of the community. They are not acting primarily in their capacity as private consumers of goods and services. Further, when individuals act for the community, it is not unreasonable to treat them as part of the community for purposes of taxation. Stated more technically, it is plausible to view individuals as constituent parts of another taxing (or, more accurately, non-taxing) unit. That non-taxing unit is the community.\textsuperscript{177}

Under this concept, “community income” includes that income which is initially received by a donor and which, but for the charitable contribution, would properly be included in her individual income for tax purposes. For example, consider a nun who has taken a vow of poverty. Every penny she earns from performing private tutoring services is handed over to an auxiliary of the Catholic Church. Under the familiar assignment of income doctrine, the sister is treated as the earner of the income assigned to the Church.\textsuperscript{178} Nonetheless, subject to limitations based upon her adjusted gross income, her contribution reduces her income subject to tax. This treatment is justified if the sister’s income from tutoring is properly viewed as the income of the Church.

One may reasonably argue that when she receives compensation for tutoring and then

\textsuperscript{170} See I.R.C. § 1(a) (2003).
\textsuperscript{171} See id. § 1(b).
\textsuperscript{172} See id. § 1(g).
\textsuperscript{173} See id. § 151(a), (c).
\textsuperscript{174} See id. § 213(a).
\textsuperscript{175} See Gould v. Gould, 245 U.S. 151, 153-54 (1917).
\textsuperscript{176} See Bittker, supra note 36, at 973.
\textsuperscript{177} Professor Andrews espouses a similar concept when he likens “community” to an extension of the household. See Andrews, supra note 29, at 369. However, Andrews does not support this notion with an underlying theory, and his emphasis is on the treatment of imputed income from household services. See id.
\textsuperscript{178} See, e.g., Lucas v. Earl, 281 U.S. 111, 113-15 (1930) (holding that income which was earned by a husband and which, pursuant to a prior contract with his wife, was transferred to her is properly attributable to the husband for federal income tax purposes); Rev. Rul. 77-290, 1977-2 C.B. 26 (ruling that income received by a member of a religious order from outside employment is taxable to the person providing services notwithstanding a commitment not to retain such income).
donates her salary to the Church, her membership in the community of the Church is more dominant than any other capacity in which she acts. If this is true, it is at least plausible to treat her for some purposes as part of the non-taxpaying unit to which she contributes (the Church, and ultimately the community itself). 179

Of course, many charitable contributions are, on the surface, less compelling cases for deductibility (under the theory advanced above) than that of our hypothetical sister. Whereas she was bound to transfer all compensation to the Church, many donors are not similarly constrained. Yes, some donors may feel morally obligated to tithe their income to a church or synagogue, and others may be obligated to fulfill a charitable pledge made before the income was earned. But countless other donors decide to donate sums well after they have earned the income. Is it still plausible to treat their income as "community income"?

One obvious argument against deductibility is that it unjustifiably collapses the receipt of income and the use of income. Some view a taxpayer's voluntary entrance into the market as the trigger of taxation. 180 Criticizing Professor Andrews' argument that a cash-contributing donor should be taxed as the taxpayer who donates services to charity (the latter of whom is not taxed on the imputed value of such services), Professor Kelman argues that "people ought to be taxed only when they voluntarily convert property rights into marketable form." 181 He believes this principle reflects "a basic human resistance to commoditization." 182 One problem with this analysis is that the argument can be turned on its head. It recognizes the imperative not to "commoditize" people with respect to their potential receipt of funds, but it arguably forces commoditization of taxpayers with respect to their use of funds. That is, Kelman's argument treats all non-business uses of funds that are not accumulated as though the taxpayer has entered the market and purchased goods and services, but charitable donors have decided to do just the opposite—to sacrifice the opportunity to purchase goods and services on the market. 183 Granted, the average charitable donor may have more "control" over her earnings than our hypothetical nun. However, as argued above, income is not synonymous with control over wealth, or even control over accretion.

It is difficult to deny that the concept of income depends to some extent on the uses to which taxpayers put accretion. All disciples of Henry Simons agree, for example, that when a taxpayer expends funds for business purposes, he is entitled to a deduction. Once it is admitted that the income tax does (and should) pay some attention to a taxpayer's use of funds, the distinction between the nun (who ex ante intends to donate her salary to the Church) and the more impetuous giver (who conclusively decides to donate to charity only after his salary has been earned) may not be pivotal. Both taxpayers have decided that the community of which they are a part ultimately should

179. This analysis suggests that the portion of the nun's income assigned to charity should be excluded from her gross income. A deduction (more precisely, a deduction that is unlimited) produces the same result as an exclusion. See McNulty, supra note 120, at 243.
180. See, e.g., Kelman, supra note 60, at 838, 842.
181. Id. at 842.
182. Id.
183. Cf. Thurony, supra note 36, at 75 (arguing that not taxing both the donor and donee of an intra-family gift may be justified because the parties have intended a "private, noncommercial transaction motivated by human affection").
receive some or all of the earnings that they have commanded in the marketplace. In each case, the community has appropriated income, and it has done so through the decisions of a community member acting on its behalf.

One's perspective of the capacity in which a taxpayer receives income may prove critical to resolving the difficult question of whether charitable contributions should be deductible. The common view is individualistic. It assumes that people who realize income do so as independent economic actors who are taxable in their own right. As Simons explained, a personal income tax is, strictly speaking, a tax on persons according to their incomes, not a tax on income itself. The implicit assumption appears to be that persons who earn income are presumed to have received it exclusively on behalf of themselves. But this is not the only way of viewing the world. The tax system could adopt a more neutral conceptual view of persons and how they behave. The system already recognizes that persons act in numerous capacities when they provide compensated services. The system could also reserve judgment on the capacity in which a taxpayer has received income until the taxpayer has acted with respect to that income. For example, a taxpayer who earns money not simply to spend it on himself but also to share his bounty with the poor would be taxed as one who acts on behalf of the community with respect to that portion of his income given to charities organized to relieve poverty. Although this view is arguably quite problematic if one focuses only on the moment in which this taxpayer receives a paycheck, the perspective is more sensible when one considers that income is a function of time. The relevant period of time is the taxable period. It is not unreasonable to reserve judgment on the question of to what extent a taxpayer has realized income for the community until the taxable period has ended.

The preceding explanation obviously departs from typical, individualistic notions of how personal income should be taxed. However, even radically individualized approaches to income taxation must deal with an analogous issue. Market purchases require a determination of the capacity in which a taxpayer acts. Thus, items purchased for personal consumption at home are not deductible, whereas many of those same items may be fully deductible if purchased for exclusive business use at the office. Stated another way, if a taxpayer is acting as a businessperson, many expenses are fully deductible, notwithstanding that the same expenses would not be deductible if the same taxpayer were acting primarily as a consumer. Simons himself recognized this problem, and conceded that a completely "precise and objective distinction" between personal

184. See id. at 69.
185. See SIMONS, supra note 37, at 128.
186. For example, income derived from the services of an agent is taxed to the principal, not the agent.
187. Taxpayers may act in this manner from a sense of moral duty. Some have argued that expenditures made in performance of this moral duty should reduce the donor's income for tax purposes. See, e.g., Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants?, 28 TAX L. REV. 37, 58-59 (1972).
188. Opponents of the charitable contributions deduction often approach the analytical issues from an individualistic view of the world. See, e.g., Kelman, supra note 60, at 880 (likening charitable donors to "everyone else in an individualist culture"); Koppelman, supra note 30, at 703 (asserting that if income is selected as the tax base because it best measures economic welfare, "it should be interpreted in an individualistic way").
consumption and business expense is "inconceivable." As Marvin Chirelstein has commented, notwithstanding that a plain distinction "between pleasure-seeking and profit-seeking is alien to human psychology and essentially unrealistic," the concept of net income "depends directly on the idea that one's business and one's personal life can be distinguished." That the system must determine whether a taxpayer is acting in the capacity of a businessperson or a consumer does not mean that we are taxing something other than "income." Similarly, that the system may require a distinction between a taxpayer's activities conducted primarily in her capacity as an individual consumer and those conducted primarily in her capacity as a member of the community does not imply that the system is no longer taxing personal income.

Still another way of looking at this issue is to reflect upon Simons' analogy of society as a partnership. He analogizes an individual's consumption to withdrawals by a partner, and his accumulation as the change in the value of his equity in the partnership. This analogy is sensible if all of society's income and wealth is attributable to individuals. The problem is that this conception defies reality. As argued above, some of society's resources are better attributed to the community than to individuals. A better analogy is to think of society as comprised of two partnerships. One is a partnership consisting of all private wealth, and the other is a partnership consisting of assets held by the community. When an individual makes a charitable contribution, there is no question that she has contributed to the community partnership. The only questions are (1) whether she has withdrawn from the private partnership (and thereby "consumed" assets, according to Simons); and (2) if so, whether her income should be offset by her contribution to the capital of the community partnership. Assuming, arguendo, that Simons properly analogized consumption to "withdrawals," it would seem appropriate to conceptualize partnership "contributions" as negative consumption. Moreover, when a taxpayer contributes money to the partnership of community, there is no increase in any capital account reasonably attributed to the taxpayer. Unlike a partner in a private partnership, a member of the partnership of community has no percentage share in the income and assets of the community. Thus, even if we characterize a person's charitable contribution to the community as a "withdrawal" from the private partnership that gives rise to positive consumption, this amount should be offset by the negative

189. SIMONS, supra note 37, at 54.
191. I readily admit that conceptualizing individual taxpayers as agents of the community acting on its behalf (with respect to that portion of their income that is transferred to the community) is more difficult than conceptualizing charitable organizations as agents of the community. Charities are organized for purposes that are exclusively in the public interest. Individuals are not. However, many people see themselves as existing, and even as having been created, for purposes that transcend their own individual desires. They see themselves as living not only for themselves, but also for others. We might even say that they live in part for purposes described in §§ 170(c)(2)(B) and 501(c)(3) of the Internal Revenue Code. To the extent that they manifest their charitable purposes through actual gifts, the charitable contributions deduction effectively exempts some of their income from taxation, just as § 501(c)(3) exempts the income of charitable entities from taxation.
192. See SIMONS, supra note 37, at 51.
193. See id.
consumption that inheres in the contribution to the community partnership. The net result is no income to the taxpayer. By reducing a taxpayer's income subject to tax, the charitable contributions deduction effectuates the same result.

C. Responding to Anticipated Objections

The purpose of this Article is to introduce and explain the community income theory of the charitable contributions deduction, rather than to defend it against every conceivable objection. Nonetheless, because a few likely criticisms of the theory are obvious, I will identify and briefly respond to them in this Part.

One likely objection to my theory is that it too quickly dismisses the personal benefits (psychic or otherwise) that donors receive from charitable contributions. In addition to what I have written previously with respect to how utility is (and is not) taxed, I would offer two further comments. First, the idea that the charitable contributions deduction should be denied simply because donors may receive some tangible benefit from their donations is inconsistent with how business expenses are treated under the income tax. Numerous types of outlays that are conceived as "pure" business expenses (or expenditures that result in a deductible depreciation expense) nonetheless produce material personal benefits to the business taxpayer. Examples include the purchase of beautiful office furniture, the payment of utility bills after setting the office thermostat at a comfortable seventy-two degrees Fahrenheit, the hiring of employees who are not only competent but also affable lunch partners and interesting conversationalists, the purchase of bottled water and decent coffee for office staff, the rental of office space in an exclusive section of town, the acquisition of the most technologically sophisticated and ergonomically suitable office machines, and the construction of a plush business facility. In the case of personal benefits received by business taxpayers as a result of these outlays, we allow a deduction because the business purpose appears primary. Similarly, in the case of charitable contributions, a deduction is arguably proper because the purpose of the taxpayer in producing community income is primary.

Moreover, we allow a deduction for state and local income taxes (and property taxes) paid to states and municipalities, notwithstanding that these governmental bodies provide benefits to taxpayers. Some question the deduction for such taxes on account of the benefits received by taxpayers. Although it has been correctly

194. See supra text accompanying notes 97-99.
195. See Thuronyi, supra note 36, at 62 (observing that taxpayers enjoy personal consumption benefits in the workplace); Kahn, supra note 85, at 44 (observing that many deductible business expenses confer personal benefits on taxpayers).
196. But cf: Koppelman, supra note 30, at 706 (alleging that salary expense is deductible "because it provides no direct personal benefit to the employer").
197. See I.R.C. § 164(a) (2003). Professors Billman and Cunningham have observed the parallel between transfers to charity and those to local governments for federal income tax purposes. See Brooks D. Billman & Noël B. Cunningham, Nonbusiness State and Local Taxes: The Case for Deductibility, 28 Tax Notes 1107, 1119 (1985).
198. See, e.g., Koppelman, supra note 30, at 710. Koppelman states that the system must choose between total denial of a deduction for state and local taxes, and total allowance of a deduction, except where one can precisely identify the benefit received from the tax. See id.
observed that there may be no strong correlation between taxes paid and benefits received, the deduction is often justified more affirmatively on ability-to-pay grounds. The community income theory offers an independent justification for the deduction. Just as charities produce community income, so do state and local governments. Those who pay taxes are acting as law-abiding members of the community, just as charitable donors are acting as conscientious members of the community. Just as charities may be seen as agents of the community, so may governmental bodies. In each case, the receipt of benefits by individuals from the respective community agents appears ancillary to the primary purpose of the transfer of funds to those agents.

A second objection to the community income theory is that it requires a difficult determination of whether any given entity purporting to qualify as “charitable” is a sufficient representative of the community. I agree, but this determination is already inherent in federal income tax law, and more generally, in the common law of charity. Although the determination is necessarily imprecise, it is not devoid of governing criteria. We ought not to reject a theoretically sound approach simply because its implementation requires the exercise of judgment. Moreover, my theory may suggest that some reforms are in order. For example, if the charity income tax exemption and the charitable contributions deduction are properly understood to hinge on the notion that charities are agents of the nontaxable community, it may be proper to reexamine whether the regulations issued under Code § 501(c)(3) suffice to ensure that charitable organizations are truly representing the community.

Another possible objection is that the community income theory does not necessarily explain various tax-imposed limitations on the activities of charitable organizations and numerous limitations on the deductibility of charitable contributions under Code § 170. My general response is that the theory may be sound, even if Congress is unwilling to implement it to its logical extreme. For example, it is easy to speculate why the charitable contributions deduction is available only within limitations based upon a taxpayer’s adjusted gross income. But for these limitations, a wealthy taxpayer could avoid paying taxes by donating all of her income to charity and living off of her savings. While this may be theoretically acceptable under a proper
conception of income, it may be quite objectionable as a political matter.\(^{204}\) Charities are not the only agents of the community. The federal government is also such an agent—indeed, a highly significant one. To allow all of the resources of the wealthy to fund those charitable activities that they value, at the cost of denying the federal government any control over the use of such funds, may simply be politically unacceptable to governmental policymakers.\(^{205}\)

**CONCLUSION**

This article has introduced and explained the community income theory, a new tax-base theory in support of the charitable contributions deduction. I do not contemplate that my discussion will resolve all doubts concerning the theory, nor do I suspect that it is my final word on the subject. My primary goal is to articulate the theory and explain why it is plausible.

The community income theory hinges on two elements of a system of personal income taxation: the proper tax base, and the proper taxpaying (or non-taxpaying) unit. The thrust of the theory is that some income, identified in this article as "community income," is properly excluded from the personal income tax base because it is more naturally attributed to the community than to the individual members of the community. Moreover, the community is properly viewed as an entity exempt from federal income taxation. Charities are exempt from taxation because (or perhaps "when") they are merely agents of the community. When individuals donate to charitable entities, they likewise may be viewed as acting on behalf of the community with respect to the portion of their income that is donated. The charitable contributions deduction is a mechanism for excluding the portion of income received by an individual that is properly attributed to the tax-exempt community.

I do not intend this paper to posit that the community income theory is the only way of thinking about the charitable contributions deduction. However, I do believe that the theory offers a fresh lens through which we may assess the merits of the deduction, and that it may help illumine some of the philosophical assumptions of those who have previously considered the deduction. Further, the theory may advance academic thought with respect to the proper personal income tax base, and the extent to which the income of charitable entities should be taxed.

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204. Denying a deduction because doing so may be necessary for some governmental purpose (other than the purpose of implementing a theoretically correct concept of income) is hardly novel. See, e.g., I.R.C. § 162(f) (2003) (denying a deduction for the payment of governmental fines).

205. Phrased a bit less cynically, the federal government may recognize that community income is not properly taxed, and may even accept that members of the community ought not be taxed on sums that they devote to the use of the community, but nevertheless may require that some portion of such funds be channeled through the federal government. Of course, a taxpayer receives no deduction (for federal income tax purposes) for tax payments to the federal government. But because the government could raise the same revenue by allowing a deduction and increasing the rate of tax, this observation is inapposite.