TAXING STATUS: TAX TREATMENT OF MIXED BUSINESS AND PERSONAL EXPENSES

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When, in disgrace with fortune and men's eyes,
I all alone beweep my outcast state,
And trouble deaf heaven with my bootless cries,
And look upon myself and curse my fate,
Wishing me like to one more rich in hope,
Featured like him, like him with friends possessed,
Desiring this man's art and that man's scope,
With what I most enjoy contented least;
(William Shakespeare, Sonnet 29)

What is the proper tax treatment of mixed business and personal expenses? This question has much baffled legislators, courts and legal academics. This Article proposes a new approach to this question that justifies the strict elimination of any deduction for mixed expenditures. Namely, the tax code should seek to tax status itself, not merely to redistribute wealth or improve welfare. This Article argues that the social status that accompanies mixed expenses justifies eliminating the deduction and fully taxing the individual, regardless of whether the individuals actually benefits from the social status gained. The central justification for taxing social status is based on the theory of relational egalitarianism which calls for social policy to shift its focus from redistribution of resources and welfare, to the social relationships among individuals in society. Furthermore, the argument for taxing status has broader implications beyond the case of mixed expenditures: This Article therefore also addresses the tax treatment of fringe benefits, executive compensation,

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consumption of luxury goods, and charitable contributions.

INTRODUCTION

One of the most celebrated problems in tax policy is the proper tax treatment of expenses that both have a business rationale and personal benefits (henceforth: "mixed expenditures"). On the one hand, it makes sense that such expenses should be deducted from a taxpayer's tax liability. After all, these expenses reflect a taxpayers' cost of doing business, and thus should be subtracted from her gross income to reach her net income, the relevant benchmark for tax purposes. On the other hand, such costs reflect the taxpayer's consumption, and as such should be fully taxed and not deducted from her tax liability.

Take, for example, a torts lawyer's two-day trip from Chicago to New York for an ABA conference. The conference is held at a state-of-the-art hotel and the lawyer will go to Broadway shows in the evenings to bond with other attorneys. The cost of the trip is $1000. The business value of the trip is greater than the cost for the lawyer, he really plans to expand his practice, and the conference will provide him the most up to date information in the field and connect him with top practitioners. In addition, he will also derive greater personal benefits than costs from the trip because he loves New York and is a big Broadway fan.

The tension between these two values has not been solved in the American legal system. The different elements in this case of mixed expenditures–the food, the lodging, the airfare, and the entertainment—are all treated differently by the tax code. Some are fully deductible, some are nondeductible and others are somewhere between the two, permitting a partial deduction.[1]

This article asserts that the general principle of tax law should be to fully tax such mixed expenditures, and not permit any deductions. This assertion rests on a fundamental argument regarding the purposes of tax policy: that it should be concerned with the individual's social status and not only his income or welfare level. Consequently, social status should be incorporated into the tax base, or in other words, social status should be taxed as such. This argument has potential implications far beyond the case of mixed expenditures, which will be discussed later in this article.

In the context of mixed expenditures, the assertion is based on two arguments, the first clearing the field for the second, more fundamental, proposition. The first argument is purely economic: taxing mixed expenses would reduce the distortionary costs of draping personal consumption as business expenses. Simply put, the business expenses deduction incentivizes individuals to incur additional personal consumption expenses because these expanses can plausibly be represented as a business expenses and deducted from the taxable income. Eliminating the business deduction, however, could generate a deadweight loss by reducing the amount of efficient business economic activities, though reduced distortion from the disguising of personal expenses as business might offset this loss.[2] Furthermore, even if in the overall elimination of the deduction creates a deadweight loss, it might still be efficient if the additional revenue raised by eliminating the deduction creates less deadweight than any alternative tax, since the elimination of a deduction is equivalent to a tax. Almost all forms of taxation are accompanied by deadweight loss. The answer to the

1. The term "mixed expenses" bundles up a few distinctive situations that differ in the magnitude of the business expense relative to the magnitude of the personal benefit. For the complete taxonomy of mixed expenses situations, see Daniel I. Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859 (1974) (detailing mixed expenses situations). *See also* Thomas D. Griffith, *Efficient Taxation of Mixed Personal and Business Expenses*, 41 UCLA L. REV. 1769 (1994) (discussing mixed personal and business expenditures and methods of taxing such expenditures). The example above is a case that Halperin labels as "Either Alone"–where both the business benefit and the personal benefit exceed the cost. Halperin at 866.

2. For a discussion of businesses shifting consumption to the investment category, *see* Mary Louise Fellows & Lily Kahng, *Costly Mistakes: Undertaxed Business Owners and Overtaxed Workers*, 81 GEO. WASH. L. REV. 329 (2013) (challenging traditional conventions of consumption and investment).

question of whether a tax is efficient does not hang on whether it generates a deadweight loss, but on the relative size of the deadweight loss in comparison to other forms of taxation that raise the same amount of revenue. A tax that is accompanied by deadweight could be efficient, if the deadweight it generates is lower than alternative taxes that could potentially raise the same amount of revenue.[3]

The second proposition behind this article is a philosophical argument regarding the proper base. Namely, should taxation encompass social status even if this social status is not reduced to the form of consumption? This article argues that social status itself should be subject to tax, even if that status is not grounded directly on monetary consumption. Thus because being situated in a position in which business and personal expenses are mixed confers high social status, an individual in this situation should be taxed regardless of whether the higher social status contributes to his welfare. This insight, the central proposition of this article, is reinforced by the previous economic argument. If the economic costs of this tax are not high, then the philosophical argument tilts the scales in favor of the tax, the tradeoff with efficiency being reasonable. Examples of some additional implications of this philosophical argument will be discussed after presenting the two arguments for excluding mixed expenses deductions.

In most tax policy scholarship, there is wide agreement that the tax base should be based on income. Most inquiries regarding the tax base ask whether the transactions in question should be defined as income. For this purpose, in most cases the Haig-Simons definition of income is employed:

$$I = C + S$$

In plain English, income equals consumption plus savings. From this equation it can be inferred that if a transaction does not generate any consumption or savings for the taxpayer, it cannot be defined as income and thus should not be taxed. This article questions whether taxation should be limited to income in this sense. It argues that there may be other attributes besides consumption and savings that should be taxed. This article will focus on the attribute of status, arguing that if a taxpayer gains status, even if he does *not* benefit from his status and thus cannot necessarily be viewed as consuming it, his status-creating or confirming activity should still be taxed. For an individual, the possibility for mixed expenditures—the idea that in order for an individual to perform his job she needs mahogany furniture and a black limousine—is a feature of high

3. Angar Sandmo, *Optimal Taxation: An Introduction to the Literature*, 6 J. PUB. ECON. 37 (1976).

social status. Therefore, the individual should be taxed for her mixed expenditures even if she does not benefit from the expenditure. Although she might have sincerely preferred to work at a metal desk or commute on a bike, she is still 'gaining' high status by working at an expensive desk or riding in a limousine—a form of a limited positional good that should be taxed.[4]

The idea that social status is a good that should be taxed independent of whether the taxpayer actually benefits from the good is based on a relational egalitarian view. According to relational egalitarian view espoused by scholars such as Elizabeth Anderson,[5] Samuel Scheffler,[6] and

4. This view is linked to the benefit principle approach for defining the proper tax base on grounds of fairness. According to the benefit principle, the relative parameter for determining the fair amount of tax an individual should pay is the level of the benefit the state confers on him. *See* F.A. HAYEK, THE CONSTITUTION OF LIBERTY 315-16 (1960) (discussing that "almost all economic activity benefits from the basic services of government" and proportional taxation allows higher taxes imposed on the people who receive more benefits). The benefit principle stands in contrast to the sacrifice principle, which is the primary alternative principle for defining tax fairness. The sacrifice principle focuses on the subjective sacrifice individuals make in tax payments and strives to equate it. The first scholar to which the equal sacrifice principle is attributed to is John Stuart Mill, *see* JOHN STUART MILL, PRINCIPLES OF POLITICAL ECONOMY WITH SOME OF THEIR APPLICATIONS ON SOCIAL PHILOSOPHY 540 (5th London ed., New York, D. Appleton & Co., 1896) (discussing equal sacrifice). For the various possible versions of the equal sacrifice principle, see LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 24-28 (2002). The most dominant version of the equal sacrifice principle is the ability to pay principle, under which ability to pay is a proxy for the sacrifice incurred. Regarding the various versions of the ability to pay principle, see Richard A. Musgrave, *Ability to Pay*, *in* THE ENCYCLOPEDIA OF TAXATION AND TAX POLICY 1 (2d ed. 2005). As will be elaborated later, the sacrifice principle also has a subjective version, but it is concerned with the sacrifice that the subject actually incurs. The subjective element recasts the equality component of the equal sacrifice—the idea that the sacrifice imposed will be measured in absolute terms in contrast to a sacrifice of equal proportion relative to the features of the individual (in terms of welfare or resources). *See infra* note 68 (discussing subjective and objective measures of prestige). While the conventional understanding of the benefit principle is that the benefit should be determined subjectively—by reference to the actual extent which the individual values the benefit, the status approach focuses on an objective benefit—the status of the individual, independent of the individual's personal valuation of the status signal. This idea stems from the rationale of setting the price for public goods in proportion to the utility one derives from the public goods and not in proportion to the quantity consumed as in the conventional market based price setting. *See* Barbara H. Fried, *The Puzzling Case for Proportionate Taxation*, 2 CHAP. L. REV. 157, 166 (1999) (summarizing and critiquing interpretations of the benefit principle). The analogy assumes that the benefit could be portrayed as a benefit that the state confers, an assumption that will be explained later, *infra* note 68.

5. Elizabeth S. Anderson, *What is the Point of Equality*, 109 ETHICS 287, 288 (1999).

6. Samuel Scheffler, *Choice, Circumstance, and the Value of Equality*, 4 POL., PHIL. & ECON. 5 (2005).

Jonathan Wolff,[7] social policy should focus on the relations between individuals, rather than a simple calculation of their relative wealth or even welfare level. The main redistributive implication of such view is that such an approach may lead to equal taxation of individuals with different welfare levels. In this sense it is similar to the rationale in the context of universal welfare programs that treat all individuals equally, independent of their resources or welfare level.[8] According to the relational egalitarian view, the redistributive element in the heart of social policy should not necessarily aim solely at reducing gaps in wealth or welfare level.[9] Instead, their *direct* concern is with the relations between individuals and not with other elements of just how well-off these individuals happen to be. These other elements, such as welfare and resources, may be important due to their effects on relations between individuals, but they have no significance *per se*. In contrast, positional elements, such as social status, receive greater attention due to their significant effect on the relationships between individuals within a society.

This article argues that the relational egalitarian view may also have the reverse effect—it may prescribe transferring resources between individuals even when there are no wealth or welfare gaps. There may be 'relational gaps' that should be mitigated that do not necessarily reflect wealth or welfare gaps. The classic case of such relational gaps is gaps in social status. Being in a position where one's business requires expenses that also benefit one on a personal level signals social status that should be taxed independently of whether one benefits from the expenses or even from the social status.

This article proceeds as follows: Section I lays out the legal framework of the tax treatment of mixed expenses. Section II presents the economic argument for taxing mixed expenses. Section III presents the philosophical argument for taxing these expenses. The first part of this section will lay out the relational egalitarian view, which functions as the normative framework for the argument. The second part of the section will substantiate the claim that mixed expenditures is a paradigmatic case of creation of high social status from the perspective of the Weberian analysis of social status. This turns it to a classic case for applying the argument for taxing status. Section IV lists other possible tax implications of the

7. Jonathan Wolff, *Fairness, Respect and the Egalitarian Ethos Revisited*, 14 J. ETHICS, 335, 339 (2010); Jonathan Wolff, *Fairness, Respect, and the Egalitarian Ethos* 27 PHIL. & PUB. AFF. 97 (1998).

8. THEDA SKOCPOL, THE MISSING MIDDLE: WORKING FAMILIES AND THE FUTURE OF AMERICAN SOCIAL POLICY 30 (2000).

9. Anderson, *supra* note 5, at 336. These scholars' views stand in contrast with luck egalitarianism, see *infra* note 50, defining luck egalitarianism.

article's main argument. Section V then presents three possible critiques of the idea and their implications. Finally, Section VI provides a conclusion.

I. THE EXISTING LEGAL FRAMEWORK FOR TAXING MIXED EXPENDITURES.

Currently, tax law covering mixed expenses does not seem to be governed by one coherent principle—instead, it seems to be comprised of several different principles corresponding to several different situations. In contrast to the positions held by many other scholars, however, it is possible to delineate an overarching principle unifying the treatment of mixed expenses.

The ambiguity in the tax treatment of mixed expenses is rooted in the tax code. Section 162 of the tax code states, "[t]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ."[10] Yet section 262 of the tax code includes the following, "[e]xcept as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses."[11] The question then arises: how should expenditures that are both 'ordinary and necessary' business expenses as well as personal expenses be treated? The example at the beginning of the introduction is typical: a case where the expense maximizes the business's profits and simultaneously confers considerable personal benefit on the taxpayer.

Different types of mixed expenses receive distinctive treatments by statues, courts and I.R.S. regulations. Some mixed expenses explicitly cannot be claimed for deductions, such as expenses for home offices and vacations homes,[12] luxury water travel[13] and inherently personal expenses such as haircuts.[14] Other mixed expenses see significantly restricted or limited deductions; for example, entertainment and sport events deductions are limited to face value and the deduction for luxury box seats is limited to the face value of regular box seats.[15] Some expenses permit only a partial deduction, such as meal expenses.[16] Sometimes, courts have conditioned the deductibility of alleged business expenses on the existence of a

10. 26 U.S.C. § 162(a) (2012).
11. 26 U.S.C. § 262(a) (2012).
12. 26 U.S.C. § 280A, 280F (2012).
13. 26 U.S.C. § 274(m)(1)(A) (2012).
14. Richard Walter Drake v. Comm'r of Internal Revenue, 52 T.C. 842, 844 (1969).
15. 26 U.S.C. § 274(l) (2012).
16. *See* 26 U.S.C. § 274(n) (limiting the deduction for business meals and entertainment to 50% of cost).

"primary" business motive.[17] In other cases the courts have required that the expenses simply be "reasonable."[18]

Because there are so many tests and standards, most scholars have concluded that there simply is no unifying principle for the tax treatment of mixed expenses. As Professors Michael Graetz and Deborah Schenk have noted "neither the IRS nor the courts had developed an overarching theory."[19] Professors Bankman, Shaviro and Stark have stated that "our tax system's approach to this general problem has been somewhat ad hoc."[20] This understanding is reinforced by political economy theories of legislation: most scholars believe that the legal treatment of mixed expenses does not stem from the acceptance of a systematic normative view or theory, but from political forces that determine the legal outcome ad hoc.[21]

The existence of various tests does not necessarily mean that there is no overarching theory. On the contrary, there may be a unified theory behind the legal treatment of mixed expenses but for practical reasons it is manifested in various legal tests. There are two distinctive questions that need to be addressed before determining the legal theory behind the treatment of mixed expenses. The first is the conceptual-theoretical question of how mixed expenses should be treated. Assuming that the expense could be justified solely on business grounds or solely on personal grounds—and where neither is obviously the primary purpose—which of the two should have conceptual precedence? Should the deductibility of the business expense be affected by the fact that the expense is also personal? Should the tax liability of a personal form of consumption be affected by the fact that the personal form of consumption serves a business purpose? If the expenses serve both purposes, should the motivation of the taxpayer be of any concern? Should the deduction be proportional to the business and personal benefit?[22]

17. Nickerson v. Comm'r of Internal Revenue, 700 F.2d 402, 404 (7th Cir. 1983).

18. Boehm v. Comm'r of Internal Revenue, 326 U.S. 287, 292 (1945).

19. MICHAEL J. GRAETZ & DEBORAH SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 252 (5th ed. 2005).

20. JOSEPH BANKMAN, DANIEL SHAVIRO & KIRK STARK, FEDERAL INCOME TAXATION 393 (16th ed. 2012).

21. *See* James M. Buchanan, *Positive Economics, Welfare Economics, and Political Economy*, 2 J.L. & ECON. 124, 134 (1959) (arguing that political outcomes are not necessarily shaped by social values).

22. According to some scholars, the conceptual question might run one level deeper to the analytic level. The problem might be not only how should cases in which there is both a business component and a personal component be treated. The question whether a certain element is a business or personal expense might be indeterminate and is itself a social construct. Tsilly Dagan, *Commuting*, 26 VA. TAX REV. 185, 193-95 (2006-2007).

Besides the conceptual question, there is also the pragmatic evidentiary question. Almost any expense can conceivably be portrayed as a business expense. In the case of *Irwin v. Commissioner*, a novel writer argued that his expenses for sending his daughter to a dormitory were a business expense—his writing was based on exposure to different experiences, and he sent his daughter to a dormitory as a research assistant so he would be exposed through her to the experience of living in a dormitory.[23] Even if this argument seems farfetched, there is a whole array of cases in which personal expenses can indirectly generate significant revenue for a business. There is no entity that we can rely on to determine whether the expenses will actually generate higher revenues. Courts do not have the ability or skills to determine if a certain expense will really increase profits of a certain business. Neither is the taxpayer a reliable entity for determining whether the expenditure is a sound business investment: in contrast to business decisions of directors and officers that are protected by the Business Judgment Rule in corporate law,[24] taxpayers' personal incentive does not necessarily allow us to presume they are doing their best to make rationale business decisions in the tax context. The central rationale for the court's reliance on the discretion of the directors and managers is their motivation for making a sound business investment is generally aligned with the decision the legal system would like them to make: they would incur a personal loss from a bad business investment.[25] In the case of the taxpayer, the taxpayer benefits from classifying a transaction a business investment even if it is a very bad one. He benefits significantly from classifying personal consumption as a business investment because of the tax benefits, even if the actual business impact of the expenditures is negative. Although it is possible that managers and directors could gain from a bad business investment in which they invested less than optimal time obtaining relevant information because they gained leisure time as a consequence, in most cases they bear loss for bad business decisions on a personal level.[26] The incentive to depict a decision as a sound business investment is therefore much stronger in the case of tax deductions, and thus could lead to excessive classification of expenses as

23. 72 T.C.M. 1148, 1150-51 (1996). In addition he claimed a deduction for other business expenses, such as dental services and purchase of flowers as part of his research expenses for his writing, for which he needs to be exposed to a whole array of experiences. *Id.* at 1151.

24. Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

25. *See* Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 40 BUS. LAW. 1437, 1442 (1985) (suggesting that managers and workers of a firm are more prone to suffer significantly from the firm's poor results than investors who in most cases are diversified).

26. *Id.* at 1441.

business related, as the case of *Irwin* exemplifies.[27]

There is another important reason the plethora of tests does not necessarily reflect a profusion of competing principles on the conceptual level. It may well be that on the conceptual level a certain principle is accepted, but due to evidentiary problems, Congress, the I.R.S. and the courts apply various presumptions to various expenses, trying for a rough approximation rather than theoretically optimal results. For example, the rule that 50% of meal expenses are deductible[28] does not necessarily stem from the assumption that a business meal both fully functions as an ordinary and necessary business expense and as a form of personal consumption and so rationally justifies a fifty-fifty split. Instead, it may simply be that it is next to impossible to figure out how to properly split meal expenses. Thus we chose to split the amount equally on pragmatic evidentiary grounds and not on theoretical considerations of the proper treatment of mixed expenditures.

If the tax treatment of mixed expenditures is especially affected by evidentiary considerations, this fact sharpens the question on the conceptual level: what, therefore, is the basic principle underlying the legal system's view of mixed expenses? This article argues that the central premise underlying the legal system is the idea that serving a business goal is sufficient for entitling an activity to a deduction, independent of whether the expense also confers a personal benefit. The limitation on business expenses that confer a personal expense stems from evidentiary considerations, and not from conceptual considerations. Both the rhetoric of congressmen engaged in the legislative process and of the courts in rulings regarding mixed expenses support this view.

When Congress enacted the statute that limits the deductibility of meals to 50% of costs in section 274(n) of the tax code in 1986, a report of the Senate Finance Committee explained:

> The committee believes the present law, by not focusing sufficiently on the personal-consumption element of deductible meal and entertainment expenses, unfairly permits taxpayers who can arrange business settings for personal consumption to receive, in effect, a Federal tax subsidy for such consumption . . . . [I]n some cases the consumption may bear only a loose relationship to business necessity.[29]

The Central Finance Committee's motive for revising the law thus appears

27. *See supra* text accompanying note 23 (listing excessive business deductions sought by Irwin).

28. *See supra* note 16 (citing 26 U.S.C. § 274(n) to illustrate the limited deduction).

29. S. REP. NO. 99-313, at 68 (1986).

to have been the fear that the taxpayer might use the meal expenses as a means to manipulate the tax system, not any concern about the underlying theory behind business deductions.

In *Rudolph v. U.S.*, Judge Douglas expressed a similar view, arguing that in essence all that matters for the deductibility of business expenses is that the expense have a real business purpose, and that it makes no difference whether the taxpayer benefits from the expense, "[w]hether a person enjoys or dislikes the trip that he makes with all expenses paid has no more to do with whether the expenses paid were compensation 'for services' rendered than does his attitude toward his job."[30] Treasury regulations also echo this view, noting "[i]t is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits [for the activity to be eligible for a deduction]."[31]

All three of these quotations reflect the idea that the focal issue for receiving a deduction is simply that the expense actually serve a business purpose. Therefore, a taxpayer's desire to gain a personal benefit from the activity should not affect the deduction. Judge Douglas went so far as to hold that personal benefits should be completely disregarded, while the regulations still allow for the possibility that an activity for which personal benefit is the *primary* motivation might see a reduced deduction. But either way the focus is placed on the existence of a business purpose.

II. THE ECONOMIC ARGUMENT

Usually, scholars argue that business expenses deductions are economically beneficial even when the supposed business activity includes personal consumption elements. In short, if the expense serves the goal of maximizing profits it should not be taxed. After all, a tax on such expenses might deter the investment, and therefore an efficient business transaction would not take place.

C. Douglas Dillon, Secretary of the Treasury in the Kennedy administration, succinctly expressed this idea in response to Kennedy's policy of limiting mixed expenses deductions:

> Expenses incurred for valid business purposes should not be discouraged since such expenses serve to increase business income, which in turn produces additional tax revenues for the Treasury. If valid business expenses were to be disallowed as a deduction (particularly expenses associated with selling

30. Rudolph v. U.S., 370 U.S. 269 (1962).
31. Treas. Reg. § 1.183-2(b)(9) (1972).

> functions), there might be a substantial loss of revenue where business transactions are discouraged, or where they to fail to be consummated.[32]

This section demonstrates why, on the contrary, economic analysis may support taxing mixed expenditures. First, taxing mixed expenses is not necessarily inefficient all things considered: the reduction in the distortionary effect of the deduction may offset the loss from the reduction in beneficial economic activity that accompanies the elimination of the deduction. Second, even if taxing mixed expenses is not necessarily more efficient than providing a deduction for such expenses, the costs of taxing mixed expenses aren't as obvious as Dillon assumes. Given that the economic costs of taxing mixed expenses aren't significant, enables the philosophical argument in the following section to tilt the scales toward the elimination of mixed expenditures deductions.

Taxing mixed expenditures will reduce the inefficient distortion of consumption patterns that the deduction generates. Because goods that can be portrayed as business expenses are tax deductible, taxpayers probably tend to compensate themselves through such goods. While they might prefer to be compensated through other goods of equivalent value or cash, the fact that mixed expenditure goods are tax deductible makes these goods desirable. Compensation through goods that would not have been desired in a tax-free world creates a suboptimal allocation of goods.[33]

An example easily illustrates this point. An individual in a 50% marginal tax bracket contemplates whether he should purchase a mahogany desk for her business. The mahogany desk is tax deductible as a business expense, even though it will not have any significant effect on the revenues of the individual's business. The cost of the desk is $100. The individual is not a big fan of expensive furniture, and values the desk at $60. He will still purchase the desk although it would be an inefficient transaction—a cost of $100 for a benefit worth $60. Why? Because he prefers being compensated with a Mahogany desk worth $60 that is tax free, to receiving $100 in cash that will only amount to $50 after tax. This example reflects

32. S. Comm. On Fin., Revenue Act of 1962, S. REP. NO. 87-1881, at 25 (1962), *reprinted in* 1962 C.B. 707,731 (1962).

33. *See* HALPERIN, *supra* note 1, at 898 (arguing inefficiency is created by the differing values individuals ascribe to entertainment). For a parallel argument regarding suboptimal regional allocation of resources, due to a similar effect caused by exempting amenities from taxation, *see* Michael S. Knoll & Thomas Griffith, *Taxing Sunny Days: Adjusting Taxes for Regional Living Costs and Amenities*, 116 HARV. L. REV. 987, 1016-17 (2003) (arguing failure to consider regional living costs in income tax calculation discourages investment in high-cost regions). Knoll and Griffith themselves draw the analogy between taxation of mixed expenses and taxation of living costs amenities. *Id*. at 1016.

how the deductibility of mixed expenditures generates a distortive effect in the allocation of goods. In a tax-free world, the funds would be invested in other goods than the desk that would generate higher levels of utility, but due to the tax an additional mahogany desk will be manufactured although it is inferior to other goods.

Furthermore, the mixed expenditures deduction might be inefficient even in situations where providing the deduction would generate higher profits for the firm. For example, assume that the desk generates a $50 increase in the firm's profits. If the expense were not deductible, the desk would not have been purchased. Thus the taxpayer incurs a cost of $100, and his private benefits are only $85 (the $60 value he attributes to the desk plus the $25 after tax profits the desk generates). Yet the social value of the desk—$110 ($60 stemming from the private benefit + $50 from the increase in profits)—is greater than its cost ($100). The deduction thus drives the individual to make a socially optimal investment that would not have occurred without it. But, even if 75% of the cases in which the deduction motivates purchasing a Mahogany desk correspond to the efficient case, and 25% correspond to the inefficient case, in the aggregate the deduction will still be inefficient. For every three cases in which it generates a social surplus of $10, there will be one case that it generates a social cost of $40. Therefore, knowing that some efficient investments will not take place without the deduction for mixed expenses is not sufficient for concluding that the deduction is efficient. The costs of the deduction's distortionary effect *may* offset the costs of the investment decisions lost by eliminating the deduction, depending on the variables mentioned above. The claim here is not that eliminating the deduction is necessarily more efficient, but only that no categorical determination could be made regarding the efficiency of the mixed expenditure deduction, as implied by Dillon, without detailed information regarding the variables above.

Besides the distortionary effect, providing a deduction for mixed expenses might have an additional cost that stems from its distributive effect. As noted, enabling one to deduct mixed expenses permits individual opportunities for tax-free consumption. Needless to say, this effect raises considerable fairness problems, particularly a violation of the horizontal equity principle. According to the horizontal equity principle, individuals with a similar welfare or income level should pay a similar amount in taxes.[34] By permitting an individual to convert some of his consumption

34. The term horizontal equity was coined by Richard Musgrave, see RICHARD MUSGRAVE, A THEORY OF PUBLIC FINANCE 160 (1959), for a description of the principles of horizontal equity. The term that couples horizontal equity in fairness analysis is that of vertical equity: treating individuals with different welfare levels or income levels differently from a tax perspective. Some scholars have questioned whether the two terms are

into tax-free consumption, we allow him to pay less in taxes than other individuals with an equivalent level of real income or consumption level.

The distributive effect of enabling mixed expenses is not only problematic on the fairness level, but also on the efficiency level. A progressive tax under which an individual's tax liability increases as her income increases is justified on efficiency grounds. Given the decreasing marginal utility of money, the decrease in one's welfare from paying a dollar of tax grows as the individual has less money. Accordingly, an optimal tax scheme would prescribe minimizing the overall social decrease in welfare resulting from tax payment by equating the marginal sacrifice taxpayers incur from the payment of the marginal dollar.[35] Enabling some individuals with a certain income or consumption level to pay less and thus reduce their marginal sacrifice per dollar of taxes ensures that other individuals will have to pay more with a higher marginal sacrifice per dollar of taxes. Permitting individuals to deduct mixed business and consumption expenses and provide them with tax-free consumption will cause an increase in the overall sacrifice of welfare required for raising a certain amount of taxes. As a consequence, aggregated social welfare will decrease.

This economic analysis strengthens the case for taxing mixed expenditures, but as noted above, it is not necessarily a decisive argument. It yet may be that the efficiencies of providing a deduction for mixed expenditures outweigh the efficiencies of eliminating a deduction for mixed expenditures. The overall effect depends on the contingencies in each mixed expenses setting. The next section presents a normative-philosophical argument for eliminating a deduction for mixed expenditures. Even though this argument stands on its own, it is important to show that even from the economic perspective neither of the two options is categorically more efficient than the other. In this setting the normative-philosophical argument is much more significant in affecting the legal outcome.

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superfluous: are analytically equivalent and are two sides of the same coin. *See generally* Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191 (1992); Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NATL. TAX J. 139 (1989). For counter arguments regarding the analytic need of both terms, see generally Alan J. Auerbach & Kevin A. Hasset, *Tax Policy and Horizontal Equity*, *in* INEQUALITY AND TAX POLICY 44 (R.G. Hubbard & Kevin A. Hasset eds., 2001); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NATL. TAX J. 113 (1990).

35. MUSGRAVE, A THEORY OF PUBLIC FINANCE at 91.

III. THE NORMATIVE-PHILOSOPHICAL ARGUMENT FOR TAXING STATUS

This section provides a justification for eliminating the mixed expenditures deduction based on an argument for taxing status. Taxing status means taxing a transaction that contributes to an individual's social status, even if it did not confer a personal benefit on that individual. In other words, even if an individual does not feel she benefits personally from higher social status, or is not interested in so benefiting, she should still be taxed for gaining status.

The argument in this part of the article will be comprised of two steps. First it will substantiate the claim that the tax base should not necessarily be comprised of income and could consist of other features such as social status. This claim will mostly rely on a strand in the philosophical scholarship that has been labeled "relational egalitarianism."[36] The second step in this part of the article will substantiate the claims that the existence of mixed expenses intensifies one's social status. Being in a position where one's vocation compels one to use resources that seem to benefit him on a personal level is itself a proxy for strong social status. In this part I will mostly rely on the Weberian analysis of social status and its various sources.

A. *Incorporating Social Status into the Tax Base*

The crux of the argument of this article is that social status should be incorporated into the tax base, independent of its effects on one's welfare. Such argument deviates substantially from the conventional approach in tax policy, in which the tax base consists of consumption, income or one's welfare in the wider sense. After all, why should one be taxed for social status, if one derives no benefit from it and it does not promote one's welfare in any sense?

In order to answer this question, we need to examine the definitions of the proper tax base and the discussions in the scholarship regarding these definitions. Such an examination will expose that the argument presented in this article is less revolutionary than it seems at first glance. Although the question of 'what is income?' is perceived as one of the most fundamental questions in tax policy, some scholars have questioned its centrality to tax policy.

Many tax articles, examining whether a certain transaction should be taxed, start with the Haig-Simons definition of income. Scholars analyze the different components that comprise income according to the Haig-

36. *Infra* note 49.

Simons definition—savings and consumption—and their scope.[37] They then pass on to an analysis of whether the transaction in question fits that definition. If the transaction fits into the definition of income provided, it is argued that it should be taxed,[38] and if it is not it is mostly argued that it should not be taxed.[39]

Professor Stanley Kopelman defines income as "[the] power to consume that is reduced to economic rights and is capable of valuation."[40] Kopelman's underlying justification for his definition is rooted in an attempt to capture what constitutes one's personal welfare. Professor Johnny Rex Buckles adds an additional element to this definition: control. Power to consume without the ability to exert control over that power should not be defined as income.[41] Professor Mark Kelman adds yet additional element: in order to credit an individual with having income, it is not sufficient that the individual has the power to control the usage of the resource, but that he derives satisfaction from the usage of resource.[42] The differences between definitions of income mainly stem from the consumption element in the underlying Haig-Simons definition. In order for an activity to be defined as consumption, does it require the agent's intentions? Does it require that the agent benefit from the resources?

My argument is based on the notion that the question of whether a certain transaction should be defined as income is *not* the key question for determining whether the transaction should be taxed, in contrast to the scholarship surveyed above. In this respect, I follow Professor David Weisbach's argument that inquiries into the definition of income are futile for providing an answer for whether a given transaction should be taxed. According to Weisbach:

> The issue for mixed personal and business expenses is whether they should be treated as personal or business expenses. But the Haig-Simons definition of income is simply that–a definition. The definition itself cannot make that determination. Thus the

37. *See supra* Introduction (describing Haig-Simons analysis).

38. *See, e.g.*, Joseph Dodge, *Taxes and Torts*, 77 CORNELL L. REV. 143, 152-62 (1992) (discussing taxation of personal injury recovery).

39. *See, e.g.*, STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES 17-20 (1973) (addressing income definition); R.A. Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44 (1967) (arguing for a basic income concept).

40. Stanley A. Koppelman, *Personal Deductions under an Ideal Income Tax*, 43 TAX L. REV. 679, 694 (1988).

41. Johnny Rex Buckles, *The Community Income Theory*, 80 IND. L. J. 947, 962 (2005).

42. Mark G. Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 831-58 (1979).

> Haig-Simons definition is unhelpful for line drawing consistent with its strictures.[43]

Weisbach claims that in determining whether a certain transaction should be taxed, it is of no use analyzing whether the transaction fits into a certain definition or doctrinal rule. Instead we should examine the values that the tax system seeks to promote.[44] It is possible that these values will justify taxing a transaction that is not necessarily defined as income-generating or as consumption. The conventional approach is that the tax system has three overarching goals: redistribution, efficiency and fairness.[45] Assessing fairness, furthermore, is mainly broken into two tests: vertical and horizontal equity, which essentially both require that similarly situated taxpayers be treated equally.[46] But as Weisbach points out, just referring to vertical and horizontal equity in and of itself does not provide an answer for how a transaction should be treated. In order for the principles of vertical or horizontal equity to generate any concrete implications, one has to determine the meaning of "similarly situated taxpayers."[47] What criteria should we use to determine if individuals are "similarly situated"?

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43. David Weisbach, *Line Drawing, Doctrine and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1626, 1646 (1999).

44. This argument is grounded in the legal realist view, which rejects the essentialist approach toward doctrinal rules. The most prominent supporter of this view was Judge Oliver Wendell Holmes, see *The Path of Law*, 10 HARV. L. REV. 457, 460 (1897), for a discussion of legal realism.

45. Some scholars argue that the fairness goal coincides with the redistributive goal. *See* Murphy & Nagel, *supra* note 4, at 38 (addressing equal sacrifice).

46. Among scholars there is a dispute as to whether there is an analytical need for both vertical and horizontal equity, or whether one is a logical implication of the other; namely, that these two concepts are two sides of the same coin, as this article implies. Richard A. Mussgrave, Kevin Hasset, and Alan Auerbach, the major proponents for both terms, do not consider them to be analytically equivalent. *See generally* Alan J. Auerbach & Kevin A. Hasset, *Tax Policy and Horizontal Equity*, *in* INEQUALITY AND TAX POL. 44 (R.G. Hubbard & Kevin A. Hasset eds., 2001); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NATL. TAX J. 113 (1990). In contrast, Louis Kaplow, Liam Murphy, and Thomas Nagel do view the two terms as analytically equivalent and thus as superfluous. As Liam Murphy and Thomas Nagel state in their book:

> Horizontal equity is just a logical implication of any traditional answer to the question of vertical equity. If tax justice is fully captured by a criterion that directs government to tax each level of income at a certain rate, it simply follows that people with the same pretax incomes, should be taxed at the same rate.MURPHY & NAGEL, *supra* note 4, at 37.

See also Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191 (1992) (criticizing the concept of horizontal equity); Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NATL. TAX J. 139 (1989) (suggesting rationales offered for horizontal equity align with conventional understandings of risk and vertical equity).

47. Weisbach, *supra* note 43, at 1647.

According to Weisbach, in order to provide an answer for whether a certain transaction should be taxed, one has to address the fundamental social values that the tax system should promote and it is not sufficient to merely refer to these definitions or principles.

Following Weisbach, this article analyzes the fundamental social values that the tax system should promote.[48] Simply put, the tax system should aim at reducing the social status gap between individuals. This idea stems from an alternate understanding of redistribution known as relational egalitarianism,[49] which stands in contrast to the conventional redistributive view known as luck egalitarianism. While luck egalitarianism focuses on the equal distribution of resources or welfare in society by compensating misfortune,[50] relational egalitarianism seeks something more subtle—equality as manifested in social relations, and not necessarily in the redistribution of welfare or resources.[51]

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48. Tsilly Dagan has made a similar argument to Weisbach's in the context of the classification of business and personal expenses. Dagan pointed out the futility of working with the distinction between business and personal expenses. Dagan claimed that expenses are not inherently 'business expenses' or 'personal expenses'—the classification of the expense is value-driven, and thus in order to determine whether an expense is deductible one should examine directly the expense through the lens of the values we think the tax system should promote. *See* Tsilly Dagan, *Ordinary People Necessary Choices: A Comparative Study of Childcare Expenses*, 11 THEORETICAL INQ. L. 589, 616 (2010) (analyzing business and personal deduction distinctions for child care). For a similar argument in the context of commuting expenses, see Tsilly Dagan, *Commuting*, 26 VA. TAX REV. 185 (2006-2007), which uses commuting expenses to illustrate the difficulty of distinguishing business and personal expenses).

49. The term was coined by Stuart White. Stuart White, *Welfare Philosophy and the Third the Way*, *in* WELFARE STATE CHANGE: TOWARDS A THIRD WAY 25, 37 (Jane Lewis & Rebecca Surender eds., 2004).

50. As Anderson defines luck egalitarianism, "[l]uck egalitarianism relies on two moral premises: that people should be compensated for undeserved misfortunes and that the compensation should come only from that part of others' good fortune that is undeserved." Elizabeth Anderson, *What is the Point of Equality*, 109 ETHICS 287, 290 (1999).

51. Although the discussion of Anderson, Wolff, and the luck egalitarians whom they criticize is centered on the concept of equality, it has a significant application to welfare policy at large. As scholars have noted, most of the arguments among luck egalitarians concern the proper 'space' or 'currency' for the application of egalitarianism. *See* Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 J. PHIL. & PUB. AFF. 283, 333 (1981) (supporting the view, held also by scholars such as John Romer and Eric Rakowsky, that egaliterian justice should focus on the distribution of resources; *See also* G.A. Cohen, *On the Currency of Egalitarian Justice*, 99 ETHICS 906 (1989) (supporting the view that egalitarian justice should focus on the distribution of welfare). Thus, these arguments are relevant to almost any welfare policy, even one which isn't strictly egalitarian, yet must still define the 'space' or 'currency' for its application. As a consequence, the discussion of relational egalitarians such as Wolff, Anderson, and Schefler and the luck egalitarians is a discussion regarding the normative underpinnings of almost any welfare policy: the social phenomena on which it should primarily focus.

The central critique of luck egalitarianism and the redistributive views that emanate from it is that it reinforces the hierarchical structure of society. As Anderson has pointed out:

> [E]quality of fortune makes the basis for citizens' claims on one another the fact that some are inferior to others in the worth of their lives, talents, and personal qualities. Thus, its principles express contemptuous pity for those the state stamps as sadly inferior and uphold envy as a basis for distributing goods from the lucky to the unfortunate. Such principles stigmatize the unfortunate and disrespect the fortunate by failing to show how envy can obligate them.[52]

Accepting that the primary social goal of egalitarianism should be breaking the hierarchical structure of society, Anderson calls for, "focusing on equality as a social relationship, rather than simply as a pattern of distribution, at least enables us to see that we have a choice between redistributing material resources and changing other aspects of society to meet the demands of equality."[53]

While Anderson suggests "changing other aspects of society" in order to promote relational egalitarianism, she does not define these other "aspects of society" and the policies that should be enacted in order to affect such changes. This article aims to enter into this void. Sublimating society's hierarchical structure could be achieved by eradicating symbols of social status. Total eradication by regulation that does not permit the existence of certain social statuses obviously raises considerable liberty and autonomy problems.[54] Taxing such symbols of social status, however, strikes a good balance between the goal of redistributing social status and liberty and autonomy considerations. By placing a higher price on symbols of social status such taxation restricts and limits their existence in society, while still enabling individuals to make use of such symbols if they attribute great importance and value to them despite their increased price.

52. Anderson, *supra* note 50, at 289.

53. *Id*. at 336. For a discussion of Anderson's conception of relational equality and its policy implications, see Adi Libson, *Transforming Social Welfare Policy: The Sages' Reconstruction of the Institution of the Second Tithe as a Model for Social Welfare Policy*, 29 J. L. & RELIG. 259, 274-75 (2014).

54. This is rooted in the general tension between liberty and equality. See Isiah Berlin, *Two Concepts of Liberty*, *in* FOUR ESSAYS ON LIBERTY 118, 125-26 (1969), for an examination of conceptions of freedom.

B. *Instances of Mixed Expenditures as Paradigmatic Cases of Social Status*

After presenting the argument why social status should be incorporated into the tax base, I turn to the second step required for the claim of this article—that instances of mixed expenditures constitute a significant source of social status. The Weberian analysis of social status and its sources substantiates this claim. Max Weber defines social status as "an effective claim to social esteem in terms of positive or negative privileges."[55] Weber enumerates three central sources for such status, one of which is "occupational prestige."[56] He goes on to note four means by which status is expressed, one of which is "appropriation of privileged modes of acquisition."[57]

Mixed business and personal expenses fully correspond to the Weberian locus of status and its expression. These expenditures arise in the relevant context: they can, and often are, interpreted as a claim for social esteem stemming from occupational prestige. These expenditures also constitute one of the venues for the expression of status that Weber mentioned: a privileged mode of acquisition. In the context of mixed expenses, one is able to acquire personal goods while depicting them as business expenses that are not incurred for one's own sake, but for the sake of the business. Only a limited number of individuals, usually the economic elite, are in positions in which the interest of the business could be aligned with their own personal interests.[58]

Weber emphasizes that although social status often overlaps with economic status—what he names in his analysis the commercial class or social class—it is a distinctive social phenomenon. The significance of the Weberian analysis stems from this distinction: conceptualizing and pointing out to social power that does not solely stem from economic factors:

> Status *may* rest on class position of a distinct or an ambiguous kind. However, it is not solely determined by it: Money and entrepreneurial position are not in themselves status qualifications, although they may lead to them; and the lack of property is not in itself a status disqualification, although this

55. MAX WEBER, 1 ECONOMY AND SOCIETY 305 (Guenther Roth & Claus Wittich eds., 1978)
56. *Id*. at 306.
57. *Id*.
58. This argument regarding taxing privileged modes of acquisition applies to the related case of fringe benefits provided for employees, that will be discussed *infra* Part IV, Section A.

> may be reason for it. Conversely, status may influence, if not completely determine, a class position without being identical with it. The class position of an officer, a civil servant or a student may vary greatly according to their wealth and yet not lead to a different status since upbringing and education create a common style of life.[59]

The Weberian framework therefore illuminates the justification for taxing mixed expenditures, even if the individual does not derive any utility from them. Even though these expenses cannot be defined as income in the narrow sense, they still enhance that individual's status relative to others. Although the indicators of status are not purely economic phenomena and thus cannot necessarily be classified as consumption, they are still a significant phenomenon from which the individual gains status and social power. This social dimension is relevant to tax policy if we follow a relational egalitarian approach.

It has already been noted that the social status argument is independent not only of first order benefit—whether the individual benefits directly from the business expense—but also from the second order benefit: whether the individual benefits indirectly from the social status the business expense generates. Taxing the international travel expenses in a case where the individual does not benefit from them due to his preference to stay with his family is not based on the assumption that the individual benefits indirectly from the social status the expense generates. Even if the individual does not benefit from the social status generated, the argument still applies and we should still tax these business expenses. An individual might not be interested in prestige, and it may even cause him disutility. Yet if social status is admitted into the tax base, it can justify taxing prestige even if the individual does not benefit in the economic sense from the prestige that accompanies mixed expenditures. There are two arguments why it is justified to tax social status independent of the question of whether the individual actually benefits from her social status. The first is the positional nature of social status and the second is that that objective power, and not subjective benefit, might be the primary focus of the tax base.

Firstly, the nature of social status, that is in essence a relative or positional good, justifies taxing social status even when it does not enhance the individual's utility level. The enhancement of one's social status will always be at the expense of the social status of others, independent of whether one actually desired to enhance one's social status. As Professor Balkin writes:

59. *Id.*

> Status Competition is intense because status is a relative good. One has more of it because others have correspondingly less. Status Competition tends to be zero-sum, at least in the short run. More generally, it is non-paretian: one cannot increase the status of one group without decreasing the status of another. High prestige is prestige over others and in distinction to others. Increased respect for lower status groups because their identity has been constructed around their greater prestige and the greater propriety of their ways of living.[60]

The fact that status is a limited good reinforces the rationale of taxing those who obtain it, independent of whether they actually derive utility from possessing it. It is possible to frame the concern for social status in economic terms. The social status of one individual causes envy among her peers and reduces their welfare. In other words, social status is a negative externality, and thus should be internalized by the individual generating it.[61] Just like the internalization of any other negative externality, its internalization does not depend on whether the individual generating the negative externality has benefited from it.[62]

The second justification is that gaps in social status are a social bad *per-se*, independent of their welfare effects on individuals. While the first justification could be presented in a standard economic-welfarist form, the second is a non-welfarist justification. It is not based on the assumption that an individual's high social status necessarily diminishes the welfare level of other individuals in society. One may argue that it could still be presented in an economic form—that in some sense social hierarchy is a bad that should be internalized by the agent—but that applies to almost any moral theory that could be described in an economic form.[63] Almost any

60. J.M. Balkin, *The Constitution of Status*, 106 YALE L.J. 2313, 2328 (1996-1997).

61. Robert Frank is the leading economist on the incorporation of social status into economic models that are relevant to various legal contexts. *See generally* ROBERT H. FRANK, CHOOSING THE RIGHT POND: HUMAN BEHAVIOR AND THE QUEST FOR STATUS (1985); Robert H. Frank, *Should Public Policy Respond to Positional Externalities*, 92 J. PUB. ECON. 1777 (2008); Robert H. Frank, *Positional Externalities Cause Large and Preventable Welfare Losses*, 95 AM. ECON. REV. 137 (2005); Robert H. Frank, *Cost-Benefit Analysis and Relative Position*, 68 U. CHI. L. REV. 323 (2001).

62. *See* A.C PIGOU, THE ECONOMICS OF WELFARE, 188 (2d ed. 1924) (discussing mechanisms for internalization of externalities).

63. Regarding the possibility that a certain social outcome is bad independent of the welfare level of individuals in society, see Dereck Parfit, *Equality or Priority*, 10 RATIO 202, 205 (1997), noting equality could be valued based on deontological grounds, and not only based on consequential grounds. *See also* Larry Temkin, *Weighing Goods: Some Questions and Comments*, 23 PHIL. & PUB. AFFAIRS 350 (1994) (demonstrating how an outcome in which everyone's welfare is relatively low might have lower social value than the outcome in which everyone's welfare level is relatively high, when taking into account

moral theory could be described as aiming to minimize a moral bad or trade-off welfare for minimizing the moral bad up to a certain point.[64] The emphasis is that the argument for taxing social status is not *necessarily* a welfarist argument. Even if the second justification could be framed as an *economic* argument, it certainly cannot be framed as a *welfarist* argument. In other words, while it could be described as maximizing the social good in broad terms, it is not concerned necessarily with the welfare of individuals in society.

The best account for explaining why prestige should be measured objectively and not subjectively goes back to the relational egalitarian view.[65] The relational egalitarian view stands in contrast to standard theories of distributive justice that are primarily concerned with the distribution of welfare or resources. Welfare is mostly perceived as a subjective element.[66] Thus distributive theories that center on distribution of welfare are oriented toward subjective valuation of goods. This article is based on a version of the relational egalitarian distributive theory that is not primarily concerned with distribution of welfare, but in the distribution of status.[67] Such theory is interested in the phenomena of status *per-se*, and thus the question of the subject's valuation of her status is irrelevant. This view provides the grounds for which we should be concerned with prestige on the objective level and not on the subjective level of the individual's valuation of prestige.[68]

considerations such as desert).

64. *See* Chris W. Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797, 805-06 (2000) (emphasizing that economic models, such as models of maximization of social goods, could incorporate non-welfarist goods such as equity).

65. *See supra* Introduction (summarizing relational egalitarian view).

66. JOHN BROOM, ETHICS OUT OF ECONOMICS 4 (1999). *But cf.* DERECK PAFRIT, REASONS AND PERSONS 499 (1984) (describing a theory of objective welfare).

67. *See supra* notes 49-53 and accompanying text (discussing relational egalitarianism and luck egalitarianism).

68. There may be other justifications besides the relational egalitarian one that provide a non-welfarist justification for ignoring the subjective valuation of status and prestige. It is possible to explain such view through the prism of tax fairness without alluding directly to any redistributive theory. Two of the central principles defining tax fairness could justify relying on objective standards: the benefit principle and the equal sacrifice principle. According to the benefit principle of tax fairness an individual's tax liability should be proportional to one's benefit from public goods. *See supra* text accompanying note 4 (describing the benefit principle). Applying the benefit principle to the case of social status and prestige requires adopting a fairly wide understanding of public goods; the benefit principle applies only to benefit derived from public goods. A wide definition of public goods will include any good derived from the public or any good for which there isn't a feasible method for charging consumers. *See* Stephen Enke, *More on the Misuse of Mathematics in Economics: A Rejoinder*, 37 REV. ECON. & STATISTICS, 131 (1955) (warning

This section of the article has presented the central argument for the non-deductibility of mixed expenditures. The argument was comprised of two parts: the first substantiated the idea that social status should be incorporated into the tax base and taxed, grounded on the relational egalitarian view; the second exposed how instances of mixed expenditures fit neatly into the Weberian definition of social status, and thus constitute a classic case for applying the taxation of social status. While the latter part of the argument was especially tailored to the case of mixed expenditures, the former part of the argument is much wider in its scope, and may apply to a large array of cases. The next section will examine the applicability of the social status tax to other instances in which the existence of social status may be relevant to tax treatment.

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against overly formal economic definitions); Julius Margolis, *A Comment on the Pure Theory of Public Expenditure*, 37 REV. ECON. & STATISTICS 247 (1955) (arguing for a broad definition of public goods). *But see* Paul Samuelson, *The Pure Theory of Public Expenditures*, 36 REV. ECON. & STATISTICS 387-89 (1954) (presenting a narrower and conventional definition that limits public goods only to non-rivalry and non-excludable goods). The motivation behind the benefit principle is to mimic the purchase of private goods in the market with taxes functioning as a kind of shadow price for goods and services provided. Fried, *supra* note 4, at 162, 165. Just like in the private sector the price determination of a good thus does not depend on the subjective valuation of the individual purchasing the good, instead, the price in conventional models is universal. *Id.* Fried argues against this view, claiming that there is no reason to mimic the feature of the market which determines one price for all individuals, independent of their subjective valuation of the good. This feature of the competitive market has no inherent justification, besides its technical ability to 'clear the market'—make sure that there is no additional unit that its marginal cost is lower that the value an individual attributes it. If the system would try to price discriminate between individuals with different valuations of the good, it might cause an inefficient allocation by charging an individual a price higher than his actual valuation of the good, and thus causing that that individual to not possess the good, although his valuation of the good is higher than the goods marginal cost. The pricing of a public good will not affect the quantity of the good produced, and thus this technical advantage is not relevant to the pricing of public goods. *Id.* at 166. The general maxim of the equal sacrifice principle is simple: a fair tax burden is one in which all individuals sacrifice equally, see MURPHY & NAGEL, *supra* note 4 (summarizing the equal sacrifice principle). One of the central differences between the different versions is whether the sacrifice should be measured in subjective units such as welfare, or in objective unit of resources such as money. Regarding the former metric, see Ronald Dworkin, *What is Equality? Part 1: Equality of Welfare*, 10 J. PHIL. & PUB. AFFAIRS 185, 245 (1981). Regarding the latter view, that Dworkin himself accepts, see Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 J. PHIL. & PUB. AFFAIRS 283, 333 (1981). According to the objective units theory, it makes more sense to measure prestige in objective units, and not in subjective units of the benefit the individuals drives from prestige. Just like the measurement of sacrifice in terms of money could be done without differentiating between the different value individuals attribute to money, so can the prestige element be measured without differentiating between the different value individuals attribute to prestige.

IV. ADDITIONAL APPLICATIONS FOR TAXING STATUS

So far, this article has focused on the application of taxing social status as embodied in mixed expenditures, but the argument for taxing social status may have other implications on the tax system. This section focuses on four additional applications: the treatment of fringe benefits, consumption taxes, the deductibility of extremely high salary expenses, and the tax treatment of charitable contributions.

A. *The Tax Treatment of Fringe Benefits*

The term "fringe benefits" refers to in-kind benefits transferred to an employee by the employer. In some cases these benefits may be similar to the benefit derived from mixed expenditures, such as trips to Europe and pick-ups by limousines, and in others, they may be a distinctive set of benefits that are relevant mostly to employees, such as uniforms and qualified discounts for employees. The main difference between benefits derived from mixed expenditures and fringe benefits is that while the former are at the discretion of the taxpayer, the latter are mostly imposed on him by his employer. Fringe benefits may serve as an additional form of compensation and as such should be taxed, or may also be essential to the performance of the employee's job, creating a strong argument for exempting them from taxable income.[69] The most direct implication of the argument above for the tax treatment of fringe benefits concerns what is labeled in the I.R.C. as "working condition benefits":

> For the purpose of this section, the term "working condition fringe" means any property or service provided to an employee of the employer to the extent that if the employee paid for such property or services, such payment would be allowable as a deduction under section 162 or 167.[70]

This section of the I.R.C. refers directly to section 162, the section that discusses the treatment of mixed personal and business expenses. Thus any argument that would apply to section 162—including this article's argument that mixed expenditures should be taxes as personal expenditures—should also apply to expenditures made by an employer on behalf on an employee. If an entrepreneur should receive no deduction for a business flight, then neither should an employee be able to exclude it from his income when his employer pays for the flight.

69. Graetz & Schenk, *supra* note 19, at 96.

70. 26 U.S.C. § 132(d) (2012). Working condition benefit is excluded from income under § 132(a)(3).

But this article's argument for eliminating mixed expenditures deductions rests on the social status conferred, and so should not necessarily apply to the same benefit incurred by an employee. An identical benefit does not necessarily generate the same social status in the context of an employee as for an entrepreneur or self-employed individual. The social status emerges from the individual's control over the decision to incur the expense, an element that is generally absent for an employee in the case of fringe benefits. That said, in many cases there is no difference between the social status the benefit generates for a self-employed individual and an employee. There seems to be no difference between the social status generated by a business trip of top executives and that of a self-employed individual. This argument may justify differentiating the tax treatment of fringe benefits according to the employee's hierarchical level. Lower status employees, for example the state troopers who received free lunches in the case of *Commissioner v. Kowalski*,[71] should receive a tax deduction. Higher status employees, such as the manager of an exclusive Hawaiian resort who received free meals and lodging perks in the case of *Benaglia v. Commissioner*,[72] should not receive a deduction. Deciding when fringe benefits should be fully deductible may turn out to be a factual determination best left to a case-by-case determination, which will impose considerable complexity on the implementation of this general argument.

In order to demonstrate how some fringe benefits are inherently distinct from mixed expenditures, the discussion below will focus on two types of fringe benefits: qualified employee discounts and no-additional-cost services. Qualified employee discounts are an example of a type of fringe benefit that almost categorically should not be affected by the argument for taxing status.[73] Under the qualified employee discount exclusion, an employee can exclude from income a discount of up to 20% from the price at which the employer offers the service to customers,[74] or in case of merchandise, up to the employer's gross profit percentage.[75] These fringe benefits typically apply to salespeople and do not confer high social status on the individual benefiting from them; therefore these benefits should not be taxed.

A borderline exclusion for fringe benefits from the perspective of taxation of status is the no-additional-cost service exclusion.[76] According to this exclusion, as long as the service that the employer, or a business

71. Commissioner v. Kowalski, 434 U.S. 77 (1977).
72. Benaglia v. C.I.R., 36 B.T.A 838 (1937).
73. 26 U.S.C. § 132(a)(2)(2012).
74. 26 U.S.C. § 132(c)(1)(b) (2012).
75. 26 U.S.C. § 132(c)(2) (2012).
76. 26 U.S.C. § 132(a)(1) (2012).

with a reciprocal agreement with the employer, does not require them to incur any extra costs, the service could be excluded from income.[77] For example, an employer might enable the employee to make use of the employer's office's parking space even for non-work related purposes. On the one hand, in contrast to the qualified employee discount exclusion, it does not seem to be necessarily correlated with low or medium level of social status. On the other hand, it is hard to determine clearly that it is unrelated to high social status. While there is an incentive to provide such benefits to all employees—an opportunity for the employer to provide compensation which is both cost-free from his side and tax-free from the side of the employer[78]—such additional cost services may be especially tailored for higher-end employees and thus signal high social status.[79] Because there is no clear answer in this case without additional empirical data, it does not seem that taking into account the taxation of status should affect the tax treatment of such cases.

The justification for taxing status in all types of fringe benefits is not decisive, even in the types of fringe benefits to which it seems that taxing status argument should apply. There may be other considerations—economic and otherwise—that might lead to a different conclusion. The primary purpose of this article is to expose an additional reason for levying a tax that has not been addressed. In order to reach a conclusion regarding the desired policy, one would have to balance the reason for taxing based on the social status argument with all other considerations that may apply within a specific context.

B. *The Taxation of Top Executive Compensation*

Since the beginning of the millennium, legal scholarship has grappled extensively with the apparently excessive compensation received by top U.S. corporate executives, compensation that seems to result from non-arms-length dealing and that all too often seems to bear no relation to performance.[80] This trend intensified after the 2008 market crash.[81]

77. 26 U.S.C. § 132(b) (2012).

78. *See* GRAETZ & SCHENK, *supra* note 19, at 103 (discussing the general economic incentives to provide fringe benefits).

79. It should be noted that there is a nondiscrimination requirement in order for such benefits to be excluded. *See* 26 U.S.C. § 132(e)(2) (2012) (requiring the benefit "not discriminate in favor of highly compensated employees"). Yet even if the benefit has to be provided without discriminating between the employees in the same firm, it may yet signify social status of workers in certain industries, e.g., if the parking benefit is mostly provided to all employees in law firms but not to any blue-collar employees in factories.

80. *See* LUCIAN BEBCHUK & JESSIE FRIED, PAYMENT WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004) (suggesting managers use

Looking to ameliorate this problem, the tax code eliminates the deductibility of compensation of over one million dollars that is not incentive-based.[82] In addition, golden parachute payments receive only limited deductibility,[83] and an additional 20% tax is imposed on certain compensation packages.[84] Due to the limited applicability of the current tax scheme, many scholars have argued for a greater role for the tax code in curbing excessive compensation for top executives.[85]

The argument presented in this article reinforces the case for imposing a special tax on top executives, but on different grounds than the aim to curb non-arms-length dealing and non-performance based compensation. As Professor Robert Frank has noted, motivation for receiving very high compensation packages is not necessarily rooted in an executive's desire for consumption power, but instead in many cases by the desire for higher status. Over a certain level, compensation does not affect one's consumption patterns, and the main motivation to attain it is the desire for higher social status.[86] The fact that many executives' compensation packages are common knowledge exacerbates this dynamic. Frank notes that social status is a positional good and thus unlike other goods for which there is not necessarily any firm cap on their production, the attainment of social status is a limited good and is always at the expense of others; as such, it constitutes a negative externality. The fact that a high degree of social status generates a negative externality, unlike other forms of consumption, justifies imposing a higher tax rate, similar to other Pigouvian Taxes.[87]

This additional justification for increasing the tax burden on highly compensated executives, whether by increasing their tax rate or by eliminating the corporation's ability to deduct expenses tied to the compensation given to them that are economically equivalent, has two

flaws in corporate governance to distort their own pay).

81. *See* Katalin T. Haynes, Joana Tochman Campbell & Michael A. Hitt, *When More is Not Enough: Executive Greed and its Influence on Shareholder Wealth*, 20 J. MGMT. 1 (2014) (finding a negative relationship between CEO greed and shareholder return); Adair Morse, Vikram Nanda & Amit Seru, *Are Incentive Contracts Rigged by Powerful CEOs?*, 66 J. FIN. 1779 (2011) (suggesting CEOs rig the incentive portion of their pay).

82. 26 U.S.C. § 162(m) (2012).

83. 26 U.S.C. § 280G (2012).

84. 26 U.S.C. § 4999 (2012).

85. *See* David I. Walker, *A Tax Response to the Executive Pay Problem*, 93 B.U. L. REV. 325, 326-29 (2013) (suggesting imposing an additional 10% surtax on executives and coupling it with a tax relief for investors); Tristen Cohen, *Curbing Executive Compensation: A New Tax Scheme*, 5 LEGISLATION AND POLICY BRIEF 199, 200-01 (2013) (suggesting a 90% tax rate for earnings that exceed 100 times the earnings of the average employee).

86. FRANK, CHOOSING THE RIGHT POND, *supra* note 61, at 45-55.

87. *Id.* at 122-23.

important implications. While the main concern of the current tax scheme is the burden imposed on shareholders by the excessive pay given to top executives, under the rationale suggested in this article the main concern is the excessive compensation given to these top executives *per se*. Under the former rationale, the question of whether such tax scheme is desirable depends on the incidence of the tax. Some scholars argue that the tax incidence of the current scheme lands on share-holders in any event: boards "gross-up" these additional taxes so that executives will end up with the same amount of post-tax compensation despite higher taxes, and thus shareholders end up baring the additional tax burden.[88] If this is the case, the stated rationale cannot support the tax scheme: a tax designed to protect shareholders ends up harming them. Furthermore, this rationale should apply only to public companies for which there is a need to defend shareholders from this non-arms-length dealing.[89] Bebchuk and Fried note that the excessive compensation stems from the managerial power due to dispersed ownership.[90] Dispersed ownership is typically a feature of publicly traded companies and not private companies.[91]

In contrast, according to this article's proposition, the elimination of the deduction or the higher tax rate on excessive compensation should be implemented in the two cases above. In this analysis, even if the tax burden rests on shareholders, it should not make a difference. The practice of providing compensation that is mainly directed at enhancing one's social status generates a negative externality on society, which should be internalized.[92] Who should internalize the externality—shareholders or

88. Joy Sabino Mullane, *Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code*, 13 LEWIS & CLARK L. REV. 485 (2009); Ryan Miske, *Can't Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code*, 88 MINN. L. REV. 1673, 1679 (2003-2004); Bruce A. Wolk, *The Golden Parachute Provisions: Time for Repeal?*, 21 VA. TAX REV. 125, 128-29 (2001). Besides the issue of tax incidence, some scholars claim that this tax scheme does not make any difference on compensation package decisions for top executives. *See* Nancy Rose & Catherine Wolfram, *Regulating Executive Pay: Using the Tax Code to Influence Chief Executive Officer Compensation*, 20 J. LABOR ECON. 138, 142-43, 166-67 (2002) (finding little correlation between performance sensitivity of CEO pay and tax policy). This is a concern if the purpose of the tax is to reduce corporate spending on compensation packages for top executives, but not if the concern is really the proper tax attached to status.

89. Miske, *supra* note 88, at 1674.

90. Although there might be an additional need to protect the minority shareholders in a privately held company, Bebchuk and Fried argue that the main source for excessive compensation is managerial power in companies in which ownership is dispersed, see BEBCHUK & FRIED, *supra* note 80, at 17, 42.

91. *Id*.

92. While it could be argued that any compensation package enhances the employee's social status, a distinction should be made between compensation that is directed toward increasing the individual's ability to consume conventional goods and the enhancement of

executives—is of lesser concern; the main point is that it should be internalized. In addition, because this justification for internalization is not based on the goal of protecting shareholders in contexts in which ownership is dispersed, but on imposing a price on high compensation that is mainly targeted toward generating high social status *per se*, the tax should be implemented also in the context of private companies and not only in the context of public companies.

C. *Consumption Taxes*

Many countries that have some form of consumption tax impose a higher tax rate on luxury goods such as yachts, diamonds, private jets, and others goods whose consumption does not proceed linearly with income. From the beginning of the millennium, there has been a renaissance of the luxury tax around the world. In 2000, Australia imposed a special tax on luxurious automobiles[93] as did Russia at the same time.[94] China currently has a tax on a wide range of luxury goods ranging from a rate of 4.4% to 60%.[95] In the U.S., President George H.W. Bush passed through Congress a special tax on luxurious commodities such as yachts and private planes in 1990. Purchases of certain listed commodities above a certain price threshold were taxed an additional 10%.[96] This tax was repealed by Congress, however, by 2002.[97]

Generally, the primary motivation behind luxury consumption taxes is redistribution: they attempt to offset the regressive effect of consumption taxes that apply equally to individuals of different income levels. Increasing the tax rate on goods whose consumption correlates strongly

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the individual's social status is only a side effect and compensation, mostly to the top earners, which is directly directed toward enhancing the individual's social status. While in the former case, the individual gains an additional benefit besides the benefit he derives from the negative externality of appropriating social status, in the latter case there is no such benefit and it is merely a zero sum game.

93. *See* Praful Pearce, *The Luxury Car Tax: Past its Use-by Date*, 47 TAX'N IN AUSTL. 703 (2013) (criticizing Australia's luxury car tax).

94. *See* Dale Chua, *Tax Reform in Russia*, in RUSSIA REBOUNDS (2003) 77, 82 (noting Russia's luxury car tax).

95. Barton Beebe, *Shanzhai, Sumptuary Law and Intellectual Property Law in Contemporary China*, 47 U. C. DAVIS L. REV. 849, 856 (2014).

96. 26 U.S.C. § 4002 (1993). Regarding the American luxury tax and its consequences, see Lillian R. BeVier, *Judicial Restraint: An Argument from Institutional Design*, 17 HARV. J. L. & PUB. POL'Y 7, 11 (1994) (suggesting the luxury tax raised little revenue).

97. Thomas D. Griffith, *Progressive Taxation and Happiness*, 45 B. C. L. REV. 1363, 1396 (2003-2004)

with high levels of income creates a more progressive consumption tax.[98]

The argument for taxing social status reinforces the redistributive argument for taxing exclusive goods. Many of these goods signify the higher social status of their owner, which justifies an additional tax beyond a conventional consumption tax. The application of the taxation of social status justification to these cases may be significant, because it does not necessarily overlap with the redistributive argument. In cases where the redistributive and social status arguments do not overlap, a higher tax rate on such products would eliminate or decrease significantly the consumption of the goods. In such cases, the redistributive argument would not apply. Applying the additional tax would be self-defeating: not only would it not increase the ability to redistribute, it would even decrease it. The state would lose the tax it collected from the consumption of these exclusive products up to the point where additional taxation would destroy the demand for these products, significantly decreasing revenue that could be redistributed.

In contrast, the argument for taxing status still applies even if it reduces the ability to promote redistribution of resources and indeed still justifies a higher tax rate. The elimination of consumption of a good that intensifies social status gaps and competition in society may make society better off in real terms. This aspect in which society is better-off may off-set the costs of decreasing the aggregated wealth, and as a consequence, the government's ability to redistribute income.

D. *Tax Treatment of Charitable Contributions*

An additional application of the argument for taxing status is the tax treatment of charitable contributions. There has been a longstanding dispute regarding the tax benefits provided in many countries to those who donate charitable contributions, whether in the form of a deduction, as in the U.S.,[99] or in the form of a credit or partial credit in other countries such as Canada, France and New Zealand.[100] Most of these arguments have centered on whether such contributions should be defined as part of donors' income: on the one hand a donor does not consume the resources donated in the everyday sense of the word, but on the other hand this donor had control over the resources and he exercised his control in spending them.[101]

98. *Id*. at 1395.

99. 26 U.S.C § 170(b) (2012).

100. *See generally* INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION, Global Tax Surveys, https://www.ibfd.org/IBFD-Products/Global-Tax-Surveys.

101. *See* BUCKLES, *supra* note 41 (arguing control should be an aspect of income definition); KOPPELMAN, *supra* note 40 (offering a definition of income); KELMAN, *supra*

As noted earlier,[102] the question of whether a transaction should count as income should not be a constitutive element for answering whether a certain transaction should be taxed. In order to decide on whether the transaction should be taxed, one has to analyze the transaction in light of the overarching goals of the tax system. The taxation of status argument justifies eliminating any tax benefit from charitable contributions, even if it does not constitute a form of consumption or income. Charitable contributions also signify the high social status of the donor, justifying the taxation of the contribution independent of whether the donor consumed or personally benefited from the donation. The donation places the donor in the position of a public benefactor, a position that radiates high social status.

Even if one is not willing to adopt the broad implications of taxing status and eliminating the charitable deduction altogether, there may be a more limited application. Namely, it may reinforce the case for eliminating the deduction from borderline cases, such as quasi quid pro quo transactions. Quasi quid pro quo transactions are charitable contributions in which there is a "price menu" or "fee schedule" depending on the level of recognition in which the donor is interested.[103] Current practice of the I.R.S. does not differentiate between a regular charitable contribution and a quasi quid pro quo charitable contribution and grants a deduction to such contributions.[104] An example of a quasi quid pro quo charitable contribution is a contribution to a university that 'prices' various forms of commemorations: a contribution over X amount of dollars earns the donor a plaque with him name on a room, over Y amount of dollars earns professorship chair endowed with his name, and over Z amount of dollars earns a building with his name; the donor actually contributes over and above one of these sums in order to purchase one of these forms of commemoration or acknowledgment.

The treatment of such contributions is surprising in light of the I.R.S.'s interpretation of charitable contributions as a transfer that is made by the donor to the donee "without adequate consideration" in return.[105] It seems quite plausible that such definition would exclude the quasi quid pro quo transaction in which the "fee schedule" and "price menu" reflect that

note 42 (suggesting satisfaction derived from a resource is part of income definition).

102. *See* discussion *supra* Part I (summarizing current approaches to taxation).

103. J.D. Colombo, *Marketing of Philanthropy and the Charitable Contributions Deduction; Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 664 (2001).

104. *Id.* at 666.

105. Rev. Rul. 67-246, 1967-2 C.B. 104.

the donor it receiving "adequate consideration" in return for his donation.[106] The donation is essentially a transaction in which the donor is purchasing a good: recognition, commemoration, or fame.[107] While some views regarding the rationale for the charitable deduction justify the I.R.S.'s decision to permit applying the charitable deduction to such transactions,[108] the taxation of status rationale will reinforce the case for taxing the donor in a quasi quid pro quo transaction. After all, the quasi quid pro quo transaction signifies clearly that an increase of one's social status is involved and, as such, should be taxed whether in the form of a direct tax or an excluded deduction. The taxation of status provides an additional reason to exclude the charitable deduction from quasi quid pro quo donations.

V. CRITIQUES

Even assuming one has accepted the arguments presented in this

106. COLOMBO, *supra* note 103, at 665-67. This is especially true in light of the *Hernandez* decision. *Hernandez* v. *Commissioner*, 490 U.S. 680 (1989). In *Hernandez* the Supreme Court accepted the I.R.S.'s position that a contribution to the Church of Scientology could not qualify for the charitable deduction. The Church of Scientology's fee schedule provided the grounds for the decision: it required payment per spiritual auditing and resembled a quid pro quo transaction. In its ruling, the court has expanded the "adequate consideration" exclusion for the charitable deduction. Such an expanded interpretation is more likely to include conventional quasi quid pro quo transactions in which there is a fee schedule or price menu.

107. COLOMBO, *id*.

108. Colombo argues that scholars that adopt the community benefit rationale for the charitable deduction should justify applying the deduction to quasi quid pro quo transactions as well. According to the community benefit rationale the grounds for the deduction is supplying more resources to NGOs; the setting in which the resources are supplied does not matter. The only reason for the restriction on quid pro quo transactions is so NGOs will not use the subsidy to compete unfairly with for-profit firms that produce the same good and do not receive a subsidy. As long as the good in question is not supplied by for-profit firms, such as in the case of the standard quasi quid pro quo transaction, there is no reason to restrict the charitable deduction from applying to such transactions. COLOMBO, *id*. at 692-96. *See also* John Colombo & Mark A. Hall, THE CHARITABLE TAX EXEMPTION (1995), 63-65 (stating that the community benefit theory suggests a subsidy that matches the size of an organization also matches the merit of the organization); Rob Atkinson, *Theories of the Special Tax Treatment of Nonprofit Organizations, in* FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS 15-1, ¶ 15.02[2] (Francis Hill & Barbara Kirsten eds., 1994)(claiming that while the Bittker and Rahdert income definition theory assumes charitable donation exemptions are due to the technical difficulty of including charities in the income tax, not an effort to subsidize these charitable activities, this is faulty assumption, and therefore there must be a substantive reason for the exemption). The position narrowing the "adequate consideration" limitation for benefiting from the charitable deduction was adopted by Justice O'Connor in her dissenting opinion in *Henandez*. *Hernandez*, *supra* note 106, at 704-13.

Article for taxing status *per se*, there are two possible objections to the form of its central application in the context of mixed business and personal expenditures. The first concerns the rate for taxing status, the second concerns the tax base on which status is taxed. In addition, there is a more general critical objection against taxing nonmarket, non-monetized goods such as status on grounds of commodification.[109]

A. *The Rate for Taxing Status*

Even if one accepts the argument for taxing status, it does not answer the question of why the proper tax rate for taxing status equals exactly the value of the deduction of the expense in the case of mixed expenditures. Without taxing status, one would have received a deduction for the business expense that includes a personal element, especially in cases in which the individual was not motivated by the personal element. According to the argument above, because being in the position where one's business expenses are aligned with personal elements is a feature of high social status, one should be taxed simply for being in that position. As a consequence, one is taxed by eliminating the deduction one would have been entitled to if no consideration of social status was involved. But why should the tax on status exactly equal the value of the deduction? After all, the tax on status could be lower than the value of the deduction, and thus would only reduce the deduction and not eliminate it completely. Alternatively, it would be possible to set the tax higher and require an additional payment from people in the position to record mixed expenditures and not limit the tax the deductibility of the expense. Furthermore, taking status and considerations of vertical equity[110] seriously might entail not only taxing jobs from which one derives high social status, but also crediting individuals who have jobs that confer upon them a low social status.[111]

109. The most basic critique of a novel suggestion, such as the one presented in this paper, is its practicability and applicability. In this article this problem is especially pressing due to the novelty and abstractness of the suggestion that raises many technical problems. For this reason this question was mostly addressed in the section examining the economic justification for the argument, which also addresses its economic feasibility, at Part II of this article. In addition, questions of practicability and feasibility have been streamlined in other sections of this article, especially the previous section discussing the additional possible applications of the argument and also in some of the critiques below. Consequently, this section of critiques does not include a separate subdivision discussing practical problems in the implementation of the taxation of status.

110. *See* Musgrave; Auerbach & Hasset, *supra* note 46 (discussing horizontal and vertical equity).

111. The idea of crediting individuals whose jobs confer upon them low social status is

Analytically, this point seems correct. There is no inherent reason why the tax on status in cases of mixed expenditures equals the value of the deduction of the expense. The argument in this Article could justify a tax on status that is lower or higher than the deduction of the expenses. There is nothing in the argument that implicates a tax on status should exactly equal the deduction. There are two reasons for the form of the suggested application. The first and more obvious one is technical: this is the most convenient form for applying the argument. Any other partial deduction or increase of the tax rate would complicate its application and require higher costs for its implementation. This is especially true in case of imposing a higher tax rate on instances of mixed expenditures: it will create a serious compliance problem—the taxpayer will have no reason to inform the tax authorities of such expenditures, which will only increase his tax liability. Consequently, it would be extremely costly for the tax authorities to obtain information regarding the occurrence of such expenditures. The second reason is the supplementary role of the argument for taxing status. It was noted earlier that it is very complicated to determine whether the individual actually derived utility from the expense and, if so, whether it was the underlying motivation for spending the resources.[112] The status argument 'piggy-backs' on the additional reasons for eliminating the deduction, and it can tilt the scales towards the elimination of the deduction but is not necessarily strong enough to prescribe the legal outcome independently.

This critique is also relevant to the other applications suggested for taxing status such as the executive compensation and charitable deduction examples. The argument for taxing status does not justify the total exclusion of the deduction in cases of excessive executive compensation or charitable contributions. Also, in the additional application suggested for the taxation of status, similar reasons shaping the two examples noted above shaped the application suggested.

more problematic, and not only due to technical limitations. One might claim that the low social value is already incorporated in the wages they receive. To this there are two main responses. The first is that people in low socioeconomic levels might not have the bargaining power to compensate themselves through their wage for the low socioeconomic status that accompanies the job. The second is that, similarly to the case of high social status, the objective social disvalue of low social status might exceed the subjective disvalue. The bigger problem of crediting low social value is that it may have the adverse effect of increasing the social gaps in social status. A credit for jobs with low social status might increase the supply of such jobs and people will have a greater incentive to take such jobs.

112. *See supra* Introduction (examining definition of income).

B. *Universality of the Tax Base: Taxing Status Only in a Specific Context.*

Even if one assumes that the argument for taxing status *per se* is a valid argument, one may argue that it might still be better to avoid applying it if it is not applied systematically. This article addresses a limited problem—tax treatment of mixed expenditures—and suggests a solution based on a fundamentally new approach toward the principle that underlies the tax system. Although four additional applications for a 'status tax' have been suggested, one may argue that it is better not to apply it at all than to apply it in a limited form in a few narrow cases. A limited application raises the problem of horizontal equity—not treating equally situated individuals alike. Taxing the status that an individual derives from mixed expenditures without taxing the status that undoubtedly arises in many other contexts violates horizontal equity.[113] If status should be part of the tax base, then it should be taxed consistently or not taxed at all.

There are two replies to this point. The first is that it is not necessarily correct to see all social status as one conglomerate. It may be possible to distinguish between different kinds of social status that emerge in different contexts. Taxing one form of social status, such as the social status and prestige that emerges from working in a job with mixed expenditures, does not necessarily entail taxing other forms of social status. Hence taxing social status in the context of mixed expenditures does not necessarily violate horizontal equity.

This reply is problematic. Even if we are willing to accept the fact that there may be many forms of social status, and that treating these forms of status differently does not necessarily violate horizontal equity, it may still be problematic to tax social status only in the context of mixed expenditures or even the additional applications suggested. The social status that the position of mixed expenditures generates is the phenomenon we saw earlier that Weber paid special attention to—prestige from one's vocation.[114] There may be many other instances of the Weberian form of social status that is not accompanied by mixed expenditures. One may claim that certain jobs, such as a sports star or movie actor, are accompanied by a similar social status that originates from the prestige of their vocation, even if they are not necessarily in the position in which there are many mixed expenditures. Thus taxing social status in case of mixed expenditures without a systematic approach toward similar forms of

113. *See* MUSGRAVE, A THEORY OF PUBLIC FINANCE, *supra* note 34, at 26 (outlining horizontal equity).

114. *See supra* Part III, Section B (discussing Weber's definition of social status).

social status is highly problematic, even it is hard to imagine how to apply this theory to other situations.

This brings us to the second reply. The problem is a genuine concern that cannot be refuted. It is true that the application of the 'status tax' is fairly limited, which raises concerns of horizontal equity and thus that it might be better not to apply it at all than to apply it partially. Furthermore, it is questionable whether it is actually possible to apply a status tax more broadly than in the few cases mentioned in the conclusion of this article. This is a question for which this article does not provide a full answer. Yet also in this context it is worth pointing out that in the case of mixed expenditures there are other grounds for taxing mixed expenditures. The individual may have derived utility from the personal consumption element. The status can be seen as a consideration that joins other considerations in tilting the scales—even if the individual did not necessarily derive any utility or was not necessarily motivated by the personal consumption element, the social status he derives tilts the scale to the side of eliminating his ability to deduct his expenses. As mentioned above, this critique and reply apply in general to the other applications suggested.

Also, in the other applications, in most cases, there are independent reasons, even if not as strong, for reaching the same bottom line as under the taxation of statues argument. In the case of fringe benefits, there are reasons to suppose that they should not be excluded from income and should be fully taxed: providing in-kind benefits should not be treated differently from monetized compensation. In the case of charitable contributions, there are reasons to suppose that the quasi quid pro quo charitable contribution should be fully taxed: they are a form of consumption that should not be treated differently from other forms of consumption of intangible goods such as going to the movies. The taxation of status rationale still makes a difference because the prior reasons weren't sufficient to be decisive. The status tax is an *additional* reason that can be used in order to tilt the scales toward the conclusion of fully taxing the transaction in the cases above.

C. *The Commodification Critique*

Some scholars have criticized extending the application of taxation to certain social contexts that are normally perceived as outside the realm of the market and taxation.[115] The central reason for such objection is the

115. *See, e.g.*, Douglas A. Kahn, *Exclusion from Income of Compensation for Services and Pooling of Labor Occurring in a Noncommercial Setting*, 11 FLA. TAX. REV. 683, 686-

negative commodification effect of taxation: taxation requires placing a price tag on the item taxed.[116] This monetization of the good devalues it because it flattens out its unique value by assuming the good could be fully replaced by money.[117] This critique applies especially to the case of taxing status: social status is normally perceived as a realm in which taxation does not apply, at least not directly. Placing a price tag on social status turns social status into a commodity that one could buy and sell, and empties it of social meaning.[118]

Even scholars who are disturbed by effects of commodification, however, should not be disturbed in this case. First, as Professor Tsilly Dagan has noted, commodification might also have a positive effect in certain contexts.[119] This might be true in the case of status. If we accept a normative position that views social status as negative phenomenon, its devaluation through commodification might actually be a desirable effect.

It is possible to argue that even if one views status as a negative phenomenon, commodification may yet have a negative effect. Scholars have pointed to an additional effect of commodification besides devaluation: intensification of saliency through commodification.[120]

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91 (2011) (concluding that income tax only applies to commercial activities); Debra Lefler, *"Keeping Books on Romance": The Gift Exclusion in Nonmarital Relationships*, 105 NW. U. L REV. 1739, 1762-66 (2011) (contending that market behavior is not an fitting approximation of intent); Tsilly Dagan, *Itemizing Personhood*, 29 VA. TAX REV. 93, 95-101 (2009) (using the commodification critique to argue against applying market tools to all areas of life); Ray Madoff, *Taxing Personhood: Estate Taxes and the Compelled Commodification of Identity* 17 VA. TAX REV. 759, 763-64 (1998) (claiming that "the estate tax can force the commodification of an individual's identity"); Nancy Staudt, *Taxing Housework*, 84 GEO. L. J. 1571, 1573-75 (1996) (suggesting women's nonmarket labor inside the home should be valued in addition to market labor performed outside the home); Mark Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 841-44 (1979) (arguing taxpayers should be taxed on their actual earnings, not their capacity to earn). For scholarship on the commodification phenomenon in general, see MARGARET JANE RADIN, CONTESTED COMMODITIES: THE TROUBLE WITH TRADE IN SEX, CHILDREN, BODY PARTS AND OTHER THINGS 1-15, 155-64 (1996), for a description of commodification as a world view and in the context of objectification and subordination; Margaret Jane Radin, *Market Inalienability*, 100 HARV. L. REV. 1849, 1905-06 (1987), for a general definition of commodification within the context of personal identity.

116. Dagan points out four dimensions in which taxation might have a commodifying effect. Of the four she points out, the one that is relevant to the case of taxing status is the third one–commodification through the attachment of a price tag. *See* Dagan, *Itemizing Personhood*, *supra* note 115, at 96 (suggesting four ways in which tax law and commodification interact).

117. RADIN, CONTESTED COMMODITIES, *supra* note 115115, at 56.

118. Dagan, *Itemizing Personhood*, *supra* note 115, at 110.

119. *Id*. at 112.

120. *Id*. at 135.

Placing a price tag on the status element isolates it and signifies its self-standing significance. This increases the saliency of the status element that accompanies mixed expenditures and may result in enhancing individuals' pursuit of status and only intensifying gaps in social status.

There are two replies to this point. One is that even if this effect is true, it works simultaneously with the devaluation effect of status mentioned previously, and thus to some extent they cancel out each other. The second is that it is questionable how strong the commodification effect is in the case of eliminating a deduction for mixed expenses and consequentially, to what extent saliency might increase. This article seeks to introduce the idea that social status should not be disregarded, but also not to place specific price tag on status signifiers. In the implementations discussed in this article there is no active evaluation of status, only a passive elimination of a deduction on grounds of status. This was part of the critique mentioned in the previous point—that there is no proper assessment of social status, that its value may be higher or lower than the value of the deduction. While this is a problematic feature of the suggestion proposed in this article addressed in the beginning of this section,[121] it ameliorates the commodification problem. This critique applies in principle also to the other application of the status tax mentioned in this article, and so does the response. As noted above, commodification is context sensitive and thus might apply to a different extent in each of the applications. This article does not go into the ranking of the level of the commodification problem in each of the applications mentioned, but only raises the general concern of commodification.

CONCLUSION

This article suggests redefining the tax base to include social status, a suggestion that provides a new rationale for fully taxing mixed business and personal expenses. I have demonstrated how the economic cost of such a tax is probably overrated. Even though it is possible that such tax may prevent some efficient business investments from taking place, there are economic benefits that may offset this cost. Taxing such mixed expenditures will prevent the distortion of providing compensation through goods that could be classified as mixed expenses at the cost of other goods that the individual would have actually preferred. In addition, the employer has the best information regarding the real value her employee attributes to the mixed expenses. She could just gross-up the employee's compensation so it will not be affected by the tax imposed on the expenses. This could be

121. *See supra* Part V, Section A (discussing status tax rate).

done by compensating the employee for the tax payment that exceeds the value he attributes to the personal expense element.

The purpose of the economic argument is to clear the stage for the normative–philosophic argument that stands at the center of this article. It substantiates the claim that the economic costs of fully taxing mixed spending are not necessarily that high. The normative-philosophical argument justifies fully taxing mixed expenditures based on the idea that the existence of such mixed expenditures signifies high social status. Under the economic justification, taxing the individual for a mixed expense that he did not really benefit from is a false positive: a negative side effect of the attempt to capture individuals who do benefit personally from the mixed expense. Under the philosophical justification, however, taxing such individuals is justified in and of itself: according to the Weberian analysis of social status, the fact that they are in a position in which mixed expenses occur is itself an attribute of high social status that should be taxed regardless of whether they actually benefit personally from the expense. This argument for taxing high social status is grounded in a wider philosophical view labeled as "relational egalitarianism." According to the relational egalitarian view, social policy should not focus solely on the distributive pattern of resources or welfare. Instead it should be concerned with the structure of relationships among individuals. This concern may overlap with the distribution of resources and welfare to a great extent, but it may still differ from it significantly. The argument for taxing social status and mixed expenditures attempts to fill the void in the actual positive implications of the relational egalitarian view.

The primary purpose of the argument for taxing status in this article is to provide a new perspective on the tax treatment of mixed expenditures. Furthermore, as an argument for redefining the proper tax base, it may have much wider implications. In this article I have discussed four possible applications of the argument for taxing status: tax treatment of fringe benefits, tax treatment of high compensation levels for top executives in corporations, consumption taxes, and tax treatment of charitable contributions. The implication on the tax treatment of fringe benefits is quite similar in theory to the implication on mixed expenditures but in practice might be narrower due the lower social status gained by simple employees. Regarding top executive compensation, the taxing status rationale provides an additional justification for eliminating deductions on excessive compensation packages. It justifies employing such schemes even in contexts in which the traditional justification for such schemes—protecting shareholders—does not apply, namely, when the tax incidence rests on the shareholders, or compensation for executives in private corporations. The third implication is a higher tax rate for commodities that signal high level of social status. A 'status tax' would justify implying a consumption tax, even in cases in which it would undermine the central justification for such tax: redistribution of resources. The fourth is regarding the tax treatment of charitable contributions. The taxation of status consideration turns on the question of whether charitable contribution is a form of consumption to be irrelevant to the question regarding the proper tax treatment of such contributions. The fact that the contribution intensifies the social status of the individual is sufficient for taxing him and eliminating the deduction for his contributions.

The new argument presented in this Article raises quite a few problems. The first is the arbitrariness of the tax rate in all of the implementation mentioned, besides fringe benefits and taxation of consumption. Taking into account social status as part of the tax base does not explain why the proper way to take it into account is by denying a deduction for mixed expenditures, executive compensation and charitable contributions. The second is that even though this article has listed numerous possible implementations for the taxation of status approach, these are still small islands in the wide sea of economic activity to which taxation applies. Surely, social status aspects are involved in many other transactions to which taxation applies. While the reluctance to imply status taxation widely is easily understood due to numerous practical problems such as quantification, it raises the concern of whether there is any value in a partial implementation, even if it includes a few different cases for implementation.

The answers to these two concerns are similar: biting the bullet—acknowledging the weaknesses in the applications of the argument but insisting that the advantages of these applications offset the weaknesses. While granting that the concerns raise true problems with the form suggested for applying status taxation, I still think that there is no better form for applying taxation of status; a partial implementation is better than disregarding social status all together.

The third critique I dealt with was a more radical critique of taxing status that did not confine itself only to its form of implementation: the commodification critique. I have argued that, even to scholars that are disturbed by issues of commodification, the case of taxing status might be one of the cases in which the effects of commodification are positive.

While the argument for taxing status may seem farfetched, I do think it could especially play an important role in tilting the scales in cases in which there are conflicting reasons for the proper tax treatment of a transaction such as in the case of mixed expenditures and the other cases discussed in this article. Beyond the application of status taxation to the issue of mixed expenditure, I hope this article succeeds in shedding a new light on the fundamental question that underpins taxation: the theoretical question of what should comprise the tax base.