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Competing Concepts of Income and the Double Taxation of Saving

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The KU School of Business established the Center for Applied Economics in February of 2004.

The mission of the Center for Applied Economics is to help advance the economic development of the state and region by offering economic analysis and economic education relevant for policy makers, community leaders, and other interested citizens.

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Competing Concepts of Income and the Double Taxation of Saving

We find, in the statutes, very few attempts to define income. Rather do they assume the meaning of that term, so puzzling in economic literature, to be self-evident. Consequently the meaning of the statutes themselves is always vague and varying. The growing precision and progress toward a truer concept consists chiefly in the gradual disentangling of income from capital.
—Irving Fisher[1]

Introduction

Irving Fisher, one of America's greatest economists, made that statement in 1927. Eight decades later, disentangling income from capital remains the essence of the chronic debate over income tax reform. Policy makers have made some progress, in fit and starts, but usually in ways that increase the administrative complexity of U.S. tax codes. The many tax rules that deal with retirement savings offer good examples. As early as 1921, Representative Ogden L. Mills (R-NY), who became Secretary of the Treasury in 1932, proposed a federal tax reform plan that would have comprehensively addressed the income-versus-capital issue.[2] That effort did not succeed. Nor did the numerous comprehensive reform efforts proposed in succeeding decades.[3] The Advisory Panel on Federal Tax Reform appointed by President George W. Bush in January 2005 offers yet another opportunity to resolve the income-versus-capital issue in a comprehensive and logical manner.

The unsatisfactory distinction between income and capital in the current income tax laws manifests itself as two driving forces behind the modern tax-overhaul debate — the quest for both administrative simplification and greater economic growth potential through the elimination of the tax bias against saving and investment. Many people think that this quest should result in the replacement of the traditional income tax with a consumption tax. Proponents of consumption tax systems argue that such systems can simplify the process of complying with the tax laws for the same reason that they can increase economic growth opportunities — they eliminate (or substantially reduce) the taxation of capital accumulation and capital mobility. Eliminating the required income tax accounting for capital can reduce administrative complexity and, therefore, administrative expense. Eliminating the taxation of capital accumulation and capital mobility would remove the current tax bias against two key ingredients of the economic growth process.

The debate in the postwar era over the relative merits of consumption taxation versus income taxation is a carryover of a long-running, almost ancient, debate over the proper definitions of capital and income. The early debate drew many international participants from both the economic and legal professions. The key figures in America were economists Irving Fisher, Robert M. Haig, and Henry C. Simons. The debate, on its surface, may appear as an esoteric argument over labels. But it was a debate over profound economic substance. Labels like "capital" and "income" matter because they guide thinking and create focal points for administrative and legal issues. Contrasting and comparing Fisher's views with those of Haig and Simons illuminates the modern debate — in the context of economic fundamentals — over the relative merits of consumption taxes as opposed to the traditional income tax.

For his enormously influential book, *Personal Income Taxation* (1938), Simons chose the subtitle: "The Definition of Income as a Problem of Fiscal Policy." This subtitle aptly conveys the modern relevance associated with revisiting the debate over the proper definition of income. The tax-overhaul debate is a fiscal policy debate focused primarily on the proper tax base — the proper definition of taxable income.

Fisher embarked on his quest for a definition of income almost two decades before the income tax became a staple feature of Ameri-

can political economy. Consequently, concerns over fiscal policy had no direct bearing on his analysis. His sole criteria was to create a scientifically rigid definition of income that was consistent with a scientifically rigid definition of capital, an analytical issue of fundamental importance that the economics profession had yet to conquer. Fisher succeeded in his objective, but the force of his analysis failed to overturn the conventional thinking, which confused capital and income by incorrectly counting capital formation as a component of income. The perpetuation of this confusion into the era of the income tax grew to have destructive fiscal policy consequences, because the failure to distinguish between capital and income results in the double counting of income — and, therefore, double taxation.

Unlike Fisher, Haig and Simons had the income tax firmly in mind when they embarked upon their quests for a definition of income. Haig agreed with Fisher on the fundamental nature of economic income, but, because of a key analytical error, he diverged from Fisher with regard to the proper measure of income for income tax purposes. Simons' definition of income co-opted the conclusions — but not the basic rationale — of Haig's earlier work (1921). The Haig-Simons definition of income evolved into a textbook standard. However, this standard is economically flawed. It has institutionalized the age-old confusion between capital and income. The double taxation inherent in the use of Haig-Simons income, therefore, pinpoints a key cause of fiscal policy problems that concern policy makers today — namely, the punitive tax treatment of capital formation.

However, income redistribution, not capital formation, embodied the "fiscal policy" Simons had in mind with regard to the subtitle of his book, *Personal Income Taxation*. He said that this book "perhaps combines strangely the characteristics of an academic treatise and a tract for the times."[4] He meant that his book had two goals. First, Simons sought to derive an academically concise definition of personal income for income tax purposes. Second, Simons sought to use the resulting definition as a foundation for his advocacy of progressive income taxation as the best political tool for mitigating income inequality. Simons acknowledged that his "remarks about the definition of income [were] colored not a little by considerations of tax policy."[5] He further acknowledged that implementation of his ideas would adversely affect capital formation, but for reasons less fundamental than Fisher emphasized.[6] (It is noteworthy in this connection that Simons was strongly trying to counteract the trend toward the nationalization of U.S. industry. He argued that income redistribution through the use of progressive income taxation — as he defined income — represented the less destructive policy option.[7])

WEALTH AND THE RELATIONSHIP OF CAPITAL AND INCOME

At the turn of the twentieth century, Irving Fisher said that: "Of economic conceptions few are more fundamental and none more obscure than capital."[8] He diagnosed the obscurity as follows:

> Perpetual collapse of proposed definitions suggests that the foundations have not been properly laid. Now we find, beginning with Adam Smith, that every definition of capital has been erected on the unquestioned assumption that the problem was one in the *classification* of wealth. Every writer has tried to separate wealth into capital and non-capital. This, I believe, is the faulty foundation which has weakened all structures built upon it. . . . It overlooks the fact that all wealth presents a double aspect with reference to *time*. It forms a *stock* of wealth, and it forms a *flow* of wealth.[9]

With this diagnosis in mind, Fisher set out to create a scientifically sound theory of capital, and to unify that theory with an equally sound theory of income. The result, in 1906, was Fisher's enduring economic classic, *The Nature of Capital and Income*. In this book, Fisher noted that among all the discordant theories of capital, several recurrent elements of the theories were

correct. "The definitions concur," he said, "in striving to express the important facts that capital is *productive*, that it is *antithetical to income*, that it is a *provision for the future*, or that it is a *reserve*. But they assume that only a part of all wealth can conform to these conditions."[10] Fisher's diagnosis allowed him to understand that each of these elemental conditions could extend to all forms of wealth (the material objects owned by human beings) and the property rights to such wealth.

The time element associated with Fisher's diagnosis highlights the fact that people can measure someone's wealth either at a point in time or over a space of time, but not both. Wealth as a point-in-time measure represents the economic concept of capital, a stock measurement. Wealth as a space-of-time measure represents the economic concept of income, a flow measurement. In principle, the two measures are equivalent, because the economic value of capital merely embodies the present value (a point-in-time estimate) of the economic value of the flow of expected future income. This equivalence results from the all-important fact that capital is inseparable from income because capital and income are reciprocally related. Therefore, past attempts by economists to categorize wealth into capital and non-capital served only to distract attention away from a robust economic principle — the principle of capitalization.

"Capitalization" means that people adjust their evaluation of the worth of the stream of services (income) through time. Capital has value to people (and therefore represents wealth) only because it offers a flow of valuable uses or services to people. The price someone is willing to pay for an article (or the property rights to an article), whether in money or in barter, is the capitalized (discounted) value of the expected services from the article. These services are "discounted" over time based on (1) an individual's preferences for the flow of near-term versus distant-term services and (2) the risk and uncertainty associated with actually enjoying the services expected in the future. Fisher concluded, therefore, "we cannot distinguish capital as that wealth which bears income. All wealth bears income, for income consists simply of the services of wealth."[11]

The general conclusions in *The Nature of Capital and Income* about the distinction between capital and income with regard to time became part of accepted economic wisdom. Capital is the stock of wealth that exists at an instant of time. This stock, when reckoned in its broadest sense, includes human beings. Income is a measure of wealth represented by the flow, through a period of time, of the uses of (or services provided by) capital. This flow of uses (income) is what allows people to value their capital at any given point in time. If a motion picture of the economy were stopped in freeze-frame, the frame would reveal capital and nothing else. The frame would show everything from factories to the uneaten fruit on someone's kitchen table. Income becomes discernable only when the motion picture is rolling — when the actors in the picture are using the services provided by their capital to achieve some desired end. The essential conclusion for purposes of both definition and measurement is that capital and income represent alternative modes of measuring wealth, not two different types of wealth.

Despite Fisher's clarity, his definition of income as strictly the services from capital was not as well accepted as his general time distinction between capital and income. His arguments, perhaps because of their novelty, failed to displace the age-old confusion over capital and income; and his scientifically consistent definition of income could not overcome the force of common usage of the term "income."

The debate over the exact definition of income — or, more particularly, over how best to measure the "flow" of economic benefits from capital remains directly relevant to the modern tax-overhaul debate. Unfortunately, the long-running debate never adequately informed those participating in the legislative and judicial process. The result has been a poorly constructed legal framework. The failings of this framework have been manifested over the past eight decades in the form of (1) the punitive tax treatment of capital formation and (2) chronic confusion over income tax laws which virtually everyone considers needlessly complex.

Fisher argued that the "dire results are due to the lack of a simple concept at the start."[12] Dr. C. A. Le Deuc, a controller and income tax expert writing in the mid-1930s, stated that the income tax law "was not built upon any scientific

and logical concept of income, but grew out of the necessity of raising revenue for immediate needs, with very little concern about its long-range effects upon the economic life of the nation."[13] Fisher elaborated, in a statement that sounds timeless within the context of U.S. income tax law, when he said that "the false start has led to trouble; trouble has led to correction; and, in the absence of an absolutely fresh start, each correction has grown more tangled than the one corrected; each builder of a new and better extension has been handicapped instead of helped by the very ability of his predecessor, until . . . the aggregate structure, instead of being simplified, grows more and more like a labyrinth."[14] With only the Internal Revenue Code of 1939 as a reference point (never mind the 1954 and 1986 Codes along with the 38 significant enactments interspersed among the three different Codes), Robert H. Montgomery, a contributor to the *Federal Tax Handbook, 1940-41*, said:

> It isn't the taxpayers' books and records and returns which are so complicated; it isn't the revenue agents and their superior officers in the Bureau of Internal Revenue; it isn't the lawyers in the Department of Justice; it isn't the Tax Board Members nor the Judges in our Court. It's the infernal law. No one pretends to understand what it says or means.[15]

THE LEGAL DEFINITION OF INCOME

The infrastructure of this "infernal" income-tax law is based upon the Sixteenth Amendment to the Constitution, which authorized the federal income tax in 1913, and upon a handful of Supreme Court decisions that straddle the ratification of the Sixteenth Amendment. The case most germane to the definition of income question is known as *Eisner v. Macomber*.[16] This case, in turn, referenced the 1895 case *Pollock v. Farmers' Loan and Trust Co.*, which deemed unconstitutional an income tax law passed in 1894, and two cases construing the Corporation Tax Act of 1909.[17]

Without the Sixteenth Amendment, Article I, Section 8 of the Constitution allows Congress to impose all manner of duties, imposts, and excise taxes. More generally, the Constitution authorizes Congress to impose any type of so-called "indirect" tax as long as it is imposed uniformly throughout the United States. However, Article I, Sections 2 and 9 of the Constitution restrict Congress in the manner in which it can impose so-called "direct" taxes. Direct taxes, such as capitation taxes and taxes on land, must be apportioned among the states based on their populations.

The restrictions on direct taxation gave rise to the Sixteenth Amendment. Income tax legislation passed in 1894 ran afoul of the apportionment restriction, argued a majority of the Court in the 1895 *Pollock* case, because it taxed the rents and profits of real estate along with returns from investments of personal property. A tax on the returns to property was ruled to be equivalent to a direct tax on the property itself. Such a tax, therefore, had to adhere to the Constitution's apportionment restriction. The Sixteenth Amendment was designed explicitly to overturn the 1895 ruling. The Amendment reads: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

Notice that the Amendment implicitly takes the definition of income to be self-evident. Its primary stipulation is that Congress faces no restrictions with regard to the source of the income. As a result, the early income tax statutes (which have prevailed fundamentally unchanged) provided only a list of sources from which taxable "income" could be derived. They did not stipulate the nature of income itself. Section 2B of the Tariff Act of 1913 stated that

> the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, or from professions, vocations, business, trade, commerce, or sales, or dealings in property, whether real or

> personal, growing out of the ownership or use of or interest in real or personal property, also from business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent. . . .

Because Congress enumerated only the sources from which income could derive, without any reference to a definition or concept of income, the courts and the hapless citizenry were left to decide exactly what the Sixteenth Amendment allowed. Enter *Eisner v. Macomber*. Congress, in the Revenue Act of 1916, legislated that a "stock dividend shall be considered income, to the amount of its cash value." Mrs. Macomber took her challenge of this statute to the Supreme Court and won. The Court ruled that a stock dividend did not constitute income. This five-to-four decision generated controversy immediately, but it has remained the general law of the land.

In many ways, it is unfortunate that history provided this case as the Supreme Court's benchmark for the definition of income question. A stock dividend amounts to nothing more than splitting a stockholder's previous ownership into more pieces. The new stock certificates derive their value from a reduction in the value of the certificates previously outstanding. The Court stated this fact clearly when it said that a stock dividend "is no more than a book adjustment, in essence not a dividend but rather the opposite; no part of the assets of the company is separated from the common fund, nothing distributed except paper certificates that evidence an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company. . . ."[18]

Nevertheless, the reasoning behind the *Eisner v. Macomer* decision (although distorted substantially in subsequent decisions[19]) provides a concise reference point for understanding both the technically inconsistent legal definition of income and the debate over the proper economic definition of income. The Court's majority, led by Justice Pitney, based its opinion on the following criteria:

> The Sixteenth Amendment must be construed in connection with the taxing clauses of the original Constitution and the effect attributed to them before the Amendment was adopted. . . . A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real or personal. This limitation still has an appropriate and important function, and it is not to be overridden by Congress or disregarded by the courts. In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter may have proper effect, it becomes essential to distinguish between what is and what is not "income," as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.[20]

Despite Justice Pitney's eloquent declaration to determine the case on "truth and substance, without regard to form," the opinion immediately abandoned this criteria in the subsequent paragraph. It started off on the right track by acknowledging the distinction between capital and income. In a statement that was probably inspired by Irving Fisher's *The Nature of Capital and Income*, Pitney wrote that "[t]he fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during

a period of time."[21] However, Pitney discarded the capital-versus-income line of inquiry in the next sentence, and said that "[f]or the present purpose we require only a clear definition of the term 'income,' as used in common speech, in order to determine its meaning in the [Sixteenth] Amendment. . . ."[22]

In the Court's opinion, therefore, the "truth and substance" of an issue that eluded the economics profession for well over a century was to be found in common usage of the term "income." Yet, about 15 years before the *Eisner v. Macomber* decision, Fisher noted that popular usage "gives its sanction to the term 'income' . . . usually with very little intelligent discrimination" between competing conceptions of the term.[23] Years after the decision, he took the Court's presumption to task by surveying the "common man's" understanding of the term income. The results of his survey led him to this concluding statement:

> To found our whole system of income taxation, as legislated and as judicially interpreted, on the common man's notions, so hybrid, self-inconsistent, confused, uncertain, and vague is preposterous — just as preposterous as for physicists to found their theory of thermodynamics on what the common man thinks is "heat."[24]

Nevertheless, because the general population effectively ratified the Sixteenth Amendment, common usage was the criterion on which the majority decided the stock dividend question — and also the criterion on which the four dissenting Justices based their dissents. (The virtually even split provided a good reflection of the "common man's" opinion.) Pitney wrote that "[a]fter examining dictionaries in common use, we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 — 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided that it be understood to include profit gained through a sale conversion of capital assets. . . ."[25]

Despite the alleged succinctness of this definition, it provided little guidance. The Court, in effect, merely substituted the word "gain" for the word "income." As such, its definition fits almost any concept of income. Sixteen years after this decision, Roswell Magill, author of an authoritative, four-hundred-page book entitled *Taxable Income*, called this definition "cryptic," and stated, with regard to the enduring truth and substance of the definition, that "one can trace with some accuracy the *outlines* of a concept of income through the decisions of the past twenty-three years," but these outlines are in some particulars "rather vague."[26]

Elaborations on the above definition and its application to stock dividends help foreshadow key elements of the ensuing economic debate over the *Eisner v. Macomber* decision, and the definition of income generally. Pitney argued that the government (Eisner) placed too much emphasis on the word "gain" in the Court's definition of income. Pitney emphasized instead the word "derived," which appears in both the Court's definition of income and the language of the Sixteenth Amendment, as in "the gain derived from capital" and "incomes, from whatever source derived."

In placing his emphasis on the word "derived," Pitney said:

> Here we have the essential matter: not gain accruing to capital, not growth or increment of value in the investment; but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital however invested or employed, and coming in, being "derived," that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal; — that is income derived from property. Nothing else answers the description [of income].[27]

Based on this statement, the thrust of the "essential matter" is the receipt of cash, whether dispersed by another party or received from a transaction. This thrust is consistent both with the most common usage of the term income and the accountant's concept of "realization." The Court seems to have made the word "derived" synonymous with the term "realized."

A stock dividend (in the Court's majority opinion) did not conform with the "substance" of the term income in the Sixteenth Amendment because it did not represent a receipt of cash. "The essential controlling fact," argued Justice Pitney,

> is that the stockholder has received nothing out of the company's assets for his separate use and benefit. . . . We are clear that not only does a stock dividend really take nothing from the property of the corporation and add nothing to that of the shareholder, but that the antecedent accumulation of profits evidenced thereby, while indicating that the shareholder is richer because of an increase of his capital, at the same time shows he has not realized or received an income in the transaction. . . . [Furthermore], without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock. Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax.[28]

That the Court's reliance on the realization concept coincides with the popular and accounting conception of the term income may make the above opinion seem unsurprising, even if the Court was not unanimous on this point. The Supreme Court's definition of income evolved from the taxation of corporate income, not income received by individuals. Even though the realization criterion used by the accounting profession is often at odds with the economic conceptions of income, the practice of the accountant provided a ready guide for establishing a tax base. Indeed, the Revenue Act of 1918 specifically stipulated, for the first time, that certain compliance procedures be consistent with generally accepted accounting procedures.

With regard to the definition of income in U.S. tax laws, the economist Robert M. Haig said, in 1921, that in "its general scope it approaches almost to the point of complete identity the working concept of profit used by the accountant. It is by all odds the most theoretically perfect income tax law extant, from the point of view of its general scope. Whether it is, after all, the most scientific law is another question, for that involves the degree of skill that has been used in modifying the theoretical concept to meet our actual conditions. In that we have not been strikingly successful."[29]

Over a decade after Haig wrote this statement, the accountant, Dr. Le Deuc, rhetorically asked: "Would not the economic concept of income, which is simple and scientific, be a better basis for taxation than the accounting concept of income which is technical and complex?"[30] The answer, to a great extent, depends on which economic definition of income is chosen.

ACCRETION INCOME VERSUS YIELD INCOME

Haig could assert that the fledgling U.S. income tax was "the most theoretically perfect" because he agreed with the breadth of its scope in defining income, or at least the breadth of the sources of income listed in the statutes. The economic definition of income that forms the theoretical underpinnings of the modern income tax system is known as Haig-Simons income, in tribute to the writings of economists Robert Haig and Henry Simons. This definition of income is also commonly referred to as "accretion income," a term that evolved out of Haig's reference to the accretion of value in a person's capital stock over an accounting period. In the tax laws to date, the concept of accretion income has prevailed over its competing economic concept of "yield income," the concept favored by Irving Fisher for purposes of taxation.

Yield income — that is, services from capital — constitutes a definitional subset of accretion income. One can obtain a summary understanding of the difference by analyzing one of the earliest concise statements of the accretion concept of income. The statement came from the esteemed British economist Edwin Cannan in response to the writings of Irving Fisher. In 1897, Cannan wrote that: "The income of a

community is the mass of economic goods produced or obtained by it in a given length of time over and above the mass which is necessary to maintain the capital. . . . The income is divided into two parts, (1) the increase of the capital, and, (2) the things enjoyed. . . ."[31]

The key element of Cannan's definition revolves around his reference to the term "increase of capital." This term can have more than one meaning. It can mean an increase in the value of *savings*; that is, an appreciation of the value of the existing capital stock — more commonly known as a capital gain (whether realized or not). It can also mean *saving*, a flow concept indicating that some fraction of current production (or its monetary equivalent) remains unconsumed and is used to augment the existing capital stock. The term "increase of capital" can also refer to both appreciation in the value of savings and the act of saving combined.

Cannan's definition of accretion income differs from (and is more narrow than) the definition provided by Haig and Simons, because of the different meaning given to the term "increase of capital." Cannan, based on his reference to "economic goods produced or obtained," clearly refers only to saving. This interpretation is further supported by the fact that British thought (and tax law) has typically not categorized capital gains as income.[32] By contrast, "increase of capital" as defined by Haig and Simons refers to both saving and savings combined — what Haig referred to as "accretion" and Simons referred to as "gain."

Irving Fisher's Position: "You Can't Have Your Cake and Eat It Too"

Fisher rejected the idea of accretion income as a proper economic definition of income and, especially, as a guide to the formation of tax policy. Indeed, Fisher's life's work in this subject area focused on exposing the fallacy in thinking that an "increase in capital" belongs in any proper definition of economic income. Fisher qualified his position by asking rhetorically: "Is there no justification for the very common usage by which increase of capital is regarded as income? the reply is: Yes, if only we count it as outgo! All such income is turned back into capital."[33] That is, if people insist on thinking in terms of "money income" — interpreted literally as the net amount of cash that comes in — then proper income accounting requires that people distinguish between "income" used for current expenditures and "income" used for saving.

Income and capital are mutually exclusive categories. In any final accounting, claims generated by the production process can result in either current income or capital accumulation, but not both. The final tally depends upon how the owners of the claims generated by current production choose to employ these claims. If the claims are used for saving, then they are "saved" from being categorized as current income because the newly acquired savings represents the capitalization of future income. The same holds true for any increase in the value of existing savings, the capital stock. (Using similar reasoning, any decrease of capital — dis-saving — represents a conversion of capital into current income. Notice, however, that Cannan's definition cannot account for this important point, because his definition assumes that the value of the capital stock is maintained at a constant level.)

According to Fisher, therefore, an increase in the value of a person's or community's capital stock (wealth), whether through saving or appre-

* By the term "savings," Fisher and his contemporaries meant capital accumulation of any form. This usage presents some rhetorical problems for the modern economist, because (ironically) of the stock-flow distinctions Fisher helped to promulgate. Modern terminology uses the term "saving" to refer to the flow concept of the rate of (or amount of) augmentation to the existing capital stock. It uses the term "savings" to refer to the value of the existing stock of capital. Nevertheless, throughout this text, the term "savings" used in isolation means capital accumulation, whether through appreciation in the value of the capital stock or the claims generated by current production used to augment the capital stock.

Exhibit 1: Inconsistent Federal Agency Definitions of Income

Makers and administrators of tax law in the United States have conceptually adopted the Haig-Simons definition of income, whereas administrators at the U.S. Department of Commerce have, since the early 1920s, conceptually adopted Cannan's definition of income. Income tax law in the United States has always categorized capital gains as "income," although it has been almost always treated as something different from "ordinary" income. (The primary difference between the Haig-Simons definition and U.S. tax law has been in the area of administration. Rather than require mark-to-market accounting every tax year, as Haig and Simons would have had it, capital gains are taxed in the year in which they are realized.) The U.S. Department of Commerce, however, does not recognize capital gains as income. In its compilation of the National Income and Product Accounts, the Commerce Department counts as income only the claims generated by current production.* The value of income in any given period is defined as being equal to the value of what the economy produces in that period. Capital gains do not qualify for such categorization, because they represent the "capitalization" of claims on expected increases in *future* productive capacity.

* U.S. Bureau of Economic Analysis, "Definitions and Classifications Underlying the NIPA's," in *National Income and Product Accounts of the United States*, *1929-97*, Vol. 1 (Washington, D.C.: U.S. Government printing Office, September 2001).

ciation, remains capital. It represents savings.[*] And Fisher rejected the notion that savings, within the context of scientific analysis, can logically belong to the economic category called income:

> No sound theory of capital value can gain acceptance until we give up thinking of capital value as an independent entity existing apart from anticipated income. Capital value is merely a present expression for future income. We must always begin our capital reckoning with income, and with that item of income most remotely future. We then proceed backward in time to the present, generating present capital out of future income. The ordinary man, however, thinks in precisely the opposite order, proceeding from capital to income and regarding an increment of capital as growing out of the capital instead of being merely part of the capital value of subsequent income. . . . Nothing but confusion can result by thinking of an increase in the capitalized value of income as itself income. It can be turned into income, but only by cutting out an equivalent from the future income for which it stood.[34]

To count capital appreciation or saving as income violates the reciprocal and inseparable relationship between capital and income — and results in double counting. Only the claims generated by current production that people do not save can count as current income. Such claims correspond to what Cannan's definition described as "the things enjoyed." Fisher would add that the result of dis-saving would also correspond to "the things enjoyed."

A. Fisher's Definition of "Earnings"

A complete understanding of Fisher's position requires an understanding of his distinction between "earnings" and "income." In his lexicon, the term earnings equates to the concept of accretion income, as understood by Haig and Simons. Fisher readily acknowledged the legitimacy of the accretion income concept, and thought that for some purposes — like reporting the financial standing of a business enterprise — it offered the more useful concept. Nevertheless, Fisher maintained that accretion income is composed of two dissimilar ingredients — yield and net capital accumulation — "and nothing but confusion can result from having to consider two kinds of income so widely divergent."[35] Yield — what Fisher called income — is whatever expected future claims people capitalize. Capital accumulation, by contrast, represents capitalized future yields. It follows, therefore, that the accretion concept counts as current that which is current and also that which is future. As a result, double counting occurs when capital accumulation is categorized as current income. The only benefit of such an accounting procedure is to track in any time period the acquisition of the command over expected future yields. That is how the concept of accretion income has been used historically.

The concept of accretion income is rooted in the practice of mercantile bookkeeping.

Cannan alluded to this practice in his definition as that of maintaining the item called "capital" as a fixed sum over an accounting period. This practice, by holding fixed the beginning-of-year capital stock of an enterprise, necessitates treating capital accumulation as "income" and a decrease in capital value (dis-saving or depreciation) as negative "income." This centuries-old bookkeeping convention helps explain why the accretion income concept is so entrenched in the minds of many as the proper definition of income. Fisher argued, however, that this convention fails to measure actual income properly. Instead, it amounts to "an ideal standard which [bookkeepers] set up for reference."[36] "Confusing the actual and the ideal," said Fisher, "is one of the commonest fallacies" in the study of income.[37]

"The fallacy that savings, though taken out of [money] income to form capital, are still regarded as [actual] income," Fisher claimed,

> is due, oddly enough to the usages of accounting. Businessmen and bookkeepers delight in conforming all accounts to a fixed norm, in which capital is regarded as invariable and income as a perpetual annuity. In economic theory we find the same tendency in many economists . . . whose very concept of capital postulates its perpetual reconstitution or upkeep. In the actual world there is not and cannot be any case of absolute immutability of capital value and perpetuity of income. Surely our theories of capital and income should admit the variability of both capital and income. But the bookkeeper prefers to make the fiction of invariability even when there is actual variability. In fact this fiction is of great convenience for bookkeeping purposes; it enables us to compare every condition with a fixed standard. No objection is offered here to the practice as practice. The objection is to conceiving a mere bookkeeping fiction as economic reality.[38]

The benefit of this accounting practice for business is that it shows, at a glance, what the history of an enterprise has been with regard to capital accumulation — and, therefore, its prospects for generating *future* actual income. Such practical convenience explains why Fisher keeps the notion in his lexicon and distinguishes between "earnings" and "income." Earnings provide a store of potential future income. If, over a period of time, the capital stock of a business or person increases in value over its initial value, whether by saving or appreciation, one can proclaim that increase to be "earnings" because "it is simply the income which he *would* receive if he chose to keep his capital unimpaired and unincreased."[39] But, as Fisher argued, "possibilities are not actualities, and an item is not made income merely because it might so be used."[40]

Economic reality, and therefore income, is dictated by actual behavior. Capital and income are inseparable and correlative concepts, but they represent mutually exclusive categories. An increase in income comes only at the expense of the size of the stock of capital, and vice versa. From the viewpoint of economics, as opposed to mercantile bookkeeping, actual income accrues when the claims generated by current production are not saved and when dissaving occurs out of past capital accumulation.

B. Fisher's Definition of "Income"

In Fisher's framework, actual income — yield — is a very general concept. It consists of services rendered by capital. These services represent what people capitalize when they evaluate the worth of something. "Income, in its fundamental sense of yield," argued Fisher, "is: services rendered by property or persons. A service is the occurrence of a desirable event or the prevention of an undesirable event. . . . Capital is wealth owned by human beings at an instant of time. It is owned *solely for the sake of some kind of service or services*, which it is expected to yield. . . . The essential relation of capital to *yield* income is the relation of a service-rendering instrument to the services rendered by it; for instance, between a shovel and its shoveling, . . . a singer and his singing, a share of stock and its bringing in dividends."[41] Things acquire the economic status of capital (wealth) because

Exhibit 2:
The Five Necessary (and Sufficient) Conditions for Defining Income

Conditions Defining Yield Income

1. It must consist of *services* (payments being one species of services).
2. It must flow through a *period of time*.
3. It must flow from a *source* or sources.
4. It must belong to some *person* or persons.

Fifth Condition Needed for Accretion Income

5. The accretion income must include the yield, as just defined, and also any increase (or decrease) in the value of the source of that yield.

This capital-increase, in turn, implies the following:

5a. A *future expected yield*.

5b. *Chances* as to the size of said future expected yield and its distribution in time.

5c. A *rate of interest* by which that future expected yield is discounted.

It is by means of 5a, 5b, and 5c that the future yield is translated into present values, (1) at the beginning and (2) at the end of the taxable year, the difference between them being the capital-increase or decrease.

Source: Irving Fisher and Herbert W. Fisher, *Constructive Income Taxation: A Proposal for Reform* (New York: Harper and Brothers Publishers, 1942), p. 210.

human beings value the services — the *income* — rendered to them by the things.

Understanding the reciprocal relationship between capital and yield is crucial to understanding why capital accumulation — savings, as Fisher would say — cannot be counted as income without committing the fallacy of double counting. The value of capital always and necessarily represents a present expression of future income.

> By no sleight of hand can we escape the dilemma in theory which confronts every capitalist in practice. Either he can take out a dollar's worth of income or save a dollar's worth of capital, but he cannot do both. His savings "come out" of [money] income to make capital, but for that very reason they are capital, not [actual] income. . . . The upshot of the whole matter, therefore, is that "savings" imply a change in the "time shape" of an income stream, viz., (1) a decrease of present income, and (2) an increase of future income. What is subtracted from present income is added (with interest) to future income. But the future addition cannot occur without the present subtraction. . . . To regard savings which are reinvested for the sake of future income as still constituting a part of the present income, is to assume a future return without a present sacrifice.[42]

By Fisher's reckoning, capital accumulation cannot possibly count as income in a proper income accounting framework that seeks to derive a person's *net* income. In the final analysis, what matters from an economic perspective is net income, or the net services rendered to people from their capital. Each item of capital typically renders both services and disservices. These services and disservices may take the form of money payments, productive operations, or enjoyable activities. However, most of these services "consist of intermediate services preparatory to enjoyable services" that have offsetting diservices.[43] Fisher, therefore, employs standard double-entry income accounting to show that when all of the services and disservices from capital are properly accounted for all that remains is "the things enjoyed."

1. Fisher's Income Accounting Framework

"The whole secret of the theoretically correct bookkeeping of income," said Fisher, "consists of crediting and debiting the plus and minus items of income to their proper capital sources as services or disservices rendered by those sources."[44] Services represent income; disservices — the economic concept of costs — represent outgo. The balance of the services and disservices equals net income.

In the case of the whole economy or of an individual, the bulk of economic activity consists of exchange transactions that merely transport or transform wealth. Each of these transactions implies income from one capital source but also a simultaneous reinvestment in a different capital source; that is, self-canceling credits and

debits under double-entry income accounting.

One can demonstrate this point from an economy-wide perspective by considering, for example, an agricultural industry like cotton growing. The yielding of a cotton crop is a service to cotton growers, but the labor undertaken to work the land represents a disservice (outgo) to the growers. If the analysis stops at this point, there appears to be a net yielding or incoming to the industry: the value of the cotton less the value of the labor. However, from an economy-wide perspective, the analysis cannot stop with the mere yielding of raw cotton. One must follow the economic process that results in the final use of the cotton. Raw cotton must be ginned. The ginning process transforms raw cotton into usable, processed cotton. From the perspective of those in the ginning industry, the monetary value of the processed cotton is a service (credit) and the monetary value of the raw cotton and labor undertaken are disservices (debits or outgo). Following the process to its end, one would successively observe yarn appear and processed cotton disappear; cloth appear and yarn disappear; clothing appear and cloth disappear. Finally, the clothing will be worn. All of the services and disservices arising from each stage of the transformation process from raw cotton to clothing will be equal and offsetting. Only the use value of the clothing has no offsetting disservice (except the maintenance of the clothing). Only the labor undertaken at each stage of the transformation process has no offsetting service.

The same general outcome results if one isolates the income accounts of an individual cotton farmer. The disservice of his labor renders him the service of bringing in raw cotton. When the farmer sells the cotton, it provides the service of yielding money and the offsetting disservice of losing the property rights to the cotton. When the farmer uses the money to buy food, the money provides a service, but the groceries provide an offsetting disservice (relative to the farmer's money or bank account, the capital source). When the farmer consumes the food, there is no objective offsetting disservice to the service the food provides, except the farmer's labor exerted to yield the raw cotton.

Fisher calls these offsetting or self-canceling services and disservices "interactions," and concludes that "[i]nteractions constitute the great majority of the elements which enter into income and outgo accounts. The only services which are not merely the positive side of interactions are mental satisfactions — desirable conscious experiences — often miscalled 'consumption'; and the only disservices which are not the negative side of interactions are pains or 'labor.' But these are only the outer fringes of the economic fabric. Between them is a connective network of productive processes and commercial transactions, every fiber of which has two sides, a positive side of services and a negative side of disservices."[45]

Based on this logical result, many of Fisher's critics who favored the accretion income concept accused him of simply redefining "income" to equal "consumption." Fisher responded to his critics by saying that "if there is one misrepresentation of my views which I have deplored more than any other, it is this which represents my concepts as being limited to 'consumption.' 'Consumption' is, perhaps, the most significant result but it is not the only one; and it is most certainly a result and not the starting point."[46] Although Fisher's ideas closely correspond to the modern understanding of the term "consumption," the primary economic reason he was adamant on this point is that consumption connotes a "using up." Fisher wanted to focus on the services from capital, services that could endure through long stretches of time. In particular, he wanted to focus on those "uses or services which give direct satisfactions to the user, that is, satisfactions without the intervention of further productive processes or of money payments."[47]

The irony is that Fisher used the bulwark of accounting theory as a retort to his critics who favored the accretion concept, an income concept rooted in accounting practice. He argued that "[s]ince none of the opponents of the service concept even mention the interaction concept nor double-entry bookkeeping its omission by them suggests that they have not had the patience to trace in detail the 'ins and outs' of income accounting, so essential to an understanding of the variegated, but integrated, consequences of the service concept. Yet, without making use of this fruitful concept, it is impossible, I believe, to reach a scientific income theory worthy of the name."[48]

Fisher's application of double-entry bookkeeping, or the "interaction" of services and disservices, also generalizes to the rearrangement of individuals' asset portfolios. The rearrangement is a self-canceling interaction. Proper income accounting requires that the payment of money from one fund to another must be credited to the first fund and simultaneously debited to the second. This procedure highlights the importance of Fisher's framework for proper individual income taxation.

Proper income accounting also demonstrates why the accountant's understanding of realization, as used by the courts, represents an unsatisfactory definition of actual income, and therefore a faulty basis for income taxation. Fisher's example of a passbook savings account demonstrates the shortcoming of the realization criterion. The principle in this example generalizes to any type of financial transaction in which the composition of an investment portfolio is simply rearranged or in which an investment returns interest, dividends, or capital gains that are reinvested:

> A savings bank depositor is sometimes thought to draw income from his deposit when the interest "accumulates." This is an error. He draws income when, and only when, he draws money out of the bank [and spends it]; he suffers outgo (relative to the bank) when, and only when, he puts money into it. If he merely lets his deposit accumulate, he derives no net income and suffers no net outgo. There is no effect on net income at all. What does occur is an *increase in capital*. He cannot have his cake and eat it too. If we accept the fiction that the man who allows his savings to accumulate in the bank virtually receives the interest, we must, to be consistent, also accept the fiction that he virtually re-deposits it. That is, if we suppose the teller to hand over the interest across the counter, the depositor's account certainly yields up "income" to him, but if we also suppose him to hand it back, it must, in consistency, be charged as "outgo", and the net result on his income is simply a cancellation. This procedure reveals clearly the fact that the accumulation is not income. It is increase of capital.[49]

Table A helps illustrate the income accounting mechanics behind Fisher's example. Suppose an individual works to earn $50,000 per year. The individual also begins a saving program in order to purchase a car in four years. The individual puts $5,000 per year into a bond portfolio that yields 10 percent annually. The earnings on the bond portfolio are placed into a passbook savings account that yields five percent annually. The annual accounts in *Table A* illustrate the self-canceling "interactions" among the individual's different funds and, therefore, the individual's net income or net cash yield.

The first panel of *Table A*, Year 1, shows the individual yielding the services of the property rights to a $50,000 checking account in exchange for the disservice of working. However, $5,000 of the gross yield is "saved" from being income (net yield) by being converted into capital in the form of a bond portfolio. The second panel, Year 2, illustrates the gross yield obtained from working and the $500 return on the $5,000 bond portfolio. It also shows the new savings in bonds and offsetting interaction between the bond portfolio and the savings account. The third panel, Year 3, shows the gross yield obtained from working, the return on the $10,000 bond portfolio, and the return on the $500 savings account. It also shows the new savings in bonds, the offsetting interaction between the bond portfolio and the savings account, and the offsetting interaction of the savings account with itself. The final panel, Year 4, shows the gross yield obtained from work, the return on the $15,000 bond portfolio, and the return on the $1,000 savings account. It also shows the result on the individual's income or net cash yield resulting from the planned dis-saving required to purchase a car.

2. Fisher's Definition of Income and the Income Tax

When Fisher first presented his comprehensive definition of income in his 1906 book, *The Nature of Capital and Income*, the United States had no income tax. In fact, the Supreme

Table A:
An Example of Fisher's Income Accounting

Year 1 Source of Yield	Gross Yield from Specified Source (Money Income)	Negative Yield (Outgo)	Net Yield for Year (Actual Income)
Work	$50,000	$0	$50,000
Checking Account	45,000 (Spent)	50,000	-5,000 (Saved, Bonds)
Net Cash Yield			45,000
Year 2 **Source of Yield**	**Gross Yield from Specified Source (Money Income)**	**Negative Yield (Outgo)**	**Net Yield for Year (Actual Income)**
Work	50,000	0	50,000
Bond Portfolio	500		500
Checking Account	45,000 (Spent)	50,000	-5,000 (Saved, Bonds)
Savings Account		500	-500 (Saved)
Net Cash Yield			45,000
Year 3 **Source of Yield**	**Gross Yield from Specified Source (Money Income)**	**Negative Yield (Outgo)**	**Net Yield for Year (Actual Income)**
Work	50,000	0	50,000
Bond Portfolio	1,000		1,000
Savings Account	25		25
Checking Account	45,000 (Spent)	50,000	-5,000 (Saved, Bonds)
Savings Account		1,025	-1,025 (Saved)
Net Cash Yield			45,000
Year 4 **Source of Yield**	**Gross Yield from Specified Source (Money Income)**	**Negative Yield (Outgo)**	**Net Yield for Year (Actual Income)**
Work	50,000	0	50,000
Bond Portfolio	16,500		16,500
Savings Account	1,076.25		1,076.25
Checking Account	67,576.25 (Spent)	67,576.25	
Savings Account			
Net Cash Yield			67,576.25

Court had ruled income tax legislation unconstitutional in 1895. Consequently, Fisher gave little thought to how his theory of income could be integrated with the practical problem of income taxation. As he lamented in his 1942 book, *Constructive Income Taxation*: "An unfortunate result of this omission was that when, seven years later [1913], America adopted the Sixteenth Amendment, some of those who then proceeded to consult *The Nature of Capital and Income* gained the impression that its theory of income could not be practically applied."[50] Indeed, not until around the mid-1930s did Fisher himself realize how readily his definition of income could be applied to a working income tax system.[51] *Constructive Income Taxation* presented a plan quite similar to the mid-1990s proposal known as the Unlimited Savings Allowance (USA) Tax System, an expenditure (or "spendings") tax with graduated marginal tax rates.

Fisher's late discovery of this practical model seems odd when one learns that the expenditure tax proposed in 1921 by New York congressman and subsequent Secretary of the Treasury (1932-1933) Ogdon L. Mills was authored by one of Fisher's Yale colleagues, Professor Thomas S. Adams, who remarked to Fisher at the time that the legislation applied Fisher's definition of income, as embodied in *The Nature of Capital and Income*.[52] Mills said that his expenditure tax proposal "maintains the principle of a graduated tax based on what economists have held to be true income for taxation purposes."[53]

An expenditure tax fits Fisher's notion of a tax system that taxes actual income. As a practical matter, income is best measured by people's periodic expenditures, because the price paid for an item is an expression of the buyer's subjective valuation of the psychological satisfaction — the stream of services — the yield — the income — he expects to receive from the (capital) item purchased.

Contrast and Comparison of Robert Haig and Irving Fisher

Robert Haig, unlike Fisher, embarked on the task of defining income with the fledgling U.S. income tax firmly in mind. In 1921, soon after the ratification of the Sixteenth Amendment, Haig wrote:

> Congress has, for eight years past, collected taxes upon what it pleases to call income. In no one of the three statutes passed during that time has Congress attempted to formulate definitely a positive definition of income. Moreover, eight years have been insufficient to secure from the courts a fully adjudicated definition. . . . Such decisions as have been handed down appear to be leading toward a definition of income so narrow and artificial as to bring about results which from the economic point of view are certainly eccentric and in certain cases little less than absurd.[54]

Haig's concern about an undue narrowing of the legal definition of income is, in some respects, a curiosity. The concern, which was largely a reaction to the *Eisner v. Macomber* stock dividend decision, is at odds with Fisher's concern about distinguishing capital from income. The narrowing of the definition of income that sparked Haig's concern resulted from the "gradual disentangling of income from capital" that Fisher applauded.

Haig's concern is curious because he was in complete agreement with Fisher about the proper theoretical definition of income. "Modern economic analysis," wrote Haig, "recognizes that fundamentally income is a flow of satisfactions, of intangible psychological experiences. . . . A man strives for the satisfaction of his wants and desires and not for objects for their own sake. . . . The testimony of our leading economists on this point is unanimous."[55] Indeed, Irving Fisher provided a sample of the testimony Haig quoted in defense of his argument. And the other quotational testimony used by Haig, all of which

Exhibit 3:
Irving Fisher's Prototype Tax Return for a Net Cash Yield System

A. WORK

1. Net cash receipts from salaries, wages, fees, and commissions

B. INVESTMENTS, ETC.

2. Net cash receipts from private business, partnerships, syndicates, and pools
3. Dividends
4. Rents and Royalties
5. Interest received, less interest paid (the difference may be either plus or minus)
6. (As to principal of loans to others) repayments received on such loans less any lendings made in the taxable year (may be plus or minus)
7. (As to principal of loans from others) any borrowings less repayments* (may be plus or minus)
8. All cash received from the from sales of investments, less all cash paid out in purchases of investments and less all brokerage and other expenses incidental to said transactions (plus or minus)
9. Cash from windfalls, gifts, bonuses, insurance, bequests, etc.
10. Net cash from any other sources (specify)
11. Total Net Cash Yield from "investments, etc." (sum of lines 2-10)

C. CASH BALANCES

12. Cash on hand at the beginning of year
13. Cash on hand at end of year
14. Net cash yield from Cash Balances (line 12 less line 13) (plus or minus)

SUMMARY

15. (A) From work (line 1 repeated)
16. (B) From "Investments, etc." (line 11 repeated)
17. (C) Drawn (net) from cash balances (line 14 repeated)
18. Total Net Cash Yield from all sources (sum lines 15, 16, 17, but subject to any deductions authorized by law**)

FINAL RESULT

19. Taxable Spendings (line 18 less any deductions authorized by law)

** When these repayments to others consist of paying off mortgages on a dwelling or other consumer good, the repayment may be treated as spendings.*
*** No deductions of income are recommended, such as from tax-exempt securities.*

Source: Irving Fisher and Herbert W. Fisher, *Constructive Income Taxation: A Proposal for Reform* (New York: Harper and Brothers Publishers, 1942), p. 8.

post-dated Fisher's seminal work, teemed with Fisher's intellectual influence.

However, Haig parted ways with Fisher when he derived a measurement for the theoretical definition of income. He danced around the concept of yield income, but ultimately rejected it in favor of accretion income. Two discernable reasons account for this rejection. First, Haig, unlike Fisher, focused his attention on the practical problem of defining income for purposes of taxation, and, therefore, something "less diaphanous and elusive than . . . psychic satisfactions."[56] This focus led to "money income" as the best measure of psychic satisfactions. Second, and related to the notion of money income, Haig, despite his criticisms of the tax laws, deferred to the definitional precedents established by the fledgling income tax code — which, in turn, gave deference to (1) traditional mercantile accounting methods and (2) popular usage of the term income.

Haig, however, clearly understood the economic implications of making these concessions to practicability and common terminological usage. In a statement that sounds like Fisher, Haig said:

> It should be carefully noted that, first, when one abandons "usances" and satisfactions and substitutes the goods and services yielding these satisfactions, he is taking a step away from the fundamentals, for two equal sets of goods and services may yield very different satisfactions; and second, if one takes the next step, as most income tax laws do in the main, and substitutes money received during a period in place of goods and services used, as the content of the term income, he has really moved a very appreciable distance from the fundamental conception. . . .[57]

Haig agrees with Fisher on the fundamental nature of income. They differ on how to make the fundamental practical for tax purposes. Fisher ultimately accepted the practicality of taking the first step away from the fundamentals by including the money spent on goods and services. However, Haig parted ways with Fisher (unless strict qualifications are made) when he accepted the second step away from fundamentals and said that "everyone is, in effect, considered to be in receipt of his income when he gets the money with which to buy the goods and services which will yield the usances and satisfactions which go to make up his true income."[58]

Haig's deference to the popular usage of the term "income" is put more forthrightly in a 1908 passage from Professor R. T. Ely, which Haig quotes in support of his viewpoint: "Money income should, perhaps, refer to the value of the goods consumed and the services enjoyed, although in popular speech and by many economists the word is used in the literal sense of the net amount of money that comes in, whether it is spent for enjoyable things or is saved."[59] This popular usage violates Fisher's notion of true income because it fails to distinguish between money income expended and money income saved; that is, between income and capital.

Haig seemed to at once understand this violation and to be confused by it. With his "either-or" language, he established an equivalence between consumption itself and the latent power to consume. In the summation of his argument, he defaulted to the latent-power-to-consume approach because it was most closely aligned with accounting practice and the operation of working income tax systems:

> Perhaps it is clear, then, how and why the fundamental economic conception of income as a flow of satisfactions must undergo substantial modification to fit it for use in economic analysis generally and for use particularly as a basis for apportioning a tax burden. The satisfactions themselves become economically significant for the purpose only when they are susceptible of evaluation in terms of money. It is necessary as a practical proposition to disregard the intangible psychological factors and have regard either for the money-worth of the goods and services utilized during a given period or for the money itself received during the period supplemented by the money-worth of such goods and services as are received directly without a money transaction.

> If the first option is taken, *viz*., the money-worth of the goods and services utilized during a given period, we arrive at a pure consumption tax. . . . The second option, however, has been the one generally adopted as the definition of income in modern income tax acts. Under this conception, income becomes the increase or accretion in ones power to satisfy his wants in a given period in so far as that power consists of (*a*) money itself, or, (*b*) anything susceptible of valuation in terms of money. More simply stated, the definition of income which the economist has to offer is this: Income is the *money value of the net accretion to one's economic power between two points of time*.[60]

This definition of income shows the stark contrast between Haig and Fisher, despite their intellectual departure from the same starting point. Haig arrived at his definition of income by drawing an economic equivalence between (1) the money-worth of the goods and services utilized during a given period and (2) the money itself (plus any savings) acquired during the period; that is, he asserts an equivalence between consumption and the latent power to consume. In drawing his equivalence, Haig neglected the requisite double-entry income accounting that cancels out of "income" that which is saved. He, like the mercantile bookkeeping tradition and unlike Fisher, counted capital accumulation as income.

As Fisher said: "The seeming contradiction between money income and enjoyable income is readily resolved if we consider debits and credits."[61] How people use their money is what matters. Possibilities are not actualities. "In taxation, [money] should merely personify what it is used for. Whatever its *origin* — whether wages or isolated capital gains — the test should be its *destination* — it *purpose* — its *function*. So far as it buys real income, its flow should be entered on the government books as income. So far as it buys capital, it should be entered on the government books as capital. Thus, the income tax would hit every spending and miss every investment."[62]

How Haig and Fisher reacted to the Supreme Court's *Eisner v. Macomber* decision (that stock dividends are not income) reveals the conceptual gulf between the accretion and yield concepts of income. Their reaction also reveals how the operating legal definition of income, based on the mere realization of cash receipts, is an inadequate splitting of the difference between the two economic concepts. Both Haig and Fisher agreed with the outcome of the Court's decision, but for opposite reasons.

Haig argued that the adoption of accretion income led to the conclusion "that stock-dividends are not income, but the reason is not that the income has not yet accrued to the shareholder when the stock-dividend is declared, but rather that, economically, it has accrued to the shareholder even before the stock-dividend was declared, *viz*., if and when the improved economic position of the corporation was reflected in the holdings of the stockholder with sufficient definiteness to be susceptible of evaluation."[63] To insist, like the Supreme Court, that a taxpayer is not in possession of income until a receipt of cash is realized creates a definition of income so narrow that it becomes impossible to "remove the inequity as between different classes of security holders."[64] Tax should not be contingent on a financial transaction subject to the security holder's discretion. All security holders should be taxed, according to Haig, when the change in the stock's value is measurable.

Within Fisher's concept of yield income, the decision that stock dividends do not constitute income is obvious. Fisher's criticism of the Court was that the reasoning behind the decision stopped far short of a coherent principle. He argued that realization, as the Court expressed the concept, provides no real guidance to the definition of income problem, because it continued to blur the distinction between capital and income. Indeed, Justice Brandeis, in his dissent to the *Eisner v. Macomber* decision, unwittingly buttressed Fisher's point when he said that "[s]o far as [business owners'] profits are represented by stock received as dividends they will pay these taxes not upon their income but only upon the income of their income."[65] But income does not yield income, only capital yields income — highlighting Fisher's conclusion that "[w]ithout a law which takes account of reinvest-

ment it is, of course, difficult to determine any general rules or presumption."[66]

Fisher also wondered, with Haig, about the equity implications of the Court's realization criterion. But his analysis focused on the "true income" of a taxpayer as opposed to accrued economic power:

> Evidently the tax, to be just, should be levied not according to what [a taxpayer] *might* do but to what he *does* do. If the administration of the tax laws were so perfected as to take true account of stock sales and purchases, the man who sells stock (whether new or old) without reinvestment, thus obtaining income, not offset, would be taxed, while the man who did not sell would not be taxed because he had no true income.
>
> We may say that a stock dividend is economically equivalent to a cash dividend combined with a cash investment. If I receive $1,000 in cash as a dividend and immediately turn back the $1,000 in purchase of more stock, the result to the company, to me and to all concerned is precisely the same as though I had simply received the stock. Therefore the tax situation also should be the same in the two cases. The fact that the two cases are not treated as identical is a clear indictment of the whole present method of collecting our income tax, because it disregards the reinvestment entirely while investments left to slumber go untaxed. The law should be revised to avoid the ridiculous anomalies resulting or we should frankly face the fact that we have a "hit or miss" capital levy.[67]

The Juxtaposition of Henry Simons, Haig, and Fisher

History has merged Haig's and Simons' thoughts about income to establish the label Haig-Simons income. However, despite the similarities, Haig and Simons had different interpretations about what they thought their definition of income measured. Simons, unlike Fisher and Haig, held the view that thinking about income as a flow of benefits was distracting. Instead, he strove to establish a categorical distinction between income *from* things and income *to* people. In making this distinction, Simons tried to draw a clear line between his definition of income to people and Fisher's services-from-capital concept. To some degree, however, Simons's categorical distinction amounts to hair-splitting. Fisher's yield income postulates income *to* people *from* capital.

Simons wanted to stress the propriety of including capital accumulation (with special emphasis on the appreciation of a person's savings) in the definition of income. While he acknowledged that the notion of income from things (what Fisher meant by yield income) represented the "most common in economic theory," he found this traditional economic conception to be inadequate. His preferred definition, income to people, followed Haig in emphasizing the notion of economic power as it manifested itself through economic "gain."

The measurement of personal income, said Simons, "implies estimating merely the *relative* results of individual economic activity during a period of time."[68]

> Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to "wealth" at the end of the period and then subtracting "wealth" at the beginning. The *sine qua non* of income is *gain*, as our courts have recognized in their more lucid moments — and gain *to* someone during a specified time interval.[69]

Simons's reference to the courts echoes the comments made by Haig with regard to the unwarranted narrowing of the definition of income. The Supreme Court, in its *Eisner v. Macomber* decision on stock dividends, explicitly rejected the idea that "gain accruing to capital" represented

income. Instead, the Court emphasized that income is "derived" or realized as the receipt of cash from an exchange of property, in the form of either remuneration or the profit from a financial transaction. By contrast, Simons, like Haig, rejected (in theory) the realization criterion emphasized by the Court and thought that accretion of capital value constituted the essence of income.

Simons, like Fisher, though with different emphasis, also rejected the idea "that methods of calculation deemed expedient in business indicate exhaustively the real meaning of income."[70] Simons further explains himself while coming to Haig's defense:

> A standard manual on our federal income tax quotes Professor Haig's definition of income and then remarks: "It should include the word realized" — as though the omission were only a careless oversight! This view is widely held by accountants, by the courts, and even by some economists. It derives clearly enough from the conventional practices of financial accounting. The accountant, faced with problems of valuation for which data are often meager, has developed and followed religiously a rule-of-thumb procedure which sacrifices relevance to "accuracy." Instead of attempting the best estimate which can be made, he is usually content to employ figures already available in his accounts and thus to minimize demands upon mere judgment. . . . Income, for him, is perhaps only what may be reported safely to unsophisticated directors as income. He aims, it would seem, never to ascertain what income is, in any really definable sense, but rather to devise rules of calculation which will make the result a minimum or at least give large answers only in the future.[71]

Haig came to his own defense, with regard to the concept of realization, in this way: "[W]e say in effect that nothing appreciates in value until it is sold. This, of course, is not in accord with economic facts, however perfectly it may synchronize with accounting practice. The truth is that certain so-called accounting principles have been evolved with other ends primarily in view than the accurate determination of relative taxpaying ability."[72]

In a continuation of this reasoning, Simons argued that "[t]hose who emphasize realization are attempting to define personal income in terms of transaction profit."[73] But he did not think an adequate conception of annual personal income could be built around the idea of transaction profit (realization). In sum, Simons position was that:

> One may gain without realizing and realize without gaining; and, if either is essential to the existence of income, the other must be excluded. Common sense and established usage suggest that gain is the *sine qua non*; but much of the current discussion of the income concept, especially by the courts, may be regarded as emphasizing realization to the exclusion of gain. . . . Realization, broadly conceived, is something achieved only in consumption, for only there does one find a stopping-place among the sequence of economic relations. Consumption is essentially a destruction, a using-up, an end. Such a solution to the dilemma, however, is not one that will commend itself to most advocates of the realization criterion. Indeed, it finds almost a lone supporter — Professor Fisher. . . .[74]

Haig seems to have missed this point about the logical finality of realization, which may explain why he erroneously postulated an economic equivalence between Fisher's yield concept and his accretion concept. But Simons knew that the conceptual gulf between yield and accretion could not be bridged, despite his acknowledgement of the logical soundness of Fisher's yield income concept. As a result, Simons differed from Haig in his emphasis on what the definition of income should measure. Haig argued, in language similar to Fisher's, that his definition of income constituted "the closest practical approximation of true income. It coincides very closely indeed with the flow of economic 'usances' and satisfactions expressed in

terms of money, which all economists agree constitutes the thing after all we are attempting to measure."[75] For Simons, however, "[p]ersonal income connotes, broadly, the exercise of control over the use of society's scarce resources. It has to do not with sensations, services, or goods but rather with rights which command prices (or to which prices may be imputed)."[76]

Indeed, Simons asserted "the folly of describing income as a flow."[77] Nevertheless, he argued that Haig's definition of income, with its emphasis on "economic power," properly carries "the essential implication that income is a mere value fact; that the things to be valued . . . are rights; and that the idea of gain is fundamental."[78] Defining income as "gain" facilitates measurement, because the notion of gain isolates the value of the store of rights at given points in time. "We do best in general," said Simons, "to regard income not as something accruing or flowing with time — for such language is dangerously figurative — but merely as a result imputed to particular periods."[79]

Simons's rejection of income as a flow of satisfactions in favor of income as the exercise and accumulation of property rights clearly reveals that he had no interest in distinguishing between capital and income, because property rights simply amount to claims on the wealth embodied in capital. In a manner reminiscent (but the reverse) of Fisher's inquiry into the nature of capital, Simons asserted that the historical confusion over the definition of income

> arises largely from the manner in which the problem is stated. Most discussion appears to be directed toward answering the question: What kind of items are income and what kind, not income? At the risk of seeming pedantic, one may insist that inquiry is more properly addressed to a different problem: How should the calculation of income proceed? Income is merely the result of certain arithmetical operations; and confusion is inescapable as soon as one attempts to classify receipts into income and not-income.[80]

This perspective turns Fisher's theoretical framework on its head. It seems to perpetuate rather than solve the definition of income problem. Simons' statement implies a reverse in the direction of causality in income theory. His argument violates the reciprocal relationship between capital and income. Capital has value because items of capital promise a flow of services — income — to people. Capital appreciation generally results from positive changes in the assessment by market participants of the discounted flow of services the capital is expected to yield. The value of apples economically dictates the value of the orchard.

Simons, by contrast, argued that the market value of apples is determined by the market value of the orchard. He asserted in this regard "that there is no circularity in the position that value determines income."[81] He reckoned that

> the relation between income (yield) and value, in the case of capital goods, is by no means a one-way relation. The cost of instruments has important consequences for their rate of production; and the rate of production certainly affects their yield or productivity. The statement that income (yield) determines or causes value is only a dangerous half-truth, for income (yield) is not a datum in the problem.[82]

But, in fact, as Fisher would argue, yield is *the* datum in the problem (assuming a stable discount rate). If capital yields no services it will cost nothing, because it will be valued as worthless.

Despite this conceptual gulf, Simons thought that the "quarrel" between him and Fisher was "essentially one of terminology rather than of logic."[83] Fisher disagreed. The reason for Simons' interpretation had to do with Fisher's substantive (but perhaps rhetorically confusing) distinction between "income" and "earnings."

Fisher's definition of "earnings" equates to "accretion," which is the Haig-Simons definition of income. Fisher readily acknowledged the practical convenience of the accretion concept for the purpose of business bookkeeping. Nevertheless, Fisher maintained that accretion "consists of two very unlike ingredients — yield and capital-increase."[84] Given these two unlike

gredients, argued Fisher, "one referring to income which is realized or actual and the other to income which is earned or potential, it would seem that the basic term income should be preferably applied to what is real rather than to what is hypothetical."[85] First, how people actually use their resources is all important. Only when capital is liquidated *and spent* does it become a measure of actual income. Second, and more to the point, yield constitutes the more fundamental concept, because yield is what people capitalize. The capital-accumulation component of earnings or accretion is causally dependent upon the concept of yield. "The fundamental term income," argued Fisher, "seems to befit best the more fundamental of the two concepts."[86]

What was Simons's response to Fisher's line of reasoning? Rename the income tax an "earnings tax." "This concession," he mused, "might serve to focus attention on significant issues."[87] Fisher could not have agreed more. He had insisted for decades that "the main desideratum is to use correct *concepts* in our *thinking*, statistics, tax legislation, tax administrations and judicial decisions, not simply to insist on the use of certain *terminology*."[88]

DOUBLE TAXATION

"In science," Fisher warned, "logical distinctions are inexorable, and their violation always brings retribution."[89] The Haig-Simons (accretion) concept of income for taxation purposes violates the inexorable distinction between capital and income. Specifically, it includes capital accumulation in the definition of income. The retribution has been more than nine decades of double taxation.

The double taxation that results from including capital accumulation in the definition of income is analogous to, but different from, the more familiar forms of double taxation:

(1) Different levels of domestic government taxing the same person's or business's income,

(2) more than one country taxing the same person's or business's income, and

(3) the taxation of both corporate profits and the distribution of the profits to shareholders. (Neither Simons nor Fisher found any justification for a corporate income tax.)[90]

A simple example of an apple tree can illustrate the fundamental economic issue involved in the double taxation problem. The tree represents capital. The apples the tree yields represent income to the owner of the tree. Furthermore, the capital value of the tree "is entirely *derivative* and has no separate existence" from the present (or discounted) value of the apples the tree is expected to yield.[91] This relationship of capital to yield refers back to Fisher's seminal thesis, which states that capital and income (yield) are alternative modes of measuring wealth, not two different types of wealth. To tax the tree and the apples, therefore, is to tax the same quantity of wealth twice.

To illuminate this fact further, suppose (1) the tree owner saves some of his apples to invest in a new tree, (2) one barrel of apples buys one tree, and (3) a 50 percent tax is imposed on apples. The 50 percent tax doubles the after-tax cost of the tree owner's investment to one tree for every two barrels of apples saved. This cost may be stated equivalently as one tree's worth of apple production for every two barrels of apples saved. Taxation of the saving used to invest in the purchase of a new tree is, therefore, equivalent to a pre-tax on the yield of apples from the new tree. Thus, the tax on apples results in double taxation so long as the tax fails to distinguish between apples saved and apples not saved.

A neutral income tax — that is, an income tax using a proper definition of taxable income — would either tax the tree (the saving or the principle of an investment) or the apples (the return to saving). But an income tax using accretion income (or the accounting concept of realization) instead of yield income would tax the saving represented by the new tree and also tax the apples from the new tree. Therefore, an income tax that uses accretion income results in an effective tax rate of 75 percent rather than the statutory rate of 50 percent — 1.5 barrels of tax (from both the saving and the yield from investment) for every two barrels saved rather than one barrel of tax for every two saved using yield income. The extra 25 percent is the measure of the double taxation.

The analogy to the apple tree holds for any form of physical, financial, or human capital. Several giants in the field of economics have

Exhibit 4:
Why Additions to Capital Cannot Count as Income

Fisher's challenge to the orthodox, but muddled, conceptions of capital and income had little to do with the insistence on terminology. He was happy to continue counting capital accumulation as income, "if we are willing to give up saying that capital value is the capitalized value of expected income." *

Fisher rejected the notion that capital accumulation, under a rigorous scientific definition, can belong to the category called income. He based his technical argument on the fact that people discount additions to capital (both saving and savings) much differently than items of income. Fisher assumed that the term "income" should describe the most fundamental concept: Income is that which people capitalize. If capital accumulation is part of what is termed income, then a new term must be invented to describe that which is capitalized.

Year	Capital Value	Additions to Capital	Income
0	$30,101	$-	$-
1	30,606	505	1,000
2	31,136	530	1,000
3	31,693	557	1,000
4	32,278	585	1,000
5	32,892	614	1,000
6	33,536	645	1,000
7	34,213	677	1,000
8	34,924	711	1,000
9	35,670	746	1,000
10	36,453	783	1,000
11	37,276	823	1,000
12	38,140	864	1,000
13	39,047	907	1,000
14	40,000	952	1,000
15	40,000	0	2,000
-	-	-	-
-	-	-	-
-	-	-	-

Key differences exist between capital and income. Each difference relates to the all-important fact that additions to capital have no independent existence apart from the value of the flow of expected income. The value of capital will vary based upon (1) the time period in which each item of expected income accrues, (2) the variation in the size of each item of expected income in the flow, and (3) the rate of interest used to discount the flow. Two other points are crucial. First, items of actual income can be varied at will, each independently of the others. However, additions to capital cannot be known until all of the actual income is known. Second, the flow of expected income does not vary with respect to the interest rate. However, the value of additions to capital depends, in part, on the interest rate.

As a general principle, then, the value of capital at the beginning of any accounting period is composed of the sum of two parts. The first part is the discounted value of the income accruing during that period. The second part is the discounted value of the capital at the *end* of that period — but, it is vital to understand that this end-period capital value is equal to the discounted value of all *subsequent* income. Additions to capital are capitalized income, not income itself.

An examination of the accompanying table helps illustrate this robust principle. The table shows an annuity that has an expected income of $1,000 for the first 14 years and $2,000 in perpetuity thereafter. Assuming an interest (or discount) rate of five percent, the price (or initial capital value) of this annuity is equal to $30,101. As the table shows, the annuity will have a capital accumulation phase over the first 14 years, at which point the capital value will grow to $40,000 — the capital value of a perpetual annuity that pays $2,000 in actual income per year with a five percent rate of interest.

(continued on page 24)

Exhibit 4 Continued:
Why Additions to Capital Cannot Count as Income

One can demonstrate that the $9,899 of capital accumulation (or the annual additions that sum to $9,899) does not play the same role in the capitalization process as the actual payments of expected income designated by the annuity. That is, income and additions to capital value represent fundamentally different things — so they cannot both belong to the category called income.

A straight-forward demonstration of this fact comes from recalculating the price (initial capital value) of this annuity assuming that the additions to capital *are* income. Making such an assumption means that the numbers in the columns labeled "Additions to Capital" and "Income" are summed together and that the resulting time series (flow) is discounted at a five-percent rate of interest. The resulting present value becomes $36,836 instead of the correct valuation of $30,101.

The initial capital value increases by $6,734 when saving counts as income because double counting takes place. Items — additions to capital — that represent the discounted value of future income are being counted as items of current income. Moreover, this double counting takes place on a compounded basis.

Another demonstration may provide more intuition. Suppose that the annuitant sold his annuity at the end of the first year for $30,606 and the initial $30,101 is reinvested. This situation would indeed increase the annuitant's first year income by $505. But this increased income comes at the expense of future income, because the annuitant has now lost one year's worth of capital accumulation. Reinvesting the $30,101 will now only purchase a flow of income equal to $983.50 for 13 years and $1,967 in perpetuity thereafter. The annuitant must reinvest the full $30,606 in order to preserve the original $1,000 and $2,000 income streams. However, reinvesting the full amount precludes the annuitant from counting the $505 as current income. It follows, therefore, that an increase in current income comes at the expense capital accumulation — the capitalization of future income. Capital and income are mutually exclusive categories. Or, as Fisher would say: "You can't have your cake and eat it too."

[*] Irving Fisher, "Professor Fetter on Capital and Income," *Journal of Political Economy*, Vol. 15, p. 426. The numerical example presented in this Exhibit derives from the discussion presented in this citation (pp. 426-433). Also see Irving Fisher, "Are Savings Income?" *Publications of the American Economics Association*, Third Series, Vol. 9 (1908).

acknowledged the validity of this thesis — namely, John Stuart Mill, Alfred Marshall, and Arthur C. Pigou.[92] Mill seems to have articulated the problem first:

> [T]he proper mode of assessing an income-tax would be to tax only the part of income devoted to expenditure, exempting that which is saved. For when saved and invested (and all savings, speaking generally, are invested) it thenceforth pays an income-tax on the interest or profit which it brings, notwithstanding that it has already been taxed on the principle. Unless, therefore, savings are exempted from income-tax, the contributors are twice taxed on what they save, and only once on what they spend. . . . To tax the sum invested, and afterward to tax also the proceeds of the investment, is to tax the same portion of the contributor's means twice over.[93]

However, Fisher detailed the elements of the double taxation problem more thoroughly than anyone. The primary error made by the proponents of the accretion concept of income, argued Fisher, is that they violate the age-old principle of double-entry accounting. "Unfortunately," he said, "there has been too much haste to get

at the *total* income received by an individual from all sources to permit a patient study of *each item* of income flowing from each item of source. . . . Most of the confusions over income are due to the failure always to relate each item of income to its [capital] source, combined with the failure to see that an item of income credited to one kind of wealth is often, at the very same time, an item of outgo (negative income) relatively to some other kind [of wealth]."[94] In fact, the only items of individual economic activity that do not have an offsetting service or disservice are labor and consumption. Labor (psychic sacrifice) is a negative item only. Consumption, or more fundamentally, psychic satisfaction, is a positive item only.

The omission of a careful netting-out of all income sources speaks directly to the question of the double counting of income and, therefore, double taxation. Double counting occurs when money saved is included in the definition of income. Fisher acknowledged that "savings come out of [money] income." However, one can escape misunderstanding if we add that the phrase "savings come out of income" is not to be taken in the sense that savings were first income and afterward became capital. On the contrary, these savings always were, and still remain *capital*. They are "saved" from becoming income. *Savings come out of income in the sense that whatever amount is saved diminishes current income by just that much*. It is contended that savings, coming out of income, cannot be *in* income. Those who regard savings as taken out of income and yet as still a part of income are guilty . . . of a species of double counting and of a confusion between capital and income.[95]

Haig clearly regarded savings — accretion to capital — as a part of income. However, his views on double counting are uncertain. Given his conviction that "the net accretion to one's economic strength in a given period constitutes . . . the closest practicable approximation to true income," Haig must have either thought that double counting was unavoidable or did not exist. He mentioned John Stuart Mill's arguments about double taxation, but only in passing, and Haig seems to have concluded that Mill's arguments were unrelated to the quest for a proper definition of income.[96]

Yet, as Fisher argued, a scientifically consistent definition of income is central to the question of the double taxation of income. Haig argued that his definition of income is "scientific in the sense that it is broad enough to include everything of like nature. Anomalies are avoided by the very simple expedient of casting the definition in broad terms."[97] Because of the broadness of his definition, however, Haig rhetorically asked whether or not his definition is so broad "that it includes items fundamentally dissimilar." He answered that the "test of similarity applied is power in terms of money to command goods and services yielding usances and satisfactions."[98] Yet this test does not directly address the issue of dissimilarity — that is, income versus capital. Haig never directly confronted the question of whether or not including capital formation in his definition of income constitutes double counting and, therefore, double taxation.

Haig may be silent on the double taxation question because of his key contention that "[n]o great harm is done if the person who postpones spending his money is taxed upon it when he receives it rather than when he spends it."[99] However, this statement contains only an element of truth. It does not extend to Haig's definition of income. It holds only for income derived from labor, as Fisher's arguments indicated. Once money derived from labor is saved, it enters into the realm of mutually canceling "interactions" until the returns to saving are used for consumption expenditures, at which point the saver converts capital to actual income. That Haig missed this point once again relates back to his mistaken theoretical equivalence between the actual purchase of satisfaction-yielding goods and services and the latent power to command such goods and services.

The Taxation of Savings and Tax Equity: Haig v. Fisher

Haig, as the stock dividend question showed, was concerned with tax equity among security holders. The quest for a definition of income that resolved the tax-equity problem may have distracted him from the double taxation question. To demonstrate the inequality of the Supreme Court's stock dividend decision, Haig

set up an example with three taxpayers (Smith, Jones, and Williams) who each own a like amount of stock in three different, but equally profitable, corporations. The "economic power" of all three has increased by $100,000, their share of the corporations' profits since the date each taxpayer purchased the shares. Each corporation treats their shareholders differently. Smith receives a cash dividend. Jones receives a stock dividend. Williams receives no dispersement, but the market value of his shares increases by $100,000 as the result of his corporation retaining its profit. Before the *Eisner v. Macomber* stock-dividend decision, both Smith and Jones were subject to individual income tax. Williams was not. After the decision, only Smith was subject to tax. Haig's response to both situations was a rhetorical question: "Can justice be established in an income tax as among [Smith, Jones, and Williams] by any action short of making each of them subject to income tax upon the increase in his economic strength resulting from the earnings of the corporation in which he is interested? . . . All of them, under assumption, have received a net accretion of economic strength during the year definite enough to be susceptible of evaluation. Can a more narrow concept of income than this solve the problem here presented?"[100]

The answer is that Fisher's "more narrow" definition of income — yield income — can indeed solve the problems presented. Furthermore, Fisher's definition even solves problems unaddressed by Haig, and offers a strong counterchallenge to Haig's accretion concept on the grounds of tax equity. Fisher, in essence, argued that Haig's definition of income is too broad. It taxes both income and capital. The accretion concept of income for tax purposes results, therefore, in unequal tax burdens.

Fisher repeatedly demonstrated this conclusion with his example of three brothers (Duke, Jake, and Slim) each of whom receives a net inheritance of $100,000.[101] The economy's market rate of interest is five percent. Duke invests his $100,000 in a perpetual annuity of $5,000 per year, none of which he reinvests. Jake puts his in trust to accumulate at five percent for 14 years, at which time, after doubling his inheritance, he invests in a perpetual annuity of $10,000 per year, which he does not reinvest. Slim, the black sheep of the family, buys an annuity of $20,000 per year for (nearly) six years and does not reinvest.

Tables B, *C*, and *D* report the annual income of each brother under the concept of accretion income and Fisher's concept of yield income. Duke, as *Table B* shows, has a perpetual income of $5,000 per year under both concepts. Jake has annual accretion income equivalent to the returns on his growing capital stock, as *Table C* reports. Under the yield income concept, Jake has no income for 14 years, and an income of $10,000 per year thereafter. Slim has annual accretion income equivalent to the returns on his declining capital stock, as *Table D* reports. Under the yield income concept, Slim has an income of $20,000 per year for five years and $18,000 in year six, which would exhaust his capital stock.

If a 10 percent income tax is imposed on the brothers, the two different definitions of income produce much different results. Yield income will tax each brother equivalently on a present value basis. However, accretion income, because of its inherent double taxation, will burden each brother differently on a present value basis.

Under an income tax guided by the concept of yield income, Duke would pay $500 in income taxes annually, Jake would pay no taxes for 14 years and pay $1,000 in taxes annually thereafter, and Slim would pay $2,000 in taxes annually for five years and $1,797 in year six. Given the five percent market rate of interest, these tax-payment streams would be equivalent to each brother pre-paying their taxes in the amount of $10,000 when they received their inheritances. (The pre-payment equivalence would also hold if it were assumed that each of the brothers received $100,000 in wages instead of inheritance and then used their wages in the ways described in Fisher's example. Restructuring the example to account for a 10 percent tax on wages only shows the partial truth in Haig's statement that it matters not when the tax is imposed. It also shows that the tax outcome of the "flat tax" designed by economists Robert Hall and Alvin Rabushka[102] would be the same, in present value terms, to using yield income.) Thus, under yield income, each brother bears an economically equal tax burden.

However, each brother bears a different tax burden under accretion income. Duke, as

Table B: Duke's Tax Situation Under Accretion and Yield

Year	Capital	Accretion Income	Tax	Yield Income	Tax
Inheritance	100,000	*	*	*	*
Thereafter	100,000	5,000	500	5,000	500
PV @ 5%	*	*	10,000	*	10,000

Table C: Jake's Tax Situation Under Accretion and Yield

Year	Capital	Accretion Income	Tax	Yield Income	Tax
Inheritance	100,000	*	*	*	*
1	105,000	5,000	500	0	0
2	110,250	5,250	525	0	0
3	115,763	5,513	551	0	0
4	121,551	5,788	579	0	0
5	127,628	6,078	608	0	0
6	134,010	6,381	638	0	0
7	140,710	6,700	670	0	0
8	147,746	7,036	704	0	0
9	155,133	7,387	739	0	0
10	162,889	7,757	776	0	0
11	171,034	8,144	814	0	0
12	179,586	8,552	855	0	0
13	188,565	8,979	898	0	0
14	197,993	9,428	943	0	0
14.2	200,000	*	*	*	*
Thereafter	200,000	10,000	1,000	10,000	1,000
PV @ 5%	*	*	16,768	*	10,000

Table D: Slim's Tax Situation Under Accretion and Yield

Year	Capital	Accretion Income	Tax	Yield Income	Tax
Inheritance	100,000	*	*	*	*
1	85,000	5,000	500	20,000	2,000
2	69,250	4,250	425	20,000	2,000
3	52,713	3,463	346	20,000	2,000
4	35,348	2,636	264	20,000	2,000
5	17,116	1,767	177	20,000	2,000
6	0	856	86	17,971	1,797
Thereafter	0	0	0	0	0
PV @ 5%	*	*	1,580	*	10,000

Table B shows, would have the same tax payments — $500 annually — using either accretion or yield income. But, for Jake and Slim, using accretion income creates much different tax burdens, and violates the present value equivalence of their tax payments, as one can discern from *Tables B* and *C*. *Table B* shows the double counting inherent in the concept of accretion income. Jake must pay an annually increasing tax on his saving for 14 years, after which he must pay a tax on the $10,000 annually generated by his savings. *Table D* shows that Slim, using accretion income, will pay tax only on the returns generated by his annually declining savings balance. His consumption expenditures that result from drawing down his saved inheritance do not work into the equation. As a result, Slim's tax liability is markedly lower under accretion income than under yield income.

Comparing the present value equivalents of the tax streams illustrates the double taxation that results from using accretion income for taxation. Unlike the outcome under yield income, where the present value of the tax stream for each of the brothers was $10,000, accretion income returns a present-value equivalent of $10,000 for Duke, $16,768 for Jake, and $1,580 for Slim. Jake, the most thrifty brother, pays the most in taxes, while Slim, the least thrifty, pays the least in taxes.

The outcome of Fisher's example shatters Haig's apparent belief that taxing consumption and the latent power to consume are economically equivalent. From this example, Fisher reasserted his conclusion that an "income tax laid according to the correct idea of income would not disturb the comparative merits of these different income streams; but if income be interpreted to include savings, the tax would disturb them greatly."[103] He observed further that the "spendthrift [Slim] virtually has some of his taxes remitted to him, whereas the saver [Jake] is made the victim of that too frequent concomitant of fallacious economic theory, — double taxation; . . . Such a system of taxation is clearly unjust, not to say that it discourages the saver, while it encourages the spendthrift."[104]

The Taxation of Savings and Tax Equity: Simons v. Fisher

Simons never suffered Haig's illusion of equivalence between yield and accretion. He stated forthrightly that the "taxation of income, to many, will seem to favor unduly the person who 'consumes' inherited capital as well as the income therefrom. These and other limitations are simply inherent in income taxation per se." He accepted this outcome of his definition of income despite his professed concern that "taxes should bear similarly upon persons similarly situated."[105]

The different outcomes that result from using accretion income for taxation reveals the pitfalls associated with Simons' insistence on making "gain" the sine qua non of the income definition and rejecting the traditional approach of defining income as a flow. By contrast, Fisher's definition of income as a flow of services to people from capital avoids the problem of double counting and reveals the variable economic nature of income through periods of time that fails to correspond with arbitrarily designated accounting periods.

Simons was unmoved by Fisher's line of reasoning (and, based on his self-proclaimed objective of using the income tax to actively redistribute wealth, arguably was indifferent to whether or not his definition of income resulted in the imposition of double taxation). Simons clearly understood that his definition of income included capital. He said that the "notion of accrual is really best reserved for assets and liabilities. Interest accrues really not as revenue or expense but as an asset or liability."[106] Simons was concerned not with double taxation but only the question of when capital value changes should be recognized for tax purposes.

In fact, when Fisher raised the issue of double counting with regard to Haig's definition of income, Simon asserted that it was a "lame" criticism.[107] Simons rejected Fisher's double counting criticism, because he rejected the premise of Fisher's theory of income: The "discounting process" underlying yield income, argued Simons,

> is conceived in terms of choices between present and future consumption goods, as though all saving were intended as redistribution of consumption through time. Now the observable fact is that many people save instead of consuming, just as some smoke pipes instead of cigarettes; and it seems reasonable to hold that the choices are of the same order in the two cases. . . . To assume that all economic behavior is motivated by desire for consumption goods, present and future, is to introduce a teleology which is both useless and false."[108]

Simon's critique has two flaws. First, from Fisher's perspective, this statement begs the question of double counting. But from Simons' perspective, it does not, because of his erroneous contention that the value of capital causally determines income. Second, the teleology Simons referred to stems from a perspective that he imputed to Fisher, an imputation that may have resulted from Simons' rejection of income as a flow concept. Fisher's analysis focused not on inter-temporal consumption, but on the flow of direct services from capital. The importance of inter-temporal consumption patterns represents just one *result* of Fisher's integrated analytical framework.

Simons was concerned only with the accrual of economic power. He, therefore, focused only on how people may variously employ their purchasing power. With regard to the question of whether or not savings is income, he said that

> not only is it gratuitous [for the purposes of defining income] to divide goods into those yielding pleasurable sensations and those which are intermediate [savings] but, if these words mean anything at all, it seems hard to deny that acquisition of property rights may mean increase of power, greater freedom, security, prestige, and respectability. . . . Income implies achievement of certain objectives; and these achievements we propose to measure by the impartial judgment of the market. The market asserts that property rights are just property rights, whether they permit one's eating eggs or clipping coupons [from bonds]. Likewise, the market values additional resources just as it values vegetables; and the economic circumstances of him who owns either is measured in terms of prices or values. Why he may have bought claims to future goods, services, or funds, rather than that which he might eat or drink at the moment, the market does not inquire.
>
> To ask whether savings are income suggests again the disposition to think of income in terms of things. Saving is accomplished by certain uses of purchasing power; savings are expenditure. . . . Income is not saved or spent; it is rather a measure of saving and consumption together. To maintain that savings are not income is not illogical, however, if one is willing to go the whole way and define income as a concept already nicely covered by the word "consumption." If savings are not income, then depreciation is not negative income; and all gain connotations must be abandoned. This, Fisher is willing to do.[109]

Fisher rejects the notion that depreciation represents negative income for the same reason that he rejects the notion that savings represent income: Changes in capital value represent just that — capital, an economic valuation of the future income (services) which capital is expected to provide. Fisher made a place for depreciation as negative income in his notion of "earnings," or business bookkeeping, but not in his notion of real economic income.

Fisher argued that depreciation, as reckoned in Simons' "gain" framework, is another fallacious holdover from the convention of accounting practice that maintains the capital stock of a business as fixed over the accounting period. For Fisher, how people use their money is everything. Income is a matter of money's actual function or economic use, not its form. Setting money aside in a fund for repairs or improvements actu-

ally reduces current income (yield) and increases current capital by the same magnitude so as to offset the depreciation. Economic depreciation, in fact, represents a measure of the service — income — generated by the use of an item of capital. Merely reckoning depreciation as a bookkeeping procedure does not reduce current income. It artificially masks actual income. "There is, therefore, a vast difference between *reckoning* a depreciation fund and actually sacrificing it."[110]

CONCLUSION: MAKING THE THEORETICAL DEFINITION OF INCOME PRACTICAL

Fisher, Haig, and Simons all thought that accretion income represented an ideal. Fisher thought accretion (what he called "earnings") represented a bookkeeper's "hypothetical norm." This norm provides a practical benchmark that leaves capital intact over an accounting period in order to measure "actual income [yield] and the deviation from which in one direction or the other registers the depreciation or the 'savings.'"[111] However, only actual income in the sense of yield, in Fisher's view, provides a proper income tax base. Haig and Simons, by contrast, thought of accretion as the ideal measure of actual income and, therefore, the ideal income tax base. This difference of opinion about the ideal form of income has important implications for tax law and tax administration.

Fisher boasted that, in addition to the all-important goal of eliminating double taxation, his income tax proposal, based on yield income, would be the most simple system yet devised. He said that "in order to adhere strictly to a money economy, we wish to avoid appraisals; that is, we wish to tax only net cash yield, which means *spendings*, which means real income as approximately *measured* by spendings."[112] Thus, Fisher's recommended system would strictly adhere to double-entry, cash yield accounting. It would be "entirely free from such troublesome questions as what markdowns are to be taken on merchandise, how much shall be written off for bad debts, what is legitimate depreciation and depletion — questions which are uncertain, debatable, and often costly to decide."[113]

Haig and Simons understood the practical difficulties of applying their definition of income. In fact, Simons said that if "one accepts our definition of income, one may be surprised that it has ever been proposed seriously as a basis for taxation. Income, so conceived, would be readily and accurately measurable only in a world where goods and services fell neatly into a small number of homogeneous classes; also, where definite market prices were available at all times for evaluation of all commodities and capital assets in existence."[114]

Both Haig and Simons acknowledged that a tax code based on accretion income would require compromising on the theoretical integrity of that definition of income. They argued, nevertheless, that their ideal income should exist both as a guide and as a benchmark for the judgment of working tax law. Haig conceded that it is a "long step for the economist between his general definition of income and the content of the category which in his opinion forms the best basis for the imposition of an income tax. . . . A perfect income tax is unattainable so long as modifications must be made because of imperfections in our standard of value, our accounting, and our administration."[115] "Strictly speaking," added Simons, "the calculation of income demands complete revaluation of all assets and obligations at the end of every period. Practically, the question is: How shall the requisite value estimates be obtained? This is where the realization criterion may properly be introduced as a practical expedient. But the problem here is one of administration, not of definition."[116] Simons, in language like Haig's, rationalized his willingness to default to the realization concept, which he aggressively criticized in theory, by arguing that "every income tax is, and probably must be, based largely on presumptions. . . . Tax laws do not really define income but merely set up rules as to what must be included and what may be deducted; and such rules by no means define income because they are neither exhaustive nor logically coherent."[117]

Yet even if a general awareness of an "ideal income" serves as a benchmark to help improve the system of presumptions, an acceptance of

logical incoherence in the tax laws exacerbates the inherent, appraisal-based complexities associated with using accretion income as a tax base. A fine line separates economic analysis that, on the one hand, criticizes court decisions for unduly "narrowing" the definition of income and, on the other hand, implicitly sanctions the courts' opinions because of inadequate standards of value, inadequate accounting methods, and inadequate administrative methods. Such a default, even if it had an ideal definition of income as a guide, inevitably ends in idle comments like that made by Simons: "Our income taxes . . . must follow the realization criterion, but not so blindly and reverently as in the past."[118] Such a default also leads immediately to the never-ending, but "real questions," asked rhetorically by Haig: "Is it justifiable to treat this item of income in some special way as compared with other items of income because of special circumstances surrounding its receipt?" or "Is the method used for reaching this class of income justified?"[119]

Aside from the goal of developing the theoretical foundations of economic science, the entire point of developing a scientific definition of income is to eliminate such ambiguous questions and thereby infuse logical coherence into tax laws and tax administration. The nature of accretion income, however, makes it an inherently complex guide to follow. The inherent complexity demands the violation of its logical coherence for the sake of administrative expediency. Expediency, in turn, result in exceptions to exceptions to the rule. Income tax laws have remained needlessly complex, therefore, largely because courts, legislators, and tax administrators have employed the type of questions and vague benchmarks posed, and acknowledged, by Haig and Simons.

To date, the general answers to these questions, as Fisher argued, have resulted in tax laws that have "taken over the vices of accretion but not its virtues."[120] Using accretion for tax-base purposes has three key vices:[121] First, it does not consistently relate income to capital because it violates the principle of discounting. Second, it double taxes the process of saving and creates a double exemption for the process of dissaving, thereby penalizing the thrifty and sparing the spendthrift. Third, it may tax items of capital that have no "wherewithal" to pay, thereby forcing taxpayers to finance such tax payments.

Accretion income is a legitimate concept whose only tax-base virtue is that it isolates a measurable quantity of "economic power" within a given accounting period. Even this virtue, however, is turned into vice when, as a matter of expediency, the principle of year-to-year reappraisals of assets is abandoned for the realization criterion. Realization results in "income" which frequently straddles accounting periods. As a result, the realization criterion generates a tax burden that affects certain patterns of "income" differently from others, thereby allowing taxpayers to avoid taxation by manipulating their realization patterns.

Yield income stands out in marked contrast to the inherent drawbacks of using accretion income as a guide for taxation. With yield income, theoretical integrity and administrative simplification fit well together.[122] First, yield income consistently relates income to capital through the inexorable economic principle of discounting. Second, it represents a sound monetary measure of real economic income — the satisfaction people derive from the services of their capital. Third, it consistently uses the principle of double-entry income accounting to arrive at net cash yield as an income tax base, and thereby avoids complicated appraisals. Fourth, and of paramount importance, it eliminates the double taxation of saving and the double exemption of dis-saving.

ENDNOTES

1. Irving Fisher, "The Income Concept in Light of Experience," English reprint, New Haven, Conn., 1927, p. 17.

2. Ogdon L. Mills, "The Spendings Tax," *Proceedings of the 14th Annual Conference on Taxation (New York: National Tax Association*, 1922), p. 331.

3. Illustrative examples include three different types of administrative systems: direct consumption taxes that follow the Fisher-inspired "spendings tax" advanced by Ogdon Mills, the so-called "flat tax" system, and retail sales tax systems. For examples of spendings tax systems see: (Treasury Secretary Henry Morgenthau's) Proposal for a "Consumption Expenditure Tax," Staff Memo, Division of Tax Research, Treasury Department, (July 9, 1924), in Box 6, Papers of Roy Blough, Harry S. Truman Presidential Library, available at http://www.tax.org/THP/Civilization/Documents/Spending/hst9369/9369-1.htm;
David F. Bradford and the U.S. Treasury Tax Policy Staff, *Blueprints for Basic Tax Reform* (Arlington, Va.: Tax Analysts, 1977 & 1984); USA Tax Act of 1995, S. 722, 104th Congress, 1st Session (1995). For examples of the "flat tax," see Robert E. Hall and Alvin Rabushka, *The Flat Tax*. (Stanford, Calif.: Hoover Institution Press, Stanford University, 1985 & 1995). Before the *Flat Tax* book came an opinion article by the authors in the *Wall Street Journal* (December 10, 1981), which gave rise to legislative initiatives. See, for example, Sen. Dennis DeConcini's S. 2147 (Flat-Rate Income Tax, March 1, 1982) and Rep. Leon Panetta's H.R. 6070 (The Income Tax Simplification Act of 1982, April 5, 1982), both in 97th Congress, 2nd Session (1982), and Rep. Dick Armey's and Sen. Richard Shelby's The Freedom and Fairness Restoration Act of 1995, H.R. 2060 and S. 1050, 104th Congress, 1st Session (1995). For examples of the sales tax, see Rep. Dan Schaefer's National Retail Sales Tax Act of 1996, H.R. 3039, 104th Congress, 2nd Session (1996), and Rep. Tom Delay's Fair Tax Act of 2005, H.R. 25, 109th Congress, 1st Session (2005).

4. Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), p. v.

5. *Ibid*., p. 100.

6. *Ibid.*, pp. 20-24.

7. *Ibid.*, pp. v-x.

8. Irving Fisher, "What is Capital?" *The Economic Journal*, Vol. 6, December, 1896, p. 509.

9. *Ibid*., pp. 513-14. Fisher's thoughts in this area clearly benefited from correspondence with British economist Edwin Cannan. See Cannan's "What is Capital?" *The Economic Journal*, Vol. 7 (1897), p. 284.

10. Irving Fisher, *The Nature of Capital and Income* (New York: The Macmillan Co., 1912), p. 57. Italics in original.

11. *Ibid*., p. 58.

12. Irving Fisher and Herbert W. Fisher, *Constructive Income Taxation: A Proposal for Reform* (New York: Harper and Brothers Publishers, 1942), p. 125.

13. *Ibid*., p. 123.

14. *Ibid*., p. 126

15. *Federal Tax Handbook*, 1940-41, Volume I. Preface pages v and vi. Cited in Fisher, *Constructive Income Taxation*, p. 125.

16. *Eisner v. Macomber*, 252 U.S. 189 (1920).

17. *Pollock v. Farmers' Loan and Trust Co.*, 157 U.S. 429 (1895); *Stratton's Independence v. Howbert*, 231 U.S. 399 (1913); and *Doyle v. Mitchell Bros. Co.* 247 U.S. 179 (1918).

18. *Eisner v. Macomber*, p. 210.

19. *United States v. Phellis*, 257 U.S. 156 (1921); *Rockefeller v. United States*, 257 U.S. 176 (1921); *Cullinan v. Walker*, 262 U.S. 134 (1923); *Marr v. United States*, 268 U.S. 536 (1925); *Koshland v. Helvering*, 298 U.S. 441 (1936); and *Helvering v. Gowran*, 302 U.S. 238 (1937). The guiding influence of the *Eisner v. Macomber* decision (and the use of any definitive concept of income) was largely nullified when Justice Holmes, in *U.S. v. Kirby Lumber Co.* [284 U.S. 1, (1931), p. 3], said that: "We see nothing to be gained by the discussion of judicial definitions."

20. *Eisner v. Macomber*, pp. 205-6.

21. *Ibid*., p. 206.

22. *Ibid*., p. 207.

23. Fisher, *The Nature of Capital and Income*, p. 111.

24. Fisher, *Constructive Income Taxation*, p. 119.

25. *Eisner v. Macomber*, p. 207.

26. Roswell F. Magill, *Taxable Income* (New York: The Ronald Press Company, 1945), p. 443 and Chp. 12 generally. (Originally published in 1936.)

27. *Eisner v. Macomber*, p. 207.

28. *Eisner v. Macomber*, p. 211-12

29. Robert M. Haig, "The Concept of Income — Economic and Legal Aspects," in Robert M. Haig, ed., *The Federal Income Tax* (New York: Columbia University Press, 1921), p. 22-3.

30. Fisher, *Constructive Income Taxation*, p. 124.

31. Edwin Cannan, "What is Capital?" *The Economic Journal*, Vol. 7 (1897), p. 284.

32. Nicholas Kaldor, *An Expenditure Tax* (London: George Allen and Unwin, Ltd., 1955), pp. 30-36.

33. Fisher, "Professor Fetter on Capital and Income," *Journal of Political Economy*, Vol. 15 (1907), p. 432.

34. Irving Fisher, "Professor Fetter on Capital and Income," p. 432.

35. Fisher, *The Nature of Capital and Income*, p. 249

36. *Ibid*., p. 110.

37. *Ibid*., p. 126.

38. Irving Fisher, "Are Savings Income?" *Publications of the American Economics Association*, Third Series, Vol. 9 (1908), p. 39.

39. Fisher, *The Nature of Capital and Income*, p. 110.

40. Fisher, "Are Savings Income?" p. 40.

41. Fisher, *Constructive Income Taxation*, pp. 40-1.

42. Fisher, "Are Savings Income?" p. 36-7.

43. Fisher, *The Nature of Capital and Income*, p. 112.

44. Fisher, "The Income Concept in Light of Experience," p. 4.

45. Fisher, *The Nature of Capital and Income*, p. 145.

46. Irving Fisher, "The Concept of Income: A Rebuttal," *Econometrica*, Vol. 7 (1939), p. 359.

47. Fisher, *Constructive Income Taxation*, p. 24-25.

48. Fisher, "The Income Concept in Light of Experience," p. 6.

49. *Ibid*., pp. 10-11. Italics in original. Also see, Fisher, *The Nature of Capital and Income*, p. 135.

50. Fisher, *Constructive Income Taxation*, p. 39.

51. *Ibid*., p. x.

52. *Ibid*., p. 209.

53. Ogdon L. Mills, "The Spendings Tax," *Proceedings of the 14th Annual Conference on Taxation* (New York: National Tax Association, 1922), p. 331.

54. Haig, "The Concept of Income," p. 1.

55. *Ibid*., pp. 2, 3.

56. *Ibid*., p. 3.

57. Haig, p. 4.

58. *Ibid*.

59. *Ibid*., p. 5. Also see R.T. Ely, *Outlines of Economics* (New York, 1908), p. 98.

60. *Ibid*., pp. 6, 7. Italics in original.

61. Fisher, "Professor Fetter on Capital and Income," p. 425.

62. Fisher, *Constructive Income Taxation*, p. 149.

63. Haig, p. 8.

64. *Ibid*.

65. *Eisner v. Macomber*, p. 237.

66. Fisher, "The Income Concept in Light of Experience," p. 21.

67. *Ibid*., p. 21.

68. *Ibid*., p. 49.

69. *Ibid*., p. 50.

70. *Ibid*., p. 81.

71. *Ibid*., pp. 80-81. Also see Fisher, *The Nature of Capital and Income*, p. 71.

72. Haig, pp. 10-11.

73. Simons, p. 82.

74. *Ibid*., pp. 84, 89.

75. Haig, p. 7.

76. Simons, p. 49.

77. *Ibid*., p. 50.

78. *Ibid*., p. 62.

79. *Ibid*., p. 100.

80. *Ibid*., p. 78.

81. *Ibid*., p. 94.

82. *Ibid*., p. 94.

83. *Ibid*., p. 89.

84. Fisher, *Constructive Income Taxation*, p. 49.

85. Fisher, "Are Savings Income?" p. 44.

86. *Ibid*.

87. Simons, p. 226.

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89. *Ibid*., p. 4.

90. Simons, p. 39. Fisher, *Constructive Income Taxation*, p. 28.

91. Fisher, "Are Savings Income?" p. 33.

92. John Stuart Mill, *Principles of Political Economy with Some of their Applications to Social Philosophy* (New York: Augustus M. Kelley, 1965), Book V, Chp. II, Sec. 4. (Originally published in 1848); Alfred Marshall, "Memorandum by Alfred Marshall on the Classification and Incidence of Imperial and Local Taxes to the Royal Commission on Local Taxation" (1887), in *Official Papers of Alfred Marshall* (London:

Macmillan and Co., 1926), pp. 337-339; A.C. Pigou, *A Study in Public Finance* (London: Macmillan and Co., 1928), Chp. 10.

93. John Stuart Mill, *Principles of Political Economy*, pp. 813, 814. Also quoted in Irving Fisher, "The Double Taxation of Savings," *American Economic Review*, Vol. 29 (March 1939), p. 16.

94. Fisher, "The Income Concept in Light of Experience," p. 4.

95. Fisher, "Are Savings Income?" p. 23. Italics in original.

96. Haig, p. 6.

97. *Ibid*., p. 7.

98. *Ibid*., p. 7.

99. *Ibid*., p. 5.

100. *Ibid*., p. 9.

101. See, for example, Fisher, *The Nature of Capital and Income*, pp. 249-254; "The Concept of Income In Light of Experience, pp. 12-13.

102. Robert E. Hall and Alvin Rabushka, *The Flat Tax*, 2nd ed. (San Francisco: Hoover Institution Press, 1995).

103. Fisher, *The Nature of Capital and Income*, p. 253.

104. Fisher, "The Income Concept in Light of Experience," p. 13.

105. Simons, pp. 106, 107.

106. *Ibid*., p. 100.

107. *Ibid*., p. 227, n. 4.

108. *Ibid*., p. 95, 96.

109. *Ibid*., pp. 97-98.

110. Fisher, "Are Savings Income?" p. 39. Also see *The Nature of Capital and Income*, p. 239.

111. Fisher, "Are Savings Income?" p. 40.

112. Fisher, *Constructive Income Taxation*, p. 25.

113. Fisher, *Constructive Income Taxation*, p. 33.

114. Simons, p. 103.

115. Haig, pp. 13, 16.

116. Simons, p. 100. Also see Haig, pp. 14-15.

117. Simons, p. 104-5.

118. Simons, p. 208.

119. Haig, pp. 14, 27.

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121. *Ibid*., pp. 194-5.

122. *Ibid*.

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