Tax Law's Imperium: Income Tax Law's Role in Society

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I. INTRODUCTION

This Article proposes a study of law through the vantage point of the role of income tax in modern society, exploring what income tax law can teach us about law and modern society. The approach examines the role of income tax in capitalist, free-market economies. The radical premise of this Article is that tax law presents an unusual, unexpected, and incredibly valuable point of entry into the study of law in society.

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This Article adopts a philosophical method for thinking about income tax law, law more generally, and society. Human development stands on the shoulders of giants, and this method is the result of the principle contributions of four philosophers over the centuries since ancient Greece: Heraclitus, Aristotle, Hegel, and Marx.

"To the Greek mind, the most impressive fact of observation was the fact of change."[1] The ancient Greek philosopher Heraclitus was the first to formulate a conception of the world wherein everything is in flux or is in a process of changing, constantly coming into being and passing away; hence, everything is and is not.[2] He saw change in terms of the contradictory nature of reality itself.[3] Aristotle later provided the tools of formal logic that we still follow today. His deductive thinking gave us the principles of identity and contradiction.[4] Aristotle and others also provided the first form of dialectical reasoning based on using discourse or argumentation to seek knowledge based upon opposing viewpoints.[5]

Over two thousand years later, Georg Hegel reconsidered principles of logic by developing thinking about phenomena through the contradictions disclosed in thought itself.[6] His conception of dialectical reasoning provided a logic that was capable of incorporating change and dynamics into an understanding of phenomena.

Karl Marx subsequently reinterpreted Hegel's dialectics by changing their orientation from idealism to materialism.[7] Idealism is a philosophical outlook that the physical world is derived from human thinking or ideas.[8] Materialism is a philosophical outlook that takes nature and the universe as real, and peoples' thinking or ideas are part

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1. M.T. McClure, *Appearance and Reality in Greek Philosophy, in* STUDIES IN THE HISTORY OF IDEAS 21 (Dep't of Philosophy of Columbia Univ. eds., 1918).

2. Robert Sewell, *What is Dialectical Materialism?*, IN DEFENCE OF MARXISM (July 8, 2005), https://www.marxist.com/what-is-dialectical-materialism.htm.

3. OTTO WILLE KUUSINEN, FUNDAMENTALS OF MARXISM-LENINISM 76 (Clemens Dutt ed., 2d ed. 1963).

4. Robin Smith, *Aristotle's Logic,* STAN. ENCYCLOPEDIA OF PHIL., http://plato.stanford.edu/entries/aristotle-logic (last updated Feb. 17, 2017).

5. *Id.*

6. *See* KUUSINEN, *supra* note 3, at 84 (explaining Hegel's concept of negation as it relates to broader principles of contradiction and idealistic dialectics).

7. *Id.*

8. Sewell, *supra* note 2.

of that nature.[9] Marx also conceived the phenomena of nature as existing only in relation to other phenomena as part of the totality of existence.[10]

The process by which people can think about themselves in nature and society, and under law, begins with their senses and perceptions of what they experience.[11] This has been the approach of the sciences and of materialist philosophy since Aristotle and before. John Locke, an influential thinker at the time of the founding of the United States, concluded that the origin of humans' reason and knowledge was "*[e]xperience*."[12] He stated:[13]

> Our Observation employ'd either about *external*, *sensible Objects; or about the internal Operations of our Minds, perceived and reflected on by our selves, is that, which supplies our Understandings with all the materials of thinking*.[14]

People, however, are not simply collectors of data. They think about what they perceive, synthesize the perceptions, and find similarities and relations among phenomena which lead to general principles known as abstractions. This is called inductive logic or reasoning from the particular to the general. Though the concepts generated by thought are produced by reflecting on nature and social life, they require testing by reapplying them to the world or particular things to see if they provide the necessary tool for humans living in the world and changing it. The process of utilizing concepts to achieve results is a process of deductive logic pioneered by Aristotle.[15] Deductive logic is a thinking process which tests the consequences of concepts by seeing if they uncover the truth of concrete particular phenomenon.[16] Consequently,

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9. *Id.*

10. *Id.*

11. ARISTOTLE, POSTERIOR ANALYTICS (Jonathan Barnes trans., Clarendon Press, 2d ed. 1994) (c. 350 B.C.E.).

12. JOHN LOCKE, AN ESSAY CONCERNING HUMAN UNDERSTANDING IN FOCUS 67 (Gary Fuller et al. eds., Routledge 2000) (1689).

13. *Id.*

14. *Id.*

15. *See* Smith, *supra* note 4.

16. Sidney Hook, *From Hegel to Marx: Studies in the Intellectual Development of Karl Marx*, *in* 3 STUDIES IN THE HISTORY OF IDEAS 389 (1918).

"induction is a kind of deducing too,"[17] and thinking to gain knowledge requires both.

However, the traditional logic of Aristotle has its limitations. Though the principles of identity (A=A) and contradiction (A cannot be both A and not A)[18] are incredibly useful parts of thought, they are flawed in situations where people need to understand phenomena which are constantly changing. Since A is always changing, it is always becoming something different.[19]

Aristotle's formal laws of logic explain phenomenon that are static. But where things constantly change, deeper understanding of phenomena requires the logic behind the fact that A is simultaneously the same and becoming different. Hegel's philosophical method provides a logic for incorporating change into our thinking and making concepts dynamic.[20] Dialectics advances three principles: the unity of opposites, the change of quantity into quality, and contradiction as the logic of thinking. Dialectical reasoning perceives contradiction as the source of all movement and change in life.[21] In the case of a materialist conception, contradiction is also the logic of social, legal, and natural life.

This Article uses dialectics to understand the law and social-economic relations. This Article finds the income tax law as a particularly enlightening vantage point for this purpose. Part I provides an overview of the role tax plays in modern society. Part II compares income tax law to law in general to seek a better understanding of its nature. Part III looks at income tax as a part of socio-economic relations and sets up the structure of the Article's analysis. Part IV examines the essential concepts of income tax law dialectically, focusing on how each concept represents a unity of opposites based in contradiction. Part V concludes that the application of dialectics to income tax

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17. GEORG W.F. HEGEL, LECTURES ON THE HISTORY OF PHILOSOPHY: THE LECTURES OF 1825–26, at 116 (Robert F. Brown ed., Robert F. Brown et al. trans., Univ. of Calif. Press 1990) (1884).

18. Smith, *supra* note 4.

19. *See* PAUL PAOLUCCI, MARX'S SCIENTIFIC DIALECTICS: A METHODOLOGICAL TREATISE FOR A NEW CENTURY 70 (2007) (describing the laws of dialectics).

20. *See generally* Sewell, *supra* note 2.

21. KUUSINEN, *supra* note 3, at 78; *see also* Sewell, *supra* note 2.

law demonstrates the law's relationship with society and economic activity to provide insight into the direction of both.

II. UNDERSTANDING LAW THROUGH INCOME TAXATION

Tax law has been a part of life for thousands of years.[22] Its importance as one of the most dominant legal institutions in the world today is of somewhat recent development, however. The colossal change in the role of taxation can be traced historically to dramatic changes over the last two hundred and fifty years in the economic system,[23] in the role of the state,[24] and in the form and complexity of tax systems.[25] Tax law's transformation has been accomplished mainly through the world-wide adoption of income taxation.[26] The adoption of far-reaching tax structures has coincided with nations' adoption of the principles of democratic government.[27] Today, states have undertaken a much greater role in providing public goods and services to their peoples.[28] The costs of significant public goods and services require substantial resources under the control of the state. Funds for carrying out these governmental tasks can be obtained by revenue generated through taxation or amounts borrowed by the government.[29]

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22. STEPHAN SMITH, TAXATION: A VERY SHORT INTRODUCTION 8 (2015). Tax records date from 3300 BCE listing gold, animals, and slaves received by city-state temples which were the core of organization in Sumeria, Southern Mesopotamia. *Id.* at 5.

23. *See generally* MICHAEL ANDREW ZMOLEK, RETHINKING THE INDUSTRIAL REVOLUTION: FIVE CENTURIES OF TRANSITION FROM AGRARIAN TO INDUSTRIAL CAPITALISM IN ENGLAND (2013).

24. *See generally* MAX WEBER, ECONOMY AND SOCIETY: A NEW TRANSLATION (Keith Tribe ed. & trans., 2019).

25. *See generally* HUGH J. AULT & BRIAN J. ARNOLD, COMPARATIVE INCOME TAXATION: A STRUCTURAL ANALYSIS (2d ed. 2004).

26. *See* VICTOR THURONYI, COMPARATIVE TAX LAW 23 (2003).

27. *See* William B. Barker, *Expanding the Study of Comparative Tax Law to Promote Democratic Policy: The Example of the Move to Capital Gains Taxation in Post-Apartheid South Africa*, 109 PENN ST. L. REV. 703, 703–05 (2005).

28. *See* RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 52–55 (2d ed. 1976).

29. William B. Barker, *The Tax Cuts and Jobs Act of 2017: The SALT Deduction, Tax Competition, and Double Taxation,* 56 SAN DIEGO L. REV. 73, 84 (2019).

Taxation is the predominate method for paying for government-provided goods and services.[30]

Taxes fund the state by requiring the transfer of resources from the private sector to the public sector.[31] Tax law mandates a compulsory exaction from people and private entities. In theory, these exactions fund public goods and services of common interest to the people generally without regard to the benefits received by particular taxpayers.[32]

Consequently, "taxation is the primary way democratic societies allocate the financial burden of government to its people."[33] In most societies, tax law requires legislative enactment,[34] which in democratic societies requires legislation by the popularly elected assemblies.[35] Tax law's impact on society is immense, and in democratic societies this impact can be said to be self-willed. According to estimates by the Organization for Economic Cooperation and Development (OECD), modern democratic governments collect taxes that represent approximately one-third of Gross Domestic Product (GDP).[36] Individual nations range from less than 20 percent in many emerging markets to 50 percent of GDP or greater in many European nations.[37] Of taxes imposed, income tax is usually the pre-dominant tax.[38] Consequently, governments have a dominant financial interest in their economies and have become partners with their people through taxation.

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30. *Id.*

31. LOUIS EISENSTEIN, THE IDEOLOGIES OF TAXATION 22 (1961).

32. *See* William B. Barker, *A Normative Approach to the Concept of Tax*, *in* THE CONCEPT OF TAX 21 (Bruno Peeters ed., 2005).

33. William B. Barker, *Statutory Interpretation, Comparative Law, and Economic Theory: Discovering the Grund of Income Taxation,* 40 SAN DIEGO L. REV. 821, 822 (2003).

34. *See* William B. Barker, *The Ideology of Tax Avoidance*, 40 LOY. U. CHI. L. J. 229, 234 (2009).

35. *See id.* at 230–31.

36. *Global Revenue Statistics Database*, OECD, https://www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm (last visited Nov. 21, 2020). The average for OECD countries is 34 percent, for Latin American and Caribbean countries is 23.1 percent, and for African countries is 19.1 percent. *Id.*

37. Both Belgium and Sweden, for example, reach almost 50 percent. *Id.*

38. *See* JOSEPH P. QUINLAN & KATHRYN L. STEVENS, 101 TRENDS EVERY INVESTOR SHOULD KNOW ABOUT THE GLOBAL ECONOMY 145–46 (1998).

The effect of tax law is immense. Laws have many forms and purposes. Private laws, like contracts and property, deal with regulation of the relations between private parties. Private law's principle function is to facilitate and sanction the existing economic and social relations that are typical.[39] Public laws, like tax, deal with regulation of the relations between the state and its people.[40] Unlike private law, which upholds the validity of socio-economic intercourse, tax law has its significance in the state-mandated assessment of tax liability.[41] Tax law takes on new significance, however, upon examination of its consequences. The reality of tax law goes much further than its obvious purpose of raising revenue. It directly effects a broad spectrum of human activity. This includes not only the overtly financial activities that dominate our lives like work, business, and investment, but also many predominantly personal activities with an important financial aspect. The latter includes birth and death, marriage and divorce, and family life, including support and wealth transfer, charity, education, consumption, and leisure.[42]

Tax law often affects taxpayers' behavior in many ways due to policies at variance with tax law's purpose of raising revenue. The income tax law is replete with incentives and differentiations in tax incidence that encourage people to change their activity to save tax. Few laws have the force that tax law has to continuously reach into our lives and alter our behavior and even our life choices.[43] Thus, the penetration of tax law into human activity both supports[44] and molds those social, economic, and legal relations[45] due to its obvious power to influence and manipulate human action through its structure of rewards

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39. *See* Willi m B. B rker, *The Disconnect Between Tax Concepts and the World of Fact: State Law as the Gatekeeper,* 57 WASHBURN L. J. 129, 136–37 (2018).

40. *See* B rker, *supra* note 33, t 827.

41. *See id.* t 826–27.

42. *See id.* t 823.

43. *See id.* t 822–23.

44. See *infra* Part V for a discussion of how tax supports the economic system.

45. See Barker, *supra* note 34, at 240 for a discussion of how transactions are changed to avoid tax. The extreme moves that taxpayers make to avoid tax is well documented. *See generally* JOHN BRAITHWAITE, MARKETS IN VICE, MARKETS IN VIRTUE (2005).

and punishments.[46] The penetrating saying that "*there is no such thing as a pre-tax world"* captures the sense that socio-economic activity today is inseparable from the tax law.[47]

Modern life is affected by many different tax structures. Three basic tax systems provide most government revenue today. The first, which is the focus of this Article is the income tax. It is applied to both persons and entities. Second and third are consumption taxes, like the American sales tax, and the broadly adopted value added tax.[48]

Both income and consumption taxes are principally concerned with commerce, that is, production, investment, and the flow of goods and services. The income tax, however, affects daily life more than the others. Initially, the underlying premises of these taxes is quite different. Income taxes start with the inflow of values gained by a taxpayer, while consumption taxes focus on the outflow of value paid by the taxpayer for consumption. Consumption's base is the value of goods and services in an exchange transaction; the ultimate goal is to tax the entire value that is received in the exchange with the end user. Income measures the changes in wealth before consumption. Income is derived from human activities typically measured at the point of an exchange.

The relation, however, between these two types of taxes is strong because they examine many of the same financial transactions,[49] albeit from a different vantage point. Income, or what people gain over the course of the year, represents that which is available to the taxpayer to consume over the course of the year.[50] Thus, consumption by a taxpayer is typically derived from income, either self-produced or

46. *See* examples in text accompanying *supra* notes 113–18 (accelerated depreciation), 182–94 (denial of business deductions to employees, allowance to independent contractors and other businesses).

47. *See* Barker, *supra* note 39, at 135 (emphasis added).

48. See JOSEPH A. PECHMAN, FEDERAL TAX POLICY 204–08 (5th ed. 1987), for a general discussion of the value-added tax.

49. Some consumption taxes, like the cash flow model, can be considered a subset of income taxes. *See* William B. Barker, *International Tax Reform Should Begin at Home: Replace the Corporate Income Tax with a Territorial Expenditure Tax*, 30 NW. J. INT'L L. & BUS. 647, 687–88 (2010).

50. "[I]ncome . . . denotes that amount of wealth which flows in during a definite period and which is at the disposal of the owner for purposes of consumption, so that in consuming it, his capital remains unimpaired." *See* EDWIN .A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY, AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD 19 (2d ed. 1914).

received from others. A taxpayer's ability to consume out of income must be reduced, however, by the amount of income tax paid on that income. Similarly, a taxpayer's actual consumption must be reduced by the amount of consumption taxes paid. However, there is an important difference between the bases of the taxes. Because income represents the ability to consume, not simply actual consumption, it also includes the potential to accumulate wealth.[51]

Before the income tax, taxation rarely reached wealth accumulation, only consumption.[52] The income tax that included all inflows—including amounts saved—was a revolutionary change in the history of taxation. Indeed, the purpose of the modern American income tax was to "reach the vast amounts of wealth generated by the rapid and massive industrialization of the United States, to shift the tax burden from real property and consumption onto financial and industrial assets."[53]

Broad-based income tax is a recent development in the history of law. Its adoption was often born in crisis. Comprehensive income taxation began in the United Kingdom in 1799 due to the government's need for revenue to support the war effort against France in what can be called the first modern world war.[54] Consistent with the origin of income tax in the United Kingdom as a measure meant to deal with fiscal crisis, the first national income tax in the United States was enacted in 1861 at the commencement of the Civil War.[55] Though

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51. *See* HENRY C. SIMONS, PERSONAL INCOME TAXATION, THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938). As Simons put it, income = Consumption +/- savings. *Id.* A taxpayer may save a portion of her income rather than spending it all.

52. *See generally* RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 30–109 (1954). In describing the previous tax system, the House committee responsible for the income tax stated, "These taxes rest solely on consumption. The amount each citizen contributes is governed not by his ability to pay tax, but by his consumption of the articles taxes. . . . The result is that the poorer classes bear the chief burden of [those taxes]." H.R. REP. No. 63-5, at XXXVII (1913).

53. JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSI E ERA 382 (1985).

54. *See* 2 STEPHEN DOWELL, A HISTORY OF TAXATION AND TAXES IN ENGLAND: FROM THE EARLIEST TIMES TO THE PRESENT DAY 208–09 (3d ed. 1965). *See generally* William B. Barker, *A Comparative Approach to Income Tax Law in the United Kingdom and the United States*, 46 CATH. U. L. RE . 7, 12–13 (1996).

55. Revenue Act of 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862). *See generally* SELIGMAN, *supra* note 50, at 430–31.

taxation has been part of the fabric of society for thousands of years, the income tax developed in modern times. Its connection with this time is obvious. The income tax is an essential instrument of the modern state closely attuned to modern capitalist economy.

Thus, the income tax law—the most comprehensive of all tax laws—is the best entry point for understanding tax law as law and how tax law makes a profound contribution to our thinking about law and society. Income tax law is that system of taxation whose scope encompasses the incredible diversity of socio-economic relations. The income tax law penetrates and is penetrated by those human activities that are its subject; it constantly changes and is changed by those relations. Income tax law is so tightly bound up with the totality of socio-economic relations that it is today an essential part of those relations.

Capturing income tax's dynamic nature will lead to a better understanding of law and our society today. In order to discover the interrelationship of tax, law, and society, the analysis turns to tax as law.

III. TAX AS LAW

Though income tax law and taxation in general has been an important part of life for centuries, it was not uncommon in the past to find tax law absent from law school curriculum.[56] Even today, scholars focus more on the differences between tax law and other areas than on the similarities. John Prebble, a leading New Zealand tax scholar, argues that the income tax law is singular because it has a characteristic that clearly separates itself from law in general.[57] Income tax is different "because, at its borders, income is a fiction . . . that does not have independent existence in the world of physical fact or abstract thought."[58] Thus, income tax lacks "a natural, almost organic, relationship between law and what law is about."[59]

56. *See* Barker, *supra* note 33, at 824–25 (dis ussing tea hing tax in the U.S. and abroad).

57. *See* John Prebble, *Philosophical and Design Problems that Arise from the Ectopic Nature of Income Tax Law and Their Impact on the Taxation of International Trade and Investment*, 13 CHINESE (TAIWAN) Y.B. INT'L. L. & AFF. 111, 114–15 (1995).

58. *Id.*

59. *Id.* at 113.

Consider the short history of income tax law and its incredible growth since World War II. It can be argued that this brief existence deprives income tax law of the stature of the laws of contracts or property that have been part of the human experience for thousands of years. In addition, income tax law is subject to constant and oftentimes dramatic change. However, though contract and property law are venerable institutions, they too have been subject to change over the years to meet the needs of a changing society. If it were true that the concept of income were a fiction, the concept of income would not be able to capture the reality of socio-economic life; income tax law, therefore, would be terribly ineffective. The immense power of income taxation belies this conclusion.[60] Instead, the concept of income, created by human thought reflecting on human activity, provides accurate knowledge of the world because, as Aristotle put it, the forms are in the things themselves as the defining essences of those things.[61] Consequently, the accelerated pace of significant change in the income tax presents legal theory with a unique opportunity to study the role of law in social change in a diverse and dynamic world.

Income tax law's imperium is contained within a short historical period that has been supercharged with economic, political, and social development.[62] Income tax brings into focus the importance of politics and law. Consequently, the laboratory of income tax law provides a perfect opportunity to study law and its role in society.

Some might also dismiss income tax law as not worthy of philosophical study due to its instability and impermanence. Such a view

60. *See* STEPHEN G. UTZ, TAX POLICY: AN INTRODUCTION AND SURVEY OF THE PRINCIPLE DEBATES 1 (1993).

61. *See* ARISTOTLE, DE ANIMA bk.I, pt. 1 (last visited Nov. 21, 2020) (http://classics.mit.edu/Aristotle/soul.1.i.html); ARISTOTLE, METAPHYSICS bk.VII, pt. 6 (last visited Nov. 21, 2020) (http://classics.mit.edu/Aristotle/metaphysics.7.vii.html).

62. Comprehensive income taxation has only been a feature of our social system for a little more than two hundred years. *See supra* text accompanying notes 35–36. This period has witnessed, starting in the nineteenth century, the industrial revolution, the experiential growth in world trade, capital growth and global capital flows, and vast international migration. *See* QUINLAN & STEVENS, *supra* note 38. Two world wars, the rise of the modern administrative state, the rise of free trade, open capital markets, and the enhanced mobility of many of the factors of production and the technological revolution mark the major events in human activity in the last one hundred years. *See* Barker, *supra* note 49, at 647.

reflects inherent human discomfort with change. Law is often viewed as an anchor, a structure of permanence that orients human life. Income tax law instead reflects the impermanence of things and constant change. What is central to tax today can be peripheral to tax tomorrow. With every change, tax law must show its flexibility in seeking consequences. Tax law forces people to understand law's role in those changes.

IV. THINKING ABOUT INCOME TAXATION AND SOCIETY

Before a person can speculate, theorize, make determinations, and conceive systems, a person needs to know the purpose of the inquiry. What problem is being investigated? What are the essential features of the problem? The problems of tax law are no exception. Tax law is concerned with people's resources. To tax and acquire resources from its people, the state needs knowledge of its people, their resources, the ways they hold and acquire these resources, and the ways they spend their resources. People's resources are its base. Tax law's objective is to take some portion of these resources for government purposes.

Different taxes focus on different aspects of human activity. For example, real property taxes require, in their most basic aspects, knowledge of property ownership and the uses to which real property is put. Wealth taxes require knowledge of a taxpayer's total resources at a particular time and how to value them. Consumption taxes, like sales and value added taxes, look to sales of personal property and services.

Sales taxes, which are the simpler of the two general consumption taxes, look to sales or exchanges to persons who are the ultimate consumer. Value added taxes aim at the same objective but assess and collect taxes in stages. Two primary questions are asked for consumption taxes: is there a relevant transaction, and what is the value of the goods or services exchanged? Though the value added tax has become quite complex over the years,[63] it has two principle issues, much like sales tax: (1) value, which is defined by the contract, and (2) the taxable event, which is the included transaction.

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63. See BEN TERRA & PETER WATTEL, EUROPEAN TAX LAW 115–45 (3d ed. 2001) for a history of the value added tax in Europe.

It is not an exaggeration, however, to state that the starting point for income taxation is the totality of human activity. Income tax's interest in human activity is essentially inexhaustible. To make what humans are doing relevant for tax, a person must have questions that give thought an entry point for grasping the important factors. Whereas the questions we ask are posed in regard to an integrated system of tax and socio-economic activity, we must begin our study by seeking fundamental knowledge of the very phenomenon that the state seeks to tax and control.

Tax systems have many differences in the way they seek to tax and thus influence people's behavior. These differences can result in different degrees of effectiveness. Because of its differences from other tax systems that make it more comprehensive, income tax has come to dominate world taxation and the world economy in a way that gives its study unequalled informative power. This study works on the problem of how the power of income taxation has been unleashed. It applies a philosophical method of reasoning to income taxation to expose knowledge of law and socio-economic conditions. To accomplish this, one sets up a process by which the income tax law is seen as a major part of the world order. To begin, law must be grounded in the problems of experience.

Thinking about the subject of tax begins with the process of abstraction, which can be used to recreate the phenomenon of income tax. Tax is one process within the ongoing process of human activity; consequently, thinking through this process is limited to a certain moment in time and space. The world we perceive today is already thoroughly imbued with the law we attempt to analyze, and that law is constantly changing. All thinking about law and society, however, is subject to similar conditions. The process of abstraction to gain knowledge of phenomena is a process that starts with the many particulars of human activity. The particulars are those conditions that make people and things unique. It is not possible to grasp the way law governs and reflects socio-economic activity without an understanding of that activity.

Thinking that begins with socio-economic conditions is a process of inductive logic. A person begins with observation of all the different, particular phenomena of human activity. Thinking begins with the abstract: interpretive frameworks erected in our minds to think about the daily lives of people.[64] Abstraction proceeds by pulling apart the particulars into their parts or components to find those parts that are like other phenomena.[65] Abstraction is the intellectual process of recognizing similarities in phenomena, their likeness, to find their essential or common characteristics. Thinking about what is similar and what is different about the phenomena can be described as comparative thinking. The discovered similarities are what bonds different phenomena, and these similarities are abstracted in thought as the general essences shared by like phenomena from a particular vantage point. Abstractions are general propositions that capture the essential features of the phenomena examined. Abstractions reduce phenomena to a smaller number of determinate, general relations. Concepts represent the results that are used to communicate these general relations. Successful concepts provide a true description and explanation of reality.[66]

Grasping the essences of incredibly complex human activity leads to different generalities about the phenomena in study. Using these generalities to produce law to control and manipulate socio-economic activity requires a different kind of logical reasoning. This is deductive logic. The three principles of thought, as described by Aristotle, are: the principle of identity (A = A), the principle of contradiction (A cannot be both A and not A), and the principle of the excluded middle (A is either A or not A, there is no middle alternative).[67] Logic proceeds by deducing from two propositions or general abstractions a third that logically follows.[68] The conclusion is a product of the logical relations between the generalities; it results in new testable propositions about socio-economic conditions.[69]

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64. PAOLUCCI, *supra* note 19, at 156.

65. BERTELL OLLMAN, DANCE OF THE DIALECTIC: STEPS IN MARX'S METHOD 60 (2003).

66. *See* PAOLUCCI, *supra* note 19, at 148.

67. ARISTOTLE, METAPHYSICS bk.IV, pt. 3 (last visited Nov. 21, 2020) (http://classics.mit.edu/Aristotle/metaphysics.4.iv.html); *id.* pt. 6.

68. ARISTOTLE, PRIOR ANALYTICS bk.I, pt. 1 (last visited Nov. 21, 2020) (http://classics.mit.edu/Aristotle/prior.1.i.html).

69. Simply put, "[f]rom living perception to abstract thought, and from this to praxis,—such is the dialectical path of the cognition of truth, of the cognition of objective reality." 38 VLADIMIR LL'ICH LENIN, LENIN COLLECTED WORKS 171 (Stewart Smith ed., Clemence Dutt trans., Progress Publishers 4th prtg. 1976) (1895–1911).

Deductive or syllogistic reasoning conceived dialectically grasps the concept as a complex whole by containing three moments interacting with each other—the Universal, the Individual, and the Particular.[70] Using concepts requires a return to the real world to test their validity. The world, however, is always changing. To Hegel we owe a logic that incorporates dynamics and change into concepts. Without this logic, income is lifeless.

The phenomenon of which tax law seeks knowledge is the same world that economists, sociologists, historians, and legal scholars study. Each discipline approaches human activity from the vantage point of its own questions and reasons for knowing.

Where disciplines view the same particulars, the knowledge gained represents an interrelated approach to phenomena. Tax law does not work in isolation; rather, it learns from the body of knowledge that is available. It takes available knowledge of the world into its own process to determine the significance of the socio-economic life of people for itself, that is, for the purposes of tax law. The essential conditions of human activity that are relevant to tax law form concepts that communicate the aspects of socio-economic activity upon which tax acts. Concepts represent the results and, like income, put thought boundaries on particular things so that tax law can deal with them, that is, tax them.[71]

Tax law begins with all the particularity of human activity approached from the necessity to find resources for government use. The endowments of nature are many, but many of them are not accessible yet, like gold on Mars. The secret is to discover people's resources and to determine how people make these resources available for use.

The key to taxable resources is physical and mental labor that transforms the world and makes things available for human use. Labor's role in capitalist society is no longer sufficient in itself to transform society today. The transformation of the world through production requires both labor and capital. Indeed, one could easily believe that capital is of first importance because the predominant form of labor today is contract labor that capital purchases and brings into being.

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70. JOHN H. MCCLENDON III, C.L.R. JAMES'S NOTES ON DIALECTICS: LEFT HEGELIANISM OR MARXISM-LENINISM? 276 (2005).

71. *See* discussion *infra* Section V.C.

To understand capital, we must start with property, which consists of things that are owned by persons. Ownership grants certain exclusive rights to the use of that property in perpetuity. Capital, in the sense we think of it in our capitalist system, is property that is used in the process of production. Capital, as a resource available to people, is a necessary part of production which joins with labor to transform the world.

It is the process of labor's making resources available for use that makes these resources available to tax. Tax's grasp of these transformative processes begins with the production of commodities. Commodities are goods and services produced for human needs and satisfactions. These include both commodities that are produced for human consumption and commodities produced to then produce more commodities (which can be referred to as capital goods and services). Commodities become available to others through the exchange of those commodities for value.

The value of commodities is their worth in terms of how much of another commodity they can fetch. Modern society uses money as the substitute for commodity exchange value: money is the universal exchange value of commodities. Even where commodities are directly exchanged, parties to the exchange would likely engage in a process by which the commodities bargained for were first valued in money to arrive at an equal, bargained-for exchange.[72] Money today is synonymous with exchange value. Money, viewed as a commodity, differs significantly from other commodities.

Money as an abstract property lacks typical self-consumable use value, which is severable from the property itself, like the use value of a car or a home that can be self-consumed by the owner. Money's value is in putting it to work, either by exchanging it for something else or by lending it to another who will pay interest. Its use value is its aptness as a universal equivalent to all other commodities: money is a substitute for value removed from the real value of resources. Money is a symbol whose essence is in those functions it performs in the world based on human convention. Yet today's society treats money as the *thing*, the true source of wealth and power.

72. *See* Rev. Rul. 79-24, 1979-1 C.B. 60, 1979 WL 50765 (explaining that members of a barter club would negotiate the value of their services to be performed).

John Locke concluded that the natural worth of anything consists of its fitness to supply the necessities or serve the conveniences of human life.[73] Locke here spoke of the use of value of things or their intrinsic value independent of their exchange value. The exchange value of things upon which today's socio-economic life focuses is *not* intrinsic value. The exchange value of a thing, whether it is property, a commodity, or one's own labor, is exactly as much as it will fetch in the markets, no more or less. Thus, the exchange value of all things is a relative value expressed in terms of the value of other things. Money, the measure of exchange value, also has a relative value, which is measured by how much it can purchase at a given place and time. Money's value and the exchange value of commodities are in constant flux.

As an example, consider the value of an automobile. To a person who wants the auto, the value is what she must pay for it; to the person who has the car, it is the price for which he can sell it for. According to the tax law, its value is its Fair Market Value: the amount for which it would be exchanged between a willing buyer and a willing seller both being reasonably aware of the circumstances.[74] Here, the economic and tax sense are the same. The exchange value is denominated in money, which is a thing that people will accept for other things. Consider that the car is sold for $1,000. This represents its value established by an arm's-length transaction which is true for both tax and economics. The next day, however, the purchaser sells the car for $1,500.

Is the car exchanged the first day the same as the car exchanged on the second? The answer depends on one's reason for asking the question and one's measure of value. Logic states that a car is a car (A = A). It is equally true that money is money. This is essentially true from the perspective of use value. But from the perspective of exchange value, the car is different the next day. Has the car changed value or has the money changed value? Probably both have happened depending on one's vantage point. If instead of exchanged cars we were speaking of exchanged currencies, we could see the value of the U.S. dollar changes constantly in regard to Euros, for example.

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73. JOHN LOCKE, TWO TREATISES OF GOVERNMENT AND A LETTER CONCERNING TOLERATION 111 (Ian Shapiro ed., Vail-Ballou Press 2003) (1690).

74. Treas. Reg. § 20.2031-1(b) (as amended in 1965).

However, both business and tax law start with the perspective that money (measured as the nation's currency) is a constant. Exchange value measured in money fixes both economic and tax consequences at a particular moment in time. Therefore, the car has changed value for economic and tax purposes measured in money. Thus, income starts with things that are the same (a car is a car) which are different over time (the car that was sold is not the same as the car that was purchased). It is this very fact that is a fundamental underpinning of capitalism and the tax system.

In the middle ages, God was the center of the universe. In the Renaissance, it was man.[75] In the capitalist society, it is money.[76] The role of money today supports the structure of modern socio-economic life, which consists of market valuation of practically everything in the world of people.[77] Money's worth does not have intrinsic value but rather represents a claim on future work and production.[78] However, because the exchange value of those future things is continuously changing value in money's worth, money's claims are changing as well.

Tax law needs an entry point into the activity of people to share the wealth and products made available by the people. Oftentimes, that entry point is the exchange. Even where commodities or services are directly exchanged, tax law requires the restatement of the transaction in money's worth.[79] Consequently, money today makes income tax viable because it provides not only a readily gathered resource for government expenditures but also the tool for tax to grasp the incredible

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75. The change from a God-centered hierarchical approach to an individualized human centered understanding of man is a central feature in the development of western civilization. *See Renaissance Conceptions of "Man,"* SUNY ONEONTA ART DEPARTMENT, http://employees.oneonta.edu/farberas/arth/arth200/artist/renaissance_man.html (last visited Nov. 21, 2020); *see also* WILLIAM N. ESKRIDGE, JR., DYNAMIC STATUTORY INTERPRETATION 3 (1994) (referring to Thomas Aquinas on the a/s relation of divine law and positive human law).

76. G.A. COHEN, KARL MARX'S THEORY OF HISTORY 407 (Princeton Univ. Press, expanded ed. 2001) ("[W]ithout money, there can be no accumulation of abstract wealth, as opposed to wealth in particular, useful, perceptible forms.").

77. *Id.*

78. *See generally* KARL MARX ET AL., MARX AND ENGELS ON LAW (Maureen Cain & Alan Hunt eds., 1979); *see also infra* note 123.

79. *See* Rev. Rul. 79-24, 1979-1 C.B. 60, 1979 WL 50765; see also *infra* Part V for a discussion of how tax supports the economic system.

diversity of human activity and the cycle of capital, labor, production, commodity exchange, consumption, and capital creation. These concepts that capture the essences of people's socio-economic lives are also the essences that income tax law must itself encompass to effectively accomplish its tasks. Income tax is the process of the state sharing with the people a portion of the consequences of the people's socio-economic activity. As a partner in humanity's total enterprise, income tax law must have a method to understand, control, and share in the product of human activity.

V. The Essential Relations of Income Tax Law

To truly understand income tax law, one must not treat it as isolated and abstract but as a part of the movement of the whole of human activity, interconnected with all of the things that make up a nation and the world. The purpose of income tax is to harness capitalism, the most developed and complex social form of production the world has ever seen. To accomplish its goal, income tax has thus become the most developed and complex form of taxation in history.

In order to accomplish its legal function, tax law sets boundaries by conceptualizing its subject matter, the socio-economic relations of humanity, where that subject matter is boundless. These concepts are the product of legislation adopted at a given moment in time and are reflective of the contemporary socio-economic conditions. These concepts, however, can never capture the totality of their subject matter because it moves, changes, and expands.

At the same time, the social process of tax law, as part of the whole of human activity, shapes the processes it governs and in turn is shaped by those processes.

Consequently, to be effective, concepts must capture both the fluid and the stable qualities of socio-economic relations. Concepts must be dynamic or they will distort the subject matter that they seek to understand. What is required is a process of logical thinking and application that incorporates the dynamics and fluidity of the subject matter of income tax law. Only dialectical reasoning accomplishes this task.

The analysis of any tax system begins with the understanding that tax is all about the base and the rates. The base is that which is subject to tax. The rates represent the percentage of the base that is appropriated by the state. The rates represent a judgement call on what percentage the government needs counterpoised with the question of how much can the people stand. The base, however, is the composite of the many facets of human resources that are available to a particular tax scheme.

Income tax is a tax on income. This seemingly not very helpful principle of identity is the definition provided by the Internal Revenue Code: "[I]ncome means income from whatever source derived . . . ."[80] What is income, however, is not immediately obvious where economic happenings like production and commerce are examined. Splitting this singular concept and thinking about its parts are essential to understanding the tax base. With the flows of capital, labor, and commodities, each movement is at the same time an inflow to one person and an outflow to another.[81] The income tax base targets financial happenings in motion. Income, or something that comes in, is based on that flow to the taxpayer. Consequently, one part of the concept of income captures the flow of value to a taxpayer.

The defect in the concept of the tax base as income (described above) is that the base, which the tax law characterizes as gross income,[82] is not truly available to the taxpayer for paying tax. Expanding the view of the taxpayer's activities exposes the taxpayer's acts of making expenditures. The outflows that are of interest to income tax are those related to the inflows because, without these expenditures, the inflows would not be possible.[83] Consideration of outflow captures a second part of the concept of income.

Income, which is the concept that describes the tax base, is the central dialectical unity of the income tax law. The splitting of this concept into its parts to contemplate the relations of its parts is the foundation of dialectics. The three laws of dialectics are the unity of opposites, change of quantity to quality, and negation of the negation.[84] This

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80. I.R.C. § 61.

81. General principles of income tax begin with inflows that are included in income and proceed to outflows or expenditures that are potentially deductible. *See* I.R.C. §§ 61, 162, 212.

82. The tax base begins with gross income. I.R.C. § 61.

83. Outflows on expenditures that are costs associated with producing income are deducted or capitalized. *See* I.R.C. §§ 162, 212 (deductions); *id.* at § 263 (capitalization).

84. *See* PAOLUCCI, *supra* note 19, at 244.

process, in its more fundamental form, can be illustrated by Hegel's discussion of Being and Nothing.[85]

Hegel begins his analysis with Being or existence. However, Being is finite (people die) and its limitation is destruction or Nothing. Nothing is the opposite of Being: [86] Nothing is the negation of Being. Being is negated by Nothing.[87] Being becomes Nothing, its opposite which is the absence of Being. Our experience, however, is that people do exist. Within this contradiction are movement and change, and this is explained logically by the negation of the negation.[88] Nothing is negated by its opposite, Being is part of a unity of opposites. Being and Nothing is the unity of Becoming.[89] The missing movement of the pure concept of Being is that it becomes Nothing. The missing movement of the pure concept of Nothing is that Being emerges. Neither expresses the dynamic of life without the other; each has its expression in the other; and together as the unity described as Becoming, the dialectical analysis of Being and Nothing grasps constant change.[90]

A. The Centrality of Income: The Unity of Gross Income and Deduction

The tax concept *income* communicates the central dialectical unity of the income tax law. It can be seen as a unity of its parts, which are inflows and outflows or, in tax nomenclature, gross income[91] and deductions.[92] Deductions, produced by outflows, are the opposite of gross income, which are produced by inflows. The tax base in its most basic form is income minus deductions.[93] Deductions are a negation of gross income. They make what was income and subject to taxation into something that is not income. Yet through the expenditure of funds,

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85. GEORG WILHELM FRIEDRICH HEGEL, THE SCIENCE OF LOGIC 111 (George Di Giovanni ed. & trans., Cambridge Univ. Press 2010) (c. 1813–16).

86. *See* PAOLUCCI, *supra* note 19, at 84 (theory of contradiction).

87. *See id.*

88. *See id.* at 96 (laws of dialectics).

89. *See generally id.*

90. *See id.* at 97.

91. *See* I.R.C. § 61 (defining gross income).

92. *See* I.R.C. §§ 162(a), 212 (providing the general principles for deductions).

93. *See* I.R.C. § 1 (imposing tax on taxable income); I.R.C. § 63(a) (defining taxable income as gross income minus allowable deductions).

income is created, hence, the negation of the negation. This synthesis of the tax base is often referred to as taxable income, net income, or profit.

This concept of the tax base must be incorporated into the reality of people's activities, because socio-economic activity is in motion. Change is the essence of this activity. Income tax starts with this movement and reflects it in its most fundamental concept: net income. Net income captures this motion and, in doing so, links it to its consequences. Income views activity from the perspective of the flows to persons and entities, that is, what comes in. It sees at every part of the process flows to taxpayers that represent resources available for taxation. These flows occur when people sell their labor to their employer, they happen when they sell commodities to others, and when they exchange the use of commodities or property for value.

The opposite of inflows is outflows. Deductions represent expenditures made by a taxpayer.[94] Each happening that creates an inflow to one person creates an outflow to another. The employer pays the employee. The producer buys other commodities or property. People buy commodities for consumption. Movements of goods and services contain both income and deductions, but the movements represent different aspects of the concept of net income to different people. The concept of the income tax base is not whole without both, but they are different and are in conflict. Dialectically, income and deductions interpenetrate, and the reality of one is contained within the other. They are dialectically related in a process of becoming.

B. The Unity of Income and Capital

Though the unity of income and deduction is the primary category of income taxation; in its totality there are many conceptual approaches that aid in knowledge of this base. A second level of abstraction is necessary for understanding the essential contradiction of income, income's opposite, or deduction. This is the concept of capital. Capital we immediately recognize as one of the two primary forces in production, along with labor.[95] Income taxation immediately elevates capital as a critical consideration of income taxation.

94. I.R.C. §§ 162(a), 212 (providing the general principles for deductions).

95. *See supra* text accompanying notes 44–45.

The role of capital is critical to understanding the income tax base. Capital produces income. Capital purchases labor essential for production. Capital purchases commodities for use in the process of production. Capital acquires the use value of property that is used in the process of production. A central truth of income tax is that it is a tax on income, not capital.[96] Hence, income and capital are opposites, forming a unity for tax under the concept of net income.

Capital, however, is not simply something that is not taxed; rather, it is part of net income because its nature provides the underlying reason for deductions. Instead of something that is simply not taxed, its role in income taxation is that it must be preserved. Where it is expended and transformed into income, it must reduce taxable income by being deducted. As a unity of opposites, income and capital are only real in terms of each other. They represent forces that are part of a dialectical unity negated by capital becoming income and income becoming capital. This process of becoming is in its totality the tax base at a particular moment in time.

C. The Unity of Capital and the Use of Capital

Capital in itself is also a concept standing for a unity of opposites. This unity is the result of its parts: capital and the use of capital. The tension created in income taxation results from the fact that income includes the use value of capital but not capital itself. When use value is exchanged for money or other commodities, that value is part of income.[97] Thus, rents, royalties, and interest are all included as income.[98]

The distinctions in income tax treatment of many financial activities are many, and they are often not logically consistent. Property includes tangible and intangible interests, as well as the return from those assets, which includes rents, royalties, and interest. Land and money are not depreciable assets,[99] so, the return from these assets—subject to deductions for out of pocket expenses—are fully taxable. Improvements to land are depreciable, however.[100] Such use by the

96. *See* Eisner v. Macomber, 252 U.S. 189, 207 (1920).

97. *See id.*

98. *See* I.R.C. § 61(a).

99. *See id.* § 167(e)(1) (articulating to be depreciable, property must have a fixed and determinable useful life).

100. *See id.* § 168(b)(3)(A)–(B)

owner can be categorized as either business or as investment activity. Those who rent intellectual property can also receive depreciation.[101]

Though gross income is not capital but its opposite, income can become capital through the process of production where capital reproduces itself.[102] The cycle of production turns labor, capital, and the use of capital into commodities. Commodities are turned into money when sold. Money represents potential capital. If consumed, it is gone. If saved, it can become capital that can enter the productive process. Even workers can participate in this process from the point of view of tax with the sale of commodity labor. Once some portion of the wage that has been reduced by income tax is saved, it is capital free from future tax.[103]

Capital, from the vantage point of capitalism, is property and money devoted to the production of commodities. Capital is useful because it makes possible the acquisition of things. Acquisitions are exchanges. An exchange is also a dialectical unity with two opposing parts; an exchange is both a disposition of the old and an acquisition of something new.[104] When capital is spent, it is no more. It is nothing. An exchange is Being negated by Nothing. However, an exchange is also a purchase. Though capital has vanished, it has become something new.

Thus, capital, is always changing. From money-capital to money spent. Though capital has disappeared, it has become something else: a commodity. Though production is a unity of labor and capital, tax law focuses on production through the lens of capital. Tax constantly assesses the ever-changing nature of capital. Where capital has been consumed, tax law focuses on that consumption in its aspect as an expenditure of capital.[105]

Where the expenditure of capital for profit-making is classified as current, tax law provides for an immediate deduction of the full

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101. *See id.* § 167(f)(1)(A) (discussing depreciation of intangible property interests that have a fixed or determinable useful life); *id.* § 197 (noting depreciative of other intangibles).

102. *See* MARX ET AL., *supra* note 78, at 201.

103. Capital used in production of income is either deducted or capitalized, and in some cases, depreciable. *See* I.R.C. §§ 162, 167, 212, 263.

104. *See* Phila. Park Amusement Co. v. United States, 126 F. Supp 184, 187–88 (Ct. Cl. 1954).

105. *See* I.R.C. § 263.

amount, because its utility in the profit-making activity is presumed to have been used up completely during the taxable year.[106] The tax law here reflects the first moment of the dialectic, that is, spent capital is now nothing. Consequently, a deduction is appropriate.

Where the expenditure of capital is perceived as having utility for more than a year, however, tax law requires the capitalization of the expenditure.[107] Capitalization prevents the immediate deduction of the expenditure; instead, the expenditure is treated as capital or cost-basis in the acquired commodity.[108] These changes are captured in the dialectical relation of the exchange. An exchange is the unity of opposites. One part is the sale or disposition of the old capital, and the second part is the acquisition of the new capital. Therefore, the negation of property that has been sold becomes its opposite—money or other property. The negation or nothingness has become a commodity which has tax basis which is new capital in the enterprise in the form of that commodity (like machinery).[109] In this unity, the commodity has equal exchange value at the moment of exchange, and this is reflected in basis which represents the capital for taxation metamorphosized.

Current expenditures do not produce new capital and basis in the form of an asset. The expenditure was still made to acquire a commodity, however, such as labor. The acquisition cost of labor is typically not capitalized because it is usually unrelated to the acquisition of a long-lived asset of the business. Once labor is performed it is nothing; it has vanished.

The employee sells her labor for a wage. Unperformed labor belongs to the employee, and it is a thing that can be sold. The act of exchanging labor for money, however, ends the worker's relation with her creation, which is the negation of her labor. The laborer's work is now nothing to her. Her labor has metamorphosized into money. That money is the laborer's capital, which is safe from income taxation as long as it remains capital.

Purchased labor is simply a commodity in the hands of a business. However, its existence as labor vanishes as soon as the worker works. Tax law follows the transformation of labor into commodities

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106. *See id.* § 162 (allowance of trade or business deductions); *id.* § 263 (denial for deduction of capital expenditures).

107. *See id.* § 263.

108. *See id.* (capitalization); *id.* § 1012 (cost basis).

109. *See id.* § 1012(c) (determination of cost basis).

through production.[110] Purchased work is the property of the employer. It has become the employer's capital. However, the process transforms this capital into another commodity. It is the new commodity where people can find the old capital transformed. The new commodity is usually a product or service for sale. Thereafter, that commodity will itself be the subject of an exchange and will be transformed into money, that is, an inflow that will be included in income. Deductions for the expenditure of capital (as opposed to capital expenditures that are not deductible) offset or negate gross income. This can be seen as the flow of capital to labor, to commodity, to cash. However, the exchange value of the commodity is taxable income only to the extent that it exceeds the costs (or capital expended). The money flow that was seen for tax purposes as part income and part capital is now all capital: old capital transformed into new capital and income subject to tax transformed into new capital.

D. Tax Law's Reproduction of Capital

The movement of capital and its reproduction through production are carried out in a different manner for capitalized expenditures of capital.[111] Assets with bases that are used in the productive process to produce commodities are subject to cost or capital recovery over time where those assets' utilities are both fixed in time and capable of estimation.[112] This is known as capital recovery or depreciation.[113] The basic formula for depreciation is:

Basis – Salvage Value/Useful Life.[114]

Depreciation is based upon the economic understanding that some assets are used up over time.[115] The depreciation deduction for

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110. Current expenditures for labor are deductible expenses. *See id.* §§ 162, 212.

111. *See id.* § 263.

112. *See id.* § 167 (general depreciation); *id.* § 168 (accelerated cost recovery system).

113. *See id.* §§ 167, 168.

114. *See id.* § 167. Section 168 modifies this general formula by substituting "recovery period" for "useful life" and eliminates "salvage value." *Id.* § 168(a).

115. *See* MARVIN A. CHIRELSTEIN & LAWRENCE ZELENAK, FEDERAL INCOME TAXATION: A LAW STUDENT'S GUIDE TO THE LEADING CASES AND CONCEPTS 182–85 (Robert C. Clark et al. eds., 14th ed. 2018).

tax purposes represents an estimate of that portion of historical exchange value of the capitalized asset at the time of purchase that is used up or consumed during each taxable period of the asset's useful life.[116] This allows a deduction for the annual cost of property used in the process of producing goods and services that become taxed as income when exchanged.[117] Where goods and services are produced for sale to customers, the cost of labor, materials, and the portion of the cost of assets used up in the enterprise for their production are viewed by the tax law as capital destroyed (and deductible).[118] That same capital, however, is transformed into new capital as part of the value of the commodities exchanged that is offset by the deduction and not taxed.

The tax analysis expands our grasp of socioeconomic relations in the case of taxpayers who do not produce commodities for sale to customers in the ordinary course of their trade but who instead produce commodities that are to be used by the taxpayers to produce *other* commodities for sale in their trade or business.[119] Tax incidence pays particular attention to following the transformations.[120] To produce a commodity, a business requires labor, materials, plant, and equipment. Where the commodity produced is an asset intended to be used in the business, the tax treatment of the costs used to produce that asset depend on whether the asset produced has long-lived or short-lived utility. Expenditures for an asset with short-term utility are current and deductible;[121] non-deductible expenditures for an asset with long-term utility are capitalized. Where the asset's utility is long-term, labor and materials are transformed into the commodity, and the costs of labor and materials are capitalized as cost basis of the self-created property.

In addition, the depreciation allowance of the plant and equipment that is used to make a self-used commodity is also included as

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116. *See id.*

117. *See id.*

118. *See* Comm'r v. Id ho Power Co., 418 U.S. 3, 9 (1974).

119. *See id.*

120. *See id.* at 10–19.

121. A principle akin to that found in *Idaho Power Co.* was adopted by Congress for inventory accounting which requires direct and certain indirect costs of inventory to be added to cost of goods sold and only deducted in accordance with inventory accounting principles. 418 U.S. at 19 (holding that "the equipment depreciation allocable to taxpayer's construction of capital facilities is to be capitalized"); *see also* I.R.C. § 263(a).

part of the commodity's cost. Though the depreciation allowance represents that equipment's use, it has not been used up in directly producing a commodity to be sold quickly and included in income but in producing a commodity that will be useful to the business for years. The value consumed and gone, represented by the depreciation allowance, has been transformed into the new commodity to be used in the trade or business. That depreciation allowance is viewed by the tax law as being in or represented by the commodity that is not itself immediately negated by sale. Therefore, the depreciation allowance of the assets used in production, like the costs of labor and materials, is added to the cost basis of the commodity.

All of the aforementioned costs of the new commodity will be subject to depreciation over its useful life (or recovery period).[122] Income tax, which is focused on the changes taking place in socioeconomic relations, finds tax incidence where these significant transformations occur (the taxable event) and must accurately follow the flow of capital, including its transformations into new commodities. Dialectics provides the tools for capturing this real-world process of change and transformation.

The dialectical unity of income and deduction is a relationship of becoming. The integration of these concepts is merely an ideal that helps us begin to grasp the dynamic of change and imbalance. The tension in this unity can push net income in different directions, oftentimes the result of the politicized nature of tax laws in democratic societies. In the case of depreciation, it can be seen how the legislative process can shift the original balance, creating a different kind of tax while at the same time preserving the categorical relations.

The modern law of depreciation is quite different than it was even fifty years ago.[123] Legislation over the years has abandoned the idea that depreciation deductions should follow economic principles in allowing deductions that are a best efforts approximation of the actual use of a capital expenditure over the economic period of an asset's utility (known as useful life).[124] Depreciation has been changed to provide the recovery through deduction of a taxpayer's capital or basis much

122. *See* I.R.C. §§ 167, 168.

123. *See id.* § 168. Section 168, enacted as part of the Tax Equity and Fiscal Responsibility Act of 1982, dramatically changed the scope of depreciation. Pub. L. No. 97-248, 96 Stat. 324; *see also* CHIRELSTEIN & ZELENAK, *supra* note 115, at 194.

124. *See generally* I.R.C. § 168.

more quickly that economic depreciation would allow.[125] The faster the depreciation, the larger the initial deductions; the larger the deductions, the less income that is taxed in the earlier years. Saving the person taxes on business income permits the accumulation of more capital over the years: The faster the deduction for depreciation, the lower the effective tax on income produced by business.[126]

Recent legislation in the United States has carried this pro-business policy to its extreme. Under the 2017 Tax Cuts and Jobs Act ("TCJA"), the Code now permits taxpayers to deduct the entire cost of a long-lived asset that has been initially capitalized in the year of acquisition.[127] The impact of this legislation is the economic equivalent of simply not taxing the basic income return on capital.[128]

The example of present day depreciation illustrates quantity and quality in dialectics.[129] "The totality of the essential features that make a particular thing or phenomenon what it is and distinguish it from others, is called its *quality*."[130] The essence of income tax law, as conceived in the original 1913 income tax law,[131] was that "[t]he tax upon incomes is levied according to ability to pay[.]"[132] The quality of the original income tax law was its essence as a tax based on taxpayers' ability to pay. However, "*quantitative changes of a thing inevitably bring about a change in its quality*."[133] The change in the quantity of depreciation deductions has changed the quality of the tax base (net income) for capitalists; its quality has changed from a tax on economic income and a tax coinciding with a taxpayer's ability to pay to no tax at all.

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125. *See id.*

126. *See* CHIRELSTEIN & ZELENAK, *supra* note 115, at 192–95.

127. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended at I.R.C. § 168(k)(l)–(k)(6)(A)(i)).

128. *See* William B. Barker, *An International Tax System for Emerging Economies, Tax Sparing and Development: It Is All About Source!,* 29 U. PA. J. INT'L L. 349, 382 (2007).

129. *See* PAOLUCCI, *supra* note 19, at 245 (identifying Marx's three principles of dialectics as the unity of opposites, change of quantity to quality, and negation of negation).

130. KUUSINEN ET AL., *supra* note 3, at 70.

131. *See* Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114.

132. H.R. REP. NO. 63-5, at XXXVII (1913).

133. *See* KUUSINEN ET AL., *supra* note 3, at 73.

Consequently, under a system of 100 percent first year depreciation allowance, taxable income no longer effectively includes the normal return of profit or net income from that capital. Deductions have swallowed up the income. Capital has been reaffirmed by the tax law as the tax-favored aspect of production. Capital reproduces itself through the creation of profit. Profit is normally conceived of as derived from the value of commodities in excess of their costs which include all expenditures of capital. In general theory, the income tax law takes an active role in the preservation of capital through nontaxation.[134]

Today, however, the tax law purposefully engages in the increase of capital to the owners of capital using a reduced or zero tax on capital through depreciation.[135] The result—that the government does not share the normal profit return that capital produces—is hidden in the income-deduction relationship. The offset of income by economically excess deductions for capital has made the income tax no longer an income tax on income produced from capital.[136]

The centrality of capital in socio-economic relations is sustained and expanded by the income tax. Where a corporation or individual taxpayer receives an immediate deduction for all capital expenditures, [137] the normal return on capital is not taxed.[138] The normal return is the risk adjusted return after inflation that investors seek for the particular risk involved.[139]

The treatment of interest shows this. If all of a corporation's capital were borrowed, the entire return on that capital, or interest, would be deductible and earned by the creditor.[140] An enterprise's

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134. *See* I.R.C. § 168(k)(6)(A)(i) (allowing up to 100% depreciation for the cost of machinery and equipment).

135. *See id.*

136. *See* William B. Barker, *A Common Sense Corporate Tax: The Case for a Destination-Based, Cash Flow Tax on Corporations*, 61 CATH. U. L. REV. 955, 962 at tbl.1 (2012).

137. *See* I.R.C. § 168(6)(B)(i) (allowing up to 100% depreciation for the costs of property).

138. *See* Barker, *supra* note 136, at 974; *see also* Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax Is Exempt Under a Cash Flow Tax?*, 52 TAX L. REV. 1 (1996).

139. *See generally* RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 146–79 (8th ed. 2005).

140. *See* I.R.C. § 163.

success is measured in the financial literature by whether the enterprise generates profits over and above the normal cost of capital.[141] Finance teaches that businesses focus on the net present value (the discounted value of the expected flow of income: NPV) of a proposed undertaking and only will pursue that undertaking where the NPV sufficiently exceeds the cost of capital.[142] If borrowed capital cost six percent per year, the undertaking would have to produce over six percent after an allowance for capital recovery.[143] The excess over the normal return from capital is known as supernormal returns or economic rents.[144] Though economic rents are the product of the labor of the participants in the enterprise (including management), they are the property of the shareholders whose capital paid for that labor and are legally deemed to have produced them.[145]

The tax treatment of debt enlarges the income tax law's role in supporting capitalist production and growth of capital. Loaned money is the capital of the creditor. The creditor is compensated for the use of her capital with interest. The borrower's production of income produced by debt capital is not the borrower's income economically or taxwise due to the offset of income by the interest deduction. The principle of the loan, however, is also treated by the tax law as the capital of the borrower.[146] The same money is double capital, it is now the capital of both the creditor and the borrower. The creditor's capital is her basis in the principle of the loan. The expenditure of the debtor's capital derived from loans is either a deductible expense that offsets current income or a capital cost providing basis in assets that are acquired even though the capital is not truly her own. Such basis often results in immediate depreciation deductions offsetting income or, as in the case of present tax law,[147] immediate deduction through first year capital allowances. Those excess deductions offset the supernormal return from borrowed capital, producing a negative rate of tax on the normal return from capital. Where deductions exceed even that normal and supernormal return, they can offset other income earned by the

141. *See* BREALEY ET AL., *supra* note 139.

142. *See id.* at 20–24.

143. *See id.*

144. *See id.*

145. *See* Barker, *supra* note 128, at 382–83.

146. *See* Crane v. Comm'r, 331 U.S. 2, 5 (1947).

147. *See supra* text accompanying note 106–09.

taxpayer which eliminates tax on other income and produces an uncompensated flow of government funds to the taxpayer.

E. The Unity of Exchange Value and Use Value

Both tax law and capitalism equally fail to account for the use value of things that are not transformed into things for sale. The use value of labor and capital is consumed by people outside capitalist production and the income tax system. Tax law refers to this as imputed income, which is not taxed.[148] Self-production and consumption deprive capitalist production of these resources and deprive the tax system of tax on these resources. By not taxing imputed income, capitalism and the income tax work at cross purposes because the income tax enhances the value of imputed income through nontaxation. Even though the tax law could tax the significant types of imputed income, like the use value of owner-occupied real property, it is difficult to value this kind of income without a market transaction making that value certain.

Use value is the value of labor or the use of capital in itself; exchange value is value by reference to something else, represented by the standard of money.[149] To tax, use value must be measured as exchange value. Use value and exchange value are a unity of opposites. The relationship of identity could be captured by taxation since such use is often exchanged in the markets. However, a plausible explanation for tax's failure is the probable consequences to the owner of valuable property interests like stock. For example, a taxpayer who owned one billion dollars' worth of shares of a corporation that does not pay a dividend could have an annual income of $50 million at an imputed rate of 5 percent.[150]

148. *See generally* Helvering v. Indep. Life Ins. Co., 292 U.S. 376, 381 (1934) (imputing income from property).

149. KARL MARX, CAPITAL 36, 38 (Frederick Engels, ed., Int'l Publishers Co. Inc. 1967) (1867) (use value and exchange value).

150. Dividends represent the use value in the form of money of shares of stock and are taxed as income. *See* I.R.C. § 61(a)(9).

F. Appreciation in Capital's Value

Gain or loss from the sale of business property, however, were common elements of income taxation because all changes in value of business property are part of business income.[151] Taxation of capital gains and losses that applied to non-trade or business assets, however, was not initially included by all other countries and was adopted by many nations relatively recently.[152] The taxation of capital gains and losses from the sale or other disposition of investment property, however, has always been an element of United States tax law.[153] The measure of the income (gain or loss) is determined by subtracting adjusted basis (which represents capital invested in the property) from the amount realized from the property.[154] The amount realized is the incoming flow to the seller, that is, the money and fair market value of the property received.[155] Gain, where the amount realized is greater than the basis, is income to the seller; loss, where the amount realized is less than the basis, is deductible subject to certain limitations.[156]

Loss stands for the loss of capital that is fully preserved as a matter of income tax because the taxpayer receives a deduction for the prior capital expenditure that has been established as lost by the sale. This deductible loss can offset the taxpayer's capital gain. Further deference to capital income is advanced by the treatment of capital gain (or net capital gain). Net capital gain earned by individuals is subject to special reduced tax rates unavailable to labor income.[157] Net capital

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151. This result is derived from the conclusion that the source of the gain or loss from the sale or exchange of business property is the business activity. *See* Barker, *supra* note 32, at 30–31.

152. After the United States, the next nation to adopt the taxation of capital gains and losses was the United Kingdom in 1965. *See* Capital Gains Tax Act 1979, c. 14 §§ 1–3 (Eng.). *See generally* Barker, *supra* note 32, at 29.

153. *See* I.R.C. § 1001 (determination of the gain or loss from the sale or other disposition of property).

154. *See id.* § 1001(b).

155. *See id.*

156. *See* I.R.C. § 1211 (limitations on capital losses). Capital loss deductions are generally limited to the amount of capital gains. Individuals are entitled to deduct net capital losses up to $3,000 annually. *Id.* Taxpayers can generally carry remaining capital losses forward in the case of individuals, and both forward and backwards in the case of corporations. *See* I.R.C. § 1212.

157. *See id.* § 1(h).

losses, in the case of individuals, can be fully deducted from regular income up to $3,000 each year.[158]

In the American tax system, basis is virtually synonymous with capital. It is basis that is the vehicle in tax law for preserving capital by allowing basis to be recovered as an offset to income.[159] Basis can be described as that which is the cost of property (including money) that has been through the income tax system and should never be taxed as income again. A principle of income taxation is that income is only taxed once to any particular taxpayer.[160] Once it has been subject to tax, that money is one's own capital. People use their money in various ways. Where it is spent on consumption, the capital is lost without income tax significance.[161] Where it is saved or invested in the purchase of property, capital is preserved.

The income tax treatment of the disposition of property shows another element of the partnership between state and taxpayer through the state's sharing of the risk of loss.[162] The income tax law takes a portion of the increase in the value of capital when capital is sold:[163] when the value of capital is diminished, the tax law gives back a portion of the loss.[164] In both cases, the tax law takes or gives only a portion. It does not restore the taxpayer's full capital when lost because it does not take the full gain when realized.[165] That is the balance of income tax: it shares the results of the taxpayer in good times and in bad.

Additionally, tax law reflects how the definition of capital has changed in modern society. Until the modern American income tax, taxation, like in England, reflected a feudal concept of gain from

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158. *See id.* § 1211(b).

159. *See id.* § 1001(a) ("gain from the sale or other deposition of property shall be the excess of the amount realized therefrom over the adjusted basis. . . .").

160. Once subject to tax, money and whatever it acquires has cost basis. *see id.* § 1012. Basis is used to offset an inflow of income through depreciation deductions. *See id.* § 167; *id.* § 1001 (upon sale).

161. Occasionally the tax law allows deductions, known as personal itemized deductions, for personal consumption expenditures. *See id.* § 63(d).

162. *See* BREALEY ET AL., *supra* note 139; *see also* I.R.C. § 165 (allowance of losses incurred in business and investment).

163. *See* BREALEY ET AL., *supra* note 139; *see also* I.R.C. § 165.

164. *See* BREALEY ET AL., *supra* note 139; *see also* I.R.C. § 165.

165. The tax savings is the amount of the loss deduction times the applicable tax rule. *See* BREALEY ET AL., *supra* note 139; *see also* I.R.C. § 165. The tax cost (or tax) is the amount of the income times the applicable tax rate. *See* I.R.C. § 1(a).

property.[166] Land, the primary form of capital in feudal times, was difficult to sell.[167] But even where the alienation of property gained momentum in the transition from feudal to capitalist ownership, the fact that the value of land changed relative to the value of money was irrelevant. The land was still the capital, and capital was the thing in itself. Whether the land was worth its original price or double that, the land was still the capital free from tax whether exchanged for money or other value, or not.[168] Most of the world adopted this analysis in concluding that capital gains were not income.[169] To tax capital gains, capital must be seen not as the thing in itself but as a commodity like any other that has exchange value. To produce income from the sale of capital, one must see capital as the historic exchange value when acquired, which is capable of producing profits through an increase of exchange value even though the property is the same.[170] Both capitalism, and its partner the income tax, depend upon the truth that all things change, and that even capital is a commodity.

G. The Unity of Labor and Capital: Production

In the process of production, capital and labor become one: production is the unity of capital and labor. Labor is a concrete quality. It is an active, sensuous creation. Capital, however, is an abstract quality. Capital can only produce if it is acted upon by work.[171] Therefore, capital without labor is nothing, because labor frees the use value of capital in modern production. It is the *use value* of capital that is a resource to be taxed, not the capital in itself. The income tax law includes exchanged use value in its base; hence, income tax is designed to tax capital in its productive aspect. Thus, the opposites of capital and labor can be seen as a unity in which capital is necessary to provide labor for production, and labor activates capital. This is the

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166. *See* Barker, *supra* note 34, at 29–30.

167. *See* WHITMAN ET AL., THE LAW OF PROPERTY 11–12 (2019).

168. *See* Graham v. Greene, [1925] 2 KB 37, 41 (Eng.).

169. *See id.*; *see also* Barker, *supra* note 27 at 716–19 (the adoption of capital gains taxation in post-apartheid South Africa).

170. *See* MARX, *supra* note 149, at 38.

171. See LOCKE, *supra* note 73, at 133–46, for the importance of labor. Indeed, Locke's justification of property rights is based on the appropriation of what god gave to mankind in common by labor. *Id.*

contradiction of capital and income: the interpenetration of one and the other, each recognizing its identity in the other, and the one becoming the other. The result is a commodity. Neither has force in the world today without the other. Both become nothing in the process of becoming something—a commodity. Thus, income taxation is designed both to reach capital through its use and to not tax capital at the same time.

Though labor and capital are indispensable parts of the creation of value and are dialectically related, tax law treats them differently. Whereas labor is no longer the worker's as soon as it has been performed, capital must be preserved in such a way that income tax does not diminish it. This undiminished core is capital as a thing in itself. This core must not be affected by the incidence of income taxation. Capital temporarily becomes gross income that is earned through the sale of products. It is not taxed because it is offset by a deduction or by basis or cost in property produced by the capital itself.

Though capital and labor are a unity of opposites as production, both capitalism and the income tax only see their differences. Over the years, one can make serious investments in oneself, resulting in labor income. People can acquire an education and job skills that will aid oneself in obtaining a higher exchange rate for one's work. These can represent large cash outlays. The acquisition costs of an education are not considered by the tax law as an expenditure for profit making, however.[172] Instead, education that qualifies a person for a trade or business is merely a consumption item that is neither deductible nor amortizable in reaching net income.[173] Though education can be expensive, a person's services are not treated as value that is the product of capital investment. Human capital is not an asset recognized by tax; consequently, expenditures by an employee in creating human capital are neither deductible nor capitalized resulting in basis.[174] Thus, no part of the taxation of commodity-labor income is offset by any investment in that source. The result is that wage labor under the tax law is a pure income receipt.

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172. *See* UTZ, *supra* note 60, at 91–96.

173. See Treas. Reg. § 1.162-5(a) (as amended in 1967), that sets forth the general rules for when education is deductible. However, under recent legislation, employees are not entitled to any deduction for business expenditures, including education. *See* Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended at I.R.C. § 168(k)(l)–(k)(6)(A)(i)).

174. *See* I.R.C. § 168(k)(l)–(k)(6)(A)(i)).

In contrast, business expenditures for labor are a deductible expenditure of capital. Costs associated with the education and training of the workforce—including the business owner herself—are typically considered to be the business owner's costs of production which are deductible.[175] Where a business is sold, the intangible value of labor or workforce is often valued as an asset by the parties and its acquisition cost creates basis. This cost can be depreciated by the purchasers under § 197.[176]

Since the income tax system reaches little (if any) income from capital, what is left is labor. Not only is the laborer's wage included in income, so too is the business owner's labor.[177] In some cases, the business owner will take part of her compensation as a wage. In other cases, her labor adds value to the commodities produced and takes the form of increased sales or gross income of the business.[178] In the corporate setting, the owner-manager may limit or refuse to take a wage and her labor will take the form of additional corporate profits that belong to the owners as shareholders.[179]

Though gains from labor are included in income,[180] they are not taxed consistently. Tax law makes clear distinctions between employees and other labor providers. Viewed dialectically, employment is a unity of employer and employee. The employer purchases the labor of the employee, and that labor becomes the property and capital of the employer. The employer profits by selling the labor of the employee to others through the provision of services or through the products produced by labor.

Through the principle of freedom of contract in the law, capitalism extols the illusion that the employee has received full value for her labor. That value is the exchange value or the amount of money the employer will pay. The labor is treated just like any other commodity: it has an exchange value at the point of contract. The purchaser uses the commodities including labor, raw materials, machinery, real

175. Treas. Reg. § 1.162-5(a) (as amended in 1967).

176. I.R.C. § 197(a), (d)(1)(C)(i).

177. *See id.* § 61.

178. *See id.* § 61(a)(2) (gross income derived from business).

179. *See* STEPHEN SCHWARTZ, DANIEL J. LATHROPE, & BRANT J. HELLWIG, FUNDAMENTALS OF BUSINESS ENTERPRISE TAXATION 7–8 (7th ed. 2020).

180. *See* I.R.C. § 61(a)(1)–(2) (including gains from labor in the definition of gross income).

property, and the use of property (rent or interest paid) to make new commodities to sell for a profit. Though in truth, labor unleashes the value of all the other commodities used in production, and in the process of the commodification of labor, labor loses its intrinsic or use value. The concept of value is a unity of opposites—use value and exchange value. Use value is the intrinsic value of a phenomenon. Exchange value is the fluctuating value of a thing in terms of its money's worth at a moment in time. In capitalism, labor's use value disappears in exchange value. Tax reflects this economic understanding of labor and other commodities of production by affirming their value as exchange value. Thus, tax and capitalism emphasize that a person's worth and contribution to socio-economic activity are as determined by both the law of contracts and income taxation. The worker's value is her exchange or fair market value.[181]

Though the concepts of independent contract labor and employment have many similarities, tax law sees the most important features in their distinctions.[182] Other types of laborers, designated as independent contractors in tax law, may still be seen to share many elements of commodity labor. The tax law treats non-employee laborers, however, as capitalists engaged in business.[183] Though the distinction in tax and employment law has many benefits to business because it removes the service provider from many of the legal headaches of employment status under tax and other law, it creates significant distinctions between the employed and the self-employed in taxation.

Though under the principles of taxation employment is categorized as a trade or business, which is the central form of the production

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181. *See e.g.,* I.R.C § 83(a)(1) (property transferred in connection with the performance of services included at fair market value); Treas. Reg. 1.61-21(b) (1989) (setting forth the information of fair market value of fringe benefits).

182. U.S. Dep't of the Treasury, *Understanding Employee vs. Contractor Designation*, INTERNAL REVENUE SERV., https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation (last updated July 8, 2020) (fact sheet from the IRS); INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE (2018) (https://www.irs.gov/pub/irs-prior/p15a--2019.pdf) ; DEP'T OF THE TREASURY, INTERNAL REVENUE SERV., PUB. 15-B, EMPLOYER'S TAX GUIDE TO FRINGE BENEFITS (2018) (https://www.irs.gov/pub/irs-prior/p15b--2019.pdf).

183. INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. 15-A, EMPLOYER'S SUPPLEMENTAL TAX GUIDE (2018) (only employees are denied ordinary and necessary business deductions); *see also* I.R.C. § 62(a)(1).

unit, this characterization as business starkly contrasts with the reality of employment's income tax treatment.[184] Net income is the unity of income and deduction. Labors' wages are income. Any business or profit-making activity is generally entitled to offset income inflows with expenditure outflows associated with those inflows.[185] For many years, the tax law respected the business nature of labor and generally provided employees with deductions for business expenditures,[186] even though requirements for deduction were often more rigorous than those for non-employee business people.[187] One restriction that was imposed in the past was that employees could only deduct an employment expense as a personal itemized deduction, and that the amount was only deductible to the extent the total amount exceeded 2% of adjusted gross income.[188] This substantially curtailed deduction was eliminated in 2017 under the TCJA.[189] Today, the general principle of net income taxation does not apply to employees.[190]

Persons who are engaged in business in a capacity other than that of an employee are allowed deductions with little restrictions.[191] In order to draw the line between employment and business, the tax law classifies those who perform services for hire, but who are not formal employees, as independent contractors. Many service providers who contract directly with customers for services are treated as separate businesses.[192] The distinction can be subtle. For example, an electrician who performs services for a contractor can be classified as an employee or independent contractor based on contract formalities and certain badges of independence.[193]

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184. I.R.C. § 62(a)(1).

185. *See id.* § 162.

186. Treas. Reg. § 1.162-17(b)(3) (1990).

187. *See id.*

188. I.R.C. § 67(a). Adjusted gross income is defined as gross income minus mainly business deductions. *See id.* § 62(a).

189. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (codified as amended at I.R.C. § 1045).

190. *See supra* notes 169–73 and accompanying text.

191. I.R.C. §§ 162, 62(a)(2).

192. *See id.* §§ 1401–1403 (imposition of tax on self-employed). The self-employed are generally defined as persons engaged in a trade or business who are not employees. *See id.* § 1402(c)(2).

193. MCCLENDON, *supra* note 70.

Persons who are not employees are generally entitled to all business deductions.[194] The stakes of classification are high, and tax law creates both uncertainty and artificiality in taxpayer conduct. The tax law clearly manipulates how the labor markets work at the margins.

It could be argued that the limitation or denial of employee business deductions is often justified for the reason that it is proper to leave the decision to the employer as to what expenditures are appropriate. Employees, it could be said, do not need to exercise independent judgment as to how best to carry out their duties as employees. The decision and the deduction belong to the employers. Eliminating employee business expenses can also be said to promote simplicity in taxation. The policy of simplification can obfuscate the shifting of the tax burden from owners of capital to laborers. Such treatment downgrades employment's status. Where the assumptions prove incorrect, employee innovation is stifled, and employees pay more tax.

The outcome hides another reality of taxation, which is the distinction in the tax treatment of different categories of consumption. Income gives taxpayers the ability to consume. Consequently, tax does not usually provide deductions for personal consumption expenditures like those for food, shelter, and entertainment.[195]

Deductible business expenditures, however, include many items that represent business-related consumption, like meals, lodging, and entertainment.[196] These expenditures also satisfy peoples' needs and wants. Personal and business consumption are a unity of opposites. Viewed from the vantage point of business deductions, the personal tends to become business. The wage earner has little chance to enjoy the unfettered advantage of tax subsidized consumption, whereas the businessperson has many opportunities to enjoy deductible consumption that reflects her personal choice.

Tax law's objects are often hidden in complexity and ideological justifications. However, in many areas, the TCJA of 2017 has abandoned obfuscation. The bias of business over labor has become more blatant. The TCJA also provides a special deduction of 20 percent of

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194. *See* I.R.C. §§ 162, 62(a)(2).

195. *See id.* § 262.

196. *See id.* § 162 (a)(1)–(3). For a discussion of nondeductible personal versus deductible business consumption see CHIRELSTEIN & ZELENAK, *supra* note 115, at 133–39. For provisions restricting business entertainment deductions, see I.R.C. § 274.

net income to most businesses conducted in non-corporate form.[197] The rational for the tax benefit was to equalize the tax treatment between taxable corporations, which were given substantial rate relief from 35 percent to 21 percent,[198] and business enterprises operated through entities and sole proprietorships where the individual owner pays the tax. The entities affected are partnerships, limited liability organizations, and subchapter S corporations. The result is that whatever income is left over after the generous treatment outlined above for capital income is now augmented by a special deduction for business.[199] Looking at the results and not the rhetoric, labor pays a larger share of taxes so that people who own businesses can pay less.

VI. HOW THE STUDY OF TAX LAW ILLUMINATES LAW AND REALITY

Tax law, like law in general, is created by people to help fulfil people's goals. Thus, law is part of the making of mankind by mankind itself.[200] In a world where governments play an ever-increasing role in the lives of their peoples, the income tax law has taken on an increasingly dominate role. Tax law should not be viewed as isolated from the life of people. Instead, it must be treated as an active part of the whole, connected with all of the aspects that make up a community. Its imperium is human society, and its success can be measured by how well it becomes part of the people's daily life and helps satisfy our needs and wants. As a result of the interpenetration of tax law and society, in the process of tax law grasping socio-economic relations for itself, tax law is mediated and changed by those conditions, and those conditions are mediated and changed by the tax law.

Income taxation grew as part of a society that was in the process of rejecting feudal forms of production and ownership and was adopting capitalist forms.[201] It was capitalistic principles that provided the fertile field for the growth of tax law. Of great surprise to those

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197. I.R.C. § 199A.

198. *See id.* § 11.

199. *See id.* § 199A.

200. Mitchell Franklin, *Legal Method in the Philosophies of Hegel and Savigny*, 44 TUL. L. REV. 766, 792 (1970).

201. *See generally* SIDNEY RATNER, AMERICAN TAXATION: ITS HISTORY AS A SOCIAL FORCE IN DEMOCRACY (1942).

capitalists who firmly opposed the adoption of income tax law,[202] income tax law's imperium is coextensive and supportive of capitalism's imperium.

The needs of capitalism have changed the role of taxation in the modern world. The needs of capitalism have expanded the role of the state, which has resulted in the need for vast amounts of revenue to support the state's role.[203] This need could only be satisfied by the adoption of broad-based, comprehensive taxes like the income tax.[204]

As capitalism has changed in the modern world—with vast changes in the modes of production[205] and with the advent of freer trade and the international mobility of many of the factors of production in the latter half of the twentieth century[206]—income tax law has also changed. The birth of the modern income tax in America was the culmination of intense political struggle:

> For 25 years a contest has been waged throughout the country in behalf of the adoption of a national income tax as a permanent part of our fiscal system, and the sentiment in favor of this movement finally became so strong that the people overturned a decision of the Supreme Court of the United States by writing into the Constitution the first amendment within 40 years.[207]

Income tax emerged "in response to the general demand for justice in taxation, and to the long-standing need of an elastic and productive system of revenue."[208] Income tax was chosen because "[t]he tax

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202. *See* PAUL, *supra* note 52, at 71–109 (arguments advanced against the passage of the 16th Amendment); *see also* Pollock v. Farmers' Loan & Tr. Co., 157 U.S. 429, 450, 452, 497–98, 532 (1895); *id.* at 596 (Field, J., concurring) (arguments including that income tax was class warfare against the rich).

203. *See supra* notes 30–31.

204. By the year 1938, the income tax rates ranged from 4% on the first dollar of taxable income up to 79% on taxable incomes over $5,000,000 for single persons. *See* I.R.C. § 1.

205. QUINLAN & STEVENS, *supra* note 38, at 38–39.

206. *See* GARY BURTLESS ET AL., GLOBAPHOBIA: CONFRONTING FEARS ABOUT OPEN TRADE 89 (1998).

207. H.R. REP. NO. 63-5, at XXXVII (1913).

208. *Id.* at XXXVI.

upon incomes is levied according to ability to pay, and it would be difficult to devise a tax fairer or cheaper of collection."[209]

However, the scope and objective of income taxation has changed over time. The tax law began as a tax on high income taxpayers at modest rates.[210] Early in its history, it reduced its impact on capital with the adoption of lower taxes for capital gains.[211] Later, with the impetus of the incredible need for revenue during World War II, it evolved into a tax on the general population at higher rates.[212]

In the 1980s, Congress again transformed the tax adopting accelerated depreciation or cost recovery systems for tangible properties.[213] This began the steady decrease of the income tax impact on income from capital.[214] Today, there are even more tax benefits for capital investment.[215] The consequence is that the income tax has been transformed from a tax of the income from the labor and capital of the wealthy to a tax on the wages and professional income of the middle class.

Capitalism has transformed modern life from a society centered on humanity's creative work to today's new center of money and capital. Indeed, capitalism's singular accomplishment is its ability to commodify most areas of human activity reducing most human functions to money.[216] This center is reflected in the income tax of today. The irony of capitalism is that that thing that was most hated by the capitalists in the past—the income tax—is now a primary support for capital in our social-economic system.[217] The evil asserted by the capitalists was that the income tax law was class warfare advocated by anarchists

209. *Id.* at XXXVII.

210. *See* Revenue Act of 1913, ch. 16, § II(B), 38 Stat. 114, 167.

211. *See* I.R.C. § 117 (adding Revenue Act of 1924).

212. *See id.* § 167(e)(1).

213. *See id* § 168 (first enacted in 1981).

214. Economic Recovery Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (codified as amended at I.R.C. § 168)

215. In addition to accelerated depreciation and first year deduction of capital costs under I.R.C. § 168, which is discussed in text at notes 112–14, the code provides full deductions for research and development in I.R.C. § 174(a); the election to expense certain depreciable business assets in I.R.C. § 179; and special deduction of 20% of taxable income for non-corporate businesses in I.R.C. § 199A.

216. *See* PAOLUCCI, *supra* note 19, at 210–14.

217. *See supra* text accompanying notes 110–12.

and communists.[218] Present capitalist ideology has shifted from general condemnation to comfortable acquiescence, advocating little tax on the wealthy as the road to a nation's economic prosperity.[219] As Louis Eisenstein remarked, "But even in times of peace, businessmen have to be encouraged to do the right thing."[220] Income tax law provides much of the encouragement. Legislative decisions to tax or not to tax or to distinguish activities and to tax them in different ways are a cause of the increase in the wealth and power of a minority in our society.[221]

The penetration of capitalist need into the tax law also becomes the interpenetration of income tax law into capitalism and socio-economic relations. Business decisions necessitate a knowledge of the tax incidence.[222] A businessperson may start with a simple human question of whether a product or service will meet a human need or desire. This question implies that the undertaking must yield a profit. However, these questions are suffused with the issue of tax and after-tax return.[223] Even the expenditure of the businessperson's time and energy requires consideration of the impact of taxes. As any businessperson knows, the evaluation of the investment often comes down to the incidence of tax.[224] The government's role is, in part, to secure the conditions for the preservation, and increase of capital and the creation of profitable investments.[225] The needs of capital have come to dominate income taxation.

To the business owner, tax is often a positive, not a negative. It often provides government goods and services to the businessperson

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218. *See* I.R.C. §§ 167, 168.

219. The theory of trickle-down economics popularized as Reaganomics, refers to the proposition that taxes on the wealthy and businesses are counterproductive and less taxes will stimulate the economy and lead to greater production and wealth. *See* Kimberly Amadeo, *Why Trickle-Down Theory Economics Works in Theory But Not in Fact*, (Sept. 24, 2020), https://www.thebalance.com/trickle-down-economics-theory-effect-does-it-work-3305572.

220. EISENSTEIN, *supra* note 31 at 119.

221. *See* RATNER, *supra* note 201, at 13.

222. *See* BREALEY ET AL., *supra* note 139, at 469–70.

223. *See Id.*

224. *See Id.*

225. *See* MARX ET AL., *supra* note 78, at 201.

for below cost.[226] Tax law often creates the opportunity to make an after-tax profit where there was no economic profit before tax.[227] Dialectically, the negation of a negation is positive. The mutual support of business and income tax law is an essence of modern life.

Using a dialectical approach to income tax law provides important insights into how this dynamic between tax law and society works. Through its categories, tax reflects socio-economic activity from the vantage point of tax law's objectives. These concepts were the result of reflection on real-world activity. The concepts discussed, like income and deduction, are part of a handful of those tax concepts that communicate the essence of much of human activity. There are many more subcategories in tax that are an aid to understanding more specific problems. Taken together, they are parts of a whole system that is intended to be a comprehensive, interrelated state institution. Tax's imperium is as large as its subject matter, and its subject matter is the whole of socio-economic activity today.

These dialectical unities are a tool for understanding the real objectives of taxation, the workings of the system, and the interaction of law and society through knowledge of the change in socio-economic relations in the process of law adjusting to and being adjusted by those conditions. This knowledge exposes both the appearance and the reality of the different objectives tax law serves in our society.

The state has different options to foster the development of capital and business. Today, there is pressure to reduce and repeal many of the laws and regulations that put an economic burden on business and capital.[228] It is common policy today for the state to provide capital through the medium of private banks, thereby making it available to businesses at low interest rates without direction but with the deluded expectation of providing funds for investment in domestic

226. *See, e.g.*, G.A. MACKENZIE ET AL., THE COMPOSITION OF FISCAL ADJUSTMENT AND GROWTH LESSONS FROM FISCAL REFORMS IN EIGHT ECONOMIES (1997), https://www.elibrary.imf.org/doc/IMF084/06848-9781557756299/06848-9781557756299/Other_formats/Source_PDF/06848-9781452739922.pdf

227. *See generally* BRAITHWAITE, *supra* note 45.

228. *See, e.g.*, William G. Gale, *A Fixable Mistake: The Tax Cuts and Jobs Act*, BROOKINGS (Sept. 25, 2019), https://www.brookings.edu/blog/up-front/2019/09/25/a-fixable-mistake-the-tax-cuts-and-jobs-act/.

production.[229] Taxation, however, is also touted as a well-known device for providing economic stimulus.[230]

Income taxation has certain features that automatically control and stabilize the economy.[231] With progressive tax rates, where a nation experiences inflation, the income tax acts as a curb on that inflation by collecting a higher percentage of those profits, taking more money out of society. Contrarily, where a nation experiences deflation, the progressive system takes a lower percentage of the remaining income, taking less money out of society.[232] When legislation lowers the rates or increases the rates, the income tax law has similar effects.[233]

Tax incentives for business directly benefit only certain members of our society.

Though governments through the expenditure function have different ways to subsidize the owners of business, many of these have been temporary subsidies enacted to address particular economic conditions.[234] The income tax, however, has been an institution of our law for over 100 years. Though the tax law is not immune to being used for temporary fixes, it has a clear and quasi-permanent structure biased toward capital and its enhancement.[235] Its structure creates a particularly effective partnership between state and taxpayer wherein government shares in the profits created. When these profits represent the net income produced by capital and labor in accordance with income tax's original intent in 1913,[236] they represent a share of the addition to wealth that has been created by people through the course of the taxable period and are a true reflection of taxpayers' ability to pay.

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229. *See* FEDERAL RESERVE, THE FEDERAL RESERVE SYSTEM: PURPOSES & FUNCTIONS 35 (2016), https://www.federalreserve.gov/aboutthefed/files/pf_complete.pdf (last visited Nov. 21, 2020).

230. PECHMAN, *supra* note 48, at 8–12 (discretionary changes in taxes).

231. *See id.* at 9–12.

232. *See id.*

233. *See* MUSGRAVE & MUSGRAVE, *supra* note 29, at 549–50.

234. *See, e.g.*, Coronavirus, Aid, Relief, and Economic Security (CARES) Act, Pub. L. No. 116-136, 134. Stat. 281 (2020).

235. This has been particularly true since the beginning of the 21st century. *See, e.g.*, American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418; American Taxpayer Relief Act of 2012, Pub. L. No.112-240, 126 Stat. 2313; Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054.

236. *See supra* text accompanying notes 131–34.

Contrary to its original intent,[237] the income tax law embraces a different concept of net income today. Today's ideology is that labor needs no incentive; after all, most people supply their needs and wants through work. Capital's use, however, needs to be encouraged.[238] Capital's role is too important not to be subsidized.[239] What is needed is for the government to ensure that the return on capital is high and that more opportunities are created for the employment of capital. The ideology of business non-taxation is that the recipients of these benefits will spend them on people. The reality is that the recipient business owners simply grow wealthier and wealthier.[240]

This analysis of tax law teaches us some important truths about law in general. Law has an enormous impact on society in the way it affects daily life. Income tax law, due to its increasing significance as a critical feature in society, allows us to use a broad-based system of norms that opens new insights into the workings of society. Due to its clear purpose of raising revenue for the state, it provides a singular vantage point for viewing socioeconomic relations that law in general seeks to acknowledge, understand, facilitate, and harness.

The abstractions of those relations that are important for tax law provide a rather straightforward series of generalities that capture the essences of the socio-economic relations necessary for tax law's purpose. Socioeconomic relations are a circular flow of phenomena that are moving humankind along in history. From capital to labor, commodities (things and services) are produced. Commodities are exchanged into money which flows into commodities for consumption, or for more capital. Though this completes the circle, it does not complete the process. The process is repeated. The metamorphosis of phenomena into other phenomena (like commodities into money) are the moments in the flow that tax law seeks to capture to raise revenue, and

237. *See* Barker, *supra* note 33, at 859–61.

238. EISENSTEIN, *supra* note 32, at 61.

239. *Id.* ("The prosperity of the middle and lower class depend[s] upon the good fortunes and light taxes of the rich.") (questioning Secretary of the Treasury Andrew Mellon).

240. The United States has the highest percentage of global wealth at 41.6% (the second highest is China at 10.5%). The United States also has the highest wealth inequality of any nation in the world. *See* Erik Sherman, *America Is the Richest, and Most Unequal, Country*, FORTUNE (Sept. 20, 2015, 3:28 PM), http://fortune.com/2015/09/30/america-wealth-inequality/.

to support capital, and to change human conduct. Income tax law is an irrelevancy without the changes it observes in this process. It can be seen in the basic approach to the notion of income that income includes accessions to wealth, clearly realized, over which the taxpayer has dominion and control.

Realization is a concept central to income tax law because all processes and relations necessary to produce another process or relation are centered on the process of realization.[241] Realization is the concept that encompasses income in terms of gain that is made certain by a financial event or exchange.[242] An accession to wealth is made real by a taxable event, that is, by the exchange of property. Income tax law views these happenings and classifies them as taxable events through the concept of realization.[243] The concept of realization is also embedded in every payment for goods and services. It understands these events through the many dialectical units that make them accessible to tax (such as income, deduction and income, capital and capital, and labor) and understands that they are opposites in tension. These thought-tools make it possible for tax law to penetrate the very core of socioeconomic activity today. To be useful, tax concepts must reflect the socioeconomic activity that tax seeks to harness.

Their affirmation is in the success tax law has in taxing and supporting the economic system. However, the process these concepts target is in movement. Thus, the circular flow of countless realizations is really a spiral. Each stage represents a new phenomenon whose roots are in the past; old capital that has been preserved joins new capital produced by the prior flow. Labor, in contrast, is always created afresh by people and is used to produce new commodities, which are paid for by capital produced in turn by capital and labor.

At its most general level, social income has been defined as the total result of economic activity during a period which "must equal the aggregate money value of all goods produced and services rendered during the year."[244] Put simply, social income is the total creation of a society during a period. The relation between the most general notion

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241. *See* PAOLUCCI, *supra* note 19, at 210.

242. *See* I.R.C. § 1001 (realized gain upon the sale or other disposition of property).

243. *See generally* Barker, *supra* note 56, at 33–38.

244. *See* RICHARD T. ELY, OUTLINE OF ECONOMICS 100, 105 (4th rev. ed., MacMillan Co. 1925) (1893).

and the most specific notion of income from things is best described by Adam Smith in the *Wealth of Nations*:

> The gross revenue of all the inhabitants of a great country, comprehends the whole annual produce of their land and labour; the neat [net] revenue, what remains free to them after deducting the expence of maintaining; first, their fixed; and, secondly, their circulating capital; or what, without encroaching upon their capital, they can place in their stock reserved for immediate consumption, or spend upon their subsistence, conveniences, and amusements.[245]

The concepts of taxation are not descriptions of isolated features of human activity. Dialectics provides the epistemological framework for viewing socioeconomic activity as a changing whole. It accomplishes this by capturing socioeconomic activity dialectically in the unity of opposites like capital and labor or income and deduction. Labor is distinct from and opposite to capital. Labor is the sensuous expression of human's drive to create.

Capital is a thing given expression through labor. Yet today, one is helpless without the other, hence, each sees its existence in the other. The dialectical understanding of the relationship expresses the interpenetration of opposites. Though their existence requires the other, their unity is a contradiction because each has the power to negate the other.

Hence, their relation is both supportive and at the same time destructive. For example, advances in technology develop machines to replace human labor. The technology and its commodification are creations of intellectual and physical labor that creates things that have the capacity to deprive humans of the essence of their being—their capacity to create. However, labor can negate capital, for example, by societal movement to more socialistic forms of production where bourgeois capital can lose its importance. For example, capital is constantly being created by governments and handed out to capitalists through low and negative interest financing and negative taxation of capital without that capital having been created by the labor of the capitalist. Dialectical

245. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 286–87 (R.H. Campbell & A.S. Skinner eds., 1979).

analysis of tax law demonstrates that tax law can change the relations of production through the manipulation of the dialectical relations of opposites, like income and deduction. The designed movement of the income tax law from a tax on the income from labor *and* capital to a tax on labor is dramatically changing social relations through the ever-continuous concentration of wealth and power in the few.[246]

People are often teased by the riddle, "which comes first, the chicken or the egg?" In this endeavor, we can be teased by the question of which came first, capitalism or the income tax? There may be several answers to that question, but the purpose for asking the question is not to answer it. Instead, when we observe that chickens produce eggs and eggs produce chickens, we realize that the question is meant to suggest that life is a process of creation and change. In analyzing this process, every question a person asks freezes in thought the world at its place and time. This article's focus is on the role law plays today. From the point of view of their interaction, there is a unity of opposites between capitalist society and the income tax law. They interpenetrate each other, exist through each other, and are in tension with each other because they represent contradictory opposites, both mutually supportive and destructive. Capitalist society is about the control of production and human activity through the primacy of capital and its universal symbol—money. Income taxation is designed to share in peoples' profit in order to provide funding for public functions. The unity of the income tax and the expenditure function goes to the essence of the modern state. Taxation and expenditure are largely supportive of the capitalist system. Our society has turned away from the progressive past that intended to tax the income from capital and provide public benefits for a better life for all. The way that present state action has veered the income tax from its foundation as, at least in part, a tax on the income from capital demonstrates the power of the dialectical understanding the unity and contradiction of labor—capital and income deduction. The dialectic of movement through internal contradiction and the negation of the negation demonstrates that income tax can change again. Changes in the way capital is conceived of and provided for in income tax can be a tool for capital's demise.

Capitalism is a cause of the income tax and the income tax is a cause of capitalism today. It is our goal to understand the role of law

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246. *See supra* text accompanying note 171.

in society by understanding this cause and effect between human law and human society. People create society, and people create law that reflects social relations to facilitate people's advancement and happiness. Human law acts upon society and becomes an essential part of its change. Income tax law provides not only a view of a dominant part of what that process is today, but a method for determining the possibilities of where we are headed tomorrow.

VII. CONCLUSION

This Article analyses socio-economic activity through the perspective of income tax law. Like science, it starts with understanding human activity as part of nature through cognition. Science uses concepts to deal with the natural world known as natural laws. People adopt laws using concepts that reflect and regulate their social activities as a part of nature. Dialectics conceive that the relations of one thing to another are a part of what that thing is. Thus, law cannot be understood without understanding its part in human's social and economic life. These parts, construed as logical categories, present the interrelationships of law and society as a process. This process is understood dialectically as a unity of opposites in contradiction that presents the logic of process and motion.

Income tax law, analyzed dialectically, captures important insights into both law's social control and society's legal control. Income tax law and socioeconomic relations are interrelated and mutually supportive of common goals. This provides a key to who we are and where we are headed. Consequently, income tax law has tremendous power to sustain or change economic relations, either as a tool for advancing the interests of a few or those of the many. Today, certain socioeconomic forces have captured the income tax to preserve the status quo and the existing pyramid pattern of individual wealth. Future choices on income tax can either continue the trend toward greater disparity in people's control of society's resource or change the future toward greater economic equality. Dialectics provides the tools for understanding what is, what was, what should and should not be, and what can be done about it all.

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