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TAX RATIONALITY AND THE INDEPENDENCE OF IRRELEVANT ALTERNATIVES

by

JAMES P. SPICA*

I. INTRODUCTION

Patricia White recently asked a simple question: What is the value of systemic coherence, or rationality, in tax legislation?¹ This is asked along the way of an errand that does not require its answer,² but White supposes, in passing, that the value queried is relative: no doubt systemic coherence is desirable, but it may conflict with other values predicable of a tax system, values it cannot invariably trump.³ This entails, on the one hand, that normative claims for rationality in this sphere regularly imply assignments of weights,⁴ and, on the other hand, that systemic coherence ought to be irresistible whenever it can be achieved without prejudice to competing values—whenever, that is, other things may be said to be equal.

The Internal Revenue Code (hereinafter “IRC” or the “Code”) displays cases of the latter description in which Congress has, nevertheless, contrived to resist rationality’s appeal. These represent a highly refined strain of incoherence in the Code. In each of them, coherence could have been achieved without prejudice to any systemic value with which it might otherwise compete. These are not cases in which rationality has been sacrificed for the sake of simplicity, administrative convenience, taxpayer-morale, or any other colorable desideratum. They are cases in which the only *principled* purchase of incoherence is incoherence. Yet they are evidently not inadvertent: at places in which Congress might easily have stumbled on coherence, it has drawn itself up, and gone carefully around.

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1. Patricia D. White, *Realization, Recognition, Reconciliation, Rationality and the Structure of the Federal Income Tax System*, 88 MICH. L. REV. 2034, 2037-38 (1990).

2. White’s concern is to specify certain structural features without which a system of rules could not be recognized as an income tax system. *Id.* at 2038. No doubt some coherence is a necessary feature of anything that can be recognized as a *system*, but White’s interest is in the conditions of minimum suitability for the special purposes of taxation. Beyond the threshold necessary for a set of rules to count as a system at all, White regards systemic coherence as a contingent feature. *Id.* at 2038, 2088-89.

3. *Id.* at 2088-89.

4. *Id.*

Such 'refinement' suggests analogies to the kind of irrationality displayed by decision makers whose preferences violate the standard axioms of decision theory.⁵ The goal of this article is to explore one such analogy. It will be argued here that certain provisions of the Code—we shall focus on section 642(g)⁶ for illustration—are analogous to violations of what decision theorists sometimes call a "sure thing principle."⁷ The analogy yields both a precise account of what evidently goes wrong in these provisions, and a straightforward general characterization of the sense in which they are irrational. The Code's treatment of an item is irrational in this sense if it would be possible to make a book against someone having the same pattern of preferences (for the treatment of that item) in such a way that she would lose out, by *her own* standards, no matter what happened.⁸ On this conception, tax rationality is a kind of *formal* coherence.⁹ It has nothing to say about the *ends* Congress pursues through taxation;¹⁰ it requires only that a tax scheme be suited to those ends (whatever they are) so as to promote, rather than frustrate, their achievement.

We can invoke the straightforwardness of this conception of irrationality without trying to model the circumstances in which Congress is liable to be swindled. It suggests the value of systemic coherence is partly the value of voluntary compliance which makes an easy start to an answer to White's question. If one's preferences are irrational in the sense described, one's attempts to effect them are liable to be self-frustrating. To the extent a system of commands is self-frustrating from the point of view of the *issuer* it undermines respect for, or goodwill towards, the issuer as a motivation for compliance. Someone who understands the commands to be incoherent in this sense may have reason to comply—she may wish to avoid sanctions noncom-

5. This kind of irrationality is sometimes called "instrumental." See, e.g., ALLAN GIBBARD, *WISE CHOICES, APT FEELINGS* 10 (1990); David Gauthier, *On the Refutation of Utilitarianism*, in *THE LIMITS OF UTILITARIANISM* 144, 146 (Harlan B. Miller & William H. Williams eds., 1982). It concerns the means chosen to achieve given ends. GIBBARD, *supra*; JOHN RAWLS, *A THEORY OF JUSTICE* 14 (1972).

6. I.R.C. § 642(g) (West 1995). Section 642(g) forces the executrix of a decedent's estate to an election for the deduction of certain expenses that would otherwise be deductible against both the income and estate tax bases. See *infra* notes 42-50 and accompanying text.

7. See *infra* note 27 and accompanying text.

8. This is the sense of irrationality to which decision theorists appeal. "The claim that a rational pattern of preferences *is* rational may be justified in this sense: if someone has a set of preferences that is not rational, it is possible to make book against him in such a way that whatever happens he will lose out by his own standards." DONALD DAVIDSON, *Hempe on Explaining Action*, in *ESSAYS ON ACTIONS AND EVENTS* 261, 268 (1980). See also GIBBARD, *supra* note 5, at 286; F.P. Ramsey, *Truth and Probability*, in *PHILOSOPHICAL PAPERS* 52, 78 (D.H. Mellor ed., 1990).

9. See GIBBARD, *supra* note 5, at 13 (characterizing the upshot of the standard axiomizations of decision theory as "a kind of formal coherence").

10. See *supra* note 5.

pliance will trigger or think that the benefits of automatic respect for the issuer's commands outweigh those to be obtained by insisting the issuer make sense. However, she cannot be motivated by a desire to achieve the *issuer's* immediate ends, for the issuer is evidently of two minds (at least) as to what its immediate ends should be.

Of course, this is only *part* of the answer. The value of rationality is no doubt complex. At one extreme, surely, it is aesthetic: other things being equal, there is no reason why the Code should be ugly.¹¹ At the other extreme, a modicum of systemic coherence is a practical necessity even *assuming* voluntary compliance, for some degree of coherence is needed for interpretation,¹² and we expect tax legislation will have to be interpreted regularly to be applied.¹³ Between these extremes lies a vast range of concerns (including, presumably, Congressional determination not to be swindled). Systemic coherence must have a lot to do, for instance, with our attempts both to be fair in determining what to consider as like cases¹⁴ and to be prudent in respecting the *nontax* incentives with which we tamper.¹⁵

11. The relevant sense of 'ugliness' must be something like the mathematician's when she says, for instance, "[b]eauty is the first test: there is no permanent place in the world for ugly mathematics." G.H. HARDY, *A MATHEMATICIAN'S APOLOGY* 84-85 (4th prtg. 1969).

12. This idea is standard among contemporary philosophers. See Donald Davidson, *Judging Interpersonal Interests*, in *FOUNDATIONS OF SOCIAL CHOICE THEORY* 195, 206 (Jon Elster & Aanund Hylland eds., 1986). It is frequently discussed in terms of "principles of charity." See WILLARD VAN ORMAN QUINE, *WORD AND OBJECT* 58-59 (1960); RONALD DWORKIN, *LAW'S EMPIRE* 53 (1986). In a discussion of conscious motivations, Donald Davidson puts the matter this way:

If we are to understand any of these ["human thoughts, speech, intentions, motives, and actions"], make sense of them *as* thoughts and speech and actions, we must find a way to read into them a pattern subject to complex constraints. Some of these constraints are logical, and some are causal People are in general right about the mental causes of their emotions, intentions, and actions because as interpreters we interpret them so as to make them so. We must, if we are to interpret at all.

DONALD DAVIDSON, *Hume's Cognitive Theory of Pride*, in *ESSAYS ON ACTIONS AND EVENTS*, *supra* note 8, at 277, 290. The same idea is widely known (by the same name) as a convention of textual interpretation. See GREGORY VLASTOS, *SOCRATES, IRONIST AND MORAL PHILOSOPHER* 236 (1991).

13. This has implications at various levels of administration. To the extent, for instance, that taxpayers and their advisors can fairly be relegated to their wits, authorities charged with administration may fairly eschew opportunities to pronounce on the treatment of particular cases.

14. The necessity of criteria for determining what count as like cases for a particular purpose is arguably fundamental to the concept of law. See H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 *HARV. L. REV.* 593, 623-24 (1958), *reprinted* in H.L.A. HART, *ESSAYS IN JURISPRUDENCE AND PHILOSOPHY* 49 (1983), and in *THE PHILOSOPHY OF LAW* 17 (R.M. Dworkin ed., 1977).

15. Such prudence is surely indicated. See generally Paul Samuelson, *Tax Deductibility of*

Still, this *part* of the answer is important. It is important *practically* because voluntary compliance is a necessity of such weight that practically anything undermining it is significant.¹⁶ (Thus, for instance, utilitarian arguments for energetic enforcement adduce not the net amounts to be wrested from scofflaws, but the margin of compliance to be secured by deterrence.¹⁷) This part of the answer is important *analytically* because it is uniquely implicated by the limiting case, the case in which other systemic values may be said to be equal. In other cases, as noted, normative claims for rationality will involve assignments of weights,¹⁸ and these assignments are bound to be controversial. A taxpayer may reasonably disagree with them without exhausting her own goodwill towards the legislature (or the legislative process, or the communities it represents, etc.) as a motivation for compliance. In the cases we have in view, however, such accommodations are unavailable.

II. THE SURE-THING PRINCIPLE

Overt inconsistencies in the Code need not detain us. To the extent such inconsistencies result from competition among legitimate policy goals,¹⁹ they lack the sort of 'refinement' we want. To the extent they result merely from legislative inadvertence²⁰ (or even from expediency), they are sufficiently condemned on the ground that (other things being equal) the Code should not be ugly. We are interested in a subtler form of irrationality, one that bears marks of deliberation, and which (perhaps sometimes for that reason) may be relatively difficult to detect. We will, however, begin with an example that seems to be glaring, and, for that purpose, we stray briefly from the Code.

Suppose a person *X* is shopping for a translation of the *Aeneid*. *X* tells a clerk in a book store "I prefer the translation by C. Day Lewis [*a*]; if you haven't got that, I'll take the one by F.W. Jackson Knight [*b*]; but I don't want the translation by Allen Mandelbaum [*c*]." The clerk says "I've got [*a*] and [*b*], but not [*c*]." To which *X* replies "All right, I'll take [*b*]." The clerk goes off (scratching her head). Presently she reappears saying "I'm sorry—I was

Economic Depreciation to Insure Invariant Valuations, 72 J. POL. ECON. 604 (1964).

16. See Leo P. Martinez, *Taxes, Morals and Legitimacy*, 1994 B.Y.U. L. REV. 521, 569 (1994).

17. See Walter T. Henderson, Jr., *Criminal Liability under the Internal Revenue Code: A Proposal to Make the "Voluntary" Compliance System a Little Less "Voluntary"*, 140 U. PA. L. REV. 1429, 1434 (1992).

18. See *supra* note 4 and accompanying text.

19. See Charles E. McLure, Jr., *The Budget Process and Tax Simplification/Complication*, 45 TAX L. REV. 25, 52-54 (1989).

20. See Stanley S. Surrey, *Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail*, 34 LAW & COMTEMP. PROBS. 673, 686-89 (1969).

wrong: I've got [a], but I haven't got either [b] or [c]." "In that case," X says "I'll wait."

Strange goings on! Of course, we can imagine attitudes towards the prospects involved that would make sense of X's preferences. It might be, for instance, that, other things being equal, X prefers [b] to [a], but that X is also concerned (for some reason) that [a] should show well against [c] in a marketing survey that X knows is being conducted currently, and which, to X's knowledge, will not register a purchase of one book as a preference over the other unless, at the time of the purchase, the store in which the purchase occurs has copies of both books available for sale. But suppose there is no such rationale for X's behavior; suppose her motivation throughout is merely a desire to own a copy of the translation she judges to be the best (in some sense) among those with which she is familiar. In that case, X's behavior is certainly strange, but is it *irrational*?

We can rule out *logical* incoherence. One might think X's saying "if you haven't got [a], I'll take [b]" (call this statement S_1) *logically* implies 'if you have got [a], I won't take [b]—I'll take [a]' (call this statement S_2). But that is an instance of the "fallacy of denying the antecedent,"²¹ which is to say that S_2 cannot be validly deduced from the conjunction of S_1 and the statement 'You have got [a].'²²

On the other hand, the hypothetical itself suggests that logical consistency is not sufficient for rationality, and indeed, the philosophers, economists, and decision theorists who model rational choice under uncertainty²³ do not suppose that it is. They represent rationality as a decision procedure (known as the Bayesian decision rule²⁴) that can be derived mathematically from "axioms," that is, from extralogical contingencies we are more or less readily prepared to accept as characterizations of rational decision making.²⁵ In addition to *logical* consistency, the standard axiomizations require that a

21. See RICHARD JEFFREY, *FORMAL LOGIC, ITS SCOPE AND LIMITS* 65-66 (2d ed. 1981).

22. See *id.* at 3-10, 59-62, 66.

23. *I.e.*, between uncertain outcomes.

24. After the 18th-century English mathematician T. Bayes. See HERMAN CHERNOFF & LINCOLN E. MOSES, *ELEMENTARY DECISION THEORY* 136 (Dover Publications 1986) (1959).

25. See LEONARD J. SAVAGE, *THE FOUNDATIONS OF STATISTICS* 21 (2d rev. ed. 1972); Gauthier, *supra* note 5, at 146; John C. Harsanyi, *Nonlinear Social Welfare Functions: Do Welfare Economists Have a Special Exemption from Bayesian Rationality?*, 6 *THEORY AND DECISION* 311, 311-12 (1975), *reprinted in* JOHN C. HARSANYI, *ESSAYS ON ETHICS, SOCIAL BEHAVIOR, AND SCIENTIFIC EXPLANATION* 64, 64-65 (1976); John C. Harsanyi, *Morality and the Theory of Rational Behavior*, 44 *SOC. RES.* 625, 628-29, 636-37 (1977), *reprinted in* UTILITARIANISM AND BEYOND 39, 43, 48-49 (Amartya Sen & Bernard Williams eds., 1982). See generally Peter Gärdenfors & Nils-Eric Sahlin, *Introduction: Bayesian Decision Theory—Foundations and Problems*, in *DECISION, PROBABILITY, AND UTILITY*, 1, 2-8 (Peter Gärdenfors & Nils-Eric Sahlin eds., 1988).

decision maker's preferences form an ordering,²⁶ and what is sometimes called a "sure-thing principle,"²⁷ according to which if o_1 , o_2 , and o_3 are outcomes the decision maker cares about, and p is some prospect (an outcome or an independent event) about which she cares not at all, then if she prefers o_1 to o_2 , she prefers the compound prospect

o_1 if p , otherwise o_3

to the compound prospect

o_2 if p , otherwise o_3 .²⁸

Assuming the absence of any covert rationale,²⁹ X 's preferences in the *Aeneid* hypothetical clearly violate the sure-thing principle. Given (i) the outcomes

o_1 : X gets [a],

o_2 : X gets [b],

o_3 : X waits,

(ii) that X prefers o_1 to o_2 , and (iii) that she has no wish to acquire [c] at all, the principle dictates that she should prefer the compound prospect

o_1 if the store has no copies of [c], otherwise o_3

to the compound prospect

26. See SAVAGE, *supra* note 25. This condition is sometimes characterized by saying that "preferability is a transitive asymmetrical relation." RAMSEY, *supra* note 8, at 78. Talk about the "transitivity," "asymmetry," and "ordering" of preferences is by way of informal description. These are merely (more or less convenient) names for results formally entailed by "axioms." We can afford to speak loosely of the axioms. The points to be made here do not depend on specific formulations.

27. SAVAGE, *supra* note 25, at 21-26. See generally GIBBARD, *supra* note 5, at 13; Gärdenfors & Sahlin, *supra* note 25, at 8. A similar, though stronger, principle is widely referred to in the literature as "the independence axiom." See, e.g., Paul Samuelson, *Probability, Utility and the Independence Axiom*, 20 *ECONOMETRICA* 670 (1952); Mark Machina, *Generalized Expected Utility Analysis and the Nature of Observed Violations of the Independence Axiom*, in *FOUNDATIONS OF UTILITY AND RISK THEORY WITH APPLICATIONS* 263 (B.P. Stigum & F. Wenstøp eds., 1983), reprinted in *DECISION, PROBABILITY, AND UTILITY*, *supra* note 25, at 215. Social choice theorists—who study preference-aggregation devices such as voting schemes—employ a similar rationality constraint which they refer to as "the independence of irrelevant alternatives." See KENNETH J. ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUES* 26-28 (2d ed. 1963).

28. This is a loose formulation of the principle based on GIBBARD, *supra* note 5, at 13. See also *supra* note 26.

29. See *supra* p. 5.

o_2 if the store has no copies of [c], otherwise o_3 .

But X prefers the reverse.³⁰

Again, the principle is not a *logical* constraint.³¹ There is room for debate about whether a preference scheme that violates it is irrational just for that reason.³² And the principle is in fact debated.³³ There are settings in which it seems to hinder a decision theory descriptively,³⁴ and settings in which it seems to hinder normatively.³⁵ But these debates lack motivation here. X's behavior seems to be irrational in an obvious sense (namely that, assuming she means what she says throughout, her behavior is self-defeating³⁶), and the sure-thing principle seems to give an exact account of what goes wrong. In the *Aeneid* hypothetical, at least, the principle seems to be irresistible as a way of thinking practically,³⁷ and ultimately, attractiveness as a way of thinking practically may be the only test we have for a normative principle.³⁸

30. For a similarly homely illustration of the sure-thing principle (involving the irrelevance of a presidential election) see SAVAGE, *supra* note 25, at 21.

31. See *supra* notes 21-22, 25-27 and accompanying text.

32. See Gärdenfors & Sahlin, *supra* note 25, at 11-13.

33. *Id.* at 8.

34. In these settings the principle requires people to do something they are not actually inclined to do in circumstances in which they would be well advised to do what the principle requires. A problem known as "Allais' paradox" (after the French economist Maurice Allais) is a widely discussed setting of this kind. See Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263, 265 (1979), reprinted in *DECISION, PROBABILITY, AND UTILITY*, *supra* note 25, at 183, 186; SAVAGE, *supra* note 25, at 101-103. It suggests the sure-thing principle hinders a decision theory descriptively, but it seems also to suggest the *irrationality* of the behavior it fails to predict. SAVAGE, *supra* note 25, at 103.

35. A well-known example of this kind is the "Prisoner's Dilemma," a standard "game" (attributed to the mathematician A.W. Tucker) used by decision theorists to characterize situations in which self-interest leads "players" to take mutually disadvantageous decisions. WILLIAM J. BAUMOL, *ECONOMIC THEORY AND OPERATIONS ANALYSIS* 452 (4th ed. 1977); R. DUNCAN LUCE & HOWARD RAIFFA, *GAMES AND DECISIONS* 94-95 (Dover Publications 1989) (1957). Self-interest is the widely known interpretation on which the game yields suboptimal results, but it is not the only such interpretation. AMARTYA SEN, ON ETHICS AND ECONOMICS 82 n.22 (1987). The Dilemma's description of behavior in the situations it characterizes is widely supposed to be accurate. See, e.g., BAUMOL, *supra* (the Dilemma "shows why citizens may not contribute taxes voluntarily even though each wants the government to function," why "storekeepers will keep their shops open on Sunday although they all prefer a holiday," etc.). In this context, debate over the sure-thing principle focuses on its *normative* force. See ANATOL RAPOPORT, *FIGHTS, GAMES, AND DEBATES* 174-77 (1960); DEREK PARFIT, *REASONS AND PERSONS* 91-92 (1984). Interpreted normatively, the principle advises people to do what they are actually inclined to do in circumstances in which they would be well advised to do otherwise.

36. This is the sense of irrationality to which decision theorists appeal. See *supra* note 8.

37. Irresistible, that is, as a way of thinking about how someone in X's situation should behave.

38. Thus Leonard Savage states:

In any case, we can sympathize with *X*'s friend *Y* who, let us say, intervenes on *X*'s behalf, or, rather, *tries* to. Before *X* has been to the book store, *Y*, who happens to be going there directly, offers to save *X* the trip. "I'm going there now," she says. "Just tell me what you want." Whereupon *X* describes the same pattern of preferences described above: "I prefer [*a*]" she says. "If either they haven't got [*a*], or they haven't got [*c*], I'll take [*b*]; but I don't want [*c*]." *Y*, wondering if she can have heard this right, says "Am I to understand that if they've got [*a*] and [*b*], but not [*c*], you want [*b*]?" "That's right" *X* says. "What if they've got [*a*], but they haven't got either [*b*] or [*c*]?" "In that case," *X* says "I'll wait." *Y* then asks whether there is any reason the store's not having [*c*] should either increase the value of [*b*] to *X* or diminish that of [*a*], to which *X* replies (with an expression of puzzlement almost as extreme as *Y*'s own) "Not at all!" At this point, thinking it best not to pursue the matter, *Y* goes off hoping for *X*'s sake that the store will have copies of both [*a*] and [*c*]. But (of course) she hopes in vain, "I've got [*a*] and [*b*]," says the store clerk, "but not [*c*]."

Y's problem, if she has one, is only that she wishes *X* well. (For the moment, we can ignore the possibility that *Y* intends to make *X* a present of the book, and, therefore, the possibility of a price differential that *Y* thinks significant.³⁹) If *Y* does not care whether *X* gets the book *X* really wants, then she can do as *X* has instructed her to do in these circumstances (buy a copy of [*b*]), and be done with it. But to the extent *Y*'s concern is *X*'s best interest, she must be tempted to ignore *X*'s instruction, buy *X* a copy of [*a*], and keep mum about the store's not having a copy of [*c*]. For as the sure thing principle suggests,⁴⁰ the likeliest diagnosis of *X*'s trouble in this case is a failure to appreciate the independence of an irrelevant alternative, namely the possibility of buying a copy of [*c*]. *Y* is likely to think *X* does indeed prefer [*a*] to [*b*], but that she has somehow overlooked the *practical* implications of that preference for a certain case involving [*c*].

At any rate, if *Y* decides to *follow X's* instruction (because, for instance, she fears that otherwise *X* may learn of her officiousness and be angry), it cannot be because, out of regard for *X*, *Y* wishes to achieve *X's* immediate ends. From *Y's* point of view, *X* is evidently of two minds as to what her

[i]n general, a person who has tentatively accepted a normative theory must conscientiously study situations in which the theory seems to lead him astray; he must decide for each by reflection—deduction will typically be of little relevance—whether to retain his initial impression of the situation or to accept the implications of the theory for it.

SAVAGE, *supra* note 25, at 102.

39. These possibilities are taken up *infra* note 83 and accompanying text.

40. See *supra* notes 27-30 and accompanying text.

immediate ends should be. Her instructions are incoherent—not logically, but practically—in a way that forces *Y* to conclude that either *X* is confused about what it is she really wants, or she has a conception of practical reason so radically different from *Y*'s own as to be incomprehensible to *Y*. Either conclusion vitiates *Y*'s goodwill towards *X* as a motivation for following the instructions.

III. CHIMERICAL DOUBLE DEDUCTIONS

The point is that there are instances in which the Code expresses a pattern of preferences (for the treatment of some item of tax significance) that seems to be incoherent or irrational in exactly the way *X*'s preferences are. With respect to those instances, the well-disposed taxpayer is in a position very like *Y*'s. One example (the one we shall focus on for illustration) is IRC section 642(g),⁴¹ which forces the executrix of a decedent's estate to an election for the deduction of certain expenses that would otherwise be deductible in the computation of *both* the decedent's taxable estate and the estate's taxable income.⁴²

Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction . . . in computing the taxable income of the estate . . . unless there is filed, . . . a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054⁴³

A decedent's estate is treated as a separate taxpayer for federal income tax purposes⁴⁴ and the taxable income of an estate is determined, for the most part, under the rules applied in determining the taxable income of an individual.⁴⁵ In many cases, items deductible in the computation of the taxable estate under IRC sections 2053⁴⁶ and 2054⁴⁷ will also be deductible in the computation of the estate's taxable income. Administration expenses, for example, may be deductible under IRC section 212⁴⁸ as well as section 2053;

41. I.R.C. § 642(g) (West 1995).

42. See generally 3 BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 81.2.6, at 81-25 (1981); M. CARR FERGUSON ET AL., FEDERAL INCOME TAXATION OF ESTATES, TRUSTS, AND BENEFICIARIES § 4.2.6, at 4:23 (2d. ed. 1995).

43. I.R.C. § 642(g) (West 1995). The election may be selective. Treas. Reg. § 1.642(g)-2 (West 1995); BITTKER, *supra* note 42; FERGUSON ET AL., *supra* note 42, § 4.2.6, at 4:23-24.

44. I.R.C. § 641(a) (West 1995).

45. *Id.* § 641(b).

46. I.R.C. § 2053 allows a deduction in the computation of a decedent's taxable estate for claims and administrative expenses paid by the decedent's executrix. *Id.* § 2053.

47. I.R.C. § 2054 allows an estate tax deduction for casualty losses sustained during the period of administration. To the extent such losses are not compensated by insurance, they can be deducted in computing the decedent's taxable estate. *Id.* § 2054.

48. *Id.* § 212.

and an uncompensated casualty loss suffered by an estate may be deductible under IRC section 165⁴⁹ as well as section 2054. Under the caption “Disallowance of double deductions,”⁵⁰ section 642(g) withdraws roughly half of the combined generosity of these provisions. It requires the affected deductions to be taken against one or the other of the relevant tax bases. But it is hard to see why this should be.⁵¹

Suppose an individual Z owns investments in respect of which she incurs expenses, say \$100, for investment advice, clerical assistance and safe-deposit rentals. She pays the expenses in the taxable year in which she incurs them, and dies on the first day of the following taxable year. In that case, the expenses yield Z a \$100 deduction, under section 212,⁵² on her penultimate income tax return, and her “gross estate” for federal estate tax purposes will not include \$100 of value attributable to the deductible expenses.⁵³ In these circumstances, an expense described in section 212 is allowed as an income tax deduction even though it reduces the value of the payor’s estate for transfer tax purposes.⁵⁴ But the same treatment is not permitted if the expense is incurred after the date of Z’s death. In that case, section 642(g) will allow the expense to reduce either Z’s taxable estate or her estate’s taxable income, but not both.⁵⁵

Section 642(g)’s discrimination here is arbitrary. Congress evidently regards the income and estate tax bases as separate—it subjects them to separate rate schedules.⁵⁶ Its reasons (whatever they are) for allowing a deduction against one of the bases must be independent of those for allowing it against the other, otherwise the notion that the different taxes tax different things is inexplicable. The question in each case is presumably just what is it that Congress wishes to subject to the relevant rate schedule.⁵⁷ And this is true even if one of the taxes is viewed as an adjunct to the other.⁵⁸ In that case, the idea must be that the success of Congress’s attempts to tax one thing depend

49. *Id.* § 165.

50. *Id.* § 642(g).

51. See FERGUSON ET AL., *supra* note 42.

52. See I.R.C. § 212(1)-(2) (West 1995).

53. See *id.* § 2031(a) (defining the “gross estate” as the value, as of the decedent’s death, of all property described in I.R.C. §§ 2033-2046, which sections compose the statutory definition of the estate tax base). See generally RICHARD B. STEPHENS ET AL., FEDERAL ESTATE AND GIFT TAXATION ¶ 4.02[1]-[2] (6th ed. 1991).

54. See FERGUSON ET AL., *supra* note 42, § 4.2.6, at 4:24.

55. See *supra* notes 42-43 and accompanying text.

56. I.R.C. §§ 1, 2001 (West 1995).

57. FERGUSON ET AL., *supra* note 42, § 4.2.6, at 4:24.

58. See, e.g., Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 YALE L.J. 259, 270-73 (1983) (suggesting a justification for the federal estate tax based on its ensuring

on its taxing *another*,⁵⁹ for (again) Congress has eschewed a unified federal tax base.⁶⁰ To the extent of the deductions allowed in the computation of the taxable estate,⁶¹ the estate tax is intended to be a tax on the net amount distributable to those persons entitled to take the decedent's property.⁶² To the extent of the deductions allowed in the computation of taxable income, the income tax is intended to be a tax on *net* income rather than gross.⁶³

Clearly, though, an expense described in section 2053 reduces the amount distributable to those entitled to take the decedent's property regardless of whether that expense is deducted in the computation of the estate's taxable income. Likewise, an expense described in section 212 reduces the amount of net accounting income regardless of whether that expense is deducted against the decedent's estate tax base. Whether it is a good idea to allow a given expense or loss to be deducted for one of these purposes has, in principle, nothing to do with whether it is a good idea to allow that expense or loss to be deducted for the other purpose. Apparently, Congress has decided that *both* section 212 and section 2053 (and that *both* section 165 and section 2054) are good ideas. If the rationale for disallowing "double deductions" is supposed to be simply that the same expense ought not to be deducted twice,⁶⁴ it is plausible *assuming* one is talking about a single tax base. But the deductions disallowed by section 642(g) are not "double" in *that* sense. They are "double" only because Congress has accepted reasons for allowing them against each of two distinct tax bases, and this can hardly be grounds for disallowing them.

Section 642(g) itself suggests that Congress must have been aware of the section's incoherence. The last sentence of the section says "This subsection shall not apply with respect to deductions allowed under [section 691⁶⁵]."⁶⁶ IRC section 691 provides a solution to an accounting problem. But for that

the progressivity aimed at by the income tax).

59. The estate tax, for instance, may be viewed as being dependent in this way on a gift tax. See Joseph Isenbergh, *Simplifying Retained Life Interests, Revocable Transfers, and the Marital Deduction*, 51 U. CHI. L. REV. 1, 2 (1984).

60. See *supra* note 56 and accompanying text.

61. I.R.C. § 2051 defines the "taxable estate" as the value of the "gross estate" minus the deductions provided in part IV of chapter 11A of the Code, namely §§ 2053-2056A. I.R.C. § 2051 (West 1995).

62. STEPHENS ET AL., *supra* note 53, ¶ 5.03, at 5-4.

63. See generally 1 BITTKER, *supra* note 42, ¶ 2.1.1.

64. For a flat-footed acceptance of this rationale, see Patricia Ann Metzger, *The Deduction of an Estate's Administration Expenses: Section 642(g) of the Internal Revenue Code and Its Impact*, 21 TAX L. REV. 459, 462-63 (1966).

65. I.R.C. § 691 (West 1995).

66. *Id.* §§ 642(g), 691(b).

section, the rule that an individual's final taxable year terminates on the date of her death⁶⁷ would cause symmetrical inequalities with respect to "cash basis" taxpayers and amounts receivable but not received prior to death on the one hand, and "accrual method" taxpayers and expenses payable but not paid prior to death on the other.⁶⁸ On the expenses side, the problem is that an accrual method taxpayer would be entitled to deduct on her final return a deductible expense payable in her final taxable year notwithstanding that the expense might actually be paid by her executrix, in which case the expense would be deductible in the computation of the estate tax.⁶⁹ But a cash basis taxpayer under these circumstances would not be allowed to deduct the expense on her final return, and since there is no income tax deduction for claims against a decedent's estate, the payment by the executrix will give rise to an estate tax deduction only.

Congress had two alternatives when it decided to equalize the treatment of accrual method and cash basis taxpayers regarding expenses incurred but not paid prior to death. It could either deny the accrual method taxpayer one of the two deductions available to her in the relevant case, or make another deduction available to the cash basis taxpayer. It chose to do the latter.⁷⁰ Section 691(b) grants the estate of a decedent who reported her income on the cash basis an income tax deduction for expenses incurred by the decedent but not paid prior to her death. And, of course, the punch line is that the deductions referred to in the last sentence of section 642(g)⁷¹ are the very ones described in section 691(b). The latter section was enacted precisely because Congress thought it appropriate to allow an income tax deduction for expenses paid by an estate that would otherwise be deductible only against the estate tax base. Congress went out of its way, so to speak, to *allow* "double deductions" in cases in which, depending on the taxpayer's method of accounting, they might have been unavailable. By enacting section 642(g), Congress went out of its way again, this time to deny "double deductions" in cases in which they would otherwise have been available without regard to section 691(b), and yet it chose to let the rule of section 691(b) stand.

67. *Id.* § 443(a)(2); Treas. Reg. § 1.443-1(a)(2).

68. *See* FERGUSON ET AL., *supra* note 42, § 4.3.1, at 2:30.

69. *See supra* note 46.

70. *See* I.R.C. § 691(b) (West 1995).

71. *See supra* note 66 and accompanying text.

IV. THE ANALOGY

This is perhaps as strong an antimony as one can find in the Code, and it represents a rare instance in which the usually antithetical goals of fairness and simplicity could both be advanced by a single legislative act, namely the repeal of section 642(g). What is more important for our purposes, though, is that the pattern of preferences for the treatment of deductible expenses effected by section 642(g) bears a strong resemblance to that of *X*'s preferences in our *Aeneid* hypothetical.⁷² We may think of the prospects as follows.

P_1 : The estate tax base is reduced by [a given] expense or loss.

P_2 : The income tax base is reduced by the expense or loss.

With respect to any given expense or loss, Congress's principled reasons for preferring P_1 to $\sim P_1$ ⁷³ (or vice versa) must be independent of those for preferring P_2 to $\sim P_2$ (or vice versa).⁷⁴ Thus in a given case, Congress ought to prefer P_1 to $\sim P_1$ (if it does) *regardless* of whether P_2 or $\sim P_2$ obtains (and vice versa). The preference (expressed in section 642(g)) for the prospect P_1 if $\sim P_2$, otherwise $\sim P_1$ is as irrational as *X*'s preference in the *Aeneid* hypothetical for the prospect [a] if the store has a copy of [c], otherwise [b].⁷⁵ And both seem to be irrational for the same reason: the independent alternative P_2 ought to be as irrelevant to Congress's choice between P_1 and $\sim P_1$, as the independent possibility of buying a copy of [c] should be to *X*'s choice between [a] and [b].

Of course, we can imagine attitudes towards the pairwise alternatives P_1 , $\sim P_1$ and P_2 , $\sim P_2$ on which they *would* draw linked preferences (just as we can imagine rational motivations for *X*'s behavior in the *Aeneid* hypothetical⁷⁶). The most plausible such attitude for the actual case (the case in which Congress enacts section 642(g)) is a concern for revenue.⁷⁷ But it has to be a *marginal* concern. The problem with section 642(g) (if there is one) is not that it denies deductions,⁷⁸ but that it denies deductions which are indistinguishable, from Congress's point of view, from deductions that Congress evidently wants to allow. The possibility worth considering, then, is that Congress

72. See *supra* Part II of text.

73. I. e., the prospect that the estate tax base is *not* reduced by [a given] expense or loss.

74. See *supra* notes 56-64 and accompanying text.

75. See *supra* note 30 and accompanying text.

76. See *supra* Part II of text.

77. See FERGUSON ET AL., *supra* note 42, § 4.2.6. at 4:24-:25.

78. Again, we conceive systemic rationality as a kind of *formal* coherence requiring only that the tax scheme be suited to whatever ends Congress pursues through taxation so as to promote, rather than frustrate, the achievement of those ends. See *supra* notes 8-10 and accompanying text. There is no reason why a tax scheme that involved *no* deductions could not be "rational" in that sense.

thinks there are good reasons for allowing certain deductions against the income tax base, and equally good reasons for allowing the same deductions against the estate tax base but that at the point located by section 642(g), concern for revenue offsets approximately half of the combined weight of these reasons, leaving Congress with a motivation to allow the deductions against one or the other of the relevant bases, but not both.

This story is intelligible, but it is hardly mitigating. Even if there were anything precise in this respect about section 642(g), even if it could be shown that the marginal cost of allowing the so-called “double deductions” is crucial, the idea that we should *therefore* deny the “double deductions” is too facile to credit. Viewed as a response to marginal revenue loss, section 642(g) is *completely* arbitrary. Congress might as well have secured the margin by denying *all* deductions to estates of decedents who were (at some time in their lives) over six feet tall, or whose surnames begin with letters falling in the latter half of the alphabet. Again, the claim that the same expense ought not to be deducted twice makes sense only if one is talking about a single tax base, otherwise it is a meaningless slogan.⁷⁹ For the purpose of deciding who should shore up a given margin of internal revenue, an estate’s having an expense that Congress thinks it has good reasons for allowing to reduce each of two different tax bases is as arbitrary a feature of the case as is the letter with which the decedent’s surname begins.

Thus, someone who understands section 642(g), and suspects it was enacted out of a concern for revenue, has to conclude that either Congress was deluded by its own slogan, or the slogan was merely a pretext for gouging the citizenry. The latter conclusion brings its own incentives for noncompliance,⁸⁰ and we can ignore them—they have nothing in particular to do with the idea that section 642(g) expresses an irrational set of preferences. The former conclusion (that Congress was deluded by its own slogan) *is* relevant to the incoherence we have in view, but only in that it suggests a causal account. It suggests Congress may have failed to appreciate the independence of the pairwise alternatives $P_1, \sim P_1$ and $P_2, \sim P_2$ ⁸¹ because some of its members failed to notice that the attraction of the idea that the same expense ought not to be deducted twice depends on the assumption that one is thinking of a single tax base.

With or without such a causal account, the well-disposed taxpayer contemplating the application of section 642(g) (either to an estate of which she is an executrix, or to her own prospective estate) is in a position very like *Y*’s

79. See *supra* notes 56-64 and accompanying text.

80. See Martinez, *supra* note 16, at 543-44.

81. See *supra* notes 73-75 and accompanying text.

in our *Aeneid* hypothetical,⁸² with the difference that the taxpayer's own economic interests (or those of people to whom she owes at least a fiduciary obligation) are at stake. (The cases are brought closer together in this respect by the possibility, mentioned briefly above,⁸³ that, in the *Aeneid* hypothetical, *Y* intends to make *X* a present of the book involved, and that [*b*] is considerably more expensive than [*a*].) This means the taxpayer has an added motivation *not* simply to do as Congress has instructed her to do in the relevant circumstances (effect the mandated election, or—with respect to her own prospective estate—leave no instructions suggesting a contrary intention). But to the extent the taxpayer wants to do what *Congress* wants (out of regard for Congress, or the legislative process, etc.), she must be tempted to thwart the express intention of section 642(g).⁸⁴ For, again, the likeliest diagnosis of Congress's problem here is a failure to appreciate the independence of an irrelevant alternative. Unless the taxpayer believes section 642(g) is merely an attempt to gouge the citizenry,⁸⁵ she is likely to think that, with respect to the items affected, Congress does indeed prefer P_1 to $\sim P_1$ ⁸⁶ (and P_2 to $\sim P_2$ ⁸⁷), but that it has somehow overlooked the practical implications of that preference for a certain case involving P_2 (or P_1).

In any case, if the taxpayer does *not* believe section 642(g) is an attempt to gouge the citizenry, and she decides *not* to thwart (or to encourage the thwarting of) its express intention, it cannot be because she wishes to achieve *Congress's* immediate ends. From the point of view of someone who understands section 642(g), its principled concerns are the respective descriptions of the income and estate tax bases, and its testimony is that Congress is of two minds as to what those descriptions should be.

82. See *supra* Part II of text.

83. See *supra* note 39 and accompanying text.

84. The government is notoriously liable to be whipsawed in situations in which it is possible to file the requisite waiver of estate tax deductions, see *supra* note 43 and accompanying text, or amended income tax returns after the statute of limitations for the estate tax has expired. See JEFFREY N. PENNELL, *CASES AND MATERIALS ON THE INCOME TAXATION OF TRUSTS, ESTATES, GRANTORS AND BENEFICIARIES* 29-30 (1987). A taxpayer prepared to ignore *other* provisions of the Code (in order to thwart section 642(g)) could proceed less elaborately. She might, for instance, simply take the affected deductions against the income tax base, and understate the value of properties includible in the gross estate by amounts equal, in the aggregate, to the aggregate amount of the denied estate tax deductions. See *supra* note 53.

85. See *supra* note 80 and accompanying text.

86. I.R.C. §§ 2035, 2054 (West 1995). See *supra* notes 46-47.

87. I.R.C. §§ 165, 212 (West 1995). See *supra* notes 48-49 and accompanying text.

V. CONCLUSION

Section 642(g) is only one example of its kind. There are other instances in which the Code suggests analogies to violations of the sure-thing principle, or of other formal, nonlogical, principles of practical reason,⁸⁸ analogies, that is, to the kind of irrationality displayed by decision makers whose preferences violate the standard axioms.⁸⁹ IRC section 2001(e)⁹⁰ is an example from the estate tax. It prevents the half of the gift tax value of certain property transferred by the decedent's spouse that was electively treated for *gift tax* purposes as having been transferred by the decedent⁹¹ from being counted twice in determining marginal estate tax rates—once in the decedent's estate and once in the estate of the decedent's spouse. The odd thing is that the section has that effect only in the narrow circumstance that the 'split gift' occurred within three years of the decedent's spouse's death.⁹² Otherwise, half of the gift tax value of a split gift *is* counted twice in the way just described whenever the property subject to the gift is included in the donor spouse's "gross estate."⁹³ Yet there is evidently no distinction between gifts that trigger inclusion in the gross estate occurring within three years of the donor's death on the one hand, and such gifts occurring *more* than three years before the donor's death on the other that would provide a principled basis for penalizing an election to split gifts in the latter case, but not in the former.⁹⁴

The Code's preferences for the treatment of split gifts can be shown to be analogous to preferences that violate the sure-thing principle on an analysis that is in many respects identical to the one applied above to section 642(g). We need not work out the analogy here. The point is only that examples like section 642(g) can be multiplied. (On reflection, the reader will no doubt find she has favorite examples of her own.) What such examples show is a kind of irrationality that is only slightly less striking than *logical* inconsistency. For they show patterns of preferences that violate the standard axioms of

88. For example, the standard requirement that a decision maker's preferences form an ordering. See *supra* note 26 and accompanying text.

89. See *supra* notes 25-27 and accompanying text.

90. I.R.C. § 2001(e) (West 1995).

91. I.R.C. § 2513(a) provides that on the consent of both spouses a gift made by one spouse to anyone other than her spouse will be treated, for purposes of chapter 12 of the Code (the gift tax), as having been made one-half by her and one-half by her spouse. I.R.C. § 2513(a) (West 1995).

92. See I.R.C. §§ 2001(b)(1)(B), (e), 2035(a), (d)(2) (West 1995). See generally James P. Spica, *Federal Transfer Tax Treatment of Actuarial Appreciation*, 42 *DRAKE L. REV.* 123, 155-59 (1993).

93. This can happen under any of the various I.R.C. sections listed in I.R.C. § 2035(d)(2). See, e.g., I.R.C. § 2036 (West 1995) (concerning transfers subject to retained life interests).

94. Spica, *supra* note 92, at 158. See STEPHENS ET AL., *supra* note 53, ¶ 2.01[1] n.14.

decision theory, and someone in the grip of such preferences is liable to lose out by *her own* standards, no matter what happens.⁹⁵

What we have argued here is that the price of such irrationality is not primarily that Congress is liable to be swindled, but rather that it hobbles goodwill towards Congress (or the legislative process, etc.) as a motivation for compliance. Confronted with a provision like section 642(g) (or section 2001(e)), the comprehending taxpayer has to conclude either that Congress is surreptitiously and haphazardly pursuing objectives that could be achieved forthrightly and systematically by raising marginal rates, or that it simply does not know what it is that it hopes to achieve. In the latter case, the well-disposed taxpayer's reasons for compliance cannot include a desire to achieve *Congress's* objectives. By hypothesis, Congress is unable to say what its objectives are. We have treated this as a local phenomenon, cropping up here and there in the Code, neutralizing the taxpayer's goodwill as a motivation for compliance with specific provisions. And that would be enough to condemn it. But attitudes towards the Code as a whole surely affect taxpayers' dispositions, and to that extent, presumably, the idea that the Code is *characteristically* irrational would be marginally demoralizing with respect even to provisions that make sense. In some quantity, then, incoherence of the *quality* examined here must pose a global threat of the kind we have noticed locally.

95. See *supra* note 8.

