This thesis is written for a doctorate of philosophy. As such, it entails a philosophical examination of the manner in which the present use of the word income achieves the generally accepted policy objective of horizontal equity in taxation of individuals. The treatise reviews the optimal tax theorists' view that taxation should target individuals' features or attributes that yield well-being. Optimal tax analysis is accepted as a conceptually valid theory. However, as commendable and appropriate as optimal tax analysis is in theory, it is not a goal that is currently attainable in practice. The existing state of knowledge is such that abstract attributes that make up an individual's overall state of contentment are unable to be measured in a manner that is sufficiently practical and objective on which to levy tax.

In practice, income is employed as the surrogate indicator for taxing individuals' characteristics, which depict welfare. The level of one person's income therefore determines the quantum of taxation that is extracted from that individual to contribute towards financing a government's social or collective objectives.

Since societies generally place much importance on the notion of income, income must be evaluated in a socially and politically acceptable manner. It is essential that a well defined and consistent concept of income prevails as the basis of transferring resources by way of direct taxation from the private sector of society to government. Equity is a predominant factor in taxing income. Therefore, society needs to adopt some generally agreed fair notion of income to serve as the basis of the calculation of income tax.

In 1778, the Scottish moral philosopher and economist, Adam Smith, first published his now-famous four basic maxims of taxation: certainty, convenience, administrative simplicity, and equity. ¹

Certainty requires that people's tax burdens should be readily and precisely ascertainable. This criterion has been considerably compromised in recent business income tax legislation.

Convenience means that taxpayers ought to be levied tax at the time or in a manner that is most likely to be convenient for them to pay. Nowadays, this basic canon has been extended to efficiency in the tax system, which means broadly

that tax should be economically neutral; that is, tax should not influence or distort the production, investment, or consumption decisions of private producers, investors, or consumers. The efficiency principle has been the cornerstone of taxation policy in most modern Western economies during the 1980s and the 1990s.

Administrative simplicity means that the costs (being both tax-payer compliance costs and a government's revenue collection costs) of determining and collecting a tax liability should be minimized.

Equity falls into two categories: vertical equity and horizontal equity. Vertical equity proposes that the tax burden should differ between people in different positions such that a proportionately heavier burden falls on those who are better able to bear it. The vertical equity criterion has manifested itself in most income tax systems by way of progressive marginal tax rates and in indirect value added tax systems by way of the imposition of higher tax rates on luxury goods and services and lower rates on necessities.

Horizontal equity is a primary tenet of income tax policy; that is, people who are in the same economic position should be taxed equally. The principle of horizontal equity requires that income of one person be measured using the same methods as income of another person. Equity also demands that, as far as practically possible, all factors that might constitute a person's income are included in the definition of income for everyone. This dissertation argues that the present interpretation of income for taxation purposes is deficient and that income as a practical basis of taxation can be developed further to enhance horizontal equity. Therefore, the aim of this thesis is to find a path towards the ideal basis of an income tax, which improves the existing income tax regime, and which is also capable of practical implementation.

While recognizing the importance of integrating all of the above factors into tax policy, this thesis is confined principally to one aspect only: the achievement of horizontal equity in formulating an appropriate concept of income for taxation purposes. Scholars and policymakers must then resolve the tensions of that notion of taxable income with the other objectives of the income tax system.

Part I examines the theoretical aspects of concepts of income. Chapter 1 sets out the framework in which the dissertation is written. It examines the meaning of well-being and how optimal tax theory attempts to identify, as targets of taxation, personal characteristics and features that make up a person's well-being. A person's income is, of course, only one of those features, but it has been widely used in practice as a surrogate for all of the features. It is therefore important that income, as a means of transferring private wealth to the state, should be measured fairly among all of a society's taxpayers. Chapter 1 discusses the notions of fairness in the context of income tax.
Chapter 2 examines the concept of income from an economic perspective. The chapter begins with an examination of psychic income and its shortcomings as a practical tax base and then traces the economists' shift from subjective interpretations of income in search of objectivity in income determination. A foundation concept of income, which is comprehensive, objective and equitable, is found in the Schanz-Haig-Simons wealth accrual and consumption models. This foundation concept of income is taken as a benchmark against which other income measures are compared. The remainder of Part I examines different interpretations of income, which are assessed against the benchmark.

Over time, the economic, accounting and legal disciplines have developed their own understandings of income. Even within these disciplines, different interpretations of income have arisen. To some extent, each discipline has looked to the others for guidance. While each discipline has developed its concept of income from the same central theme, each discipline has evolved its own divergences from that theme, which have resulted in vast differences in the practical measurement of income. The effect of these differences has been to undermine the primary objectives behind the use of income as a taxation base; namely, a measure of well-being and therefore, ability to pay tax.

The purpose of investigating different interpretations of income is to seek out evidence of the convergence and divergence in existing understandings of income, which might signal the foundation concept as a broadly acceptable notion of income in which a high degree of horizontal equity is achieved. Detailed examination of vertical equity, and efficiency and administrative considerations is beyond the scope of this work.

In Part II, the evidence of convergence of, and variation in, the various meanings of income (particularly in the context of the foundation concept of income as a gain and the legal distinction between income and non-income receipts) is evaluated against the foundation concept with reference to selected events and transactions; specifically, business transactions (Chapter 6), transactions that produce capital gains (Chapter 9), gifting and windfall receipts (Chapter 10), the provision of benefits in kind (Chapter 11), and events that give rise to imputed income (Chapter 12). Chapters 7 and 8 highlight the deficiency of treating a receipt as taxable income when there may be no real economic gain in the period that the receipt is derived (if there is any economic gain at all) or, conversely, not treating a receipt as taxable income when it represents an economic gain. The review of income tax legislation in Part II illustrates how inconsistencies in the legal interpretation of taxable income often undermine the policy objective of horizontal equity in taxation.

Chapter 13 concludes with some suggestions about how a comprehensive concept of income, which is more closely aligned to the foundation concept, might be adopted for income tax purposes, with particular reference to New Zealand.