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# "KEEPING BOOKS ON ROMANCE": THE GIFT EXCLUSION IN NONMARITAL RELATIONSHIPS

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## INTRODUCTION

David Kritzik, "a wealthy widower partial to the company of young women," befriended twin sisters Lynnette Harris and Leigh Ann Conley and, over several years, gave them each more than half a million dollars.[1] In return, the sisters supplied Kritzik with companionship and sex.[2] By the time Kritzik died in 1989, neither sister had reported any transfers from Kritzik on their income tax returns as taxable income.

After Kritzik's death, the Government charged both sisters with income tax evasion, claiming that the cash from Kritzik constituted payments for services rendered.[3] In their defense, the sisters argued that the transfers

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[1] United States v. Harris, 942 F.2d 1125, 1127 (7th Cir. 1991).

[2] *See* Harris v. Kritzik, 480 N.W.2d 514, 515 (Wis. Ct. App. 1992); Martha Atkins, *Tax Man Puts Squeeze on Sex-for-Hire Kittens*, WKLY. WORLD NEWS, June 26, 1990, at 9.

[3] *Harris*, 942 F.2d at 1127–28, 1130. The Government charged both sisters under § 7203 of the Internal Revenue Code, which provides that "[a]ny person . . . required . . . to make a [tax] return . . . who willfully fails to . . . make such return . . . shall, in addition to other penalties provided by law, be guilty of a misdemeanor." I.R.C. § 7203 (2006). It is not clear how the Harris sisters' potential tax evasion came to the attention of the government. The lower court records of the women's criminal cases are not

constituted gifts[4] and thus were not considered taxable income under the Internal Revenue Code (Code).[5] The jury agreed with the Government, and both women were convicted of criminal willful tax evasion, sentenced to prison, and fined.[6]

The women appealed. In *United States v. Harris*, the Seventh Circuit addressed the question of whether transfers to mistresses are properly categorized as gifts or income.[7] The Supreme Court had developed a general test for determining whether transfers are gifts or income: the "critical consideration" in this analysis is the donor's reason for making the transfer.[8] If "detached and disinterested generosity" motivates the donor, the transfers are gifts,[9] and the donee need not claim the value of the gifts as taxable income. However, if the transfers result from "the constraining force of any moral or legal duty, constitute[] a reward for services rendered, or proceed[] from the incentive of anticipated benefit of an economic nature," then the transfers are income,[10] and the donee must include them on her tax return.

To apply this test to the twin sisters' situation, the Seventh Circuit had to determine whether Kritzik had been motivated by kindly altruism or by an expectation that the women would reciprocate. The court found this test almost impossible to apply in this case. The court could not determine intent: with the donor deceased, the court had to divine his intent from the varied and often conflicting evidence examined at trial.[11] Moreover, case law provided no assistance: the cases involving transfers to mistresses displayed such opaque reasoning and contradictory conclusions that they offered no

available; the briefs submitted on appeal are likewise unavailable. There are a few possibilities. An unrelated claim Conley filed with the IRS is mentioned in the opinion, *Harris*, 942 F.2d at 1128 n.2, and may have prompted an investigation. Harris also initiated numerous suits against Kritzik's estate in an effort to recover the "inheritance" Kritzik had promised her but had not included in his will. *See Harris*, 480 N.W.2d at 516 n.1 (collecting cases Harris filed against Kritzik's estate). However, Kritzik died the same year the sisters were convicted, so it is not clear that Harris's suits against Kritzik's estate preceded the criminal investigation. One source claims that "an anonymous tip" prompted the government's investigation of the twins, Atkins, *supra* note 2, but this assertion is not corroborated elsewhere. *See also infra* note 64 (describing the different methods the IRS uses to select returns for auditing).

4 *See Harris*, 942 F.2d at 1128, 1130.

5 Section 102(a) of the Code reads: "Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance." § 102(a) (2006).

6 *Harris*, 942 F.2d at 1127 & n.1. By the time the Seventh Circuit heard their appeal, both sisters had served almost their entire prison sentences. *Id.* at 1135 n.7.

7 *See id.* at 1127.

8 *Id.* (quoting Comm'r v. Duberstein, 363 U.S. 278, 285–86 (1960)).

9 *Id.* at 1128 (quoting *Duberstein*, 363 U.S. at 285).

10 *Id.* (quoting *Duberstein*, 363 U.S. at 285).

11 *Id.* at 1128–29 & n.3. Kritzik had filed gift tax returns for transfers made to the sisters, which could have demonstrated "detached and disinterested generosity." *Id.* at 1128–29 (quoting *Duberstein*, 363 U.S. at 285) (quotation mark omitted). The gift tax imposes a tax on the donor for transfers above a particular threshold. I.R.C. §§ 2501–2503 (2006); *see also infra* note 205. At the same time, in affidavits created before his death, Kritzik referred to the sisters as "prostitutes." *Harris*, 942 F.2d at 1129 n.3.

clear guidance about distinguishing altruistically motivated transfers from those made as payment for services in long-term, nonmarital relationships.[12]

The sisters' convictions could stand only if case law was clear enough that they could have violated it willfully.[13] Given the ambiguity in the case law concerning mistresses, the court had to reverse the sisters' convictions: "current law on the tax treatment of payments to mistresses provided [the sisters] no fair warning that [their] conduct was criminal."[14] The sisters therefore could not have intentionally violated the law by neglecting to claim the transfers as taxable income.

The *Harris* decision and the cases the court considered in making it highlight the difficulty of distinguishing between income and gifts in long-term, informal relationships such as those between a mistress and her lover. As the *Harris* court noted, such relationships inevitably contain elements of both affection and economic interest: "The relationship would not be long term were it not for some respect or affection. Yet, it may be equally clear that the relationship would not continue were it not for financial support or payments."[15] Thus, determining a single intent underlying transfers made in the course of such a relationship presents the intractable problem of disentangling complex motivations that the parties themselves may be unable to identify.

This Comment examines the cases that the *Harris* court considered in making its decision. These cases—dubbed "the mistress cases" for the purpose of this Comment[16]—followed an identifiable pattern. All concern nonmarital relationships during which male lovers transferred money or property to their mistresses. The IRS eventually audited the women's tax returns, discovered the transfers, and assessed deficiencies for unclaimed

[12] *Harris*, 942 F.2d at 1133–34 (citing Jones v. Comm'r, T.C.M. (P-H) ¶ 77,329 (1977); Reis v. Comm'r, T.C.M. (P-H) ¶ 74,287 (1974); Libby v. Comm'r, T.C.M. (P-H) ¶ 69,184 (1969); Starks v. Comm'r, T.C.M. (P-H) ¶ 66,134 (1966); Blevins v. Comm'r, T.C.M. (P-H) ¶ 55,211 (1955), *aff'd*, 238 F.2d 621 (6th Cir. 1956)).

[13] *Id.* at 1131. Criminal tax evasion requires willfulness, I.R.C. § 7203, and proof of each element beyond a reasonable doubt, Linda S. Eads, *From Capone to Boesky: Tax Evasion, Insider Trading, and Problems of Proof*, 79 CALIF. L. REV. 1421, 1425 (1991), so the standard in *Harris* for the Government to meet was fairly high. In civil cases, taxpayers who display "willful neglect" in not filing returns can be liable for paying back taxes. I.R.C. § 6651(a).

[14] *Harris*, 942 F.2d at 1131.

[15] *Id.* at 1132.

[16] A mistress is defined as "a woman other than his wife with whom a married man has a continuing sexual relationship." *Mistress Definition*, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/mistress (last visited Nov. 22, 2011). This Comment uses a slightly expanded definition of "mistress." Instead of examining only extramarital relationships (those in which at least one partner is married to someone else), this Comment addresses all nonmarital, noncohabitating relationships (both those relationships in which one or both partners is married to someone else and those relationships in which neither party is married). This broadened definition encompasses all of the Tax Court cases discussed in this Comment in which a woman petitioning the court refers to herself as a mistress. *See infra* Part II.B.

income. In their Tax Court hearings, the women all asserted that their lovers made the transfers in question with altruistic generosity, rendering the transfers nontaxable gifts and thus not includable in gross income. In all cases, the courts evaluated the women's claims by trying to determine the dominant intent underlying the relationships. As this Comment demonstrates, efforts to determine a single dominant intent underlying long-term, informal relationships contain problems of information, valuation, and consistency that expose courts' inability to grapple with the intimate details of relationships undefined by law.

To solve these problems, this Comment suggests a default rule for long-term, nonmarital relationships: all transfers should be treated as income and thus taxable to the recipient unless the relationship is casual or the lovers exchange only token gifts. Part I discusses the gift–income distinction and examines the current rule for distinguishing the two. Part II examines the specific gift–income distinctions in Tax Court cases involving transfers made in the course of intimate, long-term relationships. Part III analyzes the difficulty of trying to define social relationships in a legal context. Part IV recommends a "nonmarital income rule" to remedy issues in the current jurisprudence. Part IV also discusses the expected benefits of such a rule and examines some of the policy considerations involved.

At the outset, it is important to emphasize what this Comment does *not* address. This Comment examines only heterosexual couples in which an economically advantaged man transferred property *inter vivos* to his female mistress. This narrow focus does not imply that such transfers take place only in the context of heterosexual relationships or that economically advantaged women never make transfers to their lovers. Rather, my limited concentration reflects the narrow focus of the case law: my research did not uncover a single case in which a court addressed the gift–income question in the context of a noncohabiting, nonheterosexual relationship.[17]

Although this Comment only explores a narrow subset of cases, these decisions highlight a broader debate about the intersection of intimacy, economics, and social policy. In examining how judicial inquiries approach issues of love, money, and morality, this Comment questions whether the law can and should make such investigations.

## I. DISTINGUISHING BETWEEN GIFTS AND INCOME

### A. *The Gift Exclusion and Its Rationales*

The Code defines "gross income" somewhat circularly: "gross income means all income from whatever source derived."[18] In *Commissioner v.*

[17] I searched federal district court and circuit court cases in addition to Tax Court cases. The gift–income distinction arises only infrequently with *inter vivos* transfers and even less often in the context of nonmarital relationships.

[18] I.R.C. § 61(a).

*Glenshaw Glass Co.*, the Supreme Court elaborated on the Code's definition: income includes all "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion."[19] Together, the Code definition and its judicial gloss encompass almost every increase in wealth imaginable. Income can be derived from almost any source, including earned wages;[20] exchanges of goods or services;[21] profits from life insurance,[22] pensions,[23] and annuities;[24] gains from business dealings;[25] and profits from investments.[26] Income can result from any legal activity as well as from any illegal activity—the government recognizes accessions to wealth arising from illegal drug sales, prostitution, and embezzlement as income.[27]

Section 102(a) of the Code provides one conspicuous exclusion from the broad conception of income: gifts.[28] Even when a recipient has received an "undeniable" and "clearly realized" benefit over which she has "complete dominion," if that transfer is categorized as a "gift," she need not include its value in her gross income or pay tax on it.[29]

The gift exclusion has contradictory and occasionally confusing results. For example, if my employer pays me $4000 per month, I must claim that $4000 as income and may be taxed on the amount. However, if a friend motivated by pure generosity gives me $4000, the transfer is categorized as a gift, which I do not have to include in my gross income and on which I will not pay tax. In both cases, I have certainly experienced an "undeniable accession[] to wealth" that is "clearly realized" and over which I have "complete dominion."[30] From my perspective, the source of the

19 348 U.S. 426, 431 (1955).

20 I.R.C. § 61(a)(1) ("[c]ompensation for services, including fees, commissions, fringe benefits, and similar items").

21 *E.g.*, *id.* § 61(a)(3) ("[g]ains derived from dealings in property").

22 *Id.* § 61(a)(10) ("[i]ncome from life insurance and endowment contracts").

23 *Id.* § 61(a)(11).

24 *Id.* § 61(a)(9).

25 *Id.* § 61(a)(2) ("[g]ross income derived from business").

26 *Id.* § 61(a)(4)–(7) ("interest," "rents," "royalties," "dividends").

27 Treas. Reg. § 1.61-14(a) (2006) ("Illegal gains constitute gross income."). In 1913, the first modern income tax (enacted after the passage of the Sixteenth Amendment) restricted its definition of income to only gains from "*lawful* business carried on for gain or profit." Act of Oct. 3, 1913, ch. 16, Pub. L. No. 63-16, § II(B), 38 Stat. 114, 167 (emphasis added). In 1916, Congress excluded the word "lawful" from the definition of income. Revenue Act of 1916, ch. 463, Pub. L. No. 64-271, § 2(a), 39 Stat. 756, 757. Courts have inferred from the exclusion of the word "lawful" that gains from unlawful activities are also includable in gross income. *See, e.g.*, James v. United States, 366 U.S. 213, 218 (1961) (referring to the assumption that "unlawful, as well as lawful, gains are comprehended within the term 'gross income'" as "a well-established principle").

28 I.R.C. § 102(a) ("Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.").

29 Recipients do, however, pay tax on income the gift generates. *Id.* § 1015(a).

30 Comm'r v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

money makes no difference to how I can squander, save, or share the $4000. This fungibility renders the gift exclusion difficult to rationalize because the question inevitably arises: Why should gifts and income be treated differently when their objective value is exactly the same?

That Congress has never expressed a policy reason for the exclusion[31] exacerbates the difficulty of answering this question and leaves commentators struggling to explain why gifts are treated differently from income. Most scholars who have considered the question have been unable to express a principled distinction between gifts and income—and have thus suggested that the distinction be abolished.[32] They have called the distinction between gifts and income "arbitrary"[33] and "irreconcilable with any intelligible, coherent scheme of values."[34] Moreover, the absence of a clear distinction between gifts and income "introduces serious administrative difficulties" by requiring taxpayers and tax authorities to distinguish between transfers that can look very much alike.[35] As one tax scholar put it, "If it is impractical to graduate taxes according to the pleasure return from one's

[31] Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 13 (1992). A full discussion of the history of the gift exclusion exceeds the scope of this Comment, but a number of sources discuss the topic at length. *See, e.g.*, William A. Klein, *An Enigma in the Federal Income Tax: The Meaning of the Word "Gift*,*"* 48 MINN. L. REV. 215, 229–46 (1964); Kornhauser, *supra*, at 38–52. *See generally* C. Lowell Harriss, *Legislative History of Federal Gift Taxation*, 18 TAXES 531 (1940) (detailing the legislative history of gift taxation).

[32] *See, e.g.*, HENRY C. SIMONS, PERSONAL INCOME TAXATION 135 (1938) ("[I]t is hard to defend exclusion of certain receipts merely because one has done nothing or given nothing in return."); John C. Chommie, *Payments to Employees: Gifts or Compensation for Services?*, 31 TAXES 620, 628 (1953) ("The incongruity of a gift in the usual commercial setting may indicate that the gift concept is being overworked; that it should be restricted, in so far as possible, to the intra-family transaction."); Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177, 1182–88, 1211 (1978) (arguing that "[b]oth theoretical and practical considerations" require that gains from gifts be included in the donee's income); Kornhauser, *supra* note 31, at 54 ("A new provision should be enacted stating that a gift, bequest, legacy, or devise is a realization event to the donor/decedent and thus taxable to him.").

Douglas Kahn and Jeffrey Kahn rationalize the gift exception by suggesting that it is "consistent with income tax policy" insofar as the gift-giver "purchases the right to have the taxed income used by the taxpayer, or by someone else of the taxpayer's choosing, to acquire and consume societal goods or services." Douglas A. Kahn & Jeffrey H. Kahn, *"Gifts, Gafts, and Gefts"—The Income Tax Definition and Treatment of Private and Charitable "Gifts" and a Principled Policy Justification for the Exclusion of Gifts from Income*, 78 NOTRE DAME L. REV. 441, 444 (2003). They do not, however, offer a way to distinguish between gifts and income that courts can apply in any principled manner. *Id.* at 478–79 ("If the donor's primary motive is not to vicariously enjoy the donee's consumption, but rather is to purchase an attitude from the donee, then the condition that justifies granting an exclusion is not present.").

[33] SIMONS, *supra* note 32, at 56–57.

[34] Klein, *supra* note 31, at 263.

[35] SIMONS, *supra* note 32, at 135; *see also id.* at 134 ("Considerations of equity surely afford little ground for excluding (or including) particular receipts according to the intentions of second parties. Gifts are very much like earnings, and earnings are often quite like gifts.").

earning activity, surely it is hard to defend exclusion of certain receipts merely because one has done nothing or given nothing in return."[36]

Other exceptions to the broad income rule exist. Imputed income—such as income obtained from self-supplied services or self-owned property[37]—is not included in gross income, although no specific Code provision excludes it.[38] Also, most small transactions between family members are excluded.[39] However, both of these exclusions have strong administrative justifications: both imputed income and intrafamilial transactions would be unwieldy to enforce and difficult to regulate.[40] Transactions between family members are often called gifts to justify their exclusion, but there is little support for excluding gifts to nonfamily members.

### *B. Applying the Gift–Income Distinction*

Regardless of the gift exclusion's theoretical tenability, courts must apply the exclusion in practice—as a practical matter, they must determine which transfers are "gifts" and which are "income." Given that the exclusion lacks a discernible underlying principle, courts' income–gift distinctions have understandably been inconsistent.

Jurisprudence in the employment context has been especially fraught. In *Old Colony Trust Co. v. Commissioner*, an employer had paid his employee's taxes; the employee claimed that this discharge of his debt to the IRS was a gift and not taxable income.[41] The Court determined that this transfer could not be a gift because the employer had received a benefit in the form of services from the employee.[42] Thus the transfer was effectively a payment for services rendered.[43] However, in *Bogardus v. Commissioner*, an employee's bonus was a gift (and therefore nontaxable) because, in giving the bonus, the employer had been "inspired by gratitude for . . . past faithful service."[44] Although both *Old Colony* and *Bogardus* made it clear

[36] *Id.* at 135.

[37] Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 79 (1990) ("Imputed income may be defined as the benefits to the individual from (1) self-performed services and leisure, and (2) the use of consumer durable goods, including housing, owned by him.").

[38] Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571, 1576 (1996) ("Gains obtained in the formal, informal, and illegal markets are all taxable, while the economic benefits received from self-supplied services or services from a family member are exempt from taxation.").

[39] *Id.*

[40] *See* Thomas Chancellor, *Imputed Income and the Ideal Income Tax*, 67 OR. L. REV. 561, 561–62 (1988) (noting that the "traditional view" explaining the exclusion of such gains from income rests on the impracticality of taxing such gains).

[41] 279 U.S. 716, 720 (1929).

[42] *Id.* at 729.

[43] *Id.* ("The taxes were paid upon a valuable consideration, namely, the services rendered by the employee and as part of the compensation therefor. We think, therefore, that the payment constituted income to the employee.").

[44] 302 U.S. 34, 44 (1937).

that the distinction between gifts and income was based on the motivation of the donor, neither case explained how courts could distinguish between payments for services and gifts inspired by gratitude.[45]

In *Commissioner v. Duberstein*, the Supreme Court attempted to articulate a clear standard distinguishing income from gifts.[46] A business owner had given a Cadillac to a contact who had provided useful information.[47] The IRS claimed that the value of the Cadillac constituted income taxable to the recipient.[48] The recipient of the Cadillac contended that the car was a gift and therefore nontaxable.[49] In determining that the Cadillac was income to the recipient, the Court described the proper approach to distinguishing between income and gifts as "one that inquires what the basic reason for [the donor's] conduct was in fact—the dominant reason that explains his action in making the transfer."[50] If the donor's payment arose primarily from "detached and disinterested generosity"[51] and proceeded "out of affection, respect, admiration, charity, or like impulses," the transfer was a gift.[52] But if a payment stemmed "primarily from 'the constraining force of any moral or legal duty,' or from 'the incentive of anticipated benefit' of an economic nature," the transfer was not a gift and was therefore taxable as income to the recipient.[53] Determining a donor's dominant intent was a facts-and-circumstances test that allowed the factfinder broad discretion.[54]

The *Duberstein* Court rejected a test suggested by the Government that would have categorically denied gift status to most transfers made in the business context.[55] The Government argued that, in business situations, "it doubtless is, statistically speaking, the exceptional payment by an employer to an employee that amounts to a gift."[56] Although the Court agreed with that proposition, it refused to create a categorical exception to gift status in

[45] In response to the ambiguity surrounding the status of corporate transfers to employees, lower courts tried to develop objective criteria for finding the donor's "inspiration." Courts looked at the way formal corporate resolutions described the transfer, whether the payor had deducted the transfer, whether the payment was calculated in reference to salary, and whether the shareholders had ratified the transfer. *See* Brief for the Petitioner at 11 n.6, Comm'r v. Duberstein, 363 U.S. 278 (1960) (No. 376); Chommie, *supra* note 32, at 622–24; Klein, *supra* note 31, at 222 & n.35.

[46] 363 U.S. 278 (1960).

[47] *Id.* at 280.

[48] *Id.* at 281.

[49] *Id.*

[50] *Id.* at 286.

[51] *Id.* at 285 (quoting Comm'r v. LoBue, 351 U.S. 243, 246 (1956)) (internal quotation marks omitted).

[52] *Id.* (quoting Robertson v. United States, 343 U.S. 711, 714 (1952)) (internal quotation marks omitted).

[53] *Id.* (quoting Bogardus v. Comm'r, 302 U.S. 34, 41, 58 (1937)).

[54] *Id.* at 288–89.

[55] *Id.* at 287 ("[Such] inferences cannot be stated in absolute terms.").

[56] *Id.*

the commercial realm, preferring to leave such decisions to Congress.[57] In the meantime, it was the factfinder's responsibility to determine whether a transfer was primarily motivated by affection ("detached and disinterested generosity") or self-interest ("anticipated benefit of an economic nature").[58]

The Court understood that many transfers have elements of both affection and self-interest.[59] But the Court also assumed that, given enough evidence, the factfinder would be able to determine which motivation predominated. This assumption seems plausible in the business context—businesses keep records of board meetings and memorialize their business transfers in writing, both of which could provide relevant information to the factfinder about the transferor's underlying intent. In practice, however, the determination proved far more difficult than the *Duberstein* Court foresaw, and courts' outcomes were divided. The Tax Court generally found that transfers to employees (or to employees' surviving spouses) constituted taxable income, whereas district courts almost always found that these transfers could be "excluded from income as gifts."[60] Finally, in 1986,

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[57] *Id.* at 290.

[58] *Id.* at 285 (citations and internal quotation marks omitted). Some contemporary scholars strongly criticized the *Duberstein* standard. *See, e.g.*, Erwin N. Griswold, *The Supreme Court 1959 Term—Foreword: Of Time and Attitudes—Professor Hart and Judge Arnold*, 74 HARV. L. REV. 81, 90 (1960) ("Is this not an example of an undue and unfortunate yielding of responsibility to juries and other triers of the facts, when what was called for was some clarification of the law applicable in cases of this sort?"); Klein, *supra* note 31, at 217 ("[T]he opinion did little, if anything, to narrow the ambiguity that in earlier cases had proved to be inherent in the word 'intention.'"). The *Duberstein* Court appeared to recognize that the standard it presented was not the most lucid: "This conclusion may not satisfy an academic desire for tidiness, symmetry and precision in this area, any more than a system based on the determinations of various fact-finders ordinarily does." *Duberstein*, 363 U.S. at 290. As applied in the context of business relationships, *see infra* notes 60–62 and accompanying text, and mistress relationships, *see infra* Part II.B, the standard has not provided any "tidiness," "symmetry," or "precision."

[59] This insight is not unique to the Court—a large literature on gifts and exchanges questions the distinction and asks whether it is possible to give anything disinterestedly. *See, e.g.*, PETER M. BLAU, EXCHANGE AND POWER IN SOCIAL LIFE 88–114 (1964) ("People's positive sentiments toward and evaluations of others, such as affection, approval, and respect, are rewards worth a price that enter into exchange transactions, but they must not be explicitly bartered in exchange lest their value as genuine feelings or judgments be compromised."); MARCEL MAUSS, THE GIFT: THE FORM AND REASON FOR EXCHANGE IN ARCHAIC SOCIETIES 3 (W.D. Halls trans., 1990) ("[E]xchanges and contracts take place in the form of presents; in theory these are voluntary; in reality they are given and reciprocated obligatorily."); Jane B. Baron, *Gifts, Bargains, and Form*, 64 IND. L.J. 155, 157 (1989) ("In light of . . . historical, comparative and social scientific evidence, the presumed dichotomy between gifts and bargains is difficult to sustain."); Carol M. Rose, *Giving, Trading, Thieving, and Trusting: How and Why Gifts Become Exchanges, and (More Importantly) Vice Versa*, 44 FLA. L. REV. 295, 296 (1992) (describing "the ways in which the seemingly pure gift and the seemingly pure exchange melt together—patterns in which the unilateral aspects of gift transfers blur into the reciprocal aspects of exchange transfers, and vice versa"); Jeanne L. Schroeder, *Pandora's Amphora: The Ambiguity of Gifts*, 46 UCLA L. REV. 815, 819 (1999) ("[E]goism complements altruism as an equally true and necessary moment of human nature.").

[60] Kahn & Kahn, *supra* note 32, at 447 n.32. Disagreements in tax law interpretation and application tend to multiply given that numerous trial courts hear petitions from taxpayers who contest tax decisions. A taxpayer who contests an IRS assessment before paying the disputed tax can either file in the

Congress enacted § 102(c) of the Code, which explicitly denies gift status to "any amount transferred by or for an employer to, or for the benefit of, an employee."[61] In so doing, Congress essentially adopted the rule that the Government had proposed in *Duberstein*: In the business context, all transfers count as income.[62]

Although Congress has resolved the question of primary donative intent in business cases by categorically excluding business transfers from gift treatment, the dilemma remains in other contexts. The next Part discusses how factfinders have fared in identifying a dominant intent in one particularly thorny area: transfers from lovers to their mistresses.

## II. ACCOUNTING FOR LOVE: GIFTS AND INCOME IN THE MISTRESS CASES

### *A. An Introduction to the Mistress Cases*

Before addressing the question of intent in transfers to mistresses, it is worth briefly describing the category of cases this Comment considers under the moniker "the mistress cases." The mistress cases concern eight petitions heard by the Tax Court from 1955 through 1992.[63] Although the cases' details differed, they shared similar underlying structures and features. This section proceeds by describing how these cases came to the Tax Court, what procedures the Tax Court followed, and what types of tax issues the cases raised.

The mistress cases all began as most tax disputes do: the IRS audited the taxpayer's returns[64] or noted that she had failed to file returns altogether.

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Tax Court, I.R.C. § 6213(a) (2006), or raise the issue in a Bankruptcy Court proceeding, 11 U.S.C. § 505(a) (2006). *See* Thomas D. Greenaway, *Choice of Forum in Federal Civil Tax Litigation*, 62 TAX LAW. 311, 312 (2009). A taxpayer who requests a refund can raise the claim in the Tax Court, I.R.C. § 6512(b); in a U.S. district court, 28 U.S.C. §§ 1340, 1346(a)(1) (2006); in a bankruptcy proceeding, 5 U.S.C. § 505(a) (2006); or in the Court of Federal Claims, 28 U.S.C. § 1491. *See* Greenaway, *supra*. A primary source of disuniformity in tax law arises from the appellate process. Tax Court decisions can be appealed to federal circuit courts, but the Tax Court need not—and often does not—follow circuit precedent. *See* Susan Striz, Note, *The Key to Closing the Tax Gap: Understanding*, 112 W. VA. L. REV. 1053, 1085–86 (2010).

61 Tax Reform Act of 1986, Pub. L. No. 99-514, § 122(b), 100 Stat. 2085, 2110 (codified at I.R.C. § 102(c) (2006)).

62 Kornhauser, *supra* note 31, at 45.

63 Toms v. Comm'r, T.C.M. (P-H) ¶ 92,125 (1992); Austin v. Comm'r, T.C.M. (P-H) ¶ 85,022 (1985); Jones v. Comm'r, T.C.M. (P-H) ¶ 77,329 (1977); Reis v. Comm'r, T.C.M. (P-H) ¶ 74,287 (1974); Libby v. Comm'r, T.C.M. (P-H) ¶ 69,184 (1969); Starks v. Comm'r, T.C.M. (P-H) ¶ 66,134 (1966); Brizendine v. Comm'r, T.C.M. (P-H) ¶ 57,032 (1957); Blevins v. Comm'r, T.C.M. (P-H) ¶ 55,211 (1955), *aff'd*, 238 F.2d 621 (6th Cir. 1956).

64 The IRS chooses to audit an individual return in three different ways: random selection, special projects, and computerized scoring. Sarah B. Lawsky, *Probably? Understanding Tax Law's Uncertainty*, 157 U. PA. L. REV. 1017, 1068–69 (2009). Special projects concern IRS decisions to focus on tax returns with specific characteristics. *Id.* Computerized scoring involves the Differential Index Function, a method whose criteria and cutoffs are known only to the IRS. *Id.* Because no one knows how the IRS

During the audit or in the process of investigating a failure to file, the investigator noticed a deficiency—an understatement of income and a corresponding underpayment of income tax. The IRS then sent the woman a notice of deficiency. Without paying the amount the IRS had determined she owed, the woman filed a petition with the Tax Court contesting the IRS's assessment.[65]

The method the IRS used to determine deficiencies in these cases informed the issues the women raised in their petitions. Each woman petitioning the Tax Court in the mistress cases had kept insufficient records of her income and had either neglected to file tax returns or filed returns that insufficiently described her economic activity. To determine the existence and amount of deficiency, the IRS had to reconstruct the woman's income for the years in question.

In the mistress cases, this daunting task was accomplished through some variety of the "cash accrual" method.[66] This method requires the IRS to determine the value of the assets a woman had at the beginning of the year of underpayment by investigating her bank records, valuing her home, and determining how much cash she had on hand. From this number the IRS subtracts liabilities, such as the amount the woman paid on loans and mortgages. The IRS then determines her net worth at the end of the year of underpayment and (if possible) the amount of any expenditures, including living expenses, she made during the year. Finally, the IRS calculates how much the amount of money she gained during the year, measured by expenditures and assets minus liabilities, differs from the income she claimed for that year. The difference between these two numbers provides her net unclaimed income for the year:

*(Expenditures + ending net worth) – (starting net worth + claimed income + liabilities) = amount of unclaimed income*

The amount the taxpayer should have paid on the unclaimed income equals her deficiency.[67] The IRS can add penalties to this amount that vary

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chooses which returns to audit, it is possible that there is a selection bias present in these cases that is indiscernible to outsiders.

[65] For an explanation of the process of filing tax claims, see *supra* note 60.

[66] This method is explained only briefly here. For a detailed explanation, see *Holland v. United States*, 348 U.S. 121, 125, 131 (1954). This method is also called the "net worth" method. *Id.*

[67] As a concrete example, consider the method as executed in *Blevins*, T.C.M. (P-H) ¶ 55,211, at 704. Blevins had not filed returns for the years 1940 to 1951, so the IRS had to calculate her net income for each separate year in order to determine how much tax she owed. *Id.* at 703. The IRS calculated her net income for 1940 as follows. First, the government calculated Blevins's assets by adding together the value of her government bonds, the value of the home that she owned, the amount of cash she kept in her safe deposit box, and the amount of money in her savings account, for a total of $2075. The IRS subtracted from that number Blevins's liabilities for that year ($498.83 for her mortgage payment) for an end-of-year net worth of $1576.17. *Id.* at 704. The IRS then took the net worth it had determined she had at the beginning of the year ($1300.82) and figured out that during 1940 her net worth had increased by $275.35 ($1576.17 – $1300.82). The IRS then added her estimated living expenses, $2000, to this

according to the length of time the taxpayer neglected to pay and the taxpayer's intent to defraud the IRS.[68]

When the IRS assesses deficiencies with this method, taxpayers invoke two main defenses.[69] First, they claim that their net worth at the beginning of the time period exceeded the IRS estimate. These taxpayers assert that they had a cash hoard—a large sum of cash that was unrecorded because the taxpayer kept it in an unofficial place, such as at home or in a safety deposit box.[70] Second, taxpayers claim that the money they spent during the tax period came from a legal but nontaxable source, such as gifts.[71] The eight women in the mistress cases all claimed that the discrepancy between

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number to determine that Blevins's net income for that year was $2275.35. *Id.* (In assessing the accuracy of the IRS's calculations, the Tax Court found that Blevins had had a small amount of extra income and adjusted the total accordingly, to $2287.32. *Id.* at 705.) The IRS then added the amount of Blevins's deficiency (the amount of tax she should have paid after subtracting deductions from her net income), her penalty for not filing returns (according to the Code provision that is now I.R.C. § 6662 (2006)), and a penalty for the fact that her failure to file was willful (now I.R.C. § 6651(f)): $54.90 + $13.73 + 27.45 = $96.08. *Blevins*, T.C.M. (P-H) ¶ 55,211, at 704. See *infra* note 68 for more information about penalties.

[68] The Code provides a number of penalties for delinquent taxpayers. The IRS is likely to penalize a taxpayer who underreports income, especially if she intended to defraud the IRS. I.R.C. § 6651(a)(1) (providing that, absent reasonable cause, a deficient taxpayer must pay 5% for each month that taxes are late, up to 25% of the amount of taxes due); *id.* § 6663(a) (providing that a taxpayer must pay a 75% penalty on amounts underreported due to fraud). The IRS will assess similar penalties for a complete failure to file. *Id.* § 6662 (providing that a taxpayer who substantially underreports income or underreports out of negligence must pay 20% on the underreported amount); *id.* § 6651(f) (providing that a taxpayer who fraudulently fails to file must pay 15% per month for every month the return is delinquent, up to a maximum of five months, or 75%).

[69] Jeffrey W. Loubet, *Combating the Net Worth Method*, 49 TAXES 54, 57 (1971) ("The number of defenses against [the net worth plus cash expenditures method] are extremely limited. . . . [T]he taxpayer is limited to either demonstrating that there was a nontaxable source for the cash he spent, or relying upon the somewhat hackneyed 'cash hoard' explanation."); Clyde R. Maxwell, *Tax Evasion Cases—The Cash Hoard Defense*, 50 L.A. B. BULL. 59, 59 (1974) ("The usual and principal defense urged by a taxpayer against whom the Internal Revenue Service seeks to use [the net worth and cash expenditure] method is that the taxpayer had a cash hoard at or near the beginning of the first year for which he finds himself under investigation . . . .").

[70] *Holland*, 348 U.S. at 127 ("Among the defenses often asserted is the taxpayer's claim that the net worth increase shown by the Government's statement is in reality not an increase at all because of the existence of substantial cash on hand at the starting point."); Scot P. Gormley & Thomas M. Porcano, *Reconstruction of Income by the Internal Revenue Service*, TAXES, Apr. 1999, at 34, 41 ("[T]he taxpayer will claim that a portion of his or her assets represents nontaxable income that has been accumulated over a period of years."); Marvin M. Levy, *The Net Worth Question: Defending Against the IRS's Potent Investigative Weapon*, 4 WASH. LAW., July/Aug. 1990, at 40, 41 ("The defense that a large amount of currency existed, outside the bank, is the 'cash hoard defense.'").

[71] *See Holland*, 348 U.S. at 127 ("It may be that gifts, inheritances, loans and the like account for the newly acquired wealth."); Pamela H. Bucy, *Criminal Tax Fraud: The Downfall of Murderers, Madams and Thieves*, 29 ARIZ. ST. L.J. 639, 666 (1997) ("In some net worth cases, the defense actively seeks to prove that the increase in net worth is due to nontaxable sources such as gifts or loans.").

their expenditures and their net worth came from a nontaxable source: gifts from lovers.[72]

In accordance with the donor's intent test from *Duberstein*,[73] judges in the mistress cases attempted to assess the motivations behind the transfers from paramour to mistress. If the relationship had been primarily one of love and affection, the transfers would be nontaxable gifts. But if the transfers had been payments for the mistress's services, the gains would be considered part of her income.

As the *Duberstein* Court pointed out, the gift–income distinction is fact-intensive and puts a great deal of responsibility on the factfinder.[74] The Tax Court is an Article I court, which means that no jury trial right attaches to civil cases conducted there.[75] Thus, the Tax Court judges deciding the mistress cases functioned as factfinders; they considered the petition and the results of the IRS investigation, held a trial so the parties could present their cases and witnesses, and made decisions based on their assessments of the facts. As a closer look at these cases demonstrates, Tax Court judges were unable to distinguish between gifts and income with any clarity, primarily because the donor's intent test presents insurmountable obstacles in cases involving long-term, nonmarital relationships.

### *B. For Love or Money: The Tax Court's Decisions*

Because the distinction between taxable income and nontaxable gifts turns on the donor's intent,[76] the mistress cases pinpoint the question of proving intent in long-term relationships that are often kept from public view. Because intent requires a facts-and-circumstances determination, the judges had to parse the evidence carefully. When the evidence proved inconclusive, the judges relied on their "experience with the mainsprings of human conduct."[77] In the sections below, I discuss the evidentiary issues that confronted the judges in the mistress cases and the assumptions about

[72] The cases considered here only include *inter vivos* transfers. There are also a number of cases in which mistresses won suits against or settled with their deceased lovers' estates, claiming that they had exchanged companionship for a promise of bequest. *See, e.g.*, Braddock v. United States, 434 F.2d 631 (9th Cir. 1970); Roberts v. Comm'r, T.C.M. (P-H) ¶ 95,171 (1995); Green v. Comm'r, T.C.M. (P-H) ¶ 87,503 (1987); Cotnam v. Comm'r, 28 T.C. 947 (1957). The IRS later determined a deficiency in these women's income tax reporting. The women (or their estates) then claimed that the settlement or verdict amount constituted gifts from a lover, not taxable income. This Comment does not consider these cases because the courts' determinations of the gift–income question were often constrained by the terms of the verdict or settlement agreement—a fact that limited their ability to pursue the donor's intent standard that this Comment addresses.

[73] 363 U.S. 278, 285 (1960); *see supra* notes 47–57 and accompanying text.

[74] *See supra* text accompanying notes 53–58.

[75] *See* Martin H. Redish, *Legislative Courts, Administrative Agencies, and the* Northern Pipeline *Decision*, 1983 DUKE L.J. 197, 207.

[76] *Duberstein*, 363 U.S. at 285–86; *see supra* notes 46–66 and accompanying text.

[77] *Duberstein*, 363 U.S. at 289.

human conduct that informed the cases' outcomes. Section 1 describes the scarcity of documentary evidence in the mistress cases. Section 2 explores the particular unreliability of witness testimony in these cases. Section 3 discusses the problematic distinction between services and affection that the judges made. Section 4 assesses the difficulty of valuing companionship that confronted these decisionmakers.

*1. A Dearth of Documentary Evidence.*—Lovers do not make good bookkeepers, or so the mistress cases imply. In all of the mistress cases, the mistresses themselves had kept insufficient records, which forced the IRS to assess the women's deficiencies by reconstructing their incomes.[78] The secrecy of these relationships probably explains the lack of documentary evidence: usually either one or both of the lovers were married to someone else at the time the contested transfers took place. Thus the lovers usually went to great lengths to avoid detection, in part by avoiding creating a paper trail. For example, in *Libby v. Commissioner*, a lover had tried to hide the payments to his mistress from his wife by lying to the IRS about the amount of the transfers and convincing the mistress to open a checking account under the name of a nonexistent business entity.[79] *Toms v. Commissioner* concerned a woman who kept records of the payments she had received in a code that the IRS could not decipher.[80] A number of lovers made payments to their mistresses in cash, presumably to avoid detection.[81]

Although several of the mistress case judges suggested that the frequency and regularity of payments indicated that the transfers were compensation for services,[82] financial records were generally of little help in determining intent. Moreover, none of the decisionmakers could rely on the kinds of documents that might be helpful in assessing the motivation underlying the transfers: throughout the cases, neither party introduced a single love letter or other declaration. In short, the judges had very little documentary evidence with which to analyze the donors' intentions.

*2. The Lovers' Testimony.*—Without much documentary evidence to rely on, the judges in the mistress cases usually had to consider the testimony of any parties involved. However, the problem of secrecy presented itself here too: in relationships that were clandestine and usually informal, only the lovers themselves were competent to testify about the relationships' qualities.[83] But the judges tended to find those witnesses unreliable.

78 See *supra* notes 66–67 and accompanying text for a description of the net worth method.

79 T.C.M. (P-H) ¶ 69,184, at 989 (1969).

80 T.C.M. (P-H) ¶ 92,125, at 581 (1992).

81 *See, e.g.*, Reis v. Comm'r, T.C.M. (P-H) ¶ 74,287, at 1259 (1974); Starks v. Comm'r, T.C.M. (P-H) ¶ 66,134, at 764–65 (1966).

82 *See infra* Part II.B.3–4.

83 *E.g.*, *Starks*, T.C.M. (P-H) ¶ 66,134, at 765.

When mistresses testified, they provided detailed descriptions of their relationships with their paramours to demonstrate that love—not money—prompted those liaisons. If they could convince the judges that the discrepancies between their claimed income and the gains the IRS had determined were attributable to gifts from their paramours, the mistresses would not pay tax on the value of those gifts. Given that their characterizations of their relationships with their lovers had direct tax consequences, mistresses were highly motivated to emphasize the affectionate qualities and to deemphasize the transactional aspects of their relationships. Such self-serving testimony rarely sufficed to convince the judges.[84]

The mistresses' paramours proved even less reliable. For example, *Starks v. Commissioner* involved the petition of a woman who had received living expenses, a house, furniture, a car, jewelry, and clothing from one man over a period of five years.[85] The IRS called the value of these transfers "income . . . 'for services rendered'" and argued that the woman owed unpaid self-employment tax on the gain; she argued that the transfers had been nontaxable gifts motivated by affection.[86] When the donor was called to the stand, he explained that "the purpose of the payments" was "[t]o insure the companionship of Greta Starks, more or less of a personal investment in the future on my part."[87] Did the lover's testimony shed any light on the question of the purpose underlying the transfers? The court thought not; it found the lover's statements "incomprehensive and rather absurd as statements of purpose."[88] The court did not provide any direction about what it might have considered a valid purpose.

In fact, in almost every case in which a lover testified, the judge found him not credible. In *Jones v. Commissioner*, the judge described the lover's testimony as "evasive" and "contradictory."[89] The *Toms v. Commissioner* judge dismissed the paramour as "unpersuasive."[90] Based on the facts in *Blevins v. Commissioner*, the court simply assumed that the paramour was lying.[91] In *Libby v. Commissioner*, the one case in which the judge found the lover's testimony at least somewhat believable, the judge's response to the testimony was still lukewarm: he found the lover's testimony "obscure

[84] *See, e.g.*, *Libby*, T.C.M. (P-H) ¶ 69,184, at 997 (characterizing the mistress's testimony as "vague, self-serving, inconsistent, exaggerated and somewhat incredible"); Blevins v. Comm'r, T.C.M. (P-H) ¶ 55,211, at 705 (1955) (describing the mistress's testimony as "uncorroborated" and "self-serving"), *aff'd*, 238 F.2d 621 (6th Cir. 1956).

[85] T.C.M. (P-H) ¶ 66,134, at 764–65.

[86] *Id.* at 765.

[87] *Id.* (internal quotation marks omitted).

[88] *Id.* at 766.

[89] T.C.M. (P-H) ¶ 77,329, at 1323 (1977).

[90] T.C.M. (P-H) ¶ 92,125, at 579 (1992).

[91] *See* T.C.M. (P-H) ¶ 55,211, at 706 (1955), *aff'd*, 238 F.2d 621 (6th Cir. 1956).

and in conflict with what he told the special agent during the [IRS] investigation."[92]

In some cases, the lover's unreliable testimony was not even available because the lover had died or the IRS could not locate him.[93] In *Reis v. Commissioner*, the IRS found that a nightclub singer had underreported her income for six years.[94] The woman claimed that at the beginning of the time period she had over $100,000 in cash, most of which she had received as gifts from a lover.[95] The lover, however, was nowhere to be found.[96] The relationship between the two had ended almost fifteen years before the woman petitioned the Tax Court, and the two had long since lost touch. Without any evidence other than the woman's testimony, the court somewhat grudgingly allowed the woman's gift claim to stand.[97]

*3. Sex for Sale.*—Without evidence demonstrating intent, the judges in the mistress cases had to base their decisions on proxies for intent: factors that did not directly demonstrate intent but could be used to infer it. The courts relied most often on a proxy that might be called market behavior: whether the couple behaved more like rational actors making an impersonal exchange or more like actors whose behavior could only be explained by personal interests and affections. The most reliable indicator of market behavior in the mistress cases was the woman's former prostitution: if a woman had any prostitution in her past, the judge presumed that the relationship at issue was motivated primarily by self-interest and that the transfers made in the context of the relationship were payments for services.[98]

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[92] T.C.M. (P-H) ¶ 69,184, at 997 (1969).

[93] *See, e.g.*, Austin v. Comm'r, T.C.M. (P-H) ¶ 85,022, at 103 (1985) (lover had died); Reis v. Comm'r, T.C.M. (P-H) ¶ 74,287, at 1265 (1974) (lover could not be located).

[94] T.C.M. (P-H) ¶ 74,287, at 1258.

[95] *Id.* at 1263.

[96] *Id.* at 1264.

[97] *Id.* at 1265.

[98] This is similar to the Seventh Circuit's interpretation in *United States v. Harris*: "*If* these cases make a rule of law, it is that a person is entitled to treat cash and property received from a lover as gifts, as long as the relationship consists of something more than specific payments for specific sessions of sex." 942 F.2d 1125, 1133–34 (7th Cir. 1991).

The rule makes sense insofar as the proceeds from illegal prostitution constitute income and are taxable to the recipient. In *United States v. Tunnell*, the Fifth Circuit explicitly stated that income from illegal prostitution falls under the Code's definition of gross income. 481 F.2d 149, 151 (5th Cir. 1973). Even before *Tunnell*, "It had been a well-established principle . . . that unlawful, as well as lawful, gains are comprehended within the term 'gross income.'" James v. United States, 366 U.S. 213, 218 (1961); *see also* Treas. Reg. § 1.61-14(a) (2006) ("Illegal gains constitute gross income.").

Legal prostitution is also taxed, even though some detractors object to taxation, arguing that taxation confers legitimacy on a morally corrupt industry. *See, e.g.*, Kimberly D. Krawiec, *A Woman's Worth*, 88 N.C. L. REV. 1740, 1754 (2010) (noting the "unwillingness to provide a stamp of government approval to Nevada's brothel industry"). The legal brothels in Nevada have lobbied extensively to be taxed by the state, hoping that taxation will signal state approval of a morally condemned legal business.

This sounds like a straightforward rule, and in some cases it probably functioned as an accurate proxy for intent. Consider, for example, *Toms v. Commissioner*,[99] a case in which the relationships between a woman and her paramours were almost certainly just business. Toms owned and operated a "freelance escort service and a house of prostitution" for three years.[100] She advertised for and hired prostitutes and solicited business in local newspapers.[101] She also practiced prostitution herself and at one point advertised "for a millionaire who could financially support her."[102] This conspicuous illegal activity triggered an investigation by local law enforcement,[103] and Toms pleaded guilty to prostitution in 1985.[104] Three years later, she was convicted of willful tax evasion for failing to pay federal taxes on the proceeds from her illicit business.[105]

Toms contested the amount of the tax and penalties the IRS claimed she owed, arguing that a substantial amount of what the IRS had calculated as income actually was gifted to her from lovers and thus should not have been included in the IRS's assessment of her unreported income.[106] However, her criminal history and the fact that she was paid every time she saw these men undermined the credibility of her claims.[107] The court had little difficulty determining that the transfers "were payments for services, not gifts" and therefore were taxable income to Toms.[108]

However, the prostitution-as-proxy approach was not always reliable in the mistress cases, primarily because a woman's past behavior did not necessarily extend to the relationship the Tax Court was examining. In *Jones v. Commissioner*, for example, the petitioner admitted to both the FBI and the IRS that she had worked as a prostitute.[109] The court thus determined that the transfers from her lover could not constitute gifts—they were clear-

Kathleen Hennessy, *Brothels Want To Be Taxed; Legislature Not that Greedy: Proprietors Believe Paying Taxes Would Lend Legitimacy to Houses of Prostitution*, PAHRUMP VALLEY TIMES, May 13, 2005, at A20, *available at* http://www.pahrumpvalleytimes.com/2005/05/13/news/brothels.html; *see also* Krawiec, *supra*, at 1743 (noting the perceived benefits from imposing a tax on legal Nevada brothels).

[99] T.C.M. (P-H) ¶ 92,125 (1992).

[100] *Id.* at 571.

[101] *Id.*

[102] *Id.*

[103] *Id.* at 572.

[104] *Id.* at 571.

[105] *Id.*

[106] *Id.* at 570.

[107] *Id.* at 579 ("Mr. Cohen paid petitioner for the first evening she spent with him and paid her most nights she saw him. This suggests a paid escort relationship, not gifts to a friend."); *id.* ("[Mr. DeFelice] began seeing [Toms] twice a week in May 1982 and three to four times a week in 1983. Each week he paid her. We find that the payments were for services rendered, not gifts.").

[108] *Id.* at 580.

[109] T.C.M. (P-H) ¶ 77,329, at 1323 (1977). The court's opinion does not reveal why Jones had been talking with the FBI.

ly payments for services.[110] However, the relationship at issue seemed more complex than the court assumed: the woman's paramour had also given her a legitimate job, the couple went on dates, and the relationship had lasted for a number of years.[111] Although the woman had been a prostitute at some point, it was not clear that this was a business relationship. Similarly, in *Brizendine v. Commissioner*, a woman's five convictions for prostitution (all before the time period when the deficiency was assessed) were decisive factors in the court's determination that a lover's weekly financial support could not be gifts to the woman—even though the lover had supported the woman financially on the condition that she stop practicing prostitution.[112]

The prostitution-as-proxy-for-intent approach in the mistress cases led to some incongruous results: judges found gifts in some circumstances and income in others, even when the behaviors in the two cases were almost indistinguishable. Compare, for example, the cases of Thelma Blevins and Lillian Reis. Blevins operated a "house of prostitution," "staged immoral shows," furnished call girls to local hotels, and personally practiced prostitution.[113] The IRS claimed that Blevins had underreported income over a period of eleven years;[114] she contended that more than half of the money had come from "an admirer" and that the transfers were nontaxable gifts.[115] The court disagreed and found Blevins liable for all deficiencies assessed.[116] However, there was ample evidence that Blevins's relationship with her lover had several characteristics demonstrating that it was far more than just business. The relationship was long and ongoing—the lover had partially supported her for almost eleven years.[117] He also demonstrated an interest in her life that went beyond the purely transactional. He accompanied her

[110] *Id.* ("Certainly the funds which [the lover] gave to petitioner were not gifts within the meaning of the income tax statutes. [He] gave this cash to petitioner because petitioner had sexual relations with him when he was in Atlanta.").

[111] *Id.* at 1321.

[112] T.C.M. (P-H) ¶ 57,032, at 126 (1957). The court's reasoning in *Brizendine* was particularly convoluted. The mistress met a man who offered to support her if she would stop practicing prostitution. She accepted his offer and stopped working as a prostitute. *Id.* The court found that her "promise constituted valid consideration for the payments which cause[d] them to be taxable as ordinary income." *Id.* at 127. In other words, a woman who agreed to stop practicing prostitution in exchange for support was practicing prostitution by making the agreement.

[113] Blevins v. Comm'r, T.C.M. (P-H) ¶ 55,211, at 705 (1955), *aff'd*, 238 F.2d 621 (6th Cir. 1956). It is unclear how the court knew about Blevins's illegal activities. There was no evidence of a criminal case against Blevins for exchanging sex for money, nor did this case involve tax deficiencies for unreported business income. Blevins did not contest the court's characterization of her as a prostitute, so it is possible that she stipulated that fact for reasons unclear.

[114] *Id.* at 703.

[115] *Id.* at 706.

[116] *Id.*

[117] Mulhall gave Blevins $1500 in 1941 and $2500 every year thereafter. *Id.* at 705. It seems that these transfers covered the bulk of Blevins's living expenses: the Commissioner found that Blevins's living expenses totaled $2000 per year. *Id.* at 706.

to the IRS office when she received a notice of deficiency and visited her son in the hospital when he was injured.

In contrast, Lillian Reis's relationship with her paramour had begun with money: on first seeing her perform at a nightclub, an admirer offered to write her a check for any gift she would like.[118] When the check cleared, Reis and the man began a relationship. During the course of their relationship, the couple had regularly scheduled liaisons—they met twice weekly, and he paid her each week.[119] Reis herself characterized the relationship as transactional, claiming that she had "earned every penny" of the payments she received from him.[120]

The judge determined the transfers had been gifts: "[W]e find that there was sufficient donative intent and no expectation of a quid pro quo."[121] In a footnote, the court distinguished *Blevins* without explanation.[122] Blevins had certainly conducted relationships in which she exchanged companionship for money. But Reis, too, had undertaken a series of relationships in which men had given her money in exchange for her companionship.[123] And while Reis's regular dates with her lover may have signaled a romantic relationship, they just as easily could have implied some sort of economic exchange as well.[124] Thus, what sounds like a relatively simple test—transfers from a lover become taxable income if sex is exchanged for money—proved nearly impossible to apply in the factual complexity of the mistress cases.

*4. Valuing Companionship.*—If a woman at some point placed her sexual services on the market, the Tax Court assumed that the relationship in question was motivated by self-interest—it used prostitution as a proxy for intent. The mistress cases also demonstrate that the Tax Court used behavior that seemed economically irrational as a proxy for love. In other words, if the transfers demonstrated behavior that would not make sense in a market exchange, the court assumed that the transfers were made with donative intent and were thus nontaxable gifts.

118 Reis v. Comm'r, T.C.M. (P-H) ¶ 74,287, at 1259 (1974). Reis asked the man for $2400 for two mink stoles—one for herself and one for her sister. *Id.*

119 *Id.*

120 *Id.* at 1265 n.11. Recall that Reis's descriptions of the relationship had little effect on the court's determination because the *Duberstein* test concerns the donor's intent, not the donee's.

121 *Id.* at 1265.

122 *Id.* at 1265 n.11.

123 *Id.* at 1259 ("She had accumulated approximately $12,000 in cash by this time. This accumulation resulted primarily from gifts from a certain gentleman friend in Florida."); *id.* (noting that, after one lover went to jail for passing bad checks, a new lover "started paying all of [Reis's] living expenses").

124 *Id.* at 1265 n.11 ("In making this finding we have considered the remarks in [*Blevins*]. We have also considered the fact that petitioner met Mr. Miller on a regular basis . . . ." (citation omitted)).

For example, in *Starks v. Commissioner*, Greta Starks had conducted a relationship with an older married man for five years.[125] For four of those years, his transfers to her (in the form of purchases and living expenses) had averaged just under $6000 per year. During one of the five years, however, the value of the lover's transfers to Starks had been much higher. In that year, the lover had put a down payment on a house for Starks, bought her furs, taken her shopping at Saks, purchased a piano and furniture, and provided a weekly allowance—all for a grand total of over $41,000.[126] The IRS called the transfers for all five years "assets received for services rendered,"[127] claiming that "'[c]ompanionship' was the service sought by [the lover] and 'companionship' is the service that he received. In exchange for this service, [the lover] housed, clothed and fed the petitioner."[128] The Government concluded that, "[c]ertainly, the 'companionship' of the petitioner constituted 'services rendered.'"[129]

The court found this characterization ludicrous. Companionship could not be a service because typical prices for services did not vary that radically: "Evidently [the IRS] would argue the man paid her over $41,000 for her companionship in 1955 and $5,000 or $6,000 for her companionship in the other years."[130] The court did not indicate how it would have decided if the payments had been more regular—if the lover had given Starks the same amount of money each year—but the court certainly implied that payments for services can be distinguished from gifts because the former have a more stable market price.

*Austin v. Commissioner*[131] presents another example of the Tax Court distinguishing between gifts and income by assuming that irrational market behavior functions as a proxy for love. Austin and a married man conducted a relationship for the two years leading up to the man's death.[132] After his death, she sued his estate for several million dollars, claiming that he had promised to leave her half of his estate.[133] She settled for $42,500, which the settlement agreement characterized as payment for "various services."[134]

A few years later, the IRS mailed notices of deficiency to Austin, claiming that she had underreported her income from the two years of her

[125] T.C.M. (P-H) ¶ 66,134, at 764–65 (1966); *see supra* notes 85–88 and accompanying text.
[126] *Starks*, T.C.M. (P-H) ¶ 66,134, at 765–66.
[127] *Id.* at 765.
[128] *Id.* at 766 n.1.
[129] *Id.*
[130] *Id.* at 766.
[131] T.C.M. (P-H) ¶ 85,022 (1985).
[132] *Id.* at 100–01.
[133] *Id.* at 101.
[134] *Id.* at 102.

relationship with her lover.[135] In the first year, Austin's paramour had bought her a house and given her regular checks, amounting to a total gain of almost $48,000.[136] In the second year, he had given her regular checks totaling $9214.[137] In her petition, Austin claimed that all of this money constituted gifts and that she had thus properly excluded these amounts from her tax returns; the IRS, of course, argued that these amounts were payments for services rendered.[138]

The court conceded that the $42,500 settlement amount was payment for services because the settlement agreement explicitly termed it as such.[139] The court could not believe, however, that all of the transfers from the lover to Austin constituted compensation: "In order to hold for [the IRS] . . . we would have to conclude that [the lover] paid petitioner $47,704 for her 1972 services to him and $9,214 for her 1973 services to him . . . and that petitioner nevertheless had been undercompensated by $42,500 [the amount of the settlement] for these services."[140] The court assumed that to pay Austin almost $100,000 for less than two years of companionship "services" would be to seriously overvalue that companionship.[141] In other words, paying so much for companionship was irrational. Because the transfers were irrational, they had to be gifts.

The court most clearly stated its rationale for characterizing "irrational" transfers—those that varied without explanation (as in *Starks*) and those that overvalued companionship (as in *Austin*)—as gifts in *Libby v. Commissioner*.[142] Virginia Libby and her husband had understated their income for six consecutive years, but Virginia claimed that a substantial amount of the money had come from a lover.[143] The court characterized both Virginia and her lover as financially savvy about bookkeeping, investing, and evading tax responsibilities.[144] Nonetheless, the court accepted that the lover's transfers to Virginia were gifts in the amounts that she claimed. The court explained the couple's failure to keep records of transfers in this realm of their lives (as opposed to all other realms of their lives) by asserting that people in love have better things to do than accounting: "[W]e are not too con-

135 *Id.* at 103.
136 *Id.*
137 *Id.*
138 *Id.*
139 *Id.* at 104.
140 *Id.*
141 *Id.*
142 T.C.M. (P-H) ¶ 69,184, at 997 (1969).
143 *Id.* at 996.
144 The lover and Virginia had both displayed considerable dishonesty in other financial matters. *See id.* at 996–98. Virginia herself was fairly financially savvy: much of the court's opinion detailed her failure to accurately report sources of income and other fraudulent tax behavior. *Id.* at 998 ("[D]espite the lack of formal education, Virginia was knowledgeable about her business and personal affairs, albeit with flexible scruples.").

cerned [about the insufficient evidence] because there is little likelihood that [the couple was] interested in 'keeping books on romance.'"[145] In other words, romantic relationships exist in a realm separate from the public world of market exchange and rational valuation. Some amount of irrationality is accepted—and maybe even expected.

* * *

The Tax Court's mistress case decisions reveal that the intent assessment at the center of the gift–income distinction is incredibly difficult to make when cases involve intimate relationships. The opinions seem to exemplify the fears that Justice Frankfurter expressed in his *Duberstein* dissent.[146] In disagreeing with the majority's newly enunciated donor's intent standard,[147] Justice Frankfurter voiced concerns about the fact-heavy inquiry the standard required:

> What the Court now does sets fact-finding bodies to sail on an illimitable ocean of individual beliefs and experiences. This can hardly fail to invite, if indeed not encourage, too individualized diversities in the administration of the income tax law. I am afraid that by these new phrasings the practicalities of tax administration, which should be as uniform as is possible in so vast a country as ours, will be embarrassed.[148]

The mistress cases exemplify the confusion that the donor's intent standard can cause. The next Part suggests that, in addition to the practical difficulties accompanying the donor's intent standard, the judicial assessment of intimate relationships presents normative problems.

## III. COMPARING CADILLACS TO COMPANIONSHIP

*Commissioner v. Duberstein* provides a useful frame for the argument that courts should not make intent inquiries in cases concerning intimate relationships. In *Duberstein*, the Supreme Court assessed a transfer in which a man received a Cadillac from a business contact.[149] The Court found that the Cadillac was income to the recipient because the transfer "was at bottom a recompense for Duberstein's past services, or an inducement for him to be of further service in the future."[150] In the mistress cases, courts investigated the difference between a Cadillac and companionship—that is, they attempted to articulate what distinguishes a voluntary transfer in the business context from a similar transfer in the context of a personal relationship.

[145] *Id.* at 997.
[146] *See* 363 U.S. 278, 294–98 (1960) (Frankfurter, J., concurring and dissenting).
[147] *See supra* notes 41–54 and accompanying text.
[148] *Duberstein*, 363 U.S. at 297.
[149] *Id.* at 280 (majority opinion).
[150] *Id.* at 291–92.

This Part contends that there is no difference between the exchange in *Duberstein* and the exchanges in the mistress cases—not because a Cadillac and companionship are both equally alienable market commodities but because there is no way to get to the "bottom" of intimate relationships to determine a dominant intent.

The primary obstacle to the Tax Court's determination of a donor's dominant intent in the mistress cases was the dearth of evidence these relationships produced.[151] In some ways this is unsurprising: we generally do not expect lovers to keep records of their transactions in the way we expect business professionals to. These expectations are keyed to a relationship's level of intimacy. We do not expect lovers to "keep books on romance,"[152] but we do expect those conducting business at arms' length to record their transactions. In other words, the more intimate a relationship, the less legal regulation and enforcement the economic exchanges within the relationship receive.[153]

Part of the rationale for not regulating or enforcing exchanges in intimate relationships is that these exchanges are often treated as if they occupy a "sphere of life removed from the market."[154] Tax law in particular manifests this logic.[155] Only gains from market transactions count as income, and transactions in the most intimate relationship—marriage—are not considered market transactions.[156] Thus, taxpayers need not claim transfers from their spouses as income.[157] On the other hand, prostitution is deemed

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151 *See supra* Part II.B.2.

152 Libby v. Comm'r, T.C.M. (P-H) ¶ 69,184, at 997 (1969).

153 As Jill Elaine Hasday asserts, "The law loudly denies enforcement to a variety of economic exchanges between husbands and wives," including interspousal contracts for domestic services and sex. Jill Elaine Hasday, *Intimacy and Economic Exchange*, 119 HARV. L. REV. 491, 499–501 (2005); *see also* Noah D. Zatz, *Sex Work/Sex Act: Law, Labor, and Desire in Constructions of Prostitution*, 22 SIGNS 277, 294 (1997).

154 Hasday, *supra* note 153, at 499.

155 Tsilly Dagan, *Itemizing Personhood*, 29 VA. TAX REV. 93, 95 (2009) ("[T]ax law reflects an effort to restrict itself to the market sphere and steers away from personal attributes and relationships in order to preserve a market-free environment.").

156 Staudt, *supra* note 38, at 1575–76. Staudt calls this distinction the "market proviso." *Id.*

157 The Code does not categorize transfers between spouses as gifts per se but instead treats them as nonrecognition events. I.R.C. § 1041(a) (2006) ("No gain or loss shall be recognized on a transfer of property from an individual to . . . a spouse . . . .").

The marital nonrecognition rule is clear, but scholars fiercely debate whether tax law *should* provide special treatment to married couples. Numerous commentators note that Code provisions giving married couples special privileges and benefits have a normative basis. *See, e.g.*, MARTHA ALBERTSON FINEMAN, THE NEUTERED MOTHER 145–66 (1995); Patricia A. Cain, *Heterosexual Privilege and the Internal Revenue Code*, 34 U.S.F. L. REV. 465 (2000); Vivian Hamilton, *Mistaking Marriage for Social Policy*, 11 VA. J. SOC. POL'Y & L. 307 (2004); Nancy J. Knauer, *Heteronormativity and Federal Tax Policy*, 101 W. VA. L. REV. 129 (1998); William P. Kratzke, *The Defense of Marriage Act (DOMA) Is Bad Income Tax Policy*, 35 U. MEM. L. REV. 399, 406 (2005); Nancy D. Polikoff, *Ending Marriage as We Know It*, 32 HOFSTRA L. REV. 201 (2003); *see also infra* note 183. Concerns other than bias have prompted others to condemn marital benefits such as those conferred by the joint income tax return. For an impersonal market transaction, one in which little or no intimacy exists, so gains from prostitution are considered income.[158]

However, the mistress cases demonstrate the difficulty of trying to clearly distinguish between intimate relationships with nonmarket exchanges and impersonal relationships with market exchanges. This problem arises because many relationships are not purely intimate or purely impersonal.[159] Sexual relationships in particular occupy a spectrum of intimacy;[160] in fact, "sexual activity often occurs without regard to intimacy or in varied forms of relationship to intimacy."[161] In determining whether the transfers between lovers were gifts or income in the mistress cases, the Tax Court struggled with relationships that lay somewhere on the spectrum between marriage and prostitution.[162]

Questions about the relationship between economics and intimacy extend beyond the mistress context and into all areas of life in which economic motivations and activities intersect with nonmarket behaviors.[163] At the heart of this discussion lies a normative debate about the desired relationship between economics and intimacy. Scholars on one side of this debate are concerned with "commodification"—they worry that allowing market concerns and market interests to invade personal relationships degrades the most valuable aspects of our selves:

> [C]ommodification . . . refers to the extent to which our bodies, our selves and our labor become commodities with a market exchange value, either literally, or rhetorically in the sense that we conceive of human bodies and capacities as

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example, Lily Kahng argues that the benefits conferred on married people by the joint return effectively penalize unmarried taxpayers. Lily Kahng, *One Is the Loneliest Number: The Single Taxpayer in a Joint Return World*, 61 HASTINGS L.J. 651, 657–60 (2010); *see also* James M. Puckett, *Rethinking Tax Priorities: Marriage Neutrality, Children, and Contemporary Families*, 78 U. CIN. L. REV. 1409, 1415–16 (2010) (noting the "marriage penalt[ies]").

158 *See* Zatz, *supra* note 153, at 294 ("[I]n hegemonic Euro-American culture, sexuality and money are thought of as things that cannot, do not, and/or should not mix. This separation is related at least in part to the attribution of money, commerce, and contract to the public realm of work and intimacy, desire, and pleasure to the private realm of familial and other affective relationships."); *supra* notes 27, 98.

159 *See* VIVIANA A. ZELIZER, THE PURCHASE OF INTIMACY 16 (2005) ("[E]xactly where we set the limit between intimate and impersonal relations remains arbitrary.").

160 *Id.*; *accord* Laura A. Rosenbury & Jennifer E. Rothman, *Sex in and out of Intimacy*, 59 EMORY L.J. 809, 835 (2010).

161 Rosenbury & Rothman, *supra* note 160, at 835.

162 *See supra* Part II.B.3–4.

163 Although this Comment discusses only tax cases, other courts confronting the intersection of economic exchange and intimacy often have difficulty maintaining strict distinctions between the two. Viviana A. Zelizer, *The Purchase of Intimacy*, 25 LAW & SOC. INQUIRY 817, 827–28 (2000) ("[D]espite the specter of prostitution as the end point of any commodification in sexual relations, in practice courts and judges have not maintained a simple dichotomy of legitimate, nonmonetary sexual relations versus illegal monetized prostitution.").

> amenable to market value and reducible to a matter of satisfying economic preferences.[164]

These "anticommodification" scholars object to the prospect of valuing human qualities on the market, insisting that such valuation diminishes personality and individuality. They argue that treating human qualities in market terms "allow[s] certain market norms to govern our treatment of a thing [and] expresses a mode of valuation not worthy of it."[165] A theorist taking this position might argue that when courts treat exchanges in mistress relationships as market interactions and thus imply that sex and companionship can be bargained for and purchased, they degrade the intrinsic value of sex and companionship that in fact are incommensurate with the market and cannot be valued appropriately in a market setting. From an anticommodification perspective, such "legalized 'commodification' . . . has no place in intimate relationships."[166]

Scholars on the other side of this debate object to the law's efforts to maintain the separation between economics and intimacy. They argue that most human qualities can be valued on the market; they thus point to "the equivalence of all transfers as quid-pro-quo exchanges."[167] According to these theorists, the market can resolve all problems efficiently, including the problems associated with intimacy.[168] Those supporting this theory might argue that when courts treat mistress relationships as nonmarket interactions in which transfers are not predicated on rationality or bargaining, courts miss the fact that all relationships—personal or otherwise—are nothing but market exchanges.

Exchange in the mistress cases more accurately involved what Margaret Jane Radin calls "incompletely commodified" characteristics: these interactions were not completely inside or separate from the market but existed on a "continuum reflecting degrees of commodification that will be appropriate in a given context."[169] Interactions characterized by incomplete commodification tend to be more meaningful to the participants than the exchange of money might suggest: "market and non market aspects of an interaction coexist: although money changes hands, the interaction also has important nonmonetizable personal and social significance."[170] The mi-

[164] Peter Halewood, *On Commodification and Self-Ownership*, 20 YALE J.L. & HUMAN. 131, 133 (2008).

[165] Elizabeth S. Anderson, *Is Women's Labor a Commodity?*, 19 PHIL. & PUB. AFF. 71, 73 (1990).

[166] Hasday, *supra* note 153, at 492.

[167] Zelizer, *supra* note 163, at 825; *see* RICHARD A. POSNER, SEX AND REASON 244 (1992) (characterizing marriage as a contract to make the procurement of sex more efficient); Elisabeth M. Landes & Richard A. Posner, *The Economics of the Baby Shortage*, 7 J. LEGAL STUD. 323, 327–39 (1978) (advocating for a free market in adoption).

[168] Zelizer, *supra* note 163, at 825.

[169] Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1918–19 (1987).

[170] *Id.* at 1918.

stress cases in which courts found paramours' valuation of mistresses' companionship irrational (not fully explicable in market terms)[171] demonstrate that sex and companionship occupy a netherworld of incomplete commodification.[172]

However useful an incomplete-commodification analysis might be as description, it provides little insight into how such interactions should be treated by tax law. Although some human qualities may be incompletely commodified, their exchange cannot be incompletely taxed.[173] This analysis also demonstrates why market behavior cannot function as an appropriate proxy for intent: when relationships involve both the exchange of money and "nonmonetizable personal and social significance,"[174] the participants are likely driven by both selfish and affectionate motivations. For this reason, in the mistress cases, courts using the market behavior of the mistress (prostitution)[175] or of the paramour (rational valuation)[176] failed as a practical matter to provide a reliable proxy for the intent the *Duberstein* standard requires. And when the proxy itself is ambiguous, the characteristic it substitutes for cannot be clear.

So if courts lack the evidence to infer intent, and the market-behavior proxy is inherently unreliable, is there a way for courts to apply the *Duberstein* test in mistress cases? I argue that courts cannot do so in any principled manner because—even if evidence or an accurate proxy existed—mistress relationships are not driven by a discernable dominant intent. Courts (and perhaps even the participants in these relationships) cannot identify a prevailing intent because, while participants may hope for reciprocation, enough risk is present in the exchange that reciprocation cannot be assured enough to be the participants' motivation for making the exchange.

To draw on the language of sociology, mistress relationships are "exchange relations"—those in which "the giving and receiving of gifts are es-

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[171] *See supra* Part II.B.4.

[172] *See* Radin, *supra* note 169, at 1923 ("[W]omen's sexuality is incompletely commodified. Many sexual relationships may have both market and nonmarket aspects: relationships may be entered into and sustained partly for economic reasons and partly for the interpersonal sharing that is part of our ideal of human flourishing."); *see also* United States v. Harris, 942 F.2d 1125, 1132 (7th Cir. 1991) ("[Mistress relationships] would not be long term were it not for some respect or affection. Yet, it may be equally clear that the relationship[s] would not continue were it not for financial support or payments.").

[173] Radin makes some suggestions for legal treatment of women's sexuality. She suggests decriminalizing prostitution but criminalizing the most egregious capitalistic aspects of the prostitution business, such as pimping and recruitment. Radin, *supra* note 169, at 1924. But in the absence of such radical reform, her characterizing sexuality as incompletely commodified gives little guidance about how the exchange of sex should be treated by the law.

[174] *Id.* at 1918.

[175] *See supra* Part II.B.

[176] *See supra* Part II.B.4.

sential to cementing social relations and are never properly completed."[177] In these relationships, one person gives another person a gift as a gesture of trust; when that generosity is reciprocated, further relations are "easier and more fluid."[178] Under this view, gift-giving functions not as a discrete event but as an anticipation of future exchanges.[179] Trying to identify a single motivation in an exchange relation may be impossible given that altruism and self-interest are bound up in a complex cycle of risk-taking, reliance, and the hope—although not the guarantee—of reciprocation.

The law's inability to discern a single motivation underlying exchange relations can be further attributed to the fact that social exchange far exceeds the range of exchange recognized by the law. Social exchange "occurs as a matter of social practice and customary understandings"[180] and necessarily encompasses a broader range of behavior than the law accounts for.[181] The much narrower category of legal exchange includes those practices that are "enforced by the legal system and hinge[] on the transfer of legal right or entitlement."[182] This distinction implies that, although the law can distinguish between categories of relationships that have legal definitions (e.g., mistress relationships versus marriages), it cannot reliably distinguish between different types within those categories (e.g., those mistress relationships that are more affectionate versus those that are more selfish). As such, the categorical distinction is the only one the law is capable of making because it is the only one characterized by legal formality (or a lack thereof).[183]

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[177] Rose, *supra* note 59, at 316. Similar language pervades other social science disciplines. As anthropologist Marcel Mauss described gifts:

> A considerable part of our morality and our lives themselves are . . . permeated with this . . . atmosphere of the gift, where obligation and liberty intermingle. Fortunately everything is still not wholly categorized in terms of buying and selling. Things still have sentimental as well as venal value, assuming values merely of this kind exist. We possess more than a tradesman morality.

MAUSS, *supra* note 59, at 65. Elsewhere Mauss refers to gift exchange as "apparently free and disinterested but nevertheless constrained and self-interested." *Id.* at 3.

[178] Rose, *supra* note 59, at 316.

[179] *Id.*; *see also* BLAU, *supra* note 59, at 91 ("'Social exchange' . . . refers to voluntary actions of individuals that are motivated by the returns they are expected to bring and typically do in fact bring from others.").

[180] Hasday, *supra* note 153, at 496.

[181] *See, e.g.*, ERIC A. POSNER, LAW AND SOCIAL NORMS 3–4 (2000) (discussing the relationship between the varied and intricate "nonlegal mechanisms of cooperation" that are only occasionally recognized or enforced by law).

[182] Hasday, *supra* note 153, at 497.

[183] This argument relies on the assumption that parties are able to freely choose between marriage and other forms of domestic ordering. All of the mistress–paramour relationships discussed in this Comment were heterosexual relationships in which partners had the legal right to marry and file federal taxes jointly but chose to organize their relationships in a less formal way (either because they were already married to someone else and chose to start another relationship or because their personal preference dictated against marriage). However, when the government enacts legislation preventing some people from freely selecting from the full range of available formal relationship organizations, *see* De-

Thus, the only question remaining is how to categorize mistress relationships—as those in which most transfers are gifts or those in which most transfers constitute income. Recall that in *Duberstein*, the Supreme Court determined that, when a businessman gave a professional contact a Cadillac, this transfer constituted income to the transferee. If the *Duberstein* relationship was considered an exchange relationship because the Cadillac was given in the hope (but not with the certainty) that more useful business contacts would be provided, then the distinction between a Cadillac and companionship is less pronounced than it might first appear. In the next Part, I argue that to remedy the imprecision and uncertainty in the donor's intent standard, future mistress cases should be governed by a clear rule categorizing all transfers in mistress relationships as income.

## IV. KEEPING BOOKS ON ROMANCE: A NONMARITAL INCOME RULE

When taxpayers do not know what the law is, they cannot follow it. In the tax context, this lack of clarity means that the state can lose revenue,[184] taxpayers who perform substantially the same activities can receive different tax treatment,[185] and judges can have difficulty finding principled grounds upon which to base their decisions.[186] As the Seventh Circuit's de-

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fense of Marriage Act, Pub. L. No. 104-199, §§ 2–3, 110 Stat. 2419, 2419 (1996) (codified at 1 U.S.C. § 7, 28 U.S.C. § 1738C (2006)), courts cannot assume that parties have chosen the level of legal recognition for their relationships that they prefer. As such, in these cases, courts may have to take a functional approach by defining the relationship by how well its features match formal legal relationships.

[184] *See* Striz, *supra* note 60, at 1082 ("The direct correlation between complexity and noncompliance evidences that year after year, as the complexity of tax law increases, taxpayers are less able to comply. If tax law were simplified, greater compliance would result, which would produce a smaller tax gap." (footnote omitted)); *see also* Dave Rifkin, *A Primer on the "Tax Gap" and Methodologies for Reducing It*, 27 QUINNIPIAC L. REV. 375, 379 (2009) ("Noncompliance may be intentional (e.g., deliberately underreporting income), unintentional (e.g., underreporting income because the taxpayer did not understand that the amount was income, calculating a credit that is confusing and/or complex, or inadvertently claiming the incorrect filing status), or both.").

[185] Horizontal equity is one of the cornerstones of tax policy; it "demands that similarly situated individuals face similar tax burdens." David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y REV. 43, 43 (2006). Elkins also offers a brief summary of the philosophy underlying horizontal equity and its history. *Id.* at 43 n.1. Horizontal equity differs from vertical equity in that the latter attempts to create equality by redistributing wealth, whereas the former attempts to maintain equality by taxing similarly situated actors the same. *See* Nancy C. Staudt, *The Hidden Costs of the Progressivity Debate*, 50 VAND. L. REV. 919, 925 (1997). Horizontal equity protects against the arbitrary enforcement of the laws. *Id.*

There is some lively scholarly discussion about the normative value of the principle of horizontal equity. *See* Elkins, *supra*; Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191 (1992); Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139 (1989); Paul R. McDaniel & James R. Repetti, *Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 FLA. TAX REV. 607 (1993); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993); Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113 (1990).

[186] *See supra* Part II.

cision in *United States v. Harris*[187] and the Tax Court decisions in the mistress cases[188] demonstrate, the law governing transfers from paramours to mistresses manifests vagueness and inflicts unfairness.

To remedy this vagueness, this Part suggests a simple default rule: The Code should treat all transfers to mistresses as income taxable to the mistress. Section A discusses the benefits of adopting a clear rule—benefits that a flexible standard like the donor's intent standard cannot provide. Section B addresses some of the practical concerns associated with implementing such a rule: minimizing the costs of creating and implementing the rule and avoiding overinclusion by defining the rule's boundaries as narrowly as possible. Section C addresses questions of ensuring compliance by introducing provisions that would phase the rule in gradually and would provide certain legal assurances to mistresses.

### *A. Creating a Clear Rule*

The rule is simple. Instead of attempting to parse the minutiae of relationships to determine whether romance or economics prevails in mistress relationships, courts should presume that transfers to mistresses in long-term, nonmarital relationships constitute taxable income to mistresses under § 61(a) of the Code. A clear rule will provide notice to taxpayers, give courts clarity in their decisionmaking, and allow mistresses and their paramours to plan their behavior with certainty about the law.

The distinction between the donor's intent standard and a default income rule distinguishes "standards" and "rules" more generally: a rule specifies the type of conduct that conforms to or violates the rule and requires adjudicators only to consider factual information to determine whether someone has violated the law, whereas a standard leaves the determination of what kind of conduct conforms or violates the standard to the adjudicator.[189] A simple rule (borrowed from Louis Kaplow) might prohibit "driving in excess of 55 miles per hour on expressways."[190] In determining

[187] *See supra* notes 1–15 and accompanying text.

[188] *See supra* notes 79–145 and accompanying text.

[189] *See* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559–60 (1992). My discussion of rules and standards makes broad strokes and certainly oversimplifies the distinction between rules and standards. The distinction in the gift–income context, however, is fairly simple, so this section avoids emphasizing the more complex aspects of the rule–standard relationship. Numerous scholars have considered these concepts in more detail. *See generally, e.g.*, Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974) (evaluating the rule-versus-standard distinction in the context of common economic concepts such as efficiency and utility); Kaplow, *supra* (discussing rules and standards in the context of economic decisionmaking); Eric A. Posner, *Standards, Rules, and Social Norms*, 21 HARV. J.L. & PUB. POL'Y 101 (1997) (considering the role that social norms play in rendering rules or standards optimal); Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379 (1985) (examining the distinction between rules and standards, and questioning the simplicity with which legal scholars distinguish the two).

[190] Kaplow, *supra* note 189, at 560.

whether a driver has violated this rule, the adjudicator need only consider facts (whether or not the driver's speed exceeded fifty-five miles per hour). A standard that addressed the same category of conduct might prohibit "driving at an excessive speed on expressways."[191] This standard requires the adjudicator to determine both what constitutes "excessive speed" and whether a driver had in fact been driving at that speed.

Rules and standards each have both benefits and drawbacks. Rules draw sharp lines that give clear guidance to actors about what conduct violates the rule and render adjudication more straightforward by limiting the range of questions that judges must address.[192] After all, vague law creates "uncertainty about who and what will come within the law's proscription."[193] But the rigidity of rules is also their weakness: a bright line means that courts will punish behavior violating the law in fact but not in spirit. In contrast, standards provide flexibility and allow adjudicators to judge each situation individually, permitting them to determine if the behavior in question is the kind of behavior the law was promulgated to regulate.[194] But this flexibility also means that decisionmakers are likely to reach erratic results, especially when considering behavior that falls on the borderline of the conduct the law was meant to regulate.[195]

The donor's intent principle as applied in the mistress cases certainly qualifies as a standard: All evaluation of whether the behavior meets the standard takes place long after the transfers have been made. Because most gifts are given with elements of both altruism and self-interest,[196] it is difficult for a donor to know at the time whether his conduct has the appropriate amount of altruism to constitute the transfer as a gift to the donee. And if the donor himself is unsure, how might the recipient gain any clarity about the donor's motivations? After all, the taxpayer–recipient of the transfer is the party who bears the risk of misinterpreting the donor's intent. Given that the proportion of altruism to self-interest is likely unclear to the giver himself, the recipient's efforts to determine how the transfers should be treated for tax purposes is at best speculative. As such, the donor's intent standard provides little guidance to mistresses about what they should do to conform to the law: they must guess and hope that the Tax Court will agree.

A de facto income rule for transfers to mistresses, however, resolves problems of notice, certainty, and clarity. Dictating that all transfers to mistresses constitute income saves mistresses from engaging in mindreading to determine the tax status of the transfers. Courts need not undertake ex-

[191] *Id.*

[192] *See* Schlag, *supra* note 189, at 384–85.

[193] Gillian K. Hadfield, *Weighing the Value of Vagueness: An Economic Perspective on Precision in the Law*, 82 CALIF. L. REV. 541, 541 (1994).

[194] Schlag, *supra* note 189, at 385.

[195] *Id.*

[196] *See supra* notes 59, 177–79 and accompanying text.

tended post hoc analyses of the scant evidence of intent to determine whether such transfers are income to the mistress.

It is worth noting that a rule cutting the other way—a nonmarital *non-*income rule—could not achieve the same clarity and simplicity. It will always be the case that some mistresses (namely, prostitutes) will be required to report their gains as income.[197] For example, if a woman works as a prostitute in a jurisdiction where prostitution is legal, her gains from prostitution will clearly be treated as income. However, a discussion of gains from her personal relationships will necessarily provoke questions of intent. In other words, maintaining any distinction between gifts and income in the mistressing realm simply invites courts and litigants to replicate the mistress cases' arguments about affection versus self-interest. Perpetuating this ambiguity creates anything but clarity.

Rules create clarity and consistency in the law, but they also present risks. One danger is that of overinclusion: In order to effectively address the narrow situation at which it is aimed, the rule must prevent catching other types of relationships in its broad net. Another danger is cost: The gift standard is time-consuming and uncertain in adjudication, but an income rule will require greater specificity at the outset and thus could be costly to write. Finally, a de facto rule might simply shift the debate from one aspect of the problem to another—for example, instead of parsing the question of intent, courts may expend their efforts determining who is a "mistress." The next section addresses these concerns.

### *B. Assessing Potential Weaknesses*

*1. Preventing Overinclusion.*—One potential concern about a de facto income rule for mistresses is that it will cover a number of relationships and transfers not of the type considered here. For example, in its simple form expressed in section A, the de facto income rule could plausibly encompass transfers made between same-sex couples who live together but are prevented by law from marrying or forming a civil union—not the type of informal, occasionally transitory relationship envisioned by the rule.[198] The rule could also require reporting of token gifts in short-term dating relationships—also not the aim of the rule. To avoid overinclusion, the rule should incorporate two safe harbors to exclude some exchanges in these relationships from taxation. These provisions would exclude exchanges between lovers who share a principal residence or who exchange only token gifts.

[197] See *supra* notes 27 and 98 for a discussion of the fact that gains from prostitution—both legal and illegal—must be claimed as taxable income.

[198] Some overinclusion problems could be resolved by removing the unconstitutional barriers that prevent same-sex couples from marrying that exist in many states. A discussion of these laws, however, exceeds the scope of this Comment.

*a. Safe harbor: cohabitation.*—Lovers who share a principal residence would be excluded from the nonmarital income rule. Cohabitation includes so many *de minimis* transactions, exchanges, and shared costs that gift and income rules are immensely difficult to administer.[199] The Code usually excludes transactions that are difficult to enforce, including most intrafamily transfers.[200] In addition, state law generally is responsible for defining cohabitation relationships through common-law marriage policies, domestic partnership rules, and civil union laws.[201]

One concern with the cohabitation safe harbor is that it will simply shift the dispute from the intent question to the cohabitation question. If a woman's lover purchases a house for her, she may wish to claim that they are cohabiting in order to avoid paying income tax on transfers. This prob-

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199 This is not to say that the law concerning unmarried cohabitation is unproblematic. In *Pascarelli v. Commissioner*, the Tax Court held that transfers between long-term, intimate cohabitants do not constitute income. 55 T.C. 1082, 1091 (1971) ("These circumstances led us to find that the petitioner did not perform services for Mr. DeAngelis for the purpose of obtaining compensation, but rather with the same spirit of cooperation that would motivate a wife to strive to help her husband advance in his business."), *aff'd*, 485 F.2d 681 (3d Cir. 1973); *see also* Green v. Comm'r, T.C.M. (P-H) ¶ 87,503, at 2711 (1987) ("[P]ayments in exchange for 'wifely services' are not compensation within the meaning of section 61 even when the provider is not legally a wife." (citing *Pascarelli*, 55 T.C. 1082)). But the tax laws concerning transfers between unmarried cohabitants tend to be more complex than *Pascarelli* implies. *See* Frank S. Berall, *Estate Planning Considerations for Unmarried Same or Opposite Sex Cohabitants*, 23 QUINNIPIAC L. REV. 361 (2004); Cain, *supra* note 157; Adam Chase, *Tax Planning for Same-Sex Couples*, 72 DENV. U. L. REV. 359, 360–62 (1995); Melvyn B. Frumkes, *Taxation of Same-Sex Marriage and Live-Ins*, 22 J. AM. ACAD. MATRIM. LAW. 117 (2009); Marjorie E. Kornhauser, *Love, Money, and the IRS: Family, Income-Sharing, and the Joint Income Tax Return*, 45 HASTINGS L.J. 63 (1993); Bruce Wolk, *Federal Tax Consequences of Wealth Transfers Between Unmarried Cohabitants*, 27 UCLA L. REV. 1240 (1980). For an in-depth discussion of the legal state of "nonmarriage," see Ariela R. Dubler, *Wifely Behavior: A Legal History of Acting Married*, 100 COLUM. L. REV. 957 (2000). *See also* Charlotte K. Goldberg, *The Schemes of Adventuresses: The Abolition and Revival of Common-Law Marriage*, 13 WM. & MARY J. WOMEN & L. 483 (2007); Jennifer Thomas, Comment, *Common Law Marriage*, 22 J. AM. ACAD. MATRIM. LAW. 151 (2009).

200 *See supra* note 157. As Henry Simons points out, the exclusion of intrafamily transfers is primarily an administrative consideration: "The appropriate measures [required to include intrafamily household transfers in taxable income] are forbidding from the standpoint of administration; and we may be reconciled to the ignoring of gifts in many such cases." SIMONS, *supra* note 32, at 136. The same logic, as I argue here, applies to household transfers in general.

201 There is no Code provision that explicitly deals with unmarried cohabitants, although the Code does specify that only heterosexual married couples may file joint tax returns. I.R.C. § 6013(a) (2006). Federal legislation passed in 1996 indirectly affected state tax treatment of same-sex relationships by dictating that only heterosexual couples could avail themselves of the legal and social benefits of marriage. Defense of Marriage Act, Pub. L. No. 104-199, 110 Stat. 2419 (1996) (codified at 1 U.S.C. § 7, 28 U.S.C. § 1738C (2006)). A number of sources discuss unmarried cohabitation and taxation. *See, e.g.*, Berall, *supra* note 199 (discussing estate planning strategies for unmarried, cohabitating couples); Chase, *supra* note 199, at 361–62 (discussing the difference in tax treatment between heterosexual married couples and same-sex, unmarried couples); Cain, *supra* note 157 (discussing the tax consequences for unmarried same-sex cohabitants); Frumkes, *supra* note 199 (collecting court decisions concerning the taxation of long-term nonmarital relationships); Kornhauser, *supra* note 199 (discussing different definitions of family, including those relationships that include shared residences); Wolk, *supra* note 199 (comparing the tax consequences of economic exchanges for married and unmarried cohabitants).

lem can be avoided by using the "principal residence" concept already deployed in other areas of tax law. For example, Code § 121(a) distinguishes between income gained from the sale of a taxpayer's principal residence and from sales of other property.[202] The Treasury Regulations list a number of factors for courts to consider when determining which residence constitutes the taxpayer's principal residence: the taxpayer's use of the property, where the rest of his family abides, and the address on his driver's license.[203] Thus whether a mistress and her paramour have the same principal residence would be determined by assessing these factors for both lovers.

*b. Safe harbor:* de minimis *transactions*.—Women who receive only token gifts would also not be subject to the nonmarital income rule. The difficulty with establishing this safe harbor lies in defining what constitutes a token gift. As with the principal residence question, the question of setting a reporting threshold for gifts can be borrowed from existing tax law. The rule could establish that mistresses must report if the amount of gifts they receive exceeds $13,000 per year; they need not report below that threshold. This rule has its basis in the Code's gift tax provision, which requires that the donor pay tax if his transfers to a donee exceed $13,000 in a tax year.[204] The federal gift tax is not a tax on income but is more properly considered part of the estate tax—Congress created it to prevent people from avoiding the estate tax with *inter vivos* transfers.[205] However, the gift tax threshold provides a useful indication of what transfers the government considers large enough to require reporting and taxation. This limitation

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[202] I.R.C. § 121(a).

[203] Treas. Reg. § 1.121-1(b)(2) (2006) ("If a taxpayer alternates between 2 properties . . . the property that the taxpayer uses a majority of the time during the year ordinarily will be considered the taxpayer's principal residence. In addition . . . relevant factors . . . include . . . (i) The taxpayer's place of employment; (ii) The principal place of abode of the taxpayer's family members; (iii) The address listed on the taxpayer's federal and state tax returns, driver's license, automobile registration, and voter registration card; (iv) The taxpayer's mailing address for bills and correspondence; (v) The location of the taxpayer's banks; and (vi) The location of religious organizations and recreational clubs with which the taxpayer is affiliated.").

[204] *See* I.R.C. § 2503.

[205] The federal gift tax was enacted in part to prevent people from avoiding the estate tax by transferring wealth *inter vivos* rather than by devise. *See* H.R. REP. NO. 72-708, at 27–28 (1932). When Congress enacted the estate tax in 1916, taxpayers responded by making gifts in their lifetimes instead of making testamentary transfers. Jay A. Soled, *Reassigning and Assessing the Role of the Gift Tax*, 83 B.U. L. REV. 401, 402–03 (2003). As such, the gift tax is not related to income; its purpose is to support the estate tax. Mitchell M. Gans & Jay A. Soled, *Reforming the Gift Tax and Making It Enforceable*, 87 B.U. L. REV. 759, 761–62 (2007) ("Unlike other taxes, the gift tax does not serve an independent function. Rather, Congress designed it to protect the integrity of the estate tax and income tax. . . . While arguments continue about the justification for the estate tax, no one has argued that the estate tax can be effectively enforced without a gift tax: in the absence of a gift tax, the estate tax could be too easily defeated by lifetime gifts." (footnotes omitted)). It is thus focused on transactions from the prospective target of the statute—the potential tax-avoidant donor—not the recipients.

will keep the IRS from pursuing cases in which the amount of money concerned is *de minimis*.[206]

The $13,000 minimum would include all realized gains—those typically defined as "income" under § 61(a) and relevant case law.[207] If a paramour pays his lover's rent, for example, the value of the rent would constitute income. This provision would likely eliminate transfers in more casual relationships and encompass those made in relationships where payments from one lover constitute a substantial part of the other lover's income.

Unlike the gift tax, in which the yearly $13,000 exemption is limited to transactions from one donor to one donee,[208] the $13,000 threshold would not be limited to gifts from one donor. For example, if a mistress had two lovers, each of whom gave her $7000 in the same year, she would claim both amounts as income because the *total* amount of the gifts exceeds the $13,000 threshold. The purpose of including the aggregate value of transfers is to adequately capture the gain to the mistress—to correctly represent her income. Income is measured from the perspective of the donee, unlike the gift tax, which is meant to capture the transfer of wealth from the perspective of the donor.[209] In this respect, the nonmarital income rule more strongly resembles self-employment provisions, which measure the minimum reporting amount from the perspective of the person who receives the income, not the person who pays it.[210]

The $13,000 safe harbor would also contain an opt-out provision. If the donor wishes the transfer to be tax-free to the donee, he can file a gift tax return and pay the tax on it himself. This opt-out provision affords the donor a measure of choice but requires that his intent be expressed objectively. Without a gift tax return, courts would presume that the value of any transfers that exceeded the yearly exclusion constituted income.

2. *Mitigating Promulgation Costs.*—Declaring that transfers to mistresses must be claimed by the recipients as income would be only the first step in promulgating this rule. A number of other questions need to be answered in order to make the rule practically applicable: As what kind of

[206] It is not unusual for Congress to add provisions to the Code to decrease the number of low-value cases heard by the courts. *See, e.g.*, I.R.C. § 165(h) (allowing casualty deductions only if they exceed 10% of the taxpayer's adjusted gross income).

[207] *See, e.g.*, I.R.C. § 1001 (providing for the "[d]etermination of amount of and recognition of gain or loss"); *id.* § 305 (providing exceptions for certain "[d]istributions of stock and stock rights"); Pulsifer v. Comm'r, 64 T.C. 245, 247 (1975) (holding that income is taxable when the taxpayer has received the "economic benefit" of the income); Amend v. Comm'r, 13 T.C. 178, 182 (1949) (holding that income is taxable when it has been "constructively received"); *see also supra* notes 18–27 and accompanying text.

[208] I.R.C. § 2503(b) allows a donor to exclude each year up to $13,000 of gifts made to each donee.

[209] *See supra* note 205.

[210] If net earnings from self-employment are less than $400, the taxpayer need not claim them as income. I.R.C. § 1402(b)(2). Self-employment income is cumulative—measured by the amount of income received regardless of the number of sources. *See* I.R.C. § 1402(a)–(b).

income should these transfers be classified? What kind of withholding is required? What enforcement procedures apply? The numerous complex questions that must be answered before such a law can be promulgated require some "investigation and deliberation"—administrative factfinding and decisionmaking about the provisions best able to achieve the rule's goals.[211]

This time-consuming and costly process can be avoided, however, if mistress income is placed in one of the categories of income already defined by the Code. Such income fits most logically into the Code's self-employment provisions, which already contain detailed reporting and withholding requirements[212] that are unlikely to require any adaptation to the special situation of mistresses. Like self-employed people, mistresses are in the best position to report their own income. Thus they would be required to file a tax return reporting their yearly mistress income. They would also be required to pay taxes at the applicable rate, withholding their own Social Security and other taxes. As in self-employment reporting, if a mistress has more than one source of income (more than one paramour), she would combine these sources of income when reporting.

*3. Avoiding Fighting the Same Battle on Different Grounds.*—A final concern about creating a default nonmarital income rule is that doing so will not resolve the problems inherent in the donor's intent standard. Instead of arguing about intent, parties may instead argue about whether a woman is a mistress. One can imagine that this argument could also turn on questions of intent: Did the parties intend a mistress–paramour relationship, or were they just friends? The cohabitation and token-gift safe harbors resolve some of these concerns, but failing to clearly define what kind of relationships the rule covers will invite dispute over who must conform with the rule.

Avoiding these problems is one reason I have dubbed the rule a "nonmarital" income rule rather than a "mistress" rule. It might be more accurate to say that the rule would cover all intimate relationships in which transfers are not accounted for by other provisions in the Code. Transfers between friends, for example, might be subject to the rule and its provisions. Transfers between spouses would not be covered by the rule because other provisions of the Code already address these transfers. Transfers from employers to employees would not fall under the rule for the same reason.

Some might argue that broadening the rule to include all affectionate, nonfamilial relationships goes too far—that only extramarital sexual relationships should fall within the rule's scope. Upon examination, however, it is difficult to find a principled justification for making distinctions between different kinds of affectionate relationships. In 2001, the Law Com-

[211] Kaplow, *supra* note 189, at 569.

[212] *See* I.R.C. §§ 1401–1403.

mission of Canada came to a similar conclusion, determining that there are no justifications for legally distinguishing between different personal relationships for the purposes of taxation.[213]

Aside from this theoretical point, covering all affectionate adult relationships under the rule would prevent litigants from simply shifting the intent argument to a different ground. As the mistress cases demonstrate, it is virtually impossible to coherently distinguish between personal relationships that are not already defined by law.[214]

### *C. Ensuring Compliance*

Promulgating a clear rule does not necessarily ensure that taxpayers will follow the rule. The difficulty with new tax rules is implementation—making certain that people whom the rule affects know about the rule and are incented to abide by it. Consider the widespread noncompliance with tax law, which creates a substantial gap between the government's actual and owed tax revenue every year.[215] Noncompliance increases when taxpayers themselves are responsible for reporting their own income to the IRS,[216] as mistresses would be under the nonmarital income rule.

The possibility of noncompliance does not suggest that the nonmarital income rule should not be implemented, however. The IRS could take steps to ensure compliance. First, in order to allow time for implementation, the application of penalties could be phased in gradually. Mistresses who do not report their mistress income within the first few years that the statute is in effect should have to pay back taxes but should not be subject to any other penalties for noncompliance.[217] Otherwise, the penalty for not knowing about the new rule would be too high.

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213 For a discussion of the Law Commission's report, *Beyond Conjugality*, see Polikoff, *supra* note 157, at 203–04. The Commission asserted that "governments need to pursue a more comprehensive and principled approach to the legal recognition and support of the full range of close personal relationships among adults." *Id.* (internal quotation marks omitted). In her proposal for a marriage-neutral tax policy, Shari Motro suggests that "platonic friendships [that] evolve into income-sharing partnerships" should have access to the joint income tax return, now reserved for married couples. Shari Motro, *A New "I Do": Towards a Marriage-Neutral Income Tax*, 91 IOWA L. REV. 1509, 1549 (2006). A handful of scholars have made similar arguments, focusing on the reasons for legally recognizing friendship. *E.g.*, David L. Chambers, *For the Best of Friends and for Lovers of All Sorts, a Status Other Than Marriage*, 76 NOTRE DAME L. REV. 1347 (2001); Ethan J. Leib, *Friendship & the Law*, 54 UCLA L. REV. 631 (2007); Laura A. Rosenbury, *Friends with Benefits?*, 106 MICH. L. REV. 189 (2007).

214 *See supra* Parts II.B, III.

215 The "tax gap" for the most recent tax year available (2001) was $345 billion. JAMES M. BICKLEY, CONG. RESEARCH SERV., RL 33882, TAX GAP AND TAX ENFORCEMENT 2 (2007). According to the IRS, the "gross tax gap [is] the difference between the aggregate tax liability imposed by law for a given tax year and the amount of tax that taxpayers pay voluntarily and timely for that year." *Id.* at 1 (emphasis omitted) (internal quotation mark omitted).

216 Rifkin, *supra* note 184, at 384.

217 For a discussion of the penalties the IRS can impose on unpaid taxes, see *supra* note 68.

Second, the rule would need to be explicit that being a mistress is not connected to prostitution. Otherwise, mistresses might worry that filing would mark them as prostitutes or, worse, be used against them in a criminal charge for prostitution. This fear might prevent them from filing and thus might defeat the purpose of the rule. As such, the rule should make explicit the fact that filing mistress income can have no other legal ramifications.

Third, the benefits of the rule to mistresses would need to be made apparent to encourage compliance. Few people are thrilled to pay taxes, so the nonmarital income rule would put an immediate burden on donees that they would probably prefer not to bear.[218] Although taxation imposes a burden, it also provides individual benefits that are available only to those who pay taxes.[219] Unlike gift recipients, income earners pay a percentage of their earned income in payroll tax and are entitled to benefits (such Social Security and Medicare) when they retire or become disabled based on these contributions.[220] Mistresses may access these social welfare benefits through other avenues—e.g., employment or marriage[221]—but taxpayers receive greater benefits when they have more income.[222] Making these benefits more apparent—perhaps during the penalty phase-in period—might enencourage compliance with the rule.

## CONCLUSION

Tax law relies heavily on detailed facts and circumstances. This fact-dependency may explain the extraordinary complexity of the Internal Revenue Code, which expands as the range of potential taxpayer situations grows.[223] Fact-dependency may also explain why courts are reluctant to accept bright-line tax rules: courts may worry that such clear distinctions will create unfairness by addressing only the form, rather than the underlying substance, of transactions.

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[218] *See* Carolyn C. Jones, *Mapping Tax Narratives*, 73 TUL. L. REV. 653, 668–70 (1998) (detailing the ubiquity of tax horror stories and tax resistance narratives); Kirk J. Stark, *The Right To Vote on Taxes*, 96 NW. U. L. REV. 191, 212 (2001) (describing the political and social resistance to income tax).

[219] Katharine Silbaugh, *Turning Labor into Love: Housework and the Law*, 91 NW. U. L. REV. 1, 67 (1996).

[220] Staudt, *supra* note 38, at 1597–98.

[221] *See id.* Derivative benefits also pose more risk to women than do direct benefits. Staudt notes that "due to severe limitations found in the rules, many married women fail to ever get the benefits." *Id.* at 1597 n.105; *see also* Anne L. Alstott, *Tax Policy and Feminism: Competing Goals and Institutional Choices*, 96 COLUM. L. REV. 2001, 2059–66 (1996) (discussing and evaluating suggested feminist reforms to the Social Security system).

[222] Staudt, *supra* note 38, at 1598.

[223] *See* Deborah L. Paul, *The Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?*, 76 N.C. L. REV. 151, 164 (1997) ("Any particular combination of coherence, tractability, and complication is unstable as changes in background facts pressure the regime to produce a new combination of the three types of complexity.").

However, a highly fact-specific inquiry may be futile in contexts that produce little objective evidence. In the mistress cases, the absence of a clear standard about whether transfers between unmarried lovers in long-term, non-cohabitating relationships were gifts or income resulted in decisions that did not clearly delineate the tax consequences of gains from mistress relationships. This is a natural result of courts' efforts to distinguish economic from emotional motivations in relationships that likely involve both. This Comment has proposed a clear default rule to replace courts' arbitrary and inevitably imprecise assessments.

Although this Comment is focused narrowly—examining the gift exclusion in the context of a precisely defined set of circumstances—the problems that plagued the Tax Court's gift–income decisions in the mistress cases likely extend to the gift exclusion generally. A combination of affection and self-interest exists in most relationships, yet the donor's intent test applies to transfers in all personal relationships outside families. Predicating consequential legal distinctions on taxpayers' proportion of affection for others is a project doomed to failure—or, at least, to inconsistent adjudication. Clear rules can cure this vagueness. Love itself may be uncertain, amorphous, and unpredictable, but the tax consequences of love need not be.