Florida Tax Review

Volume 26 | Number 2 Article 4

2022

The Paradox of Taxing the Rich

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Recommended Citation
McCaffery, Edward J. (2022) "The Paradox of Taxing the Rich," *Florida Tax Review*: Vol. 26: No. 2, Article 4.
Available at: https://scholarship.law.ufl.edu/ftr/vol26/iss2/4

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FLORIDA TAX REVIEW

Volume 26 *2023* *Number 2*

The Paradox of Taxing the Rich

by

*Edward J. McCaffery**

Abstract

America does not tax its richest citizens, such as Elon Musk or Jeff Bezos, at all. This Article argues that part of the reason is the paradox that under current income tax law and theory, taxing the rich would cost resources that could be made available to benefit the not-rich. The Article explores the paradox in theory and practice, then points to ways to move beyond it. Taxing the rich will mean accepting compelling justifications for doing so other than providing resources to the not-rich. We must either pay the price or reset the terms of the debate to move society forward by breaking up large concentrations of private wealth.

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* Robert C. Packard Trustee Chair in Law, Economics & Political Science, University of Southern California (B.A., Yale (Classics & Philosophy); JD, Harvard; MA (Economics), University of Southern California.) This Article grows out of a prior work, posted on SSRN, *The Conflicting Masters of Tax*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3908106 [https://perma.cc/L52Q-YBME]. That Article was substantially revised in light of comments received at a Conference in Honor of Ed Kleinbard, November 2021, Los Angeles. I thank Joe Bankman, Bill Gale, David Hasen, Greg Keating, Emmanuel Saez, Dan Shaviro, Gabriel Zucman, and participants at workshops at the University of Florida Levin College of Law and USC Gould School of Law for helpful comments; and Kiara Jackson, Vivian Liu, Carus Newman, David Sorenson and Raeseanna Williams for research assistance. I give a special note of thanks and commemoration to my now late colleague Ed Kleinbard, with whom I shared passions for tax, social justice and the writings of Adam Smith.

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Introduction

In the summer of 2021, stories broke across the mainstream American media that the wealthiest Americans, such as Jeff Bezos and Elon Musk,

were paying *no* income taxes, perfectly legally, under the simple tax-planning advice to *Buy, Borrow, Die*.[1] By the fall, politicians were running out proposals to address the embarrassment, such as Senator Ron Wyden's "Billionaire's Tax."[2] Yet just a year later, in the summer of 2022, as President Joe Biden and his fellow Democrats were trying to salvage some semblance of Biden's once-ambitious "Build Back Better" agenda prior to the Congressional midterm elections, came word that little would be done to reverse course on recent and longstanding American tax policy. There would be only modest and largely symbolic tax increases on the rich, and no change at all to any of the planks of *Buy, Borrow, Die*.[3]

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1. *See* Jesse Eisinger, Jeff Ernsthausen, & Paul Kiel, *The Secret IRS Files: Trove of Never-Before-Seen Records Reveal How the Wealthiest Avoid Income Tax*, ProPublica (June 8, 2021, 5:00 AM) [hereinafter *The Secret IRS Files*] (citing Edward J. McCaffery, *The Death of the Income Tax (or, the Rise of America's Universal Wage Tax)*, 95 Ind. L. Rev. 1233 (2020)), https://www.propublica.org/article/the-secret-irs-files-trove-of-never-before-seen-records-reveal-how-the-wealthiest-avoid-income-tax [https://perma.cc/9FVF-ZJ3L]. *See also* David Leonhardt, *A Voluntary Tax*, N.Y. Times (June 9, 2021), https://www.nytimes.com/2021/06/09/briefing/tax-jeff-bezos-wealthy.html [https://perma.cc/8PFL-VWBC]; Rachel Louise Ensign & Richard Rubin, *Buy, Borrow, Die: How Rich Americans Live Off Their Paper Wealth*, Wall St. J. (July 13, 2021, 9:12 AM), https://www.wsj.com/articles/buy-borrow-die-how-rich-americans-live-off-their-paper-wealth-11625909583?mod=itp_wsj&ru=yahoo [https://perma.cc/K3RK-XAS3].

2. *See* U.S. Senate Committee on Finance, *Wyden Unveils Billionaires Income Tax* (Oct. 27, 2021), https://www.finance.senate.gov/chairmans-news/wyden-unveils-billionaires-income-tax [https://perma.cc/KCM6-VY6E].

3. As this Article was first being submitted, Senator Joe Manchin, who just a few weeks prior had appeared to oppose all tax increases (*see* Howard Gleckman, *Joe Manchin Pulled the Plug on Biden's Tax Increases. What Happens Next?*, Forbes (July 19, 2022, 12:18 PM), https://www.forbes.com/sites/howardgleckman/2022/07/19/joe-manchin-pulled-the-plug-on-bidens-tax-increases-what-happens-next/?sh=16939f0aa6a8 [https://perma.cc/6U6E-NG62]) somewhat reversed course and agreed to support a reconciliation bill named the Inflation Reduction Act ("IRA"). The proposed bill would raise revenues through three tax provisions: a new 15% tax on the "book income" of corporations with profits in excess of $1 billion, roughly 200 corporations, projected to raise $313 billion over a ten-year scoring window; greater funding for IRS enforcement, expected to raise $124 billion over ten years; and treating the "carried interest" of hedge fund managers as

And so the fundamental things continue to apply as time goes by. Contrary to the fears of our founders and indeed to the presumptions of common sense, the vast masses of ordinary Americans have never risen to meaningfully tax the wealthiest few of their fellow citizens. This leads to an obvious question: Why not?

A paradoxical answer is that we cannot afford to do so. Taxing the rich would cost resources that the American government has been unwilling to spend. This Article explains how this problematic paradox arises under current tax law and theory. It then turns to ways that society can move beyond the paradox by exploring and redefining the ends of redistribution—by rethinking, that is, the fundamental role of tax and redistribution in a well-functioning democratic society. The road forward will not be easy. But hope must spring eternal as the task of taxing the rich grows more urgent with each missed opportunity.

The Article proceeds as follows. Part I begins with a foundational element of contemporary normative law and economics theory, the "Leave It to Tax" theorem for redistribution most famously associated with the writings of Louis Kaplow and Steven Shavell. Part II turns to

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ordinary, not capital, income, expected to raise $14 billion. *See* Evan Liddiard, *Tax Provisions in Schumer-Manchin Inflation Reduction Act*, Nat'l Ass'n Realtors (July 29, 2022), https://www.nar.realtor/washington-report/tax-provisions-in-schumer-manchin-inflation-reduction-act [https://perma.cc/ECD7-WTK6]. The bill is also projected to save the federal government $288 billion due to prescription drug and other health cost savings. *See* Emily Stewart, Li Zhou, & Rebecca Leber, *The Inflation Reduction Act, Explained*, Vox (Aug. 16, 2022, 4:02 PM), https://www.vox.com/policy-and-politics/2022/7/28/23282217/climate-bill-health-care-drugs-inflation-reduction-act [https://perma.cc/S5YY-M7MX]. Note that the proposed tax increases were exceptionally modest in light of the multiple trillions of dollars projected by wealth tax advocates such as Senator Bernie Sanders, discussed *infra* Section VI, and would do nothing directly to shut down any of the steps of buy, borrow, die. *See* Julia Conley, *Kyrsten Sinema Opposes Tax Hikes for the Rich*, Salon (Aug. 1, 2022, 4:00 a.m.), https://www.salon.com/2022/08/01/kyrsten-sinema-opposes-hikes-for-the-rich_partner/ [https://perma.cc/E5M4-K49F]. In the end, the carried interest provision was dropped and the corporate alternative minimum tax was weakened to mitigate its adverse impact on private equity holders. *See* Edward J. McCaffery and Darryll K. Jones, *The Curiouser and Curiouser Case of Carried Interest*, Edward J. McCaffery & Darryll Keith Jones, *The Curiouser and Curiouser Case of Carried Interest*, 66 Ariz. L. Rev. 357 (2024).

the optimal income tax tradition most famously associated with the late James Mirrlees to see what tax does with its redistributive task: it turns out that the "tax" component of "optimal income tax" is driven primarily by revenue-raising concerns and does not entail any meaningful taxation of the rich. Section 3 establishes the central paradox that taxing the rich under the current framework would cost resources that could otherwise be available for the not-rich. Part IV shows how the paradox persists in theory and practice. Part V turns to hope by returning to first principles and better articulating the goals of redistribution in order to move beyond the paradox. Part VI illustrates both the paradox and the potential escape from it by considering a particular real-world policy proposal, Senator Bernie Sanders's idea for a tax designed to "eliminate billionaires." Finally, Part VII considers what is to be done to address the real and growing problems of economic inequality moving forward: advocates of taxing the rich must think harder and better about their ends and how to obtain them.

A final introductory note: this Article does not intend, except in passing, to make internal critiques of the ideas canvassed in Parts I and II. We are not questioning the theories or findings of optimal income tax or normative law and economics directly, on their own terms, but rather tracing a kind of intellectual history to show how ideas have shaped the public political discourse and become instantiated in our actual practices. From there, both our practices and the intellectual understandings of our practices begin to ossify and constrict the possibilities for our practical imaginative wills to conceive new solutions to old and intransigent problems such as economic inequality.[4] Along the way, choices for alternate forms of discourse and practice have been abandoned, or never even imagined. In both practice and theory, the problems of wealth inequality and the challenges of overcoming them only get harder as time goes by. And much time has already gone by.

I. The "Leave It to Tax" Theorem

We start with the widely accepted idea that the tax system should be used to "redistribute" wealth, that is, broadly, to take from the rich and give to the poor.

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4. Our approach derives inspiration from the critical methodology employed by Roberto Unger in Roberto Mangabeira Unger, What Should Legal Analysis Become? 39–40 (1996).

At the core of contemporary welfare economics and normative law and economics theory lies a fundamental bifurcation between allocative or Paretian *efficiency*, on one hand, and the end-state distribution of material resources, or *equity*, on the other. The two welfare theorems of neo-classical economics mark the fork. The first theorem holds, in essence, that free markets reach welfare maximizing, or, equivalently, "pareto optimal," allocations of resources: they make the celebrated social pie as large as possible. The second theorem holds that a suitable distribution or redistribution of initial entitlements can lead to different positions along the social optimum or, equivalently, Paretian frontier.[5]

Practitioners of law and economics, most notably Louis Kaplow and Steven Shavell, have used these two theorems to develop a comprehensive agenda for law reform.[6] One, laws should be arranged to

5. *See, e.g.*, ROBIN W. BOADWAY & NEIL BRUCE, WELFARE ECONOMICS 82 (1984); JOSEPH E. STIGLITZ, ECONOMICS OF THE PUBLIC SECTOR 60–61 (3rd ed. 2000). For a more general discussion of the two welfare theorems and an application to income tax policy, see Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157, 158–59 (2003). *See also* RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY 181 (1959) (adding the stabilization branch).

6. Kaplow and Shavell proposed that the tax system be used as the exclusive means for redistribution. Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income,* 23 J. LEGAL STUD. 667, 677 (1994) [hereinafter *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*]; *see also* Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821, 822 (2000) [hereinafter *Should Legal Rules Favor the Poor?*]; Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1381 (2001) [hereinafter *Fairness Versus Welfare*]. Economists had long been making similar arguments. *See, e.g.*, Arnold C. Harberger, *On the Use of Distributional Weights in Social Cost-Benefit Analysis*, 86 J. POL. ECON. S87, S113–19 (1978). For criticisms of the Kaplow-Shavell argument, see Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL L. REV. 1003, 1034–36 (2001); Chris William Sanchirico, *Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797, 800 (2000); Logue & Avraham, *supra* note 5, at 190–201; Ronen Avraham, David Fortus, & Kyle Logue, *Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell*, 89 IOWA L. REV. 1125, 1129–31 (2004). For one among several replies by Kaplow

maximize social welfare, that is, broadly, to serve "efficiency." Two, the tax system should be used to redistribute social resources to maximize the sum of individual well-being, that is, again broadly, to serve "equity." The two-part approach satisfies a Paretian constraint: the greater social pie facilitated by the first step can be used in the second step's redistribution to assure that no one is harmed by any reform.

The Kaplow-Shavell "Leave It to Tax" theorem, as we shall call it, is delightfully simple to comprehend in its original form.[7] Assume that society has an efficient rule, X, such as the Hand Formula for determining negligence in torts.[8] Further assume that high income individuals face a marginal tax rate of 30%. In the name of equity, reformers would like to change the negligence rule to get more resources to the poor. So they modify Rule X, to Rule X*, to allow additional compensation to the poor, which costs the high income taxpayers 1% of their income to finance. Kaplow and Shavell point out that it is generally preferable simply to raise the tax rate to 31%, which creates the same marginal disincentive to work as the 30% tax rate plus the 1% negligence surcharge, *without* changing the negligence Rule X. Tort law remains fully efficient, and tax is no more inefficient than it would be with the tax plus the private law surcharge. Indeed, the tax move likely generates more revenue, which can be used to meet a Paretian constraint by paying the poor the same 1% quantum they would get with the tort law surcharge, ensuring that no one is made worse off by the switch from private law to tax. In the utilitarian calculus, the tax option strictly dominates the private law one. "*[E]ven though the income tax distorts work incentives, any regime with an inefficient legal rule can be replaced by a regime with an efficient legal rule and a modified income tax system designed so that every person is made better off.*"[9]

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and Shavell, see *Fairness Versus Welfare: Notes on the Pareto Principle, Preferences, and Distributive Justice*, 32 J. Legal Stud. 331 (2003); *see also* Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 Am. Econ. Rev. 414 (1981).

7. The example follows *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, *supra* note 6, at 669–74.

8. United States v. Carroll Towing Co., 159 F.2d 169, 173–74 (2d Cir. 1947).

9. *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, *supra* note 6, at 669.

The Kaplow and Shavell approach depends on some rather complex matching between taxpayers and those who would be affected by legal reform to meet its Paretian constraint, but we set aside this practical difficulty.[10] Although the "Leave It to Tax"' theorem phrase does not do precise justice to Kaplow and Shavell's important and influential work, in its original or later developed forms, it does capture a general sense, within and outside the academy, that tax should be used, primarily if not exclusively, to meet society's redistributive goals.[11] We next consider what tax does with this task.

10. See generally Christopher P. Taggart, *Fairness Versus Welfare: The Limits of Kaplow and Shavell's Pareto Argument*, 99 Marq. L. Rev. 661 (2016).

11. According to Google Scholar, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, *supra* note 6, has been cited 815 times (331 times in legal journals, according to Westlaw) to date. *Fairness Versus Welfare*, *supra* note 6, has been cited 844 times overall and 459 times in legal journals. *Should Legal Rules Favor the Poor? supra* note 6, has been cited 244 times, 98 times in legal journals. Their work is cited in literature published in some of the top law reviews and journals, including Yale Law Journal, Columbia Law Review, Harvard Law Review, Stanford Law Review, University of Chicago Law Review, University of Pennsylvania Law Review, to name a few. These cites also include books, e.g., Klaus Mathis, Efficiency Instead Of Justice?: Searching For The Philosophical Foundations Of The Economic Analysis Of Law (Deborah Shannon trans., Law and Philosophy Library Book 84) (2009), textbooks, *e.g.*, Robert Cooter & Thomas Ulen, Law And Economics (Sally Yagan, Donna Battista, & Noel K. Seibert eds., 6th ed. 2016), and policy papers, e.g., Tomer Blumkin, Yoram Margalioth, & Efraim Sadka, *Anti-Discrimination Rules versus Income Taxation in the Pursuit of Horizontal Equity*, 91 J. Pub. Econ. 1167 (2007). Kaplow's and Shavell's influence on policy is also apparent in that their 1994 paper was produced in connection with the National Bureau of Economic Research's Law and Economics research program. Further, *Fairness Versus Welfare* was also referenced at a House Judiciary committee meeting, providing some evidence that Kaplow and Shavell had the attention of legislators. *Workplace Goods Job Growth and Competitiveness Act of 2005: Hearing on H.R. 3509 Before the H. Comm. on the Judiciary,* 109th Cong. 16 (2006) (note 6 on statement of Andrew F. Popper, Professor, American University).

II. What Tax Does with its Redistributive Task

A. The Mirrlees Bifurcation

When Kaplow and Shavell first set out their "Leave It to Tax" theorem in 1994 it had already been more than two decades since the late British economist James Mirrlees had published the elegant mathematical models of optimal income tax analysis for which he was awarded a Nobel Prize in Economics.[12] Mirrlees's work has been enormously influential in law, economics and the wider real world,[13] reminding us of John

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12. *See, e.g.*, J. A. Mirrlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 Rev. Econ. Stud. 175 (1971) [hereinafter *An Exploration in the Theory of Optimum Income Taxation*]; P. A. Diamond & J. A. Mirrlees, *Optimal Taxation and Public Production I: Production Efficiency*, 61 Am. Econ. Rev. 8 (1971) [hereinafter *Optimal Taxation and Public Production I*]; P. A. Diamond & J. A. Mirrlees, *Optimal Taxation and Public Production II: Tax Rules*, 61 Am. Econ. Rev. 261 (1971) [hereinafter *Optimal Taxation and Public Production II*]; *see also* F. P. Ramsey, *A Contribution to the Theory of Taxation*, 37 Econ. J. 47 (1927); P. A. Diamond, *Optimal Income Taxation: An Example with a U-Shaped Pattern of Optimal Marginal Tax Rates*, 88 Am. Econ. Rev. 83 (1998). In the legal literature, see Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 Cal. L. Rev. 1905 (1987); Edward J. McCaffery & James R. Hines Jr., *The Last Best Hope for Progressivity in Tax*, 83 S. Cal. L. Rev. 1031 (2010). We see an early incarnation of the "Leave It to Tax" theorem in Steven Shavell, *A Note on Efficiency vs. Distributional Equity in Legal Rulemaking: Should Distributional Equity Matter Given Optimal Income Taxation?*, 71 Am. Econ. Rev. 414 (1981), in which Shavell draws on J. A. Mirrlees, *Optimal Tax Theory: A Synthesis*, 6 J. Pub. Econ. 327 (1976). This is not the only Kaplow and Shavell connection to Mirrlees. *See Fairness Versus Welfare*, *supra* note 6 (citing J. A. Mirrlees, The Economic Uses of Utilitarianism, in Utilitarianism And Beyond 63 (Amartya Sen & Bernard Williams eds., 1982). *See also* Chris W. Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 Cornell L. Rev. 1003 (2001); Matthew Dimick, *Should the Law Do Anything About Economic Inequality*, 26 Cornell J. L. & Pub. Pol'y 1 (2016); Ronen Avraham, David Fortus, & Kyle Logue, *Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell*, 89 Iowa L. Rev. 1125 (2004) (drawing connections between the ideas of Mirrlees and Kaplow & Shavell).

13. Mirrlees has more than 15,000 citations on Google Scholar. According to Google Scholar, his two most cited articles, *An Exploration in*

Maynard Keynes's comments about academic scribblers.[14] Mirrlees's ideas have found their way from Presidential Medal of Freedom recipient Arthur Laffer to a napkin and ultimately into the mind of President Ronald Reagan.[15] Mirrlees's academic work clearly helped to inspire a movement towards lower marginal tax rates and an essentially wage-tax base that today describes the status quo, as we note further below. David Leonhardt, in a long profile of Barack Obama's economic philosophy published in *The New York Times* shortly before the 2008 election, reflected the then prevailing view:

> [w]hen Reagan was elected, in 1980, tax rates on top incomes were so high that even liberal economists now say the economy was suffering. There simply wasn't enough of an incentive for rich people to start new companies or expand existing ones, because so much of their profit would have gone to the federal government.[16]

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the Theory of Optimum Income Taxation, *supra* note 12, and *Optimal Taxation and Public Production I*, *supra* note 12, have been cited 6,114 and 3,175 times, respectively. According to Westlaw, his work has been cited 125 times in law reviews and journals, some of which include top law reviews, such as Harvard Law Review, Yale Law Review, Stanford Law Review, University of Chicago Law Review, and California Law Review. Mirrlees has also been cited in influential economics texts. *See, e.g.*, AMARTYA SEN, COLLECTIVE CHOICE AND SOCIAL WELFARE (Expanded ed. 2017); ANGUS DEATON, THE ANALYSIS OF HOUSEHOLD SURVEYS: A MICROECONOMETRIC APPROACH TO DEVELOPMENT POLICY, WORLD BANK (1997); JEAN TIROLE, THE THEORY OF INDUSTRIAL ORGANIZATION (1st ed. 1988).

14. "Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back." JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY 384 (1936).

15. *Laffer Curve Napkin* (photograph), *in* COLLECTIONS, NAT'L MUSEUM AM. HIST., https://americanhistory.si.edu/collections/search/object/nmah_1439217 [https://perma.cc/U67J-XAQQ].

16. *See* David Leonhardt, *A Free-Market-Loving, Big-Spending, Fiscally Conservative Wealth Redistributionist*, N.Y. TIMES (Aug. 24, 2008), at MM30.

Defunct economists and academic scribblers everywhere could rejoice that their words could have such an effect.

We need not engage in the complex mathematical economics of Mirrlees's model directly. We focus here on the *general strategy* of optimal income taxation vis-à-vis its redistributive task. It turns out that Mirrlees has his *own* bifurcation, following the classic one. The optimum income tax tradition essentially gives tax a *revenue-raising* task. Tax is set to be the most efficient means to pay for lump sum credits that are the primary direct means of redistribution. Efficiency concerns shape both the base and rate structure of tax. The wealthy are not taxed. At all.

Mirrlees provides a more general application of Kaplow and Shavell's logic. Kaplow and Shavell argue that a *particular* act of redistribution, of "serving equity," should be removed from the private law system (that is, we should keep Rule X as Rule X) and placed in tax. The *general*, more abstract principle is that when the government redistributes it should do so in the most efficient possible manner. Indeed, when the government chooses to do *anything*—and anything the government does is likely to be inefficient, since it is, by stipulation, not something the free market produced on its own—it should do so in the most efficient possible manner. Kaplow and Shavell argue that the income tax is generally the most efficient means for redistribution. We shall keep in mind the most general form of the logic, that society should strive to implement its goals in the most efficient manner, throughout the Article, as we explore different possible ends of redistribution. It turns out the ends ought to shape the means.

Mirrlees, who seems to be much more frequently cited than read, does not address quite the same question as the "Leave It to Tax" theorem does. Instead, Mirrlees looks to find the optimal form of "redistributive progressive taxation."[17] Whereas Kaplow and Shavell assume that the income tax is the most efficient tax, Mirrlees assumes that society will be using an income tax to redistribute wealth, and then "explores" what the optimal form of a redistributive income tax would be. Mirrlees is asking the question: "How much could society redistribute using an income tax as the sole means of redistribution, and still improve welfare?" This nuance is important for, in the end, as we shall see, Mirrlees comes to lament that an income tax is *not* an

17. *An Exploration in the Theory of Optimum Income Taxation*, *supra* note 12, at 175.

effective tool to tax the rich, and that society should consider *other* types of taxes or governmental actions to address inequality. That is a part of Mirrlees less well read.

Mirrlees takes the problem of optimal income taxation to be solely about redistribution—specifically, the redistribution of money. *All* that Mirrlees has the government doing in his models, or all that the income tax system is doing, is raising money and then giving it back. This is as good a place as any to note that this Article shall generally be talking about *money*, and wealth-maximizing, not *utility* and utility-maximizing. Neoclassical economic theory, including both Mirrlees and Kaplow and Shavell, use the unobservable quantum of "utility," and engage in various transformations of observed data to convert it into the utility metric, such as using "Hicksian" compensation to take out the income effect to isolate the pure "substitution" effect of a legal change.[18] Not only do we not need that degree of complexity in the present analysis; it is also in fact the case that real governments need real money to pay real expenses. The government has an interest in maximizing the real, observed, "uncompensated" dollars it gets; you cannot buy guns or butter with utiles. In our discussions, the government is both raising and spending actual dollars through the income tax.

This sets Mirrlees up for his bifurcation. On one hand, the spending hand, the government takes the money that it has raised, divides it by the number of citizens, and gives everyone a lump-sum grant via a tax credit. These grants came to be called "demogrants" in the literature, but we can use the more familiar term "credit," for we are now seeing in the public political practice and discourse forms of lump-sum grants administered within the income tax, as in the refundable child tax credit.[19] We are also hearing rising talk of a "Universal Basic Income" that is in essence a Mirrleesian lump-sum grant.[20] There is no

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18. *See* John R. Hicks, The Theory Of Wages 157–58 (1932).

19. *See* The White House, The Child Tax Credit, https://www.whitehouse.gov/child-tax-credit/ [https://perma.cc/7ACA-W4T6]; Benefits.gov, Child Tax Credit, https://www.benefits.gov/benefit/938 [https://perma.cc/UCK4-Q4W9]; Dep't of Treasury, Expanded Child Tax Credit, https://home.treasury.gov/system/files/136/Expanded-Child-Tax-Credit-Infographic.pdf [https://perma.cc/YT6H-LZ3K].

20. *See* Miranda Perry Fleischer & Daniel Hemel, *Atlas Nods: The Libertarian Case for a Basic Income*, 2017 Wis. L. Rev. 1189, 1191–93 (2017); Miranda Perry Fleischer & Daniel Hemel, *The Architecture of a Basic*

inefficiency in the provision of such a lump sum because it does not affect behavior—it has only "income" and not "substitution" effects.[21] This is the most efficient *form* of redistribution, of a certain sort.

Just as do Kaplow and Shavell, Mirrlees then goes to tax to provide the most efficient means to pay for the redistribution. Aside from some interactive effects on the tax side, where *some* redistribution comes from the shape of the marginal tax rate curve, tax emerges not as a *direct* means to redistribution, as many ordinary moral intuitions (including Mirrlees's own, as we shall see) might suggest, but rather as a *means to the direct means of redistribution*, that is, a means of financing the redistributive act, which Kaplow and Shavell take as an instance of private law reform and Mirrlees takes as the redistribution of money itself.[22] The "It" in "Leave It to Tax" is the *financing* of an "It" —the redistributive act—whose specification is left offstage; tax is the means to pay for some end.

As with Kaplow and Shavell, whatever inefficiency obtains is driven by the *level*, the total amount, of redistribution: redistribution through legal rules causes the same inefficiency as taxes with regard to the labor-leisure choice: "*[t]he distortion is caused by the redistribution itself and is not particular to the mechanism by which it is accomplished*. And when redistribution involves choosing less efficient legal rules, additional costs are incurred."[23]

This applies to Mirrlees too. The act of redistribution—the private law change, the lump-sum credit—is by definition inefficient because it is a deviation from what the (presumably) efficient market had been producing. It costs money. The form of the credit has no inefficient effects, as we just discussed, but the *level* of the redistribution sets the level of the burden for the tax system to meet. The second step

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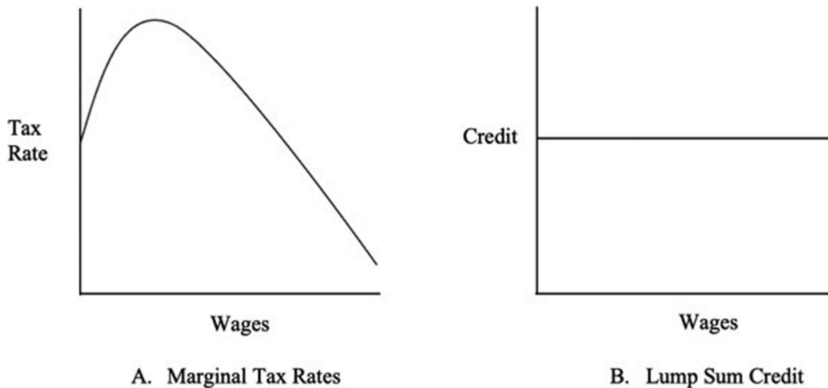
Income, 87 U. Chi. L. Rev. 625, 627 (2020); Philip Harvey, *The Right to Work and Basic Income Guarantees: Competing or Complementary Goals?*, 2 Rutgers J.L. & Urb. Pol'y 8, 8 (2005); *The Freedom Dividend*, Yang 2020, https://2020.yang2020.com/policies/the-freedom-dividend/ [https://perma.cc/2NU5-CFJ2].

21. *See* Hicks, *supra* note 18.

22. This result obtains because the efficiency costs of high marginal tax rates, especially on high wage earners, swamp the redistributive gains from imposing the taxes. We discuss further below in the text.

23. *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, *supra* note 6, at 677 (emphasis supplied).

Figure 1: Mirrleesian Tax Plus Credit



A. Marginal Tax Rates

B. Lump Sum Credit

then involves raising that money at the least possible cost. This is where tax comes in.

Figure One shows the general shape of the two-step process. On the left are the marginal tax rates that come from Mirrlees's analysis, in stylized form, and on the right is the level of the credit.

In explaining Figure One, we should first note that Mirrlees's optimal income tax, by stipulation, *only* applies to wages.[24] This is a significant problem, because, as we note further below, the actual income tax is also essentially a wage tax, with the simple tax planning steps of *Buy, Borrow, Die* mooting the taxation of wealth for the wealthiest.[25] Mirrlees and a vast consensus of economists following in the optimal income tax tradition[26] show that the "optimal" marginal tax rate schedule features a peak level in the lower/middle wages range, followed by a decline among upper wage earners, producing a shape, reflected in the left panel in Figure One, that looks like a Laffer curve.[27] Economists disagree about the precise contours but almost all agree that marginal tax rates should decline over the upper range. Matti Tuomala, a prominent proponent of the optimal tax tradition, has put it simply that "[o]ne of the main conclusions to be drawn from the Mirrleesian optimal non-linear income tax model is that it is difficult (if at

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24. *An Exploration in the Theory of Optimum Income Taxation*, *supra* note 12, at 182.

25. *See* McCaffery*, supra* note 2.

26. *See* Edward J. McCaffery & James R. Hines Jr., *The Last Best Hope for Progressivity in Tax*, *supra note* 12, at 1053–55.

27. *See id.* at 1055.

all possible) to find a convincing argument for a progressive marginal rate structure throughout."[28]

There is an important interaction between the two panels. Mirrlees is using various *social welfare functions*[29] that weigh the value of dollars, in utility terms, differently based on a person's wealth level. A dollar to a low-income person is worth more, in utility terms, than a dollar to a high income one: there is a diminishing marginal utility of money income or, equivalently, risk aversion.[30] This means that dollars moved from high to low-income individuals increase social welfare: the benefits of redistribution. But one must pay for redistribution through the tax system, and all tax systems have inefficiencies due to their disincentive effects: the costs of redistribution. As the credit on the right-hand side rises, so does the need for revenue, and so do the inefficiencies—the costs—of using tax. At some point, the marginal costs of raising taxes equal the marginal benefits of raising the credit, and the model is at equilibrium. The left-hand side of Figure One is the cost side, driven primarily by efficiency analysis; the right-hand side is the benefits side, driven by the redistributive effects of a weighted social welfare function. So, tax's primary roles in optimal income tax analysis, aside from its modest direct contribution to redistribution (in its progressive range), are both as the means of financing the redistribution and then, on account of the costs of revenue-raising, as a constraint on the level of redistribution itself.

Mirrlees included simulations in his seminal 1971 paper that featured peak and highest-end marginal tax rates of 26 and 16; 21 and 15; 28 and 19; 34 and 20; 39 and 21; and 60 and 49. These peak/highest-end rate pairs show both the considerable range of possible outcomes under an optimal tax analysis (depending on the social welfare and individual utility functions used), and the general peak-decline pattern. To set these numbers in some context, the marginal income tax rate bracket for the upper income now, under the rates established by President Trump's Tax Cuts and Jobs Act of 2017 ("TCJA"), is 37%;[31] in high tax states such as California or New York, the highest marginal rate on wage

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28. *Id.*

29. *See* Bankman & Griffith, *supra* note 12, at 1946.

30. *See* Richard Layard et al., *The Marginal Utility of Income*, 92 J. Pub. Econ. 1846, 1856 (2008).

31. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, 131 Stat. 2054 (2017).

income approaches or exceeds 50% when adding on state and payroll taxes. But *below* the range of the highest incomes, some citizens face tax rates of 90% because of the phase-outs of their benefits under means-tested programs,[32] creating a peak-decline structure. And above the highest marginal rate level, rates fall, as taxpayers derive more of their "income" from capital or wealth, and less from wages, until they reach the limiting case of paying no tax at all, with Jeff Bezos, Elon Musk, and Jared Kushner as a few ready examples.[33] Mirrlees himself did not find a zero marginal rate on the highest incomes, but many subsequent researchers did, and even, in the case of one model advanced by Nobel laureate Joseph Stiglitz, found a negative rate on the richest to be optimal.

Some researchers, such as Peter Diamond and Emmanuel Saez, have produced models justifying more steeply progressive rates under an optimal income tax approach.[34] But such conclusions remain outliers in the academy and wider public political culture. More importantly, perhaps, there are *political* obstacles in relying on the more optimistic outlier models in guiding actual tax law reform. The question of the efficiency of a tax system is an empirical one. To real politicians, optimal income tax models are empirical predictions. Ultimately, actual tax rates shape actual incentives and the actual dollars that appear. Being "wrong" about the efficiency of a tax law change means losing money, possibly *lots* of money, for the country. A risk-averse politician, given the other factors such as salience and political economy that we discuss in Part IV below, would be hard-pressed to recommend a gamble on a minority academic position by advocating steeply raising marginal rates and hoping for minimal effects on the economy. Such a position would face considerable opposition on the other side of the political spectrum,

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32. *See* Daniel N. Shaviro, Effective Marginal Tax Rates on Low-Income Households 5 (1999), http://users.econ.umn.edu/~erm/data/sr472/Data/MicroData/EPI/EffMargRates.pdf [https://perma.cc/56CF-TMBB] [hereinafter Effective Marginal Tax Rates on Low-Income Households]; Edward J. McCaffery, Opinion, *Americans' 90% Tax Rate*, CNN (Feb. 8, 2013, 10:00 AM), https://www.cnn.com/2013/02/08/opinion/mccaffery-marginal-tax-rates/index.html [https://perma.cc/Q6W6-35DS].

33. *The Secret IRS Files*, *supra* note 1.

34. *See* Peter Diamond & Emmanuel Saez, *The Case for a Progressive Tax: From Basic Research to Policy Recommendations*, 25 J. Econ. Persp. 165, 168–71 (2011).

especially at election time. It is no coincidence that in the last 70 years, the highest marginal tax rate under the income tax has only been raised on three occasions, each modest, and *always* costing the party in power dearly in the next election.[35]

B. The Normativity of Optimal Income Tax

We shall go on to consider how the very strategy of optimal income tax analysis has constrained the redistributive possibilities for tax and set up the paradox later. But first it is important to note that the Mirrleesian bifurcated approach *does* redistribute, and, further, does redistribute *optimally*, at least contingent on the choice of an income tax, in a certain meaningful sense of "redistribution." This illustrates a general point. The precise goal(s) of "redistribution" need(s) to be specified. Mirrlees takes redistribution to mean getting the most dollars to the lowest incomes without sacrificing overall welfare, what we can call an "efficient maximin" approach that we discuss further below in Part V. Optimal income tax models obtain this result.

For our present purposes, and also to reflect better how optimal income tax notions have entered into a wider public political consciousness and practice—such as in the Flat Tax/Basic Income scholarly

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35. In 1991, the top marginal rate was raised from 28% to 31% during the tenure of George H. W. Bush, who with his "quivering lips" lost the subsequent presidential election to Bill Clinton. In 1993, Clinton himself raised the top marginal rate from 31% to 39.6%, and the Democrats lost 54 seats in the House and 9 in the Senate in the 1994 midterms. In 2013, Barack Obama raised the top marginal rate from 35% to 39.6%, and the Democrats lost 13 and 9 House and Senate seats, respectively, in the next midterms, and the presidency itself in 2016. (This came after the Democrats lost *63* seats in the 2010 midterm, the most in any election since 1948, after Obama's health care plan, the Affordable Care Act, was largely coded as a tax increase by Republicans). *Historical Highest Marginal Income Tax Rates*, Tax Pol'y Ctr. (Feb. 9, 2022), https://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates [https://perma.cc/R3PL-2PZS]; *Party Divisions of the House of Representatives, 1789 to Present*, History, Art & Archives: House Of Representatives, https://history.house.gov/Institution/Party-Divisions/Party-Divisions/ [https://perma.cc/432E-V5HU]; U.S. Senate: Party Division, https://www.senate.gov/history/partydiv.htm [https://perma.cc/K24F-NFWV].

Table 1: Redistribution with 20% Tax/$20,000 Credit

Wages	Tax	Credit	Net Payment (Receipt)	Effective Tax Rate %	Marginal Tax Rate %	After Tax and Credit
10,000	2000	20,000	(18,000)	(180)	20	28,000
100,000	20,000	20,000	0	0	20	100,000
1,000,000	200,000	20,000	180,000	18	20	820,000

project somewhat endorsed by Sir Anthony Atkinson[36]—we can illustrate the effects using a flat marginal tax rate and a lump sum credit.[37] Table One presents a wage tax, as Mirrlees's model provides; a flat marginal tax rate of 20%; and an annual lump sum credit of $20,000 per taxpayer. We illustrate with taxpayers making $10,000, $100,000 and $1,000,000. We chose these numbers to make simple, analytic points, not out of any sense of realism.

Table 1 shows that, even with each taxpayer facing a constant marginal tax rate of 20%, progressivity obtains in average or effective tax rates,[38] because the *net* of tax-and-transfer is rising as a percentage of the tax's base, wages. The $10,000 wage-earner *receives* a net $18,000 from the government, for an effective tax rate of *negative* 180%. The $1,000,000 wage earner *pays* a net of $180,000 for an effective rate of 18%.

Most to the point, we can see in this simple example the redistribution from the pre-tax distribution of earnings in the far-left column—$10,000, $100,000 and $1,000,000—to the post-tax distribution

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36. "In my view, it should definitely be on the agenda for public discussion, and there are certainly circumstances in which it would be, in my judgement, the best way to develop the tax and social security system in the European Union." Anthony B. Atkinson, *Concluding Reflection: The Integration of Public Economics*, *in* Public Economics In Action: The Basic Income/Flat Tax Proposal 154 (1995).

37. *See* Bankman & Griffith, *supra* note 12, at 1912–13; Robert E. Hall & Alvin Rabushka, The Flat Tax (2nd. ed. 1995); Richard M. Bird & Eric M. Zolt, *Tax Policy in Emerging Countries*, 26 Env't & Plan. C: Gov't & Pol'y 73, 81 (2008); Jason S. Oh, *Are Progressive Tax Rates Progressive Policy?*, 92 N.Y.U. L. Rev. 1909, 1975 (2017).

38. A taxpayer's average or effective tax rate is the share of income paid in taxes. This is in contrast to a taxpayer's top marginal tax rate, which is the highest tax rate paid on only a portion of taxable income. *See generally* Bankman & Griffith, *supra* note 12.

in the far right, of $28,000, $100,000 and $820,000. The tax has moved money from the top to the bottom of the wage scale. This could increase welfare under a weighted social welfare function because the added utility of moving the low-income wage earner "up" to a $28,0000 annual consumption level is greater, in absolute magnitude, than the loss from moving the highest wage earner "down" from $1,000,000 to $820,000. The other effect in an optimal tax model, the efficiency constraint, would be measured by the fact that the sum of the tax and the post-tax distributions of all actual taxpayers will be less than the sum of the pre-tax distribution, because wealth will have fallen due to the distortions of the tax. Once more, *redistribution costs money.*

C. Mirrlees's Laments

It turns out that Mirrlees himself was not very happy with the results of his own exploration of "redistributive progressive taxation."[39] In a candid *Conclusions* section in his classic paper, Mirrlees reveals his prior intuitions and laments the results on both sides of his bifurcation, the marginal tax rate schedule and the credit level. First, Mirrlees is surprised that the models do not produce high marginal tax rates at the top of the income range:

> [b]eing aware that many of the arguments used to argue in favour of low marginal tax rates for the rich are, at best, premised on the odd assumption that any means of raising the national income is good, even if it diverts part of that income from poor to rich, I must confess that I had expected the rigorous analysis of income-taxation in the utilitarian manner to provide an argument for high tax rates. It has not done so.[40]

Mirrlees is lamenting that the predictions of a simplistic argument that "any means of raising the national income is good," which would obtain under an *un*weighted social welfare function seeking to maximize actual dollars, end up being not far off the mark. This bears noting because it is of course possible that actual legislators use unweighted social welfare functions: that there are important real-world

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39. *See* Mirrlees, *supra* note 12, at 207.
40. *Id.*

forces that view "any means of raising the national income [as] good." Yet even with Mirrlees rejecting that easy assumption, the "rigorous analysis of income-taxation in the utilitarian manner" does *not* "provide an argument for high tax rates." Efficiency analysis dominates at the upper ranges of income such that the revenue-raising task given to tax constrains its progressivity at the high end.

Second, the low end of the wage range does not fare much better, for the *opposite* reason: "I had also expected to be able to show that there was no great need to strive for low marginal tax rates on low incomes when constructing negative-income-tax proposals. This feeling has been to some extent confirmed."[41]

Here Mirrlees's intuitions were largely confirmed, but these intuitions are not felicitous for the cause of redistribution. The working low income do *not* face low marginal tax rates. In fact, in America today, as noted above, the highest marginal tax rates, approaching 90%, fall on the working poor as they begin to lose benefits under means-tested programs as their incomes rise.[42] Once more, efficiency drives this result. The higher tax rates fall on the less elastic middle-income workers, who are compelled to work, *and* they help to generate tax revenues from the upper income, who "pass through" these high tax rate ranges infra-marginally (one cannot earn $200,000 until she has first earned $50,000, say).[43]

Third, on the level of the credit, which sets the minimum consumption level (as a citizen earning $0 in the workforce would still receive it), Mirrlees's hopes again came up short.

> But my expectation that the minimum consumption level would be rather high has not been confirmed. Instead, virtually everyone is brought into the workforce. Since this conclusion is based on the analysis of an economy in which a man who chooses to work can work, I should not wish to see it applied in real economies.[44]

41. *Id.*

42. *See* Effective Marginal Tax Rates on Low-Income Households, *supra* note 32, at 4.

43. *See* McCaffery & Hines, *supra* note 12, at 1055–57.

44. Mirrlees, *supra* note 12, at 207.

Mirrlees finds that "virtually everyone is brought into the workforce" because the credit level is not sufficient to live on. Mirrlees finds this especially problematic in the real world because there are not enough jobs to go around. The disappointment at the credit level shows, once again, the dominant effect of efficiency analysis and the constraints on redistribution that it imposes. Recall that the size of the credit is driven by the interaction between the benefits of the credit and the costs of using the tax system to generate the money for it. Those costs—the efficiency losses—are what keep the credit low. It turns out that "redistributive progressive taxation" is more expensive than Mirrlees had presumed.

This all leads Mirrlees to conclude his classic work with a call for further explorations:

> (2) *The income-tax is a much less effective tool for reducing inequalities than has often been thought*; and therefore
>
> (3) It would be good to devise taxes complementary to the income tax, designed to avoid the difficulties that tax is faced with. . . . With any such method of taxation, the risks of evasion are, of course, quite great: but if it is true, as our results suggest, that the income tax is not a very satisfactory alternative, *this objection must be weighed against the great desirability of finding some effective method of offsetting the unmerited favours that some of us receive from our genes and family advantages*.[45]

In the end, then, what does tax theory do with its redistributive task? First, theory tells us that the income tax should be employed as the primary means to generate revenue to meet an independently set redistributive goal of getting more money to the poor. Then theory tells us both that the best way to meet the redistributive goal is with a flattened wage tax and that the costs of using tax constrain the magnitude of the goal. Finally, theory asks for help.

We should all read more.

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45. *Id.* at 208 (emphasis added).

D. The Facts on the Ground: Flattened Wage Taxation

As a matter of basic logic, any tax consists of a base, or what is being taxed, times a rate structure.[46]

Mirrlees's tax base is wages. Mirrlees rules out savings in large part because his is a one period model; there is no time and hence no savings.[47] The vast majority of economists in the optimal income tax tradition support the non-taxation of capital, or the returns to wealth, once again because of efficiency concerns. Taxes on capital have been considered "double taxes" at least since John Stuart Mill in 1848,[48] and economists continue to be concerned with the savings-consumption decision, just as they are with the labor-leisure one. Capital taxation distorts incentives to save.[49] The typical Mirrleesian marginal rate structure is regressive in the upper ranges of income, typically reaching zero as just discussed. The net result is that optimal tax analysis produces a consensus recommendation for what we shall call, roughly, flattened wage taxes.

Many readers consider that America has and has had since the ratification of the 16th Amendment in 1913 a progressive income tax. We do not. An "income" tax, in theory, as the celebrated case of *Eisner v Macomber*[50] put it, is supposed to fall on capital and labor and both combined: what we can call work and wealth. The "income" tax is far closer to being a wage tax because *Buy, Borrow, Die*, along with other tax law doctrines and provisions, largely moot the taxation of capital.[51] If an income tax is supposed to tax the income from capital and labor, and ours does not (much) tax the income from capital, we do not have an income tax. We have a wage tax. The increasingly important payroll tax, which only ever attempts to tax wages, not capital, and which falls off in the high ranges—a nearly perfect Mirrleesian tax—only confirms the trend.

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46. *See* Edward J. McCaffery, Income Tax Law, The Oxford Introductions To U.S. Law (2012).

47. *See* McCaffery & Hines, *supra* note 12, at 1054–55.

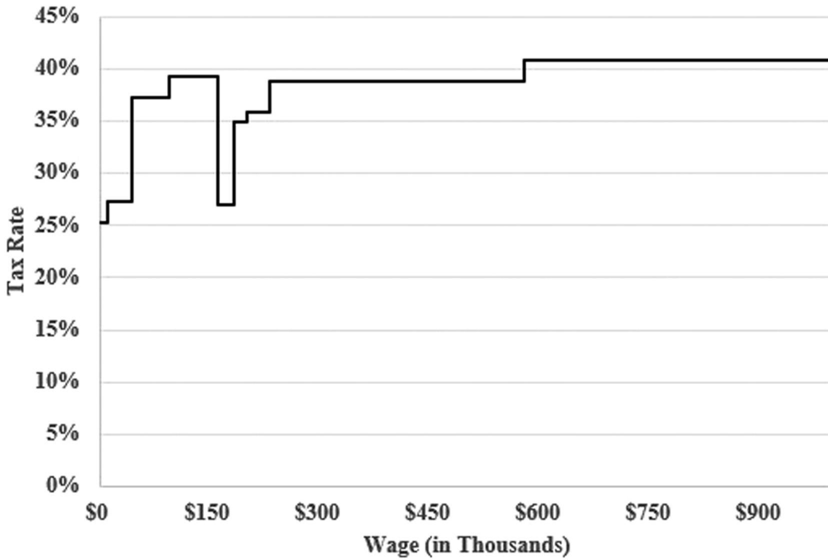
48. John Stuart Mill, 5 Principles Of Political Economy, ch. II, at 179–80 (Jonathan Riley ed., Oxford University Press 1994) (1848).

49. McCaffery & Hines, *supra* note 12, at 1042, 1054–55.

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

51. *See* McCaffery, *supra* note 1, at 1235–36, 1245–58.

Figure 2: Marginal Tax Rates on Single Worker, Income and Payroll Taxes combined, 2023.



In a further surprise, perhaps, the rates are not all that progressive. One gets a different look at wage taxation in America by combining the payroll tax, which only falls on wages, and the income tax, which mainly falls on wages. Figure 2, above, shows the marginal tax rates facing a single, childless worker who earns only wages:[52]

To a first approximation, Figure 2 looks like a flat near 40% rate schedule, with something of a lower range and an upper range slightly above. The actual U.S. tax system at present looks even more Mirrleesian when you add in two facts. One, on the lower side of the range, various phase-outs of benefits and credits under means-tested programs create marginal tax rates on the working poor of 90% or even higher, in ranges of income around $30,000 or $40,000 per household per year.[53] Two, on the high end, marginal tax rates essentially drop to 0—an optimal income tax result—because the high income convert

52. *See* I.R.S. News Release IR-2020-245 (Oct. 26, 2020), https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2021 [https://perma.cc/W4TW-32RF].

53. *See* Effective Marginal Tax Rates On Low-Income Households, *supra* note 32. *See also* McCaffery, *supra* note 32.

their taxable wages into nontaxable, unrealized gains under *Buy, Borrow, Die* planning techniques.[54]

In sum, in *both* theory and practice, we have a flattened wage tax that scores well on revenue-raising efficiency grounds but disappoints those who yearn for greater economic equality. The wealthiest pay no tax, at all.

III. The Paradox Revealed

We can now see the paradox. Theory told us that tax is the privileged tool to redistribute. Optimal income tax told us that the best way to redistribute is to pair lump-sum grants with flattened wage taxes. Practice has listened. America largely has flattened wage taxes financing whatever redistribution to the not-rich it provides.

It then follows under theory that any other way to get material resources to the poor is not optimal. It would cost money, resources that would otherwise be available for the not-rich. Any inefficient tax-the-rich structure can be reset in the manner of Kaplow and Shavell with a more efficient tax structure to meet a Paretian constraint.

To illustrate, suppose that we are providing X level of benefits to all citizens, through a lump sum credit financed by tax system T. T is a flattened wage tax of an optimal sort. Now a tax-the-rich reformer wants to replace T with T*, a tax system featuring more steeply progressive marginal tax rates. In such a world, to meet the constant revenue need of X, wealth must fall because, by stipulation, T is the most efficient tax to generate X. The world with T* can be replaced with the world of T, keeping X constant, meeting a Paretian constraint. Generalizing Kaplow and Shavell: Any inefficient tax can be replaced with an efficient tax while meeting a Paretian constraint.

In theory, taxing the rich costs resources because it leads to a world with less wealth and no more benefits for the poor. Some might consider this to be an opportunity cost—the wealth left on the table, so to speak, from any suboptimal or inefficient tax system—but we shall come to see in Part IV that opportunity costs have real effects.

Practice mirrors theory. To a first approximation, our actual tax system looks like a flattened wage tax. We have never meaningfully

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54. *See The Secret IRS Files*, *supra* note 2; McCaffery, *supra* note 9; Edward J. McCaffery, *A Voluntary Tax? Revisited*, 2000 Nat'l Tax J. Proc. 268, 271.

taxed capital, because the simple steps of *Buy, Borrow, Die* have been present since the dawn of the modern income tax. The payroll tax, which applies only to wages, has steadily risen in magnitude, while the corporate income tax, which falls in the first instance only on non-wages, or capital, has been steadily falling.[55] Effective tax rates under the individual income tax were never as progressive as marginal ones, because wealthy wage-earners had means of "sheltering" their income from tax. But in any event, we have been heading towards an explicitly flattened wage tax with growing speed since Ronald Reagan and the tax reforms of the 1980s.

To continue a feedback loop between theory and practice, much of our reigning normative theory and practical politics have now accepted the normativity of the facts on the ground, and thus have accepted a constraint that funding for redistribution must come from flattened wage taxes.

The paradox can seem inescapable, when it is seen at all. The first step in escaping from it is to understand it.

A. The Paradox in Theory

The paradox haunts and limits our theoretical discussions about tax policy. Taxing the rich costs resources, and so hurts even the poor, who could get more resources through a more efficient tax. Those arguing to tax the rich are arguing to do so *despite* its costs, but they are generally not explicit about this. We can observe the effects of the paradox by considering an influential critique of the optimal income tax tradition, one drawing on widely held ordinary moral intuitions.

It turns out that Mirrlees was not the only one unhappy with his own conclusions. The Mirrleesian bifurcation is intrinsically disappointing to those who had eagerly waited for tax to deliver on the implicit promise of the "Leave It to Tax" theorem: that is, to redistribute wealth by taxing the rich more heavily. Like Mirrlees himself, many critics have

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55. See McCaffery, *supra* note 1, at 1252, which observes that the corporate tax is a tax on capital "in the first instance." This is so because wages are a deduction from the corporate income tax base under section 162, although the ultimate incidence—who really bears the economic effect of the tax—is unclear. *See generally* Edward Fox, *Does Capital Bear the U.S. Corporate Tax After All? New Evidence from Corporate Tax Returns*, 17 J. Empirical Leg. Stud. 71 (2020).

an instinct favoring steeply progressive marginal tax rates. In the end, Mirrlees took his own "rigorous analysis . . . in the utilitarian manner" to suggest looking elsewhere for help in "offsetting the unmerited favours that some of us receive. . . ."[56] We return to this important point later. Meanwhile, other critics soldier on, making a case for progressive rates notwithstanding optimal tax analysis (as compared to making the case that optimal income tax analysis, on its own terms, *does* support progressive rates, as Diamond and Saez and others have argued[57]). These critics run into the paradox.

The moral and political philosophers Liam Murphy and Thomas Nagel, in their *Myth of Ownership*, state this case in strong and colorful language: "[i]f we are told that lower marginal rates coupled with a demogrant would be better even from the point of view of a strongly egalitarian theory of justice than graduated rates with a high marginal rate at the top, that gives us absolutely no reason to abandon high marginal rates *without* introducing a demogrant. This is blindingly obvious."[58]

Powerful as this logic may seem, what is "blindingly obvious" to the philosophers seems wrong to the economist—and, we shall argue, to the real politicians making real policy. Murphy and Nagel, searching for redistribution, conclude that there is "absolutely no reason to abandon high marginal rates without introducing a demogrant." This is wrong. There *is* a reason, and a strong one, to abandon high marginal rates: money. Part of what Mirrlees demonstrates is that a pattern of constantly increasing high marginal tax rates is inefficient. It costs money. It hurts the redistributive effort. This is the paradox.

In the bifurcated analysis of Kaplow and Shavell and Mirrlees, tax serves primarily as the means to generate resources to redistribute. Those *ends* must come from elsewhere. In Mirrlees, they derive from the social welfare function chosen. In actual practice, these ends are set by the actions of representative legislatures. America does not have an extensive form of demogrant or lump-sum credit, although, as we have noted, the refundable child credit and talk of Universal Basic Income bring us closer to this model. But optimal tax analysis sets the

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56. *An Exploration in the Theory of Optimum Income Taxation*, *supra* note 12, at 207–08.

57. Diamond & Saez, *supra* note 34, at 165.

58. Liam Murphy & Thomas Nagel, The Myth Of Ownership: Taxes and Justice 138–39 (2002).

efficient form of revenue raising *for any spending need*. We must adjust the formal model for any particular interactive effect, in case the nature of the spending program on the right-hand side, say on public health, education or welfare, changes the labor supply elasticities that are inputs on the left-hand taxing side. Once we have done that, the left-hand side gives an efficient tax rate structure to finance *whatever* the government chooses to spend. Any other way of raising the same amount of revenue would cost real money—there would be fewer dollars in the world—because, by stipulation, it would be less efficient to raise the needed revenue.

As Murphy and Nagel continue, the problem and the divergence in theoretical approaches becomes clearer:

> [b]ut in practice the point is frequently ignored. It is frequently claimed, for example by Joseph Stiglitz, that the conclusions of optimal tax theory were an influence on the trend to much lower marginal tax rates in the 1980s. This trend has been linked not with a greater role for cash transfers, but rather the reverse. No one concerned with welfare, not even utilitarians, can regard the growing inequality that has characterized the last two decades in the United States as an improvement from the point of view of justice. It is possible that, in its short-run practical consequences, economists' interest in the behavioral effects of taxation has done more harm than good to the cause of social justice.[59]

Murphy and Nagel notice a correlation. As marginal tax rates under the income tax declined radically in the 1980s, under the presidency of Ronald Reagan and in the shadows of the growing adoption of an optimal income tax perspective, public spending also declined. We shall argue that there may well be a causal connection between these two facts, brought about by the *political* dynamics set in motion under optimal income tax structures—when wage earners are taxed to finance redistribution, redistribution becomes less popular—as we explore further below.

59. *Id.* at 139.

But this aspect of Murphy and Nagel's critique ignores the rules of the game as utilitarian welfare economists see them. Murphy and Nagel assume that "redistribution"—by which they mean changing the post-tax and transfer, end state distribution of resources—is the goal for tax, the "It" that got left to tax in the "Leave It to Tax" theorem. Willing to concede that Mirrlees might be right, and the bifurcated approach might be ideal, Murphy and Nagel turn their focus to the absence of real world demogrants. Since tax is supposed to change the end state distribution of resources, and since without a demogrant we are not doing that in a first-best way, we should switch gears and implement "high marginal rates" to bring about a better end state distribution of resources.

This is not the welfare economists' view of the matter. "Leave It to Tax'" does not mean that tax, as a discipline, is equipped to set the ends for social policy or redistribution. "Leave It to Tax" means leaving to tax the task of financing whatever redistribution that society wants to do. In Kaplow and Shavell, this meant adding an equity element to a private law rule. In Mirrlees it means moving money around to maximize aggregate social utility under an exogenously chosen social welfare function. In actual practice, redistribution comes from whatever redistributive programs the government adopts. In all events, we next turn to tax to efficiently pay for the spending needs.

Murphy and Nagel's critique resonates with rather strong ordinary moral intuitions, which come close to seeing progressive marginal rates as an end unto themselves, regardless of their effects on welfare—and this may well be where we are heading in the analysis. But this is a different language than that of the welfare economists. Under the now familiar Kaplow and Shavell logic, an inefficient tax can be replaced by a more efficient tax that will generate more aggregate money, which can then be redistributed to help the low income. In the actual world as Murphy and Nagel see it (and as Mirrlees laments happens under his own optimal income tax analysis), society has set its spending levels too low, choosing not to redistribute through more generous demogrants. Murphy and Nagel then suggest that society should adopt *inefficient* tax rules that serve redistributive ends. But if society does not want to redistribute efficiently, why would it want to do so inefficiently? Why pay more money for something you do not want to do for less money? This leads to a straightforward application of the Kaplow-Shavell logic: when we redistribute using a deliberately inefficient form of taxation, measured by the total social cost of the dollars raised, we are paying for the deviation by having less money to redistribute.

This makes the deviation automatically inefficient, and subject to the Kaplow-Shavell reset, *unless* t*he very deviation is something we want to pay for*. This is the answer to the paradox of how optimally redistributive taxes can produce results that make redistributionists unhappy. It is because there are different senses—different goals—of "redistribution" *other than (just) getting resources to the poor*.

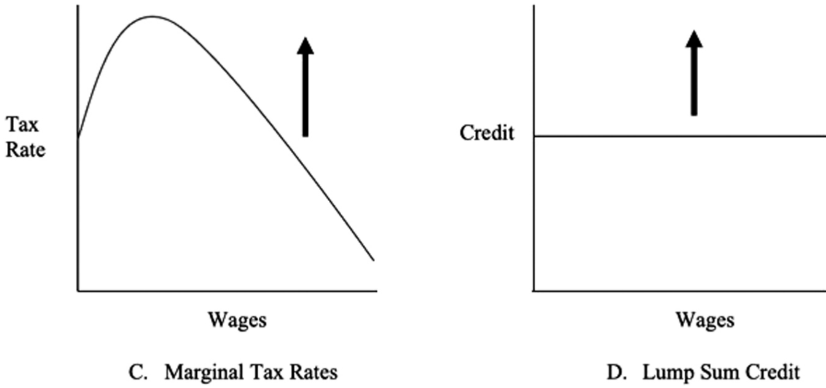
What could such an end be? We will discuss in more detail in Part V below but note that the general form of an answer must come down to taking from the rich *just to take from the rich*. We should not do so to get more resources, or to get more resources to the poor, because we could do either (more resources or more resources for the poor) with a more efficient tax. There is something *else* going on, some *other norm* of redistribution being called for, other than to raise money to give to the poor. Both Mirrlees and Murphy and Nagel feel this yearning for something else.

This desire led Mirrlees to consider exploring means of redistribution beyond the income tax. Murphy and Nagel double down on using the income tax notwithstanding its inefficiency to this end. What Murphy and Nagel's critique calls for (again assuming that Mirrlees is right in his basic analysis of the optimal marginal tax rate schedule) is the articulation of a clear goal that would justify spending money just to take money from the rich—a redistributive goal that would trump revenue raising. To be clear, the money that would be raised from these redistributive taxes ("high marginal tax rates") could be given to the poor. But because "high marginal tax rates" are not the most efficient way to raise that amount of money, there would be a greater social cost incurred. The benefit of this cost is the greater taking away from the upper income that would obtain under the inefficient high marginal tax rate. In sum: *we would be spending resources strictly to take from the rich*. The paradox requires theory to give reasons to do so.

B. The Paradox in Practice: The Means Shape the Ends

The paradox haunts theory because it seems to rule out taxing the rich at all, as long as the goal of redistribution is to help the not-rich, as it plausibly is. Practice, for whatever reason (we speculate on some of the reasons that practice might follow theory in the next Part), has followed suit, producing a flattened wage tax system and no effective taxation of the rich. To complete the feedback loop between theory and practice, normative theory has begun to accept the constraints of practice and hence to make policy recommendations in their light, conceding the

Figure 3: Mirrleesian Tax Plus Credit, Shifted Up



paradox. Contrary to ideal reasoning, a sense of the available means—flattened wage taxes—has begun to shape our sense of available ends.[60]

Consider the current tax system with its central paradox that taxing the rich costs resources that could be used to help all. What can a reformer who wants to increase resources for the not-rich do? The answer is to raise the levels of both sides of Figure One, producing the shifted-up Figure Three:

The credit level on the right has moved up, meaning that more resources (here again in the form of a lump-sum credit) have gone to all. And to pay for this improvement, an "optimal" income tax form is used. The flattened tax rate structure on the left simply increases, still being the most efficient way to finance the credit.

Once again, such a "shift up" strategy *is* redistributive. Table Two repeats Table One but with a "shifted-up" flat tax rate of 30% and lump-sum credit of $30,000. Compared to Table One, the redistribution is greater: now from the same beginning, pre-tax distribution of $10,000, $100,000, $1,000,000, we proceed to an end state, post tax-and-transfer distribution of $37,000; $100,000; $730,000. The change will be costly, because the sum of dollars in the world of Table Two is less than that in Table One on account of the efficiency losses generated by the higher

60. *See* Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 Nat'l Tax J. 139, 148 (1989); Thomas D. Griffith, *Should "Tax Norms" Be Abandoned? Rethinking Tax Policy Analysis and the Taxation of Personal Injury Recoveries*, 1993 Wis. L. Rev. 1115, 1152–55 ("[T]he policy-maker should adopt explicit normative goals. Next, she should choose a tax base which will help achieve those goals.").

Table 2: Redistribution with 30% Tax/$30,000 Credit

Wages	Tax	Credit	Net Payment (Receipt)	Effective Tax Rate	Marginal Tax Rate	After Tax and Credit
10,000	3000	30,000	(27,000)	(270)	30	37,000
100,000	30,000	30,000	0	0	30	100,000
1,000,000	300,000	30,000	270,000	27	30	730,000

marginal tax rate. Again, redistribution costs money. But there is "more" redistribution.

Increasingly, scholars have built this "shift up" strategy into their normative recommendations for real-world politicians. Tony Atkinson, a distinguished British economist who devoted much of his professional life to the problems of inequality and taxation, captured the simplified essence in his Flat Tax/Basic Income proposal, hewing close to the Mirrleesian lump-sum credit.[61] In the real world, redistribution continues to occur more often in kind (state provided health, education, welfare) but the idea of flat or flattened wage taxes financing greater social spending in the name of progressivity and redistribution has taken root. Richard Bird and Eric Zolt have developed the argument in the developing nations context, where the importance of a maximin project may be greater, and the need for meeting *other* norms of redistribution (which will be costly) lesser, than in the United States or other developed economies: "[i]n sum, the most effective way to reduce inequality is not through taxation but rather through spending programs targeted at the poor."[62] The late Edward Kleinbard had begun making a similar argument in the domestic context before his untimely death:

> There may be a case for very high marginal income tax rates to address other social issues, like the concentration of power among the wealthiest, but when it comes to maximizing the welfare of most Americans, what we need are adequate revenues from all sensible sources combined, imposed at reasonably progressive rates, without excessive reliance on very high top tax rates alone to fill the bucket.[63]

61. Atkinson, *supra* note 36.

62. Bird & Zolt, *supra* note 37, at 81.

63. Edward D. Kleinbard, What's Luck Got To Do With It? How Smarter Government Can Rescue The American Dream 219 (2021).

Kleinbard here states the project for redistribution going forward, to make the "case for very high marginal income tax rates to address other social issues," but puts it aside in the interests of "maximizing the welfare of most Americans." This is of course the paradox: we cannot afford to tax the rich now, because we must first attend to the "welfare of most Americans," and taxing the rich will not directly help them. Meantime, whatever redistribution we do—whatever money the government spends on the poor—gets financed by a mix of mostly flattened wage taxes ("reasonably progressive rates").

Getting resources to the poor is important. But it is not the only sense of redistribution, as Mirrlees suggested and Kleinbard agrees. To make matters worse, we do not live in theory or on the blackboard. In the real world, decisions about large-scale tax and spending programs are made by representative legislative bodies loosely constrained by electoral politics. The current—and limited—set of tax tools, designed with one meaning of "redistribution"—getting resources to the not-rich—in mind, ends up pitting the working classes, who bear the burdens of the increased wage taxes, against the nonworking and under-employed poor. (Note by the way, as an artifact of the numbers chosen, that everyone making less than $100,000 "wins" in the move from Table One to Table Two; everyone making more than $100,000 from wages "loses.") In theory, as we have seen, the Mirrlees model reaches an equilibrium when the marginal costs on the tax side equal the marginal benefits on the credit side. In practice, we reach an equilibrium of sorts when the *political* marginal costs of raising taxes equal the *political* marginal benefits of raising spending. And our politics, if not our theories, are mediated by salience, bias, information asymmetries, and misinformation. It is certainly possible that we are redistributing fewer resources to the poor than ideal because the costs are being borne by workers least able to afford them. We return to this theme in Part IV.

C. The Orphaned Problem of Taxing the Wealthy

Back to the real world, as it has been informed and shaped by theory. The "Leave It to Tax" theorem told practice to look to tax to redistribute. When it did so, practice found Mirrlees and a roadmap: flat wage taxes plus social spending programs lead to the best of all possible worlds in terms of getting resources to the not-rich. Liberals and progressives have read the memo and now advocate raising flattened wage taxes to finance greater aid to the poor. This all seems sensible and even noble until one looks up and notices that nothing—at all—has been done about

taxing the wealthy. They pay no tax, in theory or in practice. How did this happen, and what can be done about it?

Theory, as we have been exploring, simply provides no tools for taxing wealth. Optimal income taxation recommends a regressive or flattened wage tax to pay for whatever redistribution society provides. Increasing redistribution under our current taxes raises the burdens on work and continues the non-taxation of wealth. The readily available toolkit for taxing the wealthy is empty: the richest Americans play *Buy, Borrow, Die* and pay nothing, and have done so forever.

Then there is another problem: money. The fundamental tension comes from the fact that *redistribution costs money*. Serving what many would consider to be *one* of the goals of redistribution, getting resources to the poor, does *not* lead to high marginal tax rates or any taxation of wealth at all. In fact, it suggests the kind of midrange flattened wage tax rates that we see over the last 40 years in America. Advancing any further redistributive goal will cost additional money and will require the use of a less efficient tax, driving the social cost up further. The benefits of such actions must spring from taking the wealthy down somehow, because they will not be the most efficient way to get resources to the poor, by stipulation.

This is where our analysis has led us. Is there hope for those still yearning for "redistributive progressive taxation" of a different sort than what we see today? Is there a "case" to be made for using tax to advance other redistributive goals? Yes, there is. The pathway out of our present morass—inertia is an attribute of a stable equilibrium—is to go back to first principles. Optimal tax analysis has provided us with the most efficient means to implement *one* sense of "redistribution," an important one as captured in Mirrlees's approach. But the continued laments, of Mirrlees himself, Murphy and Nagel, and many perhaps most ordinary citizens strongly suggest that there are *other* redistributive norms of interest. These norms center on taxing the rich for the sake of taxing the rich.

We return to the escape from the paradox in Part V. But first we get a better understanding of how deep and seemingly intractable the current paradox is. It has hamstrung tax and social policy in America forever.

IV. The Paradox Deepened

We started our intellectual journey with the *fact* that America does not meaningfully tax its richest citizens. This is a fact in need of further

exploration and explanation. The central theme of this Article is that the paradox that taxing the rich costs resources that could be used to help the not-rich helps to explain the actual, observed non-taxation of the rich. This Part sketches out this argument, showing how the paradox posed by theory has shaped the practice—and theory—of tax.

A. Three Ingredients of Tax Policy

Real world tax law comes about as a stew, once analogized by Michael J. Graetz as chicken soup,[64] a product of many diverse ingredients and many diverse cooks. But there are rather commonsensical reasons why the paradox of taxing the rich would cut through the fog of tax and lead to a political equilibrium—one that has existed at least since the founding of America—in which the rich are not meaningfully taxed at all: America's past and present status quo. Not-taxing-the-rich is a social policy overdetermined by multiple causes, and we are not here offering a formal model of a game-theoretic social equilibrium. Instead, we consider the role of three factors affecting tax policy—efficiency, salience and political economy—against the backdrop of actual tax law today, to get a better sense of how deep and seemingly intractable the paradox's grip on us is.

1. Efficiency

There is an obvious reason why a representative democracy would tend towards efficient revenue-raising tax systems: money. It is hard, politically, to raise taxes. Politicians have an incentive to support efficient taxes, to buy their government dollars as cheaply as possible in terms of social cost. Inefficient taxes, by definition, cost real resources, and the absence of this social wealth can hurt incumbent politicians. Reality matters.

In the now familiar logic, if the government does not meet its revenue needs in the most efficient manner, it is leaving money on the table. In the end, the optimal income tax models show us how to raise money—for *any* reason—from a wage tax. Hence the flattened wage tax

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64. Michael J. Graetz, Opinion, *To the Point of No Returns*, N.Y. Times (Nov. 15, 2004) https://www.nytimes.com/2004/11/15/opinion/to-the-point-of-no-returns.html [https://perma.cc/VT8W-QRYG].

in the real world, and the "shift up" strategy for serving additional social spending needs.

The marginalist analysis of optimal tax theory produces this result. But it is not the only way in which efficiency analysis stands in the way of redistribution. A Paretian constraint would prevent lawmakers from taking any endowment from anyone: under this conceit, expectations can be altered, as when income tax rates change (before one decides to earn income or not), and the pre-tax distribution of income need not generate entitlements, but existing stores of wealth cannot simply be taken. Just as we are considering money, not utility, in the real-world settings of our practices, the real world does not have to abide by a Paretian constraint as religiously as neoclassical economic theory, including Kaplow and Shavell,[65] does. But in practice, the Fifth Amendment's Takings Clause[66] and Article I's prohibition on "direct" taxes without apportionment[67] raise barriers to certain forms of wealth taxation that would violate Pareto. The familiar "endowment effect" suggests heightened political psychological resistance to wealth taxation as well.[68]

Revenue- raising taxes are going to gravitate towards efficient taxes unless they are given a clear mandate not to do so. The goal of helping the poor does not provide such a reason. What Mirrlees showed is that if the charge given to tax is *just* to maximize the resources or credit level that can be given to all, flat or regressive wage taxes are

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65. See Louis Kaplow and Steven Shavell, *Any Non-Welfarist Method of Policy Assessment Violates the Pareto Principle*, 109 J. Pol. Econ. 281 (2001); see also footnote 9 and accompanying text, *supra*.

66. U.S. Const. amend. V.

67. The direct tax clause of the constitution reads: "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. Const. art. I, § 9, cl. 4. The definition of a "direct tax" was not provided, so that task was left up to the Court. Hylton v. United States, 3 U.S. 171 (1796). In that case, the Court construed the meaning of a "direct tax" quite narrowly, suggesting that only capitations and land taxes were direct taxes. *Id.* at 176–77. Later, *Pollock v. Farmers' Loan & Tr. Co.,* 158 U.S. 601, 637 (1895) expanded the definition of direct taxes to include taxes on personal property and income from personal property.

68. *See* Daniel Kahneman, Jack L. Knetsch, & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. Pol. Econ. 1325, 1344 (1990); Edward J. McCaffery & Jonathan Baron, *The Political Psychology of Redistribution*, 52 UCLA L. Rev. 1745, 1762 (2005).

optimal. Other goals need to be articulated, or the regressive tax/ progressive spending pair will continue.

2. Salience

> "Don't tax you, don't tax me. Tax the fellow behind the tree."
>
> Senator Russell Long[69]

In the political understandings of our observed practices, the reality of dollars and cents is filtered through the public *perceptions* of tax and spending programs. These can be distorted, actively or unwittingly, in various ways involving familiar cognitive tricks, such as the use of hidden taxes.[70] Perceptions matter.

People do not like to pay taxes. This simple and uncontroversial fact suggests that those taxes that are least *salient* or obvious and noticeable to people will be politically preferred.[71] In simple form, a representative democracy is likely to favor highly salient benefits and highly non-salient taxes.[72] We would expect to observe broad-based, low-rate taxes ideally paid by a third party. The payroll tax, the second major contributor of revenues (by far) in the U.S. federal tax system, accounting for some 36% of federal revenues,[73] meets this description perfectly. The "taxes" are called "contributions"; they are collected and

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69. 121 CONG. REC. S37708 (daily ed. Nov. 20, 1975) (statement of Sen. Russell Long).

70. *See* Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861, 1875 (1994) [hereinafter *Cognitive Theory and Tax*]; Edward J. McCaffery & Jonathan Baron, *Thinking About Tax*, 12 PSYCH PUB. POL'Y & L. 106, 119 (2006).

71. *See id.* at 1876; David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 TAX L. REV. 19, 24–25 (2011); Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 YALE J. REG. 253, 262–63 (2011); Edward J. McCaffery, "Behavioral Law and Economics: Tax," *in* OXFORD HANDBOOK OF BEHAVIORAL ECONOMICS AND THE LAW 599 (Eyal Zamir & Doron Teichman eds., 2014).

72. *See* Jonathan Baron & Edward J. McCaffery, *Starving the Beast: The Psychology of Budget Deficits*, *in* FISCAL CHALLENGES: AN INTERDISCIPLINARY APPROACH TO BUDGET POLICY 3 (Elizabeth Garrett et al. eds., 2008).

73. *Policy Basics: Where Do Federal Tax Revenues Come From?*, CTR. ON BUDGET & POL'Y PRIORITIES (Aug. 6, 2020), https://www.cbpp.org

paid by employers in the first instance; ordinary employees do not need to fill out forms or ever pay lump sums; the statute even calls for employers to pay one half of the total 15.3% burden, though standard economic theory shows that these sums must come out of the employee's real earnings.[74] A surprise may be that the personal income tax—the other major federal tax, accounting for 50% of federal revenues,[75] such that flattened wage taxes are at least 86% of the whole—is rapidly morphing into a similar form.[76] Some 95% of Americans either need not fill out an income tax form at all or can file a simplified, near postcard-sized return as non-itemizers.[77] The ease of doing so helps to explain the panoply of ads evident around tax-time with online and other tax preparation services offering to prepare tax returns for free.[78] For ordinary workers, taxes are withheld and paid by their employer at the source and the simple tax returns they need to file often produce refunds that bring happiness.[79] The personal income tax, for the overwhelming majority of Americans, is becoming a low-salient affair.

The general tendency towards low-salient taxes also favors a variety of lesser-noticed levies, as on alcohol, gas, cell phones, cigarettes and more.[80] These taxes will generally be low-rate, to serve efficiency

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/research/federal-tax/where-do-federal-tax-revenues-come-from [https://perma.cc/9KQZ-S9UE].

74. McCaffery, *Cognitive Theory supra* note 70, at 1876–79.

75. *Policy Basics: Where Do Federal Tax Revenues Come From?*, *supra* note 73.

76. *See* McCaffery, *supra* note 1, at 1284–85.

77. *See id.* at 1285.

78. *See, e.g.*, *TurboTax Free Edition*, Intuit Turbotax, https://turbotax.intuit.com/personal-taxes/online/free-edition.jsp [https://perma.cc/ZC2V-JMNP]; *Credit Karma Tax*, Credit Karma, https://www.creditkarma.com/tax [https://perma.cc/6WYC-SUPW]; *H&R Block*, H&R Block, https://www.hrblock.com/lp/tax-filing [https://perma.cc/LF3A-Q6FX].

79. *See* Utpal Dholakia, *Why Do People Like Getting Tax Refunds?*, Psych. Today (Mar. 18, 2019), https://www.psychologytoday.com/us/blog/the-science-behind-behavior/201903/why-do-people-getting-tax-refunds [https://perma.cc/FP5G-GGAP].

80. *See* Laurent Belsie, *Hidden Taxes Are Easier to Raise*, Nat'l Bureau Of Econ. Rsch. (Nov. 2007), https://www.nber.org/digest/nov07/hidden-taxes-are-easier-raise [https://perma.cc/W9SG-B9MW]; *Hidden Federal Taxes You Pay*, Intuit Turbotax (Dec. 1, 2022, 9:19 AM), https://turbotax.intuit.com/tax-tips/fun-facts/hidden-federal-taxes-you-pay/L1AUxT585

and keep salience low; broad-based, to generate revenue and make them worth the candle; and paid by third parties, to further suppress their salience and lower the compliance and administrative costs of the tax. Such taxes—and accounting adjustments that work like tax increases or spending decreases—form a major part of tax politics today.[81]

In contrast, any tax meant to serve a redistributionist goal other than the maximin project—ends that require strictly taxing the rich—will be highly salient. Such taxes will have a narrow base, the wealth or income of the wealthiest; and likely will feature high rates, as the redistributionists desire, efficiency be damned (even a 2% wealth tax is a high rate on the returns to capital, as we shall see in the next part). The targets of these redistributive progressive tax increases will be well known and aware of what is coming: a tax designed to eliminate billionaires will be highly salient to billionaires. Nothing hidden there.

The differential salience of different tax increases affects the politics of tax reform. When President Obama faced a "fiscal cliff" at the end of 2012, and the federal government needed $1.6 trillion to close a budget shortfall, Obama and the Congress ultimately met their mark.[82] But they only announced some $600 billion in increased taxes, from modest moves such as restoring the top marginal income tax rate bracket to 39.6%, from 35%, on incomes above $400,000.[83] They also *weakened* the gift and estate tax, especially by re-unifying and hence increasing

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[https://perma.cc/6755-XWM8]; Edward J. McCaffery, Opinion, *Why You Pay Hidden Cell Phone Tax*, CNN (Aug. 21, 2013, 12:11 PM), https://www.cnn.com/2013/08/21/opinion/mccaffery-mobile-charges/index.html [https://perma.cc/D7CF-7Z4N].

81. *See* Christopher J. Napier & Christian Stadler, *The Real Effects of a New Accounting Standard: The Case of IFRS 15* Revenue from Contracts with Customers, 50 Acct. & Bus. Rsch. 474, 476 (2020); David Trainer, *How Companies Implemented the New Revenue Recognition Standard*, Forbes (Oct. 10, 2019), https://www.forbes.com/sites/greatspeculations/2019/10/10/how-companies-implemented-the-new-revenue-recognition-standard/?sh=43c7c282920e [https://perma.cc/5KU6-2VNH].

82. Edward J. McCaffery, *Taxing Wealth Seriously*, 70 Tax L. Rev. 305, 338 (2017) [hereinafter McCaffery, *Taxing Wealth Seriously*].

83. *Id.*; Matt Smith, *Obama Signs Bill Warding Off Fiscal Cliff,* CNN: Politics (Jan. 3, 2013), https://www.cnn.com/2013/01/02/politics/fiscal-cliff/index.html [https://perma.cc/WBR7-P8DQ]; American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013).

the *gift* tax exemption, to $5 million per person, indexed for inflation.[84] Where did the "other" $1 *trillion* come from? The answer is from the expiration of Obama's "payroll tax holiday," a 2% in absolute terms reduction in the employee's share of the payroll tax, in place for just two years from 2010 to 2012 (the *only* time in the payroll tax's near ninety years of existence that its rates had been cut at all).[85] Quietly raising $1,000,000,000,000 from effectively raising the wage tax by 2% for all workers brought in significantly more money than loudly tinkering with the rules affecting the rich. And of course, nothing at all was done about *Buy, Borrow, Die*.[86]

In the end, salience poses a warning for advocates of redistributive progressive taxation. In a cautionary note, polling tends to show support for the *general* idea of taxing the rich more, but then to show opposition to *particular* means of doing so, such as via a "death" or estate tax.[87] Wealth taxes, popular in some polls, end up being

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84. Edward J. McCaffery, *Distracted from Distraction by Distraction: Reimagining Estate Tax Reform*, 40 Pepp. L. Rev. 1235 (2013).

85. McCaffery, *Taxing Wealth Seriously*, *supra* note 82, at 350–52.

86. *Id.*

87. In a Pew Research poll, 81% of responders reported being bothered to some degree that the wealthy do not pay their fair share of taxes. Amina Dunn & Ted van Green, *Top Tax Frustrations For Americans: The Feeling That Some Corporations, Wealthy People Don't Pay Fair Share*, Pew Rsch. Ctr. (Apr. 30, 2021), https://www.pewresearch.org/fact-tank/2021/04/30/top-tax-frustrations-for-americans-the-feeling-that-some-corporations-wealthy-people-dont-pay-fair-share/ [https://perma.cc/TMW7-QN94]. However only 32% of people support increasing the estate tax and at least 31% want to eliminate it altogether. Matthew Sheffield, *Polls: Hiking Estate Tax Less Popular Than Taxing Mega Wealth, Income*, The Hill (Feb. 15, 2019), https://thehill.com/hilltv/what-americas-thinking/430224-polls-increasing-inheritance-taxes-is-less-popular-than-taxing [https://perma.cc/X5W2-EFMS]. *See also Latest Massacre Drives Gun Control Support to New High, Quinnipiac University National Poll Finds; Voters Reject GOP Tax Plan 2-1*, Quinnipiac University: Poll (Nov. 15, 2017), https://poll.qu.edu/Poll-Release-Legacy?releaseid=2501 [https://perma.cc/G83E-B3QL] (showing 48% of people surveyed think it would be a "good idea" to repeal the estate tax). One reason is the "identifiable victim" effect. George Loewenstein, et al., *Statistical, Identifiable, and Iconic Victims*, *in* Behavioral Public Finance 32 (Edward J. McCaffery & Joel Slemrod eds., 2006).

repealed in states that have them, including Piketty's native France.[88] Before tax policy can help to eliminate billionaires, we will all have to watch a lot of political advertisements and see a lot of billboards making the invocation of redistributive progressive taxation highly salient, indeed.

3. Political Economy

Finally, everything—real and perceptual, theoretical and actual—gets run through the wringer of our actual political processes, raising concerns of political economy. Politics matter.

And in politics, of course, money matters. Politicians today raise and spend massive sums each electoral cycle. And the rich are more than happy to spend money *not* to be taxed. The not-rich are not.

Consider the Mancur Olson conditions for special interest group formation: a small group with high stakes in an outcome.[89] A large group with small stakes—like the tens of millions of ordinary workers seeing their payroll taxes increase by 2% after the fiscal cliff fix discussed above—will be hard pressed to organize itself, given the high transaction costs of group formation, the low per capita stakes, and the pernicious effects of free-riding.[90] The high efficiency and low salience of such taxes further their allure. The principal constraint on the government's tendency to keep expanding with highly salient benefits and less-salient taxes comes at the ballot box, where outcomes are mediated by the influence of money and misinformation. Left with only the tools of efficient taxes—flattened wage taxation—ordinary ballot-box politics

88. See Daniel Bunn, *What the U.S. Can Learn from the Adoption (and Repeal) of Wealth Taxes in the OECD*, Tax Found. (Feb. 5, 2021), https://taxfoundation.org/wealth-taxes-in-the-oecd/ [https://perma.cc/HF5N-C37L]; Greg Rosalsky, *If a Wealth Tax is Such a Good Idea, Why Did Europe Kill Theirs?*, Npr: Planet Money (Feb. 26, 2019), https://www.npr.org/sections/money/2019/02/26/698057356/if-a-wealth-tax-is-such-a-good-idea-why-did-europe-kill-theirs [https://perma.cc/4WEV-S3MB].

89. Mancur Olson, The Logic Of Collective Action: Public Goods And The Theory Of Groups (1965). *See also* Edward J. McCaffery and Linda Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. Rev. 1159 (2006); McCaffery & Jones, *Curiouser and Curiouser*, *supra* note 3.

90. *See* Garrett Hardin, *The Tragedy of the Commons,* 162 Sci. 1243 (1968); *see generally* Olson, *supra* note 89.

pits the working middle class against the nonworking poor. Republicans paint Democrats as "tax and spenders," with an emphasis on the "tax," and Democrats paint Republicans as tax-cutting fanatics who refuse to spend more on the middle class.[91] This dynamic has not favored taxes that fall on the rich, as we can see.

The political economy of any tax targeted at the rich is quite different. The Mancur Olson conditions are met: we have a small group with high stakes. There is indeed abundant evidence that the wealthy spend heavily to prevent being taxed heavily.[92] These facts give politicians an incentive to string the situation along—to use the *possibility* of taxing the rich as an opportunity to get paid *not* to do so.[93] That politicians can do this while *also* maintaining benefits at an acceptable level through less-salient, more-efficient taxes makes the game more than worth the candle. The "reverse Mancur Olson" dynamic, in which politicians set the stage for ex ante rent extraction from the wealthy, seems to be going on with the estate tax, which has seen dramatic calls for its repeal ever since at least 1994, yet which remains on life support.[94] The rich pay a lot of money to weaken it; banks, trust and insurance companies, and large nonprofits (benefitted by the charitable contribution

91. *Compare* Senator Mitch McConnell, Remarks to the U.S. Senate, *All 50 Senate Democrats to Back Chairman Sanders' Reckless Taxing and Spending Spree* (Aug. 8, 2021), https://www.republicanleader.senate.gov/newsroom/remarks/all-50-senate-democrats-to-back-chairman-sanders-reckless-taxing-and-spending-spree [https://perma.cc/S973-THZL] ("The Democrats want to . . . begin pushing through a reckless taxing and spending spree that was authored by our self-described socialist colleague Chairman Sanders.") *with* Senator Chuck Schumer, Remarks to the U.S. Senate, *Schumer Floor Remarks on the Republican Tax Bill* (Nov. 29, 2017), https://www.democrats.senate.gov/newsroom/speeches/schumer-floor-remarks-on-the-republican-tax-bill [https://perma.cc/6VL3-56A2]("Republicans are willing to paper over their serious reservations with [TCJA] in order to just get something done. They're willing to look past the fact that 60% of middle-class families will see a tax increase at the end of the day; that healthcare premiums will rise 10%, and 13 million fewer Americans will have insurance.").

92. *See, e.g.*, *The Secret IRS Files, supra* note 1.

93. McCaffery & Cohen, *supra* note 89, at 1165–76; McCaffery & Jones, *supra* note 3.

94. *Id.*; Edward J. McCaffery, *The Dirty Little Secret of (Estate) Tax Reform,* 65 Stan. L. Rev. Online 21 (2012) [hereinafter *Dirty Little Secret*].

deduction from the tax) pay a lot of money to keep it.[95] The same dynamic is present in the case of "carried interest," a tax preference benefitting billionaire hedge fund managers, where inaction has also persisted for decades.[96] There is no strong reason to think that this game will ever end. So, too, if any Democratic president were able to implement a wealth tax, for example, can there be any doubt that there would be plenty of campaign funds available for Republicans seeking to repeal it at the very next election and beyond? In contrast, there has not been a loud outcry to restore the 2% payroll tax holiday.

Redistribution is costly. The threat of redistributive progressive taxes awakens the wealthy and motivates them to spend lots of money on politics, a fact that politicians appreciate. A political equilibrium that features periodic *talk* of taxing the rich but little real *action* keeps plenty of money in politics. A century and counting of *Buy, Borrow, Die* suggests that this dynamic will not be easy to change.[97]

B. The Political Equilibrium of Not Taxing the Rich

It is easy to put the three elements together to see how hard it is to escape the paradox of not taxing the rich. Governments need money and all things being equal will tend to raise money in the most efficient manner. Political psychology suggests a democratic tendency towards low salient taxes and high salient benefits. Considerations of political economy suggest that the gains or economic rents from *not* taxing the rich can be shared between the rich and politicians, with the latter getting their payday via outsized campaign contributions. Wage-earners are taxed; the rich are not taxed much at all, although they might be *threatened* with taxes that they must pay politicians to avoid. All the while, an equilibrium of flattened low salient wage taxes continues to finance salient benefits.

A century, at least, of American tax policy confirms the power of these forces. *Buy, Borrow, Die* has been in existence, mooting the taxation of capital and hence of the rich, ever since the *Macomber* decision in 1920. Marginal rates under the remaining "income" tax drifted up during wartimes, persisting at 90% or higher from World War II until

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95. *Dirty Little Secret*, *supra* note 94; Graetz And Shapiro, Death By A Thousand Cuts (2006).

96. McCaffery & Jones, *Curiouser and Curiouser*, *supra* note 3.

97. *Taxing Wealth Seriously*, *supra* note 82.

1963, and then at 70% until Ronald Reagan in the 1980s. But these nominally high marginal rates were not "real" because of the panoply of shelters, deductions, and credits that could effectively lower them. Still the inefficiencies of tax set the stage for a reset. Reagan and his followers could cut tax rates without much reducing tax revenues, as by broadening the income tax's wage base and dramatically increasing the payroll tax. The system moved even further to a flattened wage tax, an optimal tax result. From there, Democratic Presidents Clinton, Obama, and Biden could at times *threaten* to tax the rich, but these efforts came up short, undermined by the campaign contributions reaped by those willing to oppose the moves. Perhaps most surprising of all—though it should not be—President Trump and Republicans in the House and Senate were able to cut taxes *for the rich* in 2017, notwithstanding a century long trend of not meaningfully taxing them in the first place, by slashing the corporate income tax, which falls in the first instance only on capital, not wages.[98] All the while nothing, at all, has been done to shut down *Buy, Borrow, Die*. America's richest continue to pay no tax.

C. A Ray of Hope?

Amidst the mishmash of our actual tax politics, one ray of hope shines through for the advocates of taxing the rich: the Congressional budget *scoring* rules. Number such as the $1.6 trillion needed at the fiscal cliff fix, or the $1.5 trillion tax cuts of the TCJA, or the $3.5 trillion once thought to be needed to meet the Democrats' hoped-for reconciliation target under the Inflation Reduction Act, are projections over the upcoming ten years.[99] Different scoring models can be used, and Republicans in particular have long advocated for the use of "dynamic" scoring,

98. *Id.*

99. Douglas W. Elmendorf, *"Dynamic Scoring": Why and How to Include Macroeconomic Effects in Budget Estimates For Legislative Proposals*, 2015 Brookings Papers On Econ. Activity 91, 94, https://www.brookings.edu/wp-content/uploads/2015/09/ElmendorfTextFall15BPEA.pdf [https://perma.cc/L6W3-SZBG] (indicating that the CBO and JCT compare the effects of a legislative proposal relative to a baseline—CBO's projection of what would occur in the absence of the proposal—which encompasses the current fiscal year and each of the ten subsequent years); Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, 99 Stat. 1037 (1985).

which would allow them to add in revenues from projected economic growth each time they cut taxes, bringing efficiency analysis even further into practical politics.[100] Ultimately, the scoring numbers that Congress must use come from the nominally independent Congressional Budget Office (CBO).[101]

The hope comes from the fact that progressive taxes may *score* well. Although economists generally consider them inefficient, and although countries around the world have abandoned them in part because they do not, in fact, end up producing much revenue,[102] it is easy enough to point to vast sums that can be raised by wealth taxes because there is vast and concentrated wealth. The Sanders campaign, for example, scored its own tax plans as bringing in more than $4 trillion over a ten-year period; the independent Penn Wharton Budget Model put the

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100. The use of dynamic scoring has grown controversial because a budget score can alter public perception of a bill, and there are various ways to manipulate budget scores, *e.g.*, treating changes that raise revenues initially as "tax increases" even though these changes lose revenues later, phasing in costly provisions to avoid shedding light on the full cost (at least within the budget window). Nathaniel Frentz & Chye-Ching Huang, *Four Timing Gimmicks That Could Disguise Fiscally Irresponsible Tax Reform*, Ctr. On Budget & Pol'y Priorities (October 30, 2013), http://www.cbpp.org/cms/?fa=view&id=4041 [https://perma.cc/4VWF-74BL]; Paul N. Van de Water & Chye-Ching Huang, *Budget and Tax Plans Should Not Rely on "Dynamic Scoring": Estimates Are Highly Uncertain and Subject to Manipulation*, Ctr. On Budget & Pol'y Priorities (November 17, 2014), https://www.cbpp.org/sites/default/files/atoms/files/10-18-11bud.pdf [https://perma.cc/UQM9-Q9GP]. *See generally* Tax Pol'y Ctr., *What are dynamic scoring and dynamic analysis?,* Tax Pol'y Ctr. Briefing Book (last updated May 2020), https://www.taxpolicycenter.org/briefing-book/what-are-dynamic-scoring-and-dynamic-analysis [https://perma.cc/K6UB-AT3Z].

101. Elmendorf, *supra* note 99, at 95 (describing the CBO and JCT's reliance on a broad range of evidence, including their own formal statistical analyses and anecdotal information obtained from government agencies and private businesses).

102. Hannah Murphy & Mark John, *France Waves Discreet Goodbye to 75 Percent Super-Tax*, REUTERS (Dec. 23, 2014, 10:25 AM), https://www.reuters.com/article/us-france-supertax/france-waves-discreet-goodbye-to-75-percent-super-tax-idUSKBN0K11CC20141223 [https://perma.cc/MDJ7-EC7K].

figure closer to $3 trillion.[103] That is still a nice piece of change, and one far in excess of the $14 billion expected to be raised over a decade from limiting the "carried interest" loophole for example.[104]

The purely political benefits of these scoring figures, combined, perhaps, with the greater salience brought to the utter non-taxation of the wealthy under the media's discussions of *Buy, Borrow, Die,* mean that we might at last be at a moment for more progressive taxation to take root. Still, a brief scan of tax history interjects reasons for caution: *Buy, Borrow, Die* has entered its second century of existence wholly intact.[105] And, as the Article noted at the outset, there were *no* significant tax increases on the rich in the first two years of the Biden presidency,[106] after which Biden, like his predecessors Clinton and Obama, lost having his party control both chambers of Congress. Scoring estimates that do not materialize are short-term mechanisms; ultimately, the truth of efficiency, and real dollars and cents, emerges. Wealth taxes that do not actually produce revenues are easy enough to repeal, as France among other places has found.

In sum and in short, the paradox endures.

V. The Paradox Recast

Many ordinary citizens desire more taxing of the rich.[107] Our academic theories at first seem to support the idea ("Leave It to Tax") and have

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103. Thomas Franck, *Bernie Sanders' Wealth Tax Would Raise $1 Trillion Less than He Estimates, Wharton Study Shows*, CNBC (Jan. 23, 2020, 12:06 AM), https://www.cnbc.com/2020/01/22/wharton-study-bernie-sanders-wealth-tax-would-fall-1-trillion-shy.html [https://perma.cc/9X5L-XEPJ].

104. Inflation Reduction Act One Page Summary (senate.gov [https://perma.cc/CCA2-VKG2])

105. *Taxing Wealth Seriously*, *supra* note 82.

106. A modest exception is the new corporate alternate minimum tax. Time will tell how effective this tax will be, if and when it ever becomes operative. But it is worth noting its limited domain: public companies with book income in excess of $1 billion a year, about 200 corporations in all. The $200 billion ten-year scoring is a fraction of the corporate revenues *cut* by the TCJA.

107. In a poll, 64% of their 4,441 respondents agreed to some degree that "the very rich should contribute an extra share of their total wealth each year to support public programs." Howard Schneider & Chris Kahn, *Majority of Americans favor wealth tax on very rich: Reuters/Ipsos poll*, REUTERS

apparently provided a roadmap for getting resources to all (optimal income tax). Yet our actual tax system does not tax the richest Americans and disappoints even the academics. What is going on?

The problem lies in what we are looking for. Optimal income tax theory's sense of "redistribution" involves getting the highest level of material resources, money, consumption levels, to the lowest income citizens without sacrificing aggregate welfare. We call this approach an "efficient maximin:" maximizing the minimum consumption levels of all.[108] The Mirrleesian models set a universal minimum consumption level via a lump-sum credit. This level is "maxed out" at the point where the marginal costs from further raising the tax rate on the left-hand side of the bifurcated panel equate with the welfare gains, under a weighted social welfare function, from raising the consumption level on the right-hand side. Mirrlees lamented that, even under progressively weighted

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(Jan. 10, 2020, 3:05 a.m.), https://www.reuters.com/article/us-usa-election-inequality-poll/majority-of-americans-favor-wealth-tax-on-very-rich-reuters-ipsos-poll-idUSKBN1Z9141 [https://perma.cc/3QX7-6YHB]. In a Hill-HarrisX poll of 2,839 registered voters, 56% of people said, "wealth inequality is a significant problem facing the country and billionaires paying a wealth tax is a part of the solution." Gabriella Schulte, *Poll: Majority Say Wealth Tax is Part of the Solution to Wealth Inequality,* The Hill (Mar. 11, 2021), https://thehill.com/hilltv/what-americas-thinking/542914-poll-majority-say-wealth-tax-is-part-of-the-solution-to-wealth [https://perma.cc/5XK6-6X2Z]. *See also* Elizabeth Warren, *A Wealth Tax on Ultra-millionaires is a Winning Strategy for Democrats*, Data For Progress (Mar. 1, 2021), https://www.dataforprogress.org/blog/2021/2/22/warren-wealth-tax-winning-strategy [https://perma.cc/7CEE-6Q4Y] ("My proposal is supported by 81 percent of Democrats, 66 percent of Independents, and 57 percent of Republicans."); Ben Casselman & Jim Tankersley, *Warren Wealth Tax Has Wide Support, Except Among One Group*, N.Y. Times (Nov. 29, 2019), https://www.nytimes.com/2019/11/29/business/economy/economy-politics-survey.html [https://perma.cc/6RBC-8VQN] ("Three-quarters of Democrats and more than half of Republicans say they approve of the idea of a 2 percent tax on wealth above $50 million."); Geoff Colvin, *The Rising Interest in a Wealth Tax*, FORTUNE (Apr. 2, 2021, 11:00 a.m.), https://fortune.com/2021/04/02/wealth-tax-bill/ [https://perma.cc/26Q9-6N98] ("A 2019 poll found that 74% of registered voters, including 65% of Republicans, favored the Warren tax.").

108. *See* John C. Harsanyi, *Can the Maximin Principle Serve as a Basis for Morality? A Critique of John Rawls's Theory*, 69 Am. Pol. Sci. Rev. 594 (1975); *see also* Bankman & Griffith, *supra* note 12, at 1915–16 (discussing "leximin").

welfare functions, his model did not produce a particularly high credit level: not enough to live on. Still, details aside, Mirrlees's general approach is to efficiently meet a maximin goal.

Key to the path away from the paradox—or away from the constraining grip of the paradox on our actual practical tax politics—is to accept that taxing the rich *is not about directly helping the not-rich*. We must be willing to have fewer resources to help the poor if we want to tax the rich. There are indeed *other* goals of redistribution, and ordinary moral intuitions supporting their invocation, such as "breaking up large concentrations of wealth," or getting everyone to pay their "fair share." What is needed is a strong consensus on one or more such ends, and a commitment to obtaining them despite their cost.

This Section turns to a discussion of these alternative ends, painting a way to accept the paradox and move beyond it.

A. The Optimal Form of Optimal Tax

First, consider the general logical framework for thinking about tax and *any* social goal. To begin, we need an end, a purpose. There is nothing in the word "tax" that can set a goal for practical tax systems; tax must look to the political system to do so.

Mirrlees took the *end* of the tax system in his explorations to be maximizing society's minimum consumption level. This *end* produced an optimal *means* of flattened wage taxation. Now under the paradox those unhappy with what Mirrlees and company have produced have to answer a different question than Mirrlees did, setting a redistributive goal other than one of maximizing the minimum consumption level. Making this task more challenging, there are many different philosophical approaches to the question, many different senses of "redistribution," and many different reasons for taxing the rich. In social contractarian theory at least, an "overlapping consensus" of reasonable citizens and lawmakers must agree on a plan going forward.[109] We do not pretend to be the final arbiter of what redistributive measures society wants; we mean instead to point to the need for articulating ends,

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109. The concept of an "overlapping consensus" derives from John Rawls, A Theory Of Justice (1971) [hereinafter Rawls, A Theory Of Justice]; John Rawls, *The Domain of the Political and Overlapping Consensus*, *in* Debates In Contemporary Political Philosophy: An Anthology 171-193 (Derek Matravers and Jon Pike eds., 2003).

and to sketch out both the general form of and the wide range of possible ones.

B. The Many Ends of Redistribution

This section offers a brief and non-exhaustive taxonomy of types of answers to the question of why we should consider taxing the rich strictly to tax the rich.

1. Efficient Maximin

We have been calling what optimal income tax analysis produces an "efficient maximin." The lump-sum credit provides the social minimal consumption level, what a non-working citizen receives each year. The goal of optimal tax is to raise this level as high as possible without losing welfare. Someone somehow chooses a social welfare function and then we turn to tax to efficiently raise the funds for the lump-sum credit.

By stipulation, this two-step tax-and-spend process gets the most resources to the poor. The "shift up" strategy discussed in Part III shows how optimally to raise society's minimal consumption level and hence redistribute more, using flattened wage taxes. Once again, this is a meaningful sense of "redistribution" that sets an important baseline for all *other* norms of redistribution: these other ends are *not* just about giving more resources to the poor. They are also about taking from the rich, and they will cost money over and above what is needed to meet the maximin goal. That is the paradox under present law.

2. Relative Utilities

Mirrlees and company demonstrate that utilitarian theory using traditional, neoclassical welfare economics methods does not produce arguments for progressively high marginal tax rates or for taxing capital. A core assumption of the classic models is that individuals are discrete and independent actors. Giving an extra dollar to *anyone* cannot possibly lower utility in such a model. Letting the rich get richer is not doing any direct harm.

Utilitarian social theorists unhappy with the results of optimal income tax models, and unwilling or unable to challenge them on their own terms, as Diamond and Saez and others have done, look to relax or change altogether certain elements of the mainstream models. A core critique is against the idea of independent utility functions. We know

that any redistributive goal other than maximizing the resources given to the poor must involve a taking from the rich—the use of a tax that is *inefficient* as a revenue-raiser compared to the maximin approach. Under independent utility functions, this is a hard argument to make because a dollar given to anyone cannot lower aggregate welfare. The common element of a "relative utility" or interdependent utilities approach is in contrast to see harms to *others* from a particular citizen's greater wealth. As some get richer, aggregate social utility or welfare falls because of this interdependence; giving one more dollar to a rich person can be a bad thing from the social point of view. It would be better to burn the extra dollar.

There are many reasons this might be the case. Traditional welfare economics analysis rules out envy in its standard "no envy" condition,[110] but others question this, finding that there can be understandable or excusable envy that causes a fall in utility when the rich get richer.[111] Other models look to "sympathy" or "warm glow" effects whereby the wealthy gain in utility from greater equality even with a fall in their own material resources.[112] We might think of the income distribution itself as a "public good," because all citizens live in a society with the same distribution of resources, such that there might be "negative externalities" from increasingly concentrated wealth.[113] Other theorists and models consider that welfare or happiness is intrinsically relative, such that the poor in an unequal society are more unhappy than the poor in a society of greater equality, even given a greater objective resource level, the so-called Easterlin paradox.[114]

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110. *See generally* Duncan Foley, *Resource Allocation and the Public Sector*, *in* Yale Econ. Essays 45 (7th vol. 1967); *see also* Bankman & Griffith, *supra* note 12, at 1961–62.

111. *See* Robert Young, *Egalitarianism and Envy*, 52 Phil. Studies: An Int'l J Phil. Analytic Tradition 261 (1987); Bankman & Griffith, *supra* note 12, at 1961–62; Rawls, A Theory Of Justice, *supra* note 109 at 468 (describing "excusable" or "justifiable" envy).

112. Bankman & Griffith, supra note 12, at 1961–62; P. A. Diamond, *Optimal Tax Treatment of Private Contributions for Public Goods With and Without Warm Glow Preferences*, 90 J. Pub. Econ. 897 (2005).

113. Lester C. Thurow, *The Income Distribution as Pure Public Good,* 85 Q. J. Econ. 327 (1971); *see also* Stiglitz, *supra* note 5.

114. Andrew E. Clark et al., *Relative Income, Happiness, and Utility: An Explanation for the Easterlin Paradox and Other Puzzles*, 46 J. Econ. Lit. 95 (2008). *See generally* Richard A. Easterlin, *Does Economic Growth Improve the*

Any such theory will stand out of the mainstream of contemporary welfare economists, in no small part because it may risk violating the sacred Pareto condition by leading to the taking of endowments from some without any direct transfer of material resources to any. We are here giving only a loose and non-exhaustive discussion of a possible family of arguments for more progressivity in tax burdens. It is worth noting, however, that, like the weighted social welfare functions used in optimal tax analysis, there is no general practical way to adopt an "interdependent utility" model in our actual politics. But the idea that one person's gain could be another's loss, that we are one society in which adding more wealth to the wealthiest affects us all, stands behind many of the ordinary moral intuitions clamoring for something beyond flattened wage taxes. Such ideas deserve to be further modeled and better understood.

3. Taxing Privilege

The most persistent and compelling criticisms of the status quo in redistributive taxes come from those outside a narrow utilitarian tradition. Many are in the spirit of John Rawls's social contractarianism, an approach derived from Kant and the deontological status of citizens as free and equal moral beings.[115] Rawls sets out his two principles of justice in *A Theory of Justice:*

> (1) Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberties for all, and
>
> (2) Social and economic inequalities are to be arranged so that they are both (a) to the greatest benefit of the least advantaged and (b) attached to offices and positions open to all under conditions of fair equality of opportunity.[116]

Human Lot? Some Empirical Evidence, *in* Nations And Households In Economic Growth 89 (1974); Richard A. Easterlin, *Will Raising the Incomes of All Increase the Happiness of All?* 27 J. Econ. Behav. & Org 35 (1995).

115. See John Rawls, *Kantian Constructivism in Moral Theory*, 77 J. Phil. 515 (1980).

116. Rawls, A Theory Of Justice, *supra* note 109 at 83, 302 (1971).

Principle 2(a), namely that "economic inequalities are to be arranged so that they are . . . to the greatest benefit of the least advantaged," is often taken to be a maximin principle.[117] But Rawls' language in context is much more nuanced and richer than simply getting the highest level of material resources to the poor. Even under 2(a), "economic inequalities" must be arranged "to the greatest benefit of the least advantaged." But "economic inequalities" can do harm to the least advantaged other than by the failure to give more material resources to the poor: there are a wide range of instrumental and non-instrumental harms that can flow from concentrated wealth. And of course, such wealth, and the privileges it confers, can easily be in tension with the first, and lexically prior "equal basic liberties" principle. Rawls is concerned not just with material resources but with such "primary goods," objectively valued, as the "social basis of self-respect."[118]

Such concerns lead to a desire to tax the wealthy as a means of checking their power and privilege, to foster a range of liberal egalitarian values. Mirrlees himself concluded his "exploration" into optimal income taxation with a desire to find *other* taxes or means to meet "the great desirability of finding some effective method of offsetting the unmerited favours that some of us receive from our genes and family advantages."[119] Bruce Ackerman and Anne Alstott propose a "privilege" tax in their *Stakeholder Society* to meet just such a goal.[120] Ronald Dworkin and other scholars have looked to tease out the effects of "brute luck" in individuals' wealth levels, attempting to instantiate a norm of "luck egalitarianism" that would correct for arbitrary advantages

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117. See Michael Gardner, *Rawls on the Maximin Rule and Distributive Justice*, 27 Phil. Stud. 255, 256 (1975).

118. *See* Rawls, A Theory Of Justice, *supra* note 109 at 54. *See also* John Rawls, Justice As Fairness: A Restatement at 59-60 (1985). The sense of "objective" social values is derived from T.M. Scanlon, *Preference and Urgency*, 72 J. Phil. 655, 658–59 (1975).

119. *An Exploration in the Theory of Optimum Income Taxation*, *supra* note 12, at 208.

120. The "privilege tax" is a tax levied annually against taxpayers between the age of 21 and 67, with the amounts paid determined by how much the taxpayer's parents earned during their childhood. Ackerman and Alstott proposed three levels of taxation: $3,800 for those in the top 20%, $2,090 for those in the middle 60%, and $380 for those in the bottom 20%. Bruce Ackerman & Anne Alstott, The Stakeholder Society (1999).

and make differences be matters of choice and effort.[121] While such deontological norms overlap with the "fair share" norm discussed below, they are distinct in targeting the unearned privileges that come from good fortune. Like each norm other than the efficient maximin, they suggest taking from the rich even without corresponding redistribution to the poor.

4. Breaking up Concentrations of Wealth/"Eliminate Billionaires"

A goal of breaking up "concentrations of wealth," frequently mentioned by liberal politicians such as Senators Bernie Sanders and Elizabeth Warren, is conceptually distinct from concerns over "privilege" or "unearned" wealth. The worry over concentrated wealth or power is independent of any moral judgment about the pathways that produced the concentration, earned or not.

There are in fact a variety of instrumental (such as the effects on ordinary politics and free markets) and non-instrumental (such as the effects on basic human rights or dignitarian interests) harms that at least correlate with large private concentrations of wealth. The rather vague way in which this norm tends to be invoked illustrates the importance of greater specification in setting our redistributive ends. If the concerns are over the effects of unequal concentrations of wealth on ordinary politics or markets, then the end might be most efficiently reached through reform of other, nontax, laws, such as those regulating campaign financing or antitrust. On the other hand, tax might indeed be a better—optimal? —means to address these "other" problems, as in switching to a progressive *spending* tax to control political spending, an idea we pick up in Part VII.[122] We need more better theory.

Once again, the main point lies in the general form: first we must specify a specific redistributive end; then we consider how most efficiently to meet it. We will consider the goal of "breaking up

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121. *See* Ronald Dworkin, Sovereign Virtue: The Theory and Practice of Equality (2000); Jeesoo Nam, *Taxing Option Luck*, 11 U.C. Irvine L. Rev. 1067 (2021) (and sources cited therein); Kleinbard, *supra* note 63.

122. Edward J. McCaffery, *A Better Hope for Campaign Financing*, 52 Ariz. St. L.J. 445 (2020). We return to this theme briefly in Part VI C. The Tax Swallows its Tail., below.

concentrations of wealth" further below in the discussion of Bernie Sanders' wealth tax proposal, whose stated aim is to "eliminate billionaires,"[123] which would go some ways towards breaking up concentrations of wealth.

5. Destroying Capital

We are moving along a spectrum, considering how and why, if at all, to tax the rich. We now arrive at a kind of limiting case, invoking the celebrated power of tax to destroy.[124] We turn to the influential work of Thomas Piketty, whose bestselling *Capital in the Twenty First Century* includes an interesting argument for simply destroying capital in the name of justice and equality, and who remains active along with his students Emmanuel Saez and Gabriel Zucman in tax reform discussions today. Without getting overly technical, we illustrate the reasons why taxing private capital for no other reason than to reduce the capital stock might advance a sense of social justice.

The idea of simply "destroying capital"—not Piketty's locution, but our way to describe the argument—follows from the "first fundamental law of capitalism:"

$$\alpha = r \times \beta,$$

where α, the Greek letter alpha, is the share of national income paid over to capital, r is the rate of return on capital, and β, the Greek letter

123. Thomas Kaplan, *Bernie Sanders Proposes a Wealth Tax: 'I Don't Think That Billionaires Should Exist,'* N.Y. Times: Politics (July 16, 2020), https://www.nytimes.com/2019/09/24/us/politics/bernie-sanders-wealth-tax.html?smid=tw-nytpolitics&smtyp=cur [https://perma.cc/JCV9-JVA5] (remarking "I don't think that billionaires should exist" and "I hope the day comes when they don't"). *See also* Chris Cillizza, *Bernie Sanders Wants to Get Rid of Billionaires. All of Them.,* CNN (Sep. 24, 2019, 3:09 PM), https://www.cnn.com/2019/09/24/politics/bernie-sanders-ultra-wealth-tax-billionaires/index.html [https://perma.cc/T8KB-6CXJ] ("There should be no billionaires. We are going to tax their extreme wealth and invest in working people.").

124. McCullogh v. Maryland, 17 U.S. 316, 327 (1819) ("An unlimited power to tax involves, necessarily, a power to destroy; because there is a limit beyond which no institution and no property can bear taxation.").

beta, is the capital stock.[125] Piketty's first fundamental law is about how much capital and labor, the two great factors of production, get paid in a capitalist economy. This is merely an accounting identity, a matter of definition.[126] β, the capital stock, is itself a function of national income: a β of 600% means total national savings are six times national income; *r* is the real rate of return (taking out inflation), on average. The "first fundamental law of capitalism" then leaves α, which is the share of national income that must be paid over to capital.

If the rate of return *r* is 5%, as it often is and as Piketty generally uses, then the capital stock, which is 600% of (or six times) national income, must—by definition—be paid 5% × 600%, or 30%, *of the national income each year*.[127] This conclusion follows because the 600% means "600% of national income;" taking 5% of "600% of national income" leads to "30% of national income."[79] Because the sum of national income's ownership shares must be 100%, a capital share, α, of 30% means—again by definition—a labor share of 70%.[80] Of all the dollars earned in any given year, under the above facts, 30% gets paid out to the wealthy for the use of their capital, and 70% gets paid over to workers for their labor.[128]

Next comes a major payoff from Piketty's empirical and historical research. Over time and across nations, α (capital's share of income) has varied significantly from a high of more than 40% at the turn of the twentieth century, in the so-called *Belle Époque*, to a low of 20% or lower in the mid-twentieth century after wars and economic depressions

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125. Thomas Piketty, Capital In The Twenty-First Century 52 (2014). For those keeping score at home, Piketty's "[s]econd [f]undamental [l]aw of [c]apitalism" holds that $\beta = s/g$, where s is the savings rate. *See id.* at 166. This means that the capital stock is equal to the savings rate divided by the growth rate. *See id.* Unlike the "first fundamental law" discussed in the text, however, the second fundamental law is not a simple accounting identity—it depends on some assumptions being made. In any event, this second law is far less important to ours (or Piketty's) analysis; the main point is that the capital stock can increase, possibly quite dramatically, with a constant savings rate and a low growth rate; the fundamental force for divergence, $r > g$, is also helped by a low growth rate, g, and the two factors interact, because any savings out of the "excess" r, where $r > g$, counts for savings that is driving up β. *See id.* at 167.

126. *See id.* at 52.

127. *See id.*

128. *See id.* at 199.

had levelled the capital stock. Since 1975 or so, the capital share has been on the rise, approaching 30% in developed countries.[129] These facts contradict a standard economics assumption, about Cobb-Douglas production functions, that posits that the capital share should remain constant over time. Piketty persuasively argues that the elasticity of substitution between capital and labor is likely to be greater than one, meaning that an increasing β will lead to a higher α, and less to be paid over to labor.[130] This all means that a simple Marxist story, that "[t]he [p]rinciple of [i]nfinite [a]ccumulation" will lead to a falling rate of return and ultimately the death of capitalism, will not obtain.[131] In plain English, the rich will keep getting richer . . . until something crashes, as the world did in the twentieth century.

The problem is that as α, the share of national income paid over to capital, keeps rising, the share going to wages keeps falling. So wages stagnate even as the stock market booms; Main Street is a very different place than Wall Street.[132] But if α is *the* problem, or a major part of the problem, then strategies that tax capital, β, *even if they do little more than reduce β without producing significant revenues for the state*, can make sense as efficient means to the end.[133] What is inefficient as a revenue-raising matter becomes efficient as a means to obtain an end—an end that looks to the very basic dynamic of society and the relative shares of capital and labor. As Piketty puts it:

> [t]he primary purpose of the capital tax is not to finance the social state but to regulate capitalism. The goal is first to stop the indefinite increase of inequality of wealth, and second to impose effective regulation on the

129. *See id.* at 278.

130. *See id.* at 220–23.

131. *See id.* at 7.

132. *See The Productivity-Pay Gap*, ECONOMIC POLICY INSTITUTE (May 2021), https://www.epi.org/productivity-pay-gap/ [https://perma.cc/P86G-FB7A]; Drew DeSilver, *For Most U.S. Workers, Real Wages Have Barely Budged in Decades*, PEW RSCH. CTR. (Aug. 7, 2018), https://www.pewresearch.org/fact-tank/2018/08/07/for-most-us-workers-real-wages-have-barely-budged-for-decades/ [https://perma.cc/SDK6-7B87]; Raj Chetty et al., *The Fading American Dream: Trends in Absolute Income Mobility Since 1940*, 356 SCI. 398 (2017).

133. CAPITAL IN THE TWENTY-FIRST CENTURY, *supra* note 125, at 52.

> financial and banking system in order to avoid crises.[134]

That is a clear statement of a non-revenue-raising end, as normative logic requires for a redistributive tax other than a flattened wage tax.

6. Everyone Pays a "Fair Share"

Not everything is about money. The rhetoric yearning for "redistributive progressive taxation" generally adds a *further* purpose to its aspirations. We should tax the rich more *in order to* do X, whether X be paying for programs for the poor, correcting for unfair advantages, breaking up concentrations of wealth, or destroying capital to increase the returns to labor. The problem with these constructs is the facts. Mirrlees showed that high marginal rates are *not* the most efficient way to get resources to the poor, meaning that we had to search both for other means of getting the wealthy to pay more, and for a clearer articulation of the reason for doing so notwithstanding the added cost.

But some of the most compelling and enduring justifications for getting the wealthy to pay some taxes are not about costs and benefits, dollars and cents. Instead, they are about *fairness*, an irreducible norm that every citizen should pay their "fair share," for no other reason than that this is, indeed, fair. In social contractarian terms, we might think of the "fair share" norm as being fundamental to the concept of citizenship in a society of free and equal persons, a non-delegable obligation borne by each and all. President Joe Biden has been a leading advocate of this end: "I think you should be able to go out and make a billion dollars or a hundred million dollars if you have the capacity to do it. But I ask one thing: Pay your fair share."[135]

134. *Id.* at 25.

135. President Joe Biden, Remarks by President in a CNN Town Hall with Don Lemon (July 21, 2021), https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/07/22/remarks-by-president-biden-in-a-cnn-town-hall-with-don-lemon [https://perma.cc/PXP4-RTDC]. *See also* President Joe Biden, Remarks by President Biden at Campaign Event for Virginia Gubernatorial Candidate Terry McAuliffe (July 23, 2021), https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/07/24/remarks-by-president-biden-at-campaign-event-for-virginia-gubernatorial-candidate

Although a "fair share" norm might at first suggest raising marginal income tax rates, we have seen that this would do nothing to tax the wealthy today because the wealthy need not show any wage income. Playing *Buy, Borrow, Die*, those with wealth can avoid all taxes, as Elon Musk and other billionaires have done. The underlying structural problem is that wealth, capital, is not bearing *its* fair share of taxes. Optimal "fair share" taxation is not optimal income taxation, which has given us a flattened wage tax. Optimal "fair share" taxation means getting all Americans to pay a reasonable amount in taxes, proportionate to their means, regardless of their personal mix of capital and labor income. A "fair share" norm means getting serious about taxing wealth seriously.[136]

VI. Bernie Sanders' Wealth Tax: A Case Study

This Section takes a brief look at Senator Bernie Sanders' proposal for a wealth tax, a plan endorsed by Piketty and other liberal economists,[137] to illustrate our main themes.

-terry-mcauliffe/ [https://perma.cc/AW24-LYGV]. ("The very wealthy—and I respect anybody who makes a lot of money; you should be able to be a millionaire or billionaire, whatever you want, as long as you pay your fair share."); President Joe Biden, Remarks by President Biden to Mark the Day That Tens of Millions of Families Will Get Their First Monthly Child Tax Credit Relief Payments Thanks to the American Rescue Plan (July 15, 2021), https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/07/15/remarks-by-president-biden-to-mark-the-day-that-tens-of-millions-of-families-will-get-their-first-monthly-child-tax-credit-relief-payments-thanks-to-the-american-rescue-plan/ [https://perma.cc/T8KS-KEJR] ("To the people who say we can't afford to give the middle class a break, I say: We can afford it by making people at the top and the big corporations—over 50 of which paid no taxes last year at all—to finally just—just start paying their fair share. I'm not going to gouge them. Just pay their fair share.").

136. *Taxing Wealth Seriously*, *supra* note 82.

137. *See* Thomas Piketty, *Bernie Sanders Is Trying to Rescue America's Frail Democracy*, Jacobin (Mar. 19, 2020), https://jacobinmag.com/2020/03/thomaspiketty-bernie-sanders-voting-democracy [https://perma.cc/U7TN-2KBJ]; *Tax on Extreme Wealth*, Bernie Sanders, https://berniesanders.com/issues/tax-extreme wealth/ [https://perma.cc/D7CX-MNHZ] (last visited Feb. 1, 2021). *See also* Jim Tankersley & Ben Casselman, *The Liberal Economists Behind the Wealth Tax Debate*, N.Y. Times: Politics (Feb. 21,

A. The Math of Wealth Taxes, in General

It may seem that the idea of a wealth tax has little to do with the problems of today's income tax, except as a radically different alternative, the kind of "other" tax that Mirrlees ended his exploration of the income tax considering. But in fact, a wealth tax is a perfectly clever response to the problem of the *Buy* step in *Buy, Borrow, Die*, the failure of the tax system to tax unrealized gains under *Macomber*.[138] Wealth taxes can serve as a corrective to that failure.[139]

Consider a simple example using Billionaire Bill, who helpfully has a net worth of precisely one billion dollars ($1,000,000,000). Assume that the real rate of return on assets—what Bill is expected to earn each year, in realized or unrealized growth, net of inflation—is 5%. Five percent is in fact the figure used most consistently by Piketty in *Capital in the Twenty-first Century*, the ***r*** we discussed in the first fundamental law of capitalism, above, although he and others now suggest it might be closer to 6%.[140] (For present purposes, the math is easier to follow at 5%, and the general ideas are unaffected by this numeric detail.) Let us consider the effects of a 1% wealth tax.

Bill will likely earn $50 million ($50,000,000), 5% of $1 billion, in the coming year. Bill will now have to pay $10 million, or 1% of his net worth, in taxes. As a percent of his "deemed gains" of $50 million, as we might call them, Bill's tax rate is 20% ($10 million/$50 million). Each 1% of wealth tax is equivalent to a 20% tax rate on deemed gains, given the 5% growth rate.

To better see this point, imagine that we taxed Bill's deemed gains at 20%. This would lead to a tax set at:

$$\mathbf{.20 \; \boldsymbol{x} \; .05 \; \boldsymbol{x} \; \boldsymbol{W},}$$

2020), https://www.nytimes.com/2020/02/21/us/politics/the-liberal-economists-behind-the-wealth-tax-debate.html [https://perma.cc/2AZQ-SDRR].

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

139. See Edward J. McCaffery and David Gamage, Twenty-First Century Income Taxation: Buy, Borrow, Die and Beyond, forthcoming book manuscript, for a more extended discussion of the role of wealth taxes in addressing the problems brought on by the realization requirement.

140. Capital In The Twenty-first Century, *supra* note 125.

where .20 is the tax rate, .05 is the deemed rate of growth, and *W* is the wealth level. Trivially, this leads to:

$$\mathbf{.01}\boldsymbol{W},$$

that is, a one percent wealth tax. A two percent wealth tax would be equal to a 40% tax rate on deemed gains. (At a 6% deemed rate of return, a 1% wealth tax equates with a 16.67% tax rate on deemed gains; a 20% tax rate on deemed gains would equate with a 1.2% wealth tax). In sum, a wealth tax can be a sensible, rough substitute for simply repealing *Macomber* and having an income tax with an annual assessment of actual gains.[141]

B. The Math of Sanders's Proposal, in Particular

The Sanders wealth tax proposal adds a twist to the analysis of wealth taxes by proposing rates as high as 6% or 8%. To see what effect this has, we bring back Billionaire Bill.

Assuming that the growth rate is unaffected by the wealth tax itself, and so stays at 5%, Bill would earn an anticipated $50 million in real returns each year. But now, with an 8% wealth tax, Bill must pay $80 million in taxes each year. Bill is *losing* real dollars every year, paying more in taxes than he makes in returns, and this is before we get to Bill's consumption. Even billionaires must eat, after all, and it can be expensive getting room service in outer space.[142] If Bill spends at a rate

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141. Note that each year the deemed gain amount—$50 million for a billionaire in the text's example—would be added to the taxpayer's basis in their assets. If a "deemed gains" provision were coupled with a repeal of the stepped-up basis rule, IRC §1014, and a capital gains tax on death under IRC § 1001(a), the current taxation would reduce the ultimate taxation. Conversely, any gain remaining in the estate would have escaped present taxation. The capital gains on death rate can be set higher to reflect the uncaptured deferral benefits of this situation.

142. *See* Jackie Wattles, *Virgin Galactic Founder Richard Branson Successfully Rockets to Outer Space*, CNN: Tech (July 12, 2021), https://www.cnn.com/2021/07/11/tech/richard-branson-virgin-galactic-space-flight-scn/index.html [https://perma.cc/R4KF-8Q4E]; Micah Maidenberg & Doug Cameron, *Blue Origin Launch: Jeff Bezos and Crew Complete Successful Space Flight*, Wall St. J. (July 20, 2021), https://www.wsj.com/articles/jeff

of 4% of his wealth, a common figure used in retirement planning,[143] his consumption will be $40 million a year. In real dollars, Bill's wealth would be decreasing at the rate of $70 million a year. ($50 million - $80 million - $40 million). After one year of Sanders's wealth tax, the Billionaire Bill is eliminated, replaced by the Multimillionaire Will.

C. The Tax Swallows its Tail

At first, a wealth tax such as Sanders has proposed, if effectively enforced, could bring in significant sums of revenue: hence the $3 to $4 trillion scoring estimates discussed above.[144] This may well give a ray of hope in the centuries-long quest to meaningfully tax wealth.

The problem? Over time, if the Sanders plan works the way it is designed, it will succeed in eliminating all billionaires. Billionaire Bill is bleeding wealth at the rate of $70 million a year; it would take a little over 14 years at that rate to eliminate $1 billion. At some point there is no more government revenue from the wealth tax because there are no more billionaires. The tax would have eliminated itself as a revenue source. Thus, the Sanders "eliminate billionaire" plan is costly, because it is not an efficient way to get an equivalent amount of resources to the poor. Its aim is solely to take down others without necessarily directly building up anyone. Over time, if it works, it will stop raising any revenue at all.

To all of that we can respond: So what? A Sanders-style wealth tax is not *intended* to raise revenue. Its specific redistributive end is to eliminate billionaires. That end, whether it turns out to be embraced by an overlapping consensus of citizens and lawmakers, is a reasonable one, supported by various instrumental and non-instrumental, utilitarian and

-bezos-blue-origin-crew-set-for-space-debut-11626775480 [https://perma.cc/J3PZ-SPY4].

143. *See* Julia Kagan, *Four Percent Rule*, Investopedia (July 23, 2021), https://www.investopedia.com/terms/f/four-percent-rule.asp [https://perma.cc/VY2C-YJPY]; Rob Berger, *What Is The 4% Rule For Retirement Withdrawals?*, Forbes: Advisor (Mar. 20, 2020), https://www.forbes.com/advisor/retirement/four-percent-rule-retirement/ [https://perma.cc/BP2S-28E5].

144. Memorandum from Emmanuel Saez and Gabriel Zucman, Professors of Economics, U.C. Berkeley, on Senator Sanders' Wealth Tax (Sept. 22, 2019), https://eml.berkeley.edu/~saez/saez-zucman-wealthtax-sanders-online.pdf [https://perma.cc/NU24-HQJD].

social contractarian values, as we discussed above. It advances a compelling vision of justice and equality.

The Sanders wealth tax also allows us to illustrate a central theme of this Article perfectly well: If the redistributive goal is to eliminate billionaires, then the optimal tax is the one that most efficiently eliminates billionaires.

The Sanders plan may well be the optimal "eliminate billionaires" plan, but that task has yet to be fully studied. Perhaps there is a better mechanism: some unanticipated, unrepeatable, one-time surprise corrective taking, a kind of negative windfall occurring in the dark of night without any distortive incentive effects, that some economist can derive on some chalkboard.[145] But until then, the Sanders plan is worth considering, and the fact that it may not, in steady state, raise any revenue at all is not a valid objection to it. How much would we be willing to pay to live in a world without billionaires?

VII. What Is to Be Done?

Paradoxes do not go away because we ignore or fail to see them. The forces sketched above are at work whether we are conscious of them are not. The paradox is that taxing the rich costs resources that could help the not-rich. We do not need to tax the rich to generate resources for the not-rich. If we want to tax the rich under the current structure, we must do so for some reason *other than* raising resources for the poor. These are stubborn facts derived from theory. And they map with the equally stubborn reality that America has never in fact meaningfully taxed its richest citizens for any reason at all.

What is to be done? The logic of the paradox suggests two broad pathways for getting beyond it. One is to accept the paradox on its own terms but then argue under it that we should be willing to pay a significant price to tax the rich. Two is to change the terms of the paradox by changing the structure of tax. This Section considers these two approaches generally and concludes with a call for more better theory.

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145. *See* Eric Kades, *Windfalls*, 108 Yale L.J. 1489 (1999) (arguing for a confiscatory tax on positive windfalls because there would be no distortive effects).

A. Accept the Paradox: Paying the Price

There is a general, lazy habit of thought among many both inside and outside academia that somehow "tax" is taking care of all redistribution. This is a crude over-generalization of the Kaplow-Shavell "Leave It to Tax" theorem, which is itself our own crude characterization of the Kaplow Shavell logic. Mirrlees knew better. The "it" that keeps getting left to tax is the financing of an "it" set offstage. If the "it" involves getting more resources to the poor, as in a common understanding of the task of "redistribution," then theory tells us that the "optimal" tax is a flattened wage tax.

But getting resources to the poor is not the only "it" to be served by tax, or the only meaning of redistribution. Proponents of redistributive progressive taxation, including Mirrlees, seek to do something else, something more than raising the consumption level of the poor. They aim to correct for unfair advantage or unearned privilege, to break up concentrations of wealth or even to eliminate billionaires, to lower the capital stock, or simply to ensure that every citizen pays their "fair share." These other ends must be clearly stated, and efficient means of implementing them sought, and then and only then can the costs be set against the benefits. Nor do all these ends point in the same precise direction. Taxing privilege is different from destroying capital. Redistribution costs money and warrants an astute and well-informed buyer.

Another critical step for the redistributionist cause is to build a wide public political consensus and to maintain focus on the issue. Taxing the rich, strictly to tax the rich, as the normative logic suggests we do, will be hard. It will cost money. It will trigger intense political opposition. Lawmakers will be highly tempted to take the predictably ongoing campaign contributions and look for less salient and more efficient revenue-raising means. If taxing the rich is simply linked with providing some benefits to the not-rich, it is vulnerable to the Kaplow-Shavell reset, substituting low-salient flattened wage taxes to get the job done. "Taxing the rich" may poll well, but it does not drive electoral outcomes.[146]

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146. *See supra* note 107; Cameron Ballard-Rosa et al., *The Structure of American Income Tax Policy Preferences*, 79 J. Pol. 1 (2017); Joseph E. Stiglitz, The Price Of Inequality: How Today's Divided Society Endangers Our Future (2012); Larry Bartels, *Homer Gets a Tax Cut: Inequality and*

There is some hope—it springs eternal—in the recent reporting surrounding *Buy, Borrow, Die*, which triggered a social media outrage that may portend well for actual tax reform.[147] But we began with the news that nothing serious would happen to tax the rich this time around. Those who truly wish to tax the rich must be wary, patient, and diligent. Fundamentally changing millennia of tax policy, the utter nontaxation of the wealthy, will not be easy. There have been other times when getting everyone to pay their "fair share" of taxes was salient, as during war, and some scholarship suggests that citizens are more patriotic and willing to bear higher taxes during wars and other crises.[148] But a closer look at the tax policy of Franklin Delano Roosevelt, for example, shows that he was the forefather of the current tax system, pairing largely *symbolic* taxes on the rich with a massive increase in essentially regressive wage taxes to help recover from the Great Depression and finance World War II.[149] *Buy, Borrow, Die* was alive and well when FDR took office, and it survived his thirteen years in the White House unscathed—a fact true of every other President, Democrat and Republican, before and since.[150]

The climate change movement may provide some helpful parallels for redistributionists going forward. Over time, "global warming" has become a widely accepted public political concern, garnering widespread public support for taking costly long-term actions to control a problem still mainly in the future.[151] We might best think of economic

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Public Policy in the American Mind, 3 Persp. on Pol. 15 (2005); Steven M. Sheffrin, *What Does the Public Believe About Tax Fairness?*, 46 Nat'l Tax J. 301 (1993).

147. *The Secret IRS Files*, *supra* note 1. *See, e.g.,* Karen Lynch (@karenlynchkaren), Twitter (June 8, 2021, 3:18 p.m.), https://twitter.com/karenlynchkaren/status/1402359416523952131 [https://perma.cc/KF74-H392]; Bronus Swagner (@BronusSwagner), Twitter (June 8, 2021, 10:10 p.m.), https://twitter.com/BronusSwagner/status/1402463154446155778 [https://perma.cc/G4WJ-NMFV].

148. *See generally* Steven A. Bank et al., War & Taxes (Urban Institute Press 2008).

149. *See* Carolyn C. Jones, *Class Tax to Max Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 Buff. L. Rev. 685, 685 (1989); *Taxing Wealth Seriously, supra* note 82.

150. *Taxing Wealth Seriously, supra* note 82.

151. *See, e.g.*, Cary Funk & Brian Kennedy, *How Americans See Climate Change and the Environment in 7 Charts*, Pew Rsch. Ctr. (Apr. 21,

inequality like climate change, a looming problem getting gradually but exponentially worse. Recall Murphy and Nagel's concerns that decisions we make today that seem efficient can be leading us to increasingly unequal distributions of wealth. That is a result of the paradox. At some point, as Piketty's work and our history books help show, the wars and economic depressions come.[152] Getting the public to see that economic inequality poses great dangers to our present and future selves and societies can only help to dislodge a centuries-long inertia that has left the wealthy off the hook.

B. Reset the Paradox: Changing the Terms of the Debate

There is no escaping the need to better articulate our ends. But paradoxes are also contingent on the existing social structures where they are found. A critical assumption built into the paradox of taxing the rich is that the means of redistribution will be an income tax. Mirrlees assumed an income tax, which became a wage tax because he used a one period model with no capital or savings. Kaplow and Shavell assumed an income tax. Mirrlees told us that the income tax was not very good at meeting all of its redistributive goals, and that we should look elsewhere, to other taxes. Maybe it is time to switch gears, to taxing *spending* rather than income, uses rather than sources. Then we could model what an optimal spending tax might look like.

Why might this matter? Because the behavioral effects driving the marginalist analysis that Murphy and Nagel rue change between an income and a spending tax, although the latter can be manifested, easily enough, in a similar form to the income tax. To see this point, consider the celebrated Haig-Simons definition of Income, which holds, essentially, that:

Income = Consumption + Savings[153]

2020), https://www.pewresearch.org/fact-tank/2020/04/21/how-americans-see-climate-change-and-the-environment-in-7-charts/ [https://perma.cc/ATB6-MNKJ].

152. Capital In The Twenty-first Century, *supra* note 125.

153. The definition is named after Henry C. Simons and Robert Haig who, along with several others, derived it independently. Robert M. Haig, *The Concept of Income—Economic and Legal Aspects*, in The Federal Income Tax 1, 7 (Robert Murray Haig ed., 1921); Henry C. Simons, Personal

A simple rearrangement shows that a consumption or spending tax is simply an income tax with an unlimited deduction for savings:

$$\text{Consumption} = \text{Income} - \text{Savings}$$

With the important qualification that borrowing, as a form of negative savings, counts as "income,"[154] a spending tax is an "income" tax with an unlimited deduction for savings, as with a traditional Individual Retirement Account or 401(k) plan.[155] This is all we need to know here about a progressive spending tax's form, which has been described elsewhere.[156]

Here is the critical idea. By changing the tax's *base* to consumption or spending, the hope for a progressive spending tax is that we can then change the *rates* to institute genuinely redistributive progressive taxation, because the behavioral responses to the taxes differ.[157] An income tax falls on work, and the Mirrleesian optimal income tax falls *only* on work. There is one decision facing the taxpayer: to work or not. This distorts the labor-leisure tradeoff, leading people to stop working as the only way to avoid tax. But a spending tax affects *two* decisions: one, whether to work or not, and two, whether to spend or not.[158] In other words, savings serve as an "escape valve" from labor taxation under a consistent spending tax. If the tax pushes the wealthy to continue to work and then to save more but spend less, we might think of this as a win-win solution.[159]

Income Taxation: The Definition of Income As a Problem of Fiscal Policy 50 (photo reprint 1980) (1938) ("Income may be defined as the algebraic sum of the market value of rights exercised in consumption plus the change in value of the store of property rights between the beginning and end of the period in question.").

154. This may sound odd, but should not. Consider a simple sales tax. You pay that tax when you buy a good or even a cup of coffee, even if you use a credit card. The repayment of the debt is not taxable.

155. Edward J. McCaffery, *A New Understanding of Tax*, 103 Mich. L. Rev. 807, 813 (2005).

156. *Id.*

157. McCaffery & Hines, *supra* note 12.

158. *Id.*

159. *See* Robert H. Frank, Luxury Fever: Why Money Fails to Satisfy in an Era of Excess ix, 326 (1999). *But see* Edward J. McCaffery, *The Tyranny of Money*, 98 Mich. L. Rev. 2126, 2142 (2000), which explains that

These arguments have been advanced elsewhere. The point for now is to stress that, once we better understand the need to articulate specific redistributive goals and see that an "income" tax is not the only means to meet them, the project of redistributive progressive taxation can advance. This might lead us to new and unexpected answers. That is to be welcomed and valued, especially as the persistence of the problem of rising economic inequality unchecked suggests that our old and expected answers are not working.

C. Better Theory

The problem of economic inequality, and in particular the problem of the rich-getting-richer, beyond all bounds, is growing. As Einstein put it, "[w]e cannot solve our problems by the same thinking we used to create them."[160]

Something is wrong and our current thinking is not fixing it. Ignoring the orphaned problem of taxing the rich is only making things worse. America today is doing virtually nothing to tax the rich or to check rising inequality of wealth. The tools we have to address wealth inequality are not in fact addressing wealth inequality.

On closer inspection, it turns out that the instruction manual for tax is badly lacking. We assume that we have told tax to take care of redistribution and that it is doing so. But we have only asked tax to redistribute in one sense of redistribution, that of getting more resources to the poor. And this, it turns out, is largely a revenue-raising task. A flattened wage tax and the utter non-taxation of the wealthiest have followed suit. Tax theory, in Mirrlees, told us to look elsewhere to meet other redistributive goals. But we had stopped reading by that point.

The state of our thinking about redistribution and tax is not strong, just as the state of our practices regarding taxing the rich is not strong. We must liberate our minds from a certain confused reliance on progressive marginal rates under an income tax to do all the work of redistribution. We must ask more and better questions. What are the goals of a redistributionist policy? How might tax—or other

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the described scenario is not necessarily win-win but that the progressive spending tax remains a good idea.

160. Rhonda Talbot, *Einstein Did Not Define Insanity!*, RHONDA TALBOT WORLD (Jul. 2, 2024), https://www.thedevilstrifecta.com/2014/01/the-definition-of-insanity-i-first.html.

mechanisms—most efficiently attain them? Are we willing to pay the price to tax the rich? Are we willing to pay the price *not* to? We must face up to the paradox of taxing the rich and embrace it, articulate specific reasons to tax the rich, and rally public support. Or we can work to reshape the terms of the debate, and escape from the practical constraints imposed by prior theory, however well-meaning it was and is.

In any event, when what we are doing is not working, and has not worked for a century, or ever, and the problem we are considering is only getting worse, at increasing speed, it is time to do something else, beginning with thinking better about the problem.