Taxing Wealth Seriously

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The social and political problems of wealth inequality in America are severe and getting worse.[2] As Democratic presidential candidate Bernie Sanders pointed out as he launched his candidacy in the Summer of 2015, the top one-tenth of one percent of Americans (0.1%), sorted by wealth levels, owns as much wealth as the bottom ninety percent (90%) of Americans combined.[3] These roughly 160,000 individuals and families have an average net worth over $72 million. Wealth inequality in America is far more severe than income inequality. A recent *Forbes* posting explains:

> The average annual income of the top 1 percent of the population is $717,000, compared to the average income of the rest of the population, which is around $51,000. The real disparity between the classes isn't in income, however, but in net

[2] *See generally* Thomas Piketty, CAPITAL IN THE TWENTY-FIRST CENTURY, (The Belknap Press of Harvard University Press 2014); Joseph E. Stiglitz, THE PRICE OF INEQUALITY: HOW TODAY'S DIVIDED SOCIETY ENDANGERS OUR FUTURE (WW Norton & Co. 2012). Christopher Ingraham, *If You Thought Income Inequality Was Bad, Get a Load of Wealth Inequality*, THE WASHINGTON POST (May 21, 2015) https://www.washingtonpost.com/news/wonk/wp/2015/05/21/the-top-10-of-americans-own-76-of-the-stuff-and-its-dragging-our-economy-down.

[3] Emmanuel Saez and Gabriel Zucman (2014). *Wealth Inequality in the United States Since 1913: Evidence From Capitalized Income Data* (NBER Working Paper 20625). Cambridge, MA: National Bureau of Economic Research. Retrieved Jan. 26, 2016, from http://gabriel-zucman.eu/files/SaezZucman2014.pdf. Tom Kertscher, *Bernie Sanders, in Madison, Claims Top 0.1% of Americans Have Almost as Much Wealth As Bottom 90%*, POLITIFACT (July 29, 2015) http://www.politifact.com/wisconsin/statements/2015/jul/29/bernie-s/bernie-sanders-madison-claims-top-01-americans-hav.

value: The 1 percent are worth about $8.4 million, or 70 times the worth of the lower classes.[4]

All the statistics about economic inequality in the United States are getting worse, as Thomas Piketty, among others, has extensively shown.[5]

The surprise is that the American tax system is a significant *cause* of these problems, not a cure for them. The tax-law doctrines that allow those who already have financial wealth to live, luxuriously and tax-free, are simple. They follow the steps in what I have dubbed Tax Planning 101: Buy/Borrow/Die.[6] The applicable legal doctrines have been in place for nearly a century under the income tax, the primary social tool for addressing matters of economic inequality and redistribution. The analytic pathways to reform are easy to see once Buy/Borrow/Die is properly understood. Yet our political systems show no serious interest in reforming our tax system to tax wealth seriously. We are letting capital off the hook, and ratcheting up taxes on labor, at precisely a time when deep-seated and long-running economic forces suggest that this is precisely the wrong thing to do.[7]

It is time -- past time -- for a change. Hence this Article.

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[4] Alan Dunn, *Average America vs the One Percent*, FORBES (Mar. 21, 2012) http://www.forbes.com/sites/moneywisewomen/2012/03/21/average-america-vs-the-one-percent. It is also worth noting there is a lot more turnover in the top income earners as opposed to the wealthiest Americans (when factoring in years of higher or lower wages, retirement, etc). See: Tami Luhby, *No One Stays in the Top 1% For Long*, CNN MONEY (Jan. 7, 2016) http://money.cnn.com/2016/01/07/news/economy/top-1/index.html. Kerry A. Dolan, Billion-Dollar Bloodlines: America's Richest Families 2015, FORBES (July 1, 2015). http://www.forbes.com/sites/kerryadolan/2015/07/01/billion-dollar-bloodlines-americas-richest-families-2015/#24ca14b47c74.

[5] Pikkety, *supra* note 2.

[6] EDWARD J. MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW: EXPLORING THE CAPITAL-LABOR DIVIDE xix (New York: Oxford University Press, 2012).

[7] Piketty, *supra note 2*.

1. Preliminaries

A. A Tale of Two Januarys

In January, 2016, Hillary Clinton found herself under pressure from Sanders' candidacy, the media,[8] and other forces to do or say something about economic inequality, arguably the most pressing issue of the day.[9] Warren Buffet, a prominent Clinton supporter, had previously lent his name to the "Buffet Rule," which would force millionaires such as himself to pay an effective tax rate of 30% on his or her reported income.[10] Candidate Clinton doubled down on this strategy, pledging to raise the marginal tax rate by four percentage points, in absolute terms, on those individuals or households reporting more than $5 *million* dollars annually.[11] There would not be many households affected by this proposal: the top 1% of earners had annual income of just over $700,000, far less than $5,000,0000. Clinton's Four Percent Plan would not raise much revenue.[12] Most tellingly, it

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[8] Noam Scheiber and Patricia Cohen, *For the Wealthiest, a Private Tax System That Saves Them Billions*, N.Y. TIMES (Dec. 29, 2015) http://www.nytimes.com/2015/12/30/business/economy/for-the-wealthiest-private-tax-system-saves-them-billions.html. Josh Barro, *Thanks, Obama: Highest Earners' Tax Rates Rose Sharply in 2013*, N.Y. TIMES (Dec. 30, 2015) http://www.nytimes.com/2015/12/31/upshot/thanks-obama-highest-earners-tax-rates-rose-sharply-in-2013.html. Also: Edward J. McCaffery, *U.S. tax system: Why do the rich just keep getting richer?*, CNN (Jan. 12, 2016) http://www.cnn.com/2016/01/12/opinions/mccaffery-wealthy-taxes.

[9] Elizabeth Bruenig, *The Democratic Debate Highlighted the Biggest Divide Between Sanders and Clinton*, NEW REPUBLIC (Oct. 13, 2015) https://newrepublic.com/article/123117/biggest-divide-between-sanders-and-clinton.

[10] John Harwood, *Clinton to Propose Further Tax Increases on Wealthy Americans at Buffet Event*, CNBC (Dec. 17, 2015) http://www.cnbc.com/2015/12/16/hillary-clinton-to-propose-further-tax-increases-on-wealthy-americans-at-buffett-event.html.

[11] *See* Hillary Clinton's website under ISSUES, subheading ECONOMY, Reform our tax code so the wealthiest pay their fair share. "Hillary supports ending the "carried interest" loophole, enacting the "Buffett Rule" that ensures no millionaire pays a lower effective tax rate than their secretary, and closing tax loopholes and expenditures that benefit the wealthiest taxpayers to pay for her plan to make college affordable and refinance student debt." See https://www.hillaryclinton.com/issues/plan-raise-american-incomes, (last visited Jan. 25, 2016).

[12] According to a campaign official who asked not to be named, Hillary Clinton's 4% surcharge on taxpayers with income of over $5 million annually would affect two out of every 10,000 taxpayers

would not affect at all those already wealthy individuals living off their capital, using Buy/Borrow/Die. Clinton's Four Percent Plan nonetheless had what seems to have been its main intended effect all along: it got headlines.[13] Sanders released his own tax plan featuring a marginal rate bracket taking effect at $10 million of reported income within days of Clinton's.[14] Time will tell if anything happens to Clinton's Four Percent Plan or Sanders' Ten Million Dollar Bracket, but these are, most definitely, *not* serious attempts to tax wealth seriously.

The prior January, 2015, President Obama had rolled out something in his State of the Union speech that was shocking for its rarity in America: a practical approach to taxing wealth seriously.[15] Obama proposed taxing previously untaxed capital gains on death. This is an idea that Canada has long had in place.[16] Obama's proposal if enacted and effectively implemented would end one of the great tax breaks still standing in America, the well

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(raising $150 billion over a decade). Jennifer Epstein, *Clinton Tax Plan Would Place 4% Surcharge on Incomes Over $5 Million*, BLOOMBERG (Jan. 11, 2016) http://www.bloomberg.com/politics/articles/2016-01-11/clinton-tax-plan-would-place-4-surcharge-on-incomes-over-5-million. It has been independently reported "The surcharge, firstly, would affect very, very few people. In 2013, about 34,000 (or about 0.02 percent) had an adjusted gross income of $5 million or more, per IRS statistics." Danielle Kurtzleben, *Clinton Would Raise Taxes on the Wealthy, Here's What You Need to Know*, NPR (Jan. 13, 2016) http://www.npr.org/2016/01/13/462944798/hillary-clinton-s-new-tax-proposal-likely-wont-affect-you.

[13] Greg Sargent, *It Begins: Hillary Clinton Rolls Out New Plan to Tax Super Rich*, THE WASHINGTON POST (Jan. 11, 2016) https://www.washingtonpost.com/blogs/plum-line/wp/2016/01/11/it-begins-hillary-clinton-rolls-out-new-plan-to-tax-super-rich. Also, Colin Campbell, *Hillary Clinton Just Proposed a New Tax on the Richest Americans*, BUSINESS INSIDER (Jan. 11, 2016) http://www.businessinsider.com/hillary-clinton-fair-share-surcharge-tax-2016-1.

[14] Alan Cole and Scott Greenberg, *Details and Analysis of Senator Bernie Sanders's Tax Plan*, TAX FOUNDATION (Jan. 28, 2016) http://taxfoundation.org/article/details-and-analysis-senator-bernie-sanders-s-tax-plan.

[15] Office of the Press Secretary, *Fact Sheet: A Simpler, Fairer Tax Code That Responsibly Invests in Middle Class Families*, THE WHITE HOUSE (Jan. 17, 2015) https://www.whitehouse.gov/the-press-office/2015/01/17/fact-sheet-simpler-fairer-tax-code-responsibly-invests-middle-class-fami.

[16] Jamie Golombek, *Death and Taxes: Leave Your Assets to Your Heirs Instead of the CRA*, FINANCIAL POST (Oct. 25, 2013) http://business.financialpost.com/personal-finance/debt/death-and-taxes-heres-what-happens-to-your-assets-when-you-die.

named "Angel of Death" benefit.[17] It would strike a fatal blow to the final step of Buy/Borrow/Die.

There was much to applaud in the President's gambit. Piketty's *Capital in the 21st Century* remained wildly popular.[18] Piketty's tome extensively chronicles how the United States and other advanced capitalist economies have reached and are soon to exceed levels of both wealth and wealth inequality not seen since the *Belle Epoque* era at the turn of the 20th Century, before massive wars and other social cataclysms leveled much of that wealth.[19] Obama's proposal was timely and sensible, a potential capstone to eight years of a Presidency initially premised on great progressive hope. Unlike Clinton's Four Percent Plan, Obama's Capital Gains on Death Proposal would address an essential plank in Buy/Borrow/Die. It would affect many taxpayers and raise significant revenue.[20]

Only there was no applause, no blaring headlines. Obama's Capital Gains on Death Proposal was declared dead on arrival. Nothing happened. In his final State of the Union speech in January, 2016, just days after Clinton's Four Percent Plan and Sanders' Ten

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[17] Len Burman, *President Obama Targets the 'Angel of Death' Capital Gains Tax Loophole*, FORBES (Jan. 18, 2015) http://www.forbes.com/sites/beltway/2015/01/18/president-obama-targets-the-angel-of-death-capital-gains-tax-loophole/#13262256783e.

[18] Marc Tracy, *Piketty's 'Capital': A Hit That Was, Wasn't Then Was Again: How the French tome has rocked the tiny Harvard University Press*, THE NEW REPUBLIC (April 24, 2014). https://newrepublic.com/article/117498/pikettys-capital-sold-out-harvard-press-scrambling.

[19] Piketty, *supra* note 2.

[20] The Congressional Budget Office estimated in 2014 that stepped-up basis would cost the Treasury $644 billion over the coming decade" (from http://www.taxanalysts.com/www/features.nsf/Features/1D8C0ED40D3C672B85257F42007109FB?OpenDocument.

Million Dollar Bracket were announced, Obama said very little about tax, and nothing at all about the Capital Gains on Death Proposal from the prior January.[21]

The two Januarys tell a familiar tale. America takes largely symbolic steps to tax the *reported* income of the rich. We do almost nothing about taxing wealth. Yet the problems of wealth inequality are far more extensive and troubling than those of income inequality. Our failure to tax wealth seriously means that both the income and the consumption of the propertied class can escape all taxation. Our tax policies make wealth inequality worse, by favoring capital and deterring labor from being able to accumulate capital in the first place. We have over a century of experience with this script.

B. A Joke

There is an old joke about a drunken sailor, searching for his lost wallet late one night beneath a lamppost. A well-meaning passerby tries to help and asks the sailor where he last saw his wallet. "Over there," the sailor replies, pointing far off into the darkness. "Then why are you looking here?," asks the puzzled Samaritan. "Because this is where the light is," replies the inebriated seaman.

Like that drunken sailor, liberals, progressives, and all those troubled by rising economic inequality in the United States continue to look to *income* inequality, because that is where they presume the light to be: the alluring beacon of the federal income tax, blessed by the

[21] Julie Hirschfeld Davis and Michael D. Shear, *Obama Confronts Americans' Fears in State of the Union Speech*, N.Y. TIMES (Jan. 12, 2016). http://www.nytimes.com/2016/01/13/us/politics/obama-state-of-the-union.html.

XVIth Amendment, ratified in 1913, a crowning glory of the progressive era movement.[22] Clinton's Four Percent Plan and even Obama's Capital Gains on Death Proposal both center on the *income* tax. The media plays along, needing content for its stories: the data we see in print is under the lamppost.

This reliance on income taxation to carry the weight of redistribution has proven to be a disastrous mistake. The income tax's century has been a century of rising, not diminishing, inequality.[23] The income tax, as is, is a highly limited tool for addressing social and political concerns over economic inequality, in theory as well as in practice, constrained by economic facts, political realities, popular perceptions, and more. Wealth inequality is greater, more enduring and problematic than income inequality. And the U.S. tax system is a significant *contributor* to wealth inequality. The income tax allows those with capital to get richer, while making it harder for those living off labor returns, or wages, to get capital in the first place. This is at a time when the rich are getting richer *anyway*, because, as Piketty points out, the return on assets is higher than the overall growth rate: economic forces are generating greater returns to capital than labor.[24] Attempting both to finance the modern state and to address economic inequality through the income tax has done considerable collateral damage to the progressive agenda, leading to a conservative ascension personified by Ronald Reagan and fueled by an anti-tax fervor, one that has left

[22] *See, e.g.*, Sheldon D. Pollack, *Origins of the Modern Income Tax, 1894-1913*, 66 THE TAX LAWYER 2 (2013).
[23] Piketty, *supra* note 2.
[24] Piketty, *supra* note 2.

liberals such as Barack Obama, when they have been able to obtain power at all, hand-tied from advancing any form of meaningful egalitarian agenda.[25]

We must get beyond the joke and look for a better light to explore the darkness.

C. An Embarrassment

In the darkness, offstage from practical policy proposals, lies the surprising fact that America does not tax wealth much. Wealth is our lost wallet. We tax "income:" *some* income, mainly the income that comes from labor in the form of wages. Our "income" tax is not and never has been a true income tax. It systematically fails to reach income from capital, which, with labor, is one of the two great factors of production in a capitalist economy. No other tax comes anywhere close to making up for the omission.[26] As a result, those Americans wealthy enough to live off existing stocks of wealth are let altogether off the social hook for having to pay for the privileges of civilization. At the same time the working classes must bear an ever-greater burden of tax to finance an ever-growing public sector, making it harder for them to cross over to the capital side of the street. All of the attendant problems from this embarrassment – and there are many – are getting worse, relegated to the darkness of our socio-political life.

Understanding tax, which few do, only deepens the sense of embarrassment. It turns out to be shockingly easy to avoid all taxation if one already has financial wealth, as the top 1%, with average fortunes of over $8 million, do. The three basic steps of Buy/Borrow/Die

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[25] Edward J. McCaffery, *Missing Link in Tax Reform*, *Distracted by Distractions from Distraction*. Pepperdine L.Rev. (2013).*See also* Michael Tanner, *Obama's Class Warfare*, NATIONAL REVIEW (Jan. 21, 2015) http://www.nationalreview.com/article/396775/obamas-class-warfare-michael-tanner.

provide a roadmap for those with existing stores of financial wealth to avoid all major taxes.

Buy/Borrow/Die is not a joke. Whatever its status as an elegant, reductive witticism, Buy/Borrow/Die points to longstanding, deeply rooted and unquestionably legal features of the income tax. There is abundant evidence of its pervasive use by the wealthy. There is no reason, in theory or in practice, to assume that the wealthy are not taking advantage of. Buy/Borrow/Die. Its very existence constrains important matters of tax-law design, as by keeping capital gains rates low.

Yet there is hope. Understanding Buy/Borrow/Die – which, fortunately if curiously, is not hard to do – is key to the task of reversing the course of centuries of tax policy in America, to taking taxing wealth seriously.

D. An Example

Section 3 explains the legal bases for Buy/Borrow/Die. To motivate further reading, consider an example developed further below, if only because there is some light here, in the form of publically available data.[27]

Warren Buffet, the world's fourth wealthiest person according to *Forbes*' annual survey, publicly revealed that he paid $6.9 million of income tax in 2010, on reported taxable income of $39.8 million.[28] Although Buffet's tax bill was more than most Americans will ever earn in their lifetimes, his income taxes were only some 17% of his *reported* income –

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[27] *See infra* Part 4.A.
[28] Janet Novack, *Warren Buffet's Effective Federal Income Tax Rate Was Just 11%*, FORBES (Oct. 12, 2011) http://www.forbes.com/sites/janetnovack/2011/10/12/warren-buffets-effective-federal-income-tax-rate-is-just-11/#4af75ed6132b.

an effective tax rate, as Buffet himself famously pointed out, below that of his secretary.[18] The Wizard of Omaha kindly lent his support to the "Buffet Rule," whereby millionaires such as he would pay tax at an effective, flat rate of 30%.[29] Such a rule would have raised Buffet's taxes to just under $12 million, again a significant sum. Hillary Clinton's Four Percent Plan would add another $1.4 million to her booster's tax bill.

Yet public records indicate that Buffet's personally held Berkshire Hathaway shares, *alone*, rose by $8 billion -- with a "b" -- in the calendar year of 2010.[30] The year 2013 was even better, with a $12.7 billion rise in value, but we are staying where the light is, and Buffet disclosed his 2010 tax return. This "mere appreciation" need not, under very longstanding tax laws, be *reported* as income on any tax return (the "Buy" step). Yet it was avaliable for all the world to see, and certainly increased Buffet's borrowing powers (the "Borrow" step).

Buffet's tax rate on his *real* income, including the gain in value of Berkshire stock, was 0.08625%, less than one-tenth of one percent. This is equivalent to a wage-earner, such as a young law associate, earning $100,000 (which also happens to be Buffet's salary as CEO of Berkshire)[31] and paying annual taxes of . . . $86.25. Buffet could have brought his taxes down to $0 by following Buy/Borrow/Die more relentlessly, but he did well enough.

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[29] Warren E. Buffett, *Stop Coddling the Super-Rich*, N.Y. TIMES (Aug. 14, 2011) http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html?_r=0.

[31] Sarah Schmalbruch, *Here's How Long It Takes Warren Buffett to Earn Your Salary*, BUSINESS INSIDER (Jan. 27, 2015) http://www.businessinsider.com/how-rich-is-warren-buffett-2015-1.

E. No Easy Way Out

The more one understands the analytics of tax, the more a sense of despair deepens. It is possible, after all, to make a liberal egalitarian case for wealth, as opposed to income, inequality. Such a case would moot the need to tax wealth seriously.

The argument runs as follows: A modern capitalist economy needs some savings. The poor have nothing to save, and the laboring classes, burdened by taxes among other costs of modern life, have a hard time saving much at all. Governments at all levels and places have demonstrated fiscal irresponsibility, running up massive deficits – that is, dissavings -- of all sorts. This leaves the rich, like Buffet, as the last element standing, the last hope for providing a social pool of capital. For just these reasons, John Maynard Keynes lauded the wealth inequality of England at the turn of the nineteenth century as an important element in the nation's rise to world-wide power, arguing that unequal wealth, and the wealthy's lessened tendency to consume out of capital, provided the needed financial backing to fuel empire.[32] Perhaps this happy tale of noblesse oblige masks the urgency to venture forth into the darkness to find our wallet.

Alas, the analytics of the American tax system take away this slim reed of hope. There is no reason, under the current U.S. tax system, for the wealthy to continue to save to enjoy tax-free living. Our tax system is not simply held hostage to our profligate society's need for savings, such that we must refrain from taxing accumulated wealth as a matter of principle, or necessity, or both. A deeper problem of Buy/Borrow/Die is that it provides a roadmap

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[32] John Maynard Keynes, *A Treatise on Money*, NEW YORK, HACOURT, BRACE & CO. (1930) http://catalog.hathitrust.org/Record/007150328 (last visited Jan. 26, 2016).

for *spending* financed by capital to escape taxation.[33] If Buffet borrowed $8 billion and spent it all, perhaps to run for president, he would pay *no* tax at all on his very good adventure. *Neither the income nor the consumption of the propertied class need bear any significant tax burden*.

It is difficult not to see that as a major problem, for those who see it at all. There is no escaping the task of attempting to tax wealth seriously.

2. Matters of Definition

We continue with some simple terms and concepts.

Income is a flow, what comes into a taxable unit or household each taxable period or year. As a matter of **statutory income**, Section 61 of the Internal Revenue Code directs each taxpayer to add up her sources of income each year – mainly from wages, but also from rents, royalties, interest, dividends and the like – and list them on an annual return, like the Form 1040. This becomes **reported income**.

Theory presents a different definition. In the celebrated Haig-Simons definition, "income" is 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 the end of the period in question."[34] Fancy words, but the simple point is to connect "income," which is

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[33] Lawrence Zelenak,*Debt Financed Consumption and a Hybrid Income-Consumption Tax* (2010); EDWARD J. MCCAFFERY, FAIR NOT FLAT: HOW TO MAKE THE TAX SYSTEM BETTER AND SIMPLER (University Chicago Press, 2002).

[34] Robert Murray Haig, "The Concept of Income – Economic and Legal Aspects," in R.M. Haig, The Federal Income Tax, (New York: Columbia University Press, 1921) 1-28 at p. 27. Henry C. Simons,

about *inputs* or *sources*, with *uses* or *outputs*. All income is either spent ("the market value of rights exercised in consumption"), or not ("the change in value of the store of property rights"). The Haig-Simons definition of income becomes Income equals Consumption plus Savings, or

$$I = C + S,$$

in simple algebraic terms.

The Haig-Simons definition helps to show that an income tax is supposed to be a "double tax" on savings, as John Stuart Mill famously pointed out in 1848.[35] This is because the yield to savings is taxed, even though the initial receipt of the saved-value was *also* taxed.[36] This is problematic, in part because America wants savings, on both a national and individual levels. So the income tax, as is, is riddled with exceptions like preferential provisions for retirement savings that move it far from a pure "income" tax and into a mish-mosh, a hybrid of income and consumption tax elements, often producing wholly counterproductive results.[37]

Income ultimately must come from **labor**, in the form of wages, fringe benefits and the like, or from **capital**, in the form of interest, rents, royalties, and the like, or from some combination of capital and labor, one's own or someone else's (to sweep in gifts and

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Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy, (Chicago: University of Chicago Press, 1938) at p. 50.

[35] John Stuart Mill, 5 Principles of Political Economy, ch. II, § 4, at 179-80 (Jonathan Riley ed., Oxford University Press, 1998) (1848).

[36] Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?,* 89 YALE L.J. 1081 (1980).

[37] Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807 (2005).

various forms of support).[38] The returns to capital (K) and labor (L) lead to one's income (I), which, as Haig-Simons informed us, equals one's consumption (C) plus nonconsumption or savings (S). In simple algebraic terms:

$$K + L = I = C + S$$

We can have a **consumption tax** in one of two ways. One, we could ignore K, not taxing the returns to capital on the sources or left-hand side, which leads to a wage tax. Two, we could ignore S, by not taxing savings on the uses or right-hand side, which leads to a spending tax.[39] Under certain standard assumptions, the two approaches lead to the same place.[40]

Statutory or reported income does not include **unrealized appreciation**, which is the change in value of an asset being held before there is some **realization event**, such as a sale, to make it taxable. This "mere appreciation," such as the $8 billion rise in Buffet's holdings in 2010, *is* included in the Haig-Simons definition of income, as the "change in value of the store of property rights between the beginning and end of the period in question." We can define **real income** as reported income plus unrealized appreciation, ignoring other differences. Buffet's tax rate of 17% on his *reported* income in 2010 became 0.08625% of his *real* income.

There are many tax-law concepts and terms meant to ensure that "mere appreciation" *eventually* gets taxed. **Basis** refers to one's after-tax cost of acquiring or holding an asset. Suppose that Jane buys a share of Berkshire Hathaway for $200,000. She gets a basis of

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[38] Eisner v. Macomber, 252 U.S. 189 (1920).
[39] Edward J. McCaffery, *On the Right Side of the Equation: A Tribute to William D. Andrews*, Harvard Law Bulletin (2007).
[40] McCaffery, *A New Understanding of Tax*, *supra* note; MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW, *supra* note.

$200,000 in the stock.[41] If the stock rises in value to $1,000,000 without any sale or dividend, Jane pays no tax. The difference between the **fair market value** of the stock, $1,000,000 and Jane's basis, $200,000 -- that is, $800,000 -- is yet untaxed or **built-in gain**. If Jane were to sell the stock that, $800,000 would become **realized gain**.[42] In simple form:

realized gain = fair market value of property received - basis of asset sold

Realized gain is typically taxed at a **capital gains rate**, a lower rate than what falls on **ordinary income** such as, paradigmatically, wages.[43]

The tax law typically acts to preserve built-in gain so that it will eventually be taxed. If Jane were to gift her share of Berkshire-Hathaway to her friend Dick, Dick would take the stock with a **carryover basis** of $200,000, Jane's basis, such that the built-in gain would be preserved in Dick's hands.[44] But assets held until death and then passed on to heirs receive a **stepped-up basis**, to fair market value, meaning that the built-in gain disappears on death—never to be taxed.[45] It was this "angel of death" provision, the death step of Buy/Borrow/Die, that Obama's Capital Gains on Death Proposal would have changed.

3. A Road Map to Embarrassment

We are now ready to understand Buy/Borrow/Die in all of its elegant, if embarrassing, simplicity.

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[41] IRC Sec. 1011.
[42] IRC Sec. 1001(a).
[43] IRC Sec. 1221.
[44] IRC Sec. 1015.
[45] IRC Sec. 1014.

A. Tax Planning 101: Buy/Borrow/Die

Step One is to **buy**. Not just any asset, but one such as land, growth stock (Berkshire Hathaway definitely counts)[46], art – assets that appreciate in value without producing taxable cash flows. This is owing to the realization requirement under the income tax from, among other sources, the celebrated 1920 U.S. Supreme Court case of *Eisner v. Macomber*.[47] The realization requirement holds that the change in value of an existing asset is not income until and unless the gain is "realized" through a sale or other disposition. The requirement is key to the gap between real and reported income; Buffet's $8 billion gain in 2010 was real enough, but was not reported on his 1040 form, perfectly legally.

The Harvard law professor William D. Andrews has called the realization requirement the "Achilles' Heel" of the income tax.[48] The key step to convert the realization requirement of *Macomber* into Buy/Borrow/Die, a means of tax-free living, is to follow some very basic, simple financial advice: Never sell. Follow – as Buffet most certainly has – a simple "buy and hold" financial strategy. As long as Buffet never sells his Berkshire Hathaway stock – and he certainly never sells much of it – he pays no tax on his "mere" appreciation.

Given the tax incentive to hold capital-appreciating assets, it is not surprising that Wall Street and other financiers should produce many such opportunities. Growth stocks rarely pay dividends. Wall Street even tried to give the wealthy their cake, in the form of risk-free

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[46] Berkshire Hathaway has only paid dividends once under Buffett's reign, in 1967. "I must have been in the bathroom when the decision was made," Buffett is often quoted as saying. John Maxfield, *Why Warren Buffett Doesn't Pay Dividends*, THE MOTLEY FOOL (Apr. 30, 2013) http://www.fool.com/investing/general/2013/04/30/why-warren-buffett-doesnt-pay-dividends.aspx.

[47] McCaffery, *A New Understanding of Tax*, *supra* note.

[48] *See* William D. Andrews, *The Achilles' Heel of the Comprehensive Income Tax*, NEW DIRECTIONS IN FEDERAL TAX POLICY FOR THE 1980S, at 278, 280 (Charles E. Walker & Mark A. Bloomfield eds., 1983).

returns, and allow them to eat it, tax-free, too, by designing relatively risk-free bonds that simply rolled up all interest payments to pay on the ultimate expiration of the bond term.[49] Congress legislated an end to this particular game, underscoring that *Macomber's* requirement is *not* Constitutionally based. It is a habit, not a necessity.

We do not need tax tomes to understand the point. Robert Kiyosaki, author of the popular best-seller *Rich Dad/Poor Dad*, gives it to his readers as "Rule No. 1:"

> You must know the difference between an asset and a liability, and buy assets. If you want to be rich, this is all you need to know. It is rule no. 1. It is the only rule. . . .It sure beats saving $100 a month, which actually starts off as $150 because it is after-tax income, for 40 years at 5 percent, and again you are taxed on the 5 percent. That is not too intelligent. It may be safe, but it's not smart.[50]

Kiyosaki is mocking wage-earners like his (poor) dad. These "not smart" individuals – most of us – must try and save out of labor earnings. Because these are taxed – at a 33% rate, in this passage -- $150 shrinks to $100 after taxes. If you were to save this $100 in a simple bank account, paying 5% interest, or $5 a year, *that* "change in value of the store of property rights," being "realized," *is* taxed, again at the ordinary income tax rate of 33% (in this example), barely if at all keeping the wage-earner/saver ahead of inflation. Wage earners pay Mill's double-tax on savings -- when they don't just try to skip the whole

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[49] These instruments came to be known as "zero coupon" (because interest payments were once reflected in physical "coupons" clipped from the physical bond, and the new-fangled bonds had no interest payments) or "original issue discount" (because you could sell a 10-year bond with a face amount of a $1000, say, for $500, today, the difference – the original issue discount – being the interest to accrue over the term of the bond; government savings bonds work this way) bonds.

[50] ROBERT KIYOSAKI, RICH DAD POOR DAD: WHAT THE RICH TEACH THEIR KIDS ABOUT MONEY THAT THE POOR AND MIDDLE CLASS DO NOT! (Plata Publishing 1ed., 1999)

savings thing, and attempt to go straight to Rich Dad's status by playing the lottery.[51] "That is not too intelligent" either.

Step One, all in, is to buy assets that will appreciate *without* paying interest or dividends, which payments are taxed under the realization requirement. Then you do whatever you want to help the assets grow in value – which, in the case of most investments, like growth stocks, means doing nothing at all. You never sell, with the exception of assets with built-in losses – that is, where the fair market value has dropped below the basis, leading to a tax loss.[52]

Fun as it is just to be rich, there is only so much hedonic pleasure that comes from staring at a balance sheet. To truly enjoy the benefits of being wealthy, most people want money, cash, and all the things that money can buy. No worries.

Step Two is to **borrow**. Debt or borrowing is not "income" under the basic definition of income. It never has been. When one borrows, there is no "change in value of the store of property rights." Under case law, *Macomber's* rather unhelpful definition of "income" (as the "gain derived from capital or from labor or from both combined"[53]), was replaced by the Supreme Court some thirty-five years later, in the case of *Glenshaw Glass*, which held that "income" is "an undeniable accession to wealth, clearly realized, and over which the taxpayer has dominion."[54] *Glenshaw Glass*'s definition of "income" retains the realization requirement ("clearly realized"). The new definition underscores the nontaxation of debt under even a pure income tax. Borrowing is *not* an "undeniable accession to wealth." The

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[51] Edward J. McCaffery, *Why People Play Lotteries and Why It Matters*. 71 WISC. L. REV. 71 (1994).
[52] IRC Sec. 1211
[53] Eisner v. Macomber, 252 U.S. 189 (1920). *See also id.* at 32.
[54] *See* Commisssioner v. Glenshaw Glass, 348 U.S. at 431 (1955).

cash borrowed is offset by a liability to repay the debt, such that there is, in fact, no change in value of the store of property rights, no change in one's net worth. Under the income tax, one can borrow – even borrow using an asset with unrealized appreciation, built-in gain, as security[55] -- and spend away, tax-free.

This gets us to a deep problem: *consumption financed by debt is income-tax free*.[56] The existence and persistence of Buy/Borrow/Die is not a principled response to a need for more savings. It is a roadmap to a – tax-free – lifestyle for the rich and propertied.

One might think that this is all just a matter of time -- that, sooner or later, one must have to pay tax on the gain that has been building up, tax-free, under the realization requirement and Step One's buying. The Court in *Macomber* seems to have assumed this. It would make sense. It would also be wrong. Buy/Borrow/Die continues.

Step Three is to **die**: the last thing all of us will do on earth however we plan. The built-in gain that had been allowed to grow untaxed under the realization requirement disappears on death under the stepped-up basis rule of IRC Section 1014. This is a rule that Michael Kinsley has famously dubbed "the angel of death."[57] It traces back to 1921.[58] On two occasions since then, Congress has passed a law providing for a carryover basis for assets acquired after a death – the same rule as we have for gifts. Both times, in 1980 and again in 2010, Congress later retroactively repealed the repeal of stepped-up basis, without its ever

[55] *Woodsam Associates, Inc. v. Commissioner*, 16 T.C. 649 (1951), *aff'd*, 198 F.2d 357 (2d Cir. 1952). This concept is easy to understand for the many Americans who have tax-free home equity loans.
[56] Lawrence Zelenak, *Debt-Financed Consumption and a Hybrid Income-Consumption Tax*, 64 TAX L. REV. 1 (2010).
[57] Michael Kinsley, *Eight Reasons Not to Cut the Capital Gains Tax*, SLATE (Feb. 23, 1997) http://www.slate.com/articles/briefing/articles/1997/02/eight_reasons_not_to_cut_the_capitalgains_tax.html.
[58] Lawrence Zelenak, *Taxing Gains at Death*, 46 VAND. L. REV. 363 n.7 (1993).

meaningfully taking effect. Under stepped-up basis, the heirs take an asset, income-tax free under IRC Section 102, *and* with a basis equal to the asset's fair market value at date of death under IRC Section 1014. The kids can sell the asset and pay off the parents' debts—all tax-free. The circle is complete.

Why do we have the stepped-up basis on death rule? Part of the stated explanations for the rule is that the gift and estate or wealth transfer tax system serves as a "backstop" to the income tax.[59] Only, well, it does not. After the Tax Reform Act of 2012, 99.7% of Americans will leave estates *not* subject to the estate tax. Yet 100% of decedents will be allowed to leave assets with stepped-up bases to their heirs, who will get the assets tax-free. And even the top 0.3% have plenty of planning opportunities to reduce or eliminate their estate tax, as we consider below.

That is it. Buy/Borrow/Die avoids all federal taxes. It avoids the income tax because of the three doctrines just noted. It avoids the increasingly important payroll tax system by the simple expedient of never actually working. It avoids the estate tax because that is a net tax, on assets minus liabilities held at death. If Buy/Borrow/Die is taken to its limits, or to within $5.4 million of its limits per person,[60] there is no net estate to tax.

The principles of Buy/Borrow/Die are basic, unquestionable matters of tax law: gains are not taxed until "realized;" borrowing is not "income;" assets get a stepped-up basis on death. While it is true that only the wealthy have significant enough stores of capital to live

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[59] David Joulfaian, *Estate and Gift Tax, Federal*, NTA ENCYCLOPEDIA OF TAXATION AND TAX POLICY (Joseph J. Cordes, Robert D. Ebel, and Jane G. Gravelle eds., Urban Institute Press 2005).

[60] Deborah L. Jacobs, *IRS Raises Limit On Tax-Free Lifetime Gifts*, FORBES (Oct. 31, 2013) http://www.forbes.com/sites/deborahljacobs/2013/10/31/irs-raises-limit-on-tax-free-lifetime-gifts/#3fc2720f6cb0.

off the real -- not reported -- income from their wealth alone, the principles of Buy/Borrow/Die are available to all. Thus, for example, homeowners can borrow against their home equity, all tax free, and all can borrow against cash value life insurance policies, whose "inside build-up" has also been tax-free. But our concern here lies with the wealthy, who can literally live a tax-free life using Buy/Borrow/Die.

B. The Realities of Buy/Borrow/Die

The century during which Buy/Borrow/Die has survived intact has been a century of dramatically rising wealth inequality. Why do we not see the obvious, and strike a match to peer into the darkness?

There are many components of an answer to this puzzling question. Section 6 canvasses many deep structural problems in taxing wealth seriously. But another phenomenon haunts progress towards taxing wealth seriously: denial. There are many popular misunderstandings and skeptical objections that keep ordinary citizens from comprehending the importance of Buy/Borrow/Die.

There are deep-seated instincts that simple advice is too good to be true, and that the tax-planning of the wealthy must be complex and expensive to obtain. This is, of course, what many *want* ordinary citizens to think, whether they are professionals profiting from giving complex tax-planning advice, politicians hiding from a difficult task that would alienate their wealthiest donors, or wealthy individuals are happy enough to hide their wealth and tax-planning strategies simply in the shadows.

Understandable as they may be, these skeptical sentiments get in the way of taxing wealth seriously. This sub-section briefly goes through some of them.

How can anyone understand Buy/Borrow/Die?

What we do not understand, we tend to assume no one understands. Perhaps, then, Buy/Borrow/Die is simply too complex to do any real harm.

But it is not that hard to understand Buy/Borrow/Die. The widespread ignorance of Buy/Borrow/Die cannot be pawned off on its intrinsic difficulty. There is also no reason whatsoever for the wealthy to have to figure out Buy/Borrow/Die on their own -- professional advisers will find them. There is a vibrant market for providing tax advice to the wealthy, where the stakes justify the attention. Professional advisors may not know the precise phrase Buy/Borrow/Die, but they certainly know its core principles, which feature in virtually all tax-saving advice. It pays for someone, somewhere, to figure out the relevant advice and to find the many millionaires and billionaires interested in employing it.

What about the interest on the borrowing? (or, Debt-Aversion, Part 1)

Debt-aversion is a perfectly sensible heuristic, as we have known at least since Shakespeare told us to "never a borrower nor a lender be."[61] Robert Kiyosaki, in the passage quoted above, had chided his "poor Dad" readers for investing in a "safe" bank account that was "not too intelligent" given the tax laws. A reflexive distrust of "Borrow" keeps some from

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[61] William Shakespeare, *Hamlet* Act 1, scene 3, 75-77 (Dr. Barbara A. Mowat and Paul Werstine Ph. D. eds., 2012).

understanding Buy/Borrow/Die's breadth. One common skeptical objection to Buy/Borrow/Die is that playing it requires paying interest, which ordinary citizens seem loathe to do, notwithstanding, and perhaps because of, the prevalence of consumer debt in society.[62]

This is however a poor objection, financially, because it ignores both the tax savings to be gained from Buy/Borrow/Die *and* the real, economic income from the *un*sold asset.

Suppose that Dick and Jane each hold a stock worth $1,000,000, with no basis, for simplicity, such that the full million dollars represents built-in gain. Suppose, again for simplicity, a tax rate of 40% on realization.[63] Both Dick and Jane want to go on a very expensive vacation. Dick, impatient and ignorant of tax, simply sells his stock for $1,000,000, pays his $400,000 (40%) tax, and immediately spends $600,000 on his trip. Jane plays Buy/Borrow/Die. She borrows $600,000 and goes on the same trip Dick does.

Jane will, indeed, have interest to pay on her $600,000 debt. But she will *also*, unlike Dick, still have her $1,000,000 asset. Playing Buy/Borrow/Die out to death means that she will have an additional $400,000 over Dick to give to her heirs or to later borrow against. Jane will also have the return on the million-dollar asset to offset the interest on the $600,000 debt. Economic theory, common sense, and reams of historical data suggest that, over

[62] Devon Douglas-Bowers, *Mounting U.S. Household Debt and Bank Overdraft Fees*, GLOBAL RESEARCH (Jan. 12, 2016). http://www.globalresearch.ca/mounting-household-debt-and-bank-overdraft-fees/5500771.

[63] This is not unrealistic considering capital gains in high tax states like California are close to 40%, and, as noted in 3 C below, the best explanation for a lower capital gains rate is the existence of Buy/Burrow/Die.

time,[64] the rate of return on a million dollar appreciating asset will significantly outperform the interest on a secured debt of $600,000. [65] The wealthy benefit from a long time frame.

If the rate of return on Jane's $1,000,000 asset is 10%, she will earn $100,000 a year in real income. If the $600,000 loan bears interest at 5%, she will pay $30,000 in interest. Jane will be making, in *real* income, $70,000 a year (100,000 - 30,000) -- potentially forever -- that Dick will not. Jane can continue to borrow against the asset to pay the interest, as margin accounts would allow her to do automatically.

To tally up, both Dick and Jane have their $600,000 luxury trip to remember. But Jane has an additional $400,000 of wealth, *and* an extra $70,000 a year, from having followed Buy/Borrow/Die. It is more than worth it for professional financial advisors to make Jane aware of all this, and Jane would happily pay for the advice.

What if assets go down in value? (or, Debt-Aversion Part II)

Needing to pay interest is one aspect of debt aversion. Another is the fear that assets will go down in value, such that the Buy/Borrow/Die player will face a margin call or, worse, bankruptcy.

This is another misplaced objection.

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[64] McCaffery, *Distracted from Distraction by Distraction*, *supra* note.

[65] For 1928 to 2013, the arithmetic average return on the S & P 500 index (of the 500 most valued companies trading on stock exchanges) was 11.50%; the average return on a 3 month T-bill, a good proxy for the kind of interest rate that the wealthy could obtain, was 3.57%. The difference over time is astounding. If one had borrowed $100 in 1928 at the T-bill rate, and invested the money in the S & P 500, letting the stock holdings ride and the interest accrue into the debt, the debt would have grown to $1973, and the asset would have grown to $255, 553. In other words, borrowing $100 and holding onto a $100 stock portfolio, over the past 85 years, would lead to a *net* gain over $250,000. The number is $25 million with an initial investment of $10,000. See: http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

Return to Dick and Jane. We had left Jane far ahead on the financial planning score -- she had $400,000 more in wealth, and perhaps $70,000 more in annual untaxed real income than Dick. Who would not choose Jane's path? Perhaps someone who is worried that there could be a crash in the asset market, such that Jane's million dollar holding fell in value, and she was no longer making real income and, in a worst case scenario, would be unable to pay off the loan.

This problem is overstated.

One, the problem is not a significant one for the *very* wealthy, because they have more than enough wealth to weather out any financial storm. Surely Warren Buffet would not worry about using some of his $8 billion in appreciation (or $70 billion in total wealth), to help secure a $600,000 loan. This is one of the many ways that Buy/Borrow/Die, while not only available to the wealthy, is certainly easier and better for them. The 160,000 American households with an average net worth of $72 million can all get favorable interest rates.

Two, even at Jane's level, the debt aversion can be handled. Suppose Jane put a "stop loss" order on *any* decline in her million-dollar asset -- if it falls even a penny below $1,000,000, her stockbroker, or her computer, is under orders to sell it. On sale, Jane would get $1,000,000, pay $400,000 in taxes, and be left with $600,000, which she would use to pay off her debt. Jane would then be in the same position as Dick -- $600,000 spent, no debt, no asset. But if there were *any* chance that the asset never falls below $1,000,000, Jane would be better off than Dick.[66]

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[66] We can simplify matters by putting Dick, after his trip, at $0. Jane's financial position can be described as $\mathbf{(p)(400K + ((r - .6i)1{,}000{,}000^{n})) + (1\text{-}p)0}$, where p is the probability that the asset

It is unfair to tax mere appreciation as there is no cash to pay the tax

The objection relates to the above. Since the government will not accept mere appreciation as a form of tax payment, what does a follower of Buy/Borrow/Die do at tax time? How could Buffet pay $2.4 billion in cash on his 2010 "mere" appreciation?

Once again there are compelling responses to the objection.

One, it is a fact that, in a wide-range of contexts, we do, as a matter of general tax principles, tax non-cash receipts.[67]

Two, we could also tax at least the borrowing secured by yet-untaxed appreciation, because there is cash in these contexts.

Three, and most fundamentally, this objection to Buy/Borrow/Die assumes a solution -- a repeal of *Macomber*'s realization requirement -- and, finding that solution unacceptable (because assets might fall in value, or there is no cash, or some such), goes back to ignoring the problem. This is not very good logic. The objectors simply assume an answer and deny the problem because they do not like that answer. But there is in fact no reason to tax unrealized appreciation directly in order to reverse course and start taxing wealth seriously. Buy/Borrow/Die is the problem. The path to reform involves addressing any of its planks, as Section 7 explores. We will get there in due course.

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never falls below $1,000,000, (1 - p) is the probability that it does fall below $1,000,000, r is the rate of return on the $1,000,000 holding, and i is the interest rate on the ($600,000) debt. This ignores transaction costs which, if the strategy were set up by Jane on-line would be modest in any event. Transaction costs aside, Jane's strategy strictly dominates Dick's in technical terms.

[67] IRC Sec. 61.

Who would take Buy/Borrow/Die to the limit?

Skeptics often assert that it is too costly, or risky, or both to take Buy/Borrow/Die to its limits so as to pay no tax. Buffet, for example, paid nearly $7 million in income taxes in 2010, which is a long way from nothing. Statistics of reported income continue to show that high income earners pay high taxes.[68] There are indeed significant sums of realized capital gains every year. Scholars argue that capital does contribute some tax to the fisc.[69]

These assertions contain glimmers of truth. But none adds up to a powerful objection to Buy/Borrow/Die.

The simple response is that there is no reason why any one would have to take Buy/Borrow/Die to its limit in order for it to be a problem. Warren Buffet pays significant taxes, as we have seen, but avoids far more than he pays. Other case studies are easy to find, even if norms of confidentiality preclude full transparency. Simple devices such as home equity loans, reverse mortgages, cash value life insurance make Buy/Borrow/Die pervasive and available to many. It defies common sense to think that a simple analytic possibility to save large amounts of taxes should go unused by the very rich who can most benefit from it. It is these *anayltic possibilities* of Buy/Borrow/Die that drive the project of this Article.

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[68] Laura Saunders, *Top 20% of Earners Pay 84% of Income Tax*, THE WALL STREET JOURNAL (Apr. 10, 2015) http://www.wsj.com/articles/top-20-of-earners-pay-84-of-income-tax-1428674384.

[69] Roger Gordon, Laura Kalambokidis, and Joel Slemrod, *Do We Now Collect Any Revenue From Taxing Capital Income?* Presented at the International Seminar in Public Economics conference held at the University of California at Berkeley on December 7 and 8, 2001. In 2013 (latest CBO data), 7.9% of federal individual income tax receipts came from capital gain taxes (http://www.justfacts.com/taxes.asp#f195)

Other taxes are taking care of taxing wealth

Some argue that the income tax need not address wealth inequality because other taxes are taking care of the problem. The simple answer is: No, they are not.

Most important, the gift and estate or unified wealth transfer tax system is *not* taxing wealth seriously. The estate tax has long been essentially a "voluntary tax," as it was dubbed in 1972.[70] It is easily avoided with fairly standard planning techniques.[71] To choose one example -- where a journalist shed some helpful light -- the casino magnate and Republican-party donor Sheldon Adelson was able to transfer nearly $8 *billion* to his family, at a time when the estate tax exemption level or "zero bracket" was $1 million or less, and the estate tax rate 50% or more, *altogether tax free*.[72] That is not taxing wealth seriously. Today hundreds of billions of dollars sit in Dynasty Trusts, in South Dakota and elsewhere, *forever* out of the estate tax's reach.

No other tax gets close to addressing the problem of wealth inequality. The corporate tax is largely a trick, because its incidence -- who really, in the end, pays it -- is unclear. Corporations themselves, as legal fictions, do not "really" pay taxes, even if they remit them. The money sent to the government must come out of someone's pocket. It is easy to assert that this would be the corporation's owners, the shareholders. But why would capitalists pay a tax when there are nontaxable alternatives for their money? Most economists feel

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[70] GEORGE COOPER, A VOLUNTARY TAX? NEW PERSPECTIVES ON SOPHISTICATED ESTATE TAX AVOIDANCE (The Brookings Institution, 1979).
[71] *See* Edward J. McCaffery, *A Voluntary Tax? Revisited*, NATIONAL TAX ASSOCIATION PAPERS AND PROCEEDINGS (2000).
[72] Zachary R. Milder, *Accidental Tax Break Saves Wealthiest Americans $100 Billion*, Bloomberg (Dec. 16, 2013) http://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion.

that the corporate tax is paid largely if not completely by labor.[73] There is also the fact that corporations have their own versions of Buy/Borrow/Die, typically involving international tax arrangements that substantially reduce the U.S. corporate tax sting.[74] Berkshire-Hathaway for example is able to avoid or defer significant corporate taxes.[75]

Property taxes are local and limited primarily to real estate and certain forms of tangible property. Sales and other forms of consumption tax are relatively low and flat. The taxes most raised by President Obama are excise ones such as on cigarettes and cell-phones.[76] These don't even try to tax wealth seriously. And so on.

We should never tax wealth/it is double taxation to do so

Many poor arguments lay behind the objection that wealth *should* not be taxed, having already been taxed.

As a preliminary matter, there is nothing, generally, wrong with "double taxation" -- many dollars in the flow of the economy are taxed multiple times. To give an easy example close to home, a salaried employee pays both payroll taxes and income taxes on her earnings. So the argument tends to be that the same tax cannot tax the same wealth twice, and, since the initial receipt of wealth has been taxed by an income tax, its yield should not be. This is Mill's point.

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[73] Arnold C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. POL. ECON. 215 (1962).
[74] Edward A. Kleinbard, *Stateless Income* 11(9) Fla Tax Rev. 699 (2011).
[75] Morris Propp, *Warren Buffett's Nifty Tax Loophole*, BARRON'S (April 11, 2015) http://www.barrons.com/articles/warren-buffetts-nifty-tax-loophole-1428726092.
[76] Edward J. McCaffery, *Why You Pay Hidden Cell Phone Tax*, CNN (Aug 21, 2013) http://www.cnn.com/2013/08/21/opinion/mccaffery-mobile-charges.

But that is not a very satisfactory argument in the face of the facts of vast and increasing wealth and wealth inequality. Consider the issues of windfalls and iteration.

First, windfalls. There are two forms of consumption taxes that are single taxes on wealth. One is the wage tax model -- tax earnings as they come in, and never again, like a payroll tax. The other is a spending tax model -- tax wealth as it is converted into spending, wherever the spendable resources came from (wages, capital, borrowing), but not when wealth first comes into a household.[77] It is a well known result in the tax-policy literature that these two types of tax are equivalent under certain specified conditions. But they are *not* equivalent if there are "windfalls," or outsized returns to savings.[78] Simply put, wage taxes do not fall on windfalls but spending taxes do. This is easy enough to see in a simple case of a worker who wins millions on a $1 lottery ticket. A wage tax like the payroll tax would not affect her; a spending tax would, as she consumes her good fortune.

To those concerned with taxing wealth seriously, the fact that the initial savings were at some point taxed is hardly consolation. Suppose that Jane had earned $2000 in 1965, paid income taxes of $1000, and used the remaining $1000 to buy shares of Berkshire-Hathaway stock. By 2014, that thousand dollars would have grown -- altogether tax-free

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[77] McCaffery, The Oxford Introductions to U.S. Law, Income Tax Law, *supra* note. Of course, for those (many) wage earners who do not save, the two types of consumption taxes come out to the same end. Recall the Haig-Simons definition of Income, Income = Consumption + Savings. If Savings = 0, then Income = Consumption. Equivalently, wages = spending, so a wage tax and a spending tax are equivalent.

[78] Technically, the textual statement holds only if the existence of windfalls is not related to the size of the after tax investment pool. Consider the lottery example in the prior paragraph. Jane makes $2, loses $1 to the income (or payroll) tax, and buys a lottery ticket with the other $1, which turns into a $1 million, not taxed. If there is a spending tax, Jane's $1 million would be taxed as spent, leaving her worse off than with the wage tax. The (technical) question is if Jane had *not* been taxed initially, could she win $2 million with her $2 to spend on lottery tickets. That seems unlikely. See Edward J. McCaffery, *Tax Policy under a Hybrid Income-Consumption Tax*, Texas L. Rev. (1992).

under Buy/Borrow/Die -- to $10.5 *million*, $10,500,000.[79] The government's official inflation calculator reveals that $1000 1965 dollars are equivalent to just over $7,500 by 2014;[80] hence the argument that capital appreciation should not be taxed because it represents mere paper or inflationary gains also misses the mark. Virtually Jane's entire $10.5 million reflects never-taxed real appreciation. That is a windfall.

It gets worse. If Jane were married, her full $10.5 million could be placed in a Dynasty Trust, for Jane's children, grandchildren, and so on, altogether tax-free under the gift and estate tax.[81] No subsequent generation need *ever* pay any tax, if the Trust simply follows Buy/Borrow/Die. This is the problem of iteration.

Defending these facts with the argument that the initial $1,000 that Jane invested had been taxed, such that the government should be estopped from ever taxing Jane and her progeny again, is not taking taxing wealth seriously.

Where's the data?

Another skeptical objection is that there is no data, or not enough data, to support the supposition that Buy/Borrow/Die is a problem.

A quick answer is that there is plenty of data: Piketty's data. America has great wealth and great wealth inequality. The problem of wealth inequality is getting worse, notwithstanding a tax system that is supposed to redistribute wealth. That America's top

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[79]Elena Holodny, *Here's What $1,000 Invested With Warren Buffet At Different Times in the Last Fifty Years is Worth Today*, BUSINESS INSIDER (Aug. 14, 2014) http://www.businessinsider.com/if-you-had-invested-with-warren-buffett-2014-8.
[80]Inflation Calculator: http://data.bls.gov/cgi-bin/cpicalc.pl.
[81] McCaffery, *Distracted from Distraction by Distraction*, *supra* note.

160,000 have average net worth in excess of $70 million, while most people have little or no financial wealth at all, is a problem. It is logically possible to argue, or assume, as Piketty himself seems to,[82] that the problems would be worse without the tax system -- that taxes are a cure, just a partial cure. Understanding the analytic facts of Buy/Borrow/Die makes such beliefs, however, rather heroic, at least when it comes to wealth as opposed to income inequality. Without the yoke of heavy taxation around their necks the rich can get richer, while ever-greater burdens fall on workers, who struggle to save at all. Such a tax system would *predict*, from first principles, a world of unequal wealth, and of wealth inequality more severe than income inequality. Piketty abundantly demonstrates that we have just such a world. Why not connect these dots?

There is little data on the very wealthy and their tax planning because they are relatively few, and relatively secretive, and neither the press nor the people have much time or appetite for understanding their strategies in any event.[83] We know about Warren Buffet because he helpfully disclosed his tax return data for 2010. Few Americans do that, and none really have to.[84] We know about Sheldon Adelson's $8 billion tax-free transfer of wealth because a reporter did a yeoman's job uncovering it.[85] We know about the hundreds of billions of dollars in Dynasty Trusts in places like South Dakota because of

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[82] Piketty*, supra* note.
[83]Holtz-Eakin in NYU symposium issue
[84]Edward J. McCaffery, *A 'Tax Day' Americans Could Love?*, CNN (Dec. 3, 2014) http://www.cnn.com/2014/11/26/opinion/mccaffery-finland-tax-day.
[85]Harnberger, *supra* note.

some academic research.[86] These are intriguing tips of the iceberg, but not enough data points to satisfy the empiricists crying for statistical significance.

But we know more. The analytic facts show that Buy/Borrow/Die is widely available, and has been so for nearly a hundred years. Why would the wealthy -- some, most or all of them -- not take advantage of its perfectly legal steps? Why would professional advisers not seek out the wealthy, and explain to them the tax savings available? Popular best sellers such as *Rich Dad/Poor Dad* contain the essence of the advice, and Warren Buffet and Berkshire Hathaway live it out for all to see. If the wealthy do not know that selling valuable assets with large levels of built-in gain produces tax, they will find out soon enough, at tax time. It defies logic, common sense, and every major tenet of rational choice social theory that individuals would not take advantage of a perfectly legal tax strategy that could save them millions or billions of dollars.

If Buy/Borrow/Die is a problem, it is a small problem

What we cannot deny we trivialize. Perhaps worn out by the counter-arguments raised, and unable to challenge the strictly legal, doctrinal analysis behind Buy/Borrow/Die, those who do not want to deal with it attempt to trivialize it. Maybe the *very* wealthy do play the Buy/Borrow/Die game, but they are so few, and few of them take Buy/Borrow/Die to its limits, and there is not much money to be had trying to get after them.

These are dangerously poor arguments. They take the absence of data, just considered, and use it to aid a lazy presupposition that what we do not see cannot hurt us. Freud among

[86]Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust*, 27 CARDOZO L. REV. 2465, 2466-68 (2006).

others should have taught us otherwise. While some may disagree that wealth inequality is a problem, the project of taxing wealth seriously assumes that it is, and aims to go about correcting it. There are good reasons to think Buy/Borrow/Die is a big problem.

Even if we were only talking about a single person or two, Buy/Borrow/Die is a problem. Buffet now has a net worth of about $70 billion; his good friend Bill Gates comes in at $80 billion.[87] Under Buy/Borrow/Die, both billionaires *can* spend it all and die broke -- and tax-free. The fact that neither Gates nor Buffet seem inclined to do so -- both have demonstrated a solid commitment to philanthropy[88] -- is wonderful news. But it is also a fortuity.[89] Gates, Buffet, or any other billionaire could change his or her mind and go on a massive spending spree, perhaps by running for elected office. This is a problem lurking in the darkness that we had best check out.

Although we are not all Buffets, some 160,000 households with average net wealth of $70 million does not seem like something to ignore. At a spending rate of 5% a year, such households can consume $3.5 million a year altogether tax free, while their net worth keeps increasing.[90] Piketty, while not extensively engaging in moral or political theory, suggests many of the problems that come when a "rentier class" -- one that can live off financial capital and its returns, alone -- roams the land. Workers become discouraged, students abandon education to hatch schemes to get rich, the propertied class has not

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[87] Tanza Loudenback, *Bill Gates is Again the Richest Person on Earth, With a Net Worth of $87 Billion*, BUSINESS INSIDER (Jan 27, 2016). http://www.businessinsider.com/bill-gates-richest-2016-1.
[88] Marqui Mapp, *Make Billions, Then Give It Away: Gates, Buffett Talk Philanthropy*, CNBC (May 10, 2015) http://www.cnbc.com/2015/05/08/bill-gates-and-warren-buffett-talk-philanthropy.html.
[89] John Rawls, *A Theory of Justice* (1971). John Maynard Keynes, *The Economic Consequences of the Peace* (London: Macmillan, 1919).

much incentive to do anything. Our tax system encourages exactly this pattern.[91] The social fabric is at risk of breaking down, class warfare looms. As a matter of history, real wars and crises follow.

It does not seem sensible to blindly walk into the abyss. It is easy to see the problem, and potential cures, once we have some light. Taxing wealth seriously -- reshaping Buy/Borrow/Die -- is not about the steps needed to get more revenue next month, to keep the lights on in government buildings. It is about fairness and justice and shedding light on America's caste system, before the darkness rises to harm to us all.

C. Beyond Buy/Borrow/Die

The facts of Buy/Borrow/Die are bad enough for the task of taxing wealth seriously. It gets worse. Even where Buy/Borrow/Die is not being followed directly, its very existence casts a shadow over the income tax, constraining important matters of practical tax design.

The most important instance of this effect is the persistence of low capital gains tax rates. When Jane sells an asset that she has held for over a year, like a share of Berkshire Hathaway stock, she pays tax at a rate that is one-half or less of the rate she pays on her labor earnings. Throughout history, the capital gains rate was typically set at 40% of the "ordinary" rate, so we have seen 90/36, 70/28, and 50/20 as pairs of highest ordinary and capital gains rates.

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[91] Piketty, *supra* note. Michael Simkovic, *The Knowledge Tax*, 82 U. CHI. L. REV. 4 (2015).

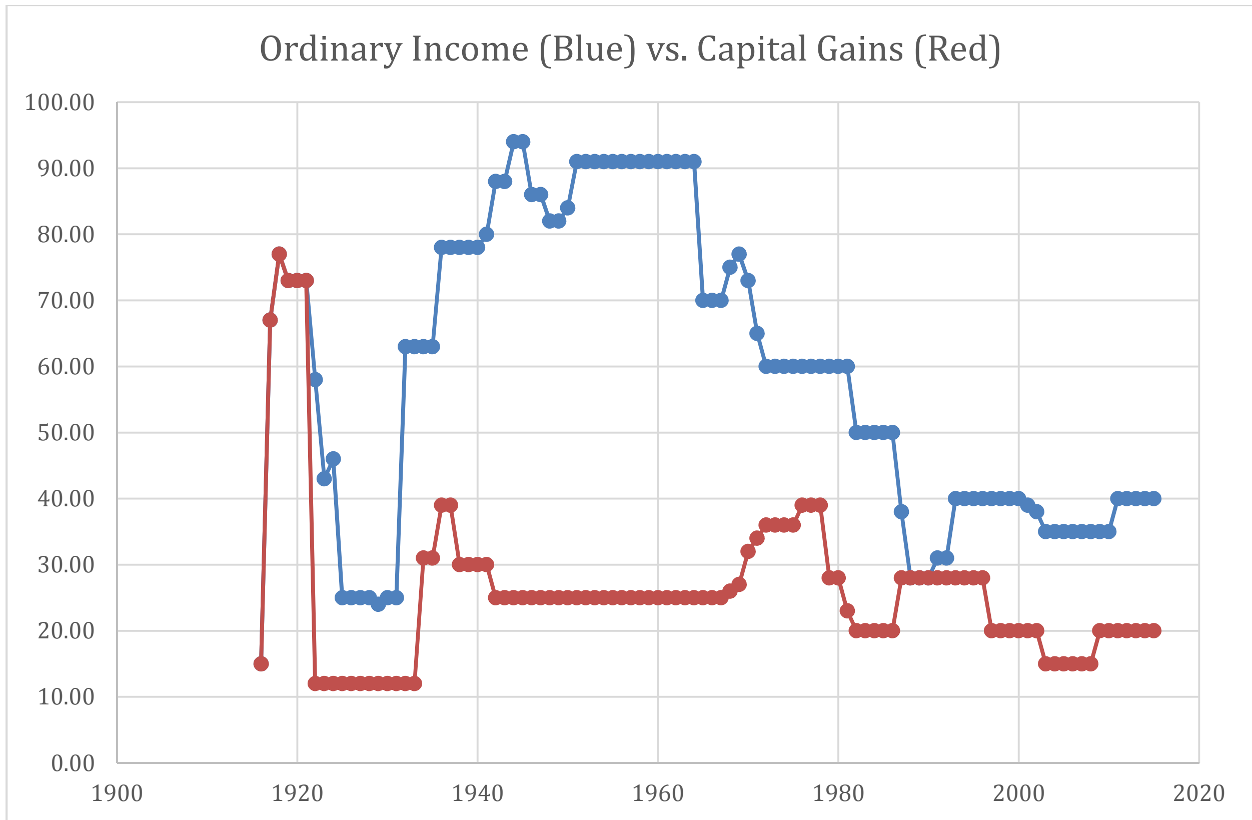

Figure 1: Ordinary versus Capital Gains Rates, 1913-present

Things are a bit harder to see now -- the politics of salience suggests many hidden tax rates, as arise from "phaseouts" of benefits and so on[92] -- but 40/20 is a rough estimate of the current top ordinary and capital gains rates in 2016. [93]

Why do we favor capital gains, notwithstanding the facts that Buy/Borrow/Die already hugely favors capital, and that capital is winning the day in the macro-economy, as well?

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[92] Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861 (1993-1994).

[93] The lower capital gains rate factors into the ongoing discussion of "carried interest," a technique that hedge fund managers, among others, employ to get their compensation in the form of capital (i.e., an equity ownership interest in the fund), with which they can play Buy/Borrow/Die and eventually get capital gains rates. Although this issue has been around for a while, with a legislative proposal to end the break from Charles Rangel (D-NY) dating back to 2004, politicians today make hay with it. Even Donald Trump has vowed to "crack down on Wall Street" by addressing this problem. Of course, it is a problem for high wage-earners, like hedge fund managers. It would not cost Warren Buffet a penny.

The paradoxical answer is that we have lower capital gains rates b*ecause of Buy/Borrow/Die*.

The realization requirement creates a "lock-in" effect under which asset-holders are discouraged from selling.[94] If taxpayers are not flocking to advisers to avoid rather modest capital gains tax rates, why would they not do so if rates increased -- bearing in mind that the highest ordinary income rate bracket under the income tax has exceeded 90%? One would predict that Buy/Borrow/Die gets used more at higher tax rates. Indeed, evidence shows that the government *gets* revenue when it cuts the capital gains rate, opening up sales that are good both for the economy and the fisc.[95] The pattern has not gone unnoticed by capitalists or by politicians, and so we can plausibly expect some future Clinton or other president to do what the first Clinton did, and cut the capital gains rate as a means to collect taxes on her, or his, watch. [96]

The simple point is that once you have made it easy for a great deal of capital appreciation to escape tax, as Buy/Borrow/Die does, it is both difficult and questionable policy to keep *any* capital in the tax base directly, at all. Thus we see a very light hand on the capital side of the capital-labor divide. Once you have that, if you are a government that needs vast sums to feed itself—and what government these days does not?—you had better be very

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[94] Capital Gains and Losses, in COMPREHENSIVE INCOME TAXATION 115, 135-40 (J. Pechinan ed. 1977).

[95] Daniel J. Mitchell, *The Overwhelming Case Against Capital Gains Taxation*, FORBES (Nov. 7, 2014) http://www.forbes.com/sites/danielmitchell/2014/11/07/the-overwhelming-case-against-capital-gains-taxation/#34f0f2016074.

[96] Charles Kadlec, *The Dangerous Myth About the Bill Clinton Tax Increase*, FORBES (July 16, 2012) http://www.forbes.com/sites/charleskadlec/2012/07/16/the-dangerous-myth-about-the-bill-clinton-tax-increase/#b449776772c7.

mindful about maintaining a *heavy* hand on the labor side of the divide, or you have nothing left to tax. This is in fact what we see in tax today, and have for a long time coming.

4. A Century of Embarrassment: Not Taxing Wealth Seriously

The XVIth Amendment was ratified in 1913, allowing Congress to reinstate a federal income tax that had been declared unconstitutional in 1894.[97] Shortly thereafter, Congress acted, and we have had an income tax – in name at least – ever since.

But the tax has never been all that effective in living up to its progressive roots. Canvassing a century of history, we see certain recurrent themes. The income tax was initially conceived, as Professor Carolyn Jones has put it in a seminal law review article, as a "class tax" on the wealthy.[98] Yet in fact the income tax has since its beginning been highly limited in that end. With wartimes, World War I and World War II especially, the tax expanded dramatically in order to help finance the war efforts, becoming, again in Jones's phrase, a "mass tax."

As the tax expanded, things changed. The theoretical commitment of an income tax to doubly taxing savings became problematic, leading to a panoply of ad hoc deviations.[99]

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[97] Pollock v. Farmers' Loan & Tr. Co., 157 U.S. 429 (1895); THE RATIFICATION OF THE 16TH AMENDMENT, http://history.house.gov/Historical-Highlights/1901-1950/The-ratification-of-the-16th-Amendment/ (last visited Jan. 28, 2016).
[98] Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 BUFF. L. REV. 685, 685 (1988-1989).
[99] McCaffery, *A New Understanding of Tax*, *supra* note; MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW, *supra* note.

More fundamentally, the seeds of Buy/Borrow/Die were firmly planted by the 1920 Supreme Court case of *Macomber*. These elements of tax have never been seriously questioned, occasional quirks such as Obama's 2015 Capital Gains on Death Proposal being inconsequential exceptions proving the rule. Coming out of World War II, nominally high tax rates persisted – they reached a peak of 94% for the top bracket in 1944 and 1945 -- but high earners were able through tax planning to soften the brunt of these high tax rates. Wealthy earners used features available on the capital side, from Buy/Borrow/Die – often, and generally, using debt to get into the game[100] – to generate tax losses that "sheltered" their wage incomes from taxation. By the 1980s, the system got around to shutting down these "loopholes," as part of a grand compromise under Ronald Reagan that dramatically lowered marginal tax rates while tightening the base of the income tax – as a wage tax. Since then, rates have crept up a bit, but the base has remained primarily as wage, or labor income.

As this income tax story has been running its course, the payroll tax has arisen as the major tax for most Americans, and a close rival to the income tax in total revenue for the fisc. And the payroll tax, by design, only ever applies to wages – and drops off dramatically at about $118,000 of salary.[101] That is a regressive, not progressive, tax.

This Section takes a deeper look at the history in light of these themes.

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[100]McCaffery, *A New Understanding of Tax*, *supra* note at 827*. See also* Calvin H. Johnson, *What's a Tax Shelter?*, 68 TAX NOTES 879 (1995).

[101] Stephen Miller, *2016 Payroll Tax Unchanged; Tax Brackets Nudge Up*, Society for Human Resource Management (Oct. 15, 2015), http://www.shrm.org/hrdisciplines/compensation/articles/pages/fica-social-security-tax-2016.aspx.

A. From a Class to a Mass Tax, Redux, 1913-1945

Jones opens her account in the pre-War, Depression-era 1930s:

> During the 1930s, no more than five percent of Americans were income taxpayers. The tax was viewed as a "class tax" directed toward the rich --- those President Roosevelt referred to as "economic royalists."[102]

The income tax radically expanded in World War II, both as a much-needed means to finance the war effort and to curtail "excess" consumer purchasing power that might otherwise have fueled inflation:

> The result was that the income tax rolls increased from about 7 million taxpayers in 1940 to more than 42 million in 1945. The income tax became in Treasury Secretary Henry Morganthau, Jr.'s words, "a people's tax."[103]

Jones's rich account of the transition of the income tax from class to mass tax rewards a careful re-reading. Her main scholarly focus is on how the official rhetoric -- "propaganda" -- surrounding the tax had to change, because the tax had been "sold" to the public as a check on the wealthy prior to its wartime transformation.[104] Three sub-themes in Jones's narrative deserve emphasis.

One, the initial income tax was rather modest in its rates and application. Figure One had shown the history of the highest marginal rates under the income tax. An initial rate of 7% was increased, during World War I, to as high as 77%, presaging World War II moves, and then fell to 25% by 1925. But there is reason to believe that few if any were in the highest

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[102] Jones, *supra* note at 685.
[103] *Id.* at 686.
[104] *See generally Id*.

rate bracket.[105] In 1932, Ogden Mills, Secretary of the Treasury under Hebert Hoover, told the Senate Finance Committee:

> We have become accustomed to high exemptions and very low rates on the smaller taxable incomes. That is our fixed conception of an income tax and it is very difficult as a practical matter to change fixed conceptions of this character.[106]

Jones goes on to note the narrow coverage of the tax:

> An average of 5.6 percent of the total population were covered by taxable returns in the period from 1918 to 1932, with a maximum coverage of 11.4 percent in 1920 and a low of 2.5 percent of the population in 1931; the low was attributable to economic vicissitudes during the Depression.[107]

The income tax had a relatively low yield during the 1930s. It accounted for only ten to twenty percent of federal revenues during a time of much smaller nominal government than today.[108] Normalizing against gross domestic product (GDP), the income tax took up 0.9% of GDP in 1940, on its way to 9.4% by 1944, an astonishing expansion.[109] It is evident from these numbers, as well as from Mills' public description of the tax and ample case studies of planning opportunities available to the very rich, that the income tax prior to World War II was hardly a "leveling" tax. Meantime, the flat 2% payroll tax with a ceiling of $3,000 – approximately $50,000 in 2015 dollars – took in *twice as much* revenue as the income tax did in 1940.[110]

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[105] Jones, *supra* note at 688.
[106] *Id.* (footnote omitted).
[107] *Id*.
[108] *Id*. at 686.
[109] *See Tax Facts*, TAX POLICY CENTER (Apr. 13, 2012), http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=205.
[110] OFFICE OF MGMT. & BUDGET, HISTORICAL TABLES https://www.whitehouse.gov/omb/budget/historicals (last visited Jan. 28, 2016).

Two, politicians -- even "progressive" politicians such as Roosevelt -- used the *appearance* of high taxes on the rich to suit their political ends. These ends at first were mainly symbolic -- make it look as if we were taxing wealth seriously. The ends later became "real," when the fisc actually needed money, and then the appearance of high tax rates on the rich was used to make income taxation of the masses more acceptable.[111] In political moves strongly evocative of the present era, "[i]ncome tax proposals [of the Roosevelt Administration in the mid-1930s] were directed at taxpayers with over $1 million of taxable income," this at a time when "only 10 percent of families had incomes of $3,200 or over" and a "subsistence or adequate income for a family of four was variously set at between $800 and $2,000."[112] Recall Clinton's Four Percent Plan and Sanders' Ten Million Dollar Bracket.

When Congress raised the top marginal rate to 79 percent in 1936, it applied to incomes over $5 million. According to the Bureau of Labor's inflation adjuster, $5 million in 1936 is equivalent to more than $85 million in 2015 dollars[113] -- far more than even Warren Buffet is showing on his tax returns. Little wonder, then, that, as Jones writes "[f]or three years thereafter only John D. Rockefeller qualified for this most atmospheric of tax brackets."[114]

The highest marginal rate bracket under the income tax is highly "salient," or prominently seen and noticed[115] Less salient is the number of taxpayers actually in the top bracket – not to mention how marginal tax rates even work. Altogether non-salient, obscured in the

[111] Jones, *supra* note at 690-92.
[112] *Id*.
[113] CPI Inflation Calculator, *available at* http://www.bls.gov/data/inflation_calculator.htm.
[114] Jones, *supra* note at 691.
[115] *See generally* David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 Tax L. Rev. 19, (2011-12). *See also* Edward J. McCaffery, *Behavioral Economics and the Law: Tax*, (Sep. 16, 2013).

darkness, is Buy/Borrow/Die, which keeps many of the truly wealthy altogether out of the top bracket because their real income need not be reported.

When these "progressive" moves were put in place, they were meant to serve a rhetorically populist agenda.[116] Later, in World War II, the appearance of high rate brackets on the rich helped to sell the lower rates for the masses.[117] Irving Berlin wrote a song, quoted by Jones, *I Paid My Income Tax Today*, opening with the stanza:

I said to my Uncle Sam
"Old Man Taxes here I am"
And he -- was glad to see me
Lower Brackets that's my speed
Mr. Small Fry yes indeed
But gee -- I'm proud as can be.[118]

The normative aspirations of Berlin's lyrics are clear: to make the taxpaying "Small Fry" of the "Lower Brackets" proud to be contributing something, anything, to the war effort. The salience of the higher – and mainly symbolic – rate brackets makes the Small Fry happy.

Three, the more progressive aspects of tax were actually *weakened* during the darkest days of the Depression, in part at least due to a "supply-side" rhetoric of jobs-creation.[119] In Jones's words, again:

> Despite the vivid contrasts drawn between Herbert Hoover and Franklin D. Roosevelt by historians and in popular culture, FDR did little from 1933 to 1939 to expand the boundaries of individual income taxation articulated by the Hoover administration. The persistence of hard times made such expansion difficult, and memories of tax revolts during 1932 rendered such expansion politically unwise. From 1933 to 1939, an average of 3.7 percent

[116] Jones, *supra* note at 690-92.
[117] *Id.*
[118] *Id*. at 685, quoting Berlin (1941).
[119] *Id.* at 689.

> of the total population was covered on taxable returns. As a result, the individual income tax accounted for a lower percentage of federal revenue during the pre-war period of Roosevelt's presidency than it had from 1925 to 1932. Corporate income and excess profits taxes also represented a smaller portion of federal tax receipts under Roosevelt than they had under the previous seven years of Republican administrations. *The ground lost by Roosevelt in the income tax arena was regained by excise taxation and regressively structured social security taxes*(emphasis supplied).[120]

Once again, history will repeat itself: at the fiscal cliff fix from the wee early hours of 2013, President Obama went along with a package that paired largely symbolic tax increases on the upper income with a large increase in "regressively structured social security taxes."

We revisit these themes in Section 5, looking at contemporary tax reform to make matches with the prior century of tax politics. But first we can add a fourth theme, one that Jones does not explicitly raise: *all* of the elements of Buy/Borrow/Die were fully in place by 1921, and persisted, unchecked, throughout this period. The truly rich, those living off financial capital, were not all that worried about the massive expansion of the income tax or the ratcheting up of its rates. They could easily weather the symbolic storm unleashed against them, taking shelter in the pleasant, tax-free harbor of reality.

B. Back to Mass: The Income Tax as High Wage Tax: 1945-1981

America awoke from World War II with the income tax as a significantly expanded "people's" tax. The tax was here to stay, but it continued to evolve. It did not do so as a total source of revenue, however: the war years more or less maxed out the capacity of the income tax. It would not be until 1998, more than half a century later, that the individual

[120] *Id.*

income tax would exceed the 1944 level of 9.4 percent of GDP; for most of the post War era, the tax swung in a fairly narrow bandwidth between 7 and 9 percent of GDP.[121] See Figure 2.[122]

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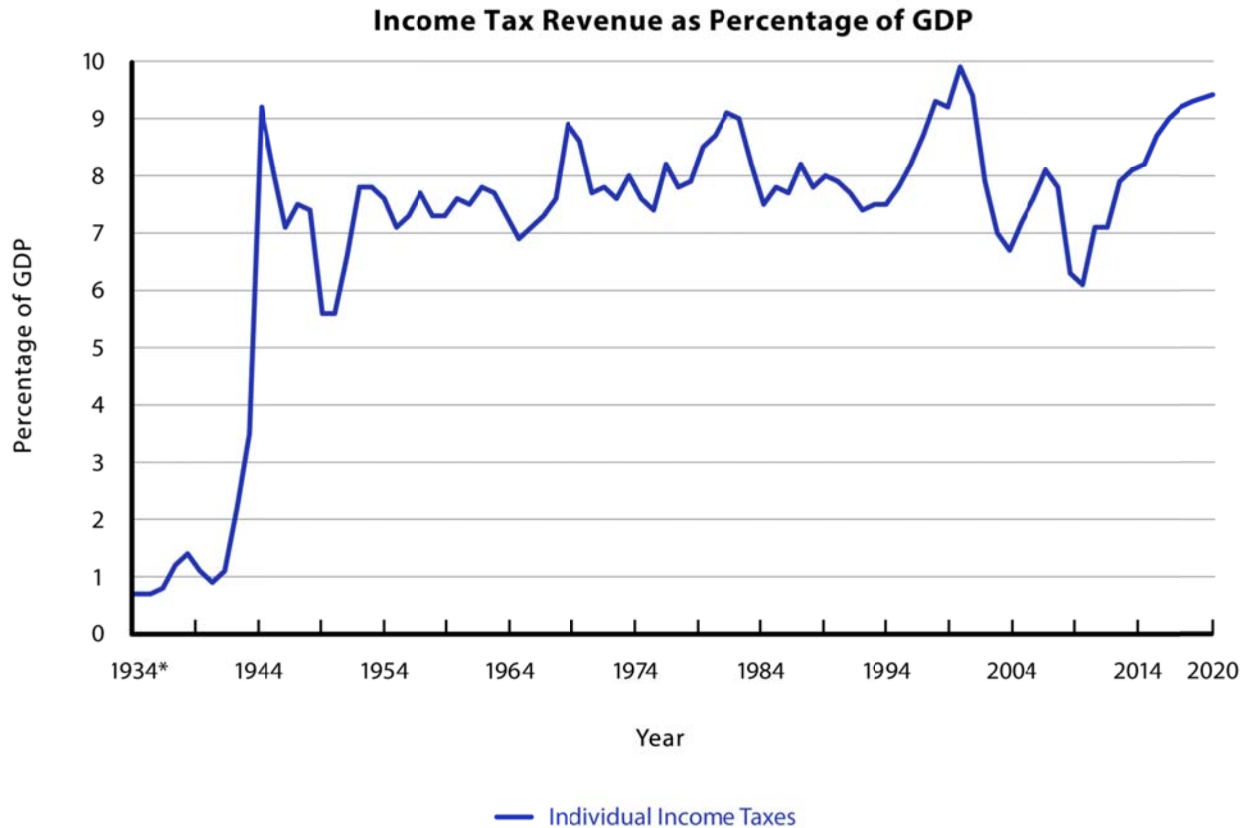

Figure 2: Income Tax as Percent of GDP, 1934-2020 (projected)

Still, the high marginal tax rates put in place during the War endured, during an initial post War phase from 1945 until 1981. This was also a period that Thomas Piketty has labelled a "catch up" phase, during which the wealth that had been decimated during the first half of

121 *Tax Facts*, *supra* note.

122 Office of Management and Budget, *Historical Tables: Table 2.3*, The White House, https://www.whitehouse.gov/omb/budget/Historicals (last visited Feb. 4, 2016); Graphic by Connor Mitchell.

the 20th Century returned, in unequal shares, as the Baby Boom generation got to work.[123] John F. Kennedy brought the top marginal rate down from 91%, where it had been since 1950, to 70% by 1965, where it essentially stayed until Ronald Reagan, in the Economic Recovery Tax Act of 1981 (ERTA), cut it to 50%, effective 1982. See Figure 1.

Rate brackets were not indexed for inflation. Workers were entering higher rate brackets – and their taxes were going up – because of increases in their *nominal* salaries, to keep pace with inflation, as opposed to *real* wages that gave real purchasing power. The failure to index the rate brackets was not addressed until ERTA in 1981, and was not made effective until many years later.[124] Hence, during this period, taxes naturally increased on all Americans without the need for Congressional action.[125] Except for some small quirks in 1968-1970, the highest marginal rate under the income tax was not raised from 1950 until 1990, a forty year period of significant government expansion. See Figure 1. High tax rates were applying to more taxpayers as the American economy took off, and yet the income tax as a percent of GDP stayed more or less constant, certainly within a narrow bandwidth. See Figure 2.

How could this be? There are two sides of the coin answering the puzzle, a public and a private one.

Publicly, with revenues rising due to a growing economy and non-indexation -- which alone meant for automatic tax increases -- Presidents and Congresses could play the role of beneficent uncle. Without rate cuts, the changes needed to keep the overall yield of the tax

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[123] Piketty, *supra* note.
[124] Stephen J. Entin, *Tax Indexing Turns 30*, TAX FOUNDATION (March 11, 2015), http://taxfoundation.org/blog/tax-indexing-turns-30.
[125] Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172 (1981).

within acceptable political bounds came on the base side,[126] with a panoply of exclusions for fringe benefits including employer-provided health care and pension plans, mortgage interest (and, indeed, a general interest) deduction, charitable contribution deductions, and more.[127] An important piece of the post-World War II "peace dividend" was spent in 1948 in moving married couples to a system of joint returns that had the -- intended -- effect of discouraging secondary-earner participation in the workforce.[128]

On the other side of the coin, private taxpayers were taking tax-avoidance matters into their own hands. Buy/Borrow/Die played a lead role, albeit in the shadows. Not only was Buy/Borrow/Die in full force and effect throughout the post War period, but other provisions, such as a nearly unlimited deduction for interest, made it easy for those *without* existing stores of financial capital to avoid the need to pay much, if any, taxes. Tax shelters that took advantage of Buy/Borrow/Die's planning opportunities were almost trivial.[129] As more wage earners entered higher rate brackets because of their nominally higher salaries, tax shelters and their promoters headed downstream, to the growing number of laboring class members facing high income tax rates.[130]

Consider a simple, stylized idea. Take a wage earner, such as a young associate in a law firm, earning $100,000 a year. Suppose that she borrows $1 million at 10% interest, and

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[126] MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW, *supra* note at 3.*See also* McCaffery & James R. Hines Jr., *The Last Best Hope for Progressivity in Tax*, 83 So. Cal. L. Rev. 1031 (2010).
[127] *Id.*
[128] EDWARD MCCAFFERY, TAXING WOMEN (University of Chicago Press 1997).
[129] MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW, *supra* note at 181-201.
[130] *See generally* Dennis J. Ventry Jr., *Tax Shelter Opinions Threatened the Tax System in the 1970s*, Tax Analysts (2006), http://www.taxhistory.org/thp/readings.nsf/ArtWeb/CC7054D5ADE17F64852571A20068ED13?OpenDocument

uses the $1 million to follow Rich Dad's Rule No. 1: she buys assets. The assets, say some Berkshire Hathaway stock, go up in value by 10%, or $100,000. Our associate has spent $100,000, in the form of interest payments, to make $100,000, in the form of the rise in value of Berkshire stock. But the "mere" appreciation in value is not taxed, as we all know by now. With an unlimited interest deduction the associate could deduct the $100,000 interest from her salary, pay *no* income tax, and play Buy/Borrow/Die with her assets. Clever and aggressive tax planners even took this basic idea to an abusive limit in a case, *Knetsch*, where the same entity "lent" the initial sum, handled the "investment" (an annuity), and facilitated the borrowing against the investment – all to a spectacular tax result, albeit one ultimately struck down by the Supreme Court.[131] Other tax shelters used debt to buy assets generating depreciation deductions to offset ordinary salary, or invested in offsetting financial positions ("straddles") and systematically sold their losses while holding their winners, and so on.[132]

There are of course risks and transaction costs in all such plans. But marginal tax rates of 70% or 90% gave plenty of incentive, and cushion, for high earners to try their hands at tax planning. The failure to index made more workers consider tax shelters – and gave an incentive to promoters, accountants and lawyers, to provide them. Plenty of evidence exists that such shelters were common.[133] Note that it was high *wage* earners who were sheltering away in this time period. Buy/Borrow/Die was in full force. Shelters were for executives, doctors, lawyers, other highly compensated individuals. The real rich, like

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[131] Knetsch v. United States, 364 U.S. 361 (1960).
[132] MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW, *supra* note at 183.
[133] George Michaels & Daniel Tilkin, *Tax Implications of Straddles*, G2 FINTECH, Feb. 15, 2015, at 1.

Warren Buffet -- who started the Buy/Borrow/Die of Berkshire Hathaway fame by buying shares in 1962[134] -- have never needed them.

C. The Income Tax as a Flat Wage Tax: 1981-2012

Ronald Reagan, swept into office in no small part on an anti-tax agenda, inherited a tax system with nominally high rates (a top rate bracket of 70%), a porous tax base, all of the elements of Buy/Borrow/Die in place, and a tax shelter industry bringing the goodies of capital-based tax avoidance to the working classes. Reagan changed *some* of this: each element except Buy/Borrow/Die.

In terms of the radical transformation of the income tax, Reagan effected a two-step. His major individual income tax acts, ERTA in 1981 and the Tax Reform Act of 1986 ("TRA 1986")[135], slashed the top marginal tax rate from the 70% he inherited to 28%. Meanwhile, in the second step, the base was broadened -- and other taxes, such as the "regressively structured social security taxes,"[136] were raised in a move reminiscent of Roosevelt's policies during the Great Depression.

The great Reagan reforms also significantly shut down the tax shelter games, by patching up a Maginot Line that was needed to keep the capitalist techniques from the laboring masses.[137] A general strategy of "netting," or creating baskets of types of income that have to be separately toted up, was expanded to shore up the gaps in the line.[138] Thus, for some quick examples, investment interest as an expense can only be subtracted from investment

[134] Shawn Allen, *How Did Warren Buffett Buy Berkshire Hathaway in 1965?*, INVESTORS FRIEND, Jan. 4, 2014, http://www.investorsfriend.com/why-warren-buffett-bought-berkshire-hathaway/.
[135] Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (Oct. 1986).
[136] Jones, *supra* note at 689.
[137] EUGENE STEUERLE, THE TAX DECADE (Urban Institute Press, Jan. 1, 1992).
[138] MCCAFFERY, THE OXFORD INTRODUCTIONS TO U.S. LAW, INCOME TAX LAW, *supra* note at 61.

income;[139] capital losses can only be deducted (except for an odd $3000 quirk) against capital gains;[140] and, most systematically, in a hallmark of TRA 86, losses from "passive activities," such as rental real estate, can only be deducted from gains from such activities.[141] These moves generally, and fairly systematically, block those who are earning *wage* income from generating tax losses by playing games with *capital*, typically someone else's capital – a classic trait of a tax shelter.

But Reagan and his great tax reforms made no effort to take away the games of the propertied classes. In particular, *no* step was taken to shut down Buy/Borrow/Die. The realization requirement was left unchecked. The non-taxation of borrowing was left unchecked. The stepped-up basis on death rule was left unchecked. Indeed, as to the final prong, Jimmy Carter had enacted a rule for carryover basis for assets acquired on death, in 1976, but the effective date of the rule was postponed, and then retroactively repealed.

Rates went up from their lows in the 1980s, from a top marginal rate of 28 or 33% percent after 1986. George H.W. Bush's quivering lips on tax increases led to his departure from the White House. Bill Clinton raised the top marginal income tax rate to 39.6% percent but also cut the capital gains tax rate to 20%. George W. Bush inherited a large fiscal surplus in 2001, and spent all of it on two major tax0-cutting bills, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). These Acts cut ordinary income tax rates by 15%, bringing the top marginal rate bracket down to 35%, where it stayed throughout Obama's

[139] IRC Sec.163(d)
[140] IRC Sec. 1211
[141] IRC Sec. 469

first term, until the fiscal cliff crisis – brought on in significant part by EGTRRA and JGTRRA – to be discussed below. These rates essentially only apply to wages. Taxes on capital, when they came due at all, went down -- capital gains fell to 15% percent under EGTRRA, and corporate dividends were added to this low-rate category, also to be raised at the fiscal cliff.

All the while, Buy/Borrow/Dies endured, untouched by tax reform.

D. On Parallel Tracks

While the income tax played out a century of steady evolution towards a burdensome wage tax another story was unfolding on parallel tracks: the steady rise of the payroll tax. Except for the brief two-year period of 2011 and 2012, to be discussed below, the payroll tax was the one major federal tax (individual income, corporate income, gift and estate) that has *never* been lowered. Its history bears note.

In the late 1930s, as World War II dawned, the payroll tax was a flat 2% of payroll, up to a maximum of $3,000 of wages – less than $50,000 in 2015 dollars. Yet this simple "regressively structured" tax brought in twice as much revenue as the "class tax" of the income tax in 1940. The contrasting histories and structures of the payroll and income tax have much to do with their relative salience. The payroll tax has long been labeled a "contribution," a fact that helps it rhetorically -- in marked contrast to the highly salient income tax. It relies on flat-rate taxes, as opposed to the confusing marginal rate bracket structure of the income tax, with its highly salient top marginal rate bracket. Payroll taxes

also do not require taxpayers to fill out and submit an annual form, a task that makes the income tax's salience saliently painful.[142]

The payroll tax began under FDR as part of the actuarially funded social security system, meaning that an individual's taxes were tied to his or her personal benefits. That link was broken in the late 1930s, a few years after the payroll tax began. Roosevelt moved the social security system to a "pay as you go" model, meaning that revenues from the payroll tax were simply available to the federal government to meet its general spending needs, not set aside in some dedicated account for each particular wage-earner or "contributor."[143] That situation still persists today. The tax was structured as a 1% employee "contribution" "matched" by an equal, 1%, employer share. Economists simply assume that the employer "share" actually comes out of the employee's pocket, for the simple reason that an employer must pay this cost when it hires a worker, and hence the worker must be worth her salary *plus* the required tax, such that, if the tax were simply repealed, the employer could, and should, give the prior taxed amount to the employee in the form of wages, rather than to the government.

The payroll tax has always had a simple structure. It has a flat rate. It has no "zero bracket," meaning that the first dollar of wages is taxed at the flat rate, and then it has a ceiling, or cap, after which the tax simply stops. There are no deductions, for anything, and no accommodation for marriage, family size, or anything else. In 1937, this simple tax was set at a flat 2% on wages up to $3000 per person, and *this* tax was the major source of federal

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[142] McCaffery, *Cognitive Theory and Tax*, *supra* note.

[143] Bruce Bartlett, *Tax Withholding Still Controversial After 70 Years*, N.Y. Times, Oct. 22, 2013, http://economix.blogs.nytimes.com/2013/10/22/tax-withholding-still-controversial-after-70-years/?_r=0.

revenue, far greater than the income tax. The tax, except for the aforementioned 2011-12 period, has steadily increased. In 1966, a similarly structured payroll tax, for Medicare's hospital insurance program, was added. In 1980, before Ronald Reagan was elected, the combined rate for these two taxes was 12.26%, by 1990 it reached its present level of 15.3%. Reagan was following in the footsteps of one of his heroes, FDR.

It is hard to overemphasize certain facts that have been left in the darkness, removed from the sometimes blinding light of the income tax. The payroll tax, a flat 12.4% wage tax up to wages of $118,500, and a 1.45% rate above that level (the Medicare component having been uncapped), is, for some 90% of Americans, the highest tax they pay.[144] The payroll tax accounts for almost as much total revenue as the income tax. In 2010, for example, the individual income tax accounted for 42% of federal revenues, the payroll tax added 40%. Put another way, the payroll tax, which by that time had yet to *ever* be cut in its seven decades of history, had risen to account for 95% as much revenue as the highly salient, much debated, frequently cut income tax. The corporate income tax, came in as a distant third, at 9%. See Figure 3.[145]

[144] Michael J. Graetz, *100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System*, 112 YALE L.J. 261, 268-72 (2002-2003).
[145] Office of Management and Budget, *supra* note.

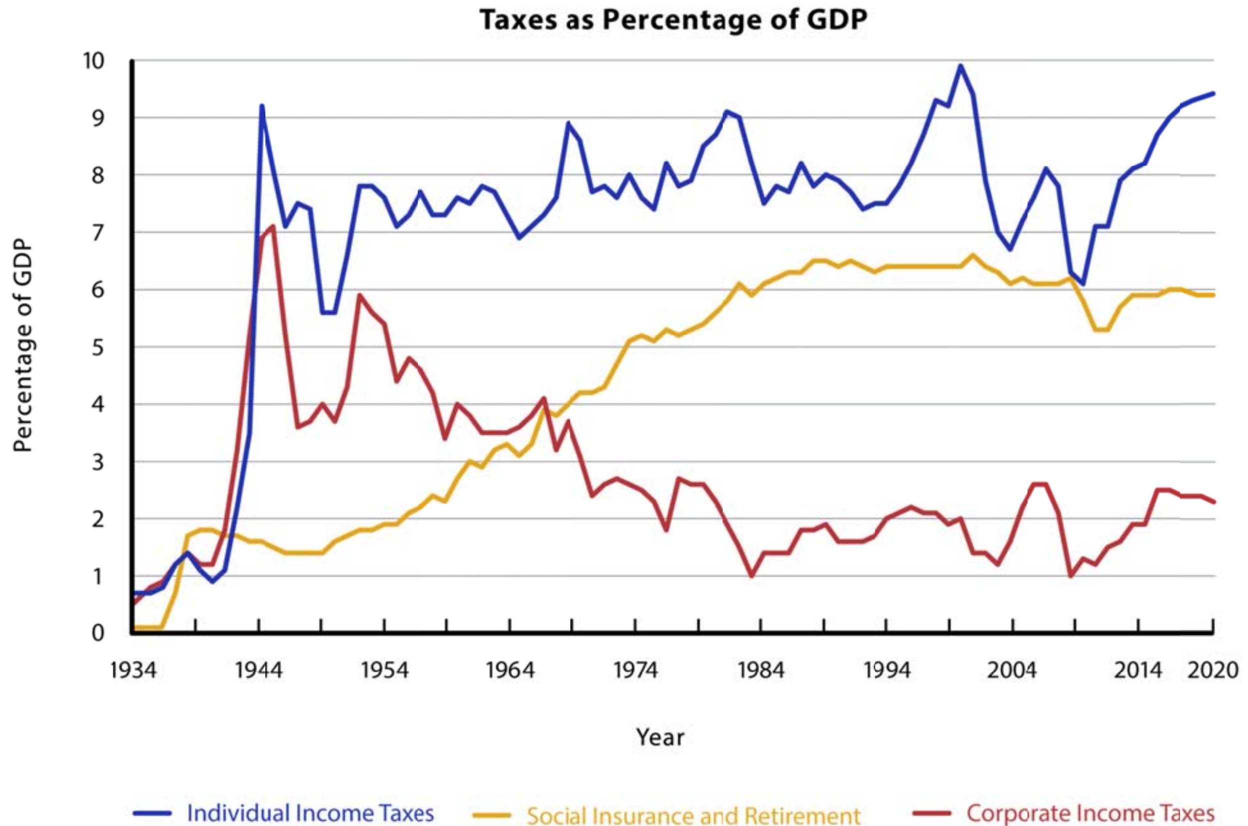

Figure 3: Income, Corporate Income and Payroll Taxes as Percent of GDP, 1934-2020 (projected)

When Obama allowed the payroll tax to increase as part of the fiscal cliff fix in early 2013, considered in the next Section, he followed in the footsteps of both Franklin Roosevelt and Ronald Reagan, in turning to the "regressively structured social security tax" to provide needed revenues allowing the income tax to be cut.

The payroll tax is strictly and simply a wage tax, which makes no attempt whatsoever to tax wealth. Buy/Borrow/Die circumvents it by not ever getting a paycheck. Combined with the century of the income tax's embarrassment, this means that the bulk of federal revenues, some 82%, are coming from wage taxes that mean little to the likes of Rich Dad or Warren Buffet.

5. Modern Times: Bringing the Embarrassment to the Present

America stared down a "fiscal cliff" of its own making approaching January, 2013. This Section presents some case studies that show that there is not much new under the sun of taxation. Once more we see *symbolic* nods at taxing the rich paired with *real* tax increases on the masses. Buy/Borrow/Die is left untouched.

A. Fact and Fiction in the Buffet Rule

In mid-October 2011, the time to file tax returns of choice for the cognoscenti, after the automatic six-month extension from April's initial tax day,[146] Warren Buffet disclosed that his 2010 tax return included $62.9 million of adjusted gross income and $39.8 million of taxable income. Buffet had just paid tax of $6.9 million, for a federal effective tax rate of 17.3% on his taxable income and just under 11% on his adjusted gross income.[147] Buffet graciously pointed out that this effective tax rate was lower than his secretary, who had not earned quite so much money.[148] There was much gnashing of teeth.

After yet another measure to raise tax rates on the rich had failed -- and after Republican presidential candidate Mitt Romney had disclosed that his own effective tax rate, on an income in excess of $20 million a year, was 14%[149] -- President Obama proposed the "Buffet Rule," applying an effective tax rate of 30% on millionaires like Buffet. By using an

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[146] U.S. Citizens and Resident Aliens Abroad: Automatic Six Month Extension of Time to File, IRS, https://www.irs.gov/Individuals/International-Taxpayers/U.S.-Citizens-and-Resident-Aliens-Abroad---Automatic-6-Month-Extension-of-Time-to-File.
[147] Stephanie Condon, Warren Buffet Doubles Down on Tax Return Challenge , CBS NEWS (Oct. 12, 2011) http://www.cbsnews.com/8301-503544_162-20119497-503544.html.
[148] *Id.*
[149] Edward J. McCaffery, *Why do the Romneys Pay so Little in Taxes?*, CNN (Sep. 25, 2012), http://www.cnn.com/2012/09/24/opinion/mccaffery-romney-tax/.

effective as opposed to a marginal tax rate,[150] the Buffet Rule would moot the progressive marginal rate brackets for high-earners, essentially subjecting them to a flat-rate tax. The liberal Citizens for Tax Justice claimed optimistically that the rule would raise $50 billion a year, and that it would affect only the top 0.08 percent of taxpayers.[151] The Buffet Rule came up to a vote in the House in April, 2012 – tax time, of course – only to go, predictably enough, nowhere.[152]

Had the Buffet Rule been in effect, Buffet's 2010 taxes would have risen to almost $12 million, nearly double what they were, based on his $39.8 million of reported taxable income, and over $18 million based on adjusted gross income – the difference in Buffet's case being attributable to large charitable contributions. The Buffet Rule would *appear* to force billionaires like Buffet to pay 30% taxes on *all* their income.

Except that, well, it would not. By far the largest component of Buffet's "income," in an economic sense, came from the untaxed "mere appreciation" in his asset and wealth holdings. This meant that Buffet's *reported* income was a small drop in the bucket of his *real* income. Buffet is a poster child for the "buy" step in Buy/Borrow/Die. Again, Buffet's Berkshire Hathaway shares rose by $8 billion in 2010.[153] Even a tax of $18 million – the Buffet Rule applied to its fullest plausible measure, adjusted gross income -- makes up far, far less than 1% of Buffet's real income: 0.225%, to be exact. The Buffet Rule, which, politically, went nowhere in any event, was far more symbolic than real, because it applied

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[150] explain here, or somewhere, then x refer

[151] *Mr. Obama and the "Buffet Rule,* N.Y. TIMES (Apr. 10, 2012), http://www.nytimes.com/2012/04/11/opinion/mr-obama-and-the-buffett-rule.html?_r= 0.

[152] Edward J. Mccaffery, *The Buffett Rule is Going Nowhere*, CNN (Apr. 16, 2012), http://www.cnn.com/2012/04/16/opinion/mccaffery-buffett-rule/.

[153] *See* Berkshire Hathaway Inc., YAHOO! FINANCE http://finance.yahoo.com/echarts?s=BRK-A+Interactive#symbol=BRK-A;range=5y.

to the easily manipulable measure of reported taxable income, not to real, economic income. Buffet still would have made over $8 billion *after* taxes in 2010 had the most onerous version of the Buffet Rule been in place.

By focusing on reported taxable income, it is easy to miss the real story, for those rich Americans who can afford to live off of their existing wealth. The Buffet Rule would force Warren Buffet to pay an effective tax rate of 30% on his reported earnings. But nothing would force him to show any significant amount of his wealth as reported income in the first place.

B. The Hidden Tax Increase of the Fiscal Cliff Fix[154]

As the nation careened toward its self-created fiscal cliff, the press was full of leaks and rumors of impending deals and the state of negotiations between the Obama Administration and the Democrats, on one side, and the House Majority Leader John Boehner (R-Oh) and the Republicans on the other. Both sides faced a problem, and a strictly rhetorical one: How to "score" the tax changes being considered.

The Bush tax cuts of 2001 and 2003 were each set to expire on January 1, 2013, meaning that there would be a return to the brackets and rates that existed in the Year 2000. Given that both parties clearly and consistently agreed that "no taxpayer earning less than $250,000" should see a tax increase -- the definition of a Small Fry in 21st Century America -- there was no chance that what Congress would ultimately enact would be anything other than a tax cut, on balance. As the law stood, all income taxpayers were set to face a tax increase. Since all political roads were leading to a resolution in which only *some* taxpayers

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[154] A version of this case study appears in *Behavioral Law and Economics: Tax*, *supra*.

would get the increase that what was due under the law -- that is, the "rich" or "high income" -- then the new law cutting the taxes of most while leaving in place the already legislated tax increases of a few would have to be a tax decrease. This is indeed how the Congressional Budget Office officially "scored" TRA 2012.[155] Only that would not do, politically.

So both sides, happily aided and abetted by the media, began talking about what they were doing as changes from the 2012 baseline – 2012 being a year in which both the 2001 and 2003 Bush tax cuts were still in full force. This conceit perfectly stood reality on its head: it "scored" the tax changes to be enacted as if the Bush era tax cuts were *permanent*, as opposed to what they were, which was *expiring*. But, more importantly, it would allow both sides to claim a tax increase on the rich from the failure to extend their tax breaks, while not highlighting the sound analytic fact that everyone else was getting a tax cut.

Taxes on January 1, 2013 were also set to go up by virtue of the expiration of the "payroll tax holiday" that President Obama had gotten enacted for 2011 (replacing the "making work pay" credit), and which Congress had extended, in late 2011, for 2012.[156] The "holiday" was a 2% break from the 6.2% employee share of the social security payroll tax, applicable to earnings (in 2012) up to approximately $110,000 per individual.[157] The "holiday" could thus save an individual over $2,000 -- $4,000 for a couple each of whom earned $100,000. This provision was set to expire, just like the income tax rate cuts of

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155 Jeff Zients, *American Taxpayer Relief Act Reduces Deficit by $737 Billion*, WHITE HOUSE (Jan, 2, 2013), https://www.whitehouse.gov/blog/2013/01/01/american-taxpayer-relief-act-reduces-deficits-737-billion.
156 John Schoen, End of Payroll Tax Holiday May Weigh on Economy, NBC News (Oct. 2012), http://www.cnbc.com/id/49506640/End_to_Payroll_Tax_Holiday_May_Weigh_on_Economy.
157 *Id.*

EGTRRA. Only both sides, Democrats and Republicans, quietly agreed to let it die – *unlike* the income tax rate cuts of EGTRRA.

The resolution of the rhetorical embarrassment was to use a 2012 baseline and measure increases off it. This same accounting construct – measuring changes from 2012's law -- would allow President Obama to count the tax increases from the payroll tax holiday's expiration as tax increases. This would seem to be a *good* thing, as politicians were scrambling to meet proposed revenue-raising targets. More specifically, President Obama had led with a proposed revenue-raising target of $1.6 trillion over ten years. Republicans had countered with $800 billion. Both sides seemed to be inching towards the obvious and inevitable compromise figure of $1.2 trillion.[158]

Only there was a problem: "counting" the payroll tax holiday's expiration as a tax increase would undercut the government's rhetorical claims about the progressivity of the fiscal cliff deal. The optics of redistribution suggested not counting it, in order to maintain a rhetorical claim about the "top 2%" bearing all of the new burdens. The truth was going to be what the truth was going to be – the payroll tax holiday was going to expire – but the (misleading) optics of redistribution prevailed. The Obama Administration did not "count" the tax increases from the payroll tax holiday's expiration as part of the tax increases, although this meant, logically, the numbers being used can only be described as "tax increases over a 2012 baseline, but not including matters not addressed in a new law," or

[158] Zachary A. Goldfarb & Lori Montgomery, *Obama to Open Fiscal Talks with $1.6 trillion plan to raise taxes on wealthy*, THE WASHINGTON POST (Nov 13, 2012), https://www.washingtonpost.com/business/economy/obama-to-open-fiscal-talks-with-plan-to-raise-taxes-on-wealthy/2012/11/13/9984cd78-2dc1-11e2-89d4-040c9330702a_story.html.

something like that. The Republicans, hardly chafing at the bit to tout any tax increase, readily played along.

What are the dollars and cents of all this? Official releases and the mainstream media reported tax increases from TRA 2012 ranging from $600 to $700 billion – a sum total below even the Republicans' opening bid -- almost all falling on the "rich" in some sense. [159] Here is an illustrative description, from the progressive group, Center for American Progress:

> The American Taxpayer Relief Act of 2012—the fiscal cliff legislation agreed to in a deal between President Obama and Senate Minority Leader Mitch McConnell (R-KY)—will raise approximately $617 billion in higher revenues from 2013 to 2022, compared to what the tax code would have generated if we had simply extended all the Bush tax cuts, which were scheduled to expire at the end of 2012. *More than 90 percent of the increase will come from households making at least $1 million a year.*[160] (emphasis supplied)

As for the expiration of the payroll tax holiday? This was estimated to bring in an additional $100 billion a year,[161] meaning $1 trillion over a decade: all from a 2% increase in this "regressively structured social security tax." Obama and his colleagues in Congress were following a bipartisan script written by FDR and played out by Ronald Reagan.

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[159] Jonathan Weisman, *Senate Passes Legislation to Allow Taxes on Affluent to Rise*, N.Y. TIMES (Jan. 1, 2013), http://www.nytimes.com/2013/01/02/us/politics/senate-tax-deal-fiscal-cliff.html.

[160] Michael Linden and Michael Ettlinger, *Revenue From the Fiscal Cliff Deal in Context* , CENTER FOR AMERICAN PROGRESS (Jan. 3, 2013) http://www.americanprogress.org/issues/economy/news/2013/01/03/48872/revenue-f rom-the-fiscal-cliff-deal-in-context/.

[161] Richard Rubin, *Bipartisan House Backs Tax Deal Vote as Next Fight Looms*, BLOOMBERG (Jan. 2013) http://www.bloomberg.com/news/2013-01-02/bipartisan-house-backs-tax-deal-vote-as- next-fight-looms.html.

With the extra $1 trillion of revenue, President Obama could have claimed to make his $1.6 trillion mark after all. But he did not -- because only a very small percent of the $1 trillion gained from letting the payroll tax cut expire would come from households "making at least $1 million a year," or even $450,000.

Roughly 62.5% of the scored aggregate tax increase in the fiscal cliff package came from a tax that applies to wage earnings, only, and which has a floor of 0 and a ceiling of $118,000. This major tax increase was not listed in the official reports or scoring, in order to maintain a rhetorical claim that 90% of the tax increases would fall on millionaires only.

C. Still Breathing (?): The Non-Death Death of the Death Tax[162]

TRA 2012 and the wider fiscal cliff deal loudly raised *income* tax rates on the top income earners, and quietly raised payroll tax rates on just about everybody. TRA 2012 also quietly continued the slow death of the wealth transfer tax system: the gift, estate, and generation-skipping taxes. The estate tax would appear at first blush to be a significant means of taxing wealth seriously. But just as with the nominally high income tax rates during World War II, the estate tax has long been little more than a symbol, much ado about rather little. Its salience leads people to believe that we are doing something about inherited wealth, but its avoidability leads to a very different reality.[163]

Even a quick look at estate tax reform shows political and perceptual games in full force and effect, all the while propping up and shaping a tax that raises little if any revenue for the fisc. EGTRRA had gradually weakened the gift and estate tax, raising its exemption

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[162] A version of this case study appears in McCaffery, *Distracted from Distraction by Distraction, supra* note.
[163] *See generally* Cooper, *supra* note.

levels and lowering its rates, until 2009, when the exemption was set to be $3.5 million per donor (spouses can double this) and the rate 45%.[164] In 2010 the estate tax was set to expire, with an unlimited exemption and, importantly a *carryover basis* for assets passed on death -- that is, EGTRRA had built within it a repeal of the stepped-up basis rule. EGTRRA itself was set to expire after 2010, bringing, in 2011, a return to a $1 million exemption and a 55% tax rate for the estate tax. As EGTRRA played itself out, the law seemed headed to a place considered unimaginable to many: a year without an estate tax at all. Surely, something would have to happen to prevent that extreme result from obtaining.

Only it did not. There was no bill at the end of 2009 to prevent 2010's year of no estate tax. That change came only at the end of 2010, when EGTRRA was about to expire, leaving us within a strengthened estate tax. TRA 2010 retroactively gave estates for decedents who died in 2010, like George Steinbrenner, a choice: accept the no estate tax/carryover basis regime provided for by EGTRRA or instead choose a $5 million exemption and a 35% rate with stepped-up basis. The overwhelming majority of families chose the latter with its stepped up basis. Buy/Borrow/Die was in the house.

This set the stage for the "fiscal cliff" slated for January 1, 2013, when EGTRAA, which had been extended by TRA 2010 for another two years, was set to expire. Insofar as the estate tax was concerned, the law as written meant a return to the $1 million exemption and 55% rate of pre EGTRRA times. Some practitioners, aided by the media, stirred up fears that this would indeed happen, leading to aggressive planning under the large gift-tax exemption in

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[164] Edward J. McCaffery & Linda R. Cohen, Shakedown at Gucci Gulch: The New Logic of Collective Action , 84 N.C. L. REV. 1201, 1208 (2006).

place for 2012.[165] This was precisely the situation that could not obtain under the initial ten EGTRRA years, because the gift tax exemption had stayed frozen at $1 million.

In point of fact, a full return to year 2000 levels never seemed to be in the cards, even though fiscal cliff fix time was supposed to involve taxing the rich. Discussions around TRA 2012 vis-a-vis the estate tax were exclusively about exemption levels and rates. Obama, as he had in his 2008 campaign platform, consistently staked out a position at a $3.5 million exemption and a 45% rate – the 2009 status quo.[166] Republicans countered with a $5 million exemption and a 35% rate: the 2012 status quo. In December 2012, Obama reiterated his stance, and commentators "scored" the proposal as raising $119 billion over ten years, from the 2012 baseline.[167] However, Senator Max Baucus, the *Democratic* chair of the Senate Finance Committee, came out in dissent, supporting the Republican position for a perpetuation of the status quo – a $5 million exemption, indexed off 2011, and a 35% rate.[168] It appears that is what would have happened, with a late leak suggesting that there was a deal brokered by Vice President Biden and Senator Mitch McConnell (R-Ky) at a $5 million exemption and 35% rate.[169] The same purported fiscal cliff deal featured a return to the top pre-EGTRRA marginal *income* tax rate of 39.6% for individuals/married couples earning more than $400,000/$450,000.[170] At this point Senator Tom Harkin (D-Ia),

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[165] McCaffery, *Distracted from Distraction by Distraction, supra* note at 1240-48.
[166] Kim Dixon, Obama Estate Tax Push Undercut by Discord Among Democrats, HUFFINGTON POST (Nov. 2012) http://www.huffingtonpost.com/2012/11/30/obama-estate-tax_n_2216992.html.
[167] Richard Rubin, Buffett Joins Soros in Effort to Raise Taxes on Estates, BLOOMBERG (Dec. 2012) http://www.bloomberg.com/news/2012-12-11/buffett-joins-soros-in-effort-to-raise-taxe s-on-estates.html.
[168] Robert Frank, Next Battle on the "Cliff's" Edge: Estate Taxes, CNBC (Dec. 2012) http://www.cnbc.com/id/100296248/Next_Battle_on_the_039Cliff039s039_Edge_Estate_Taxes.
[169] Ramsey Cox and Alexander Bolton, Dem Sen. Harkin Criticizes Possible Tax Compromise in "Fiscal Cliff" Talks , THE HILL (Dec. 31 2012).
[170] *Id*.

objecting from the left, took to the floor of the Senate and stated that the purported deal was too much of a give-away to the rich, with its $400,000/$450,000 floor on tax rate increases for singles and married couples, and its $5 million, 35% rate on estates: more specifically, that he could accept one, but not both, of these levels.[171] The next the public heard, the deal was struck with the Senate overwhelmingly approving TRA 2012 with an estate tax exemption of $5 million, a rate of 40%, and the income tax rate levels as leaked.[172] Senator Harkin was among the 8 Senators voting "no."[173]

We see a political and rhetorical bait and switch once more. While most of the focus was on the top income tax *rate* – 39.6% -- Congress was moving to raise the bracket *level* to undercut the sting of the higher rates. Even farther in the darkness, Congress was effectively killing the estate tax. When Harkin shed some light on this darkness, Congress responded with the virtually meaningless step of raising the rate on the estate tax, which would apply to some 0.3% of decedents each year, by 5% in absolute terms.

While all this was happening, no one of any great importance was noticing that stepped-up basis was staying for yet another day. Yet in terms of any matter of *principle*, stepped-up basis on death can best be understood only as an accommodation for the fact of an estate tax. Since the wealthy are paying a "death tax" for assets passed on death, the heirs should get a stepped-up basis to avoid a "double" tax. But TRA 2012 lefts us in a world in which

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[171] *Id*.
[172] Chris Frates, *McConnell: Tax Deal Struck With Biden*, NATIONAL JOURNAL (Dec. 31 2012), http://www.nationaljournal.com/mcconnell-tax-deal-struck-with-biden-20121231.
[173] Ramsey Cox and Alexander Bolton, *Dem Sen. Harkin Criticizes Possible Tax Compromise in "Fiscal Cliff"* Talks, THE HILL (Dec. 31 2012), http://thehill.com/video/senate/274975-harkin-this-is-one-democrat-who-doesnt-agree- with-tax-cuts-for-the-wealthy.

99.7% of decedents' families will not face an estate tax and yet 100% will get a stepped-up basis for assets held at death.

D. Presidential Politics and Posturings

The changes effected at the fiscal cliff crisis in the wee early hours of 2013 left us with where we have been over the entire century of the income tax: with a wage tax. The once-more increased payroll tax adds to the income tax to make for a fairly burdensome and fairly flat tax on income from labor. Warren Buffet and other capitalists dodge a bullet yet again -- the *appearance* of higher tax rates under the income tax masking the reality of increased burdens on all wage earners under the payroll tax. Every element of Buy/Borrow/Die remains fully in place -- indeed, the stepped-up basis rule informing the "die" step remains for all even as the gift and estate tax was killed for all but 0.3% of us. Meanwhile, a panoply of other "regressively structured" taxes -- excise taxes on cigarettes (which have *quintupled* under Obama's watch), alcohol, telephones -- keep adding up to help balance the books.[174]

Perhaps President Obama realized that his liberal or progressive tax policies were not doing much about growing inequality in America, except possibly making things worse. For whatever reason, Obama decided to do something. And so the President announced in his

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[174] Thomas A. Briant, *Obama Proposes Cigarette Tax Increase*, CSP Net (Feb. 4, 2015), http://www.cspnet.com/category-news/tobacco/articles/obama-proposes-cigarette-tax-increase; The National Center for Policy Analysis Task Force on Taxing the Poor, *Taxing the Poor*, NATIONAL CENTER FOR POLICY ANALYSIS (June 22, 2007), http://www.ncpa.org/pub/st300?pg=4; J.D. Foster, *The Telephone Excise and the E-Rate Add-On Tax*, TAX FOUNDATION (July 1999), http://taxfoundation.org/sites/taxfoundation.org/files/docs/2d4d6cf9bb9d64d62f23b50560766cad.pdf.

2014 State of the Union a renewed attack on *income* inequality.[175] But no doubt multiply burned by actually trying to address any form of inequality through tax reform, Obama trained his sights on . . . the minimum wage.[176] This may or may not be a good idea, but it is not taxing wealth seriously.

After the fiscal cliff crisis and fix, proposals kept circulating on tax reform. Dave Camp, Republican chairman of the House Ways and Means Committee, where federal tax legislation originates, released his own tax plan in early 2014.[177] The "tax decade" of the 1980s[178] had left us with a wage tax with a few personal deductions hanging around – for charitable contributions, state and local taxes, home mortgage interest, qualified retirement plans, employer-provided health care. What do we see in contemporary reform proposals? Attacks on these remaining breaks for *wage-earners*. Thus Camp's plan featured lower rates, in a "distributionally" and "revenue" neutral way, which means, necessarily, expanding the base. The Obama Administration, and Max Baucus on the Senate Finance Committee side, came up with their own plans, along similar general lines.[179] What are the main talking points for base expansion? Limiting personal deductions, raising

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175 President Barack Obama's State of the Union Address, The White House: Office of the Press Secretary (Jan. 28, 2014), https://www.whitehouse.gov/the-press-office/2014/01/28/president-barack-obamas-state-union-address.
176 Dave Jamieson, *Obama and the Democrats Raise Their Minumum Wage Proposal to $12*, HUFFPOST POLITICS (Apr. 30, 2015), http://www.huffingtonpost.com/2015/04/30/12-minimum-wage_n_7183780.html.
177 Jim Nunns, et al., *Description and Analysis of the Camp Tax Reform Plan,* TAX POLICY CENTER (July 8, 2014), http://www.taxpolicycenter.org/UploadedPDF/413176-Camp-Plan-Description-and-Analysis.pdf.
178 Steuerle, *supra* note.
179 Lori Montgomery, *Sen. Max Baucus Moves to Reshape Tax Code*, THE WASHINGTON POST (Apr. 8, 2013), https://www.washingtonpost.com/business/economy/sen-max-baucus-moves-to-reshape-tax-code/2013/04/08/e7f3435a-9dff-11e2-9a79-eb5280c81c63_story.html.

capital gain rates, capping retirement plan contributions, closing certain "loopholes."[180] What do *all* of these ideas have in common? They do nothing about Buy/Borrow/Die, and thus continue a very long trend of shoring up the income tax . . . as a tax on the laboring classes.

The two Januarys discussed at the start of this Article confirm and continue the trend. In January, 2015, President Obama's Capital Gains on Death Proposal was an attempt to tax wealth seriously. It took direct aim at the "angel of death" provision for stepped-up basis on death. But it was the proposal that died. Sanders and Clinton each launched their presidential campaigns in 2015, Sanders in particular talking about economic inequality as a major theme, but neither candidate was quick to roll out any kind of specific tax plan. In late 2015, two stories appeared in the New York Times: one discussing how effective tax rates on top reported income earners had indeed gone up in 2013, the first year for which the $400,000/450,000 rate bracket was in effect, the second suggesting that a "private tax system" exists for the truly high wage-earners because of tax professionals and their aggressive tax advice.[181] Soon thereafter, Clinton rolled out her Four Percent Plan. Bernie Sanders released his own tax plan shortly after Clinton's, including the Ten Million Dollar Bracket. Sanders' plan featured a panoply of taxes, most of which would continue the

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[180] Jason Tyra, *Retirement Planning Loopholes May be Closed Soon*, JASON M. TYRA PLLC (Aug. 25, 2015), https://www.tyracpa.com/retirement-planning-loopholes/; Laura Meckler, *Hillary Clinton Proposes Sharp Rise in Some Capital-Gains Tax Rates*, THE WALL STREET JOURNAL (July 24, 2015), http://www.wsj.com/articles/clinton-to-propose-rise-in-capital-gains-taxes-on-short-term-investments-1437747732.

[181] Josh Barro, *Thanks, Obama: Highest Earners' Tax Rates Rose Sharply in 2013*, N.Y. TIMES (Dec. 30, 2015), http://www.nytimes.com/2015/12/31/upshot/thanks-obama-highest-earners-tax-rates-rose-sharply-in-2013.html; Noam Scheiber & Patricia Cohen, *For the Wealthiest, a Private Tax System That Saves The, Billions*, N.Y. TIMES (Dec. 29, 2015). *See also* Edward J. McCaffery, *U.S. Tax System: Why do the Rich Just Keep on Getting Richer?*, CNN (Jan. 12, 2016), http://www.cnn.com/2016/01/12/opinions/mccaffery-wealthy-taxes/.

theme of this Article, by applying higher tax rates to high wage earners. Unlike Clinton, however, who has repeatedly distanced herself from anything like a capital gains on death plan, Sanders has shown a willingness to consider repealing stepped-up basis. Time will tell what happens there, though we have a century of reasons to have doubt.

As for the Republicans? When they were not spouting words of hell-fire and damnation against any and all taxes, looking to slash rates largely under the income tax, they showed moderation by attacking Wall Street *wage earners*. Thus Donald Trump pledged to shut down the "carried interest" loophole whereby highly compensated hedge fund managers -- many of them Democrats -- have been able to have their wages taxed as if they were capital gains. There is nothing wrong with the proposals to shut down this particular planning gimmick. But it is not a serious attempt to tax wealth; it makes no attack on Buy/Borrow/Die.

6. Problems, Problems, Problems

Buy/Borrow/Die is easy to understand yet hard to change. This has been true for a century. Both the problem and the puzzle of its obscurity only deepen.

We considered above some of the reflexive responses to Buy/Borrow/Die -- skeptical objections to the idea that saving taxes can be so easy. These misconceptions help keep Buy/Borrow/Die in the darkness. There are many more reasons to believe that the task of taking taxing wealth seriously will be hard, and no reason to deny the difficulties.   Indeed, serious reform must take these problems, arising from many different aspects of the situation and combining and conspiring to create a tangled web of inertia, seriously.

A. Problems of Theory

Neoclassical economics theory follows a bifurcated strategy, separating out matters of allocation or efficiency from those of distribution or equity.[182] The two welfare theorems suggest the path. The first holds, in essence, that free markets reach welfare maximizing or, equivalently, "pareto optimal" allocations of resources. The second holds that a redistribution of resources can lead to different positions along the social optimum or paretian frontier.[183] In other words policymakers on behalf of the state or society should, one, make the social pie as large as possible and then, two, slice it up to make all as happy as possible.

Practitioners of law and economics, most extensively Louis Kaplow and Steven Shavell, have used these two theorems to develop a comprehensive agenda for law reform.[184] First, the private laws of contracts, property, tort and so on should be arranged so as to maximize

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[182] Edward McCaffery, *Bifurcation Blues: The Perils of Leaving Redistribution Aside*, NEW YORK UNIVERSITY: COLLOQUIUM ON TAX POL'Y & PUB. FIN. (Spring 2013), *available at* http://www.law.nyu.edu/sites/default/files/ECM_PRO_074659.pdf.

[183] *See* for example ROBIN W. BOADWAY & NEIL BRUCE, WELFARE ECONOMICS, (Oxford, UK: Basil Blackwell, 1984); JOSEPH E. STIGLITZ, ECONOMICS OF THE PUBLIC SECTOR 60-61 (New York: W.W. Norton & Company, 3d ed. 2000). For a more general discussion of the two welfare theorems and an application to income tax policy, *see* Kyle Loque & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 TAX L. REV. 157 (2003).

[184] Kaplow and Shavell first proposed that the tax system be used as the exclusive means for redistribution in *Why The Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994); *see also Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 J. Legal Stud. 821 (2000); *Fairness versus Welfare* , *supra* note. 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. 87 (1978). For criticisms of the Kaplow-Shavell argument, *see* Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL LAW REV. 1003 (2001); Chris William Sanchirico, *Taxes versus Legal Rules as Instruments for Equity: A More Equitable View*, 29 J. LEGAL STUD. 797 (2000); Loque & Avraham, *supra* note; Ronan Avraham, David Fortius, & Kyle Logue, *Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell*, 89 IOWA LAW REVIEW 1125 (2004); for one among several replies by Kaplow and Shavell, *see* Louis Kaplow and Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of the Income Tax in Redistributing Income*, 29 J. LEGAL STUD. 821 (2000).

social welfare, that is, broadly, to serve "efficiency." Second, the tax system -- specifically, the income tax system -- should be used to redistribute social resources so as to maximize the sum of individual well-being, that is, again broadly, to serve "equity."[185]

To Kaplow, Shavell and others, this initial bifurcation leaves the task of redistribution to the *income* tax, for the drunken sailor to work out. What we have seen is that *our* income tax is not up to this task, in significant part because it leaves wealth, or capital, off the hook virtually completely. Kaplow, Shavell, and other scholars making the initial bifurcation point are not committed to the *actual* income tax, with its realization requirement and Buy/Borrow/Die features. But this is what the income tax is, and it will be hard to change it, for practical, political and perceptual reasons that we continue to explore in this Section.

Having been given the task of redistribution, of addressing inequality, what does income tax *theory* have to say about the responsibility? The elegant mathematical models of optimal income tax analysis, for which the British economist James Mirrlees was awarded a Nobel Prize in Economics, give a set of answers.[186] It turns out that optimal tax has its *own* bifurcation strategy and its own limits. Optimal income tax theory ends up further kicking the can of redistribution down the road to darkness.

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[185] *See generally* Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient than the Income Tax in Redistributing Income*, J. Legal Stud. 667 (1994). *See also* Chris William Sanchirico, *Progressivity and Potential Income: Measuring the Effect of Changing Work Patterns on Income Tax Progressivity*, 108 COLUM. L. REV. 1551 (2008).

[186] *See generally* J. A. Mirrlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 The REV. OF ECON. STUDIES 175 (1971). *See also* Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CALIF. L. REV. 1905 (1987); P.A. Diamond, *A Many Person Ramsey Tax Rule*, 4 J. PUB. ECON. 335 (1975); Edward J. McCaffery & James R. Hines Jr., *The Last Best Hope for Progressivity in Tax*, USC CLEO Research Paper No. C09-7 (2010).

It is worth reading Mirrlees' seminal paper from 1971-72, on which much of the modern tax reform movement, with its base-broadening and rate reduction themes, draws inspiration and from which it claims a certain intellectual legitimacy: the Reagan and Bush tax rate cuts followed along with Martin Feldstein's footprints.[187] To begin with, Mirrlees' *An Exploration in the Theory of Optimum Income Taxation* is, *explicitly*, about a tax on labor income only -- no problem with Buy/Borrow/Die or wealth inequality, here. To end with, Mirrlees himself writes, at the conclusion of his paper, that *"[t]he income-tax is a much less effective tool for reducing inequalities than has often been thought*," and that, "*therefore, [i]t would be good to devise taxes complementary to the income-tax, designed to avoid the difficulties that tax is faced with*."[188] Despite these express disavowals by the seminal figure in the field, drunken sailors everywhere continue to look to the income tax, which has become a wage tax, exactly as it is in Mirrlees' model, to do all the work of redistribution.

Why is Mirrlees himself so pessimistic about the redistributive possibilities of the income tax? As a branch of neoclassical welfare economics theory, optimal income tax is concerned with allocative questions as well as distributive ones. Efficiency losses come from high marginal rates, particularly and especially on the "top" of the income distribution scale. While there is great disagreement about the precise contours of the rate curve – such that Arthur Laffer, famously, could reduce it to a simple single-peaked curve[189] -- there is little argument that marginal tax rates end up declining over the upper income range, quite

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[187] Oliver Landmann, *The US Economy Under the Influence of the Reagan Experiment*, 19 INTERECONOMICS 207, 207-213 (1984).
[188] Mirrlees, *supra* note emphasis supplied.
[189] Arthur B. Laffer, *Reaganomics: What we Learned*, THE WALL STREET JOURNAL (Feb. 10, 2011), http://www.wsj.com/articles/SB10001424052748704364004576132473777840938.

possibly to zero (or below zero, in an analysis done by Joseph Stiglitz).[190] Matti Tuomala, a prominent proponent of the optimal tax tradition, has put it simply that:

> . . . one of the main conclusions to be drawn from the Mirrleesian optimal non-linear income tax model is that it is difficult (if at all possible) to find a convincing argument for a progressive marginal rate structure throughout.[191]

Mirrlees included simulations in his seminal paper that featured peak (that is, highest tax rates, typically on the lower-middle income class) and highest end (that is, tax rates for the highest income) marginal tax rates of 26 and 16; 20 and 15; 28 and 19; 34 and 20; 39 and 21; and 60 and 49.45. These peak-highest end rate pairs show not only the considerable range of possible outcomes under an optimal tax analysis, but also the general pattern of peaking then falling.[192]

The United States tax rate structure today looks a lot like these optimal income tax rate models. Because of the phase-out of the earned income tax credit – the "workfare" that replaced "welfare as we knew it" under Bill Clinton – combined with payroll taxes, income taxes, and other phase-outs of other benefits, the working *poor* in America face marginal tax rates of 90% or more.[193] The top wage earners face marginal rates of 40% or so. The

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[190] McCaffery & Hines, *supra* note; Stiglitz, *supra* note.

[191] MATTI TUOMALA, OPTIMAL INCOME TAX AND REDISTRIBUTION 14 (Clarendon Press, 1990). *See also* Alan J. Auerbach & James Hines Jr., *Taxation and Economic* Efficiency, 1 HANDBOOK OF PUB. ECON. 1347 (2001); Louis Kaplow, *On the Undesirability of Commodity Taxation Even When Income Taxation is Not Optimal*, 90 J. PUB. ECON. 1235 (2006); Louis Kaplow, *Optimal Policy with Heterogenous Preferences*, 8 B. E. J. ECON. ANALYSIS & POL'Y 40 (2008).

[192] Later analysis pushed the case out to finding a zero rate---even, in the case of one model advanced by the Nobel laureate Joseph Stiglitz, a negative rate---for the highest earner/most able citizen. Joseph E. Stiglitz, *Self-Selection and Pareto Efficient* Taxation, 17 J. PUB. ECON. 213, 213 (1982). *See also* J. K. Seade, *On the Shape of Optimal Tax Schedules*, 7 J. PUB. ECON. 203 (1977).

[193] Edward J. McCaffery, *Americans' 90% Tax Rate*, CNN (Feb. 8, 2013), http://www.cnn.com/2013/02/08/opinion/mccaffery-marginal-tax-rates/; Daniel N. Shaviro, *Effective Marginal Tax Rates on Law-Income Households*, EMPLOYMENT POLICIES INSTITUTE (Feb. 1999), https://www.epionline.org/wp-content/studies/shaviro_02-1999.pdf.

top real income earners, like Warren Buffet, face tax rates approaching zero. The poverty and marriage traps created by this structure are severe, and problematic – a story for another day.[194] The point for taxing wealth seriously is that the high theory of optimal tax suggests a rate structure that does *not* rise steeply at the top end, and one that only applies to wages. We have this: it is the structure that emerged from the third phase of the history set forth above, beginning with Ronald Reagan.

Things get worse. Under Mirrlees and his fellow travelers, once the government has its money from labor taxes, it can then move on to the second prong of bifurcation, redistribution. Optimal income tax theory suggests giving the revenues raised back to all citizens, including the poor, via what the literature has come to call "demogrants." Demogrants are simply lump-sum grants to all citizens – the "lump sum" component meaning that the grant does not vary with anything that the citizen does or does not do and so, by design, does not distort any prices or affect any incentives. The *net* of taxes and transfers is then progressive, or redistributive.[195]

When this all plays out on the public political stage, however, politicians and the masses go along with the efficiency-oriented analysis of the allocative prong: we get lower tax rates on high earners under a wage tax. The government of any political stripe wants this allocative prong to be followed, because a government of any political stripe wants revenue. The elegant findings of optimal income tax theory merge with a more popular sense of things,

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[194] Edward J. McCaffery, *The Burdens of Benefits*, 44 VILL. L. REV. 445 (1999).

[195]. Edward Kleinbard, in his important *We Are Better Than This*, in line with many contemporary reform proposals, suggests a similar path in the US: raise income tax rates *infra*- marginally -- that is, below the highest bracket levels, ala Mirrlees -- and then achieve redistribution through expenditures. *See* EDWARD KLEINBARD, WE ARE BETTER THAN THIS: HOW GOVERNMENT SHOULD SPEND OUR MONEY (Oxford University Press, 2015).

aided by such public intellectuals as Arthur Laffer and Martin Feldstein, that high marginal tax rates on the upper income levels are not wise. But neither the masses nor the government go along with the distributive prong of optimal tax theory. We do not have nor do we want anything like a demogrant.[196] A simple analytic fact is that optimal tax theory, *stripped of its commitment to giving lump-sum demogrants to redistribute income*, still provides a roadmap for how governments can raise the maximum amount of revenue.[197] Governments need the revenue because they have, in essence, already spent whatever could go to demogrants. High theory becomes part of the problem, not part of the solution.

Within the ivy-covered walls of the academy, more traditional tax law scholars continue to develop the centuries old income-versus-consumption debate.[198] But Buy/Borrow/Die has little to do with that debate. Certainly, as a fact of the matter, the planks in Buy/Borrow/Die did not emerge from a conscious embrace of consumption taxation, a deliberate non-taxation of savings. "Buy" follows from the mistake of *Macomber*, and has stayed with us ever since. "Borrow" follows from the choice of an income tax, which is *supposed* to double tax savings. "Die" can only be plausibly understood as part of a pair with estate taxation – the estate tax playing catch up with the realization requirement -- and has, somehow, survived a world in which there is not much of an estate tax. Buy/Borrow/Die allows the propertied class to avoid all taxes on *both* their income, which comes through "mere" appreciation, *and* their consumption (which comes through borrowing). The income-versus-consumption tax debate is beside this point.

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[196] *See* McCaffery and Hines, *supra* note.
[197] Kleinbard, *supra* note.
[198] *See* for example Louis Kaplow, *The Income Tax Versus the Consumption Tax and the Tax Treatment of Human Capital*, 51 TAX L. REV. 35 (1995-1996); Michael S. Knoll, *Designing a Hybrid Income-Consumption Tax*, 41 UCLA L. REV. 1791 (1993-1994

Still, the advocates for darkness can invoke elements of the income-versus-consumption debate to serve their ends, or to deepen the misconceptions that block understanding Buy/Borrow/Die. Any attempt to tax capital or the income from capital under the income tax is met with a barrage of criticism for being a "double tax." Yet the problem of iteration, within and across generations, makes this critique almost embarrassing for the very wealthy.

Meanwhile, across the hall from the tax-law academics, the rest of the academy, like the rest of us, dwells in the darkness. There is no general widespread understanding of Buy/Borrow/Die: of how simple it is for those with capital to avoid tax, of how deep the structural problem runs. Piketty, for example, seems variously to believe both that the American tax system is an admirable and effective antidote to inequality[199] and that the wealthy avoid taxes by using complex devices. Neither of these claims rings true once we understand Buy/Borrow/Die.

Our theories, like the drunken sailor, cannot point us to the wallet.

B. Problems of Practice

When it comes to the fisc, neither the money nor the light suggests taxing wealth all that seriously. There are a series of practical problems in even attempting to do so. High marginal tax rates on labor discourage labor, and so we are left with a fairly high but fairly flat wage tax system, the government extracting revenues at a 30-50% rate, all in, on income from labor. Changing gears to tax wealth will not be easy. Capital is highly mobile.

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[199] Thomas Piketty, Emmanuel Saez & Stefanie Stantcheva, *Taxing the 1%: Why the Top Tax Rate Could be Over 80%*, VOX (Dec. 08, 2011), http://www.voxeu.org/article/taxing-1-why-top-tax-rate-could-be-over-80

"Exit taxes" that attempt to prevent the rich from simply folding up their tents and moving elsewhere – as American *companies* have effectively done for decades – are complex to write and enforce, and comparatively easy to evade.[200] And wealth can be hidden.

Simple back of the envelope calculations suggest that a 1% wealth tax could replace the individual and corporate income taxes and the gift and estate tax as well.[201] But good luck with that. Old taxes are good taxes, as Adam Smith taught us – "good" in the sense that people have become used to them, and the government has learned how to collect them.[202] Initiating a new tax on wealth, directly, would raise large questions of valuation and administration, and would invoke massive planning opportunities to escape, evade, or mitigate its burdens. The long century of the gift and estate tax has shown how difficult it is to tax the wealthy, especially outside of market transactions to show the tax collector some light.[203] Meanwhile a century of not taxing wealth seriously, at all, has led to a large build-up of . . . wealth.[204]

Then there is the unfortunate fact that we need savings, and there are not many savers except the rich left. Taxing wealth directly not only encourages the rich to flee the jurisdiction, or at least to hide their wealth overseas, it also discourages them from having such wealth in the first place. A modest wealth tax, at say a 1% rate, sounds at first blush to

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[200]. See for example, IRC Sec. 877. *See also* Robert W. Wood, Ten Facts About Tax Expatriation, FORBES (Mar. 23, 2010), http://www.forbes.com/2010/03/23/expatriation-exit-tax-limbaugh-obamacare-personal-finance-robert-wood.html.

[201] Daniel Altman, *To Reduce Inequality, Tax Wealth, Not Income*, N.Y.TIMES (Nov. 18, 2012), http://www.nytimes.com/2012/11/19/opinion/to-reduce-inequality-tax-wealth-not-income.html

[202] See generally ADAM SMITH, THE WEALTH OF NATIONS (W. Strahan & T. Cadell, 1776).

[203] *See generally* GEORGE COOPER, A VOLUNTARY TAX? (The Brookings Institution, 1979). *See also* Edward J. McCaffery, *A Voluntary Tax? Revisited*, National Tax Association Proceedings (Nov. 11, 2000), http://gould.usc.edu/centers/class/class-workshops/usc-legal-studies-working-papers/documents/01_5_paper.pdf.

[204] Piketty, *supra* note 2.

be responsive to these concerns, but the rich could well think that, once the government had created the apparatus to tax wealth seriously, that it would be just a matter of time before rates spiked up – after all, this happened with the income tax. There is no point denying that rich dads are smart. Taxing wealth will be practically difficult, and may not in the end raise much revenue.

To cash-strapped governments pressed to keep the lights on in government buildings, there is little time or inclination to do the heavy lifting to tax wealth seriously. On the other hand, labor is easy to tax, administratively at least, ever since FDR gave us wage-withholding. Employers tell the government precisely how much their employees make, on W-2 forms; employers do this in part because their own tax deductions, for salaries paid, depend on this. For most, taxes are easy to calculate and pay. For a government with limited resources even to collect and enforce the taxes, wage taxes hold out great temptation.

C. Problems of Perception

The story of the failure to tax wealth seriously can be told as a matter of perception or "salience." Salience refers to the mental or psychic impact that some fact of interest has on a target population – it refers to what we pay attention to.[205] The income tax, with its high marginal tax rates and dreaded annual forms, is the most salient of taxes.[206] FDR in Carolyn Jones' account was able to take advantage of this salience; Clinton in her Four Percent Plan and Sanders with his Ten Million Dollar Bracket learned the lesson. Other taxes are hidden

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[205] MERRIAM WEBSTER'S DEFINITION OF SALIENCE, http://www.merriam-webster.com/dictionary/salience (last visited Jan. 30, 2016).

[206] *See* McCaffery, *supra* note at 1933-37.

to various degrees – partly hidden, such as the employer's share of the payroll tax, or fully hidden.[207] Attempts to tax the rich in contrast are, almost by definition, highly salient. Other things being equal, democratic politics favors low-salient taxes and high-salient expenditures, the latter being a major part of the problem that have us constantly staring over some fiscal cliff, and legislating under the pressing exigencies of the present.[208]

Problems of perception abound. Many studies have shown that people routinely confuse average and marginal tax rates. Thus, people *think* that being in a 39.6% bracket means that *all* of one's income is taxed at that rate. This confusion has several effects. It leads people, even the media, to ignore or neglect the infra-marginal benefits that upper income taxpayers get, as in TRA 2012, by the perpetuation of lower infra-marginal rate brackets. It leads people to believe that TRA 2012, with its restoration of the pre-Bush era rate of 39.6% on incomes over $400,000, was more progressive and redistributive than it was. More generally, it leads many people to accept their own tax burdens, such as the increase in payroll taxes effective January 1, 2013, as being tolerable, because it appears as if the upper-income have been hit even harder. Small Frys everywhere can be happy.

Behavioral perspectives also suggest that bifurcations that are logical in theory have unintended consequences in practice. The experimental decision theorist Jon Baron and I looked at what happens when a tax system is split in two. We asked people what their preferred tax system on labor earnings would be. Then we told them that there were in fact two means of taxing wages – through a payroll tax and an income tax. We stated each tax raised half of the total amount. Then we gave them rate structures, sometimes for the

[207] *Id.*

payroll tax, sometimes for the income tax. We asked them to set the other tax, and sometimes to restate the total. We found that, very consistently, subjects did not re-add the two systems together. Confronted with a flat or regressive wage tax, that is, they did not compensate by making the income tax more progressive. This illustrates what we call an *isolation effect* – people look at things in isolation, as if with blinders on. They have intuitions at how progressive a tax system should be, and, whatever tax they happen to be looking at, they want it to have their preferred pattern.

Much redistribution, as Richard Bird and Eric Zolt and others have noticed, is effected through spending programs. In the real-world, such programs play out the role given by theory to demogrants. When those spending programs are cut, then, there is not only an allocative effect (government gets out of the business of providing the good or service) but also a redistributive one. Baron and I tested whether subjects, prompted to do so, would "correct" for the level of redistribution in the residual tax system following a spending cut or "privatization." We found that ordinary subjects could not. Interestingly, they by and large did correct the tax system to make it more progressive, but not by nearly enough to keep the level of redistribution constant by replacing the "masked" with transparent redistribution.

Our drunken sailor knows all about salience: the lamppost provides it. The income tax is salient. Its top marginal rate bracket is salient. Taxing wealth seriously is sure to be salient. Buy/Borrow/Die is not salient; it dwells in the darkness where the wallet lays hidden.

D. Problems of Politics

American politics gives little reason to hope for the project of taxing wealth seriously. There is no need to repeat here a discussion of the special interest model of politics in general, or tax policy in particular. Suffice it to say that the rich are far better able than the rest of us to form groups to lobby for tax breaks or against tax increases. Linda Cohen and I have written about the politics of estate tax reform, arguing that Congress has an interest in teeing up matters of high stakes to small groups, and then stringing them along to get campaign contributions.[209] Our model of "ex ante rent extraction" suggests that Congress *wants* wealthy citizens who are insulated from taxation in order to generate campaign contributions: politicans, that is, have a narrow self-interest in not taxing wealth seriously. There is plenty of evidence of such effects in the ongoing stories of TRA 2012, estate tax reform, and more.

All of the problems begin to work together. There is not much money to be had in "soaking the rich," given the practical difficulties of taxing wealth seriously. Politicians both want to keep their wealthy donors happy and to pay the bills to keep the lights on in government offices. Optimal tax theory suggests doing so by a wage tax with declining marginal rates for the highest end. This is the easiest thing to do anyway. There is no market or other arbitrage mechanism to help ameliorate the pervasive perceptual biases in tax; indeed, we have seen, repeatedly, that politicians take advantage of and help to exacerbate misperceptions.[210] Politicians want to spend saliently and tax non-saliently: they have an

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[209] *See* McCaffery & Cohen, *supra* note.
[210] *See generally* Edward J. McCaffery & Jonathon Baron, *The Political Psychology of Redistribution*, 52 UCLA L. REV. 1745 (2005); Edward J. McCaffery, *Behavioral Economics and the Law: Tax*, (Sep. 16, 2013).

incentive, that is, to keep Buy/Borrow/Die hidden. As long as the general citizenry hangs out under the lamppost with the drunken sailor, there is no pressure on politicians to change.

E. Problems of Professionals

Most people who understand tax well enough to have even an inkling of Buy/Borrow/Die can make a very good living selling their wares to the wealthy, who are happy to buy them. Professionals may be blinded by the light of their own little corner of the tax universe, and have little time or interest to step back and take a more academic, reform-oriented view of the whole. But they are happy making money. Professionals have no real interest in simplifying matters, playing into the skeptical objections canvassed above and helping to entrench a sense that tax-planning for the rich must be complex. And often it is. Complexity is a good business model, and endures without light. But Buy/Borrow/Die is not complex.

F. The Problem of Problems

This Section underscores what ought to be obvious: that taxing wealth seriously will not be easy. What is striking is how much the different components of that difficulty all fit together.

Start with theory, which leaves redistribution to the income tax. Theory suggests that income taxation is a limited tool to that end. It tells us to hand out demogrants to solve problems of inequality. We do not and will not do that. Politicians need revenues, fast. They do not want to antagonize their wealthy. They grope for low-salient taxes, which take small

sums from the masses as a strategy. Ordinary citizens understand little of this, and no one has any incentive to educate them. In fact, tax professionals have reasons to obfuscate, to perpetuate the idea that tax planning is difficult and costly -- requiring their helpful services. People are skeptical of Buy/Borrow/Die anyway. Meanwhile, capital continues to grow, in magnitude and unequal holdings, and becomes ever more powerful and mobile.[211]

This tangled web of overlapping factors, perpetually running in multiple feedback loops, is a problem of the problems -- the failure to tax wealth seriously has so many causes, all pointing in the same direction, that the problem becomes more and more entrenched in the darkness. There is a deflection of responsibility from any one domain (theory, politics, tax professionals) and a brooding sense of hopelessness and despair. We all become drunken sailors, at best: some of us simply stop looking for hope.

Yet hope rises from the darkness. Buy/Borrow/Die is simple. It is the simple road map to a life of tax-free living for the wealthy. And it is *also* the simple roadmap to taxing wealth seriously. *Buy/Borrow/Die, itself, is the light we have been lacking*.

7. A Light in the Darkness: Getting Serious about Taxing Wealth

Buy/Borrow/Die is the root of a very deep problem: America's utter failure to tax wealth seriously. It is also the path towards reversing course.

This section briefly sketches out the possibilities for taxing wealth. Addressing any one of the planks in Buy/Borrow/Die goes a long ways toward taxing wealth seriously. There is

[211] Piketty, *supra* note 2.

no need to repeat the details of the many specific reform proposals and fine scholarship that have been set forth by academics and others: we can simply list and situate them within the analytic framework of Buy/Borrow/Die. The Article's prior analysis, of history, politics, and economic theory, among other disciplines, does shed a surprising light on the likely best path forward. The various proposals to address the "Buy" step seem unlikely to advance very far. In fact, their very mention can impede understanding of the deep problems Buy/Borrow/Die poses, and of other realistic hopes for reform. The possible steps to address "Die" in contrast seem most feasible in any kind of near-term, and could be quite effective. Perhaps counter-intuitively, however, it is the "Borrow" step that holds out the best promise for taxing wealth seriously.

A. Rethinking "Buy"

There are two broad avenues for attacking the "Buy" prong of Buy/Borrow/Die, built up under the realization requirement. One acts *within* the income tax; the other steps outside to develop a new, "complementary" wealth tax, as Mirrlees among others has suggested.[212] Unfortunately, neither track seems all that promising.

Repealing the Realization Requirement

In terms of income-tax reform, eliminating "buy" means repealing or at least radically reforming the realization requirement, which we now know is not constitutionally required. There are at least three ways to consider doing this.

[212] James Mirrlees, et al., *The Mirrlees Review: A Proposal for Systematic Tax Reform*, 65(3) NAT'L TAX J. 655, 659 (2012).

First, we could "simply" repeal the realization requirement and force taxpayers to "mark to market" their holdings every year, reporting the "change in value of the store of property" rights on their tax returns. Scholars have considered just such proposals.[213] It is fairly easy to countenance such a reform for assets with readily ascertainable market values, such as publicly traded stocks. But other assets, such as land or real estate, would be difficult. Unless capital held in non-publicly tradable forms was captured in the tax base, there would be a strong incentive to remove assets from public exchanges, with inefficiencies and inequities resulting.

Second, we could keep the realization requirement, but take away its *benefits*, by adjusting the tax due on any ultimate sale or exchange to reflect the deferral allowed by *Macomber*. This is the idea of "retrospective capital gains" developed by Alan Auerbach and others. Combined with marking to market publicly traded securities, above, this step could help to sweep more capital appreciation into the tax base. To make it effective, the "die" step, stepped-up basis on death, would also have to be repealed, as we consider below. *If* the plan could be implemented in a seamless fashion, this would mean that there would be no benefit from buying and holding, because ultimately a tax would come due, and one that compensated for its delay in its magnitude.

Third, we could keep the realization requirement in place, but broaden the scope of "realization events," specifically to include borrowing. An easy step vis-a-vis debt would be to tax borrowing secured by appreciated property. But this would only create an incentive

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[213] Joseph Bankman, *A Market-Value Based Corporate Income Tax*, 68 Tax Notes 1347 (1995); David A. Weisbach, *A partial Mark-to-Market Tax System,* 53 Tax. L. Rev. 95 (1999); David S. Miller, *The Zuckerberg Tax*, N.Y. Times (Feb. 7, 2012), http://www.nytimes.com/2012/02/08/opinion/the-zuckerberg-tax.html?_r=0.

to design unsecured debt, or to use unappreciated property to secure debt. It may not be wise to add on some realization events to the list, while keeping the basic doctrine in place.

A Freestanding Wealth Tax

A second tack on attacking the Buy step is to adopt a meaningful wealth tax, an idea with some currency. Bruce Ackerman and Ann Alstott considered such a tax in their *Stakeholder Society*, and the idea has been invoked by multiple columnists in the New York Times and elsewhere.[214] Designing an altogether new tax will not be easy, of course, along any dimension – politically or practically. But truly taking taxing wealth seriously demands that all options be put on the table, and explored under the light of something at least.

Still there are good reasons to suspect that taxing wealth directly, whether under the income tax or in a separate complementary tax, is *not* the best approach to the challenges of taxing wealth seriously. Certainly a century of estate taxation provides a cautionary tale for the efficacy of any such tax. So, too, does the history of the corporate tax. The twin facts that we need capital and that capital is highly mobile in today's global economy conspires against hope, here. Fortunately, taxing wealth seriously does *not* have to mean taking it directly, and so none of the ideas sketched out in this sub-section need, logically, be any part of the answer to taxing wealth seriously.

[214] Tyler Cowen, *Wealth Taxes: A Future Battleground*, N.Y. TIMES (July 20, 2013), http://www.nytimes.com/2013/07/21/business/wealth-taxes-a-future-battleground.html.

B. Rethinking "Borrow"

For going on two decades, I have been arguing for a particular form of taxing wealth seriously: moving to a progressive spending tax.[215] In this Article, I have been concerned with the curious failure to see the roots of the issue or to take taxing wealth seriously for more than a century. I will not repeat at length my sense of the ideal solution. But it is worth noting.

Recall that the Haig Simons definition of income, I = C + S. A simple rearrangement shows us that C = I – S. In other words, we can have a consumption tax "simply" by adding up all aspects of "income" and systematically subtracting all savings. We could have a consistent, "cash flow" consumption tax using annual returns, like the 1040, and featuring unlimited savings accounts. This is an idea that harkens back at least to the British economist Nicolas Kaldor in 1955,[216] picked up and developed in America by William Andrews at Harvard.[217]

In moving to a cash-flow consumption tax, we would have to include debt as an inflow. Borrowing that is used to save is a "wash," the input of debt as an I would be offset by the output of savings as a deduction, S. But debt that is used to consume would be taxed under a consistent spending tax. This sounds strange, but need not – it is how a common sales tax works. If you borrow to save, you do not pay the sales tax. But if you borrow to spend, as on a credit card, you do. When you pay off the debt, later, you do not pay tax again – that paying off of debt is a form of savings.

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[215] Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 YALE L.J. 283, 345-357 (1994-1995). *See generally* MCCAFFERY, FAIR NOT FLAT, *supra* note.
[216] *See generally* Nicholas Kaldor, *An Expenditure Tax*, 67(3) YALE L.J. 516 (1958).
[217] *See generally* William D Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 HARV. L. REV. 947 (1974-1975); David F. Bradford, et al., *Blueprints for Basic Tax Reform*, DEP'T OF TREASURY (Jan. 17, 1977), https://www.treasury.gov/resource-center/tax-policy/Documents/full.pdf.

Looked at through the lens of a consistent progressive spending tax, *borrowing* is the Achilles' heel, the big mistake in Buy/Borrow/Die. Unrealized appreciation from the "buy" step that is *not* converted into consumption via debt is not the problem – that is part of the social pool of capital. It is the failure to tax the spending of the rich, not their savings, that becomes the relevant social problem.

Systematically including debt as a taxable input will be difficult, of course. But if finding a way to measure debt or borrowing is challenging, it seems a challenge worth considering. The problems of not taxing wealth seriously are getting worse by the minute. Directly taxing wealth, as in repeal of the "buy" step, runs the risk of taxing the wrong thing, at the wrong time – unspent capital. Taxing debt allows us to allow the rich to continue to save, while changing their ability to use that wealth on their own personal consumption. It would seem to be a mutually beneficial arrangement, well worth taking seriously.

A progressive spending tax does more than attack the "borrow" step: it helps us to rethink "taxing." It is easy to think that the right approach to wealth inequality is to tax wealth: Piketty and scores of others motivated to tax wealth seriously have thought thus. But "taxing" does not have to mean "taking." A progressive spending tax works by having unlimited savings accounts: as featured in an actual American law proposal, the Nunn-Domenici "USA Tax" from the 1980s.[218] ("USA" stood for "unlimited savings accounts.) The actual proposal was fatally flawed by its noninclusion of debt: if there is an unlimited deduction for savings, but no inclusion for debt, a taxpayer like Jane can earn $100,000,

[218] See THE NUNN-DOMENICI USA TAX: ANALYSIS AND COMPARISONS
Center for the Study of American Business, Washington University, 1995.

save $100,000, pay no tax, and borrow whatever she needs – and we could expect financiers to help her do just that.[219]

But the USA Tax or similar ideas allow us to make a deep point. The unlimited savings accounts, like IRAs under current law or "Trust Accounts" in theory, allow us to *change the meaning of capital*. Among other things, a progressive spending tax can support higher tax rates, even under optimal income tax theory, than a wage tax.[220] This is because such rates need not deter labor; for people motivated to save and pass their wealth inter-generationally – as hundreds of billions of dollars in dynasty trusts suggest that many want to do – the progressive spending tax need not deter work or savings.

Imagine a progressive spending tax with a top rate bracket of 90%, as we saw in World War II, now imposed on spending in excess of $1 million in any year. Imagine that Dick has already spent $1 million, and has a savings account of $70 million or so – he's a top 0.1% wealthholder. If Dick desired to spend another $1 million, he would have to withdraw $10 million from his account, in order to pay $9 million in tax, at the 90% rate, first, then engage in his own consumption.

A progressive spending tax changes the meaning of wealth – it changes what one can do with it. It builds on a longstanding modern tendency to separate ownership and control. We allow the wealthy to keep their wealth, to manage and invest and grow, but should they attempt to spend it on themselves, we subject them to high tax rates for the privilege. This is an exciting way to begin to think about taxing wealth seriously.

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[219] See Laurence S. Seidman, The USA TAX: A PROGRESSIVE CONSUMPTION TAX (MIT Press 1997).
[220] McCaffery and Hines, *The Last Best Hope for Progressivity in Tax*, *supra*.

C. Rethinking "Die"

The simplest step in Buy/Borrow/Die is the last step, and this also would seem as the easiest fix.[221] We could make death a realization event, as Canada has done and as Obama proposed in 2015. We could also enact a carryover basis rule for assets passed on death. In a world without any very good reason for the persistence of stepped-up basis – a world in which almost no one will be paying an estate tax – this would seem like an easy first step, a down-payment on taxing wealth seriously. Of course, the fact that we cannot even seem to do this seemingly simple step underscores how poorly we have thought for years – how much we have not taken taxing wealth seriously.

D. Ending the Joke

It is time – past time – to give our drunken sailor some light, any light other than the income tax, to search for America's lost wallet. The income tax does some things well – it did help to finance war efforts, after all, and it has long been the major source of funds for a democratic capitalist state that still, all things considered, is better than most alternatives. But specifically in terms of the progressive agenda manifest at the dawn of its creation – the quest to chip away at "economic royalists" as FDR called them, or, at a minimum, to get the wealthy to contribute *something* to the general welfare – the income tax has been a failure. Buy/Borrow/Die moots it for the propertied class.

At the end of the day, the critique of the income tax along these lines is no more complex than the common saying that, if one is not part of the solution, she is part of the problem.

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[221] Lawrence Zelenak, *Taxing Gains at Death*, 46 Vand. L. Rev. 361 (1993); Michael J. Graetz, *Taxation of Unrealized Gains at Death: An Evaluation of the Current Proposals*, 59 Va. L. Rev. 830 (1973).

The income tax, as it has evolved over a century, is no part of the solution to the problem of wealth inequality in America. If we believe that that is a problem – and if it is, it is getting worse by the minute – it is time to look for real solutions, not jokes.