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The Death of the Income Tax (or The Rise of America's Universal.pdf

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The Death of the Income Tax (or, The Rise of America's Universal Wage Tax)

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The Death of the Income Tax (or, The Rise of America's Universal Wage Tax)

EDWARD J. McCAFFERY*

I. LOOMINGS

When Representative Alexandria Ocasio-Cortez, just weeks into her tenure as America's youngest member of Congress, floated the idea of a sixty or seventy percent top marginal tax rate on incomes over ten million dollars, she was met with a predictable mixture of shock, scorn, and support.¹ Yet there was nothing new in the idea. AOC, as Representative Ocasio-Cortez is popularly known, was making a suggestion with sound historical precedent: the top marginal income tax rate in America had exceeded ninety percent during World War II, and stayed at least as high as seventy percent until Ronald Reagan took office in 1981.² And there is an even deeper sense in which AOC's proposal was not as radical as it may have seemed at first. For whether one likes, loves, hates, or fears it, one brute fact stands out about AOC's tax gambit: it would do nothing at all to change the tax burdens facing many of America's wealthiest billionaires who pay no federal income tax. Two you may have heard of? How about President Donald J. Trump³ or his son-in-law, Jared Kushner.⁴

How can this be? How can progressive efforts to make the wealthy pay a fairer share of the overall tax burden be doomed from the start? The answer lies in a surprising, and surprisingly hidden, fact: the individual income tax, as it was intended to be, is dead. Out of its ashes, a new colossus has arisen: a universal wage tax that

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1. See Paul Krugman, *The Economics of Soaking the Rich*, N.Y. TIMES (Jan. 5, 2019), <https://www.nytimes.com/2019/01/05/opinion/alexandria-ocasio-cortez-tax-policy-dance.html> [https://perma.cc/HN3E-YZSN]; Aaron Rupar, *The Conservative Response to Ocasio-Cortez's Tax Proposal Has Been Embarrassingly Deceptive: What Conservatives Are Getting Wrong About Marginal Tax Rates*, VOX (Jan. 7, 2019, 10:40 AM), <https://www.vox.com/policy-and-politics/2019/1/7/18171803/ocasio-cortez-70-percent-marginal-tax-rate-scalise-norquist-spin> [https://perma.cc/8XKJ-4C4N]; Emmanuel Saez & Gabriel Zucman, *Alexandria Ocasio-Cortez's Tax Hike Idea Is Not About Soaking the Rich*, N.Y. TIMES (Jan. 22, 2019), <https://www.nytimes.com/2019/01/22/opinion/ocasio-cortez-taxes.html> [https://perma.cc/526T-8TUN].

2. See Niall McCarthy, *Alexandria Ocasio-Cortez's Tax Plan Isn't Unprecedented Historically*, FORBES (Jan. 24, 2019), <https://www.forbes.com/sites/niallmccarthy/2019/01/24/alexandria-ocasio-cortezs-tax-plan-isnt-unprecedented-historically-infographic/#35e7b38354dc> [https://perma.cc/X8X2-4J2V].

3. Steve Eder & Megan Twohey, *Donald Trump Acknowledges Not Paying Federal Income Tax for Years*, N.Y. TIMES (Oct. 10, 2016), <https://www.nytimes.com/2016/10/10/us/politics/donald-trump-taxes.html> [https://perma.cc/ZV87-QD3Z].

4. Jesse Drucker & Emily Flitter, *Jared Kushner Paid No Federal Income Tax for Years, Documents Suggest*, N.Y. TIMES (Oct. 13, 2018), <https://www.nytimes.com/2018/10/13/business/jared-kushner-taxes.html> [https://perma.cc/E7HE-GFN9].

is simple, formless, onerous, and inescapable. America taxes wages, not wealth. Those few who have significant wealth can easily find ways to live off it, well and tax-free. America's many workers have no such choice. AOC's increased tax rate would fall on a few working millionaires⁵ but not on the many billionaires, like President Trump and Kushner, who have no reportable "income" under current law on which AOC or anyone else can tax them.

The killing of the income tax has not been open and notorious: such is not the style of contemporary politics. As with other markers of progressive social policy—the promises of universal health care, Obamacare, come to mind⁶—the income tax is dying a death by stealth, albeit stealth played out in plain view. The plot lines of the tragedy are apparent. The individual "income" tax has been split in two. One tax, for the masses, is a simple, increasingly formless wage tax. This wage/income tax adds higher brackets onto the payroll tax, the model toward which the wage/income tax aims, to form a single "universal wage tax" providing the vast bulk of the government's revenue. A second tax, which I shall call the "ur-income tax," persists only for the wealthiest top 1%–5% of the population. This tax, the relics of a true income tax, still nominally taxes wealth—that is, income from capital—in addition to wages, as an "income" tax must in order to be an income tax. But this taxation of wealth as opposed to wages is so porous that it is largely symbolic. Structural features of the tax—loopholes—allow the wealthy to avoid its sting. Congress and the executive branch continue to add rules and regulations to help the wealthy avoid tax. Indeed, a cynic might suggest that the ur-income tax, the original and future tax that applies to America's wealthiest, persists only to feed the Wall Street financiers who help their clients avoid paying it and the politicians and lobbyists who benefit whenever tax reform specifically for the wealthy is on the legislative table.⁷ For the rest of us, the income tax has died, and we are paying a painful price for its killing.

The fate of the income tax correlates closely with an economic-class structure in America that many have begun to notice.⁸ For the very top, the 0.1% or so, tax is essentially voluntary due to basic tax planning available for those living off capital alone. For the next tier, what Matthew Stewart has taken to calling the new American aristocracy,⁹ the ur-income tax continues to apply, as these citizens have a mix of capital and labor with which to play tax-planning games. For the bottom 90%–95% of the economic scale, however, the income tax is dead, replaced by the formidable and inescapable universal wage tax. This is the tale told in the pages ahead.

5. See William Gale, *Ocasio-Cortez's Tax on the Super Rich Won't Happen. Here's a Better Way to Do It*, CNN BUS. (Jan. 22, 2019), <https://www.cnn.com/2019/01/22/perspectives/alexandria-ocasio-cortez-tax-plan-alternative/index.html> [https://perma.cc/5VH4-E73U].

6. Joanne Kenen, *The Stealth Repeal of Obamacare*, POLITICO (Dec. 19, 2017, 5:54 PM), <https://www.politico.com/story/2017/12/19/obamacare-repeal-tax-bill-trump-243912> [https://perma.cc/4KVH-X3E8].

7. Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. REV. 1159 (2006).

8. See, e.g., Matthew Stewart, *The 9.9 Percent Is the New American Aristocracy*, ATLANTIC (June 2018), <https://www.theatlantic.com/magazine/archive/2018/06/the-birth-of-a-new-american-aristocracy/559130/> [https://perma.cc/SD4F-TGA5].

9. See *id.*

A. The Trump Tax Cut, in Context

The recent “major overhaul” of the income tax under President Donald J. Trump in fact continued a decades-long trend to transform the individual income tax into a flat, or flattened, wage tax for the masses.¹⁰ There is barely a need for most Americans even to fill out forms to pay it. It has already long been the case that just over one-half of Americans even pay the individual income tax;¹¹ around 150 million individuals file returns each year.¹² Before the Tax Cuts and Jobs Act of 2017 (TCJA), only approximately 30% of those who filed had been taking “itemized” deductions—meaning, among other things, the need to fill out longer forms and a greater likelihood of being audited by the IRS.¹³ Under the changes effected by the TCJA, with an increased “standard deduction” and a continued assault on personal, itemized deductions, the percentage of itemizers is expected to plunge to around 10% of income taxpayers.¹⁴ This means that ninety-five percent of Americans either will not need to fill out an income tax return at all or will be approaching the possibility of a “postcard” return,¹⁵ or even more simply, having the government fill out tax forms for them.¹⁶ For most of these taxpayers the overwhelming component of their income will be wages reported to the government by their employers. There will not be any personal deductions to keep track of or show on a return. The typical household will simply add up its wages as reflected on W-2s, subtract the standard deduction, and look up the amount owed—most of which will already have been paid through wage-withholding in paychecks. Indeed, millions of Americans will be happy to get tax refunds on account of their overwithholding.¹⁷

10. See Edward J. McCaffery, *Taxing Wealth Seriously*, 70 TAX L. REV. 305 (2017).

11. Catey Hill, *44% of Americans Won't Pay Any Federal Income Tax*, MONEYISH (Apr. 17, 2017), <https://moneyish.com/hoard/44-of-americans-wont-pay-any-federal-income-tax/> [https://perma.cc/WD7Z-U3F5].

12. Brett Collins, *Projections of Federal Tax Return Filings: Calendar Years 2011–2018*, 31 STAT. INCOME BULL. 189, 182 fig.A (2012), <https://www.irs.gov/pub/irs-soi/12rswinbulreturnfilings.pdf> [https://perma.cc/Y4M2-CQF4].

13. Scott Greenberg, *Who Itemizes Deductions?*, TAX FOUND. (Feb. 22, 2016), <https://taxfoundation.org/who-itemizes-deductions/> [https://perma.cc/XHZ5-9TXP].

14. Gary Strauss, *Higher Standard Deduction Means Fewer Taxpayers to Itemize*, AARP MONEY (Jan. 22, 2018), <https://www.aarp.org/money/taxes/info-2018/new-standard-deduction-fd.html> [https://perma.cc/8X4B-9TTR]; Erica York, *Nearly 90 Percent of Taxpayers Are Projected to Take the TCJA's Expanded Standard Deduction*, TAX FOUND. (Sept. 26, 2018), <https://taxfoundation.org/90-percent-taxpayers-projected-tcja-expanded-standard-deduction/> [https://perma.cc/9BW4-96RC].

15. Howard Gleckman, *The New Tax Law's Really, Really Big Postcard*, FORBES (Jan. 29, 2018, 1:57 PM), <https://www.forbes.com/sites/beltway/2018/01/29/tax-new-tax-bills-really-really-big-postcard/#7a1dfe1a7bbc> [https://perma.cc/73EH-BT85].

16. See Joseph Bankman, *Using Technology to Simplify Individual Tax Filing*, 61 NAT'L TAX J. 773, 773 (2008) (describing California's attempt to reform individual tax filing through its “ReadyReturns” program, which provided a “pro-forma or tentative” tax return to taxpayers with simple returns).

17. Kathy Frankovic, *Americans Are Looking Forward to Their Tax Refunds*, YOUTOV (Apr. 16, 2018), <https://today.yougov.com/topics/politics/articles-reports/2018/04/16/americans-are-happy-looking-forward-their-tax-refu> [https://perma.cc/LBW5-WM3L].

This is a tax with few or no forms to fill out, little or no variation among taxpayers, falling only on wages, and automatically collected from paychecks. What should this remind us of? For ninety percent or more of Americans, the individual income tax is morphing into the second part of a universal wage tax system that simply adds higher rate brackets onto the federal payroll tax. The payroll tax has long been a flat-rate wage tax on the vast majority of American workers, kicking in on the first dollar of wage income—that is, having no deductions, standard or otherwise. And this payroll tax already is, for more than three out of four American workers, the major tax they pay (more than one out of four Americans *only* pay payroll taxes)¹⁸—though they do not know it.¹⁹ Most Americans never fill out any form to pay payroll taxes or pay any planners to avoid them, students almost never study the tax, the IRS does not much trouble regular citizens about it, and politicians almost never talk about it. Only once in its eighty-year history has the payroll tax ever been cut, and that cut—President Barack Obama’s payroll tax holiday—was undone after two years, when the government needed to resolve a fiscal crisis of its own making, mainly on account of reckless cuts to the individual income tax, as we shall consider further below.²⁰

The payroll tax as it is and always has been is a pure wage tax—one that makes no effort at all to tax income from wealth. It is not an income tax. The more the “income” tax looks like a payroll tax, the less it is in fact an income tax. President Trump’s tax cuts dealt a further death blow to what an income tax is supposed to be. For most Americans, the income tax is dead.

B. The Seeds Planted

The plan radically to transform the income tax into a wage tax in drag, like the entire history of the payroll tax, has been hidden in plain sight all along, at least since Grover Norquist published a seminal editorial piece, *Step-by-Step Tax Reform*, in 2003.²¹ Conservatives have been surprisingly explicit about their goals of achieving a tax system with “a single-rate tax, which taxes income one time,” as Norquist put it.²² Increasingly, since Norquist first set out the plan in simple written form, the “one time” that “income” gets taxed is as it is earned from labor, just like the payroll tax.

Norquist’s plan was to incrementally bring the “income” tax into synch with the holy grail of a flat tax, as championed by such conservative luminaries as Steve Forbes, Richard Armey, Robert Hall, and Alvin Rabushka.²³ One can see the plot in

18. Roberton C. Williams, *Most Americans Pay More Payroll Tax Than Income Tax*, TAX POL’Y CTR. (Sept. 6, 2016), <https://www.taxpolicycenter.org/taxvox/most-americans-pay-more-payroll-tax-income-tax> [<https://perma.cc/8XFP-HK9F>].

19. Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861 (1994).

20. Edward J. McCaffery, *Distracted from Distraction by Distraction: Reimagining Estate Tax Reform*, 40 PEPP. L. REV. 1235 (2013).

21. Grover Norquist, *Step-by-Step Tax Reform*, WASH. POST (June 9, 2003), https://www.washingtonpost.com/archive/opinions/2003/06/09/step-by-step-tax-reform/f200f59d-7370-42f6-837b-265501dc3701/?noredirect=on&utm_term=.fde6850c3203 [<https://perma.cc/3ARN-63NZ>].

22. *Id.*

23. See, e.g., ROBERT E. HALL & ALVIN RABUSHKA, *THE FLAT TAX* (2d ed. 2007); Lawrence Zelenak, *The Selling of the Flat Tax: The Dubious Link Between Rate and Base*, 2

the details, such as in the conservative predilection for “Roth-style” treatment of savings under the “income” tax—going so far as to label the movement “Rothification” of the income tax.²⁴ Under the Roth model, income is taxed once, as earned, and never again. This is also true of the payroll tax: income is taxed as earned, from wages, but the system makes no attempt whatsoever to track income from wealth or savings. The simple reason for the parallelism is that an “income” tax with Roth-style treatment of savings *is* a payroll tax—one that taxes wages and ignores savings. Such a universal wage tax, of course, wildly favors those who do not actually have to work for wages to support their lifestyles: those like America’s ever-growing list of billionaires (well over 500 as I write)²⁵ and ever-growing number of “dynasty-trust babies,” who can live off their wealth, not wages.²⁶

Each of Norquist’s five steps (in his own words; I have added just the numbers to track the text better) is already well on its way to becoming reality: “[1] [a]bolish the death tax, [2] abolish the capital gains tax, [3] expand IRAs so that all savings are tax-free, [4] move to full expensing of business investment rather than long depreciation schedules and [5] abolish the alternative minimum tax.”²⁷ Each step has proceeded incrementally, just as Norquist’s global strategy was meant to proceed incrementally. In particular, the TCJA severely weakened the “death” tax (step 1)²⁸ as well as the alternative minimum tax (step 5),²⁹ while moving towards expensing of business investment (step 4).³⁰ And as ordinary American wage earners continued

CHAP. L. REV. 197 (1999); Steve Forbes, *The Tax Code: Make It Flat*, FORBES (Mar. 7, 2014), <https://www.forbes.com/sites/steveforbes/2014/03/07/the-tax-code-make-it-flat/#31880e2a7e0e> [https://perma.cc/HYG8-9QNE]; Daniel Mitchell & William Beach, *How the Arney-Shelby Flat Tax Would Affect the Middle Class*, HERITAGE FOUND. (Mar. 12, 1996), <https://www.heritage.org/taxes/report/how-the-armey-shelby-flat-tax-would-affect-the-middle-class> [https://perma.cc/W36R-TSCH].

24. Bill Bischoff, *How the New Tax Law Created a ‘Perfect Storm’ for Roth IRA Conversions in 2019*, MARKETWATCH (Feb. 24, 2019), <https://www.marketwatch.com/story/how-the-new-tax-law-creates-a-perfect-storm-for-roth-ira-conversions-2018-03-26> [https://perma.cc/4XRW-PX2A]; Amir El-Sibaie, *What Rothification Means for Tax Reform*, TAX FOUND. (Sept. 12, 2017), <https://taxfoundation.org/what-rothification-means-for-tax-reform/> [https://perma.cc/9KAS-JRCG].

25. Katie Sola & Emily Canal, *Here Are the States with the Most Billionaires*, FORBES (Mar. 5, 2016), <https://www.forbes.com/sites/katiesola/2016/03/05/here-are-the-states-with-the-most-billionaires/#13fb2cfc101e> [https://perma.cc/2E38-V48G].

26. Edward J. McCaffery, *Wealth Not Wages: The Fundamental Trick of Tax Policy*, HUFFINGTON POST, https://www.huffingtonpost.com/entry/wealth-not-wages-the-fundamental-trick-of-tax-policy_us_59ea5fd1e4b034105edd4e79 [https://perma.cc/XS72-2ZYF] (updated Oct. 20, 2017, 5:27 PM).

27. Norquist, *supra* note 21.

28. Howard Gleckman, *Only 1,700 Estates Would Owe Estate Tax in 2018 Under the TCJA*, TAX POL’Y CTR. (Dec. 6, 2017), <https://www.taxpolicycenter.org/taxvox/only-1700-estates-would-owe-estate-tax-2018-under-tcja> [https://perma.cc/3GWA-RN6Y].

29. Bill Bischoff, *Meet the New, Friendlier Alternative Minimum Tax*, MARKETWATCH (Feb. 26, 2018), <https://www.marketwatch.com/story/meet-the-new-friendlier-alternative-minimum-tax-2018-02-26> [https://perma.cc/RMZ8-TUFC].

30. John Ohannessian & Stefanie Levit, *Tax Reform: Enhanced Fixed Asset Expensing Under the Tax Cuts and Jobs Act*, MAZARS (Feb. 9, 2018), <https://mazarsledger.com/enhanced-fixed-asset-expensing-under-the-tax-cuts-and-jobs-act/> [https://perma.cc/3PD2-4KKW].

to search for the \$4000 of benefits that Trump promised them from Tax Cuts 1.0,³¹ talk of Tax Cuts 2.0 featured reductions to the capital-gains rate, even by executive regulatory action (step 2),³² and an expansion of IRAs—along the Roth model (step 3).³³ At the end of this line, when all five of Norquist’s steps have been taken in full, there will be no income tax as we know it, or one that can properly be called an “income” tax: we will have arrived at a universal wage tax.

C. *The Normative Stakes at Issue*

To be clear, much has been gained as the death of the income tax plays out. The simplifications to the tax system are popular, the administrative efficiencies of a simpler tax are real, and so forth. This Article is not about parsing out blame for the status quo, but it is worth noting, in passing at least, that it is not just conservatives bent on a flat wage tax driving the policy changes. Liberals and progressives have been especially wont to use the income tax as a vehicle for advancing social and political ends—noble causes, perhaps, but ones that helped to make the income tax unpopular and unwieldy.³⁴ Whatever the causes or benefits of the income tax’s demise, some very important things have been lost in its passing: in particular, the very possibilities for politics and progressivity.

The payroll tax is again the guide—it rarely features as an issue in electoral politics and is not, and never has been, meaningfully redistributive. Indeed, there are compelling reasons, in both theory and practice, why a wage tax ought *not* to be too progressive or feature overly high marginal tax rates on the upper income: this is a lesson both of the late Nobel Laureate James Mirrlees, of optimal income tax fame,³⁵ and of the academic and political advisor Arthur Laffer, of the “Laffer Curve” and recent Presidential Medal of Honor fame.³⁶ Thus AOC’s proposal to raise marginal

31. Heather Long, *The Average American Family Will Get \$4,000 from Tax Cuts, Trump Team Claims*, WASH. POST (Oct. 16, 2017), https://www.washingtonpost.com/news/wonk/wp/2017/10/16/the-average-american-family-will-get-4000-from-tax-cuts-trump-team-claims/?utm_term=.488f058e7357 [https://perma.cc/6DQQ-YP6X].

32. Newt Gingrich, *Why THIS Must Happen Next in Trump’s Economic Revolution*, FOX NEWS (Aug. 8, 2018), <http://www.foxnews.com/opinion/2018/08/08/newt-gingrich-why-this-must-happen-next-in-trump-s-economic-revolution.html> [https://perma.cc/XD5A-72P9].

33. Laura Davison, *In New Round of Tax Cuts, Retirement Changes Seen as Most Likely to Pass*, BLOOMBERG (July 18, 2018, 3:46 PM), <https://www.bloomberg.com/news/articles/2018-07-18/in-tax-cuts-2-0-retirement-changes-seen-as-most-likely-to-pass> [https://perma.cc/T5QQ-9764].

34. See generally Edward J. McCaffery, *The Missing Links in Tax Reform*, 2 CHAP. L. REV. 233 (1999).

35. See J. A. Mirrlees, *An Exploration in the Theory of Optimum Income Taxation*, 38 REV. ECON. STUD. 175 (1971); Sam Roberts, *James Mirrlees, Whose Tax Model Earned a Nobel, Dies at 82*, N.Y. TIMES (Sept. 4, 2018), <https://www.nytimes.com/2018/09/04/obituaries/james-mirrlees-dead.html> [https://perma.cc/U42T-WZNX].

36. Arthur Laffer, *The Laffer Curve: Past, Present, and Future*, HERITAGE FOUND. (June 1, 2004), <https://www.heritage.org/taxes/report/the-laffer-curve-past-present-and-future> [https://perma.cc/442Y-HVWH]; Ian Schwartz, *President Trump Presents the Presidential Medal of Freedom to Arthur Laffer*, REALCLEARPOLITICS (June 20, 2019), https://www.realclearpolitics.com/video/2019/06/20/president_trump_presents_the_presiden

tax rates faces a plausible objection that it will deter high-end *labor* effort, while doing nothing at all for those who are already wealthy and do not have to work for wages in the first place.

The death of the income tax as an income tax—as a tax that is meant to fall on wealth as well as on wages—means a deep, structural, and likely long-lasting loss to America. To its advocates such as Grover Norquist, the death will be the crowning glory in the systematic disarmament of the state’s tools of redistribution. Once cut, complex, progressive taxes on capital and the rich will be hard to raise.³⁷ Taxes on wages, in contrast, are easy to collect and raise—their broad base means modest rate increases raise massive revenues, and their largely hidden structures keep the people from complaining too much about seemingly small increases to them. We saw this dynamic play out rather precisely under President Obama’s “fiscal cliff fix,” in 2012, when the restoration of a temporary, two percent payroll tax cut brought in the bulk of the revenues (specifically, \$1 trillion over a ten year period) to close a fiscal gap created in large part due to President George W. Bush’s reckless *income* tax cuts.³⁸ As this all plays out, wealth will be systematically left off the hook for paying any of the price of whatever civilization endures.

The income tax is not completely dead, yet. And it might never fully, literally die. Like the story of the gift and estate, or so-called “death,” tax³⁹ or like the slashing of the corporate income tax—two taxes meant to fall on wealth not wages—the *ur-income* tax may persist largely as a fig leaf giving cover to a tax system fundamentally set up to tax wages, not wealth. It will be more symbolic than real and more fodder for keeping money—lots of money—in politics. Meantime, ninety to ninety-five percent of Americans will be facing a flattened and inescapable wage tax. Tax will continue to be a deep part of the problem of exacerbating wealth inequality in America and not any part of its solution. Meaningful possibilities for getting the wealthy to pay a fair share into the collective will be dead in all but name.

We are almost at the funeral stage, though hope continues to spring eternal. New ideas, such as AOC’s marginal-rate increase, Senator Elizabeth Warren’s recent proposal for a federal wealth tax on fortunes in excess of \$50 million⁴⁰ and former Vice President Biden’s proposal to repeal the “stepped-up basis” on death rule of I.R.C. § 1014,⁴¹ bear promise of different things to come—of a real attempt to get the wealthy to pay a fair share of tax. But for progress to obtain and endure, it is best to understand the failures of past and present tax policy. These recent progressive

tial_medal_of_freedom_to_arthur_laffer.html [https://perma.cc/N3R2-J5EK].

37. Robert J. Shiller, *Once Cut, Corporate Income Taxes Are Hard to Restore*, N.Y. TIMES (June 22, 2018), <https://www.nytimes.com/2018/06/22/business/big-war-to-raise-the-corporate-income-tax.html> [https://perma.cc/795Y-GAE5].

38. See McCaffery, *supra* note 10, at 343–44.

39. This is discussed later in this Article in greater depth. See *infra* Section IV.B.3.

40. Sahil Kapur & Joe Weisenthal, *Warren Faults ‘Capitalism Without Rules’ in Pushing Wealth Tax*, BLOOMBERG (Jan. 30, 2019), <https://www.bloomberg.com/news/articles/2019-01-30/warren-faults-capitalism-without-rules-in-pushing-wealth-tax> [https://perma.cc/A3JV-PBTY].

41. *The RS Politics 2020 Democratic Primary Policy Guide*, ROLLINGSTONE (July 31, 2019), <https://www.rollingstone.com/politics/politics-lists/2020-democratic-candidates-issues-policy-positions-820811/> [https://perma.cc/XZJ6-8LZK].

proposals all work within an existing paradigm of taxing income-plus-wealth that has existed on the books in America for over a century. It is not working, as this Article argues. Sometimes paradigms must shift, and new tools need to be crafted for old and intransigent problems. Furthering this intellectual project along is a main goal of this Article.

This is an important political and legal story. Let us go through it step by step, as they say.

II. THE SCRIPT

To fully understand the death of the income tax, we need some background in diverse disciplines including political economy, history, and, not least, tax law and theory. The complexities of the subject matter help obscure its basic and profound truths—a major part of the reason that the murder can take place in broad daylight. I will keep the main discussion as simple and welcoming as possible, for the technical details tend to obscure the basic truths. More complexity can be found by following sources in the footnotes.

A. The Producers: Wealth and Wages

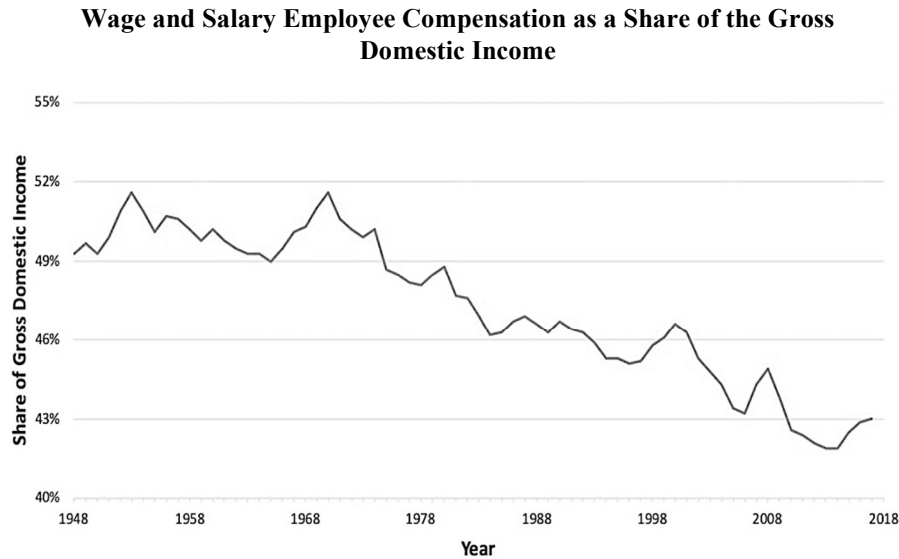
There are two major forces at work throughout our story: capital and labor, the two great factors of production in a modern capitalist economy. All wealth comes, ultimately, from one's labor or from one's capital: people earn wealth either by working for it or by using their assets (money, machines, land, buildings, intellectual property, and so forth), for which they are paid rents or profits.

Political economists from John Stuart Mill to Karl Marx and beyond have used this vocabulary.⁴² The contemporary French economist Thomas Piketty recently published a major work, *Capital in the 21st Century*, collecting vast reams of data to paint a picture of the state of capital and labor today.⁴³ The quick bottom line: capital is winning. The world has more capital than ever, more unequally held. The Western world is at, and is soon to exceed, levels of capital accumulation and inequality not seen since the Gilded Age of the early twentieth century—a moment in time that boded ill for Western civilization. Labor, meantime, has been losing: wages have been stagnating for some time, and labor's share of the national income has been in steady decline for decades, as Figure 1 illustrates.⁴⁴

42. See generally KARL MARX, *DAS KAPITAL* (1848); JOHN STUART MILL, *PRINCIPLES OF POLITICAL ECONOMY* (1848).

43. THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* (2013); accord EDWARD J. McCaffery, *THE MEANING OF CAPITAL IN THE 21ST CENTURY* (2016).

44. Jonathan Rothwell, *Make Elite Compete: Why the 1% Earn So Much and What to Do About It*, BROOKINGS (Mar. 25, 2016), <https://www.brookings.edu/research/make-elites-compete-why-the-1-earn-so-much-and-what-to-do-about-it/> [https://perma.cc/J76H-AMW8].

Figure 1: Labor Share of the National Income, 1948–2018⁴⁵

In part because “capital” and “labor” have connotations of Marxism and unpleasant undergraduate lectures, I will generally use the simpler, more colloquial terms of wealth and wages. “Wealth” refers to the value of all of one’s assets, minus debts or liabilities; “wages” refer to paychecks, income from labor. In 2017, the average American worker received wages of just under \$45,000 per year.⁴⁶ The average income (from capital and labor, combined) of the top one percent of households in America was about \$430,000, while the average wealth of the top one percent was over \$10,300,000.⁴⁷ Wealth inequality, in other words, is far more severe than wage inequality. To have some real examples in mind, Warren Buffett has a net worth, a *wealth*, of \$85 billion (\$85,000,000,000) as I write;⁴⁸ his salary as the chief executive officer of Berkshire Hathaway is \$100,000.⁴⁹ The late Steve Jobs, who died

45. *Shares of Gross Domestic Income: Compensation of Employees, Paid: Wage and Salary Accruals: Disbursements: To Persons*, FED. RESERVE BANK OF ST. LOUIS, <https://fred.stlouisfed.org/series/W270RE1A156NBEA> [<https://perma.cc/FLW8-KVY2>] (last updated Aug. 29, 2019).

46. Alison Doyle, *Average Salary Information for US Workers*, BALANCE CAREERS, <https://www.thebalancecareers.com/average-salary-information-for-us-workers-2060808> [<https://perma.cc/SBZ3-MGK5>] (last updated May 10, 2019).

47. PK, *Who Are the One Percent in the United States by Income and Net Worth?*, DQYDJ, <https://dqydj.com/who-are-the-one-percent-united-states/> [<https://perma.cc/BU3P-YFWL>] (last updated Oct. 10, 2019).

48. Tanza Loudenback, *24 Mind-Blowing Facts About Warren Buffett and His \$84.7 Billion Fortune*, BUS. INSIDER (Aug. 30, 2018), <http://www.businessinsider.com/facts-about-warren-buffett-2016-12> [<https://perma.cc/SPW8-2BZ6>].

49. Sarah Berger, *Warren Buffett Has Been Making the Same Salary for Decades—and It’s Surprisingly Low*, CNBC (Mar. 19, 2018), <https://www.cnbc.com/2018/03/19/warren-buffetts-berkshire-hathaway-salary.html> [<https://perma.cc/3LC4-J2TD>].

in 2011 with a wealth of \$10 billion,⁵⁰ did Buffett one hundred thousand better: Jobs's annual wages from Apple, the company he founded, were \$1.⁵¹

Wealth and wages are the producers in a capitalist economy, and they are the dueling players in the tax saga that will end in the income tax's death. It is important to understand that this is *not* a battle between "rich" and "poor," but rather a battle between a specific type of "rich"—those that have wealth and do not need wages—and everyone else. Most significantly, it is not a battle between "upper" income and "lower" income. There is much confusion here, as anti-income tax advocates like to point to statistics showing that upper-income persons pay most of the income tax and that the income tax is therefore, if anything, too progressive.⁵²

As often in the public political presentation of tax, there are fiscal optical illusions at work. What we see is not the full story. The income tax system *appears* progressive on its face, as those with higher incomes pay higher income taxes. But there are illusions at both ends of the income scale. On the low end, the usual claim ignores the payroll tax, which falls on wages beginning with the first dollar of them. On the high end, where the wealthy live, looking at "income" fails to capture the hugely significant *unrealized appreciation* of the wealthy, who do not have to report their true economic income as "income" on any tax form, as we shall discuss below.⁵³ Under the universal wage tax, as we shall see, Americans who work regular jobs for a living face a flattened and inescapable wage tax. The payroll tax provides the lower brackets, the wage/income tax the higher brackets: when combined, these rates flatten out considerably (see Figures 13 and 14, below, if you want to peek ahead). Meantime, those with *wealth*, who do not depend on *wages* for their lifestyle, can avoid all tax—and do not show up in the picture at all.

The reorientation involved in looking at matters of tax through the lens of wealth and wages, capital and labor, is Copernican. It answers the paradox confronting AOC: raising rates on millionaires does nothing to billionaires. The new focus allows us to see a universal wage tax structure that is surprisingly flat and virtually inescapable. This is what labor faces. All workers are taxed, and rather heavily. This stands in contrast to *all* taxes on wealth (the corporate income, gift and estate, and ur-income taxes), the coproducer of the economy. These taxes are low, when they fall at all, and are virtually voluntary all of the time.

50. Andrew Beattie, *Steve Jobs and the Apple Story*, INVESTOPEDIA (Jun 30, 2019), <https://www.investopedia.com/university/steve-jobs-biography/steve-jobs-net-worth.asp> [<https://perma.cc/L6S9-6J8A>].

51. *Why Did Steve Jobs Only Make \$1 a Year? (and What Can You Learn From It)*, MOTLEY FOOL (Mar. 7, 2017), <https://www.fool.com/personal-finance/2014/02/01/why-did-steve-jobs-only-make-1-a-year-and-what-you.aspx> [<https://perma.cc/Z8F7-9CCL>]. Jobs was far from alone. See, e.g., Robert W. Wood, *Tax-Smart Billionaires Who Work for \$1*, FORBES (Apr. 5, 2014), <https://www.forbes.com/sites/robertwood/2014/04/05/tax-smart-billionaires-who-work-for-1/#77894ad6dfee> [<https://perma.cc/4GHN-VMMC>].

52. Laura Saunders, *Top 20% of Americans Will Pay 87% of Income Tax*, WALL ST. J. (Apr. 6, 2018), <https://www.wsj.com/articles/top-20-of-americans-will-pay-87-of-income-tax-1523007001> [<https://perma.cc/ET2W-B4EN>].

⁵³ See *infra* Section III.B.

Thus the wealth-wage distinction allows us to see the fatal problem with Democratic or liberal tax policy in the post-World War II (“post-War”) era: because taxes fall primarily on wages, redistribution, if any, has to occur from more highly paid to lower paid workers or to the nonworking poor. The middle class is pitted against the lower class while the upper class sits on the sidelines. This is not a recipe for social stability.

Wealth and wages have often been on separate paths throughout history, but the present trajectories point to pressing and looming social, political, and economic perils. In short and in sum, while wealth is still winning, wages are now losing. As Piketty and others have abundantly documented, the rich are getting richer as capital takes a greater share of the social economic pie. Global forces such as free trade and, more importantly, automation bring pressure on wages or eliminate the need for human workers altogether while benefiting capital. While the rich have been getting richer, wages have been stagnating.

1. A Quick Flashback

It has not always been as it is now between wealth and wages. There have been periods of history when capital and labor moved in tandem, sharing equally in society’s productive gains. This is not the world that Figure 1 points to for the present. Figure 1 shows that labor’s share of GDP has been falling steadily in the post-War era, falling from over 50% in the late 1960s to just over 40% more recently. This means that some 10% of the annual national income—more than \$2 trillion in 2018, given a GDP of \$20.5 trillion⁵⁴—has shifted from labor to capital over this time period.

Now this *could* be so because the national income was growing so fast that labor, despite its smaller share of the pie, was better off: that is, it could be the case that 50% of the 2010 pie is a better deal than 60% of the 1970 one. Were this so, the wealthy would still be getting *much* wealthier—after all, *their* 50% of the (larger) 2010 social pie is clearly better than their 40% of the (smaller) 1970 pie. But perhaps labor is gaining, too, just not as quickly.

Figure 2 casts considerable doubt on that happy tale. This Figure, prepared by the nonpartisan Economic Policy Institute, shows the average hourly wage growth, adjusted for inflation, for ordinary (nonsupervisory) workers on one line and national productivity on the other, for the period from 1948–2011. The chart is helpfully divided in two at the year 1973. For the period from 1948–1973, wealth and wages were in virtual lockstep. These were rebuilding years, with plenty of need for labor and capital as America emerged from the cataclysms of economic depression and war. Things changed starting around 1973. Wages essentially flattened, while overall productivity continued its skyrocketing trajectory. That means that these years, of internet booms and automation and global marketplaces, were very good *overall*, but ordinary labor—wages—was not going along on the ride. The rich were getting richer, in other words, *without* pulling workers along with them. Capital and labor,

54. *Gross Domestic Product, Fourth Quarter and Annual 2018 (Initial Estimate)*, BEAGOV (Feb. 28, 2019), <https://www.bea.gov/news/2019/initial-gross-domestic-product-4th-quarter-and-annual-2018> [<https://perma.cc/475D-7X88>].

happily married during the immediate post-War phase, have been divorced for some time now.

Figure 2: Wage Growth and Productivity, 1948–2017⁵⁵

**Gap Between Productivity and a Typical Worker's Compensation
from 1948–2017**

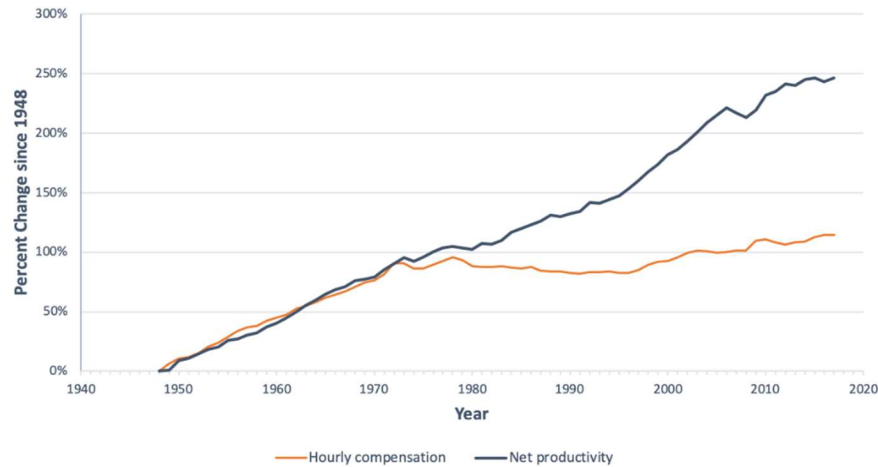
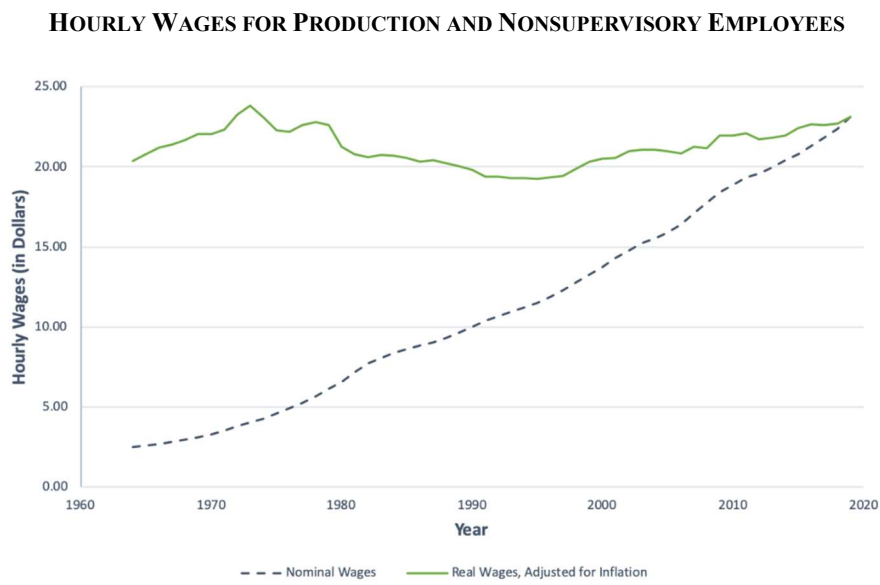


Figure 3 confirms this sense, focusing on the impacts of inflation. Since the 1960s, American wages have essentially been flat in constant-dollar (here, in 2019) terms.

55. *The Productivity—Pay Gap*, ECON. POLICY INST., <https://www.epi.org/productivity-pay-gap/> [<https://perma.cc/47G9-EKG8>] (last updated July 2019).

Figure 3: Hourly Wages for Production and Nonsupervisory Employees, Nominally and Adjusted for Inflation⁵⁶



2. Back to Tax

Tax, which could and arguably should be addressing and correcting for the growing gap between wealth and wages—by taxing wealth more and wages less—has been doing precisely the opposite. Taxes are falling more heavily on wages, less heavily on wealth, even in the face of macroeconomic forces vastly favoring wealth. Our central story, of the slow death of the income tax as an income tax, is a leading cause of this perversity.

B. The Staging: All About the Base

Any tax consists of a simple product of a “rate,” or how much is being taxed, times a “base,” or what is being taxed. The bifurcation of political issues between base and rates is key to our tale. The income tax has always depended on a series of progressive marginal rates that have contributed to its complexity and unpopularity: AOC waded into this thicket. But our story of the income tax’s death turns on the base, or the “what” of taxation, in the first instance. Norquist’s dream in five easy

56. *Databases, Tables & Calculators by Subject*, U.S. BUREAU OF LABOR STATISTICS, <https://data.bls.gov/timeseries/CES0500000008> [<https://perma.cc/2EPG-83CT>] (last modified May 14, 2020, 7:41 PM), converted through *CPI Inflation Calculator*, U.S. BUREAU OF LABOR STATISTICS, <https://data.bls.gov/cgi-bin/cpicalc.pl> [<https://perma.cc/EF5T-YKP4>].

pieces is about changing the base of the income tax into a wage one.⁵⁷ The question of rates will be dealt with separately, using another bifurcation—between the payroll and “income” taxes—to effect a significant optical illusion. We will get to that after the main tale.

Back to the base. There are three major choices of base for a comprehensive tax—one meant to apply to wide ranges of individuals and to collect significant revenues. These taxes fall on the flow of funds into and out of households, as opposed to those taxes, such as property or pure “wealth” taxes, that fall on assets or on static stocks of wealth—for example, Senator Warren has announced plans for an annual wealth tax on fortunes in excess of fifty million dollars.⁵⁸ In the flow of funds, money comes into a household from wages and/or the returns on wealth. What comes in goes out, in the form of either spending or savings. In the traditional language of tax policy:

$$\text{Capital} + \text{Labor} \rightarrow \text{Income} = \text{Consumption} + \text{Savings}.$$
⁵⁹

In words, the returns to capital (wealth) and labor (wages) come into a household and thus constitute “income.” Whatever comes in is either spent (consumption) or not (savings): the two categories of outputs from a household.

An *income tax*, by definition and in theory, is supposed to tax *both* wealth and wages, capital and labor, the two sources of income on the left-hand side of the above relation. As the Supreme Court put it in the seminal case of *Eisner v. Macomber*, decided in 1920, “[i]ncome may be defined as the gain derived from capital, from labor, or from both combined.”⁶⁰

In choosing to tax both wealth and wages, income taxes have long been criticized for being a so-called double tax, going back at least as far as John Stuart Mill in 1848.⁶¹ The reason is simple to understand. Consider two taxpayers, Ant and Grasshopper, each of whom earn \$100 from a day at work, in wages. Grasshopper spends all of his money before he goes to sleep, as is his wont. Ant, on the other hand, saves a portion of her wealth, as is her wont. When Ant’s savings yield a return—interest, rent, dividends—she has a point in complaining that she is being harmed by her thrift under an income tax. Why should she pay tax twice, when she and Grasshopper have each earned the same amount initially, and Ant is only earning more money on account of her thrift?

The criticism of the income tax as a “double tax” on savings has led economists and others to advocate for “single” taxes, which apply only once in the flow of a

57. See *supra* text accompanying note 27.

58. Naomi Jagoda, *Warren Stakes out 2020 Ground with Wealth-Tax Proposal*, THE HILL (Jan. 27, 2019), <https://thehill.com/policy/finance/427075-warren-courts-progressives-with-wealth-tax-proposal> [<https://perma.cc/4NUX-RTZP>].

59. HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY* 50 (1938).

60. 252 U.S. 189, 207 (1920) (internal quotation marks and citations omitted).

61. See generally MILL, *supra* note 42.

household's funds.⁶² This is Norquist and company's quest for a tax "which taxes income one time."⁶³

There are two major choices of single taxes, each of which can properly be called a "consumption" tax. One tax applies when income is first earned, and never again. This type of tax has been called a "prepaid" consumption tax, but we can call it by a simpler name: a "wage tax." The second type of consumption tax falls when, and only when, an individual spends money on herself. This type of tax has been called a "postpaid" consumption or a "consumed income" tax, but again we can use a simpler term: a "spending tax."

Much ink has been spent explaining the similarities and differences among income and consumption taxes.⁶⁴ In theory, prepaid and postpaid, or wage and spending, taxes lead to the same place under certain conditions. But this is not an article about tax theory or about the intellectual history of tax.⁶⁵ This Article concerns practical politics and the possibilities for the sharing of government burdens between capital and labor, wealth and wages. Consider how the different taxes affect wealth and wages. As a practical matter, there is no doubt that an income tax, in theory and by definition, is meant to fall on both wealth *and* wages. There is also no doubt that a wage tax falls *only* on wages, never on wealth. A spending tax, in contrast, *can* fall on wealth, when wealth is used to finance consumption.⁶⁶

Consider our friend Grasshopper again. Grasshopper earns his \$100 of wages and, just before he has spent his last cent, he buys a lottery ticket. He gets lucky, and the ticket pays off \$10,000. How do the three taxes affect him? Suppose all taxes have a flat 30% rate, just to illustrate (and to foreshadow a bit). An income tax falls first on Grasshopper's wages, taking 30%, or \$30, from his \$100. Then, when Grasshopper's lottery ticket hits, the income tax taxes him again, taking 30%, or \$3000, of his \$10,000 winnings, leaving him with \$7000 to consume. A wage tax taxes Grasshopper's wages, taking \$30 from his \$100, but then ignores the lottery winnings, so Grasshopper gets to keep his full \$10,000. Finally, a spending tax would not tax Grasshopper's wages, so he gets to keep his full initial \$100 of pay, until he spends them and pays his \$30. But when Grasshopper goes to spend his \$10,000 lottery winnings, he also must pay a 30% tax, or \$3000, leaving him with \$7000 of personal spending.

In sum: the wage tax, and the wage tax alone, allows Grasshopper to keep and spend his entire "windfall" from his "investment" in the lottery ticket.⁶⁷

This simple example shows that the single taxes of wage and spending taxes are different, because they fall at different times. Wage taxes completely ignore savings: savings are irrelevant to how much payroll taxes one pays, for example. Spending taxes, in contrast, do fall on "windfalls" from capital: what is irrelevant under a

62. See generally Jeffrey L. Kwall, *The uncertain case against the double taxation of corporate income*, 68 N.C. L. REV. 613 (1990).

63. Norquist, *supra* note 21.

64. See, e.g., Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807 (2005).

65. *Cf. id.*

66. See *id.* at 822.

67. See McCaffery, *supra* note 10, at 327–28 (discussing windfalls).

spending tax is where the money to spend came from (wealth, wages, gift, loan, or otherwise).⁶⁸

With just this small taste of tax theory behind us, it should come as no surprise that conservatives have aimed to transform the “income” tax—a tax which is meant to fall on both wealth and wages, to the extent of “double” taxing savings—into a “single” tax. Nor should it be a surprise that the preferred single tax has emerged to be the wage-tax model—recall that an “income” tax with unlimited Roth-style treatment of savings *is* a wage tax.⁶⁹ This is the death of the income tax. The end of days for the income tax lies with a universal wage tax.

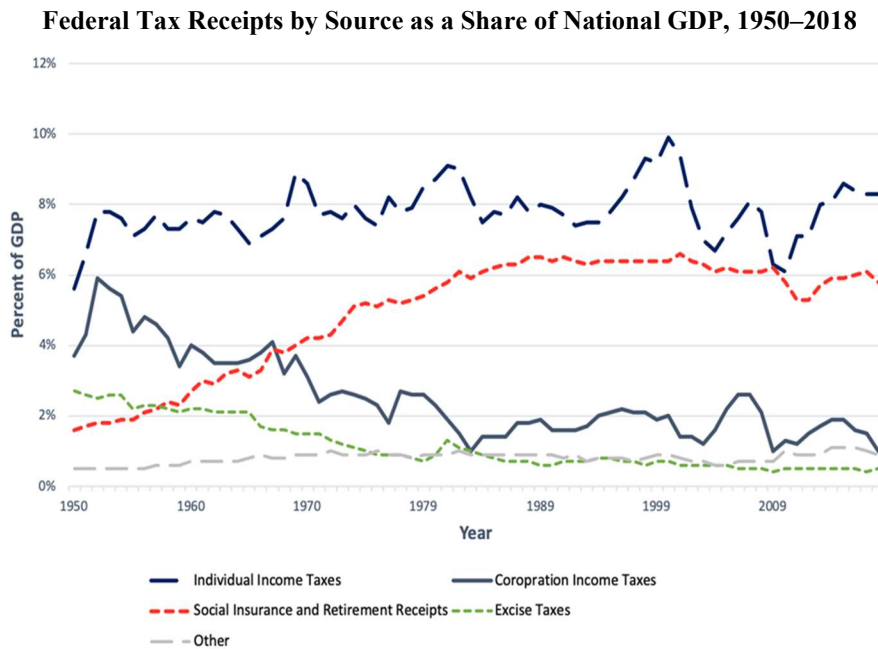
This is why our main story is all about the base. It turns on the relatively quiet, hidden transformation of the “income” tax into a wage tax. This proceeds along Norquist’s charted course, starting with wages. We systematically eliminate all additions to wages by allowing for tax-free savings and no capital-gains tax, and we also eliminate all subtractions, or deductions, from wages by limiting business deductions and repealing the personal ones. We wake up with an “income” tax that has only wages in its base, and then we discover a flattened rate structure on labor under the universal wage tax.

C. The Players: The Big Three of Taxes

Figure 4, below, taken from official government data, shows the history of the principal sources of federal revenues normalized as a percentage of gross domestic product (GDP) from 1950 to 2016. Figure 5 puts into a pie chart the data from the single year 2016. Both charts clearly show that there are and have long been three major taxes financing the federal government: the *individual income*, the *payroll*, and the *corporate income* taxes. In 2016, for example, these three taxes accounted for more than 90% of the government’s revenues; the other portion in the pie chart consists of “excise, estate, and other taxes,” which specifically includes sales of government assets—a large residual category. In sum, the “Big Three” of individual income, payroll, and corporate income taxes warrant our primary focus, although we comment a bit on the estate, or so-called “death,” tax, below.

68. *Id.*

69. *See supra* text accompanying notes 24–25.

Figure 4: Major Sources of Federal Revenue as Percentages of GDP, 1950–2018⁷⁰

To dispense with a concern that some readers might have upfront, payroll taxes are indeed “taxes,” as their revenues are available for general government purposes. Payroll taxes are not, that is, set aside in any special account dedicated for specific workers to use in their old age or retirement.⁷¹ The government both collects revenues and spends them, and the two sides of fiscal politics are not necessarily connected.

Another common misunderstanding of payroll taxes is that the employee only pays, or “contributes” (payroll taxes tend to be called social security and Medicare “contributions” under the Federal Insurance Contribution Act (FICA)),⁷² one-half of the total. The employee’s “share” of social security taxes is 6.2% of her wages, up to a ceiling of \$128,000 in 2018; her share of Medicare taxes is 1.45%, with no cap, for a total employee share of 7.65%.⁷³ The employer pays a matching “share,” another 7.65%.⁷⁴ But economists attribute all 15.3% to the employee, for the simple reason that when an employer pays a worker \$100 in wages, he must *also* pay the

70. *Historical Tables*, OFFICE OF MGMT. & BUDGET, <https://www.whitehouse.gov/omb/historical-tables/> [<https://perma.cc/P92H-VE9C>] (Table 2.3).

71. See John Olson, *What Are Payroll Taxes and Who Pays Them?*, TAX FOUND. (July 25, 2016) (citing Federal Insurance Contribution Act (FICA), ch. 531, 49 Stat. 620 (1935) (codified as amended in scattered sections of 42 U.S.C.)), <https://taxfoundation.org/what-are-payroll-taxes-and-who-pays-them/> [<https://perma.cc/89LQ-C7AB>].

72. *Topic No. 751 Social Security and Medicare Withholding Rates*, IRS, <https://www.irs.gov/taxtopics/tc751> [<https://perma.cc/L7B2-GS3B>] (last updated Feb. 14, 2020).

73. See Olson, *supra* note 71.

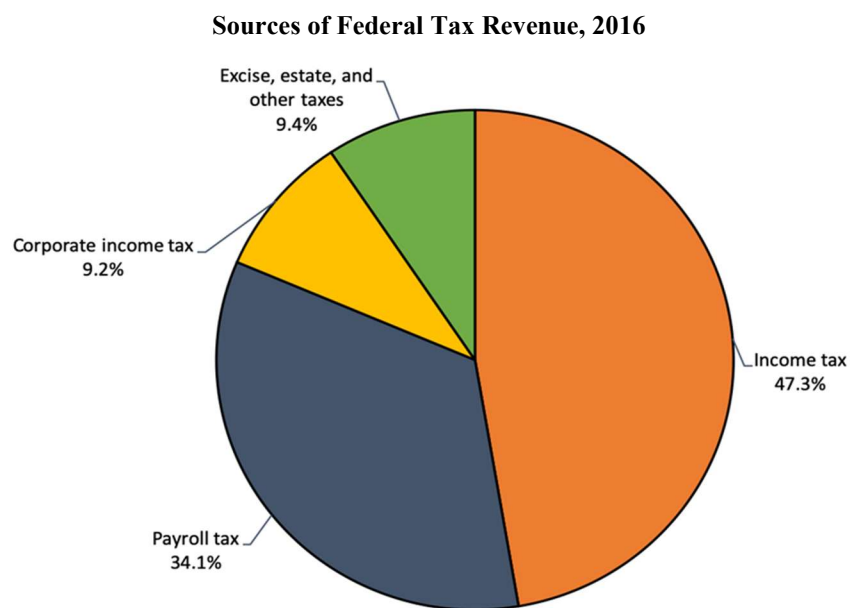
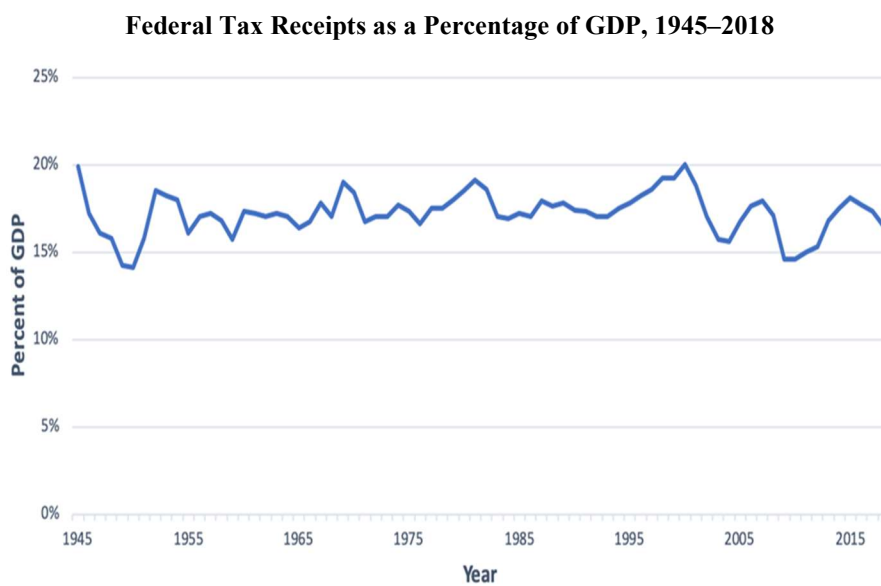
74. *Id.*

government \$7.65 in the employer's share—and that is money owed on account of the employee's working, which could otherwise be given straight to the worker.⁷⁵ The federal government now, rather to its credit, simply reports the entire 15.3% burden as part of the payroll tax, as Figure 4 does, and as we shall use throughout.⁷⁶

We can learn much from Figure 4. By starting in 1950, Figure 4 considers only the modern post-War economy and government. Before this time, as we shall discuss briefly below, the overall tax burden was much smaller, and the individual income tax in particular was, during the period before World War II, far less significant. Since 1950, on the other hand, the overall federal tax burden as a percentage of GDP has remained remarkably constant, moving within a band of 15%–20% of the economy (as shown in Figure 6). What changes—and what is a focus of the analysis in this Article—is the composition of the total, the relative shares of the Big Three.

75. *Id.*

76. Technically, an adjustment needs to be made to keep the tax rates constant between the amount of wages earned and payroll taxes, as both bases are tax inclusive. If Ant earns \$100 in wages, it is true that her employer will have to remit \$15.30 in payroll taxes. But only \$7.65, one-half of this total, comes out of the \$100. The other \$7.65 is a shadow wage of sorts. So Ant “really” got \$107.65 in pay, \$15.30 of which was paid to the government for payroll taxes. This would make Ant’s payroll tax rate 14.2% on a tax-inclusive basis (where the tax itself is included in the denominator, that is, $\$15.3/\107.65). The text uses the more common 15.3% for simplicity.

Figure 5: Sources of Federal Tax Revenue, 2016⁷⁷Figure 6: Federal Tax Receipts (Total) as Percentage of GDP, 1945–2018⁷⁸

D. The Plot: Towards a Universal Wage Tax

Before we look at trends over time, consider how the Big Three taxes fit into the prior brief discussion of tax bases. The individual income tax is in theory meant to fall on both wealth and wages, all income derived “from labor or from capital or from both combined,” as *Macomber* put it.⁷⁹ The payroll tax is, of course, a tax only on wages and the model for what the income tax is becoming. Finally, the corporate income tax, although its ultimate incidence is unclear,⁸⁰ is a tax on wealth or capital in the first instance. This is because the corporate income tax is a tax on all of the corporation’s income *minus* the wages it pays, which are subtractions from income under I.R.C. § 162.⁸¹ Just as the payroll tax is a wage tax, the corporate income tax is a *nonwage* tax.

Now focus on what happens to the Big Three taxes over the time period reflected in Figure 4. Compare in particular the two years 1952 and 2016. In 1952, the Big Three’s shares, listed as Individual Income/Corporate Income/Payroll, were 7.8%, 5.9%, and 1.8%, respectively, for a total tax burden of 15.5% of GDP. In 2016, those same shares were 8.4%, 1.6% and 6.0%, for a total of 16% of GDP. The total reflects a modest increase in the aggregate tax burden from these three taxes; as Figure 6 shows, the aggregate tax burden of all federal taxes has been fairly constant since the dawn of the post-War period. (In fact, “Hauser’s Law,” named after the investment analyst William Hauser, holds that federal tax revenues since World War II are always approximately 19.5% of GDP, regardless of marginal rates.)⁸² But the dramatic story is the near total *inversion* of the corporate income and payroll tax shares, from 5.9% and 1.8% in 1952, to 1.6% and 6.0% by 2016. In sum, the share of the pure wage tax increased over these decades by 4.2% of GDP, while the share of the corporate income tax, the pure nonwage tax, fell by 4.3% of GDP—a nearly perfect swap from nonwage to wage taxation.

Figure 4 shows that this inversion is not an artifact of choosing two particular years, 1952 and 2016. The trends are quite pronounced. The corporate income tax steadily falls throughout the decades shown in Figure 4, and the payroll tax steadily rises. Among the Big Three taxes, the marginal rates under the payroll tax alone have *never* been cut, except for the two-year period of President Obama’s payroll tax holiday in 2011 and 2012 (as seen in Figure 7).

These trends help show how the United States could emerge with a wage-tax system, given where we started in 1950: we completely inverted the relative roles of the corporate income and payroll taxes during this time period. This then leaves the

77. *Historical Tables*, *supra* note 70 (Table 2.3).

78. *Id.* (Table 2.3).

79. 252 U.S. 189, 207 (1920) (internal quotation marks omitted) (citation omitted).

80. Edward McCaffery, *The Uneasy Case for Capital Taxation*, TAX NETWORK (Mar. 1, 2012), <https://tax.network/emccaffery/the-uneasy-case-for-capital-taxation/> [https://perma.cc/2MN5-EPDZ].

81. I.R.C. § 162 (2018).

82. W. Kurt Hauser, *There’s No Escaping Hauser’s Law*, WALL ST. J. (Nov. 26, 2010), <https://www.wsj.com/articles/SB10001424052748703514904575602943209741952> [https://perma.cc/MZ29-XNU].

individual income tax, which has remained notably steady during this post-War period as a percentage of GDP, as Figure 4 shows.

Figure 7: Payroll Tax Rate History, 1937–2017⁸³

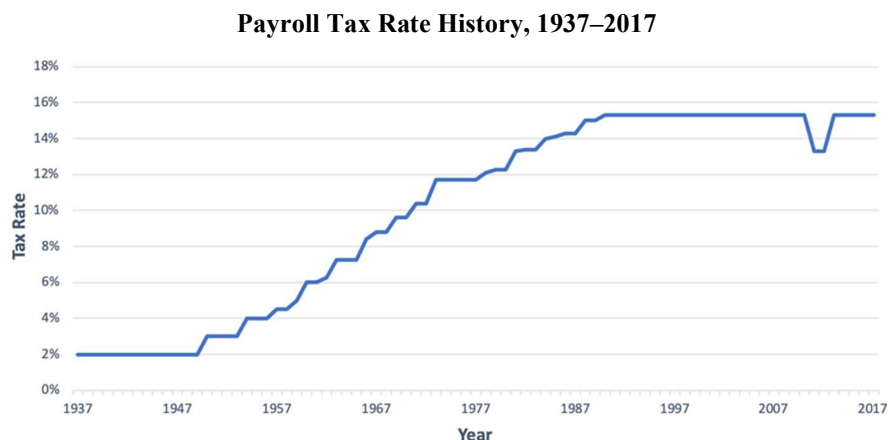
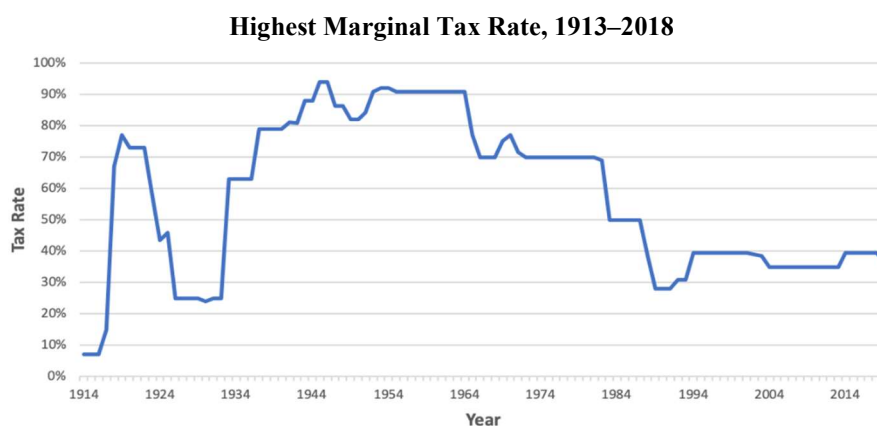


Figure 8: Highest Marginal Rate Under Income Tax, 1913–2018⁸⁴



The yield of the income tax hovers around 8% of GDP; any significant rise above that level, as we saw in the 1970s (partly due to inflation) or in the 1990s (partly due to the Internet and stock market booms), is followed by tax cuts, as we saw in the 1980s under President Ronald Reagan or in the early 2000s under President George W. Bush. Unlike the virtually monotonic increase in rates and overall burdens under

83. *Payroll Tax Rates*, TAX POLICY CTR. (July 18, 2019), <https://www.taxpolicycenter.org/statistics/payroll-tax-rates> [https://perma.cc/MZ3A-FDTC].

84. *Historical Highest Marginal Income Tax Rates*, TAX POLICY CTR. (Feb. 4, 2020), <https://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates> [https://perma.cc/3W8M-DCCT].

the payroll tax, rates under the individual income tax have frequently been cut and occasionally been raised over the post-War period, as Figure 8 illustrates: the income tax, *unlike* the payroll tax, has been a political “football” during the decades, kicked around by lawmakers, lobbyists, and their paying patrons.

The individual income tax accounted for about one-half of all federal revenues from the Big Three during this post-War period. Whereas we have just commented on the switch from corporate income to payroll taxes—a movement strengthened by the TCJA, which steeply cut corporate income taxes⁸⁵—the individual income tax’s role in the story follows a different path. The individual income tax is too big to fail or simply to be eliminated. Instead, the story of the death of the individual income tax is a story of the steady erosion of its *base* and of its transformation into a wage tax: Norquist’s quest.

Once again, the income tax is *supposed* to fall on both wealth and wages. But it has never been all that serious about falling on wealth, and this trend has accelerated as of late.⁸⁶ This is the death of which we write—the death of the tax as a true income tax, falling equally on capital and labor. The income tax will still be called an “income” tax. Why not? Old taxes are good taxes as they say.⁸⁷ But there will be two distinct regimes within the “income” tax. For the vast majority of Americans, some ninety-five percent, mainly wage earners, the tax will be simple to pay but impossible to avoid. For a growing minority of America’s rich capable of living off wealth alone, the *ur-income* tax, just like the lingering death tax, will still have its formal complexities. But it will not have many substantive teeth. Taxation for the wealthy will be complex but avoidable.

With the corporate income tax reduced to a bare fraction of its past load, with the payroll tax bolstered and here to stay, and with the individual income tax stripped of its abilities to tax wealth but not wages, the work of the conservative assault on the tools of redistribution will be at its natural end. The Big Three taxes will become cover for a burdensome and inescapable wage tax.

E. A Short Before the Feature: The Near Death of the Death Tax

Before moving on to the feature story—the transformation of the income tax into a wage tax—we take a few moments to consider a smaller story playing out on rather precisely parallel tracks. This is the tale of the U.S. wealth transfer tax system, also known as the gift, estate, and generation-skipping tax system, or, more colloquially, as the “death tax.” The careful reader will recall that killing the death tax was one of Norquist’s five easy pieces towards a flat wage tax.⁸⁸

The gift, estate, and generation-skipping tax system was intended to fall on the gratuitous transfer of wealth, whether that be during life (the gift tax) or after a death (the estate tax). The taxes fall only on wealth at the moment of its passing. Thus, just as with the corporate income tax, another nonwage tax, we would predict estate taxes to be declining in significance as the wider American tax system becomes a wage-

85. See *infra* Section V.B.2.

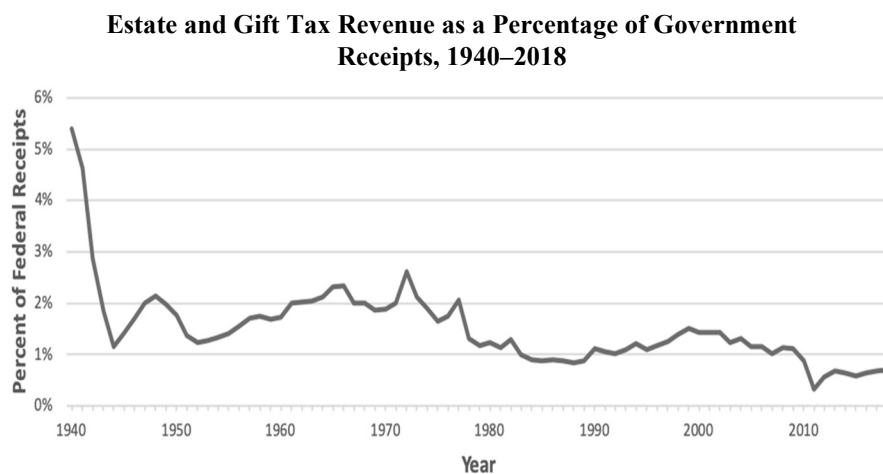
86. See McCaffery, *supra* note 10, at 328.

87. See generally ADAM SMITH, THE WEALTH OF NATIONS (1776).

88. See *supra* notes 27–30 and accompanying text.

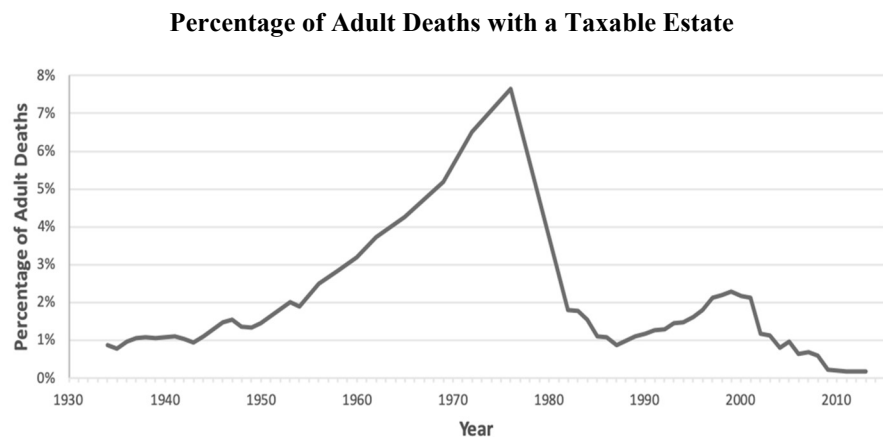
based one. And so they are. Figure 9 shows estate and gift tax revenues as a percentage of total federal *revenues*—not GDP—demonstrating both that revenues have been declining in the post-War era and that they are hardly significant today.

Figure 9: Estate and Gift Tax Revenue as a Percentage of Federal Receipts
1940–2018⁸⁹



It is clear that the wealth transfer tax system has never been a major source of revenue. Nor are many even subject to it, as Figure 10 shows.

Figure 10: Taxable Estate Tax Returns as Percentage of Adult Deaths, 1934–2013⁹⁰



89. *Historical Tables*, *supra* note 70 (Tables 2.1 and 2.5).

90. *Fiscal Facts*, TAX POLICY CTR. (July 10, 2017), <https://www.taxpolicycenter.org/fiscal-fact/historical-returns-percentage-deaths> [<https://perma.cc/3PQ5-RPN9>].

Strikingly, neither Figures 9 nor 10 reflect the changes enacted under the TCJA, which raised the exemption, or “zero bracket” of the gift and estate tax, to over \$11 million for individuals and over \$22 million for married couples, indexed for inflation. Under these levels, some 99.8% of Americans do not even have to worry about their successors’ needing to fill out forms for the death tax.

It is past time to give a shout out to two academic commentators on the estate tax saga, Michael J. Graetz and Ian Shapiro, who published the book *Death by a Thousand Cuts: The Fight over Taxing Inherited Wealth* in 2005,⁹¹ very much anticipating this present Article. Graetz and Shapiro chronicled well the steady erosion of the wealth-transfer tax system—another hallmark of progressive politics, another attempt to tax wealth, not wages. The tax has long been considered a “voluntary tax,”⁹² because the wealthy and sophisticated can readily avoid it with complex planning. The casino magnate and conservative financier Sheldon Adelson, for example, was able to get \$8 billion out of his taxable estate at a time when the official exemption level was about \$1 million;⁹³ President Trump’s then chief economic advisor, Gary Cohn, candidly stated his view that only “morons” pay the estate tax as the TCJA was coming into form.⁹⁴

Graetz and Shapiro expertly chronicle decades of legislative, regulatory, and judicial decisions and actions that continually struck blows at the integrity of the wealth-transfer tax system.⁹⁵ The authors were technically wrong, or at least premature, to herald the “death” of the death tax.⁹⁶ Significantly, even the TCJA, while rendering the wealth-transfer tax system moot for all but a small fraction of the top one percent of Americans, did not literally kill the tax. But this minor semantic detail only helps to underscore the relevance of Graetz and Shapiro’s important account to our present effort, for the script on the death tax is strikingly parallel to the story of the killing of the income tax. In the more than a decade since *Death by a Thousand Cuts* was published, the tax has continued to be cut—its exemption levels going up under President Obama and then again, and dramatically, under President Trump and the TCJA. The tax, while alive, is on life support. The tax is also unlikely to ever come back in anything like its original intended role: the exemption level

91. MICHAEL J. GRAETZ & IAN SHAPIRO, *DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH* (2005).

92. See generally GEORGE COOPER, *A VOLUNTARY TAX? NEW PERSPECTIVES ON SOPHISTICATED ESTATE TAX AVOIDANCE* (1979); George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161 (1977); Edward McCaffery, *A Voluntary Tax? Revisited*, 93 NAT’L TAX ASS’N PROC. 268 (2000).

93. Zachary R. Mider, *Accidental Tax Break Saves Wealthiest American \$100 Billion*, BLOOMBERG (Dec. 17, 2013), <https://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion> [<https://perma.cc/KFU2-Y8LY>].

94. Robert Frank, *‘Only Morons Pay the Estate Tax,’ Says White House’s Gary Cohn*, CNBC (Aug. 29, 2017), <https://www.cnbc.com/2017/08/29/only-morons-pay-the-estate-tax-says-white-houses-gary-cohn.html> [<https://perma.cc/MVU3-CKEK>]; see also Edward McCaffery, *Tax Breaks for Multi-Millionaire Morons*, HUFFINGTON POST (Nov. 2, 2017), https://www.huffpost.com/entry/tax-breaks-for-multi-millionaire-morons_b_59f9f06ae4b0b7f0915f635d [<https://perma.cc/WKZ7-A4PG>].

95. See generally GRAETZ & SHAPIRO, *supra* note 91.

96. *Id.* at 3–4.

under the estate tax has never been lowered, except for a slight technical adjustment in 1933 to coordinate the gift and estate tax levels.⁹⁷

This is a harbinger of the death of the income tax, too. The death tax has not and will not formally die. But the tax is irrelevant for the vast majority of Americans and easily avoidable by the handful still potentially subject to it who are willing to pay to play tax-avoidance games.

Why keep the much-reviled death tax hanging around at all? Aside from the symbolism of the government's maintaining the *appearance* of being serious about taxing wealth, the persistence of the death tax does an important service: it provides cover to the perpetuation of a key provision in the individual income tax, the "stepped-up basis" on death rule of I.R.C. § 1014 (this is the provision that Vice President Biden has pledged to repeal if elected).⁹⁸ We shall consider this provision, wittily dubbed the "Angel of Death" law,⁹⁹ further below: it provides the third step in the three-step guide to avoiding all income tax on wealth, Buy/Borrow/Die. Stepped-up basis for assets acquired from a decedent has long been justified as being fair in a world where wealthy decedents pay an estate tax.¹⁰⁰ Today, 99.8% of decedents do not have to worry about their estates paying a tax. Yet 100% of heirs will get stepped-up basis on the assets that they inherit.

The estate tax story is just a warm-up, a trial balloon. It perfectly foreshadows the income tax tale. The near death of the death tax is, in itself, an important element of the wider central story, because, like the decline of the corporate income tax, it is about the fall of a tax on wealth. As we consider the individual income tax, we should be under no illusion that there is some magical tax offstage, such as the estate or corporate income taxes, to miraculously solve all of our problems, to address the failures to tax wealth more vigorously.¹⁰¹ The forces favoring wealth have already killed the estate tax for all intents and purposes, leaving just the good part (the stepped-up basis) and not much else, except employment for financiers of dynasty trusts and lobbyists. We will see the same techniques emerging under the reform of the income tax. One, create a simple wage/income tax for the masses, providing most of the federal revenue and allowing a smaller tax on the rich, the ur-income tax, to emerge as a separate matter. Then, two, continually make changes to the smaller, weaker tax that only applies to the wealthiest few—a tax where changes can go unnoticed except by lobbyists and those who pay them, because the revenue effects are modest and the number of taxpayer targets is limited. This ur-income tax will be ripe for the killing by a thousand cuts. There will be no reason to formally announce its death and there will be plenty of reasons to keep the tax hanging around on life

97. See Julie Garber, *Federal Estate Tax Exemptions 1997 Through 2019*, THE BALANCE (Feb. 29, 2020), <https://www.thebalance.com/exemption-from-federal-estate-taxes-3505630> [<https://perma.cc/WD6Y-T8R6>].

98. *The RS Politics 2020 Democratic Primary Policy Guide*, *supra* note 41.

99. McCaffery, *supra* note 10, at 320.

100. Scott Eastman, *The Trade-offs of Repealing Step-Up in Basis*, TAX FOUNDATION (Mar. 13, 2019), <https://taxfoundation.org/step-up-in-basis/> [<https://perma.cc/LLB5-MF7B>]; Stephen J. Entin, *The President Proposes a Second Tax on Estates*, TAX FOUNDATION (Jan. 23, 2015), <https://taxfoundation.org/president-proposes-second-tax-estates/> [<https://perma.cc/E58Z-GHEP>].

101. See *id.* at 311.

support—to serve the ends of politicians, financiers, and the wealthy who pay them both.

Now on with the show.

III. ACT ONE: ORIGIN STORIES, FEATURING ACHILLES' HEELS

Figure 4 and the analysis above took off in the post-World War II period, starting around 1950. The individual income tax's contribution to federal revenues has been fairly stable throughout this post-War period, always taking home the gold as the single most important tax of the Big Three even as the corporate income and payroll taxes switched places for the silver and bronze medals. It was not always so. As we go through the story of the individual income tax's transformation into a wage tax, we start at the beginning, and we follow the story of taxes on wealth and wages.

A. *The Income Tax Comes of Age*

The income tax was conceived as a modest tax on wealth and the wealthy. When times called for more revenue—much more revenue by World War II—the still young “class” income tax got married to the masses of wage earners, becoming, largely, a wage tax.

1. Baby Steps: The Sixteenth Amendment and a Modest Tax on Wealth

The modern income tax was born in 1913 following the ratification of the Sixteenth Amendment to the U.S. Constitution.¹⁰² America had used an income tax during the Civil War under President Abraham Lincoln and then again in the Progressive Era of the 1890s. But the latter tax was struck down, precisely because it fell on capital (without apportionment) as well as on wages—it was the capital part that the Supreme Court found unconstitutional.¹⁰³ Thus, the movement to ratify the Sixteenth Amendment was specifically and intentionally a movement to tax *wealth*. The sponsors of the law were well aware of Mill's criticism of an income tax as a “double tax” on income that was saved. They wanted that.¹⁰⁴

But they did not want much of that. Although the individual income tax was enabled by the ratification of the Sixteenth Amendment, Congress actually enacted the income tax in the Revenue Act of 1913, also known as the Tariff Act.¹⁰⁵ The law's cuts to tariffs or excise taxes were its most politically and economically significant provisions. The income tax went into effect with a top marginal rate of 1%, albeit with “surcharges” for higher incomes that created a top marginal rate bracket of 7% for households reporting over \$500,000 in income.¹⁰⁶ To put these

102. U.S. CONST. amend. XVI.

103. *Pollock v. Farmers' Loan & Tr. Co.*, 157 U.S. 429, 583 (1895).

104. See SHELDON D. POLLACK, *THE FAILURE OF U.S. TAX POLICY: REVENUE AND POLITICS* 45–53 (1996); ROBERT STANLEY, *DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX 1861–1913* (1993); McCaffery, *supra* note 64, at 810.

105. Revenue Act of 1913, ch. 16, 38 Stat. 114 (codified as amended in scattered sections of 26 U.S.C.).

106. *Id.* § 2, 38 Stat. at 166–67.

numbers in contemporary terms, \$500,000 in 1913 is equivalent to over \$13.1 million (\$13,161,785) in 2020 dollars, according to the government's inflation calculator.¹⁰⁷ The 7% marginal rate applying to such people, if any existed, is less than the state and local sales tax rate in some twenty states today.¹⁰⁸ All in, less than one percent (1%) of Americans paid individual income taxes in 1913,¹⁰⁹ and the tax was a trivial component of government revenues.

This original modern income tax did not tax much, but it did tax wealth. Government statistics going back to 1913 fail to specifically report "wages and salaries" as a category of income in the first three years of the tax, 1913–1915.¹¹⁰ In 1916, the first year for which statistics are available, "wages and salary" accounted for less than 30% of all income reported under the income tax.¹¹¹ While this ratio varied in the earlier years of the income tax, it stayed lower than current times: wages were under 45% of the income tax's base in 1925 and under 60% in 1935.¹¹²

A major theme throughout the entire history of tax in the United States was much present in all of its glory at the birth of the individual income tax: when America taxes wealth at all, it takes small and largely symbolic steps. Professor Carolyn C. Jones has written a wonderful legal historical account of the rise of the income tax "from a class tax to a mass tax," chronicling the changes that were made as the income tax morphed from its small beginnings to its hegemonic status as America's major source of revenue during World War II.¹¹³ Illustrating our primary tale, the advent of wage withholding fueled the transformation. In the meantime, we should keep this original "class tax" model of the income tax in mind: a small tax in its total revenue contribution to the fisc, one that falls only on economic elites, who can avoid it with sophisticated ("elite") planning, and one that the wealthy can and will pay politicians to save having to pay themselves. That model already fits the death tax story just told and closely tracks the corporate income tax's fate. This model—modest, complex, and avoidable taxes on wealth; massive, simple, and inescapable taxes on wages—will lead the income tax to be split into two, a simple wage/income tax for the masses and the ur-income tax for the few.

107. *CPI Inflation Calculator*, BUREAU OF LABOR STATISTICS, <https://data.bls.gov/cgi-bin/cpicalc.pl?cost1=500000.00&year1=191301&year2=202001> [https://perma.cc/G8WL-9AKM].

108. See JARED WALCZAK & SCOTT DRENKARD, TAX FOUND., FISCAL FACT NO. 572, STATE AND LOCAL TAX RATES 2018, at 2 (2018), <https://files.taxfoundation.org/20180313143458/Tax-Foundation-FF572.pdf> [https://perma.cc/LGU8-K9CQ].

109. NAT'L ARCHIVES & RECORDS ADMIN., MILESTONE DOCUMENTS IN THE NATIONAL ARCHIVES 70 (1995).

110. See *Historical Sources of Income and Tax Items*, TAX POLICY CTR. (2019), <https://www.taxpolicycenter.org/statistics/historical-sources-income-and-tax-items> [https://perma.cc/Y5AB-V6S4].

111. See *id.*

112. See *id.*

113. 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, 686 (1988).

2. Growing Up: FDR and Wartime Expansion . . . Through Wage Withholding

The Great Depression and, even more, World War II changed things for tax and for many other aspects of America's social and political life. The income tax was at the center of the great social transformation. As Professor Jones expertly illustrates, Franklin Delano Roosevelt (FDR) relied on a massive expansion of the income tax to finance the War effort. The class tax of the wealthy was married to a wage tax for the many.

We can see the wider shift easily enough by returning to the "Big Three" taxes: Individual Income, Corporate Income, Payroll. As percentages of GDP, these shares were, respectively, 0.9%, 1.2%, and 1.8% in 1940, at the dawn of World War II.¹¹⁴ This constituted 3.9% of GDP in the aggregate, and the payroll tax was by far the largest contributor, providing over 46% of the total despite being a flat 2% rate on payrolls at the time.¹¹⁵ By 1945, things looked very different. The Big Three shares had now become, respectively, 8.1%, 7.1%, and 1.5% of GDP.¹¹⁶ The total burden of the Big Three had increased to 16.7% of GDP—a more than fourfold increase. But the payroll tax, the leading tax of 1940, had actually fallen to third in relative terms, and had fallen by 0.3% of GDP in absolute terms; payroll taxes in 1945 accounted for less than 9% of revenues from the Big Three. The individual income tax, meanwhile, went from 0.9% to 8.1% of GDP, a 900% increase.

How did this happen? A very large part of the answer comes from the development of wage withholding, an idea promulgated in part by Milton Friedman, who was then working for the U.S. Treasury Department.¹¹⁷ Wage withholding greatly assisted the government's tax collection efforts as the rates under the income tax rose and as its coverage expanded to the masses.¹¹⁸ The government could count on third-party employers reporting the wages paid to employees in order to qualify for their own deductions for wages paid; social security numbers made it easy to link individuals to their pay. All of this helped to change the tax's base, too, moving it to more of a wage tax and less of a wealth one. By 1945, for example, more than 75% of the individual income tax's reported "income" came from wages and salaries.¹¹⁹

Wage withholding did more than help the U.S. government raise the needed monies to keep the world safe for democracy. It also brought the income tax to the masses and planted the seeds of a second, comprehensive (and largely hidden) tax: the wage/income tax. As one commentator wrote:

The Treasury itself publicly acknowledges, in a fact sheet on the history of the U.S. tax system posted at its website, that wartime withholding not only "greatly eased the collection of the tax," but "also greatly reduced

114. See *supra* Figure 4; see also Jones, *supra* note 113, at 694.

115. *Payroll Tax Rates*, TAX POLICY CTR. (2019), <https://www.taxpolicycenter.org/statistics/payroll-tax-rates> [https://perma.cc/D2QK-CDB7].

116. See *supra* Figure 4.

117. Robert Higgs, *Wartime Origins of Modern Income-Tax Withholding*, FOUND. FOR ECON. EDUC. (Nov. 1, 2007), <https://fee.org/articles/wartime-origins-of-modern-income-tax-withholding/> [https://perma.cc/W2PT-AME9].

118. See Jones, *supra* note 113, at 729.

119. See *Historical Sources of Income and Tax Items*, *supra* note 110.

the taxpayer's awareness of the amount of tax being collected, i.e.,] it reduced the transparency of the tax, which made it easier to raise taxes in the future." Some evidence: in 2005 more than 130 million individual income-tax forms were filed, yielding the federal government \$1,108 billion in revenue, and of that amount, \$787 billion, or 71 percent, came from withholding.¹²⁰

Wage withholding was a major innovation. It made it practical and efficient to collect massive amounts of taxes from ordinary workers without much fuss or bother. Thus, we see the first hints of the wage/income tax—a relatively hidden, painless, routine way for average Americans to fund their government. To this day, income reported from third-party employers is the easiest, least expensive, most compliant form of income tax payments.¹²¹

The World War II transformations to the individual income tax unleashed a major political, social, and economic force. The small "class" tax became a large tax on the masses, mainly meaning a wage tax on the vast middle class. Wage withholding made things pretty simple for most and planted the seeds for the developments to follow.

B. The Grand Illusion: The Rigging Was Always in Place

The death of the American income tax as an income tax is but an episode in a much longer-running series. Understood as a battle between wealth and wages, the simple fact of the matter is that wealth tends to win—at least until the revolution, or social collapse, comes knocking. *Sic transit gloria mundi*. Wealth certainly wins in the income tax's death story.

The wealthy, by definition, do not need to rely on wages. They *always* had escape valves under the U.S. income tax. Although the original tax, as we have seen, was intended to fall on wealth and wages, structural features inherent in the income tax and others added soon after its inception made sure that this social commitment to taxing wealth lacked any real teeth. The gods of capital, in subjecting themselves to the pain of taxation, had made sure that they built in Achilles' heels—several of them—in the government's new tool: protections against any attempt to ramp up the tax, as in fact occurred during World War I, when marginal tax rates exploded to as high as 70%.¹²²

I have called the three simple steps by which the wealthy avoid income taxes, and which are all based on unquestionably legal aspects of the tax law, Tax Planning 101: "Buy/Borrow/Die."¹²³ We start with the "Buy" step, turning on the realization

120. Higgs, *supra* note 117, at 32 (alteration in original).

121. See Alan Cole, *The Top Ten Sources of Personal Income*, TAX FOUND. (Feb. 2, 2015), <https://taxfoundation.org/top-ten-sources-personal-income/> [<https://perma.cc/3YHJ-8WAT>]; Aaron Krupkin & Adam Looney, *9 Facts About Pass-Through Businesses* BROOKINGS INST. (May 15, 2017), <https://www.brookings.edu/research/9-facts-about-pass-through-businesses/> [<https://perma.cc/8EWU-EBSC>] (see item 9 and chart).

122. *SOI Tax Stats - Historical Table 23*, IRS, <https://www.irs.gov/statistics/soi-tax-stats-historical-table-23>.

123. See, e.g., EDWARD J. McCaffery, *FAIR NOT FLAT: HOW TO MAKE THE TAX SYSTEM*

requirement of *Macomber*.¹²⁴ The late law professor William D. Andrews famously dubbed the realization requirement an “Achilles’ Heel” of the income tax.¹²⁵ And so it is. But I have come to see that it is only *one* of the income tax’s heels, going along with the “Borrow” and “Die” steps. These three steps, reflecting simple tax-law doctrines, make taxation voluntary *for those with wealth*. Because these three steps exist, any actual attempt to tax wealth under the income tax—imposing capital-gains tax on the sale of assets, for example—is handcuffed from the start. Importantly, too, none of these tricks work—any more—for wage earners.

1. Heel #1: The Realization Requirement (Buy)

Eisner v. Macomber, decided in 1920, importantly gave us the *realization requirement*.¹²⁶ This doctrine means that one does not pay tax on the *gain*, or the rise in value, of an asset until and unless that gain is “realized” in some taxable transaction, paradigmatically a sale.¹²⁷ Critically, this means that simple “buy and hold” investors need pay no current tax. Tax is only paid when an asset produces cash.

It is thus no surprise that many assets never pay cash. If our friendly saver Ant, for example, had purchased \$1000 worth of Berkshire Hathaway stock in 1965, when Warren Buffett took over the company, that investment would be worth more than \$24 million by the end of 2017.¹²⁸ Only once in that fifty-two-year history—when Buffett said “[he] must have been in the bathroom” after the company declared a \$0.10 per share dividend in 1967¹²⁹—did Berkshire Hathaway ever declare and pay a dividend, on which Ant would have had to pay some tax. Otherwise, Ant has some \$24 million in *unrealized appreciation*—what has been called the “800 pound gorilla” of the tax system¹³⁰—on which she only ever has to pay tax if she sells the stock. And the simple advice of Step One, “Buy,” is never to sell (your winners, at

BETTER AND SIMPLER (2002) [hereinafter McCaffery, *FAIR NOT FLAT*]; EDWARD J. McCaffery, *THE OXFORD INTRODUCTIONS TO U.S. LAW: INCOME TAX LAW*, at xix (2012) [hereinafter McCaffery, *INCOME TAX LAW*]; McCaffery, *supra* note 64.

124. *Eisner v. Macomber*, 252 U.S. 189, 207 (1920).

125. William D. Andrews, *The Achilles’ Heel of the Comprehensive Income Tax*, in *NEW DIRECTIONS IN FEDERAL TAX POLICY FOR THE 1980s*, at 278, 280 (Charles E. Walker & Mark A. Bloomfield eds., 1984).

126. 252 U.S. at 207.

127. See I.R.C. § 1001(a) (2018).

128. John Maxfield, *An Interesting Chart About Berkshire Hathaway*, MOTLEY FOOL (July 23, 2017, 9:46 AM), <https://www.fool.com/investing/2017/07/23/an-interesting-chart-about-berkshire-hathaway.aspx> [https://perma.cc/5TK8-U87E] (last updated Apr. 30, 2018, 10:35 PM).

129. Morgan Housel, *Buffett: You Want a Dividend? Go Make Your Own*, MOTLEY FOOL (Mar. 4, 2013) (internal quotation marks omitted), <https://www.fool.com/investing/general/2013/03/04/buffett-you-want-a-dividend-go-make-your-own.aspx> [https://perma.cc/8SWD-55AV].

130. See Jesse Drucker, *Buffett-Ducking Billionaires Avoid Reporting Cash Gains to IRS*, BLOOMBERG (Nov. 21, 2011), <https://www.bloomberg.com/news/articles/2011-11-21/billionaires-duck-buffett-17-tax-target-avoiding-reporting-cash-to-irs> [https://perma.cc/779V-G9KR].

least). It is this realization requirement, alone, that Professor Andrews called the Achilles' Heel of the income tax because it, alone, with enough planning, could kill the income tax.

Unrealized income is simply not "income" that has to be reported on any tax form. Thus, for example, when Warren Buffett revealed that he had just under \$40 million (\$40,000,000) in *taxable income* for the calendar year 2010,¹³¹ he did not reveal, and his tax forms did not have to reveal, that he also had over \$8 *billion* (\$8,000,000,000) in unrealized appreciation that year from his shares of Berkshire Hathaway stock alone.¹³² This basic analytic fact, true for over a century, helps to provide one of the optical illusions hiding the rather flat universal wage tax. While high-income reporters pay high income taxes—such that most of the income tax is paid by those with the highest incomes—the wealthy do not have to show high "incomes" in the first place. They can play Buy/Borrow/Die with their wealth. Statistics of "income" hide the privileges of wealth.¹³³ This is why AOC's raise-the-rates approach will not affect the wealthy.

This might be just a curiosity, however, if the Court's decision in *Macomber* and the realization requirement were all that the wealthy had going for them. It would be true that they could amass billions, tax-free, as Buffett and other billionaires clearly have done in abundance. But what good would that do them? The realization requirement simply defers the moment of tax to when the taxpayer cashes out, which seems sensible enough. Surely America's many billionaires would have to pay some tax before they could spend their vast fortunes—for instance, before running for elective office?

Well, no, they do not.

2. Heel #2: The Nontaxation of Debt (Borrow)

Simply buying and holding assets is a wonderful way to get wealthy, and it is indeed tax-free under the realization requirement. But it can also be fun-free, because one can only have so much fun reflecting on her net worth. Real people have to live. If the wealthy had to sell assets to finance their lifestyles, the realization requirement of *Macomber* would be "just" a matter of timing—the IRS could come in and tax the gain on the sale.

But the wealthy do not have to sell their assets to live large, as President Trump, among others, knows full well.¹³⁴ They can simply move on to Step Two of Tax Planning 101 and "Borrow." Borrowing is not income, under any definition of "income." When you borrow, you have a precisely offsetting obligation to repay your

131. Janet Novack, *Warren Buffett's Effective Federal Income Tax Rate Was Just 11%*, FORBES (Oct. 12, 2011, 4:59 PM), <https://www.forbes.com/sites/janetnovack/2011/10/12/warren-buffetts-effective-federal-income-tax-rate-is-just-11/#7868ad93454d> [https://perma.cc/HH84-MSBN].

132. McCaffery, *supra* note 10, at 312–13.

133. See Jenny Bourne, Eugene Steuerle, Brian Raub, Joseph Newcomb & Ellen Steele, *More Than They Realize: The Income of the Wealthy*, 71 NAT'L TAX J. 335, 335–36 (2018).

134. See Edward McCaffery, *Trump is the King of Debt but Not of Taxes*, CNN (Sept. 2, 2016, 8:11 PM), <https://www.cnn.com/2016/09/02/opinions/trump-king-of-debt-but-not-taxes-opinion-mccaffery/index.html> [https://perma.cc/PD3S-93PW].

loan—you are, financially, no better off. This is true even when you borrow against appreciated assets.¹³⁵ Borrowing allows the wealthy to monetize their unrealized appreciation without paying *any* tax. In case one thinks that is some arcane academic matter, consider, if President Trump’s financial lifestyle is not sufficient to convince you, the fact that Oracle CEO Larry Ellison has at least a \$10 *billion* line of credit.¹³⁶ He is free to draw on that, at any time and for any reason, tax-free. Then again, it should not surprise us that the wealthy have already figured out how the tax system works to favor them.

3. Heel #3: Stepped-up Basis on Death (Die)

All things must end, or so they say. As it happens, the tax-avoidance game of Buy and Borrow can go on forever. The appreciated assets from Step One have what tax professionals call a “built-in gain.” Ant, for example again, has a tax *basis* in her Berkshire Hathaway stock of \$1000 from when she bought it in 1965.¹³⁷ That stock is now worth \$24,000,000. Ignoring the one year of dividends (Ant would have paid tax on her dividend, and this would have increased her basis), Ant has \$23,999,000 of built-in gain: the difference between the stock’s current value, \$24,000,000, and its cost or basis, \$1000.¹³⁸ If and when Ant sells her stock, she will have to pay tax on that gain, almost certainly at capital-gains rates.

Except that Ant need never sell the stock. If she wants to have some pleasure herself, she can borrow away, as just noted in Step Two. If Ant holds her stock until her death and then passes it along to her children, those little ants will get the stock income tax-free under I.R.C. § 102 and with a basis equal to fair market value, or \$24,000,000, under I.R.C. § 1014, the “Angel of Death” provision for stepped-up basis on death.¹³⁹ The little ants could sell the stock the day they get it, pay off their mother’s debts, and start playing Tax Planning 101 themselves—all tax-free. Vice President Biden and other Democratic 2020 presidential candidates have endorsed plans to repeal I.R.C. § 1014,¹⁴⁰ as did President Obama in his 2015 State of the Union Address: if this were to pass, it would end a century of this particular tax perk for the wealthy.¹⁴¹

135. See *Woodsam Assocs., Inc. v. Comm’r*, 198 F.2d 357, 359 (2d Cir. 1952).

136. Julie Bort, *Larry Ellison Has Secured \$10 Billion Worth of Credit for His Personal Spending*, BUS. INSIDER (Sept. 26, 2014), <https://www.businessinsider.com/larry-ellison-has-a-10b-credit-line-2014-9> [<https://perma.cc/E4XA-U6TD>].

137. See *supra* note 76.

138. See I.R.C. § 2502 (2018).

139. See Len Burman, *President Obama Targets the ‘Angel of Death’ Capital Gains Tax Loophole*, FORBES (Jan. 18, 2015), <https://www.forbes.com/sites/beltway/2015/01/18/president-obama-targets-the-angel-of-death-capital-gains-tax-loophole/> [<https://perma.cc/Y26B-MXSM>].

140. Rocky Mengle, *2020 Election: Tax Plans for All 19 Democratic Presidential Candidates*, KIPLINGER (Mar. 1, 2020), https://www.kiplinger.com/slideshow/taxes/_T043-S001-tax-plans-2020-democratic-presidential-candidates/index.html [<https://perma.cc/5V-KM-92KE>]; see also *supra* text accompanying note 41.

141. See *State of the Union Surprise: President Targets Inherited Assets in Middle-Class Tax Reform*, MCGUIREWOODS (Jan. 21, 2015), <https://www.mcguirewoods.com/client-resources/Alerts/2015/1/State-Union-Surprise> [<https://perma.cc/44P9-43Z9>].

The careful reader will note that none of this means that Ant's estate will pay an estate tax, because that tax is a *net* wealth tax, on assets minus liabilities. If Ant dies with \$24 million in stock and \$14 million in debt—she got to have some fun, after all, using Step Two—there would be no estate tax under the current \$11 million per person exemption. Similarly, if Ant borrowed 100% against her assets, there would be no inheritance—and no tax either. In sum, Ant will have made \$24 million over a fifty-two-year period from capital appreciation—over \$460,000 *per year* for the entire period—shared between herself and her heirs, *altogether tax-free*, forever.

4. Summing Up

It is all about wealth versus wages. It is good to be wealthy. The three steps of Buy/Borrow/Die allow Steve Jobs to reduce his wages to \$1 and Warren Buffett to become one of the wealthiest persons in the world without even maxing out on his social security contributions at his day job as CEO of Berkshire Hathaway. More particularly—and what should not be surprising at this point—the three steps of Buy/Borrow/Die lay the seeds for the conversion of the “income” tax into a wage tax. If our friend Ant were able to save \$1000 after paying tax on her wages in 1965, and to have bought Berkshire Hathaway stock, she would now have stock worth \$24 million, and she would never have paid tax again after 1965.

It is a simple fact that billionaires in America can live extraordinarily well and completely tax-free off their wealth. It is an equally simple fact that people who live off paid wages cannot do so.

C. Reality Bites

I have written a great deal about Buy/Borrow/Die and about its importance as an *analytic* possibility: this is unquestionably simple, perfectly legal tax advice.¹⁴² The possibility of the wealthy paying little or no taxes on their holdings is what constrains important matters of tax-law design, such as the preferential capital-gains rate—since the wealthy do not ever have to sell their assets in order to enjoy consumption, tax rates on asset sales can never get too high. Empirical data to back these claims has been hard to come by, in large part because the rich are too few and too secretive for much government data to exist on them. But the facts are there, and they are beginning to emerge.

A recent empirical study published in the prestigious *National Tax Journal*, for example, shows that the wealthy have very low rates of “realizing” their capital gains, and hence, they have low effective tax rates measured against their true economic gains.¹⁴³ The authors conclude:

[I]t seems clear that much capital income of top wealth holders either is not subject to federal income taxation or is effectively excluded from taxation by a preferential tax rate. Realized income from capital therefore significantly understates the true economic return to capital. *For most wealthy individuals, capital income is a discretionary event* due to the

142. See, e.g., MCCAFFERY, FAIR NOT FLAT, *supra* note 123.

143. Bourne, Steuerle, Raub, Newcomb & Steele, *supra* note 133.

large percentage of capital held in the form of assets like corporate stock or real estate that need not be sold. Top wealth holders also tend to concentrate their wealth in assets that yield the highest average long-term returns, as well as seek opportunities to shelter assets via trusts, family limited partnerships, and other means. Hence, their lower realized rates of return do not reflect lower economic rates of return¹⁴⁴

The study's authors follow this paragraph by simply stating, "These results should not be surprising."¹⁴⁵ They are certainly not surprising to those aware of the analytic possibilities of Buy/Borrow/Die.

Figure 11 gives a historical perspective and graphical look at the basic ideas. It shows both net capital gains and the actual taxes owed on them, as a percentage of GDP from 1954 to 2013. Recall that, for most of this period, overall American taxes were close to 20% of GDP, and the Big Three contributed around 16% in a typical year. Recall also that labor's share of the national income, as Figure 1 illustrated, was in steady decline. And yet taxes from realized capital gains were typically far below 1% of GDP for this period, only peaking when capital-gains rates were set to go *up* in the mid-1980s under President Ronald Reagan and during the spectacular—for the wealthy—internet boom of the 1990s. According to the Congressional Budget Office, who prepared Figure 11, "[r]evenues from capital gains realizations ranged from a low of 0.2% of GDP in 1957 (the year in which realizations measured as a share of GDP were lowest) to a high of 1.24% of GDP in 2000 (when realizations relative to the economy spiked)."¹⁴⁶

144. *Id.* at 353 (emphasis added).

145. *Id.*

146. CONG. BUDGET OFFICE & JOINT COMM. ON TAXATION, THE DISTRIBUTION OF ASSET HOLDINGS AND CAPITAL GAINS 2 (2016), <https://www.cbo.gov/publication/51831> [<https://perma.cc/QJ6K-PGGY>].

Figure 11: Capital Gains Reported and Taxes Paid on Capital Gains, Percentage of GDP, 1954–2013¹⁴⁷

Net Capital Gains Reported on Individual Tax Returns and Taxes Owed on Those Gains, 1954–2013

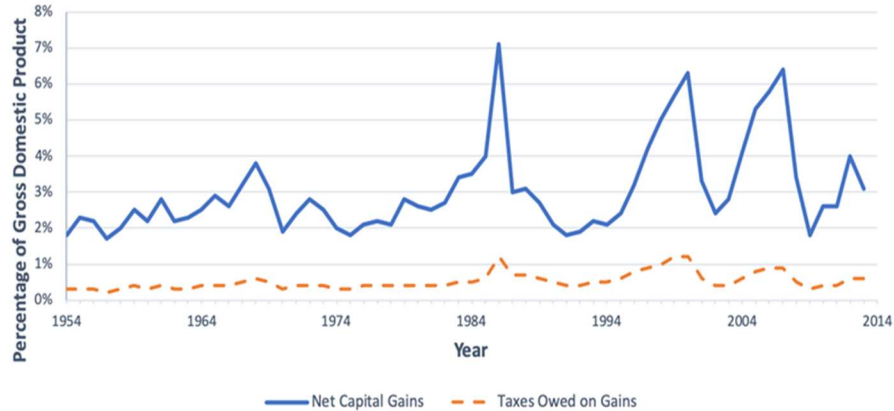


Table 1 gives a snapshot of the composition of sources for the income tax in the year 2012:

Table 1: Top Ten Sources of Personal Income, 2012¹⁴⁸

Top Ten Sources of Total Income on U.S. Individual Income Tax Returns, 2012	
Income Type	Amounts (billions)
Salaries and Wages	\$6301
Capital Gains Less Losses	\$623
Taxable Pensions and Annuities	\$612
Partnerships and S-Corporation Net Income	\$535
Business Net Income	\$304
Dividends	\$260
Taxable IRA Distributions	\$231
Taxable Social Security Benefits	\$224
Taxable Interest	\$112
Unemployment Compensation	\$71

These “top ten” sources of individual income tax revenues accounted for over 80% of total income tax revenues.¹⁴⁹ A brief glance show the importance of salaries

147. *Id.*

148. ALAN COLE, TAX FOUND., FISCAL FACT NO. 449, SOURCES OF PERSONAL INCOME 2 (2015), https://files.taxfoundation.org/legacy/docs/TaxFoundation_FF449.pdf [<https://perma.cc/YL2S-Y5TE>]; *SOI Tax Stats—Individual Income Tax Returns Publication 1304 (Complete Report)*, IRS, <https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report> [<https://perma.cc/TLH9-B2AZ>] (last updated Mar. 10, 2020).

149. *See Federal Tax Revenue by Source, 1934–2018*, TAX FOUND. (Nov. 21, 2013),

and wages. These are over ten times the magnitude of the next largest item, capital gains less losses. Simple wages, from Line 1, account for some 68.2% of the total from these ten items; capital gains come in at under 7%. A closer look deepens the perspective. Line 3 (taxable pensions and annuities), Line 7 (taxable IRA distributions), Line 8 (taxable social security benefits), and Line 10 (unemployment compensation) *also* come, overwhelmingly, from the labor side of the capital-labor divide: these are payments to people on account of their working or for time spent in the paid workforce. Adding these items in on the labor side of the ledger brings its share of the whole to over 80%. And we would not be fully done with the analysis, because much of Line 4 (partnership and S-corporation income) also comes from the labor side in the form of small proprietorships and other “pass-through” entities, which typically fail to break out their full wages.¹⁵⁰

The first two items in Table 1 give us a quick look at the basic story and show how far we have travelled since 1913. Recall that wages and salaries were not even reported by the government for the first three years of the income tax and came in at about 30% of the total in 1917.¹⁵¹ At the end of a century of income taxation in 2012, taxes collected from “wealth and wages” were more than ten times as much as the amount of taxes on “capital gains less losses,” *and* this fails to fully capture the benefits to wealth, not wages, both because most “capital gains” went unrealized *and* because the tax rate on realized capital gains is lower than that on wages.¹⁵² The income taxes attributable to wages are thus more likely twenty times as much as the taxes from capital gains. And the payroll tax, the other half of the universal wage tax, does not even apply to capital gains—only to wages.

Summing up Act One, we have seen the income tax conceived and brought into being as a modest tax on the wealthy, meant to tax both wealth and wages—but only up to a limited point. When the government needed more revenues—a lot more revenues—it engrafted a massive wage tax onto the preexisting modest wealth one. The branch then took over and killed the original tree. The individual income tax that emerged from World War II as America’s major tax was and always has been largely a wage tax, a trend that has been accelerating even while wages in the real world have been stagnating. The *ur*-income tax—the taxation of wealth, not wages—meanwhile keeps losing teeth. And all this has occurred at a time when labor’s share of the national income has been shrinking, as Figure 1 shows.

IV. ACT TWO: RONALD REAGAN AND THE TAX REFORM ACT OF 1986

Any story of the death of the income tax has to give pride of place to President Ronald Reagan. After FDR had overseen the wartime, shotgun marriage of the *ur*-

<https://taxfoundation.org/federal-tax-revenue-source-1934-2018/> [https://perma.cc/A8ZF-2S3F].

150. See Aaron Krupkin & Adam Looney, *9 Facts About Pass-through Business*, BROOKINGS INST. (May 15, 2017), <https://www.brookings.edu/research/9-facts-about-pass-through-businesses/> [https://perma.cc/ZX9P-YN2G].

151. See *supra* notes 110–111 and accompanying text.

152. *Historical Capital Gains and Taxes*, TAX POLICY CTR. (May 4, 2017), <https://www.taxpolicycenter.org/statistics/historical-capital-gains-and-taxes> [https://perma.cc/5S3A-CBKE].

income tax and an ascendant, basic, wage/income tax, Reagan, who had ridden into power based in large part on his tax-cutting bona fides as the former governor of California, advanced the cause. But he did not do so in the way most people think.

Reagan was not so much a tax-cutting president as a tax-reforming one, and his principal reforms significantly advanced the universal wage-tax project—indeed, Norquist claims that Reagan asked him to form his iconic political organization, Americans for Tax Reform, in 1985.¹⁵³ Reagan’s tax policies, particularly his signature Tax Reform Act of 1986 (“TRA 86”),¹⁵⁴ importantly laid the groundwork for a *structural* separation of wealth and wages within a nominally unified income tax. Reagan raised the standard deduction, getting people off the income tax rolls altogether,¹⁵⁵ a move that President Trump would later repeat.¹⁵⁶ More fundamentally, TRA 86 put in place a series of rules aimed at preventing wage earners from avoiding taxes by taking deductions attributable to capital that they did not own but had borrowed: “tax shelters,” in a more colloquial parlance.¹⁵⁷ At the same time, Reagan’s policies reduced the corporate income tax¹⁵⁸ and increased the payroll tax.¹⁵⁹

In sum, Act One featured a marriage of wealth and wage taxation. Act Two features their separation.

A. Saving the Income Tax as a Wage Tax

Due in part to high inflation in the 1970s—the marginal rate brackets under the individual income tax were not indexed for inflation until the passage of the Economic Recovery Tax Act of 1981 (ERTA),¹⁶⁰ and that provision of the law did not become effective immediately¹⁶¹—the size of the individual income tax had soared, as Figure 4 again demonstrates. The income tax’s burden reached 8.7% of GDP in 1980, the year Reagan was elected, and 9.1%—then a post-War high—in 1981, his first year as President. There was clear and overwhelming support for cutting the individual income tax, and Reagan did just that—first in ERTA, which reduced the highest marginal tax rate under the income tax (which had been 70% ever since President John F. Kennedy cut it from 90% in 1963) to 50%.¹⁶² Five years

153. *About Americans For Tax Reform*, AM. FOR TAX REFORM (Mar. 23, 2009), <https://www.atr.org/americans-tax-reform-a2878> [<https://perma.cc/BQ7J-BEMS>].

154. Tax Reform Act of 1986 (“TRA 86”), Pub. L. No. 99-514, 100 Stat. 2085 (codified as amended in scattered sections of 26 U.S.C.).

155. *Id.* § 102, 100 Stat. at 2099–102.

156. *See infra* Section V.A.

157. *See* TRA 86, tit. V, 100 Stat. at 2233–49.

158. *Id.* § 601, 100 Stat. at 2249.

159. *See id.* § 101, 100 Stat. at 2096–99.

160. Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34, 95 Stat. 172 (codified as amended in scattered sections of 26 U.S.C.).

161. *See* Stephen J. Entin, *Tax Indexing Turns 30*, TAX FOUND. (Mar. 11, 2015), <https://taxfoundation.org/tax-indexing-turns-30/> [<https://perma.cc/L2ND-RJ7Q>].

162. *See* ERTA § 101, 95 Stat. at 176–86.

later, TRA 86 brought the magical number to 28%¹⁶³—a radical revolution in rates, indeed.

Yet Reagan had a problem. Obviously, lower tax rates were wildly popular, and Reagan's iconic status was solidified by bringing the highly salient top marginal rate under the income tax down by more than one-half, from 70% to 28%. By any stretch of any imagination, that was a remarkable political feat. Yet the federal government could not afford to see its principal source of revenue simply cut in half. It turns out that it did not have to. By 1984 (three years after ERTA and, not coincidentally, Reagan's reelection year), the income tax had fallen to 7.5% of GDP, a 17.5% fall from its 1981 level. But 1984 represented the low water mark for the individual income tax under Reagan. It did not, that is, fall again *after* TRA 86, instead reaching 8.0% of GDP in 1989, Reagan's first year out of office.

What had happened? In order to lower tax *rates* without significantly affecting tax *revenue*, Reagan had to widen the income tax's *base*: a smaller percentage of a bigger base yielding roughly similar net revenues. How did he do this? Mainly by shutting off the mechanisms under which *wage earners* could reduce their taxes by using tricks developed on the *wealth* side, riffing off of Buy/Borrow/Die. TRA 86 reflected a systematic and thoughtful attack on tax shelters, or transactions meant to hide *wages* from the IRS. The wealthy, on the other hand, did not need anything fancier than Buy/Borrow/Die, which they always had. Blocking ordinary workers from getting the goodies set the scene for isolating out *wages*, from which ultimately there will be *no* deductions, from wealth. This is the state towards which Trump's TCJA takes us, Norquist dreamt of, and that the payroll tax has always been in.

Understanding all of this takes a pinch of tax theory. At the root of much of the complexity of an income tax lies a fundamental distinction between *business* and *personal* activities.¹⁶⁴ Crudely, business is about making money and personal activities are not. Basic tax theory—really just common sense—suggests that the government *should* allow generous deductions on the business side but *should not* allow them on the personal side. This is because when a taxpayer spends money with the hope and reasonable anticipation of making money, the government, which will tax the taxpayer's profits, should stand aside: what is good for General Motors (making money) is really good for a government that makes its money by taxing private citizens on the money they make.¹⁶⁵ But this is *not* true of personal expenses. If the government let people deduct expenditures on food, clothing, shelter, and so forth, there would be nothing left to tax.

These basic principles would leave things relatively simple or at least understandable. There would be a general *business*-expense deduction, as there is under I.R.C. § 162, and a general prohibition on *personal*-expense deductions, as

163. See TRA 86 § 101, 100 Stat. at 2096–2099.

164. See McCaffery, *INCOME TAX LAW*, *supra* note 123.

165. To illustrate, suppose that Ant invests \$1.00 and makes \$1.50, for a \$ 0.50 profit. The tax rate is 30%. If the government allows a deduction for the \$1.00 investment, Ant saves \$0.30 in taxes (30% of \$1), so the after-tax initial outlay is reduced to \$0.70. Then, when she makes \$1.50, the government takes \$0.45 in taxes, and Ant keeps \$1.05. Ant's after-tax \$0.70 therefore grows to \$1.05, and the government's \$0.30 tax benefit, originally conferred to Ant, becomes a \$0.45 tax collected—both Ant and the government earning a 50% return.

there is under I.R.C. § 262. A major problem arises, however, because of Tax Planning 101.

As we have seen, wealth was never really fully subject to the income tax, even in its purest “class tax” form from 1913.¹⁶⁶ The three steps of Buy/Borrow/Die have always existed so that the rich—by simply buying and holding assets, borrowing to finance their lifestyles, and then dying—could avoid all tax.¹⁶⁷ Workers were not so lucky, of course, but they could still play Tax Planning 101 by initially *borrowing* funds to play the game. The tax shelter industry relied on debt¹⁶⁸ to generate the kinds of business deductions (depreciation, interest, and the like) that the wealthy could always use. Tax shelters, along with the ever-proliferating number of special provisions in the Tax Code (such as helping pet political causes and so forth), made the income tax that Reagan inherited a porous mess—a tax with nominally high rates (up to 70%) but with so many deductions, exemptions, and exclusions that few paid anything close to their nominal rate brackets based on “income” alone.

This is not the place to delve into detail on *how*, exactly, TRA 86 effected its primary result—I have written more extensively about this elsewhere.¹⁶⁹ A quick summary will suffice. The problem illustrated by the analysis above is that Buy/Borrow/Die provides a means of making money without showing any taxable “income.” If we allowed deductions for the costs of earning such untaxed income, taxpayers could show a tax loss: the expenses that they would report on a tax return (interest, depreciation, and so forth) would exceed the income they were showing on the same returns (in the limiting case, none). They could then use these tax, but not economic, losses to “shelter” their wages and other income from taxation.

The strategy behind TRA 86 was not to approach this problem as a comprehensive matter. TRA 86 left Buy/Borrow/Die and each of its planks altogether unaffected for the wealthy. Instead, TRA 86 viewed the problem as occurring when *wage earners* were allowed to take the same deductions always available to the wealthy, largely because the wage earners were borrowing money. The leaks on the wage/income side are what TRA 86 addressed to broaden the income tax’s base. TRA 86 limited interest deductions under I.R.C. § 163, disallowing personal-interest deductions except for home-mortgage interest (more on that, later, too).¹⁷⁰ Most dramatically, TRA 86 put in place a powerful “antishelter” provision, the passive activity loss rules of I.R.C. § 469.¹⁷¹ This law made it impossible for taxpayers to deduct expenses attributable to *investments* from *wages*. In effect, wages were walled off under Reagan’s TRA 86; the various taxpayer attempts to “shelter” their wages from income taxation were shut down.¹⁷²

166. See *supra* Section III.A.

167. See *supra* Section III.B.

168. On debt as cause of tax shelter, see Calvin H. Johnson, *Tax Shelter Gain: The Mismatch of Debt and Supply Side Depreciation*, 61 TEX. L. REV. 1013 (1983).

169. McCaffery, *supra* note 64.

170. TRA 86, Pub. L. No. 99-514, § 132, 100 Stat. 2085, 2113–14 (codified as amended at I.R.C. § 163 (2018)).

171. *Id.* § 501, 100 Stat. at 2233–41 (codified as amended at I.R.C. § 469 (2018)).

172. Attacks on tax shelters have continued through 2010, with the economic-substance doctrine in I.R.C. § 7701(o) (2018).

1. The Evolution of Two Income Taxes

As noted, none of the Reagan-era tax acts affected Buy/Borrow/Die for the billionaire class. The realization requirement remained unchanged. The nontaxation of borrowing remained unchanged. Stepped-up basis on death remained unchanged.

What changed, and dramatically, was the ability of wage earners to take advantage of any of these things. A hard wall was created between the taxation of wealth and wages. We can see the basic wage/income tax emerging, as planning opportunities for wage earners to avoid taxes waned, more people took the standard deduction and stopped itemizing, and wage earners had little to do but pay tax at their statutory rate.

Consider the base of the income tax for most Americans at this point, with an eye towards Norquist's dream.¹⁷³ This base consists, overwhelmingly, of wages. We then add to that whatever investment returns the taxpayer has, and we subtract whatever deductions are allowed. But in the first part, the inclusions, we continue to allow tax-free provisions for savings in IRAs and pension plans, and the tax rate on investment gains remains lower than on wages. On the second part, the deductions, TRA 86 systematically eliminated or severely limited the value of deductions attributable to business or investment income for ordinary wage earners. This then leaves the "personal" deductions: state and local sales taxes, mortgage interest, charitable contributions, and the like. These personal deductions then had a target on them—ripe for a death by a thousand cuts. Thus we shall see a continued attempt to limit or eliminate personal deductions through the TCJA.

When we have taken these steps, we are at the promised land for the vast majority of American taxpayers who are wage earners. They simply add up their wages. There will be nothing to add, both because most Americans do not save much and because ordinary savings will be sheltered in something like universal savings accounts.¹⁷⁴ There will be nothing left to subtract, because there will be no business or investment deductions for workers to take, and because all the personal deductions will have been eliminated or left for a dwindling number of itemizers. For everyone else, America's laborers, a postcard will do. Stay tuned.

B. Spin-offs and Sequels

On our way to President Trump and the TCJA, consider a few more milestone moments in the income tax's death march, many illustrating the breadth of unintended consequences in tax.

1. Clinton, Roth, Gramm-Rudman, and Wage Taxation

President Bill Clinton did not do all that much in regard to income taxes, except for raising the top marginal rate (largely on *wages*) to 39.6%¹⁷⁵ and *cutting* the

173. See *supra* Section I.B.

174. See Robert Bellafiore, *The Case for Universal Savings Accounts*, TAX FOUND. (Feb. 26, 2019), <https://taxfoundation.org/case-for-universal-savings-accounts/> [<https://perma.cc/WA4W-P6NU>] (calling for universal savings accounts in Tax Cuts 2.0).

175. See John H. Cushman Jr., *The Clinton Tax Bill; Something for (or From) Everybody*, N.Y. TIMES ARCHIVES (May 14, 1993), <https://www.nytimes.com/1993/05/14/us/the-clinton->

capital-gains rate (exclusively on *wealth*),¹⁷⁶ which TRA 86 had temporarily raised, to 20%. In so doing, Clinton was advancing the cause of converting the income tax into a universal wage tax. But we pause on the Clinton years for a different reason: the creation of Roth-style IRA accounts in 1997.¹⁷⁷

Named after William Roth, a Republican Senator from Delaware, “Roth IRAs” work on the *prepaid* consumption tax model, meaning that they generate no tax deduction upfront but are never responsible for taxation again. This is unlike “traditional” IRAs, which follow the *postpaid* model: one gets a deduction upfront, hence pays no tax in the year of contribution, but is taxable on withdrawals (which can even be mandatory under complex tax rules).¹⁷⁸ As we learned above, prepaid consumption-tax treatment is wage-tax treatment, as we see under the payroll tax. Moving to Roth savings models—pursuing “Rothification” to the hilt—means moving the “income” tax to a wage tax.

Why did Clinton and the Congress sign off on this move? Rather than thinking about anything structural or long-term, a major part of the reason almost certainly derived from legislative-budgeting rules, such as Gramm-Rudman.¹⁷⁹ This law forced the government to balance, or appear to balance, its budgets over a ten-year window. In theory, prepaid and postpaid consumption-tax treatment (Roth and traditional IRAs) should lead to the same place for both taxpayers and the government. But there is a timing difference. Under traditional IRAs taxpayers get a tax break now, and the government gets its money later. Under Roth IRAs, the government gets its money now, and forswears any tax later. A government that cares about the timing of its receipts—as our government now does, due in part to Gramm-Rudman and progeny—will prefer Roth treatment.

And so we do. In 2000, taxpayers held \$77.6 billion in Roth IRAs; by 2016, the figure had ballooned to \$660 billion.¹⁸⁰ Nor is the treatment limited to IRAs—the popular Section 529 educational plans and medical savings accounts work along the

tax-bill-something-for-or-from-everybody.html [https://perma.cc/PQ45-LJHW].

176. Charles Kadlec, *The Dangerous Myth About Bill Clinton Tax Increase*, FORBES (July 16, 2012), <https://www.forbes.com/sites/charleskadlec/2012/07/16/the-dangerous-myth-about-the-bill-clinton-tax-increase/#205e431b6e8a> [https://perma.cc/WLV7-JQ5N].

177. See generally Troy Segal, *Roth IRA*, INVESTOPEDIA, <https://www.investopedia.com/terms/r/rothira.asp> [https://perma.cc/8SHD-7TJC] (last updated Jan. 17, 2020).

178. See *Retirement Plan and IRA Required Minimum Distributions FAQs*, IRS <https://www.irs.gov/retirement-plans/retirement-plans-faqs-regarding-required-minimum-distributions> [https://perma.cc/8LKH-TNPP] (last updated June 18, 2019).

179. See *1985 Balanced Budget and Emergency Deficit Control Act*, U.C. BERKELEY BANCROFT LIBR. REGIONAL ORAL HIST. OFF., <http://bancroft.berkeley.edu/ROHO/projects/debt/1985grammrudmanhollings.html> [https://perma.cc/F5W7-RB86] (last updated Mar. 7, 2011).

180. CRAIG COPELAND, EMP. BENEFIT RESEARCH INST., NO. 456, EBRI IRA DATABASE: IRA BALANCES, CONTRIBUTIONS, ROLLOVERS, WITHDRAWS, AND ASSET ALLOCATION, 2016 UPDATE 1 (2018), https://www.ebri.org/docs/default-source/ebri-issue-brief/ebri_ib_456_iras-13aug18.pdf?sfvrsn=6a58352f_2 [https://perma.cc/2WGL-NS8K]; *Roth Assets in Individual Retirement Accounts in the United States from 2000 to 2013*, STATISTA RESEARCH DEP’T (Dec. 31, 2014), <https://www.statista.com/statistics/187954/total-assets-of-roth-iras-in-the-us-since-2000/> [https://perma.cc/G86D-459Z].

Roth wage-tax model as well.¹⁸¹ “Rothification” is proceeding apace.¹⁸² This all continues to move the overall income tax towards a wage tax—that is, towards its death.

Note that Norquist seems to have not fully appreciated the Roth innovation, as his steps include both repealing the capital-gains tax and giving unlimited deductions for savings. But if we adopt universal savings accounts along a Roth model—as is currently being proposed¹⁸³—there would be no need to repeal the capital-gains rate, and no need to have deductions or subtractions for savings. All savings and investment could take place within Roth-style accounts. No investment gains would ever be taxed. Such a plan, as its advocates tout, would indeed be far simpler than the traditional, postpaid IRAs, with their rules for mandatory withdrawals and so forth. Universal Roth-style savings accounts are simple, for the same reason the payroll tax’s taxation of savings and investment is simple—because an income tax with universal Roth-style savings accounts *is* a payroll tax. People are taxed when they earn wages and never again. That is simple, but not necessarily fair.

2. Bush Tax Cuts

Clinton’s capital-gains tax-rate cut combined with the internet boom led to a surge in income tax revenues, helping to create a \$1.2 trillion budgetary surplus that Clinton himself was unable, politically, to spend. George W. Bush, elected along with a Republican Congress, had no such difficulties. When Bush took office, the income tax was again at a high, as a percentage of GDP, hitting 9.9%—an all-time record—in 2000.¹⁸⁴ President Bush slashed the income tax, first in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)¹⁸⁵ and again in the Jobs and Growth Tax Reconciliation Act of 2003 (JGTRRA),¹⁸⁶ leading to a massive change in the individual income tax’s overall burden, as Figure 4 clearly shows. After Bush’s two terms—and the onset of the Great Recession—things had changed dramatically.

In 2009, the individual income tax’s burden had fallen to 6.3% of GDP, an astonishing nearly 40% drop over the decade.¹⁸⁷ The corporate income tax, meanwhile, fell in half, from 2% in 2000 to 1% in 2009. The payroll tax? It should come as no surprise that there was little change here, a fall from 6.4% in 2000 to

181. I.R.C. § 529 (2018).

182. See generally Amir El-Sibaie, *What Rothification Means for Tax Reform*, TAX FOUND. (Sept. 12, 2017), <https://taxfoundation.org/what-rothification-means-for-tax-reform/> [https://perma.cc/EA5Y-K6SF].

183. Universal Savings Account Act, H.R. 937, 115th Cong. (2017); Sarah O’Brien, *New GOP Plan Pushes Savings Accounts That Come with Tax Break*, CNBC (Jul. 25, 2018), <https://www.cnbc.com/2018/07/25/new-gop-plan-pushes-savings-accounts-that-come-with-tax-break.html> [https://perma.cc/NBR3-ACBR].

184. See *supra* Figure 4.

185. Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, 115 Stat. 38 (codified as amended in scattered sections of 26 U.S.C.).

186. Jobs and Growth Tax Reconciliation Act of 2003 (JGTRRA), Pub. L. No. 108-27, 117 Stat. 752 (codified as amended in scattered sections of 26 U.S.C.).

187. See *supra* Figure 4.

6.2% in 2009—a decline due to macroeconomic conditions under the recession, as there were no legislative changes to the payroll tax to consider. No surprise there. The payroll tax had commenced in 1935;¹⁸⁸ seventy-five years later, in 2010, it was still the only major American tax that had *never* been cut.

But in politics, as in economics and life, there is no free lunch. Bush's massive tax cuts had a price. Barack Obama was to come into office facing a serious economic downturn, the Great Recession, and a looming budgetary crisis—brought on in large part by the massive individual income tax cuts.

3. Obama's Fiscal Cliff Fix

By 2009, Obama's first year as President, the Big Three taxes were contributing, respectively, to 6.3%, 1.0%, and 6.2% of the GDP. The total of 13.5% was low due to both the tax cuts of Bush and the severe economic downturn, depressing the wages that form the base of both the payroll and wage/income taxes. The figures also revealed that the conservative post-War assault on the income tax was working: the payroll tax, which had not been the major American tax since 1940, and which had raised 18.5% as much as the individual income tax did in 1945, contributed over 98% as much as the individual income tax did in 2009, 6.1% of GDP compared to 6.2%. That in and of itself is a stunning story.

Faced with a Great Recession and tough economic times, Obama decided to cut taxes. But for the first time in history, it was the payroll tax that he cut. Obama enacted a "payroll tax holiday" of 2% in absolute terms, cutting the employee share of social security from 6.45% to 4.45%.¹⁸⁹ Payroll-tax revenues dipped, falling to 5.3% of GDP in 2011 and 2012, while individual income tax revenues recovered to 7.1% of GDP in each year.

The holiday did not last long. By the end of 2012, the Bush tax cuts, from both EGTRRA (which had been extended) and JGTRRA, were set to expire.¹⁹⁰ To resolve the "fiscal cliff crisis," Congress needed money. President Obama asked for \$1.6 trillion in additional revenues over the following decade.¹⁹¹ There was much wailing and gnashing of teeth as politicians and pundits debated fixes such as higher marginal tax rates on the upper income.¹⁹² In the end, Obama got his \$1.6 trillion, but only

188. See Laurence M. Vance, *The Curse of the Withholding Tax*, MISES INST. (Apr. 21, 2005), <https://mises.org/library/curse-withholding-tax> [<https://perma.cc/8DYU-WKW3>].

189. Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 601, 124 Stat. 3296, 3309–10 (codified as amended at I.R.C. § 1401 note (2018)). Had Obama cut only the individual income tax, its burdens would have fallen below the payroll tax's, giving the latter tax the gold medal it had last held in 1940 as America's largest single tax. See *supra* Figure 4.

190. See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act §§ 101–102, 124 Stat. at 3298–99 (codified as amended at I.R.C. § 1 note (2018)).

191. Janet Hook & Carol E. Lee, *Obama Sets Steep Tax Target*, WALL ST. J. (Nov. 14, 2012, 10:43 AM), <https://www.wsj.com/articles/SB10001424127887323551004578117152861144968> [<https://perma.cc/SLJ4-MLW6>].

192. See, e.g., *id.*

\$600 billion of it came from individual income tax reforms.¹⁹³ The rest, \$1 trillion—62.5% of the whole increase—came from the expiration of the payroll tax holiday. Like the individual income-tax cuts, the payroll-tax cut was set to expire. But *unlike* the individual income tax's cuts, the payroll-tax cuts were *allowed to expire*.¹⁹⁴ In the process, the death tax was further gutted.¹⁹⁵ As with his Democratic predecessor Bill Clinton, Obama's tax policies ended up being swept into the wave towards wage, and away from wealth, taxation.

C. The Big Three Taxes Under Reagan

Summing up Act II, consider the Big Three taxes in 1980, as Reagan was getting elected, and again in 1990, a decade later: a total of 16.6% of GDP in 1980 (8.7%, 2.3%, 5.6%) and a total of 15.9% in 1990 (7.9%, 1.6%, 6.4%). The individual income tax fell by 0.8% and the corporate income tax by 0.7% of GDP; the payroll tax, which Reagan increased, rose by 0.8%. In sum, the total fall in the individual income tax was offset nearly exactly by a rise in payroll taxes, with a pure fall in the corporate income tax added and a continuing evisceration of the death tax to boot.

Within the generally opaque walls of the individual income tax itself, a structural change was becoming more manifest. Wages were being isolated. The typical wage earner was stripped of her access to tax shelters and left with a largely inescapable wage tax, with few if any subtractions. The table was set for a continued attack on the deductions that were left, as America continues to approach a postcard return for the masses—paying taxes on their wages and on their wages alone.

V. ACT THREE: DONALD TRUMP AND THE TAX CUT AND JOBS ACT OF 2017

We continue the tale of the transformation of the income tax's base from wealth and wages, a true income tax, to wages alone, not an income tax. In Act I, we saw the income tax born primarily as a tax on wealth and the wealthy. It grew up and married onto a wage tax during World War II. Thereafter, even as wealth continued to boom (as shown in Figure 2), it increasingly escaped its tax-paying role. Act II saw a structural, analytic separation of wages from all other sources of income under a nominally comprehensive income tax. That laid the groundwork for Act III, where wealth and wage taxation will more fully divorce, so that any remaining wealth tax—the *ur-income tax*—can die in peace, via a thousand cuts, while the wage/income tax pays the bills.

A. A Third Act Twist

As the newly elected President Trump prepared to address tax reform, there was no doubt that cuts were coming. Trump was a Republican, after all, elected with a

193. See American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, §§ 101–102, 126 Stat. 2313, 2315–19 (2013) (codified as amended at I.R.C. §§ 1, 55, 68, 121, 2001 (2018)).

194. See Joseph Bishop-Henchman, *Why Your 2013 Paychecks Are 2 Percent Less*, TAX FOUND. (Jan. 9, 2013), <https://taxfoundation.org/why-your-2013-paychecks-are-2-percent-less/> [https://perma.cc/L9JL-L7X5].

195. See McCaffery, *supra* note 20, at 1236–37.

Republican Congress behind him. Like Presidents Ronald Reagan and George W. Bush before him, Trump was going to cut taxes. In fact, Trump so much wanted tax cuts that he asked for the ultimate bill to be called the “Cut Cut Cut Tax Act.”¹⁹⁶ There were only two questions.

The first question was by how much? The answer came quickly: \$1.5 trillion over a decade, even though few thought that the country could afford that much deficit financing during good economic times (most mainstream economists consider it prudent for the government to borrow or add to its deficit during harsh economic times but then to pay down that deficit during good ones.)¹⁹⁷ Congress passed legislation, using a simple majority in the Senate, allowing for Trump’s ultimate tax cuts to “cost” \$1.5 trillion over a ten-year period, meaning that the cuts would be debt financed. Once enacted, there was little doubt that the President and Congress would spend every last cent of their newfound allowance.

The next question was, for whom would the tax cuts toll? And here came a surprise that should not surprise you readers: the bulk of the tax revenue lost, some \$1 trillion in the initial House version of the TCJA, went to a corporate income tax cut. The initial bill would have slashed the top corporate rate from 35% to 20%; after much wailing and gnashing of teeth, the final number came in, reluctantly, at 21%.¹⁹⁸ Unlike the far more modest cuts to the individual income tax in the TCJA, these corporate tax cuts are “permanent.”¹⁹⁹

To be fair, a broad consensus of economists supported corporate income tax reform, as the nominal rates under the U.S. corporate tax had grown out of step with worldwide norms and with U.S. multinationals’ “effective” (or “actual”) tax rates.²⁰⁰ This latter was because, just like the individual income tax that Reagan confronted in the 1980s, the corporate income tax is riddled with loopholes, many involving international tax planning, which erode its base.²⁰¹ But most of the mainstream economists supporting lower rates expected the same tactic used generally in the TRA 86: that is, corporate income tax rates could come down as the base was built

196. See Thea Glassman, *Tweets About Trump’s Cut Cut Cut Tax Act Are Just Savage*, ELITE DAILY (Nov. 1, 2017), <https://www.elitedaily.com/p/tweets-about-trumps-cut-cut-cut-tax-act-are-just-savage-3205103> [<https://perma.cc/MB9W-VJQ3>].

197. See, e.g., Shawn Tully, *America’s Disastrous New Normal: A Booming Economy and Soaring Deficits*, FORTUNE (Jan. 5, 2019), <http://fortune.com/2019/01/05/us-economy-deficit-government/> [<https://perma.cc/4K78-45AC>].

198. Kyle Pomerleau, *The United States’ Corporate Income Tax Is Now More in Line with Those Levied by Other Major Nations*, TAX FOUND. (Feb. 12, 2018), <https://taxfoundation.org/us-corporate-income-tax-more-competitive/> [<https://perma.cc/ZN62-7FK3>].

199. TAX POLICY CTR., BRIEFING BOOK (2016) (ebook), https://www.taxpolicycenter.org/sites/default/files/briefing-book/bb_full_2018_1.pdf [<https://perma.cc/MG4V-V7AZ>] (“The Tax Cut and Jobs Act made significant changes to the corporate income tax and taxes on pass-through businesses. Unlike almost all personal tax provisions, which expire after 2025, most corporate tax provisions are permanent.”).

200. Walter Frick, *A Brief Guide to U.S. Corporate Tax Reform*, HARV. BUS. REV. (Sept. 7, 2017), <https://hbr.org/2017/09/a-brief-guide-to-u-s-corporate-tax-reform> [<https://perma.cc/8WS7-EFB5>].

201. See generally DEP’T OF THE TREASURY, THE PROBLEM OF CORPORATE TAX SHELTERS: DISCUSSION, ANALYSIS, AND LEGISLATIVE PROPOSALS (1999), <https://home.treasury.gov/system/files/131/Report-Corporate-Tax-Shelters-1999.pdf> [<https://perma.cc/5GXB-Y9F6>].

up and reinforced.²⁰² That did not turn out to be the TCJA approach. Instead, we got a pure, net cut to the corporate income tax, scored in the House version as costing \$1 trillion over a ten-year period. This represented two-thirds of the allocated pot of gold for tax cuts. In the House version, the remaining \$500 million was split, with \$300 million—in total, in the aggregate—going to the individual income tax, and the remaining 20% going to further cuts to the death tax.²⁰³ In sum, fully 80% of the TCJA's tax cuts were allocated to wealth taxes—the corporate income and gift and estate tax cuts—at a time when wealth was gaining and wages were losing in the real world. This is a near perfect inversion of Obama's payroll tax cut, which, of course, only went to wages in the first instance—and which has long since expired.

This might seem like a third-act twist in our ongoing discussion of the individual income tax's death and resurrection as a universal wage tax. But it reminds us that our story, the tax story, is really one big story: how the wealthy escape taxes that wage earners cannot. Viewed in this light, the priority of corporate income tax cuts in the TCJA is not surprising. These cuts fit perfectly into the wider story going back to 1950: the transformation of the U.S. tax system from one falling on wealth and wages to one falling mainly on wages. The corporate income tax began trending upward under Obama, approaching the 2% of GDP level that has become its Maginot Line (much as 8% seems to be the individual income tax's political danger level), as demonstrated by Figure 4. But the corporate income tax is a nonwage tax. Its steady fall is part of the script, not a sideshow. The TCJA got us back on script.

The TCJA's massive corporate income tax cut is also the answer to a puzzling question: How can tax cuts help billionaires who do not pay much, if any, income tax?

The wealthy in America, like Warren Buffett and Donald Trump, had long been paying little or no taxes, as an effective matter, largely because they did not have to show any "unrealized income" (or the proceeds of their debt) on their tax returns in the first place by playing Buy/Borrow/Die. How could these billionaire nontaxpayers get in on the tax-cutting party? Easy. It turns out that a primary effect of the TCJA's corporate income tax cut was a rise in *stock* market prices, because corporate costs—in this case, taxes—had been cut. Buffett's Berkshire Hathaway, to pick just one example, made \$29 billion on account of the TCJA; we do not have to worry about fact-checking the math because that figure came from Buffett himself.²⁰⁴ As the owner of over one-third of Berkshire's shares, the Trump tax cuts led to a \$10 billion

202. See, e.g., Chris Atkins, *Tax Reform and Revenue Neutrality: President's Panel Should Avoid the Redistribution of 1986*, TAX FOUND. (July 13, 2005), <https://taxfoundation.org/tax-reform-and-revenue-neutrality-presidents-panel-should-avoid-redistribution-1986/> [https://perma.cc/Y584-QYPT].

203. The People's Tax Page addressed this "tax cut pie" in videos, see People's Tax Page, *Tax Cut Pie: People's Tax Page Ep. 5*, YOUTUBE (Dec. 1, 2017), <https://www.youtube.com/watch?v=HrOPLbkn47M> [https://perma.cc/8HD9-HELH]; People's Tax Page, *Tax Cut Pie: Sabrina Live! (Special Holiday Episode)*, YOUTUBE (Nov. 28, 2017), <https://www.youtube.com/watch?v=a6ZcSwyEusw> [https://perma.cc/W5ZY-69HT].

204. Emily Stewart, *Warren Buffett's Berkshire Hathaway Made \$29 Billion Off the Republican Tax Cuts*, VOX (Feb. 24, 2018), <https://www.vox.com/policy-and-politics/2018/2/24/17048378/warren-buffett-berkshire-hathaway-tax-cuts> [https://perma.cc/P8N6-TBMD].

benefit for a man who pays about \$7 million in taxes every year. This means that Buffett benefitted enough, personally, from the corporate income tax cuts of the TCJA to allow him to pay all of his individual income taxes for well over a century—not that he would *ever* have to pay taxes on the \$10 billion windfall from the TCJA.²⁰⁵

B. Back to the Tale of Two “Income” Taxes

1. The Wage/Income Tax Slouches Towards a Postcard

The TCJA did not allocate much of the tax-cut pie to individual income taxpayers: just some 20% of the whole, \$300 billion over a ten-year period, to be divided among some 120 million tax-paying households. What did the TCJA do with this relatively meager amount of tax cuts on the individual income tax side? There were some modest rate reductions set to expire after the 2024 elections.²⁰⁶ But by far the biggest theme of the TCJA on the individual side was to simplify the tax by moving it closer to a wage tax. The Reagan years left the script, annotated by Norquist: continue to chip away both at any additions to wages, in the form of the taxation of wealth, and at any subtractions from wages, in the form of lingering personal deductions. TCJA followed the script to a T.

The TCJA doubled the standard deduction for all taxpayers, individuals and married.²⁰⁷ This got many taxpayers off the tax rolls altogether and moved even more people to choose the simple standard deduction in lieu of filling out additional forms and taking itemized deductions: after the TCJA, only 10% of individual income tax filers are expected to itemize.²⁰⁸ Personal exemptions were eliminated,²⁰⁹ largely offsetting the increased standard deduction (and hurting larger families). Personal deductions were limited, furthering the push towards the simpler standard-deduction returns, which will make up 90% of all. After much politicking and discussion over even more radical changers, the TCJA settled on limiting annual state and local tax deductions to \$10,000 per household maximum,²¹⁰ and on further cutting back the personal mortgage interest deductions by limiting the principal amount of the mortgage to \$750,000.²¹¹ There were many more changes along these lines, such as getting rid of smaller deductions and further weakening the alternative minimum tax (long one of Norquist’s pet peeves, and his step 5).

The TCJA did not get us to a “postcard” tax return, and we may never quite get there, in part for reasons discussed briefly below. But it got us close, even as scholars

205. Buffett has pledged to give his Berkshire Hathaway shares away to the Gates Foundation on his death. Thus, he faces no estate tax. He can borrow away and spend against his \$10 billion windfall as much as he likes to avoid income taxes.

206. See Amir El-Sibaie, *A Look Ahead at Expiring Tax Provisions*, TAX FOUND. (Jan. 18, 2018), <https://taxfoundation.org/look-ahead-expiring-tax-provisions/> [https://perma.cc/7PZ2-CL98].

207. See Tax Cuts and Jobs Act of 2017 (TCJA), Pub. L. No. 115-97, § 11021(a), 131 Stat. 2054, 2072–73 (codified as amended at I.R.C. § 63 (2018)).

208. See *supra* text accompanying note 14.

209. I.R.C. § 151(d)(5) (2018).

210. I.R.C. § 164 (2018).

211. I.R.C. § 163(h) (2018).

have been exploring other means of getting most Americans out of the need to fill out most tax forms, such as Michael Graetz (through comprehensive tax reform and a value-added tax (VAT) for the masses)²¹² and Joseph Bankman (through government-prepared forms).²¹³ But hope springs eternal, and House Republicans were clearly *hoping* for a postcard size return for the many to emerge out of the TCJA. They even produced a version, which I have set forth as Figure 12.

Figure 12: Proposed “Postcard” Return, House Republicans, 2017²¹⁴

SIMPLE, FAIR “POSTCARD” TAX FILING		
1	Wage and compensation income	1
2	Add 1/2 of investment income	2
3	Subtract contributions to specified savings plans	3
4	Subtract standard deduction OR	4
5	Subtract mortgage interest deduction	5
6	Subtract charitable contribution deduction	6
7	Taxable income	7
8	Preliminary tax (from tax table)	8
9	Subtract child credit	9
10	Subtract earned income credit	10
11	Subtract higher education credit	11
12	Total tax	12
13	Subtract taxes withheld	13
14	Refund due / taxes owed	14

Although the final TCJA did not fully reflect this postcard return—in large part because of the difficulties in the battles over personal deductions—and thus, no one can use it (yet), we can learn much by considering it. It shows us the future—the direction toward which this all is heading. As we proceed line by line, keep in mind the end: a tax that falls on wages with no additions or subtractions. We are almost there.

Line 1 of Figure 12 is “wage and compensation income.” This will be reflected on W-2s for the overwhelming majority of American workers. All that is left is to add and subtract from these wages.

There is one line of addition, Line 2, for “½ of investment income.” The one-half reflects the favorable capital-gains rate break for income from wealth or savings. (Note, by the way, that not only are these items of income taxed at favorable rates under the income tax; they are also not taxed at all under the payroll tax.) This line,

212. See MICHAEL J. GRAETZ, 100 MILLION UNNECESSARY RETURNS: A SIMPLER, FAIR, AND COMPETITIVE TAX PLAN FOR THE UNITED STATES (2008).

213. See Joseph Bankman & Dennis Ventry, *The Case for Easy, Free Tax Filing*, FORBES (Apr. 9, 2013), <https://www.forbes.com/sites/janetnovack/2013/04/09/the-case-for-easy-free-tax-filing/#5628feac2bd2> [https://perma.cc/5UQ4-5AVA].

214. TAX REFORM TASK FORCE, A BETTER WAY: OUR VISION FOR A CONFIDENT AMERICA 18 (2016), <http://templatelab.com/a-better-way-tax-policy-paper/> [https://perma.cc/4QYT-MLF2].

however, is on deathwatch. Most Americans do not have much investment income to begin with—the wealthy can hide their investment income as “unrealized appreciation;” and the entire line will go away completely if and when Norquist’s dream obtains, and we either reduce the tax rate on all investment income to zero or allow universal Roth-style savings accounts, as is being proposed.

This brings us to Line 3 and to the start of “subtractions” from wages: “subtract contributions to specified savings plans.” This is another nod towards savings and wealth. But this line, as Norquist himself generally seems to assume, countenances savings plans along the traditional IRA or postpaid model—deduction now, inclusion later. If and when we move fully to Roth-style treatment—if and when the income tax gets fully “Rothified”—both Lines 2 and 3 would become irrelevant. There would be no investment gains to tax. Ever.

Still tracking the postcard, we arrive at a fork in the road. The taxpayer either subtracts the standard deduction (Line 4) or her “itemized” ones. In this House version of the postcard, which proved to be only aspirational for now, the potential itemized deductions have been reduced to two: mortgage interest (Line 5) and charitable contributions (Line 6). If those two deductions die—and both have been proposed to be repealed²¹⁵—and universal Roth-style savings accounts come about, then our postcard would go straight from wages and compensation (Line 1), minus a standard deduction (Line 4), to taxable income (Line 7).

Once the tax is calculated, by computer or simple table, from taxable income, all that is left is to subtract the tax “credits” and then see what is owed. This postcard retains three credits, the “child credit” (Line 9), the “earned income credit,” which is the principal form of workfare, or aid to the working poor, in America (Line 10) and the “higher education credit” (Line 11). Eliminate these three credits—as plenty of conservatives would love to do²¹⁶—and our “postcard” return would look as follows:

(Wages - Standard Deduction) x Tax Rate

That is a very simple tax. It has the same base as the payroll tax, except for the “standard deduction,” a matter easily handled by computers and software. And this “standard deduction” simply creates a zero bracket under the individual income tax that is taken away by the payroll tax, as we shall see clearly enough when we get to the full-on universal wage tax. We are almost there.

Will we ever literally see a postcard return or go formless altogether? To the major social, political, and economic themes of this Article, it does not much matter: I am attempting to center the political analysis of tax policy on reality, substance not forms. Politicians may well choose to keep a short form to continue an appearance, fostered by FDR during the massive tax expansion of World War II, that we are all in this together. Or politicians might want their credits salient (such as \$400 for

215. See Ed Dolan, *Is the Charitable Deduction Worth Keeping?*, NISKANEN CTR. (Apr. 17, 2017), <https://niskanencenter.org/blog/charitable-deduction/> [<https://perma.cc/5KVV-R2H3>].

216. See, e.g., Kelly Phillips Erb, *The Credit We Love to Hate: The Earned Income Tax Credit (EITC)*, FORBES (Feb. 1, 2012), <https://www.forbes.com/sites/kellyphillipserb/2012/02/01/the-credit-we-love-to-hate-the-earned-income-tax-credit-eitc/#2cece4bf35f6> [<https://perma.cc/CV4V-ZVNL>].

“making work pay”²¹⁷ or \$1000 for a child or two²¹⁸) to make voters like them. But reality will continue to bite. And this reality, for all Americans, is that wages are taxed heavily with virtually no options to escape or reduce the taxes, and wealth is not.

2. The Ur-Income Tax: Lingering Complexity, for Reasons

Not everyone will have it so lucky, if luck is the right term, in being able to fill out a postcard return or not even bothering with a return at all. Under the TCJA, some ten percent of individual income taxpayers, five percent of Americans, will still be itemizers. Much of this is a matter of time, as the assault on personal deductions continues in its step-by-step, death by a thousand cuts fashion. We can easily predict, at this point, continued attacks on mortgage interest, charitable contribution, and state and local tax deductions. But even if Congress eliminated all itemized deductions, some taxpayers would still face complexities requiring longer forms and more complex taxes.

Conceptually, the reason that these taxpayers need more forms is that they have wealth as well as wages, or at least (in the case of the “carried interest” crowd) they are attempting to make their wages look like wealth.²¹⁹ The postcard return will apply to those whose only source of taxable income is wages and (once Norquist and Congressional Republicans get their way and we have universal, Roth-style, savings accounts) even to those with wages and some investment returns. These taxpayers will only have to pay what I have been calling the wage/income tax. What I am calling the ur-income tax is what will face the minority—a minority we can expect to be shrinking over time as exemptions for returns to wealth rise, just as the range of the death tax has been constricted to the top 0.2% of Americans by wealth levels. For this minority, with some aspects of wealth in the picture, complexity endures. As with the death tax or corporate income tax, politicians might want this state of affairs: an income tax on death watch, applying to few, raising little, but preserving both the appearance of taxing wealth and the opportunity to extract sums from the wealthy attempting to avoid what taxes remain on them.

The taxpayers who will not be able to fill out the postcard return, or go formless altogether, fall into two categories, which often overlap. In one category, there are those whose wages can look like wealth or be mixed up with wealth (the “labor and capital combined” category in *Eisner v. Macomber*).²²⁰ These include the many self-owned businesses, small proprietorships, and other forms of entrepreneurs. In the second group are those with wealth, not (or not just) wages—that is, those wealthy who show some income that is still subject to whatever remains of the ur-income tax.

217. *The Making Work Pay Tax Credit*, IRS, <https://www.irs.gov/newsroom/the-making-work-pay-tax-credit> [<https://perma.cc/QF5P-V7GK>] (last updated June 21, 2019).

218. Gil Charney, *The New Child Tax Credit*, H&R BLOCK (Oct. 3, 2019), <https://www.hrblock.com/tax-center/irs/tax-reform/new-child-tax-credit/> [<https://perma.cc/4RQ5-PLFP>].

219. See TAX POLICY CTR., *supra* note 199 (stating that carried interest, or “income flowing to the general partner of a private investment fund, often is treated as capital gains for the purposes of taxation,” but noting that many commentators view this as an unfair advantage because the income resembles ordinary wages).

220. 252 U.S. 189 (1920); see also text accompanying *supra* notes 60, 79–81.

Until and unless all capital gains are repealed, these taxpayers will still have to track their income-tax bases, report gains or losses from sale, and/or plan on some “nonrecognition” transaction (such as the like-kind exchange provision of I.R.C. § 1031).²²¹ Of course, this latter category of taxpayers—the billionaires and dynasty trust-fund babies living off wealth alone—still have the old standby, “Buy/Borrow/Die,” to keep things from getting too serious. There may still be planners and politicians to pay, but tax burdens should remain light. After all, nothing has changed under FDR, Reagan, Clinton, Obama, Trump, or anyone else to take away Buy/Borrow/Die.

The TCJA weighed in in the first category, mixed wealth and wages. Enter the “qualified business income” (QBI) provision, perhaps the most complex feature of the TCJA, codified as the new I.R.C. § 199A.²²² QBI has parallels to TRA 86’s “passive activity loss rules”—a complex set of provisions meant to get at a structural issue in tax reform. In 1986, the concern had been with isolating wages from the benefits of wealth—making sure that there were not any deductions to subtract from (or “shelter”) the wage tax base. The concern in 2017 was to protect wealth, or capital, from getting swept into higher-wage tax rates. A small taste of theory helps set the stage.

Much of American business occurs through major corporations, called C corporations because they are taxed under the corporate income tax, located in Subchapter C of the Internal Revenue Code. As noted above, this tax is a nonwage tax because it falls on corporate income after deducting corporate wages paid.²²³ Once this net corporate income is taxed, shareholders, as owners of the corporation, face a problem—how to get cash out of the corporation and into their personal pockets. Corporations will often dividend out some or all of the corporate profits. But then the shareholder must pay a second tax on the dividends received. (This is why Berkshire Hathaway and many other companies, such as Amazon, reinvest their profits,²²⁴ helping shareholders without triggering a dividend-level tax). Even if this second shareholder-level tax on dividends is modest (15% or 20% compared to 35% or 39.6% on wages), the combination of a corporate tax rate of 35% and a shareholder-level tax of any magnitude deterred smaller businesses from becoming C corporations. Instead, many American businesses formed themselves as “pass-through” entities: partnerships, limited liability companies, S corporations, sole proprietorships, and so forth. These types of firms do not pay taxes themselves, but instead “pass through” their tax benefits and burdens to their individual owners, who reflect them on their personal, individual income tax returns.²²⁵ That is all complex, and not susceptible to a simple postcard return.

As TCJA was being discussed, the principal focus was on cutting the corporate income tax rate, which was eventually reduced from 35% to 21%, a massive

221. I.R.C. § 1031 (2018).

222. I.R.C. § 199A (2018).

223. See *supra* text accompanying note 81.

224. See, e.g., Bob Ciura, *Will Amazon Ever Pay a Dividend?*, SURE DIVIDEND, <https://www.suredividend.com/amazon-dividend/> [https://perma.cc/HRC4-C6H5] (last updated Jan. 23, 2020).

225. See TAX POLICY CTR., *supra* note 199.

decline.²²⁶ The individual income tax-rate cuts were far more modest, and many individuals would even see their taxes go up, depending on where they lived and other variables.²²⁷ At this point, however, the owners of pass-through businesses squawked: Why should businesses in C corporation form have their taxes cut when the profits of smaller businesses are still being taxed under the individual income tax rate structure, which was barely, if at all, cut?²²⁸ This turned out to be a compelling logical and political argument, and Trump and the Congress set about to help pass-through business owners.

In doing so, however, the politicians faced a technical problem. For many on the pass-through side, business profits and wages to the owner-operators were not being separately laid out. Suppose our old friend Ant went into business, selling lemonade. To pay her taxes, she would first calculate her “income” as all monies she received minus her costs for building the stand, renting some space, and purchasing supplies (lemons, sugar, etc.). She would not, necessarily, look at her net profit as having both a labor and a capital component—that is, she would not make a point of paying herself wages and then seeing the business’s profit or loss after her own pay. There would be no need to do that, as she would pay tax on the business’ profit from both labor and capital at her personal income tax rate.

Hence “QBI.” The concept of qualified business income is to give owners of pass-through entities a break—a lower tax rate—on their return to *wealth*, while protecting the inescapability of any tax on *wages*. This is not the place to go into all of the details about how the QBI provision works, and those details are still emerging and evolving—likely, as with the passive activity loss rules, this is an endeavor that will take some time to sort out and settle down. But the point, the *raison d’être*, of the QBI rules is to take out one’s own *wages* from pass-through profits and to give the residue—by definition the return to wealth not wages—a lower rate.

All this fits our basic story. Taxpayers whose income does not come primarily from third-party employers—who, in turn, withhold the taxes from employee paychecks and remit the monies to the federal government along with the taxpayer-worker’s social security number—will stay in the ur-income tax, with forms and complexity and potential audits. These will be Americans of wealth who buy and sell assets. The rules about basis, capital gains, and nonrecognition provisions (such as the “like-kind exchange rule” of I.R.C. § 1031) will endure but only affecting this minority (most Americans with some modest savings will be able to avoid this complexity through tax-favored savings accounts, perhaps Roth ones). There will also be Americans who run their own business or who mingle wealth and wages

226. Pomerleau, *supra* note 198.

227. Bill Bischoff, *Two Years After the Tax Cuts and Jobs Act—Who Are the Winners and the Losers?*, MARKETWATCH (Feb. 28, 2020, 11:38 AM), <https://www.marketwatch.com/story/two-years-after-the-tax-cuts-and-jobs-act-who-are-the-winners-and-the-losers-2020-02-11> [<https://perma.cc/9H88-WF5W>].

228. See, e.g., Patricia Cohen, *A Business Tax Fight Erupts Over the ‘Haves’ and ‘Have-Mores’*, N.Y. TIMES (Nov. 29, 2017), <https://www.nytimes.com/2017/11/29/business/business-tax-pass-throughs.html> [<https://perma.cc/497E-KWR3>]; Dylan Matthews, *“Pass-Through” Companies, the Issue That Could Make or Break the Senate Tax Bill, Explained*, VOX (Nov. 28, 2017), <https://www.vox.com/2017/11/28/16709634/pass-through-republican-tax-bill> [<https://perma.cc/VAF3-3795>].

somehow, such as the Wall Street financiers and their “carried interest.” Most Americans—some 95%—will be able to fill out a postcard return (or none at all) and will pay taxes on their wages, all of their wages, and only their wages. For the select few, there will still be complex returns, complex laws, and complex planning. But all of the resulting headaches will bring with them some elixir—lower or no tax burdens. There will be a price to be paid for the breaks—to professional tax advisors and to politicians and lobbyists—but not much given the ease with which the wealthy can avoid all taxes.

QBI gives us a good look into what is likely to continue happening with the ur-income tax. For those few Americans who must continue to pay individual income taxes but who do not qualify for the simpler postcard-style standard-deduction return, taxes will continue to be complex. QBI is complex, and many subjected to it will require professional tax assistance. TCJA also changed I.R.C. § 1031 to limit its benefits to real estate after politicians considered more radical changes (or even its repeal)²²⁹ and addressed the “carried interest” issue of concern to Wall Street financiers by requiring a three year holding period for capital-gains treatment for managers’ profit interests.²³⁰ Aside from their complexity, what do such provisions have in common? These are rules that only apply to the wealthy, and they typically point to some tax avoidance or minimization strategy.

There is a perfect parallel in the death tax. Recall that this tax, notwithstanding decades of weakening as chronicled by Graetz and Shapiro and others,²³¹ has not died. It persists, not raising much money but providing steady employment to financiers and ongoing opportunities for Congress to extract campaign contributions from the rich still subjected to it. As the universal wage tax arises as a hidden colossus to pay the bills, the lingering wealth taxes—the gift and estate, corporate income, and ur-income taxes—remain complex, porous, and frequently manipulated by politicians and their rich patrons alike.

C. The Fundamental Things Apply

Back to “Buy/Borrow/Die.” All of the elements of Buy/Borrow/Die were in place at the dawn of the modern income tax in 1913, or soon thereafter. It is plausible, even easy, to consider that *this* is the problem with the income tax—these are the Achilles’ heels that render any serious attempt to tax wealth and not wages doomed from the start. But that is not how things have gone down over the century plus. FDR did not change any of the three legal planks—the realization requirement, the nontaxation of debt, and the stepped-up basis for assets acquired on death—when he married the young wealth tax onto a wage one. Ronald Reagan did not change any of the three planks when he shored up the income tax as an effective wage tax by blocking the sheltering of wage income in TRA 86. And, to complete the trifecta, Donald Trump

229. See *Like-Kind Exchanges Now Limited to Real Property*, IRS (Nov. 19, 2019), <https://www.irs.gov/newsroom/like-kind-exchanges-now-limited-to-real-property> [<https://perma.cc/Y7AM-Z6FG>].

230. See generally Marie Sapirie, *Carrying On with Carried Interest*, TAX NOTES (Jun. 18, 2018), <https://www.taxnotes.com/featured-analysis/carrying-carried-interest/2018/06/15/284jn> [<https://perma.cc/Y95S-K8P4>].

231. See *supra* Section II.E.

did not change any of the three planks either—in fact, he sweetened the tax treatment of death by leaving the stepped-up basis in place for all in a world in which virtually no one pays the death tax.

Norquist and company are winning. The income tax's base is becoming a simple wage tax for the masses, while tax games endure for the wealthy few.

D. Coming Attractions: Seeing a Future of Tax

The script predicts the future, as America continues to move towards a universal wage tax, stumbling in Norquist's footsteps. The handwriting is already quite visible: we will end up where we have been heading for over a century, unless we awake and change the paradigms of taxation, soon.

1. In Theatres Soon! Tax Cuts 2.0

Even as the ink was drying on the TCJA, Tax Cuts 1.0, conservatives and Republicans, including President Trump, began touting Tax Cuts 2.0. Trump himself claimed it was “time to look to the individual side.”²³² What tax-cutting surprises might lurk there?

For conservative lawmakers who have been steering tax policy, three specific changes now loom on the horizon. Each furthers Norquist's quest and the dream of a universal wage tax. First, cut the capital-gains tax, which stayed at 20% under the TCJA—essentially, one-half of the universal wage tax rate. The Trump Administration even proposed effecting this result by executive action—a proposal to index the bases of assets held to reflect inflation.²³³ Second, adopt universal savings accounts along the Roth-style model—continuing the conservative assault on redistribution since Norquist set out the steps in writing and figured out that the best “one time” to tax income is as earned.²³⁴ Third, abolish the alternative minimum tax.²³⁵ It should, of course, not surprise us that all three steps harken back to Norquist's five easy pieces and help to move us towards the universal wage tax. In light of the obsessive quest for a “single tax,” which taxes income “just one time,”

232. Mike Calia, *Trump, in a Joking Manner, Suggests 'Phase 2' of Tax Cuts in Speech to GOP Lawmakers*, CNBC (Feb. 1, 2018), <https://www.cnbc.com/2018/02/01/trump-suggests-possible-phase-2-of-tax-cuts.html> [https://perma.cc/5ZSM-TURN].

233. Kelly Phillips Erb, *New Tax Break? Trump Administration Considers Indexing Capital Gains for Inflation*, FORBES (July 31, 2018), <https://www.forbes.com/sites/kellyphillips/2018/07/31/new-tax-break-trump-administration-considers-indexing-capital-tax-for-inflation/#383479325e1e> [https://perma.cc/PBN4-CZTP]. But see Bob Bryan, Gary Cohn: *The Trump Administration's \$100 Billion Tax Cut Idea Was 'Killed in 30 Seconds or Less'*, BUS. INSIDER (Aug. 6, 2018), <https://www.businessinsider.com/gary-cohn-on-trump-100-billion-capital-gains-tax-inflation-index-cut-2018-8> [https://perma.cc/G248-VDME].

234. Ted Godbout, *'Tax Reform 2.0' to Include Universal Savings Accounts*, NAT'L ASS'N PLAN ADVISORS (July 25, 2018), <https://www.napa-net.org/news/technical-competence/legislation/tax-reform-2-0-to-include-universal-savings-accounts/> [https://perma.cc/9CUU-NN96].

235. Adam Michel, *Tax Reform 2.0: Priorities After the Tax Cuts and Jobs Act of 2017*, HERITAGE FOUND. (Mar. 22, 2018), <https://www.heritage.org/taxes/report/tax-reform-20-priorities-after-the-tax-cuts-and-jobs-act-2017> [https://perma.cc/2GGN-6K7E].

many things begin to make sense. America is on a quest for a universal wage tax—that is, a quest to kill the income tax.

2. Return of the Spending Side: Starving the Beast

Even before Congressional Republicans had gotten around to daydreaming of Tax Cuts 2.0, they were indulging in another of their favorite dreams: entitlement “reform.”²³⁶ These are, of course, code words for cutting social security and Medicare benefits. It is easy to see why, going back to Figure 1, in which we see labor’s share of the national income falling. Social security and other transfer payments are helping workers adjust for the declining share of wages in the national income.²³⁷ But these payments, in a certain sense, come from the workers themselves: they are a “return” of the social security contributions of workers, baby boomers and otherwise, in their youth.

But there is a serious timing problem here. As noted above, social security payments are not set aside in any protected account for the particular worker who paid into them. Today’s retirees depend on today’s workers for their social security checks. But as older workers age and retire, and as new workers face stagnating wages and a diminishing share of the national income for their labor, continuing the payments to workers will become a challenge. Wage taxes, as we shall continue to explore, are burdensome and inescapable. What could the government do to raise more revenue without further raising payroll taxes? One answer, of course, would be to raise wealth taxes (the corporate income, gift and estate, or true income taxes) to balance the books, looking to the other factor of production to chip in. But that is not the road chosen by Norquist and pals.

The problems seem pressing. With an aging population that is living longer, there are fewer workers today to pay for workers past—to pay into the social security and Medicare systems. In 2014, there were 4.6 workers per retiree in America; by 2100, which is not all that far away, that ratio is expected to plummet to 1.9.²³⁸ The shrinking workforce is facing stagnant wage growth and—the point of this Article—is shouldering more and more of the burden of taxation even as it receives less and less of the benefits of the social economic pie. Faced with this math, and worried about any potential future assault on wealth (even a social request for capital to pay

236. See Tara Golshan, *Top Republicans Are Already Talking About Cutting Medicare and Social Security Next*, VOX (Dec. 20, 2017), <https://www.vox.com/policy-and-politics/2017/12/18/16741730/gop-agenda-medicare-social-security> [<https://perma.cc/5MNJ-2D6K>]; Jeff Stein, *Ryan Says Republicans to Target Welfare, Medicare, Medicaid Spending in 2018*, WASH. POST (Dec. 6, 2017), https://www.washingtonpost.com/news/wonk/wp/2017/12/01/gop-eyes-post-tax-cut-changes-to-welfare-medicare-and-social-security/?utm_term=.5523e74f19a0 [<https://perma.cc/CHU9-XYDQ>].

237. Scott A. Hodge, *60 Percent of Households Now Receive More in Transfer Income Than They Pay in Taxes*, TAX FOUND. (Oct. 4, 2012), <https://taxfoundation.org/60-percent-households-now-receive-more-transfer-income-they-pay-taxes/> [<https://perma.cc/AE7B-9L5D>].

238. Mark Fischetti, *Ratio of Workers to Retirees Will Plummet Worldwide*, SCI. AM. (Nov. 18, 2014), <https://blogs.scientificamerican.com/observations/ratio-of-workers-to-retirees-will-plummet-worldwide1/> [<https://perma.cc/Q9XD-B2QG>].

a more respectable share of the society's needs), conservatives continue to look to entitlement "reform" to balance the books.

Politics of the basest, most tribal sort lies at the root of much of this. Norquist and company have long sought to "starve the beast": to reduce the size of government by choking off its sources of revenue, getting government small enough to "drown it in the bathtub," in Norquist's characteristically evocative phrase.²³⁹ Killing the income tax and moving us towards a universal wage tax puts a political divide at work towards this end. Because we are taxing only workers, we pit all workers against all nonworkers—the poor, the retired, the elderly, and the sick—in practical, political public finance—while the rich can sit idly by, untaxed. We are seeing some of the results of this tension in our daily politics as I write.

3. The End (?)

The end of the days for the income tax is the culmination of Norquist's quest. For most, the income tax will have been transformed into a simple form, a postcard, or maybe no form at all. The base will be wages. Nothing need be added, for all savings will be tax free, and nothing need be subtracted, for all elective personal deductions will have died. The corporate income and gift and estate taxes will persist as annoying headaches for the wealthy few, and an *ur-income* tax will endure for the top 1%–5% or so of taxpayers, full of twists and turns, good and bad. Most of the government revenues come from the universal wage tax, a tax on salary split in two—the payroll and individual "income" taxes. This combined tax will be simple to pay, formless, exclusively drawn from wages, and inescapable. Wage-based benefits like social security and Medicare will be cut. Workers will continue to struggle with stagnating wages, disappearing jobs, and shrinking public benefits. The wealthy will be fine and tax-free.

VI. BACK TO THE FUTURE: THE MAGICAL MYSTERIES OF AMERICA'S UNIVERSAL WAGE TAX

While much Sturm und Drang was playing out over more than a century, steadily converting the income tax into a wage tax on the "base" side of the "base x rate" product, the work on the "rate" side was happening even more quietly. The payroll tax monotonically increased over its eighty-plus-year history, with the single exception of the two years of the payroll tax cut holiday under Obama.²⁴⁰ The individual income tax, in contrast, has seen massive cuts from its World War II peak of 94%, falling dramatically under Reagan and flattening out under George W. Bush.²⁴¹

Now we are ready for a big reveal. Our story in three acts was a tale about the income tax's base. We have now seen that for most Americans—and for most readers—the income tax's base is wages. There is not much to add and not much to

239. See, e.g., Donald Cohen, *Trump Wants to Drown Government in a Bathtub*, HUFFINGTON POST (Feb. 2, 2017), https://www.huffpost.com/entry/trump-wants-to-drown-gove_b_14577752 [<https://perma.cc/72ZM-6G6W>].

240. See *supra* Figure 7.

241. See *supra* Figure 8.

subtract. One day sooner rather than later, there may be nothing to add, nothing to subtract, and no form to complete. In this world, the overwhelming majority of Americans, some 95% or more, will face taxes on their wages and only on their wages under two different taxes: the payroll tax and the wage/income tax. What is the marginal tax rate schedule facing their labor efforts?

As an aside, I note that I have used many figures and tables along the way, generally drawn from easily found public materials—pictures help stretch limited word counts. But I could not find a single, combined chart showing marginal tax rates under both the income and payroll taxes.²⁴² So I had to create one, which turned out to be highly illuminating.

I began by constructing Table 2, below. This shows the tax rates for a single person who earns only wages and takes the standard deduction—a rather typical American. The chart ignores the Earned Income Tax Credit (EITC), which does not apply because our single taxpayer has no children.²⁴³ Factoring in the EITC would add some progressivity at the very bottom of the income scale but would offset this with some regressivity in the lower-middle-income “payback” range, and I simply ignore it here.²⁴⁴ Producing a table and figures for married persons would not significantly change the picture.

Table 2: Combined Income and Payroll Tax Rates, Single Earner, 2018²⁴⁵

Wages	Income Tax Rate	Payroll Tax Rate	Combined Tax Rate
\$0–12,000	0	15.3	15.3
\$12,000–21,525	10	15.3	25.3
\$21,525–50,700	12	15.3	27.3
\$50,700–94,500	22	15.3	37.3
\$94,500–128,400	24	15.3	39.3
\$128,400–169,500	24	2.9	26.9
\$169,500–200,000	32	2.9	34.9
\$200,000–212,000	32	3.8	35.7
\$212,000–512,000	35	3.8	38.7
\$512,000 and up	37	3.8	40.7

242. After a draft of this Article first appeared, a CBO study was published that shows the combined average tax rates, at any moment in time, but not the range across incomes in any given year. CONG. BUDGET OFF., MARGINAL FEDERAL TAX RATES ON LABOR INCOME: 1962 TO 2028 (2019), <https://www.cbo.gov/publication/54911> [<https://perma.cc/XMX4-SJ96>].

243. See I.R.C. § 32 (2018).

244. The EITC, as a credit rather than a deduction, gives low-income taxpayers an annual stipend of up to \$6431 if they have three or more children; this declines proportionally to a single taxpayer’s income starting at \$18,660 and is fully phased out when the taxpayer earns \$49,194. See TAX POLICY CTR., *supra* note 199, at 159–63.

245. DEP’T OF THE TREASURY, INTERNAL REVENUE SERV., PUB. 15, (CIRCULAR E), EMPLOYER’S TAX GUIDE (2019), <https://www.irs.gov/pub/irs-pdf/p15.pdf> [<https://perma.cc/4HTU-AVQU>].

Figures 13 and 14 present this Table in graphical form. Both are remarkable. First, Figure 13 shows the payroll and income tax rates. What is striking is that the payroll tax, the mainly lower line in Figure 14, provides 70% as much total revenue as the individual income tax, the mainly top line, even though the payroll tax rate is barely ever above the income tax rate in the Figure. There are once again optical illusions at work.

I scaled the x-axis in the Figure up to \$600,000, because the highest marginal rate bracket for single taxpayers kicks in at \$512,000, and I wanted to reflect the full range in which there is marginal rate variation (the top rate continues into infinity). The social security tax (or 12.4%) drops off at \$128,400 of wages in 2018; at \$200,000 of income for an individual, a Medicare surcharge of 0.9% applies. Across the range in which income tax rates are still varying, the payroll tax looks small. But few Americans earn more than \$128,400 (Warren Buffett does not, from Berkshire Hathaway anyway). Because the payroll tax starts in at 15.3% on the *first* dollar of wages, it takes a while for the income tax, which begins with a zero bracket (created by the standard deduction) and works its way through 10% and 12% brackets, to get to an *average* of 15.3%. Our taxpayer would have to earn more than \$94,500 in wages—she would have to get into the 24% marginal income tax rate bracket—before her income tax burden would exceed her payroll tax one. That is more than twice the median salary of a working American today²⁴⁶—explaining why the payroll tax is the major tax for most workers.

246. Alison Doyle, *Average Salary Information for US workers*, THE BALANCE, <https://www.thebalancecareers.com/average-salary-information-for-us-workers-2060808> [<https://perma.cc/4A82-94XG>] (last updated Feb 29, 2020).

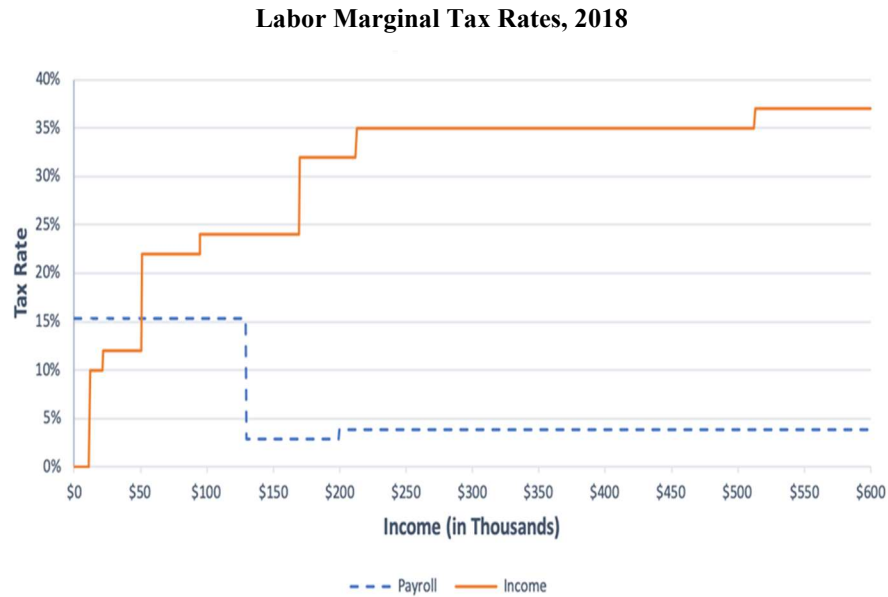
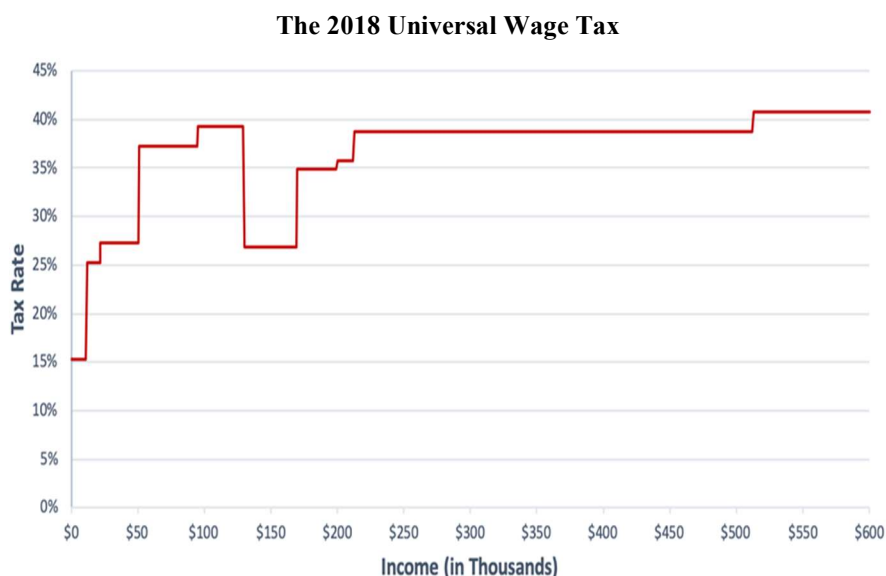
Figure 13: Income and Payroll Tax Marginal Rates, 2018²⁴⁷

Figure 13 is surprising because it appears that the individual income tax is the major tax for high incomes (which as we know by now is not the wealthy but rather the high-wage income). But Figure 14 is the real showstopper. It clearly reveals that when we combine the payroll and income taxes—when we look at the combined tax rate on wages for most Americans—things are surprisingly, even shockingly, flat. Our hypothetical taxpayer starts in at the 15.3% payroll tax rate, of course: there is no “zero bracket” under the universal wage tax. By the time she has earned \$12,000 out of the individual income tax’s standard deduction, she finds herself in a 25.3% rate bracket, which balloons to 37.3% at \$50,700—just about median household income. The rate continues to go up, hitting 39.3% for the range \$94,500 to \$128,400. That is a rate level she will not hit again until she is fortunate enough to earn more than \$500,000 in wages (which few do, of course). Aside from a brief and modest respite, from \$128,400 to \$169,500, after the social security payroll tax portion has dropped out, our taxpayer stays at or above a 34.9% rate once she hits \$50,000. Indeed, to a first approximation, this is a flat 35% wage tax after \$50,000 of wages, with a couple of steps—15% and 25%, roughly—on the way.

Figure 13 shows that as Norquist and company have been fairly quiet, working over decades to transform the *base* of the income tax into a wage tax; the *rate* work has been happening in tandem, significantly pushed along by the Reagan and Bush tax cuts. Americans have a flattened rate and are getting close to a flat wage tax for the masses. The wealthy, as they typically do, stay off the page.

247. DEP’T OF THE TREASURY, INTERNAL REVENUE SERV., *supra* note 245.

Figure 14: Universal Wage Tax Rates 2018²⁴⁸

VII. POST MORTEMES AND PATHS FORWARD

In 1913, with whispers of progressive politics in the air, Americans ratified a constitutional amendment allowing for a tax on all “incomes, from whatever source derived.”²⁴⁹ This set the stage for the individual income tax, a tax meant to fall on wealth and the wealthy. It was a small step, but it was a step. Capital and labor, wealth and wages, would each be paying the price of civilization. The corporate income and gift and estate taxes soon formed a troika of wealth taxes, though the individual income tax fell on upper-income wages as well.

Things changed. Over a century later, the “income” tax has slowly, steadily morphed into a wage tax for the masses—a simple tax on wages, withheld from paychecks, with little or nothing to add or subtract, heading towards a postcard or formlessness. As this script, set forth by Grover Norquist and like-minded conservatives, has played out, all taxes on wealth have been falling. The corporate income tax, once a major player in federal revenues, has been slashed yet again by President Trump. The death tax is almost dead, again nearly killed for good by Trump, persisting as cover for political games affecting the wealthy. And while an ur-income tax remains, ostensibly to collect some revenue from wealth not wages, its commitment to truly taxing wealth remains as porous as ever—none of the original income tax’s Achilles’ heels, Buy/Borrow/Die, have been addressed. Meantime, the payroll tax has continued its steady growth, the small exceptional hiccup of President Obama’s payroll tax holiday only proving the rule of America’s inexorable march towards wage taxation.

248. *Id.*

249. U.S. CONST. amend. XVI.

All of this matters. In the world, as Piketty's work and our own eyes can show us, wealth is winning, and wages are losing. Yet wealth is using its power to avoid paying for itself. This is a world of oligarchy, where capital has bought politicians who keep their tax burdens low for the price of campaign contributions and other support. Almost all of the burdens of taxation fall on wages, at a time when wages are barely treading water. Taxes on wages are easily collected, easily raised, and easily hidden. The brutal math of an advanced capitalist economy is that small taxes on a wide base of the masses' combined paychecks can cover up for massive giveaways to the comparatively small number of wealthy people. A two percent increase in the payroll tax can pay for repeal of the death tax, for example, with hundreds of billions to spare. Warren Buffett can gain \$10 billion from a tax cut that brings mere dollars, at best, to the many.

History and common sense, let alone empathy, supply reasons to believe that this situation cannot endure. A shrinking labor base cannot perpetually bear an increasing tax burden and see the benefits particular to their life situations slashed, while a growing class of the wealthy need not work or pay taxes. None of this bodes well for the future.

It is not too late. There is hope, as there must be. We *can* change tax—analytic possibilities for extracting a meaningful share of tax from the wealthy exist. The recent proposals from AOC, to raise the top marginal tax rates under the income tax, Senator Warren, to add a stand-alone wealth tax to the existing mix of taxes, and Vice President Biden, to repeal the “angel of death” rule of IRC Section 1014, are promising beginnings. But all of these ideas suffer from a certain allegiance to the status quo; each operates within the existing paradigm of nominally attempting to tax “income” and “wealth”—wealth transfers, in the case of the status quo, wealth itself, in the case of Senator Warren's proposal. AOC's idea would only increase rates under the existing income tax, which is not an income tax at all as we have seen, and so it, alone, would not address the central problem of taxing wealth.²⁵⁰ Warren's proposal applies only to those with wealth over \$50 million, and will be complicated to design, enact, and enforce. Biden's idea is an incremental change to the income tax, long overdue, but showing no signs of happening any time soon. Still, these are important ideas, bursting forth from a veritable desert of progressive tax alternatives in the public political discussion.

My preferred alternative involves a paradigm shift, to a progressive *spending* tax, which would tax people on what they spend, whether financed by wages or wealth, and at progressive rates.²⁵¹ The high marginal rates would not fall on wages alone, because workers could choose to save.²⁵² A separate stand-alone tax on wealth would not be needed, because wealth would be taxed as the wealthy spend. A progressive spending tax is a practical, well supported idea that I have explored at great length

250. See Edward J. McCaffery, *On Taxes, Ocasio-Cortez Has the Right Impulse but the Wrong Remedy*, CNN (Jan. 7, 2019), <https://www.cnn.com/2019/01/07/opinions/ocasio-cortez-tax-plan-right-impulse-wrong-remedy-mccaffery/index.html> [https://perma.cc/YW7K-RME5].

251. See generally McCaffery, FAIR NOT FLAT, *supra* note 123; McCaffery, *supra* note 10.

252. Edward J. McCaffery & James R. Hines, Jr., *The Last Best Hope for Progressivity in Tax*, 83 S. CAL. L. REV. 1031, 1031 (2010).

elsewhere: word counts press at the moment. The aim of this Article has not been to support a specific change; rather, its end has been to convince as many readers as possible of the need for *some* change. America needs a vigorous and serious debate about any and all means of taxing wealth seriously, and the clock for effective action is ticking.

It is time, past time, to change. The new ideas of AOC, Senator Warren, Vice President Biden, and others show promise for better days ahead. But there are miles to go before we get there—before we have real, effective taxation of the wealthy. We must be persistent on the path to economic justice. Studying and noticing the broad trends in tax policy in the United States, to see that wealth is winning by escaping taxes while wages are losing by shouldering them, is no more or less than the basic advice to all who would observe and comment on life in America today: follow the money. However long it takes, that journey usually leads to some important answers, if only after deepening a sense of despair.