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TAXING INEQUALITY

Ari Glogower*

Economic inequality in the United States is now approaching historic levels last seen in the years leading up to the Great Depression. Scholars have long argued that the federal income tax alone cannot curtail rising inequality and that we should look beyond the income tax to a wealth tax. Taxing wealth also faces two central and resilient objections in the literature: A wealth tax penalizes savings and overlaps with a tax on capital income.

This Article moves beyond this stalemate to redefine the role of wealth in a progressive tax system. The Article first introduces a generalized framework for justifying a wealth tax centered in the relative economic power theory which explains how inequality of economic outcomes generates social and political harm. This theory formalizes the problem of inequality and has specific implications for how economic inequality should be measured and constrained.

The Article then describes design problems in coordinating taxes on labor income, capital income, and wealth as factors in inequality, and the limitations of each of these factors as a base for taxation. From this Article’s outcomes-based perspective, a capital income tax favors wealth holders relative to labor-income earners. A wealth tax, in contrast, disfavors wealth holders relative to labor-income earners and cannot account for taxpayers’ varying needs to save their wealth for different

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numbers of future periods. Finally, proposals in the literature for separate taxes on both income and wealth do not account for the relationship between the two as factors in economic well-being.

Finally, the Article introduces a redefined wealth tax as part of a new combined tax on both income and wealth. This approach first recharacterizes wealth and capital income as an annuity value (the “wealth annuity”), reflecting both capital income earned during the period and a portion of the taxpayer’s wealth principal. The wealth annuity is then added to the taxpayer’s labor income for the period to yield the combined base. This new tax base resolves the coordination problems with taxing labor income, capital income, and wealth as factors in economic inequality; accounts for the needs of savers; and tailors the tax base to the specific ways that inequality causes social and political harm.

I NTRODUCTION .................................................. 1423

I. W HY T AX W EALTH? ........................................... 1433
   A. D efining “Income” and “Wealth” ..................... 1433
      1. Income .............................................. 1434
      2. Wealth .............................................. 1436
   B. T he Penalty to Savers ................................. 1437
   C. J ustifications in the Literature ....................... 1439
      1. Actual Ability to Pay .................................. 1439
      2. The Benefits and Harms of Wealth ................. 1441
      3. Welfarism and Optimal Taxation ................. 1443
      4. Equality of Opportunity ............................. 1444
   D. T he Relative Economic Power Theory ............... 1445
      1. Described ............................................. 1445
      2. Implications ......................................... 1447
      3. Intersection with Prior Justifications ............ 1450

II. T AXING I NCOME AND W EALTH ..................... 1452
   A. T axing Income or W ealth ............................ 1453
      1. Taxing Income ........................................ 1453
      2. Taxing Wealth ....................................... 1454
      3. Taxing Wealth by Taxing Capital Income ......... 1458
   B. T he Problem with Multiple Bases ................... 1460
   C. T axing Both Income and Wealth ..................... 1464

III. A COMBINED B ASE OF I NCOME AND W EALTH ...... 1467
   A. T he Wealth Annuity ................................... 1468
   B. T he Combined Base ................................... 1472
   C. R eal-World Considerations .......................... 1476
      1. Observing and Measuring Income and Wealth .... 1477
      2. Nonperiodic Labor Income ........................... 1478
      3. Characterizing Capital Income ..................... 1480
      4. Uncertain Life Expectancy ........................... 1481
      5. Exemptions ......................................... 1482
   D. C ompared with Other Tax Bases ..................... 1483
INTRODUCTION

In December 2017, Congress passed a tax bill, sometimes called the Tax Cuts & Jobs Act,\(^1\) that will deprive the government of needed revenue\(^2\) and primarily benefit the wealthiest taxpayers.\(^3\) The bill lowered the top tax rates on individuals and corporations,\(^4\) created new preferences for certain forms of income,\(^5\) and invited new opportunities for taxpayers to reduce or eliminate their taxes through strategic planning.\(^6\) These changes are almost certain to accelerate economic inequality, which is already reaching historic levels last seen in the years leading up to the Great Depression.\(^7\) Excessive inequality sub-

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1. An Estate or Inheritance Tax ....................... 1483
2. A Consumption Tax ................................. 1484
E. Final Reflections on Personal Choice and Economic Growth ............................................. 1485
CONCLUSION ................................................... 1488

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\(^2\) The bipartisan Joint Committee on Taxation estimates that the new bill will increase federal deficits by more than $1 trillion over the next decade. See STAFF OF JOINT COMM. ON TAXATION, 115th CONG., MACROECONOMIC ANALYSIS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE “TAX CUTS AND JOBS ACT” 9 tbl.1 (Comm. Print 2017). For a discussion of pressing federal revenue needs, see infra notes 79–81 and accompanying text.

\(^3\) For 2018, taxpayers in the top 1% of the income distribution are estimated to receive an average benefit from the changes that is more than 800 times greater than the benefit to taxpayers in the bottom 20%. See TAX POLICY CTR., DISTRIBUTIONAL ANALYSIS OF THE CONFERENCE AGREEMENT FOR THE TAX CUTS AND JOBS ACT 3 (2017), https://www.taxpolicycenter.org/sites/default/files/publication/150816/2001641_distributional_analysis_of_the_conference_agreement_for_the_tax_cuts_and_jobs_act_0.pdf (estimating that in 2018, taxpayers in the bottom income quintile will receive an average income tax cut of $60, while taxpayers in the top 1% will receive an average benefit of $51,500).

\(^4\) The top statutory rate on ordinary individual income is reduced from 39.6% to 37%, while the top rate on corporate income is reduced from 35% to 21%. The 2017 Tax Legislation, sec. 11001(a), § 1(j)(2)(C) (reduction in top individual rate); id. sec. 13001(a), § 11(b) (reduction in top corporate rate).

\(^5\) See, e.g., id. sec. 11011(a) (adding new I.R.C. § 199A allowing a deduction for certain forms of “qualified business income” earned by taxpayers not taxed as corporations); see also Daniel Shaviro, Apparently Income Isn't Just Income Any More, START MAKING SENSE (Dec. 16, 2017, 10:30 AM), http://danshaviro.blogspot.com/2017/12/apparently-income-ist-just-income-any.html (describing how the arbitrary preferences undermine the tenets of income taxation).

\(^6\) See generally David Kamin et al., The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation, 103 MINN. L. REV. (forthcoming 2018) (describing a variety of strategies for tax avoidance under the 2017 tax legislation, including the exploiting corporations as tax shelters, arbitrage opportunities, and creative use of pass-through entities).

\(^7\) See Thomas Piketty, Emmanuel Saez & Gabriel Zucman, DISTRIBUTIONAL NATIONAL ACCOUNTS: METHODS AND ESTIMATES FOR THE UNITED STATES, 133 Q.J. ECON. 553, 586–89 (2018) (describing current trends in income inequality); Emmanuel Saez & Gabriel Zucman,
verts democratic governance,\textsuperscript{8} stifles economic opportunity and mobility,\textsuperscript{9} and weakens the economy.\textsuperscript{10}

With these changes, Congress has taken a hammer to a progressive income tax system that was already broken. Well-advised taxpayers can already reduce or eliminate their income tax bill, for example, by manipulating the timing of their taxable income.\textsuperscript{11} Furthermore, even an effective income tax that prevented such avoidance opportunities could still allow wealth inequality to rise.\textsuperscript{12} For these reasons, many scholars have argued that to confront rising inequality, we should look beyond the income tax base and directly tax wealth.\textsuperscript{13}


\textsuperscript{8} See Ganesh Sitaraman, The Crisis of the Middle-Class Constitution: Why Economic Inequality Threatens Our Republic 223–73 (2017) (describing how inequality threatens democratic governance as the wealthy use their economic and political power to expand and consolidate their control); infra Section I.C.2.

\textsuperscript{9} See Raj Chetty et al., The Fading American Dream: Trends in Absolute Income Mobility Since 1940, 356 Science 398 (2017) (finding that inequality is responsible for a “systemic, widespread” reduction in the likelihood that children will enjoy a higher standard of living than their parents).

\textsuperscript{10} See Edward D. Kleinbard, Capital Taxation in an Age of Inequality, 90 S. Cal. L. Rev. 593, 656–58 (2017) (describing the economic cost of inequality and potential gains resulting from “inclusive growth”); infra note 284 and accompanying text. Of course, inequality can have both positive and negative effects on economic growth. See infra Section III.E.

\textsuperscript{11} See, e.g., Ari Glogower, Taxing Capital Appreciation, 70 Tax L. Rev. 111, 116–21 (2016) (describing tax avoidance opportunities resulting from the realization rule, which defers tax on asset gains until a disposition); Piketty, Saez & Zucman, supra note 7, at 598–601 tbl.II, fig.I (finding a limited effect of the income tax in reducing after-tax inequality).

\textsuperscript{12} That is, even if the income of high earners is taxed at higher rates, wealth inequality can continue to rise so long as they save a greater proportion of their after-tax income. See William D. Andrews, A Consumption-Type or Cash Flow Personal Income Tax, 87 Harv. L. Rev. 1113, 1169–70 (1974) (describing that scenario).

\textsuperscript{13} As used in this Article, the term “wealth” refers to a stock of nonhuman capital, “labor income” refers to the return to human capital, and “capital income” refers to the return to invested wealth. See infra Section I.A. For proposals in the literature for a wealth tax, see, for example, Bruce Ackerman & Anne Alstott, The Stakeholder Society 94–112 (1999); Richard M. Bird, Tax Policy and Economic Development 130–41 (1992); Thomas Piketty, Capital in the Twenty-First Century 515–18, 524–30 (Arthur Goldhammer trans., Harvard Univ. Press 2014); Edward N. Wolff, Top Heavy: The Increasing Inequality of Wealth in America and What Can Be Done
Although taxing wealth may seem like a direct—or even obvious—way to reduce inequality, a periodic wealth tax has not gained broad take-up by policymakers or the public. This hesitance is most likely attributable to two central and resilient reservations with a wealth tax. First, a wealth tax penalizes the saver, who is taxed more heavily just because she decided to defer her consumption. A wealth tax would impose the greatest hardship on the retiree, who in fact depends upon her savings for future periods. A second likely reason for the hesitance to adopt a wealth tax may result from the perception that wealth is already taxed through the current tax on capital income. From this perspective, an additional wealth tax would be unduly duplicative, and unduly burdensome to savings. Stated more generally, a wealth tax is not easily reconciled with an income tax that already taxes capital income.


15 For other objections to a wealth tax as unconstitutional or inadministrable, see infra notes 19, 237–41 and accompanying text.

16 See, e.g., Eric Rakowski, Can Wealth Taxes Be Justified?, 53 TAX L. REV. 263, 366 (2000); infra Section I.B.

17 Consequently, other proposals in the literature would address inequality by more effectively taxing capital income, rather than by directly taxing wealth. See, e.g., Edward D. Kleinbard, The Right Tax at the Right Time, 21 FLA. TAX REV. 208 (2017); Edward J. McCaffery, Taxing Wealth Seriously, 70 TAX L. REV. 305, 369–74 (2017); Deborah H. Schenk, Saving the Income Tax with a Wealth Tax, 53 TAX L. REV. 423 (2000); infra Section II.A.3.

18 See infra note 168.

19 Under a progressive tax, the average rate of tax increases with the amount of the taxable base. For a detailed presentation of the mechanics of progressive taxation, see infra Section II.B. This Article does not resolve other design considerations relevant to any tax on income, wealth, or a combination thereof. First, this Article does not propose specific definitional boundaries for the terms “income” and “wealth,” and does not specify particular assets or minimum levels of either base that should be exempt from tax. These exemptions may be set by policymakers on the basis of administrative and other relevant considerations. See infra Section III.C.5. This Article also does not prescribe the proper treatment of illiquid, non-traded, and hard-to-value assets, which pose a challenge to any tax on income or wealth. See infra Sections II.A.1–2. Similarly, this Article does not resolve theoretical problems posed by in-kind (“imputed”) income generated by a
Article makes two primary contributions to the literature. The Article first identifies basic limitations in prior proposals to separately tax income and wealth as factors in economic well-being, and then introduces a new progressive tax base derived from both income and wealth. This new tax base resolves the problems with separately taxing different factors in economic well-being, and tailors the tax base to the specific ways that inequality is understood to cause social and political harm.

To illustrate the rationale for—as well as the conceptual challenges to—taxing wealth in addition to income, consider first two hypothetical taxpayers: a doctor and an investor. The doctor earns a good salary but carries debt from medical school, while the investor has no debt and earns income from investing her wealth. Assume, for example, the doctor has $170,000 of debt and earns an annual salary taxpayer for herself. See infra Sections II.A.1–.2. This Article also does not suggest a specific rate schedule to be applied to the different components of the combined base. This determination will depend on the different behavioral responses to taxation of different elements of the base, the amount of revenue to be raised, and the degree of inequality to be constrained. Finally, this Article does not address the separate question of whether a wealth tax would face constitutional constraints. Compare, e.g., Miranda Perry Fleischer, Not So Fast: The Hidden Difficulties of Taxing Wealth, in WEALTH 261, 284–85 (Jack Knight & Melissa Schwartz eds., 2017) (arguing that a wealth tax, as a “direct tax” under U.S. CONST. art. I, § 9, cl. 4, would be unconstitutional unless it were equally apportioned among the states), with ACKERMAN & ALSTOTT, supra note 13, at 121–24 (doubting that the Supreme Court would constrain the federal taxing power). A sequel to this Article will address the real-world design of a wealth tax in light of possible constitutional constraints.

This Article follows a perspective common in the tax literature that the purpose of the progressive tax is to reduce economic inequality. See, e.g., Henry C. Simons, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 18–19 (1938) (“The case for drastic progression in taxation must be rested on the case against inequality—on the ethical or aesthetic judgment that the prevailing distribution of wealth and income reveals a degree (and/or kind) of inequality which is distinctly evil or unlovely.”); William Vickrey, AGENDA FOR PROGRESSIVE TAXATION 3 (1947) (“Progressive taxation may be defined as taxation which tends to promote economic equality . . . .”); R.A. Musgrave & Tun Thin, Income Tax Progression, 1929–48, 56 J. POL. ECON. 498, 510 (1948) (measuring the progressivity of a tax system by how much the system “results in a shift in the distribution of income toward equality”); see also Making the Wealthy, Wall Street, and Large Corporations Pay Their Fair Share, Bernie Sanders, https://berniesanders.com/issues/making-the-wealthy-pay-fair-share (last visited Sept. 30, 2018) (“At a time of massive wealth and income inequality, we need a progressive tax system . . . .”). Progressivity may also be justified on other grounds, such as within a welfarist analysis. See Louis Kaplow, THE THEORY OF TAXATION AND PUBLIC ECONOMICS 57–65 (2008); infra Section I.C.3. As described infra Section I.C.3, this Article’s perspective, which centers progressive taxation in reducing inequality, can also be incorporated within a welfarist perspective.

TAXING INEQUALITY

December 2018

of $200,000,\textsuperscript{22} whereas the investor has $10 million in savings and also earns $200,000 by investing the savings in U.S. Treasury notes.\textsuperscript{23}

Perhaps the simplest justification in the literature for a wealth tax is that the investor is better off than the doctor in economic terms on account of her additional wealth, and a tax on income alone does not account for this difference.\textsuperscript{24} Although both earn the same income, the investor can also draw upon her saved wealth, whereas the doctor must devote a portion of his income to repaying debt. The federal income tax, however, only compares taxpayers by their annual income and not by their saved wealth or debt. Consequently, both the investor and the doctor will be treated as having similar taxable incomes and will pay similar tax bills.\textsuperscript{25} If the investor and the doctor spend the same proportion of their after-tax income, an income tax alone cannot reduce the economic disparity between them.\textsuperscript{26}

Two related questions arise, however, in comparing the investor and the doctor. First, should the tax system only compare the two on the basis of their economic outcomes—and the resulting disparity—or

\textsuperscript{22}See Physicians and Surgeons, All Other, BUREAU LAB. STAT., https://www.bls.gov/oes/current/oes291069.htm#nat (last visited Sept. 30, 2018) (reporting median 2017 physician salary of approximately $208,000).


\textsuperscript{24}See, e.g., Rebecca S. Rudnick & Richard K. Gordon, Taxation of Wealth, in 1 TAX LAW DESIGN AND DRAFTING 292, 294–95 (Victor Thüroiny ed., 1996) (presenting a similar example to that of the doctor and the investor); see also James M. Puckett, Improving Tax Rules by Means-Testing: Bridging Wealth Inequality and “Ability to Pay,” 70 OKLA. L. REV. 405, 410 (2018) (explaining that taxpayers with income derived from interest on investments “are not similarly situated” to those with income derived from salary).

\textsuperscript{25}The definition of the income under § 61 of the Internal Revenue Code, which does not account for saved wealth, and the general rules for deductions from gross income under I.R.C. §§ 161–224 (2012), will generally yield similar net taxable income for both taxpayers. The substantive tax liability of each taxpayer, which is a function of both the taxable base and the applicable rates, may differ. Although the investor is better off than the doctor in economic terms, the investor would be treated more favorably if her investment return is earned not as interest income but as qualifying dividends or long-term capital gains taxed at preferential rates under § 1(a)–(d), (h). For an account of the capital gains preference as a concession to structural deficiencies in the income tax, see Noël B. Cunningham & Deborah H. Schenk, The Case for a Capital Gains Preference, 48 TAX L. REV. 319, 350–53 (1993). The example of the doctor and the investor in this Article illustrates how, even without a capital gains preference, a capital income earner would still be favored relative to a worker.

\textsuperscript{26}Assuming of course that capital income is not taxed at a higher rate than labor income. For a discussion of the role of the capital income tax as an indirect tax on wealth, see infra Section II.A.3.
should it matter how the disparity arose? Should it matter, for example, if the investor and the doctor had the same opportunities to earn and save but ended up in different economic positions due to their different choices whether to take advantage of these opportunities? Or would it be relevant if the investor only has such large wealth because she is saving for a once-in-a-lifetime vacation, while the doctor blew all of his savings last year?

This Article begins by reviewing the justifications in the literature for a wealth tax and highlights the arguments for comparing taxpayers by their economic outcomes in some circumstances, without regard to the process resulting in these outcomes. This view is frequently justified in prior works as the basis of the social and political harms that result from economic inequality. Part I then introduces the relative economic power theory as a general framework for understanding how inequality of economic outcomes generates these harms. This theory has analogues in the prior literature, but also formalizes the problem of inequality, and has specific implications for the shape of the progressive tax base, and how inequality should be measured and constrained. In particular, this theory implies that the relevant measure for comparing taxpayers’ economic well-being is their relative economic spending power during the taxing period.

The different justifications in the literature reflect different conceptions of distributive justice. For example, a wealth tax may be justified to maximize a measure of social welfare, or to ensure equal economic and social opportunity. The relative economic power theory is compatible with these views, but also aligns with a relational view of distributive justice centered in limiting social dominance and hierarchy resulting from excessive imbalances of economic power.

The relative economic power theory, and its underlying view of distributive justice, can explain why we should compare the investor and the doctor on the basis of their economic outcomes, but invites a second basic question: How should we compare the economic outcomes of the investor—who has wealth and earns capital income—and the doctor, who earns labor income? Stated more generally, how should the progressive tax system compare taxpayers with varying levels of labor income, capital income, and wealth in a progressive system, which all measure economic well-being in different terms? A
distance in miles and a distance in kilometers cannot be compared without first translating one measure into the terms of the other. For the same reason, taxing labor income, capital income, and wealth cannot be easily coordinated without first translating these factors into equivalent measures of economic well-being.

First, consider the difference between the investor’s capital income and the doctor’s labor income. An amount of capital income reflects greater economic well-being than the same amount of labor income. Labor income measures the entire return of a taxpayer’s human capital over time. If the doctor spends his entire $200,000 earned each period, he has no economic resources left when he stops working. Capital income, in contrast, measures only the investment return on the wealth principal. If the investor spends her entire $200,000 earned each period, she still has her wealth principal left. This difference between the investor and the doctor illustrates a basic limitation of the argument that a tax on capital income is a sufficient proxy for a tax on wealth: A capital income tax underestimates the wealth holder’s total economic well-being relative to a worker with a similar amount of labor income.

Prior proposals for a wealth tax would address this limitation of an income tax by taxing the investor’s wealth—either instead of or in addition to taxing her capital income—while continuing to tax the doctor’s labor income under the income tax. For example, Professors David Shakow and Reed Shuldiner propose to tax wealth as a replacement for the capital income tax and labor income under a separate income tax. Similarly, Professors Bruce Ackerman and Anne Alstott propose a separate tax on wealth, in addition to the current tax on both capital and labor income.

Income and wealth, however, are not easily reconciled as factors in economic well-being. Periodic income, whether from labor or capital, represents a potentially recurring flow of economic resources, whereas the wealth principal represents a fixed stock, which may be

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31 For a discussion of the different components of capital income, including mischaracterized returns of principal, see infra Section III.C.3.

32 Of course, the investor’s capital income could be taxed at a higher rate than the doctor’s labor income to indirectly account for the former’s additional wealth. See discussion infra Section II.A.3 on the limitations of a tax on capital income as an indirect tax on wealth.

33 Shakow & Shuldiner, supra note 13, at 540–46; infra Section II.C.

34 ACKERMAN & ALSTOTT, supra note 13, at 94–112. The authors propose a coordinating rule whereby a taxpayer pays the lesser of the wealth tax or the capital income tax for assets subject to both. See id. at 107–08.

35 For a discussion of nonperiodic income, see infra Section III.C.2.
exhausted once. Consequently, for any fixed amount $X$ of wealth or $X$ of periodic income, the latter is of greater economic value to the taxpayer. Because the wealth principal is a fixed stock, the investor’s economic benefit from her wealth each period will also depend upon the number of future periods over which her wealth must be spread. A simple tax on wealth, however, will treat all wealth holders the same and imposes the greatest burden on the retiree who must spread their wealth stock across a greater number of future periods.

Proposals to tax wealth in addition to income also face a related limitation: an assumption that income and wealth must be taxed under separate instruments with separate rate schedules. This expedience is understandable given the fact that income and wealth are not easily translated into the same terms. This Article identifies a basic limitation, however, of separate taxes on income and wealth as factors in economic well-being. Separate income and wealth taxes cannot consistently compare taxpayers on the basis of their total economic well-being from both factors and, thus, will favor or disfavor taxpayers depending on whether their economic well-being results from income, wealth, or a combination thereof. This problem results from the nature of a progressive rate schedule with increasing marginal rates, which will always tax two separate bases at a lower overall rate when compared to a single tax on a combined measure of both bases.

To illustrate this problem, consider a second scenario involving three hypothetical taxpayers with different economic outcomes:

“Worker” is a wage earner with no savings. He begins the year with $0 of wealth and earns $100,000 of labor income during the year.

“Investor” has saved wealth but no wage earnings. She begins the year with $1 million of wealth and earns $30,000 of investment income during the year.

“Worker-Investor” is a wage earner with saved wealth. She begins the year with $1 million of wealth and earns $30,000 of investment income and $70,000 of labor income during the year.

36 For the purposes of this Article, a “flow” refers to recurring economic resources each period, such as an annual income, whereas a “stock” refers to a fixed amount of resources held by the taxpayer, such as an amount of saved wealth.
37 See infra Section II.A.2.
38 See, for example, the structure of the proposals described infra Section II.C. References in this Article to proposals where different bases are taxed under separate instruments refer to cases where the rate at which one base is taxed is not affected by the amount of the other base. See infra Section II.B.
39 Of course, there may also be different efficiency considerations in the choice between taxing a single or multiple bases. See infra note 106 and accompanying text.
A progressive income tax with an increasing marginal rate schedule treats Worker and Worker-Investor equally, notwithstanding Worker-Investor’s additional wealth.\(^{40}\) A wealth tax similarly treats Investor and Worker-Investor equally, notwithstanding Worker-Investor’s additional income. Separate progressive taxes on both income and wealth would tax Worker-Investor’s income at the same rate as Worker’s, and Worker-Investor’s wealth at the same rate as Investor’s, notwithstanding the fact that Worker-Investor (with both income and wealth) has more economic resources than Worker and Investor during the taxing period. As a result, a progressive tax on economic well-being during the taxing period would require taxing Worker-Investor on both her income and her wealth at a higher average rate than either Investor or Worker. Unless labor income, capital income, and wealth are translated to comparable measures of economic well-being, these factors also cannot be simply summed and taxed under the same rate schedule, for the same reason that a distance in kilometers and a distance in miles cannot be summed to yield a combined measure of distance.

This Article then introduces a new base for progressive taxation, which is neither an income tax nor a wealth tax but a combined measure derived from both. The combined base resolves the core tensions that are central to this Article. First, the measure consistently accounts for economic well-being during the taxing period from labor income, capital income, and wealth and consistently compares taxpayers with different levels of each. As a result, these amounts may be summed and taxed under a single progressive rate schedule and avoid the limitation of separate taxes on income and wealth. Second, the combined base more accurately measures economic spending power during the taxing period and thereby tailors the progressive tax base to the relevant measure of inequality suggested by the relative economic power theory.

The central feature of this combined base translates both wealth and capital income into an annuity value (the “wealth annuity”). This Article is the first to introduce and justify using the wealth annuity as part of a new base for progressive taxation. The wealth annuity, which has been suggested in the welfare economics literature as a way to translate a stock of wealth into a measure of periodic spending

\(^{40}\) This simplified example assumes no preferential rate on capital income. Current law would also treat Investor more favorably than Worker if, like the investor in the prior example, Investor’s $30,000 of investment income qualifies for the preferential rates under I.R.C. § 1(h) (2012). See supra note 25.
power.\textsuperscript{41} may be calculated in the same manner as an actual annuity investment.\textsuperscript{42} Each period, wealth at the beginning of the period and capital income earned during the period are used to determine a hypothetical annuity payment the taxpayer would receive if this wealth was paid back to the taxpayer in equal amounts over the taxpayer’s remaining lifetime.\textsuperscript{43} In effect, the wealth annuity accounts for a taxpayer’s capital income earned during the taxing period (as under the current income tax) and also a portion, but not all, of the taxpayer’s wealth stock. The wealth annuity is then added to a taxpayer’s labor income to yield the combined base of economic well-being during the taxing period.\textsuperscript{44}

The combined base reflects a middle ground between the blunt instrument of a wealth tax and the inadequacy of a capital income tax. Through the wealth annuity, the combined base accounts for the fact that a taxpayer may depend upon their wealth principal across multiple periods, and in effect excludes a portion of the principal attributable to those future periods.\textsuperscript{45} On the other hand, the combined base will more effectively constrain inequality than a tax on capital income alone, by explicitly accounting for the role of wealth as a factor in economic well-being and including in the tax base a portion of the wealth principal considered to be available in the current period.

The remainder of this Article proceeds as follows. After a preliminary review of the “income” and “wealth” concepts, Part I reviews the justifications for taxing wealth in the literature, including arguments to tax wealth as an economic outcome in order to reduce ine-


\textsuperscript{42} For a discussion of why the wealth annuity has not been more broadly embraced in the tax literature and why it has heretofore underappreciated application in redefining the progressive tax base, see infra note 201 and accompanying text.

\textsuperscript{43} See infra Section III.A.

\textsuperscript{44} See infra Section III.B. This measure is subject to the same real-world measurement constraints and necessary approximations as an income tax base or a wealth tax base. See infra Section III.C.

\textsuperscript{45} The “excluded” amount of the wealth principal in this case is not a fixed amount for all taxpayers that may be considered necessary for basic needs, such as the standard deduction or the personal exemption. For a discussion of these additional possible adjustments to the tax base, see discussion infra Section III.C.5. Rather, the purpose of the combined base is to more consistently compare economic spending power across taxpayers, and therefore includes a portion of a taxpayer’s wealth principal that will vary with their individual circumstances, but similarly exclude a portion of their wealth principal that will also vary with their individual circumstances.
quality. Part I then introduces the relative power theory as a general framework for understanding the political and social harms caused by inequality, and considers the implications of this theory for defining inequality and the manner in which it should be constrained. Part II describes the challenges faced by prior proposals in coordinating taxes on labor income, capital income, and wealth. Part III introduces the combined base of economic well-being from income and wealth, describes real-world design considerations in implementing this base, and compares its effect to other possible tax bases.

I

WHY TAX WEALTH?

This Part describes the various justifications in the literature for a wealth tax, and their implications for the definition of the progressive tax base. Section I.A first reviews basic principles and ambiguities in defining the terms “income” and “wealth.” Section I.B then reviews the central objection to a wealth tax as a penalty to savers. Section I.C briefly reviews the different justifications in the literature for taxing wealth in response to this objection, and highlights the arguments justifying a wealth tax in order to mitigate the harms caused by economic inequality. Section I.D then introduces the relative economic power theory as a general framework for understanding how these harms operate and then considers the implications of this theory for how inequality should be measured and constrained.

A. Defining “Income” and “Wealth”

There are no objective and generally applicable definitions of the terms “income” or “wealth.” The term “income” may refer to a narrow measure of net receipts from market transactions or a broader measure that includes imputed income—benefits that accrue without the mediation of market transactions, such as from self-provided services and from the use of personal property. Similarly, “wealth” may

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47 See Brooks, supra note 46, at 259–62 (describing generally the problem of imputed income). For example, a taxpayer may earn $100 of labor, which would be taxed under an income tax, and then use the after-tax proceeds to purchase vegetables. Alternatively, a taxpayer may earn income by laboring in their garden to grow her own vegetables. From this respect, imputed income can be considered economically equivalent to income that is earned and then immediately spent, without the intermediating role of the market.
refer to assets with fungible market value or a broader measure of all sources of objective and subjective value.\textsuperscript{48}

In each case, the term’s definition will depend on the normative context in which it is used.\textsuperscript{49} As described below, the relative economic power theory implies that the taxpayers should be compared by their relative economic spending power during the taxing period.\textsuperscript{50} This principle does not conclusively define the boundaries of the terms “income” and “wealth,” but does suggest that these terms should be defined to reflect measures of economic power—sources of value that reflect the ability of holders to assert their dominance through market transactions.\textsuperscript{51}

Regardless of the definitional boundaries of the terms income and wealth, however, each of these terms measures economic well-being in fundamentally different ways. The discussion that follows describes these intrinsic differences among labor income, capital income, and wealth as economic measures.

\section{Income}

In the most general terms, “income” connotes flow of new economic resources during a specified period,\textsuperscript{52} which may be either spent or saved.\textsuperscript{53} Preexisting wealth is excluded from the income definition, in the same manner as cash pulled out of one’s wallet. As described below, from the perspective of the relative economic power theory, the income definition will depend upon the types of flows that are considered to reflect additional economic spending power during the taxing period. The easiest cases to distinguish are between accre-
tions of liquid market resources, such as cash and cash-like payments, on the one hand, and accretions that occur entirely outside of the market, such as imputed or subjective benefits, on the other.

In between these two poles lie inevitable definitional ambiguities, such as the appreciation of assets that do not readily trade in the market or that a taxpayer chooses not to monetize. The federal income tax compromises by deferring tax on this income until the asset is sold (the “realization rule”), even if the appreciation occurred in prior periods. This favorable treatment, however, currently extends to appreciation in traded assets and financial instruments, even though this income confers immediate economic value and could be taxed each period on a mark-to-market basis.

Income may result from the monetization of human capital, in the form of labor income, or the productive investment of nonhuman capital (wealth), in the form of capital income. Capital income and labor income, however, measure economic spending power in fundamentally different terms. A true capital income flow does not reflect a return of the wealth principal but rather an accretion in excess of the starting principal. This income may reflect the risk-free return to deferred consumption, compensation for bearing risk, supernormal returns from monopolies or luck, or mislabeled labor income. In each case, an investor who earns capital income could spend the income each period, while preserving her wealth principal. In the case of labor income, however, the labor income earned reflects the entire return of human capital, with none remaining once the taxpayer stops


55. A “mark-to-market” rule would require taxpayers to account each period for their income and losses from changes in asset values, even if these assets are not sold. For example, I.R.C. § 475(a) currently requires dealers in securities to mark securities held at the end of the year to their current market value. For the possibility of extending this treatment to other traded assets, see Glogower, supra note 11, at 116–21; David S. Miller, A Progressive System of Mark-to-Market Taxation, 109 TAX NOTES 1047, 1054 (2005). Income from nontraded assets, on the other hand, can be taxed upon realization as under current law, but with an appropriate interest charge to account for the benefit of deferral. See Glogower, supra note 11, at 133–40, 146–47 (describing different methods for imputing an interest charge to account for tax deferral while generally preserving the realization rule).

56. See Louis Kaplow, Human Capital Under an Ideal Income Tax, 80 VA. L. REV. 1477, 1497–98 (1994) (comparing changes in wealth resulting from financial investments, such as bonds and dividend-paying stocks, with changes in wealth from human capital).

57. See Joel Slemrod & Jon Bakija, Taxing Ourselves 302–06 (5th ed. 2017) (discussing elements of capital income besides the normal return to deferred consumption and the consequent tax implications); infra Section III.C.3.
working. In effect, labor income may be understood as a taxpayer cashing out a portion of his balance of human capital each period.\(^\text{58}\)

To illustrate this basic difference, recall again the investor and the doctor described above, who each earn $200,000.\(^\text{59}\) The investor earns this amount in the form of capital income from her invested wealth, whereas the doctor earns this amount in the form of labor income from his human capital. If both the doctor and the investor spend their $200,000 of income each period, the essential difference between capital and labor is evident. The doctor who earns labor income will have nothing left when he stops working, since his entire stock of human capital has been exhausted and withdrawn in the form of the annual labor income payments. In contrast, the investor who earns capital income will still have her original wealth principal.\(^\text{60}\) Stated more generally, labor income by definition includes a return of the human capital principal, whereas true capital income reflects a return earned in addition to the wealth principal.

2. **Wealth**

Whereas income reflects an economic flow during the taxing period from both human and nonhuman capital, wealth generally refers to a stock of nonhuman capital.\(^\text{61}\) In effect, wealth reflects accretions from prior periods that were saved rather than spent in those periods. The difference between wealth as a stock and income as a flow may thus be distinguished on the basis of their treatment of consumption: The income definition does not distinguish between the portion of the flow that is consumed and the portion that is saved for the future, whereas the wealth definition necessarily makes this distinction and only accounts for wealth that was not consumed in previous periods.

Similar to the case with the income definition, from the perspective of the relative economic power theory, the scope of the wealth definition will depend upon the forms of wealth that are considered to reflect additional economic spending power. The easiest candidates for inclusion in the wealth definition are cash, cash-like assets, and

\(^{58}\) See Kaplow, *supra* note 56, at 1482–84, 1497 (demonstrating that the return to human capital each year in the form of labor income constitutes the conversion of preexisting capital into a current flow in the same manner as withdrawals of cash from a bank account); *id.* at 1490 (“One might say, therefore, that the conventional income tax ignores the ‘capital’ in ‘human capital.’”).

\(^{59}\) See *supra* notes 21–23 and accompanying text.

\(^{60}\) For a discussion of inflation, see *infra* note 254 and accompanying text.

December 2018] TAXING INEQUALITY 1437

marketable securities. As in the case of the income definition, assets that are nontraded or with market value that a taxpayer chooses not to monetize pose more difficult cases. For such cases, it is possible to structure a wealth tax with a similar solution as the realization rule under the income tax, that would defer the wealth tax until a nontraded asset’s value is monetized through a sale.62

Regardless of its definitional boundaries, wealth measures economic well-being in fundamentally different terms than both labor and capital income. In contrast to income, which represents a flow of funds over a period, wealth represents a fixed stock of economic resources, which can only be exhausted once. Furthermore, whereas labor income reflects a return of a portion of the taxpayer’s principal of human capital each period, wealth reflects the entire principal of a taxpayer’s nonhuman capital. For the simplest illustration of this difference, contrast a worker, who earns $100,000 each year, and a retired saver, who does not work and has $100,000 in cash and no income. The worker has greater economic spending power in the taxing period, because the worker’s labor income reflects only a portion of his total human capital while the saver’s wealth reflects her entire stock of nonhuman capital.

Human and nonhuman capital also differ in an additional critical respect. An individual with human capital has a potential source of future economic resources that may or may not be monetized in the form of labor income. In contrast, nonhuman capital such as marketable assets reflect actual, rather than mere potential, economic resources.63

B. The Penalty to Savers

A basic consequence of periodically taxing wealth is that a taxpayer pays more tax if she holds her wealth for a greater number of periods.64 Advocates of taxing wealth argue that this treatment is justified because, holding income constant, a taxpayer with more wealth during the taxing period has a greater ability to pay tax.65

62 See supra note 55 (describing the realization rule under the income tax and the treatment of income from nontraded assets).
63 Cf. Andrews, supra note 12, at 1145–46 (arguing that the problem of valuating future economic prospects for nonhuman capital is also present in valuating marketable assets).
64 See, e.g., Rakowski, supra note 16, at 337.
65 See, e.g., Joseph M. Dodge II, The Taxation of Wealth and Wealth Transfers: Where Do We Go After ERTA?, 34 RUTGERS L. REV. 738, 760 & n.105 (1982) (“Wealth represents ability-to-pay for each taxable period that the wealth is held, and in theory the tax on wealth should increase with the length of the holding period.” (citing J.E. MEADE, INST. FOR FISCAL STUDIES, THE STRUCTURE AND REFORM OF DIRECT TAXATION 320 (1978))).
spective, however, evaluates a taxpayer’s ability ex post as the outcome of the decisions to earn and save, without regard to the taxpayer’s ex ante decision whether and how to earn and save.\textsuperscript{66}

Milton Friedman distilled the general objection to redistributing the outcomes from such personal choices with the following example:

Consider a group of individuals who initially have equal endowments and who all agree voluntarily to enter a lottery with very unequal prizes. The resultant inequality of income is surely required to permit the individuals in question to make the most of their initial equality. Redistribution of the income after the event is equivalent to denying them the opportunity to enter the lottery.\textsuperscript{67}

Friedman’s example illustrates the general objection to determining fairness by reference to ex post outcomes rather than the ex ante decisions, such as the decision to assume risk in exchange for the prospect of the lottery reward.\textsuperscript{68} The same logic underlying the lottery example may be extended to oppose redistribution of outcomes resulting from other personal decisions as well, such as the choices of whether to work and to save.\textsuperscript{69} For example, Professor Rakowski applies a similar logic to object to a wealth tax that disfavors a saver because of her decision to spend in the future:

What interest does the community have in whether a person consumes post-tax earnings sooner or later, apart from any profits earned on investments? [Nicholas] Kaldor and those who have broadcast his argument offer no answer to this elementary fairness objection, and I cannot write a convincing script for them.\textsuperscript{70}

Supplying this missing script, which justifies taxing a saver and not a spender, is therefore a necessary element of a justification for a wealth tax. The following section briefly describes different scripts supplied in the literature. The succeeding section then introduces a script grounded in the relative economic power theory and describes both the implications of this theory as well as points of intersections with prior arguments in the literature.

\textsuperscript{66} Cf. Louis Kaplow \& Steven Shavell, Fairness Versus Welfare 50 (2002) ("When policy analysts or members of the public at large consider what rule seems fair in a given situation, we tend to focus . . . on what has actually happened, for that is what we see . . . . [W]e do not observe the ex ante choice situation . . . .")

\textsuperscript{67} Milton Friedman, Capitalism and Freedom 162 (40th anniversary ed. 2002).

\textsuperscript{68} For a similar argument, see Kaplow \& Shavell, supra note 66, at 442–43.

\textsuperscript{69} See, e.g., Friedman, supra note 67, at 174.

\textsuperscript{70} Rakowski, supra note 16, at 365–66 (citing Nicholas Kaldor, Indian Tax Reform: Report of a Survey (1956), reprinted in Nicholas Kaldor, Reports on Taxation II 31, 58 (1980)).
C. Justifications in the Literature

1. Actual Ability to Pay

A basic justification for taxing wealth does not directly implicate questions of distributive fairness or the problems of inequality but rather the practical nature of revenue collection. Under this argument, the government must collect revenue in the form of money, and consequently, the tax base should reflect a taxpayer’s actual capacity to pay a monetary tax.\(^{71}\) Any alternative tax base, such as one that measures subjective well-being or economic earning potential, unduly burdens a taxpayer who cannot fund the resulting liability.\(^{72}\)

This constraint suggests a literal dimension to the term “ability to pay”: The tax base must reflect a measure of actual ability to pay.\(^{73}\) For example, under the income tax base, the taxpayer is presumed to have funds available from which to pay the tax, to the extent income reflects actual funds available to the taxpayer.\(^{74}\) Scholars have argued that the classic Haig-Simons income definition, as the sum of consumption and accretions to wealth,\(^{75}\) is rooted in this view that ability to pay should be measured as control of economic resources.\(^{76}\) This view may be readily extended to justify a wealth tax. If the relevant measure of ability to pay is control of economic resources, a taxpayer with wealth controls additional economic resources that may be avail-


\(^{72}\) For example, a tax on endowment (earning potential) would compel every taxpayer to realize their earning potential, a result that Lawrence Zelenak characterizes as “talent slavery.” Lawrence Zelenak, *Taxing Endowment*, 55 DUKE L.J. 1145, 1156–59 (2006).

\(^{73}\) This literal connotation of “ability to pay” is also implied in other related terms for defining the progressive tax base, such as the term “contributive capacity” used in Piketty, *supra* note 13, at 525, and the term “capacity to contribute” used in Schenk, *supra* note 17, at 459.

\(^{74}\) That is, the taxpayer may presumably fund the tax liability by setting aside a portion of their income and generally plan their budget to account for tax liabilities. See Deborah H. Schenk, *A Positive Account of the Realization Rule*, 57 TAX L. REV. 355, 360–65 (2004).

\(^{75}\) See Simons, *supra* note 20, at 50. For discussion of ambiguity in the Haig-Simons definition, see *supra* note 53.

\(^{76}\) See Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 32 (1992) (“Simons’ definition of income as the sum of accumulation plus consumption must be read in light of the gloss of control of economic resources . . . . It is this exercise of control that gives a person the ‘ability to pay’ taxes, which is the philosophical foundation of our tax system.”).
able for taxation, whereas a spender who exhausted his wealth in prior periods does not.\footnote{\textit{See} Dodge, \textit{supra} note 65, at 760.}

As a justification for a wealth tax, the actual ability to pay argument addresses the government’s practical need to raise revenue from those who can pay. As described above, the recent changes to the tax law will reduce federal tax receipts by more than $1 trillion.\footnote{\textit{See supra} note 2.} These changes come at a time when the government urgently requires additional revenue to stabilize the deficit\footnote{The Congressional Budget Office estimated that, even before the passage of the recent tax legislation, an estimated $380 billion in additional government revenue would have been required just to stabilize the federal debt at its current share of GDP. \textit{Cong. Budget Office, The 2017 Long-Term Budget Outlook} 22 (2017), https://www.cbo.gov/publication/52480. Stabilizing the national debt at its fifty-year average of 40\% of GDP would have required additional revenues of $620 billion in 2018. \textit{Id.} at 23.} and make critical new investments in infrastructure\footnote{The American Society of Civil Engineers estimated that an additional $2 trillion in spending is needed over the next decade to preserve and modernize the nation’s infrastructure. \textit{See Am. Soc’y of Civil Eng’rs, Economic Impact, 2017 Infrastructure Report Card,} https://www.infrastructurereportcard.org/the-impact/economic-impact (last visited Sept. 30, 2018).} and social programs.\footnote{The Center for Budget and Policy Priorities estimates that demographic changes and an aging population will require additional federal spending on social security, Medicare, and Medicaid even if significant cost-reduction measures are adopted. \textit{See Paul N. Van de Water, Ctr. for Budget & Policy Priorities, Federal Spending and Revenues Will Need to Grow in Coming Years, Not Shrink 6–11 (2017),} https://www.cbpp.org/sites/default/files/atoms/files/9-6-17bud.pdf.} Taxing wealth can potentially raise significant additional revenue. For example, a conservative estimate by Professors Ackerman and Alstott in the late 1990s found that a modest wealth tax at a 2\% rate could have raised more than $320 billion per year after accounting for possible behavioral effects.\footnote{\textit{See Ackerman \& Alstott, supra} note 13, at 219–24 (using data from the 1995 Survey of Consumer Finances).} A similar calculation in 2017 would have yielded a sum more than three times this amount.\footnote{Between 1995 and 2017, household net wealth more than tripled from approximately $29 trillion to more than $96 trillion. \textit{See Households and Nonprofit Organizations; Net Worth, Level}, FRED, https://fred.stlouisfed.org/series/TNWBSHNO (last updated Sept. 21, 2018).} 

The role of wealth as a significant potential source of revenue, however, does not itself provide a positive normative argument for why the tax system \textit{should} distinguish between savers and spenders, or why it is fair for those with greater income or wealth to pay relatively more.\footnote{For example, it still may be possible to raise sufficient revenues by taxing income alone, even if wealth is a potential additional base for taxation.} For the same reason, this theory does not necessarily suggest how much more wealth holders should pay or how to compare differ-
ences in ability to pay between taxpayers with varying amounts of income and wealth. The actual ability to pay argument may be understood, in that case, not as a positive argument for taxing wealth, but rather as an argument to classify both wealth and income as plausible potential bases for taxation and revenue collection, and to contrast both with other non-plausible bases, such as subjective well-being or mere earning potential.

2. The Benefits and Harms of Wealth

Other justifications in the literature for a wealth tax point to the additional and immediate advantages to the wealth holder beyond the mere prospect of future consumption, as well as the harms caused by wealth concentrations to those without.

First, wealth taxation has been justified on the basis of the benefits that wealth confers, such as economic security, social and political influence, and additional economic opportunities. Framing the argument in terms of the benefits to the wealth holder, however, invites the objection that there is no reason to tax the benefits of saving more heavily than the benefits of spending—or any other imputed benefits, for that matter. For example, if an individual chooses to spend her wealth earlier instead of saving, the personal benefits of spending earlier presumably outweigh the benefits derived from holding her wealth longer, and there still would be no justification to treat the saver differently from the spender. For the same reason, there would be no justification under an income tax to tax labor income but not leisure.

Alternatively, these same justifications for a wealth tax may be understood by reference to the harms caused to other members of society from concentrations of wealth, rather than by reference to the

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85 For a discussion of the challenges in reconciling income and wealth as factors in economic well-being, see infra Section II.C.
86 See Schenk, supra note 17, at 463–64.
88 See Ackerman & Alstott, supra note 13, at 96–100 (describing the opportunities afforded to the beneficiaries of wealth).
89 Rakowski, supra note 16, at 366–70 (discussing arguments against wealth-based taxation).
90 See id. at 367–68. Professor Schenk argues that this logic would not extend to an inframarginal saver, where the disutility from foregoing consumption is less than the utility from the additional savings, and a similar objection could apply to the labor income tax, where the utility from labor income is presumably offset by the disutility from working. See Schenk, supra note 17, at 461, 465.
benefits to the wealth holders. For example, scholars have argued that wealth doesn’t merely advantage the wealthy through political power, but the resulting imbalance of political power undermines democratic governance and suppresses the political preferences of the less wealthy.\textsuperscript{91} Furthermore, beyond the explicit process of campaign finance, the mere “selection of investments and deployment of assets” allows the wealthy to wield disproportionate political and social influence.\textsuperscript{92} Similarly, wealth doesn’t just provide additional economic opportunities to the wealthy, but impedes economic mobility\textsuperscript{93} and forecloses similar opportunity for those without equal economic power.\textsuperscript{94}

Although the benefits and harms of inequality may seem like two sides of a coin, the shift of the focus from wealth holders’ benefits to the harm caused to everyone else yields a more durable justification for wealth taxation. If wealth merely confers benefits to the wealth holder, then there may not be a principled reason for the tax system to interfere with the decision to save in order to enjoy these benefits. Once wealth concentrations cause harm to other members of society, however, these overriding social concerns provide a basis for interfering with the wealth holders’ personal choices.\textsuperscript{95}


\textsuperscript{93} See, e.g., Chetty et al., supra note 9; Repetti, supra note 87, at 838–40 (describing effect of inequality on fiscal policy and investments in education and human capital).

\textsuperscript{94} Alstott, supra note 92, at 369 (discussing the tension between affording individuals the liberty to maximize wealth and preserving equal starting points for everyone).

\textsuperscript{95} See id. at 380 (arguing that taxation of savings might be necessary to ensure equality of opportunity). That is, even if we should be neutral to the save-or-spend decision from the perspective of the taxpayer, we should not be neutral to this decision if the choice to save causes harm or limits opportunities to others.
3. Welfarism and Optimal Taxation

A welfarist analysis generally seeks to define legal rules that maximize aggregate social well-being, as weighted to reflect the social preference for equality of well-being. In this framework, reducing economic inequality can be justified by the assumption that additional units of wealth have declining marginal utility to the holder. Redistribution from the wealthy to others can thereby increase aggregate social well-being by directing wealth to the recipients who derive the greatest utility from the wealth. Furthermore, in this framework a “taste” for fairness, or the satisfaction of a commitment to a view of distributive justice, would also be a relevant measure of well-being. The significant limitation on a wealth tax in this framework is that an ex post tax on income or wealth will affect ex ante decisions whether to earn and to save and, therefore, can have the effect of reducing, rather than increasing, aggregate social well-being. The optimal income tax literature generally seeks to optimize this trade-off through the design of a tax system that achieves the desirable level of ex post redistribution while minimizing adverse ex ante incentives.

An old view in the optimal tax literature held that the optimal tax on wealth and capital income is zero, in order to preserve neutrality to the decision whether to spend or to save over the long term. Recent

96 For these purposes, “well-being” is broadly defined to include anything that an individual may possibly value, including goods and services and any sources of happiness or fulfillment, and the satisfaction of tastes, including the taste for fairness. See Kaplow & Shavell, supra note 66, at 20–21.
97 Kaplow, supra note 20, at 42–43.
99 See, e.g., Kaplow, supra note 20, at 42–43.
100 Kaplow & Shavell, supra note 66, at 21.
101 See, e.g., Shaviro, supra note 98, at 109.
102 See, e.g., Joel Slemrod, Introduction to Tax Progressivity and Income Inequality 1, 1–3 (Joel Slemrod ed., 1996) [hereinafter Slemrod, Introduction] (“The modern approach to evaluating progressivity focuses on the trade-off between the potential social benefit of a more equal distribution . . . and the economic costs caused by the disincetive effects of the high marginal tax rates required by a redistributing tax system.”); Joel Slemrod, Optimal Taxation and Optimal Tax Systems, 4 J. ECON. PERSPECTIVES 157, 158 (1990) (“[T]ax systems are also evaluated by how they affect the distribution of welfare . . . . The efficiency costs must be balanced against the distributional implications.”).
works, however, have presented four general justifications for taxing capital income or wealth\textsuperscript{104} in the optimal tax framework: First, wealth may be a signal of a taxpayer’s underlying earning ability, which is a fixed trait that is not affected by tax disincentives (and therefore an efficient base for taxation).\textsuperscript{105} Second, a wealth tax may be justified in light of the different real-world planning responses to taxes on income and wealth.\textsuperscript{106} Third, a wealth tax may be justified to the extent that taxpayer savings behavior is inelastic (that is, the behavior is not responsive to the effects of taxation).\textsuperscript{107} Finally, a wealth tax may be justified to the extent that concentrated wealth generates negative externalities\textsuperscript{108} that can reduce the welfare of others.\textsuperscript{109}

4. Equality of Opportunity

Wealth taxation has also been justified under a view of distributive justice that requires equal economic and social opportunity.\textsuperscript{110} This perspective would generally accept a degree of unequal ex post outcomes resulting from individual choices to earn, save, and assume risk, as long as individuals have the same ex ante opportunities to

\textsuperscript{104} In practice, the optimal tax literature generally evaluates the effects of a tax on capital income rather than wealth, on the assumption that a wealth tax is not available as a tax instrument. See, e.g., Banks & Diamond, supra note 103, at 553.

\textsuperscript{105} See id. at 563.

\textsuperscript{106} Under this analysis, a tax on multiple bases, including capital income and wealth, may be more efficient if a taxpayer will have less incentive to reduce any single taxable base through strategic tax planning. See David Gamage, The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth, 68 TAX L. REV. 355, 431–37 (2015). Others argue that taxing a single base may be more efficient if taxing multiple bases induces behavioral distortions along multiple margins. See Bankman & Weisbach, supra note 92, at 1423–28 (illustrating an argument favoring a consumption tax over an income tax based on A.B. Atkinson & J.E. Stiglitz, The Design of Tax Structure: Direct Versus Indirect Taxation, 6 J. PUB. ECON. 55 (1976)).

\textsuperscript{107} See Emmanuel Saez, Joel Slemrod & Seth H. Giertz, The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review, 50 J. ECON. LITERATURE 3, 35 (2012) (finding “no compelling evidence to date of real responses of upper income taxpayers to changes in tax rates”). In contrast, the authors find that the only significant behavioral responses by taxpayers to changes in tax law since 1980 pertain to the timing and avoidance of reporting taxable income. Id. at 42.

\textsuperscript{108} See Shaviro, supra note 98, at 108 (“There are numerous potential motivations for seeking greater after-tax distributional equality than that which would result from levying a uniform head tax. . . . [O]ne might believe that inequality yields negative externalities . . . ”).

\textsuperscript{109} See Kaplow & Shavell, supra note 66, at 429 (describing the aggregate welfare loss resulting from externalities, whereby the satisfaction of preferences by an individual leaves others worse off).

\textsuperscript{110} See, e.g., Ackerman & Alstott, supra note 13, at 4, 24–31 (describing purpose of equalizing opportunities through a wealth tax); see also Repetti, Democracy and Opportunity, supra note 91, at 1141–47, 1152–59 (proposing a criterion for tax equity promoting equal opportunity for “self-realization” and “participation in democracy”).
make these choices.\footnote{See Ackerman & Alstott, supra note 13, at 24 (“We are interested in opportunities, not outcomes. As liberals we believe that each citizen should be free to shape her outcomes as she thinks best. But . . . we emphasize the failure of the capitalist system to give each citizen an equal opportunity to exercise this freedom . . . .”).} For this reason, this perspective is often associated with an estate or inheritance tax.\footnote{For a review of works advocating for a wealth transfer tax in order to equalize opportunity, see Lily L. Batchelder, What Should Society Expect from Heirs? The Case for a Comprehensive Inheritance Tax, 63 Tax L. Rev. 1, 5 n.17 (2009).} These transfer taxes allow wealth to accrue during one’s lifetime but limit the accumulation and transmission of dynastic wealth across generations, and the roles of privilege and the birth lottery in economic inequality.\footnote{See Thomas Nagel, Liberal Democracy and Hereditary Inequality, 63 Tax L. Rev. 113, 116–17 (2009) (justifying inheritance taxes as a way to promote merit-based reward, equality of opportunity, and decreased class stratification).}

A basic challenge to the equality of opportunity justification is the tension between preserving individual choice—and accepting inequality resulting from these choices—and redistributing to allow equal opportunity to succeeding generations.\footnote{See Alstott, supra note 92, at 368–69 (describing the “classic dilemma” for liberal theory in balancing liberty, equality of opportunity, and fairness in distribution).} For example, under this view a taxpayer can choose to save, earn, and take risks during her lifetime but is denied the choice to pass her savings on to her children.\footnote{See Friedman, supra note 67, at 195.} By shifting the emphasis from equality of ex post outcomes to equality of ex ante opportunities, this view also implies that unequal outcomes are presumptively valid, as long as the outcomes arise from equal starting positions and do not interfere with the opportunities of others.\footnote{See supra note 111 and accompanying text.}

D. The Relative Economic Power Theory

1. Described

The relative economic power theory—used by political scientists to explain how economic inequality generates harmful social hierarchies and distorts political outcomes—formalizes the problem of inequality and has specific implications for the way that inequality should be measured and how it should be constrained.

In general terms, the relative economic power theory holds that excessively unequal distributions of economic resources and market power can result in unequal divisions of political and social power as well. This process occurs when the wealthy assert social control and prioritize their own preferences through their ability to exert their
market power. Those with fewer economic resources are discouraged from competing with the wealthy or from even attempting to assert preferences they cannot hope to realize.

Political scientists use the relative economic power theory to explain political outcomes that do not reflect voter preferences. For a recent example corroborating this account, in late 2017, Congress passed changes to the tax law that primarily benefitted the wealthiest Americans, despite the fact that the bill was only supported by a minority of the public and was likely passed with the lowest popular support for any major tax legislation in modern history. The relative economic power theory is a likely factor explaining how this counter-majoritarian legislation became law, as the threat of future political spending by wealthy donors motivated legislators to support the bill.

The relative economic power framework, however, also points towards a broader theory of how economic inequality causes social harm. In this respect, undemocratic political outcomes are just one manifestation of the unequal social hierarchies that result from unequal economic power. The following passage illustrates how the relative economic power effect operates more broadly:

When inequality is greater, poorer individuals are more often in positions of subservience. At work, the greater threat posed by

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117 See Frederick Solt, Economic Inequality and Democratic Political Engagement, 52 AM. J. POL. SCI. 48, 49 (2008) (noting that the wealthy can use their wealth to achieve political goals).

118 See id. (describing how the wealthy can exclude certain issues from debate, creating a set of political options that fail to reflect the interests of the poor and fostering political disengagement).

119 See supra notes 1–6 and accompanying text.

120 For example, a poll conducted by NBC News and the Wall Street Journal from December 13 to 15, 2017 found that only 24% of respondents believe that the tax plan was a “good idea.” HART RESEARCH ASSOCs. & PUB. OP. STRATEGIES, STUDY No. 17505, NBC NEWS/WALL STREET JOURNAL SURVEY 15 (2017), https://www.wsj.com/public/resources/documents/17505NBCWSJDecember2017Poll.pdf. To the Author’s knowledge, no statistically significant poll conducted around the time of passage recorded majority support for the legislation.


unemployment means that they must increasingly submit to the demands of their employers. In the marketplace, they must accept that they have no access to goods and services that others enjoy or risk incarceration. For richer individuals, on the other hand, greater inequality means that it is easier to find someone who will promptly and unquestioningly fill their orders—whether to deliver a new luxury automobile or tend to their lawns and gardens. For both richer and poorer individuals, greater economic inequality makes market relations with others much more likely to be characterized by obedience and deference.  

This broader interpretation of the relative economic power theory mirrors related theories from other fields explaining the social harm caused by inequality. For example, social psychologists describe how inequality generates and reinforces differences in status, power and resource inequality, and harmful social stigma. From a behavioral perspective, inequality can also distort rational decision-making and influence individuals with less power to make risky or poor choices, which can in turn compound inequality.

2. Implications

The relative economic power theory has specific implications for how inequality should be measured and how it should be constrained, and aligns with a relational view of distributive justice centered in limiting opportunities for social dominance resulting from excessive imbalances of economic power. First, the critical factor under the relative power theory is the ability of the wealthy to use their market power, which is sufficient to assert their preferences over those with

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124 See Cecilia L. Ridgeway & Sandra Nakagawa, Status, in HANDBOOK OF THE SOCIAL PSYCHOLOGY OF INEQUALITY 3, 4 (Jane D. McLeod et al. eds., 2014) [hereinafter SOCIAL PSYCHOLOGY OF INEQUALITY] (“In addition to being important in their own right, interpersonal status processes mediate people’s access to other significant aspects of inequality—resources and power. Interpersonal status processes taking place, for instance, in a job interview or the classroom, direct people towards or away from organizational positions of power and resources.”).
125 See Shane Thye & Will Kalkhoff, Theoretical Perspectives on Power and Resource Inequality, in SOCIAL PSYCHOLOGY OF INEQUALITY, supra note 124, at 27 (describing how resource inequality can reproduce and deepen differences in power, where the latter term is defined broadly as the ability to create or have impact on the world).
126 See Bruce G. Link et al., Stigma and Social Inequality, in SOCIAL PSYCHOLOGY OF INEQUALITY, supra note 124, at 49 (on the relationship between economic inequality, the process of stigmatization, and discrimination in other aspects of social and public life).
less market power. As a result, those with greater economic power need not spend their economic resources in order to achieve their preferences; a credible ability to do so is sufficient. This dynamic implies that, from the perspective of the relative economic power theory, the relevant measure of inequality to be constrained is difference in taxpayers’ economic spending power, rather than their actual spending or their income or wealth alone.

Nonmarket resources or other subjective factors in well-being that do not reflect economic spending power do not factor equivalently into this process. For example, the person who grows $100 worth of vegetables for their own personal consumption does not have the same economic power as someone who earns $100 in cash and can choose whether to use the money to buy either vegetables or politicians. For the same reason, the relative economic power theory does not necessarily suggest maximizing utility or sacrifice across taxpayers but rather reducing economic inequality in absolute terms.

Because the relative economic power relationship depends upon the mere ability to spend, a person who preserves her wealth (and her economic power) across multiple periods benefits from this process for more periods than does a person who spends her wealth earlier.

The relative economic power theory, however, also implies a more nuanced understanding of the distinction between savers and spenders. As described above, the primary objection to a tax on either wealth or capital income is that these instruments unfairly distinguish between taxpayers depending on when they choose to spend their resources. This objection suggests that a tax system should be neutral as to the timing of spending throughout one’s lifetime. The relative economic power theory, however, suggests a distinction between spending in previous periods and spending in future periods. A spender who uses his economic resources in previous periods has less economic spending power during a subsequent period than a saver. As


129 See id. at 277 (“[T]he greater one person’s economic power, the tougher a competitor he will be; and the greater will be his capacity to outbid another for goods they both desire.”).

130 For the problem of “imputed income” generated from self-provided services, see supra note 47 and accompanying text.

131 As described supra Section I.C.3, however, this theory is also compatible with a welfarist analysis.

132 See supra note 70 and accompanying text.
a result, a saver who preserved her wealth from prior periods should in fact be taxed differently than a spender who did not.

Under the relative economic power theory, however, economic resources only reflect greater economic power to the extent that they are in fact credibly expendable in the current period. A retiree with wealth that must be preserved for use in the future cannot credibly threaten to spend it in the current period and therefore cannot claim relative economic power. As a result, the relative power theory implies accounting each period for prospective spending needs by savers as a liability to be applied against current wealth, but not retrospective decisions whether a taxpayer saved or consumed in prior periods.

Finally, the relative economic power theory aligns with a relational view of distributive justice centered in minimizing opportunities for social dominance resulting from excessive imbalances of economic power. From this perspective, economic power in a market economy is a critical prerequisite for social and civic participation. Imbalances of economic power, in contrast, lead to social dominance and the unequal distribution of other nonmonetary social goods. This view demands neither absolute economic inequality nor wealth confiscation to eliminate any disparities in relative spending power. Rather, this view implies a constraint on excessive imbalances in relative economic power.

133 See WALZER, supra note 30, at 103–08 (“Unless we can spend money and deploy goods at levels beyond what is required for subsistence . . . we suffer a loss more serious than poverty itself, a kind of status starvation, a sociological disinheritation.”); see also SITARAMAN, supra note 8, at 67–74 (describing the influence of theories relating property with social and political power on framers of the Constitution during the Revolutionary period and in the years following).

134 WALZER, supra note 30, at 12. In Walzer’s view, economic power is just one possible dominant good among many. See id. at 11 (“Physical strength, familial reputation, religious or political office, landed wealth, capital, technical knowledge: each of these, in different historical periods, has been dominant . . . .”). At the same time, Walzer acknowledges that “in a capitalist society, capital is dominant and readily converted into prestige and power.” Id.; cf. supra note 110 (describing Professor Repetti’s proposed criterion for tax equity centered on promoting equal opportunity for self-realization and participation in democracy). This Article does not suggest that reducing imbalances of economic power will foreclose all opportunities for social dominance. Rather, this Article concerns the progressive tax system’s role in reducing imbalances of economic power in particular, and the dominance of economic power in this social and political moment.

135 See WALZER, supra note 30, at 15–17 (rejecting a principle of “simple equality” that would require excessive state intervention, and rather allowing “small inequalities” as long as those inequalities do not multiply and allow for dominance of other social goods).
3. Intersection with Prior Justifications

The relative economic power theory intersects with the prior justifications in the literature for a wealth tax, but also generalizes the problem of inequality and has specific implications for the definition of the tax base.\(^{136}\) By focusing on each taxpayer’s economic resources during the taxing period as a measure of their ability to pay, this theory is closely linked to the actual ability to pay justification. One significant difference, however, is that the prior justifications focused on actual ability to pay as measured by income or by wealth, whereas the economic spending power theory would imply a measure of economic spending power, regardless of the source. Furthermore, the relative economic power theory yields a positive argument for why those with greater economic power should be taxed more, beyond the practical need to collect revenue from those who can actually pay, and suggests how different taxpayers might be compared.

Under the relative economic power theory, wealth doesn’t merely generate subjective well-being to the holder but also specific and objective social harms. From this perspective, the justification for taxing wealth does not depend on the holder’s subjective well-being, but on the deleterious effect of economic power on other members of society. In this manner, the relative economic power theory also mirrors and formalizes the justifications for a wealth tax on the basis of the harms resulting from wealth concentrations. At the same time, the relative economic power theory generalizes the problem of inequality, and describes more broadly how inequality causes social harm. In this respect, effects highlighted in the prior literature, such as interference with the political process and the power afforded by directing investments,\(^{137}\) may be seen as specific manifestations of this process.

While the relative economic power theory aligns with a relational view of distributive justice minimizing social dominance through economic imbalances, this theory can also be incorporated into a perspective that would maximize social welfare or prioritize equality of opportunity. From a welfarist perspective, the relative economic power theory may be understood to describe a general negative externality resulting from economic inequality.\(^{138}\) The relative economic spending power theory would therefore suggest an independent weight on equalizing economic spending power to the extent neces-

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\(^{136}\) Contra, e.g., Repetti, Democracy and Opportunity, supra note 91, at 1153 (“The self-realization doctrine . . . does not recommend one tax base over another. The key insight from the equality of opportunity for self-realization doctrine . . . could be accomplished with an income tax, a consumption tax, or a wealth tax.”).

\(^{137}\) See supra notes 91–92 and accompanying text.

\(^{138}\) See supra notes 108–09 and accompanying text.
TAXING INEQUALITY

sary to reduce such externalities. Alternatively, the relative economic power theory may suggest a weight on equalizing economic spending power to reflect a welfare-increasing “taste” or a social preference for fairness.\footnote{See supra note 100 and accompanying text. Of course, in this framework, accounting for a social preference for fairness would depend upon whether such a social preference actually exists. See Kaplow & Shavell, supra note 66, at 21 (describing “the possibility that individuals have a taste for a notion of fairness”). Assessing a social preference for equality, however, may be confounded by the possibility that inequality may itself engender a social acceptance of social and economic hierarchies and authoritarian forms of government. See Solt, supra note 123, at 704 (“[I]ncreased direct exposure to hierarchical experiences . . . is complemented by more complete cultural domination.”). Alternatively, a social concern for fairness as articulated through different views of distributive justice may be incorporated into a welfarist evaluation of tax reforms, without regard to the effect on individuals’ utilities. See, e.g., Batchelder, supra note 112, at 6 n.18 (“Theoretically, a social welfare function . . . can value principles, such as equal opportunity, by assigning a positive weight to them or imposing a hard constraint that rejects outcomes predicated on unequal starting points.”); Emmanuel Saez & Stefanie Stantcheva, Generalized Social Marginal Welfare Weights for Optimal Tax Theory, 106 Am. Econ. Rev. 24 (2016) (proposing “a novel approach to optimal tax theory using generalized social marginal welfare weights,” which “directly reflect society’s concerns for fairness”).}

Similarly, from an equality of opportunity perspective,\footnote{See supra Section I.C.4.} the relative economic power theory may be understood as describing exactly how some members of society are deprived of equal opportunity.\footnote{For example, Professor Repetti’s criterion for tax equity centered in promoting equal opportunity for “self-realization” and “participation in democracy,” described supra note 110, highlights the necessity of limiting interference through economic disparities in order to promote opportunities to others.} Whereas an equality of opportunity perspective shifts the emphasis to ex ante opportunities, however, the relative economic power theory retains an emphasis on equalizing ex post outcomes, and not just opportunities to participate in the market. This is because the relative economic power theory describes a process of continuous harm resulting from imbalances of economic power throughout the wealth holder’s lifetime, regardless of how the wealth was acquired. Equalizing opportunity but preserving inequality of outcomes, in contrast, will not address these social harms resulting from differences in relative economic power. For example, if the inordinate wealth of both Donald Trump, Jr., and Mark Zuckerberg afforded them excessive social and political power, it would not matter if one’s wealth was due to a happenstance of birth and the other’s to what some may consider socially productive entrepreneurship.
II

Taxing Income and Wealth

The relative economic power theory, and the related justifications in the literature, can explain why we should tax wealth as an economic outcome but invite a second basic question: How should we compare economic well-being from different sources? This Part describes design problems in coordinating progressive taxes on labor income, capital income, and wealth as factors in economic spending power, and the limitations of each of these factors as a base for taxation. Section II.A evaluates the choice between taxing income or wealth and demonstrates the limitations of either instrument as a tax on economic well-being. Section II.A also evaluates the taxation of capital income as an indirect tax on wealth. Section II.B provides a detailed analysis of the functions of the tax base under a progressive rate schedule and the problems with a progressive tax on multiple bases. Section II.C then considers proposals and options for the taxation of both income and wealth, through either separate instruments or a single base of income plus wealth.

The key insight in the analysis that follows is that labor income, capital income, and wealth may all be available as bases for taxation. If, however, taxpayers should be compared by an underlying measure of economic spending power during the taxing period, then none of these factors alone fully reflect this measure. Furthermore, taxing income and wealth separately, as proposed in prior works, cannot consistently compare and progressively tax these separate factors in economic well-being. This limitation results from the fact that a progressive rate schedule with increasing marginal rates will always tax separate bases at a lower overall rate, as compared to a single tax on a combined measure of the same bases. As a result, a taxpayer will be overtaxed or undertaxed based on whether their economic spending power derives from income, wealth, or a combination thereof.

The analysis that follows also highlights additional aspects of the challenges in taxing economic spending power by taxing labor income, capital income, and wealth. In particular, reconciling income and wealth as factors in economic spending power faces three key consid-

142 Professor Daniel Shaviro similarly compares signals of well-being to turtles in the proverbial tower, wherein a bottom-most turtle reflecting an underlying measure of well-being—the desirable basis for comparing taxpayers—is difficult to ascertain, even if it must exist. See Daniel Shaviro, Endowment and Inequality, in Tax Justice: The Ongoing Debate 123, 124 (Joseph J. Thorndike & Dennis J. Ventry Jr. eds., 2002) (referencing the story of “the woman who claimed that the earth rests on the back of a turtle and, when asked what the turtle rests on, responded that it was ‘turtles all the way down’”).
erations: First, either wealth or human capital may or may not be productively employed to generate market earnings (in the form of capital income or labor income, respectively), with consequent effects on economic spending power. Second, labor income and capital income measure economic spending power in different terms because labor reflects the return of the entire principal of human capital, while capital income generally reflects an investment return in addition to the stock of wealth. Third, wealth and income, whether from labor or capital, also measure economic spending power in different terms as, respectively, a stock and a flow.

A. Taxing Income or Wealth

This Section describes the individual limitations of labor income, capital income, and wealth as measures of economic well-being and as bases for a progressive tax to reduce inequality. This Section also describes the limitations of a capital income tax as an indirect tax on wealth.

1. Taxing Income

An income tax base measures economic income each period from both labor and capital. Capital income and labor income are economic outcomes that depend, respectively, on a taxpayer’s stock of wealth and human capital, as well as the taxpayer’s decision whether and how to monetize and productively invest both. Both capital and labor income may fluctuate from year to year, and to this extent, neither will reflect a regularly recurring flow throughout the taxpayer’s lifetime. Even a regularly recurring income flow, however, is still an incomplete measure of a taxpayer’s economic spending power during the taxing period, because income alone does not account for a taxpayer’s wealth (which reflects additional economic resources) or debt (which will partially or fully absorb the income flow). As a result, income alone is insufficient for the comparing function of a progressive tax base designed to minimize inequality of economic spending power.

For example, consider again the doctor and the investor described above, who both earn $200,000 of income during the year. Even an income tax that accurately measured both capital and labor income would not account for the fact that the investor has an

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143 See, e.g., I.R.C. § 61 (2012) (defining the federal income tax income base broadly). Of course, different elements of this base may be taxed at different rates. See infra note 174.

144 For a discussion of nonperiodic income, see infra Section III.C.2.

145 See supra notes 21–23 and accompanying text.
additional $35 million of saved wealth. Conversely, the doctor who earns the same $200,000 must dedicate a portion of his income to servicing his $170,000 debt.

As described above, the difference between the incomes of the investor and the doctor may also be understood in terms of the difference between labor income and capital income. The investor’s $200,000 of capital income reflects only an investment return but does not account for her $35 million wealth principal that she preserves. The doctor’s $200,000 of labor income, in contrast, reflects a return of a portion of his principal of human capital. The easiest way to illustrate their different economic circumstances is to consider the result if the investor and the doctor each consume their $200,000 of earnings each year. At the end of the investor’s life, she is left with her $35 million stock of wealth—a large store of remaining economic resources. The doctor, in contrast, has no economic resources left when he stops working, because all of his human capital has been returned over time and taxed as labor income.

In a similar manner, an income tax does also not account for a reduction to economic spending power resulting from negative wealth, or debt. Contrast the treatment of the doctor with the treatment of a hypothetical dentist, who is fortunate enough to graduate with no debt (but who has no positive wealth) and who has the same $200,000 salary as the doctor. Because the income tax base generally ignores negative as well as positive wealth, the dentist is treated the same as the doctor and will consequently have the same income tax liability in the taxing period, even though the dentist has greater economic spending power on account of her lack of any negative wealth, or debt.

2. Taxing Wealth

A wealth tax base, in contrast to an income tax base, measures a stock of net financial wealth each period. Unlike an income tax

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146 See supra note 58 and accompanying text.
147 The federal income tax does account for debt resulting from investments in human capital in a limited fashion through tax benefits for education expenses. See, for example, the limited deduction for student loan interest under I.R.C. § 221 and the education credits under I.R.C. § 25A. For a discussion of the limited effect of government subsidies for investments in education, see generally Michael Simkovic, The Knowledge Tax, 82 U. Chi. L. Rev. 1981 (2015).
148 See, e.g., Shakow & Shuldiner, supra note 13, at 532–38 (proposing a wealth tax base encompassing financial holdings, business interests, other investment assets, and consumer durables and real estate above specified exemption levels). Because a wealth tax base measures net worth, the base must be calculated net of a taxpayer’s debt. See, e.g., id. at 537. Accounting for debt is necessary to consistently compare taxpayers under a wealth tax. If the wealth tax base is not calculated net of debt, a taxpayer with $1 million of cash
base, a wealth tax base only measures accretions from prior periods and therefore necessarily distinguishes between prior period savings and consumption. A wealth tax base thereby accounts for the factor in economic spending power missing from an income tax base: wealth saved from prior periods. A wealth tax base, however, is limited in other respects and does not account for three factors in economic spending power that will vary across taxpayers: (1) differences in labor income, which results from monetizing human capital; (2) differences in capital income, which results from the productive investment of the wealth; and (3) differences in the number of periods over which the wealth must be spread.

First, a wealth tax base does not account for differences in taxpayers’ economic spending power from labor income. Recall Investor and Worker-Investor described above, the former with $1 million of wealth, $30,000 of investment income, and no labor income, and the latter with the same $1 million of wealth, $30,000 of investment income, and also $70,000 of labor income. Although the two taxpayers have the same wealth stock and capital income earned thereon, Worker-Investor has greater total economic spending power on account of her additional labor income.

Second, a wealth tax base does not account for differences in taxpayers’ economic spending power resulting from different amounts of capital income earned from the wealth. A stock of wealth represents the potential to earn capital income but does not indicate how, or whether, taxpayers will realize this potential by investing the wealth. For example, assume two wealth holders who each have $1 million. “Risk-Avoider” holds his $1 million in a checking account, which yields a negligible investment return. “Risk-Taker” invests and $1 million of debt would pay the same tax as a taxpayer with $1 million of cash and no debt.  

149 See supra note 40 and accompanying text.

150 In the same manner, human capital represents potential labor income, but only taxpayers who realize this potential enjoy the resulting increase in economic well-being.

151 There may also be imputed benefits derived from a checking account, such as increased liquidity. See Yair Listokin, Taxation and Liquidity, 120 YALE L.J. 1682, 1712–13 (2011) (describing the imputed benefits of “free checking” accounts). This example illustrates more generally the case of different investments with different risk profiles and consequently different capital income returns. Under certain conditions, a taxpayer may be able to adjust their portfolio to eliminate the tax on returns above the risk-free rate without affecting the portfolio’s risk profile. See Noel B. Cunningham, The Taxation of Capital Income and the Choice of Tax Base, 52 TAX L. REV. 17, 29–37 (1996); Evsey D. Domar & Richard A. Musgrave, Proportional Income Taxation and Risk-Taking, 58 Q.J. ECON. 388, 388–92 (1944) (describing ideal investor reactions to three hypothetical cases of different levels of permissible loss offsetting); Schenk, supra note 17, at 426 (“[A]n investor can adjust his portfolio to increase his pretax rate of return and thus neutralize the impact of the nominal tax.”). This portfolio adjustment model is more limited in the real world,
her wealth in a risky investment, which yields an 8% rate of return.\textsuperscript{152} The capital income tax, which accounts for differences in \textit{how} wealth is invested, would treat the two taxpayers differently. A wealth tax, in contrast, does not account for this difference.\textsuperscript{153}

Finally, a wealth tax does not account for differences in taxpayers’ expectations to spread their wealth across future periods. As described above, a basic consequence of a periodic wealth tax is that a single stock of wealth is subject to repeated taxation, as the wealth is held for a larger number of periods.\textsuperscript{154} Although this feature is commonly raised as an objection to wealth taxation,\textsuperscript{155} periodic taxation of wealth is implied from the perspective of the relative economic power theory. If a taxpayer holds the wealth for a greater number of periods, this wealth generates social and political harms for a greater number of periods as well.

where the following necessary assumptions are not always present: the ability of the taxpayers to borrow at the risk-free rate, full loss deductibility, rational taxpayer behavior, and the absence of extranormal returns. See Cunningham, \textit{supra}, at 37 ("The above conclusion assumes that $B$ is able to borrow at the risk-free rate. A fair question is whether that assumption is realistic."); Schenk, \textit{supra} note 17, at 428–35 (describing assumptions of full loss offsets, indexed income tax, rational taxpayer behavior, and taxpayer ability and desire to make adjustments). An income tax can also tax the return to risk in the case of an investor who accounts for downside risk. See John R. Brooks II, \textit{Taxation, Risk, and Portfolio Choice: The Treatment of Returns to Risk Under a Normative Income Tax}, 66 \textit{TAX L. REV.} 255, 284–89 (2013) (describing effective taxes on risky returns).

\textsuperscript{152} Of course, Risk-Taker is compensated for assuming additional risk. This additional return from risk, however, mirrors the paradigmatic case of Friedman’s lottery. See Friedman, \textit{supra} note 67, at 162. Taxpayers similarly enjoy more or less economic well-being as a result of their decision whether or how to monetize their human capital. Assume, in the alternative, that Taxpayers $C$ and $D$ each have the potential to earn $40,000 a year in labor income, which, at a discount rate of 4\%, suggests a stock of human capital with a value of $1$ million each. Taxpayer $C$ productively employs this human capital stock and in fact earns $40,000 a year of labor income, whereas Taxpayer $D$ hits the beach and doesn’t earn a cent. The income tax, which compares individuals on the basis of their labor earning outcomes and not on the basis of their earning potential, will tax Taxpayer $C$ but not Taxpayer $D$. In this respect, the treatment of Taxpayer $A$’s and Taxpayer $C$’s income, on the one hand, and the treatment of Taxpayer $B$’s and Taxpayer $D$’s, on the other, is consistent and justified under a base of economic well-being: The former two taxpayers chose to productively invest their wealth to generate market income, whereas the latter two did not. Human and nonhuman capital are equivalent in this respect. In both cases, taxpayers with a stock of either can decide whether to use the stock to generate economic returns.

\textsuperscript{153} If Risk-Taker saves her investment return, she will have additional wealth to be taxed in the next period and will pay a higher tax than Risk-Avoider in that period. If, however, Risk-Taker spends her investment proceeds in the current period, the wealth tax will treat the two the same in the next period as well. As described above, a basic difference between a wealth tax and an income tax is that the latter also accounts for economic resources spent during the taxing period. \textit{See supra} Section I.A.2.

\textsuperscript{154} \textit{See} Rakowski, \textit{supra} note 64, at 337.

\textsuperscript{155} \textit{See supra} Section I.A.
The view that wealth should be periodically taxed as a factor in economic spending power, however, does not necessarily imply that the *entire* stock of wealth should be taxed each period. Unlike a recurring income flow, a single stock of wealth may be depended upon to fund consumption across multiple periods, and once the stock is exhausted nothing remains. As a result, the wealth holder’s economic spending power will vary with the number of periods across which the wealth must be spread, and a tax on the total wealth stock each period imposes the greatest burden on a pensioner who depends upon the wealth for consumption across a greater number of subsequent periods. As succinctly stated by one investment advisor, for retirees, “[their] money is *it*.156 The retiree with saved wealth cannot credibly threaten to spend the portion of the wealth that must be saved for future periods and to this extent does not derive economic spending power from the wealth in earlier periods.

To illustrate the variable nature of wealth as a source of economic spending power, consider two retirees (who no longer earn labor income):

“Late Retiree” has $100,000 of savings that earns a return of 2% a year, or $2000 in the current year. She is seventy years old and expects to live for ten more years.

“Early Retiree” has $100,000 of savings that earns a return of 2% a year, or $2000 in the current year. He is sixty years old and expects to live for twenty more years.

A tax on wealth would treat both taxpayers the same, notwithstanding the fact that Late Retiree depends on her savings to last for ten periods, whereas Early Retiree depends on his savings to last for twice that number of periods. Although they have the same stocks of wealth, Early Retiree must save more of his wealth for the future and therefore has less economic spending power during the current period than Late Retiree. This difference illustrates the limitations of measuring economic equality by reference to each taxpayer’s stock of wealth alone. Under a progressive tax that reduces disparities in economic spending power, Late Retiree should pay tax at a higher rate than Early Retiree.157

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157 Of course, this result may also be viewed as penalizing the taxpayer who chooses to save for longer. This result is consistent, however, with an economic outcomes perspectives centered in reducing imbalances of economic power. (Alternatively, Early Retiree may have been compelled to leave their job early for reasons beyond their control). Finally, unless Late Retiree’s additional economic spending power is taxed at a confiscatory 100%
NEW YORK UNIVERSITY LAW REVIEW

3. Taxing Wealth by Taxing Capital Income

According to a common presentation in the literature, a wealth tax is redundant with a tax on capital income, since wealth is implicitly taxed through a capital income tax.\(^\text{158}\) For a simple illustration, assume that a taxpayer has $100,000 of wealth that earns a return of 2% per year, or $2000. If the wealth is taxed at a 1% rate, the resulting liability would be $1000. The same liability could be generated by taxing the income from the wealth at a 50% rate.\(^\text{159}\) From this perspective, a wealth tax is duplicative with a capital income tax, and more generally, an income tax base of both capital and labor income could serve the same function as a wealth tax base of both human and nonhuman capital.\(^\text{160}\)

In the example above, converting a wealth tax into a capital income tax requires taxing a smaller base (capital income) at a higher rate. This case illustrates a practical limitation of a capital income tax as an indirect wealth tax. In a progressive tax, the base and the rate are not perfectly interchangeable variables, if it is assumed that the base cannot be taxed at a rate higher than 100%.\(^\text{161}\) In the example above, a 4% tax on wealth ($4000) could only be replicated through a 200% tax on the $2000 annual return on the wealth. Similarly, in the example of the investor and the doctor, even a confiscatory 100% tax on the investor’s capital income earned each period would still leave the investor with their substantial stock of wealth and greater economic spending power.

Beyond this practical limitation, a capital income tax is also essentially inadequate as an indirect tax on wealth, because a tax on capital income alone incorrectly compares economic well-being from wealth and economic well-being from labor income. From the perspective that a tax on capital income is replicable through a tax on wealth and vice versa, the only choice remaining for policymakers is to determine whether it is easier to observe wealth or capital income. Professors Cunningham and Schenk have argued, for example, that the tax on capital income, which is often difficult to measure and sub-

\(^{158}\) See, e.g., Rakowski, supra note 16, at 286; Schenk, supra note 17, at 436–38; Shakow & Shuldiner, supra note 13, at 500.

\(^{159}\) Assume that periodic income \((i)\), equals the invested wealth \((w)\) times the rate of return \((r)\), or \(i = wr\). A wealth tax on the principal \((T_w)\) will yield the same tax liability as an income tax \((T_i)\) when \(T_i = T_w = \frac{w}{r}T_N\).

\(^{160}\) Assuming, of course, that this ideal income tax base effectively taxed capital income. See infra note 162 and accompanying text.

\(^{161}\) Cf. Piketty, supra note 13, at 525–26 (noting the limited redistributive effects of taxing a narrow income base at an extremely high rate in the context of the very wealthy).
ject to tax reduction and avoidance strategies, should be replaced with a tax on a deemed return to the historic cost of wealth, with any additional gain or loss calculated upon a sale, as under current law. Labor income would remain taxed as under current law, since an individual’s stock of human capital cannot be measured except with reference to their observed labor income. Effectively, this approach operates as an improved method of taxing the capital income component of the current federal income tax base rather than a qualitative redefinition of the tax base.

From the perspective of the relative economic power theory, the analysis of this improved income tax base as a measure of economic spending power during the taxing period is similar to analysis of the current income tax base (setting aside the separate question of whether it is more practical to measure actual capital income or a deemed return to cost). Recall the investor and the doctor described above. Assume that, under the deemed return to cost method, the investor is taxed on an imputed annual return of 2% on her $10 million of saved wealth, the same rate that she actually earns by investing in U.S. Treasury notes, for annual taxable income of approximately $200,000. The doctor is taxed on his $200,000 of labor income, as under the current income tax. Although taxing the investor on the imputed income return in this case may allow for more accurate taxation of capital income, this approach still does not yield a taxable base that measures the investor’s and the doctor’s economic spending power in similar terms. Both would still be treated as having the same $200,000 of income for the year, with no separate accounting for the investor’s additional spending power from her wealth.

As this example illustrates, there is no metaphysical sense in which wealth and capital income necessarily overlap. Previous treat-

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162 See Noël B. Cunningham & Deborah H. Schenk, Taxation Without Realization: A “Revolutionary” Approach to Ownership, 47 TAX L. REV. 725, 729, 735–36 (1992); see also Schenk, supra note 17, at 446 (elaborating upon the proposal for a supplemental wealth tax and its implications for returns). For example, if a taxpayer purchases stock for $10,000, and the deemed return is 1%, the taxpayer is taxed on $100 of appreciation at the end of year one, and her basis in the stock increases to $10,100. If the taxpayer sells the stock the following year for $12,100, she pays tax on the remaining $2000 of gain in a manner similar to the calculation under current law.

163 See Schenk, supra note 17, at 465–66 (“[I]t is difficult, if not impossible, to measure human capital accurately.”).

164 In particular, this method avoids both the administrative costs of measuring actual capital accretions each year and the tax planning that arises from the current realization-based system.

165 See Rakowski, supra note 16, at 362 (describing this approach to wealth taxation as an “improved income tax”).

166 See supra Section I.A.1.

167 See supra note 23 and accompanying text.
ments of the relationship between taxing wealth and capital income in
the literature may have been more troubled by the practical—rather 
than the theoretical—effects of taxing both. \footnote{See, e.g., ACKERMAN & ALSTOTT, supra note 13, at 107 (“Although a wealth tax is not economically identical to an income tax, both fall on capital investments. And in some cases, the combined rate could be high . . . .”); Gunn, supra note 71, at 380 (“A tax on wealth . . . at rates more than trivial, would bring about changes more rapid and extreme than those that any reasonable income tax could effect.”); Saul Levmore, Inequality in the Twenty-First Century, 113 Mich. L. Rev. 833, 851 (2015) (reviewing Piketty, supra note 13) (“Slowly but surely, the two tiers of taxation would confiscate that original income and would discourage the work required to earn it.”). In this respect, Ackerman and Alstott’s coordinating rule, supra note 34, can be understood as a practical concession to avoid the cumulative effect of taxing both capital and the entire wealth principal each period, rather than as a way to integrate two overlapping tax bases.} From the relative economic power perspective, however, both wealth and capital income measure separate factors in economic spending power during the taxing period. Wealth at the start of the period measures economic spending power resulting from prior period accumulations. Capital income earned during the period reflects additional economic spending power resulting from a taxpayer’s decision whether and how to productively invest their starting period wealth. For a simple example of this difference, consider a taxpayer who begins the year with $1000 of wealth and invests this wealth for nearly the entire year at a 1% return, or $10, and spends the entire $10 on December 31 of that year. A wealth tax will account for the $1000 of starting period wealth but not the $10 of capital income earned, whereas a capital income tax will account for the $10 of capital income earned but not the starting period wealth. From the perspective of the relative economic power theory, however, the taxpayer enjoys greater economic spending power during the taxing period from both factors: her starting period wealth as well as her capital income earned during the period.

B. The Problem with Multiple Bases

In a progressive tax system, the average rate of tax increases with the amount of the taxable base. A graduated rate schedule, for example, taxes higher amounts of the taxable base at higher marginal rates, \footnote{See, for example, the graduated income tax schedule in I.R.C. § 1(a)–(d) (2012).} which has the effect of taxing the entire base at higher average rates as the size of the base increases. \footnote{A graduated rate schedule is not the only way to achieve progressivity. \textit{See}, e.g., Joseph Bankman & Thomas Griffith, Social Welfare and the Rate Structure: A New Look at Progressive Taxation, 75 Calif. L. Rev. 1905, 1905–16, 1921 (1987) (describing the progressive effect of a flat tax plus a cash grant).} For example, assume a progressive income tax with a graduated rate schedule, in which the
first $100,000 of income is taxed at a 20% rate and additional income
is taxed at a 40% rate. Assume that Taxpayer A has $100,000 of
income and Taxpayer B has $200,000 of income. Taxpayer A will pay
a total tax of $20,000, for a 20% average rate, whereas Taxpayer B will
pay a total tax of $60,000,171 for a 30% average rate.

In effect, the progressive tax base in the example above serves
two distinct functions. First, the base serves as a measure for com-
paring taxpayers—generally referred to as each taxpayer’s relative
“ability to pay”172—and thereby determines the applicable rates at
which each should be taxed. In the example above, Taxpayers A and
B are compared by their different levels of income, and these levels of
income determine their different rates of tax. For purposes of the dis-
cussion that follows, this function of the progressive tax base is
referred to in this Article as the “comparing” function of the base.
Second, the base serves as a variable that determines the tax liability
due when taxed under the progressive rate schedule. In the example
above, the final tax liability of Taxpayer A and Taxpayer B is then
determined by taxing the base according to the chosen rate schedule.
For purposes of the discussion that follows, this function of the pro-
gressive tax base is referred to in this Article as the “calculating” func-
tion of the base. In other words, the comparing function of the base
first determines the applicable tax rate, and then the calculating func-
tion determines the tax liability due, when the base is taxed at the
applicable rate(s) under the progressive schedule.

In the simple case, a single attribute of the taxpayer can serve
both the comparing and calculating functions.173 This is the case in
the example above, where income determines both the applicable rate
and the tax liability due, and the federal income tax operates simi-
larly.174 A base for the calculating function, however, may not neces-

171 $100,000 times 20% plus $100,000 times 40%.
172 Under this meaning of the term, “ability to pay” has no normative significance but
merely serves as a shorthand for the user’s normative basis for comparing taxpayers. Cf.
Vickrey, supra note 20, at 375 (“More often than not, ability to pay turns out to mean just
about what the user wants it to mean . . . .”); Schenk, supra note 17, at 459 n.173 (“This
phrase [‘ability to pay’] is intended as a mere notation for the idea that taxpayers should
not bear the revenue burden equally; that is, some taxpayers are able to, and therefore
should, shoulder a larger tax burden than others.”). For other uses of the term with
substantive normative implications, see, for example, Slemrod, Introduction, supra note
102, at 2 (using “ability to pay” as a normative principle of equal sacrifice).
173 This case can be expressed as \( X = C_1 = C_2 \), where \( X \) is the attribute of the taxpayer,
\( C_1 \) is the comparing function of the base, and \( C_2 \) is the calculating function.
174 First, income serves the comparing function, as the applicable tax rates are
determined under I.R.C. § 11(a)–(d) by reference to the taxpayer’s taxable income. Income
then serves in the calculating function, as the resulting tax liability is determined by taxing
this income at the resulting rates. This example is illustrative, and of course, additional
factors such as character may also affect the final applicable rates under the income tax.
sarily be a sufficient base for the comparing function,\textsuperscript{175} if taxpayers should be compared by reference to something other than the base subject to tax. For example, assume that taxpayers should be compared according to their economic well-being and that income and wealth are independent factors in economic well-being (and therefore are both factors in “ability to pay”). In this case, neither income nor wealth alone can measure amount and, therefore, serve in the comparing function of the base.\textsuperscript{176}

The distinction between the comparing and calculating functions of the base is significant, because separately taxing different bases under a graduated rate schedule does not yield the same tax liability as a single progressive tax on an aggregate measure of both bases. To illustrate this point, assume that two hypothetical attributes, \(X_1\) and \(X_2\), independently and equally measure ability to pay\textsuperscript{177} and that these attributes measure ability in units instead of dollars. Assume first that each of the separate attributes \(X_1\) and \(X_2\) are taxed under separate instruments and that each instrument has a graduated rate schedule that taxes the first 100,000 units of ability at $0.20 per unit and any additional units at $0.40 per unit. Assume now that Taxpayer \(A\) has 100,000 units of ability, all from \(X_1\), and Taxpayer \(B\) has 200,000 units of ability: 100,000 from \(X_1\) and 100,000 from \(X_2\). As in the example above, Taxpayer \(A\) will pay a total tax of $20,000, for an average rate of $0.20 per unit. If attributes \(X_1\) and \(X_2\) are taxed under separate instruments, however, Taxpayer \(B\) will pay a total tax of $40,000 ($20,000 under each instrument), for the same average rate of $0.20 per unit. As a result, under separate progressive taxes \(X_1\) and \(X_2\), Taxpayer \(B\) pays tax at the same rate as Taxpayer \(A\), despite Taxpayer \(B\)’s greater ability to pay. The object of the progressive tax schedule, to tax greater ability to pay at higher average rates, is frustrated.

This example illustrates the practical consequences of the distinction between the comparing and the calculating functions of the tax

\textsuperscript{175} That is, although progressive tax instruments generally adopt a base of a single attribute, such as income in the case of the income tax, there is no reason why an instrument could not tax multiple attributes under a single base, if it were desirable to compare taxpayers by reference to multiple attributes. \textit{See}, e.g., Chris William Sanchirico, \textit{Deconstructing the New Efficiency Rationale}, 86 \textit{Cornell L. Rev.} 1003, 1021, 1027–29 (2001) (describing the benefits of cross-dependent taxation). The case wherein multiple attributes are factors in the comparing function of the base can be expressed as \(C_1 = \epsilon(X_1, X_2, \ldots)\), where the series \(X_1, X_2, \ldots\) refers to all attributes of the taxpayer that are relevant in measuring ability to pay.

\textsuperscript{176} The case wherein both wealth and income are factors in the comparing function of the base can be expressed as \(C_1 = \epsilon(I, W)\), where \(I\) is income and \(W\) is wealth.

\textsuperscript{177} That is, \(Y\) units of either \(X_1\) or \(X_2\) reflect the same level of ability to pay.
In the example above, the problem is that each of attributes $X_1$ and $X_2$ serves the calculating function, as the taxable base of their respective instruments, but neither is a sufficient measure of ability to pay for purposes of the comparing function. As a result, Taxpayer $B$ is not taxed at a higher rate than Taxpayer $A$, despite Taxpayer $B$’s greater ability to pay.

Because each of $X_1$ and $X_2$ in the example above is a separate factor in ability to pay, a combined measure of both attributes is needed to perform the comparing function of the base. This combined base may be subsequently taxed under a single progressive rate schedule. In this case, since $X_1$ and $X_2$ measure ability to pay equally, the two attributes may be summed to yield an aggregate measure of ability. Consider the result if this aggregate measure, defined as the sum of both $X_1$ and $X_2$, is taxed under a single progressive rate schedule. Taxpayer $A$ will still be treated as having 100,000 units of ability from $X_1$ and will pay a tax of $20,000, while Taxpayer $B$ will be treated as having 200,000 units of ability (100,000 from each of $X_1$ and $X_2$) and will pay a total tax of $60,000, or an average rate of $0.30 per unit. In this case, Taxpayer $B$ is appropriately taxed at a higher average rate, in accordance with her greater ability to pay.

The distinction between the comparing and calculating functions of the tax base—and the consequences of this distinction for resulting tax liabilities—may be illustrated through an example familiar to the student of an introductory course in federal income taxation: the taxation of married couples. The income of each spouse may be available to serve in the calculating function of the base, to be taxed under a specified rate schedule. The income tax, in contrast, generally compares household units on the basis of the total income of married couples. For these purposes, the income of each spouse alone is available to serve in the calculating function of the base, to be taxed under a specified rate schedule. The income tax, in contrast, generally compares household units on the basis of the total income of married couples.
insufficient for the comparing function of the base. As would be expected, taxing each spouse’s income separately under the same specified rate schedule applicable to total household income would yield a lower total tax liability.

For example, in 2018, the ordinary taxable income\(^{184}\) of a married couple filing a joint return is taxed at marginal rates of up to 37% on combined taxable income above $600,000.\(^{185}\) Under this rate schedule, if each spouse earns $350,000 of taxable income, the total tax liability on the household’s combined taxable income of $700,000 would be $198,379.\(^{186}\) The highest rate applied to a portion of the household income is 37%, and the overall average rate is approximately 28%.\(^{187}\) In contrast, if each spouse’s $350,000 of taxable income were taxed separately under that same rate schedule, each would pay $75,379,\(^{188}\) for a total household tax liability of $150,758. The highest rate applied to a portion of each spouse’s taxable income would be 32%, and the overall average rate would be reduced to approximately 22%.\(^{189}\)

This practical consequence of the difference between the calculating and comparing functions of the base will arise in any case where progressivity is implemented through a marginal rate schedule, and all such cases follow a general rule: Separate taxes on different factors in the comparing function of the base (where each factor serves as the calculating function of a separate tax instrument) always will yield a lower tax liability than a single progressive tax on a combined base of the same factors. As a result, taxpayers will not be consistently taxed on the basis of their relative ability to pay from all of the relevant factors.

### C. Taxing Both Income and Wealth

As described in Section II.A, neither income nor wealth is independently sufficient to compare taxpayers’ total economic spending power during the taxing period. An income tax does not account for differences in spending power during the taxing period that result from taxpayers’ saved wealth. In effect, an income tax understates the value of capital income relative to labor income. A wealth tax, in con-

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\(^{184}\) Taxable income is the net amount of income subject to tax under the rate schedules in I.R.C. § 1 after accounting for “above the line” deductions under § 62(a), personal exemptions under § 151, and the itemized or standard deductions under § 63(a)–(b).


\(^{186}\) In this case, the household would pay $161,379 plus 37% of the $100,000 excess over $600,000. See I.R.C. § 1(j)(2)(A).

\(^{187}\) $198,379 / $700,000.

\(^{188}\) In this case, each spouse would pay $64,179 plus 32% of the $35,000 excess over $315,000. See I.R.C. § 1(j)(2)(A).

\(^{189}\) $150,758 / $700,000.
contrast, does not account for differences in spending power that result from labor income, the productive investment of wealth, or the number of years across which a stock of wealth must be spread.

To account for the limitations of both measures as factors in economic well-being, proposals in the literature would tax both income and wealth. For example, David Shakow and Reed Shuldiner propose taxing wealth under a wealth tax and labor income under a separate income tax. This proposal excludes capital income from the income tax base on the grounds that the wealth tax operates in lieu of a tax on capital income.

The analysis of the separate bases of wealth and labor income as measures of economic spending power during the taxing period begins with the same considerations as the analysis of a tax on wealth above. A separate tax on wealth, without regard to capital income earned from the wealth, will not account for taxpayer decisions whether, and how, to productively invest the wealth. Consequently, taxpayers with the same wealth and different amounts of capital income resulting from the investment of their wealth are treated similarly. Furthermore, a wealth tax will not account for capital income consumed during the taxing period, which is a central component of the income tax base. Finally, a wealth tax will not account for taxpayers’ varying needs to spread their wealth across different numbers of periods and will consequently disfavor the pensioner who must preserve their wealth for longer.

If wealth, capital income, and labor income all independently factor into economic well-being, an alternative would be to tax all of these factors through both a comprehensive income tax (on both capital and labor income) and a separate wealth tax. The advantage of taxing both wealth and a comprehensive income base is that these bases cumulatively account for all of the factors in economic well-being described above, which is necessary to consistently compare taxpayers by their economic spending power during the taxing period and to avoid favoring capital income relative to labor income.

190 See Shakow & Shuldiner, supra note 13, at 538–44 (describing generally the authors’ proposal for separate labor income and wealth taxes).
191 See id. at 500–01. In effect, this element of the proposal mirrors the rationale in the proposal by Schenk and Cunningham for a tax on capital income in lieu of a tax on wealth and a separate tax on labor income. See supra notes 162–63 and accompanying text. From this perspective, the biggest difference between an imputed return to historic cost and a direct wealth tax is that the latter will account for actual changes in market value in years prior to a realization event. See Schenk, supra note 17, at 448 (elaborating on the retrospective possibilities of a wealth tax).
192 See supra Sections II.A.1–2.
Taxing these factors under separate instruments, however, faces an additional and fundamental limitation to any attempt to tax total economic well-being by separately taxing the different factors in economic well-being. For the reason described in the preceding Section, progressively taxing these bases under separate instruments is not equivalent to progressively taxing economic well-being from all factors under a single rate schedule. Stated in the terms of this Article, either base can serve in the calculating function of the progressive tax base, but neither is sufficient to serve in the comparing function. Consider once again Worker, Investor, and Worker-Investor described above, where Worker has no wealth, no capital income, and $100,000 of labor income; Investor has $1 million of wealth, $30,000 of capital income, and no labor income; and Worker-Investor has $1 million of wealth, $30,000 of capital income, and $70,000 of labor income. Irrespective of the rate schedule chosen for each instrument, a separate tax on wealth will treat Worker-Investor the same as Investor, while a separate income tax will treat Worker-Investor the same as Worker. As a result, both Worker-Investor’s income and wealth are taxed at the same rate as those of Worker and Investor, notwithstanding the fact that Worker-Investor has greater economic well-being (measured as economic spending power during the taxing period) than either Worker or Investor and, therefore, should be taxed at a higher average rate on both her income and her wealth.

The three taxpayers can only be treated consistently if their economic well-being from income and wealth are taxed under a single progressive rate schedule. The problem, however, is that income and wealth cannot be simply summed and taxed under a single instrument, because the two factors measure economic well-being in different terms. As described above, income indicates a periodic flow of economic resources, whereas wealth reflects a fixed stock. Therefore, for any fixed amount $X$ of wealth or $X$ of periodic income, the latter

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193 See supra Introduction.
194 Or better, if capital income is taxed at a preferential rate. See supra note 25.
195 The analysis in this case is the same as the analysis of the limitations of separately taxing different attributes described infra at Section III.A. Assume that $C_1$ is the measure of taxpayer’s economic well-being during the taxing period and that, from a perspective of limiting inequality of economic power, taxpayers should be compared by this measure. If income ($I$) and wealth ($W$) are both factors in economic well-being, then $C_1 = \epsilon(I, W)$. Under a progressive rate schedule with increasing marginal rates, separate taxes on $I$ and $W$ are not equivalent to a single tax on $C_1$. Using the notation from supra note 181, this may be expressed as $T(I) + T(W) \neq T(C_1)$.
196 That is, $C_1$ is a function of income and wealth, or $C_1 = \epsilon(I, W)$, but the function is not the simple sum of the factors, as was the case in supra note 179, where $\epsilon(X_1, X_2) = X_1 + X_2$.
197 See supra Sections I.A.1–.2; see also Andrews, supra note 12, at 1169–70 (“[W]ealth is a stock, not a flow; it represents a different dimension along which to measure economic
December 2018] TAXING INEQUALITY 1467

signals greater economic well-being, and simply adding income and wealth yields inaccurate results. For example, if income and wealth were summed for each of Worker and Investor, Investor would inaccurately be treated as having more than ten times the economic spending power of Worker.\textsuperscript{198} This calculation would significantly overstate Investor’s economic spending power relative to Worker’s.\textsuperscript{199}

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This Part described the challenges in coordinating taxes on wealth, labor income, and capital income as measures of economic well-being. None of these factors alone fully reflects a taxpayer’s total economic well-being. Furthermore, taxing these factors through separate instruments, as proposed in prior works, cannot consistently compare and tax these factors under a progressive rate schedule. At the same time, these factors cannot be easily combined and taxed under a single progressive rate schedule, however, since all three measure economic well-being in intrinsically different terms.

III

A COMBINED BASE OF INCOME AND WEALTH

This Part introduces a new base for progressive taxation, which is a combined base of economic well-being from labor income, capital income, and wealth. This combined base resolves the coordination problems with taxing labor income, capital income, and wealth as factors in economic well-being and tailors the tax base to the specific ways that inequality is understood to cause social and political harm. In particular, the combined base provides a consistent measure of difference in economic spending power across taxpayers.

A central feature of the combined base is the wealth annuity, derived from both wealth and capital income. The wealth annuity offers a middle path between favoring wealth by only taxing capital income and including the full wealth stock in the tax base each period. The wealth annuity value is added to a taxpayer’s labor income during the period to yield the combined base of economic well-being. In

\textsuperscript{198} The sum of Investor’s income and wealth is $1,030,000, while Worker’s income is $100,000.
\textsuperscript{199} Investor does not have ten times the economic spending power of Worker, since Investor’s $1 million of wealth is a stock that will be exhausted if spent in the taxing period, while Worker’s $100,000 of income will recur to the extent this amount represents a periodic income flow. Stated differently, if Worker has any additional earning ability in subsequent years, his stock of human capital is necessarily greater than $100,000.
effect, this combined base would be a limited intervention to the tax system, which would preserve the current income taxation of both labor and capital income and then add to this base a portion, but not all, of a taxpayer’s wealth.

This combined base resolves the core concerns of this Article. First, the combined base more accurately reflects economic spending power during the taxing period than either wealth or income alone. As a result, the combined base serves as a more appropriate base for reducing inequality under the relative economic power theory. Second, the combined base compares taxpayers with varying levels of labor income, capital income, and wealth in equivalent terms. As a result, a taxpayer’s total economic well-being from all of these factors can be consistently taxed under a single progressive rate schedule.

Sections III.A and III.B describe, respectively, the wealth annuity and the combined base of income and wealth. Section III.C addresses real-world considerations in calculating the combined base. Section III.D compares the combined base of income and wealth to two other alternative tax instruments: a wealth transfer tax, such as an estate or inheritance tax, and a consumption tax. Section III.E offers brief final reflections on the social objectives of personal choice and economic growth.

A. The Wealth Annuity

As described above, labor income, capital income, and wealth cannot be taxed under a single progressive tax instrument until they are translated into terms that measure economic well-being consistently. Labor income reflects a return of a portion of taxpayer’s principal of human capital; capital income, in contrast, generally measures an investment return but not a return of the principal; finally, a wealth stock represents a taxpayer’s entire wealth principal.\footnote{See supra Section I.A.}

These differing measures can be reconciled by translating both a taxpayer’s wealth at the beginning of the period and their capital income earned during the period into a hypothetical annuity value.\footnote{Cf. supra note 41 (employing similar methodologies in the welfare context). A wealth annuity concept has been previously suggested in the literature on inequality. The most likely explanation for its lack of broader application in the tax literature prior to this Article is due to the fact that the wealth annuity, like any wealth measure, distinguishes between consumption in different periods and therefore does not measure economic well-being over the course of one’s lifetime. See, for example, the brief critique of this measure in Thuronyi, supra note 46, at 98. The relative economic power theory, however, is concerned with differences in economic spending power each period and not on a lifetime basis. See supra Section I.D. Within this framework the wealth annuity concept has new relevance and application defining the progressive tax base.}
The wealth annuity value converts a fixed wealth stock into a periodic flow over a number of periods, such that an equal amount would be returned each period. In effect, this measure reflects the amount of additional economic resources the wealth would be expected to generate over the annuity holder’s remaining lifetime. In the case of an actual annuity, the annuity holder receives back a portion of the principal, as well as an investment return on the outstanding principal. At the end of the annuity period, the entire principal has been returned, and no additional value remains. Similarly, the wealth annuity value used in the combined base estimates the amount of principal that would be returned each year if an actual annuity were purchased by the taxpayer. The amount of the wealth annuity would be calculated anew each year based on the taxpayer’s circumstances in that year, in the same manner that income or wealth would be calculated each year under, respectively, a periodic income tax or a periodic wealth tax.

For a simple example of an actual annuity, assume a taxpayer purchases an annuity for $1 million that will pay the taxpayer $100,000 at the end of each year for the next twelve years. After the final payment at the end of year twelve, the annuity is exhausted. In effect, each year the taxpayer receives back a portion of their $1 million investment plus an investment return on the outstanding principal. This stream of payments would imply an investment return of approximately 3% each year.

The same principle could be used to calculate a hypothetical annuity value derived from a taxpayer’s wealth, to yield an estimate of the value of wealth spread across the taxpayer’s remaining lifetime. For example, if Worker-Investor has $1 million of wealth and earns $30,000 of capital income in the year, implying a 3% rate of return for the year, the annuity value over each of twelve years is approximately $100,000. In the first year, the annuity amount equals the sum of the

\[ A = \frac{W \cdot r}{1 - \left(1 + \frac{r}{n}\right)^{-n}} \] where \( W \) is the taxpayer’s positive rate of return on saved wealth and \( n \) is the number of periods the annuity is paid.

202 The formula for calculating the periodic annuity return \( A \) derived from a stock of wealth \( W \) is \( A = \frac{W \cdot r}{1 - \left(1 + \frac{r}{n}\right)^{-n}} \) where \( r \) is the taxpayer’s positive rate of return on saved wealth and \( n \) is the number of periods the annuity is paid.

203 See Graetz & Chenk, supra note 182, at 156–59 (providing textbook examples of simple annuity payments).

204 Solving for \( r \) with this stream of payments in the formula described supra note 202 yields \( r = 2.92\% \). In the case of an actual annuity, I.R.C. § 72(b) (2012) would exclude from income each year part of the $100,000 deemed to reflect a return of a portion of the wealth principal.

205 In this case solving for \( A \) in the formula described supra note 202 yields \( A = $100,462.09 \).
$30,000 of capital income earned during the year and a return of approximately $70,000 of the wealth principal.

In subsequent periods, Worker-Investor’s annuity value would be recalculated based on the taxpayer’s starting wealth and capital income in those periods, in the same manner that income and wealth are recalculated each period under income or wealth taxes. If, for example, Worker-Investor in fact spends the $100,000 in the first year,\(^{206}\) she will begin the second year with approximately $930,000 to be spread over 11 remaining years, yielding the same annuity value in the second year. If, in contrast, Worker-Investor does not spend her annuity value in the first year, she will begin the second year with $1,030,000 to be spread over the 11 remaining years, resulting in a larger annuity value for the second year of approximately $110,000.\(^{207}\)

A simplified version of this annuity calculation could also be used, so that the amount of wealth principal included in the taxable base does not depend on the capital income observed in the year. For example, capital income could be calculated each period as under current law, plus a simple \textit{pro rata} proportion of the taxpayer’s wealth divided equally across the same number of future periods. In this case, Worker-Investor’s wealth annuity value would be her $30,000 of capital income, as measured under current law, plus an additional $83,333 attributable to a \textit{pro rata} portion of her $1 million wealth divided over the twelve years. Under this simplified method, the wealth principal portion of the annuity does not depend on the capital income earned in the year. This method, however, overstates the value of the wealth principal each year, as compared to the principal value under the annuity calculation.\(^{208}\) Similarly, the wealth principal portion could be calculated based on a deemed return to wealth, using the same principal proposed by Professors Cunningham and Schenk for an improved income tax.\(^{209}\)

In each case, the wealth annuity reflects a partial return of capital, as well as an investment return on the principal balance, or the taxpayer’s capital income during the year. As a result, the wealth annuity tax base differs from both the capital income tax base and from a wealth tax base in critical respects. First, and unlike a wealth

\(^{206}\) This example is illustrative and assumes, for the sake of simplicity, that the $100,000 annuity is spent on the last day of the first year.

\(^{207}\) In this case solving for \(A\) in the second year the formula described \textit{supra} note 202 yields \(A = 111,319.77\).

\(^{208}\) For example, in this case, Worker-Investor’s total taxable base would be $113,333 (the $83,333 principal value plus the $30,000 of capital income), rather than the total of approximately $100,000 under the formal annuity calculation.

\(^{209}\) See \textit{supra} notes 162–65. In this case, however, the imputed return method would be used in combined tax base of both income and wealth, rather than for an income tax alone.
TAXING INEQUALITY
1471

tax base, the wealth annuity accounts for capital income earned during the year and therefore distinguishes between taxpayers with different decisions on whether, and how, to invest their wealth. This is because the wealth annuity accounts for capital income earned during the period, as under the current income tax.

The wealth annuity accounts for both wealth and capital income but does not account for the entire stock of wealth in any single year, as a portion of the wealth principal is excluded to account for hypothetical annuity payments in future periods. As a result, the wealth annuity also distinguishes between the amount of a taxpayer’s wealth considered disposable during the taxing period and an amount preserved for future periods. For the same reason, the size of the wealth annuity value varies with the number of periods the wealth is expected to last and distinguishes between taxpayers with different needs to save their wealth for the future.

From the perspective of the relative economic power theory, the wealth annuity therefore yields a more accurate measure of economic spending power during the taxing period. As described in Sections I.D.1–.2, the relative economic power theory depends upon the credible threat by those with greater economic power to expend their resources to assert their own preferences. The retiree with wealth that must be saved for the future cannot credibly make this threat and to this extent should not properly be considered to derive greater economic power from her wealth. In contrast, a taxpayer with greater disposable wealth in the current period will have greater economic power.

The wealth annuity approximates how much economic power is available from a taxpayer’s stock of wealth (and capital income) by distinguishing between wealth that is available in the current period and wealth that is treated as saved for the future. Under the wealth annuity, a retiree who must save for the future will only be treated as having a portion of the principal available in the current period. If the retiree expects to live for longer, and therefore must save their wealth for a greater number of periods, then even less of the wealth will be considered disposable in the current period.

The purpose of the wealth annuity calculation is not to factually predict the future economic experience of the taxpayer. In future periods, a taxpayer may earn a different rate of return, or they may have more or less wealth, and each of these changes will affect the annuity value in those periods. In a similar manner, observing a tax-

210 For examples of the operation of the wealth annuity within the combined base, see infra notes 227–35 and accompanying text.
pursuer’s annual income or wealth alone during the taxing period does not predict their economic circumstances in future periods.\textsuperscript{211} Rather, the purpose of the wealth annuity is to derive a more accurate measure of the taxpayer’s economic spending power each period from wealth and capital income, using the same data points that would be used for either a wealth or an income tax: wealth at the beginning of the period and capital income earned during the period.

As described above, labor income reflects a return of a portion of a taxpayer’s stock of human capital each period, such that the entire “stock” of human capital is exhausted once the taxpayer ceases to earn labor income.\textsuperscript{212} In this respect, labor income can already be considered an annuity return to human capital.\textsuperscript{213} Under the wealth annuity, both wealth and capital income are translated into equivalent terms as labor income, as a return of a portion of a taxpayer’s stock of wealth each period plus an investment return on the principal balance. In the case of both wealth and human capital, a taxpayer is treated as receiving a return of their principal each period, which generates economic spending power, as well as an investment return on the outstanding principal.

\textbf{B. The Combined Base}

The combined base is the sum of the wealth annuity plus the taxpayer’s labor income during the taxing period. For example, Worker-Investor’s $100,000 wealth annuity value\textsuperscript{214} would be added to her $100,000 of labor income, and this $200,000 sum would be taxed under the progressive rate schedule. In effect, the combined base begins with the same base of both labor and capital income taxed under the current federal income tax base and then adds a portion of the taxpayer’s wealth.

The combined base yields key advantages over an income tax, a wealth tax, or separate taxes on both. First, the combined base translates the varying factors of capital income, labor income, and wealth into equivalent measures of economic well-being during the taxing period. Similarly, one can imagine additional factors that affect a taxpayer’s economic well-being and that are not easily accounted for in the tax system. For example, a taxpayer may have other future financial obligations that are not currently observable as debt (negative wealth) and are more appropriately analogized to contingent liabilities. Another taxpayer may reasonably anticipate a future stock of wealth in the form of a gift or bequest. These assets and liabilities can only be observable in future periods once they are realized.\textsuperscript{212}

\textsuperscript{211} See supra Section I.A.1.

\textsuperscript{212} See supra note 58 and accompanying text.

\textsuperscript{213} See supra note 205 and accompanying text.
period. As a result, these factors can be consistently taxed under a progressive rate schedule.\textsuperscript{215}

The combined base is also sensitive to the differences in economic power between an investor who earns capital income and a worker who earns labor income, or between a saver who has additional disposable income and a pensioner who does not. Neither a wealth tax nor an income tax measures economic well-being in sufficiently nuanced terms to make these same distinctions. For the same reason, both a wealth tax and an income tax are blunt instruments for constraining inequality. The combined base, in contrast, measures each taxpayer’s economic spending power and taxes them accordingly, and thereby tailors the progressive tax base to the specific ways that inequality is understood to cause political and social harm.

Finally, the combined base reflects a middle ground between a wealth tax, which could unduly burden savers, and a capital income tax, which favors investors over workers. Unlike a wealth tax, the combined base accounts for the needs of savers by exempting from tax the portion of the wealth principal that must be preserved for future periods. As a result, a tax on the combined base will never exhaust a saver’s wealth in her lifetime.\textsuperscript{216} On the other hand, the combined base will more effectively constrain inequality than a tax on capital income alone by explicitly accounting for the role of wealth as a factor in economic well-being.

To illustrate the effect of the combined base, consider first the treatment of Worker, Investor, and Worker-Investor described above in Part I. Assume that the combined base for each is according to the following rate schedule: 20% of the first $100,000, plus 40% of any additional amounts.\textsuperscript{217} Worker and Investor are each treated as having a taxable base of $100,000 for the period (Worker derives his economic spending power from labor income and Investor from her wealth and capital income), for a tax liability of $20,000 each and an average tax rate of 20% each. Worker-Investor, in contrast, will be

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\textsuperscript{215} It might be argued that these same factors could also be reconciled by converting expected future labor income into a present value of estimated human capital, and then adding this amount to the taxpayer’s nonhuman capital. As described supra note 63, however, human capital is intrinsically different than nonhuman capital, since the former will only generate actual economic resources to the degree it is monetized as labor income each year. Taxing the present value of future human capital, in contrast, would have an effect similar to endowment taxation. See supra note 72 and accompanying text.

\textsuperscript{216} This is because the wealth annuity will only tax a portion of the wealth principal while exempting the remainder of the principal that is treated as saved by the taxpayer for future periods.

\textsuperscript{217} The rates used here are illustrative and will depend on the degree to which inequality should be constrained and the different behavioral responses to the taxation of different components of the base.
treated as having a taxable base of $170,000 for the period, resulting from both her income and wealth. Worker-Investor will pay a total tax of $48,000 on this base—20% on the first $100,000 and 40% on the remaining $70,000—for an overall average rate of approximately 28%. Worker-Investor is appropriately taxed at higher average rates on both her income and her wealth, on account of her greater economic spending power during the taxing period. More critically, the combined base measures exactly how much more powerful Worker-Investor is as a result of her greater income and wealth. As a result, the progressive rate schedule can be properly adjusted in order to reduce the disparity in economic spending power among the taxpayers.

The combined base also allows for more consistent treatment of negative wealth, or debt. Recall the doctor described above, who has negative wealth from medical school debt. Assume that the doctor must make a debt payment of $10,000 each year. This payment reflects a portion of the debt principal and interest paid on the outstanding balance. The amortization payments owed on negative wealth reflect reduced economic spending power in the taxing period, in the same manner that the wealth annuity from positive wealth reflects increased economic spending power in the taxing period. Under the combined base, the doctor would be treated as having only $190,000 of available economic spending power in the taxing period. The doctor will pay a total tax liability of $56,000, for an overall average rate of approximately 29%. Compare the treatment of the doctor to the hypothetical dentist, who has $200,000 of income and no debt. The dentist will pay a total tax liability of $60,000, for

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218 The sum of Worker-Investor’s $70,000 labor income and approximately $100,000 annuity value from wealth and capital income. See supra note 205 and accompanying text.

219 See supra notes 21–23 and accompanying text.

220 Of course, a particular debt obligation is likely to have a shorter repayment period than the taxpayer’s expected lifespan. Under a wealth tax, this problem does not arise because a wealth tax fails to account for the number of periods across which the wealth must be spread. Recall, however, that the purpose of the wealth annuity is not to predict actual economic events in subsequent periods but rather to more consistently compare taxpayers in the current period. It would be administratively unfeasible to separately account for the payment terms of every financial instrument and investment. This limitation may be considered an example of the general principle that the tax system cannot account for all factors that affect a taxpayer’s economic well-being. See supra note 211.

222 The labor income of $200,000 less the negative annuity value of $(10,000) on account of the doctor’s negative wealth.

223 $100,000 times 20% plus $90,000 times 40%.

224 29.47%.

225 See supra text accompanying note 147.
TAXING INEQUALITY

an overall average rate of approximately 34%. Although both earn the same income, the dentist will pay more in tax because they do not also have debt.

The combined base also accounts for differences in economic spending power among taxpayers with equal savings but who expect to spread the wealth across different numbers of future periods. Consider the example of the two retirees above, where Early Retiree and Late Retiree each have $100,000 of savings, and each earns a return of 2% a year. Late Retiree, however, is expected to live for ten more years, whereas Early Retiree’s savings must stretch for an expected twenty years. The wealth annuity quantifies the difference between the retirees’ economic circumstances. With respect to Late Retiree, $100,000 of savings generating a 2% annual return would yield an annuity of approximately $11,000 per year over a ten-year period. With respect to Early Retiree, the same savings and return would yield an annuity of approximately $6000 per year over a twenty-year period. Because Late Retiree’s savings are expected to be spread over fewer years, Late Retiree has a higher taxable base under the combined base.

If a saver is still working and, as a result, also has labor income, they will appropriately be treated as having greater economic spending power than a saver who does not work, holding constant each taxpayer’s amount of savings and the life expectancy. Consider an additional taxpayer, “Still Working,” who, like Early Retiree and Late Retiree, has $100,000 of savings that earns a 2% annual return and who, like Early Retiree, expects to live for twenty more years. Still Working, however, also earns $10,000 of labor income each year. Still Working is treated as having available economic spending power of $16,000 in the taxing period, resulting from the $10,000 of labor income and the $6000 annuity value from saved wealth, and would consequently be treated as having greater economic spending power than Early Retiree, who has the same wealth but not labor income.

Finally, consider again the starting example of the doctor and the investor under the combined base, which represents a case of income equality but significant wealth inequality. To hold life expectancy constant, assume that both are expected to live for another forty years. As described above, the doctor will have net income of $190,000 for the

226 34.29%
227 See supra Section II.A.2.
228 $10,914.37.
229 $5995.76.
year, after making the $10,000 debt payment.\textsuperscript{230} The investor’s $35 million wealth, assuming investor’s investment return of 0.06%, would yield an annuity of approximately $980,000 per year over a forty-year period.\textsuperscript{231} Once the investor’s wealth is translated to an annuity value, the investor’s much greater economic spending power is evident and can be quantified. If the combined base is taxed at the rate schedule specified above, the doctor pays the total tax liability of $56,000 described above, for the overall average rate of approximately 29%\textsuperscript{232}. The investor will be treated as having available economic resources of $980,000\textsuperscript{233} and will consequently pay a total tax liability of $372,000\textsuperscript{234} for an overall average rate of approximately 38%\textsuperscript{235}.

\section{C. Real-World Considerations}

This section addresses real-world considerations in measuring the combined base. Calculating the combined base of economic well-being generally requires the same basic information as under income and wealth taxes: the taxpayer’s stock of wealth at the beginning of the year and their capital and labor income during the taxing period.\textsuperscript{236} The rate of return on the taxpayer’s wealth, for the purpose of determining the wealth annuity, may be derived from using the same data points that would be used for either a wealth or an income tax: wealth at the beginning of the period and capital income earned during the period.

The combined base is not intended to perfectly define a taxpayer’s economic circumstances, but rather to yield a more accurate

\\textsuperscript{230} After the debt is paid off in ten years, the doctor will no longer have negative wealth and consequently will be treated as having greater economic well-being in those taxing periods, the same as if the doctor had no debt to begin with but increased his savings during that time.

\\textsuperscript{231} $980,920.32.

\\textsuperscript{232} See supra notes 223–24 and accompanying text.

\\textsuperscript{233} See supra note 231 and accompanying text.

\\textsuperscript{234} $100,000 times 20% plus $880,000 times 40%. This amount is approximately equivalent to the liability resulting from a 1% wealth tax on the investor’s $35 million in wealth, or half of Professor Piketty’s proposed top marginal rate. See Piketty, supra note 13, at 517 (suggesting a top wealth tax rate of “2 percent above 5 million [euros]”). This example illustrates how, unlike periodic taxes on both capital income and a taxpayer’s entire wealth stock, a tax on the combined base can result in a lower cumulative tax liability, even if the portion of the wealth principal is taxed at a higher rate than the rates proposed in the literature for a tax on the taxpayer’s entire wealth stock. See supra note 168 and accompanying text (describing the cumulative effect of taxing both the entire wealth stock and capital income each period). The simple reason for this difference is the combined base will generally use a smaller wealth base than under a full wealth tax.

\\textsuperscript{235} 37.96%.

\\textsuperscript{236} The final data point required to calculate the wealth annuity, the taxpayer’s life expectancy, is discussed infra Section III.C.4.
measure of economic spending power than income or wealth alone, and to consistently account for the different factors in economic well-being. A general theme in the discussion that follows is that any base of income, wealth, or a combination thereof will encounter complications and inaccuracies in determining a taxpayer’s economic circumstances, and in measuring different elements of the tax base. In many cases, these limitations can be addressed at a cost of additional administrative complexity. The question of whether these limitations should be resolved at additional administrative cost, however, is generally a separate policy determination from the choice between taxing income, wealth, or a combination thereof.

1. Observing and Measuring Income and Wealth

Scholars divide on the question of whether it is easier to observe and measure a base of income or wealth.\(^{237}\) Whereas the income calculation necessitates determinations of timing and character, the measurement of wealth is theoretically simpler, since the only determination necessary is the asset value.\(^{238}\) In effect, however, the most significant administrative challenge to a wealth tax base is the same challenge to an income tax base: the treatment of irregularly traded assets without discernible market value. Under a wealth tax, cash and financial assets are easily valued,\(^{239}\) in the same manner as the appreciation of financial assets under an income tax.\(^{240}\) Nontraded or unique assets, however, may be difficult or impossible to value for purposes of a wealth tax,\(^{241}\) for the same reason that the appreciation of these assets is difficult to determine for the purposes of an income tax.

As described above in Section I.A, the definitions of both “income” and “wealth” will also depend on a normative determination of the sources of value that should factor into economic well-being. From the perspective of the relative economic power theory, however, the normative boundaries of the income and wealth definitions accord with the administrative challenges of measuring asset

\(^{237}\) Compare, e.g., Kleinbard, supra note 10, at 600 (arguing that capital income flows are often easier to measure), with Shakow, supra note 13, at 949 (“Although it may still seem difficult to evaluate everyone’s wealth, the growth in size and complexity of the federal income tax suggests that measuring income may not be as easy as was first believed.”).

\(^{238}\) See, e.g., Shakow, supra note 13, at 950.

\(^{239}\) See, e.g., Fleischer, supra note 19, at 276–77.

\(^{240}\) See Glogower, supra note 11, at 128–29. That is, if the value of an asset is readily observable each year, for the purposes of measuring a wealth tax, changes in the asset’s value are similarly observable, for purposes of measuring an income tax.

\(^{241}\) See, e.g., Fleischer, supra note 19, at 277.
values and appreciation, since the assets that are easiest to value are also the clearest indicators of economic spending power. As described above, appreciation of regularly traded assets is readily observable, and therefore a mark-to-market income tax on this appreciation would not pose significant administrative challenges. Such assets could be valued in the same fashion for the purpose of a wealth tax. In the case of nontraded assets, a rule deferring taxation until a sale or other realization event—with an appropriate interest charge to account for the benefit of deferral—would be equally advantageous for both an income tax and a wealth tax.

The challenges to defining and observing income and wealth are no easier, and no harder, under the combined base of both. In the case of irregularly traded assets, a similar retroactive method may be used to determine the tax liability due upon a sale, if the benefits of accurately measuring income and wealth justify the additional administrative and compliance costs. Upon realization, the asset value and rate of appreciation over the asset’s holding period may be determined, which provides sufficient information to retroactively determine the annuity value from holding the asset for each year and to tax these annuity values under the applicable rates for these years, with an interest charge to account for the deferral benefit.

2. Nonperiodic Labor Income

As described above, the basic distinction in the literature between wealth and income is that wealth is a fixed stock and income a periodic flow. In the real world, however, income is seldom perfectly periodic. A taxpayer may lose her job, receive a raise or a demotion, or retire. The most consistent comparison of taxpayers’ economic spending power would therefore account for the degree to which their labor income is periodic, because a taxpayer with income that is not expected to recur cannot afford to spend as much in the current period. The periodicity of a taxpayer’s labor income, however, is not available until the end of a taxpayer’s life, for the same

\[242\] See supra note 55 and accompanying text.

\[243\] See supra notes 55, 62 and accompanying text.

\[244\] As described above, Professors Cunningham and Schenk propose imputing an annual return to cost for certain capital assets and taxing any residual gains or losses upon disposition. See supra notes 162–65 and accompanying text.

\[245\] See supra note 61 and accompanying text.

\[246\] Consider, for example, the case of a taxpayer who is only employed for a fixed term, or who may lose their job.
reason that their total stock of human capital is not observable until that time.\footnote{247}

This problem of “lumpy income” poses a challenge to any tax base that includes labor income. Under a progressive income tax, the progressive marginal rate schedule imposes a larger tax burden on taxpayers with intermittent periods of higher income than on those with steadier and more modest income flows of equal cumulative value.\footnote{248} The problem can be more pronounced, however, under a system with separate taxes on labor income and wealth.\footnote{249} This is because a taxpayer with a high labor income that is not likely to be repeated will need to save a portion of his income to compensate for the expected shortfall in subsequent years. As a result, the taxpayer will be taxed on his entire labor income in the first year under the income tax, as well as the wealth saved from the income in subsequent years under the wealth tax. In contrast, a taxpayer with an equal amount of labor income earned over a period of years (and spent each year) will only be taxed on the income and will not face an additional wealth tax liability.

The same lumpy income problem is present under the combined base, although not to the same degree as a system that fully taxes labor income and a taxpayer’s entire wealth stock each period. This is because only a portion of the taxpayer’s wealth is included in the tax base each period, whereas the portion of wealth treated as saved for future periods is exempted from future taxation.

The impossibility of predicting the periodicity of labor income leads to a range of imperfect options for any tax base that measures economic well-being. The first option is to avoid exacerbating the penalty to lumpy income by ignoring the role of wealth entirely. While this approach limits the penalty to taxpayers who earn a high income and subsequently save a portion for future lower-earning years, omitting wealth from the tax base also will generally disfavor all labor income earners relative to wealthy investors. Taxing a taxpayer’s entire stock of wealth each period under a wealth tax results in the greatest adverse treatment of taxpayers who earn lumpy labor

\footnote{247} Of course, labor income partially indicates periodic earning capacity. In many cases, taxpayers may also be able to smooth their labor income flows across periods. For example, a taxpayer may be able to purchase wage or disability insurance, find stable employment, or “anchor” their salary in future positions on the basis of their salary in prior positions.

\footnote{248} This concern was addressed by William Vickrey, who advocated for a solution that accounted for cumulative income flows across a taxpayer’s lifetime. See William Vickrey, *Averaging of Income for Income-Tax Purposes*, 47 J. POL. ECON. 379, 389–90 (1939).

\footnote{249} See, for example, the proposal by Professors Shakow and Shuldiner described in Shakow & Shuldiner, *supra* note 13, at 538–44.
income. From this perspective, the combined base offers a middle
ground that mitigates, but does not eliminate, the disfavored treat-
ment of nonperiodic income, without entirely ignoring the role of
wealth as a factor in economic well-being.

3. Characterizing Capital Income

As described above, capital income can be decomposed into the
risk-free return to savings and compensation for investment risk.\textsuperscript{250} Capital income may also constitute other elements that are not prop-
erly characterized as investment returns, such as mislabeled labor
income, supernormal returns such as those resulting from monopolies
or rents, and inflation.\textsuperscript{251} Finally, in some cases capital income may be
a return of a portion of a taxpayer’s wealth principal.\textsuperscript{252}

As in the case of lumpy labor income, these inaccuracies are
present under the income tax and would generally present similar
challenges in the case of a tax on the combined base.\textsuperscript{253} In both cases,
more accurate measurements are possible, but the benefits of greater
accuracy must be weighed against additional administrative and com-
pliance costs. For example, under either the income tax or the com-
bined base, capital income could be calculated net of inflation, at a
cost of additional complexity.\textsuperscript{254} Scholars have also proposed methods
to distinguish more effectively between capital and labor income.\textsuperscript{255}

\textsuperscript{250} See supra text accompanying note 57.
\textsuperscript{251} See supra text accompanying note 57.
\textsuperscript{252} See, for example, the attempt in I.R.C. §§ 301 and 316 (2012) to distinguish between
the portion of a dividend from a corporation representing a return of capital and the
portion representing an investment return by reference to the corporation’s earnings and
profits. For the limitations of this approach, see Cheryl D. Block, Corporate
Taxation 145 (4th ed. 2010) (“Although the recovery of capital notion often is cited as
the rationale for the dividend definition . . . . [t]he use of both accumulated and current
e\&p sometimes produces results inconsistent with a logical application of recover of capital
principles.”).
\textsuperscript{253} Of course, the problems with measuring and characterizing capital income would be
different under a wealth tax, which only accounts for wealth at the beginning or end of
each period and which exempts capital income earned and spent during the period.
In addition to the general limitations of a wealth tax described above, supra Sections
II.A.2–3, however, the problems with mischaracterized capital income are not resolved
under a wealth tax. This is because a system that taxes labor income but not capital income
would still allow taxpayers to mischaracterize their labor income as capital income. If this
income is then spent during the period, it would not factor into either base and would
escape taxation.
\textsuperscript{254} See, e.g., Reed Shuldiner, Indexing the Tax Code, 48 Tax L. Rev. 537, 584–85 (1993)
(discussing inflation-indexed taxation of gains and losses from § 1256 futures contracts,
foreign currency contracts, and options).
\textsuperscript{255} See, for example, Professor Kleinbard’s proposal for a “labor-capital income
centrifuge.” Kleinbard, supra note 17, at 283–99 (proposing to distinguish between capital
and labor income by taxing business profits and then applying separate rules to account for
the labor income element earned by an owner who materially participates in the business).
And finally, in many cases the tax system does distinguish between capital income and a return of wealth principal, and these principles could be used elsewhere if the improved accuracy justifies the additional administrative costs.

4. *Uncertain Life Expectancy*

In order to convert the stock of wealth into a periodic flow, the wealth annuity calculation also requires estimating the taxpayer’s life expectancy. Any number used will be necessarily imprecise, but such calculations are regularly undertaken to calculate actual annuity values under current law. Section 7520 of the Code requires the IRS to publish actuarial tables and to value annuities, life interests, and reversionary interests under the estate, gift, and income taxes. These tables could be easily repurposed in order to calculate the wealth annuity component of the combined base. Similarly, Treasury Regulations under I.R.C. § 72 also provide actuarial tables for purposes of calculating the taxable and excluded portions of annuity payments.

Taxpayers who outlive or predecease their expected lifetime can both be treated equitably under the combined base. First, a taxpayer who has the misfortune to die sooner will have been treated as having less economic spending power (and therefore a lower tax liability) in prior years than as indicated by their actual lifespan. This result is unlikely to be objectionable to taxpayers, as this case in effect mitigates the tax liability for those who die unexpectedly early. The more inequitable case is where a taxpayer outlives her expected lifespan and as a result pays too much in tax in prior periods, on the basis of higher assumed annuity values in those years. Such a taxpayer is already at a greater risk of outliving their savings, and this financial strain would be increased if the taxpayer faces a higher tax liability. In this case, the government could issue a refundable credit to taxpayers living beyond their expected lifespan for the excess taxes paid in prior years. Alternatively, the wealth annuity may be calculated on the basis of a lifespan that is longer than the actuarial expectations, in order to err on the side of under-taxing wealth-holders and to avoid overtaxing an individual who lives longer than expected.

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256 See, for example, the treatment of annuities under § 72, as described supra note 204.
5. Exemptions

Policymakers can also set minimum exemption or standard deduction levels under an income tax, a wealth tax, or the combined base. Under the federal income tax, an individual taxpayer who does not itemize their deductions is currently allowed a standard deduction of $12,000 from their adjusted gross income (and twice this amount is allowed for a married couple).\(^{259}\) The standard deduction (and the personal exemption under I.R.C. § 151)\(^{260}\) originated in the notion that taxpayers should only be taxed on “clear income” above a level devoted for basic necessities.\(^{261}\) Proposals for a wealth tax have similarly included a minimal exemption level, so that wealth is only taxed above a level of savings necessary for basic financial security.\(^{262}\)

Exemptions or deductions for basic levels of income and wealth may also be incorporated into the base calculation under the combined base. The combined base also offers policymakers additional flexibility in structuring exemption levels, since exemptions can be made on a separate basis for minimal amounts of income or wealth as factors in the combined base, or on a combined basis as an integrated exemption for both. Under separate income and wealth taxes, in contrast, an integrated exemption cannot be consistently applied for the same reason that income and wealth cannot be consistently compared and taxed across taxpayers through separate instruments.\(^{263}\)

The combined base can also accommodate asset-specific exemptions to alleviate perceived hardship on taxpayers or advance other policy goals. For example, the income tax base currently excludes up to $500,000 of gains from the sale of a primary residence\(^{264}\) and allows a deduction for mortgage interest paid.\(^{265}\) These preferences have

\(^{259}\) I.R.C. § 63(b), (c)(1)–(2), (7) (Supp. V 2018). This temporarily increased standard deduction is currently in effect through 2025. Id.

\(^{260}\) The personal exemption amount is currently set to $0 through 2025. I.R.C. § 151(d)(5).

\(^{261}\) See Edwin R.A. Seligman, Progressive Taxation in Theory and Practice 80–81, 129–30, 159–61 (1894) (explaining that early theorists considered the minimum of subsistence as an expense of production).

\(^{262}\) See, e.g., Shakow & Shuldiner, supra note 13, at 547 (proposing an exemption on the first $40,000 of net wealth in 1999 dollars).

\(^{263}\) For example, Professors Shakow & Shuldiner suggest integrating a $5000 exemption under the labor income tax with the $40,000 exemption under the wealth tax by use of a unified credit against the tax liability from both. See id. at 547. As described supra Section II.C, however, without first translating income and wealth into consistent measures of economic well-being, there is no way to consistently tax both as factors in economic well-being under a progressive rate structure. For the same reason, a credit against the cumulative tax liability cannot consistently exempt a minimum level of economic well-being from both factors.

\(^{264}\) I.R.C. § 121 (2012).

\(^{265}\) Id. § 163(h).
been justified as a subsidy to home ownership and asset values, and to alleviate the compliance burdens faced by taxpayers. Either a wealth tax base or the combined base of income and wealth could similarly exempt a minimum amount of net wealth attributable to a taxpayer’s primary residence from the base calculation.

D. Compared with Other Tax Bases

The discussion above in Sections II.A and II.C described the key differences between the combined base and the other proposed bases of income and wealth in the literature. This Section briefly describes the differences between the combined base and other proposed bases for taxation: an estate or inheritance tax and a consumption tax.

I. An Estate or Inheritance Tax

As described above, an estate or inheritance tax can limit the accumulation and transmission of wealth across generations and equalize opportunity among taxpayers. An estate tax is calculated by reference to the decedent’s estate, while an inheritance tax would be calculated by reference to the amount received by each beneficiary of the estate.

The critical distinction between a periodic wealth tax, on the one hand, and either an estate or inheritance tax, on the other, is that the latter instruments are one-time levies upon the transfer of wealth across generations. As a result, neither instrument will continuously constrain economic inequality during a taxpayer’s lifetime, as implied under the relative economic power framework. Both estate and inheritance taxes also imply that death is a uniquely appropriate time to assess taxes. This feature invites common characterization of the

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267 See supra Section I.C.4 and accompanying text.

268 For 2018, the federal estate tax rate is 40% of gross estates and gifts above an inflation-adjusted exemption level of $10 million. I.R.C. §§ 2001, 2010 (Supp. V 2018). For a proposal for an inheritance tax, see Batchelder, supra note 112, at 62–67. Scholars favoring an inheritance tax to an estate tax argue that the latter only provides a “rough justice” of distributional equity because it does not account for different amounts received by different estate beneficiaries. See id. at 53–56 (describing the inequitable and inconsistent treatment of individual heirs under an estate tax). In contrast, an inheritance tax would tax inheritances received by each beneficiary and thereby account for the actual economic benefit received by each. For example, Professor Batchelder’s proposal would include inheritances above $1.9 million as taxable income, taxed at the ordinary income rates plus a 15% surcharge. See id. at 62–67.

269 See supra Section I.D.3.
current estate tax as a “death tax”\textsuperscript{270} that is exogenous to the normal tax rules that operate during the wealth holder’s life. The “death tax” label renders such instruments politically vulnerable\textsuperscript{271} and obscures the continuous role of wealth as a factor in inequality throughout the holder’s life.

The combined base of income and wealth can prevent the perpetuation and transmission of dynastic wealth without the need for a separate estate or inheritance tax. Furthermore, the combined base would constrain excessive economic inequality continuously, rather than once each generation upon the transmission of wealth from a decedent to beneficiaries. Near the end of a taxpayer’s life, the combined base effectively operates as a gradual estate tax by including increasing amounts of saved wealth in the taxable base each period, while ensuring that the taxpayer will never exhaust her savings through tax payments before the end of her life. From the perspective of the estate beneficiaries in the next generation, the combined base operates in a parallel fashion. An heir who begins life in a position of privilege from inherited wealth will similarly begin paying taxes each period on this inheritance through the wealth annuity component of the combined base.

2. A Consumption Tax

Whereas a tax base of income and wealth taxes individuals in accordance with their power to consume, a consumption base taxes individuals in accordance with their actual consumption.\textsuperscript{272} As scholars have noted, however, a consumption base could increase, rather than reduce, the harms resulting from economic inequality. A consumption tax encourages taxpayers to preserve their economic

\textsuperscript{270} See, e.g., House GOP, A Better Way: Our Vision for a Confident America: Tax 16 (2016), https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf (proposing to repeal the estate tax and the generation-skipping transfer tax “so that the death of a family member or loved one no longer will be a taxable event”).


\textsuperscript{272} For arguments favoring a progressive consumption tax, see generally, for example, Edward J. McCaffery, Fair Not Flat: How to Make the Tax System Better and Simpler (2002); Daniel N. Shaviro, Replacing the Income Tax with a Progressive Consumption Tax, 103 Tax Notes 91 (2004); Robert H. Frank, Why Have Weddings and Houses Gotten So Ridiculously Expensive? Blame Inequality, Vox (Jan. 16, 2015, 9:10 AM), https://www.vox.com/2015/1/16/7545509/inequality-waste.
power by saving and investing instead of spending, thereby amplifying differences in relative economic power.

It may be argued that a progressive consumption tax achieves the same practical result of reducing disparities in spending power by minimizing wealthy taxpayers’ purchasing power.\textsuperscript{273} Three considerations, however, minimize the effect of a consumption tax as a tool to reduce disparities in relative economic power by reducing purchasing power. First, to the extent that consumption taxes are not salient and taxpayers anchor economic ability by reference to pretax rather than after-tax prices, a consumption tax will not diminish the social effects of relative economic power.\textsuperscript{274} Second, a consumption tax will only have the effect of minimizing purchasing power if it can convincingly be implemented in perpetuity. Otherwise, taxpayers will benefit by saving and deferring their consumption until tax rates are reduced in the future. Finally, as described above, the deployment of investment capital itself can afford the wealth holder disproportionate political and social control, even if the wealth holder never consumes their wealth.\textsuperscript{275}

E. Final Reflections on Personal Choice and Economic Growth

This closing Section briefly reconsiders the social objectives of personal choice and economic growth. The purpose of this Section is not to conclusively describe the effects of measures to constrain inequality through a wealth tax on these important objectives. Rather, these final reflections describe why constraining inequality should not be viewed as necessarily conflicting with these goals. To the contrary, constraining inequality may in fact be necessary to promote a functioning free market and personal agency. This point may be obvious enough, but merits repeating in light of the sometimes reflexive objections to any form of wealth tax in the public discourse.

First, as described above, a wealth tax may be rejected by some writers as interfering with the personal choices to work, to save, and to assume risk.\textsuperscript{276} Even strident advocates of personal choice and enti-

\textsuperscript{273} That is, a consumption tax reduces purchasing power by reducing the amount of goods and services that may be acquired after consumption taxes are paid. See McCaffery, supra note 17, at 370–72; Shavro, supra note 272, at 106.

\textsuperscript{274} See Raj Chetty, Adam Looney & Kory Kroft, Salience and Taxation: Theory and Evidence, 99 Am. Econ. Rev. 1145, 1146 (2009) (finding that consumers underreact to taxes that are not included in the posted price of goods).

\textsuperscript{275} See supra note 92 and accompanying text; see also Repetti, supra note 87, at 1168–69 (arguing that capital investments are an exercise of political and social control because decisions about where to locate a factory or make a large financial deposit can have significant political and social impacts).

\textsuperscript{276} See supra Section I.B.
tlemment theories of distributive justice, however, accept limits when consecrating the outcomes from personal choices. For example, the logical conclusion of Friedman’s lottery example would be that an individual who gambles away his last dime should face the consequences and perish.277 Even Friedman, however, would allow redistribution to alleviate poverty and mitigate the harshest consequences of the lottery and other personal choices.278 A similar logic may be extended to justify redistribution in order to limit inequality: Unequal outcomes may be accepted to reward personal choice and even good fortune but still limited in the cases where excessive inequality becomes harmful to society.279 Under both views, respecting the role of personal choice does not imply an absolute prioritization of choice above all other social interests.

The relative economic power theory suggests why a constraint on economic inequality may in fact be necessary to preserve individual autonomy. As described above, under the relative economic power theory excessive economic inequality suppresses the preferences of those with less economic power.280 More broadly, a relational view of distributive justice acknowledges that individual autonomy is a function of relative, and not merely absolute, levels of economic well-being.281 Under this view, consecrating the choices of some by permitting limitless accumulations of economic power will deny agency and autonomy to others.

Others object to policy measures such as a wealth tax to constrain inequality as interfering with economic growth.282 Of course, the social objective of economic growth is distinct from the objective of maximizing social welfare described above,283 since economic wealth is just one possible factor in welfare. Studies suggest, furthermore, that in some cases economic inequality can impede economic growth

277 See supra note 67 and accompanying text.
278 See FRIEDMAN, supra note 67, at 176, 190–95 (advocating for redistribution through a negative income tax).
279 Alternatively, turning the question around would require an advocate of a choice or entitlement view to identify the degree of unequal market outcomes, if any, that would be considered unduly excessive.
280 See supra Section I.D.1.
281 See supra notes 133–35 and accompanying text.
282 See, e.g., MICHAEL SCHUYLER, TAX FOUND., SPECIAL REPORT NO. 225, THE IMPACT OF PIKETTY’S WEALTH TAX ON THE POOR, THE RICH, AND THE MIDDLE CLASS 3 (2014), https://files.taxfoundation.org/legacy/docs/TaxFoundation_SR225.pdf (objecting to the wealth tax to reduce inequality proposed by PIKETTY, supra note 13, on the grounds that it would have “disastrous results” on economic output); Levmore, supra note 168, at 836–37 (considering the argument that inequality is correlated with economic growth, and therefore increased standards of living across the distribution).
283 Supra Section I.C.3.
and distort efficient market competition.\textsuperscript{284} In effect, the same rewards to productive economic activity, if unchecked, can form the basis for market inefficiency in future transactions. Similarly, limiting economic inequality does not necessarily conflict with the promotion of economic growth. Of course, there is no simple answer to the question of whether policies to reduce economic inequality will on the balance promote or impede economic growth,\textsuperscript{285} since inequality may have conflicting effects on economic growth in different circumstances.\textsuperscript{286} As in the case of the personal choice objection, the effect of reducing inequality on economic growth cannot be reduced to a simple either-or proposition.


\textsuperscript{285} See Jason Furman, Harvard Kennedy Sch. & Peter Inst. for Int’l Econ., Should Policymakers Care Whether Inequality Is Helpful or Harmful for Growth?, Presentation at the New York University School of Law Tax Policy Colloquium 2 (Apr. 10, 2018), \url{http://www.law.nyu.edu/sites/default/files/upload_documents/Should%20Policymakers%20Care%20Whether%20Inequality%20Is%20Helpful%20or%20Harmful%20for%20Growth%20-%20Furman.pdf} (“[I]t is unlikely that any general statement about the relationship between inequality and growth would even be true—and even if one were true, it is unlikely that we could definitively document it.”).

\textsuperscript{286} See id. at 5 (“For example, if inequality was caused by an increase in innovation that rewarded the innovators, it might be associated with stronger growth. But if inequality was caused by an expansion of rent seeking that limits competition, it might be associated with lower growth.”). Furthermore, the fact that economic inequality impedes growth doesn’t necessarily imply that a consequent policy to reduce inequality would promote growth. See id. at 13–21.
CONCLUSION

The tax bill recently passed by Congress will enrich the wealthiest Americans and deprive our government of revenue needed to stabilize the deficit and fund critical public spending. These changes will accelerate rising economic inequality and its attendant harm to our democracy and our society.

Restoring and rebuilding the progressive tax system will require more than repealing these changes, which would still leave us with historic levels of economic inequality and an income tax system that favors the wealthy. Adopting a wealth tax, however, is a blunt response that unduly penalizes savers and cannot coordinate different factors in economic well-being. To address these challenges, we should instead reimagine the possibilities for a fair and efficient tax system and embrace a broader view of the progressive tax base.

This Article introduces a new direction for the progressive tax system, through a new combined tax base of income and wealth. This combined base will directly confront the problems of economic inequality while providing a new source for government revenue. At the same time, the combined base will not unduly burden the needs of taxpayers to save for the future. Finally, reorienting the progressive tax base to more effectively constrain inequality can ultimately promote, rather than frustrate, the critical social objectives of individual choice and an efficient free market.