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Taxing Wealth Seriously

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I. INTRODUCTION

The social and political problems of wealth inequality in America are severe and getting worse.¹ As presidential candidate Bernie Sanders pointed out as he launched his candidacy in the summer of 2015, the top one-tenth of 1% of Americans (0.1%), sorted by wealth levels, owns as much wealth as the bottom 90% of Americans combined.² These roughly 160,000 individuals and families have an average net worth over \$72 million.³ Wealth inequality in America is far more severe than income inequality. A recent *Forbes* posting explains:

The average annual income of the top 1 percent of the population is \$717,000, compared to the average income of

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¹ See generally Thomas Piketty, *Capital in the Twenty-First Century* (Arthur Goldhammer trans., Harvard Univ. Press 2014); Joseph E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future* (2012); Christopher Ingraham, *If You Thought Income Inequality Was Bad, Get a Load of Wealth Inequality*, Wash. Post: Wonkblog (May 21, 2015), <https://www.washingtonpost.com/news/wonk/wp/2015/05/21/the-top-10-of-americans-own-76-of-the-stuff-and-its-dragging-our-economy-down>.

² Tom Kertscher, *Bernie Sanders, in Madison, Claims Top 0.1% of Americans Have Almost as Much Wealth as Bottom 90%*, Politifact (July 29, 2015, 12:40 PM), <http://www.politifact.com/wisconsin/statements/2015/jul/29/bernie-s/bernie-sanders-madison-claims-top-01-americans-hav/>; see Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data*, 131 Q.J. Econ. 519, 551-52 (2016) ("The bottom 90% (144 million families with \$84,000, on average) owns about as much as the top 0.1% (160,700 families with net assets above \$20 million). Both groups possess about 22% of US wealth today.").

³ Saez & Zucman, note 2, at 552 tbl.I.

the rest of the population, which is around \$51,000. The real disparity between the classes isn't in income, however, but in net value: The 1 percent are worth about \$8.4 million, or 70 times the worth of the lower classes.⁴

All the statistics about economic inequality in the United States are getting worse, as Thomas Piketty, among others, has extensively shown.⁵ Obvious tensions in the social, political, and economic lives of Americans have followed suit.

The surprise is that the U.S. tax system is a significant *cause* of these problems, not a cure for them. The tax law doctrines that allow those who already have financial wealth to live, luxuriously and tax-free, are simple. They follow the steps in what I have dubbed Tax Planning 101: Buy/Borrow/Die.⁶ By buying and holding assets that appreciate without producing taxable cash flows, borrowing to finance one's lifestyle, and holding onto their assets until death, the rich—those with capital—can avoid all income taxation. The applicable legal doctrines have been in place for nearly a century under the income tax, the primary social tool for addressing matters of economic inequality and redistribution. The analytic pathways to reform are easy to see once Buy/Borrow/Die is properly understood. Yet our political systems show no serious interest in reforming our tax system to tax wealth seriously. We are letting capital off the hook, and ratcheting up taxes on labor, at precisely a time when deep-seated and long-running economic forces suggest that this is precisely the wrong thing to do.⁷

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

⁴ Alan Dunn, *Average America vs the One Percent*, *Forbes* (Mar. 21, 2012, 5:17 AM), <http://www.forbes.com/sites/moneywisewomen/2012/03/21/average-america-vs-the-one-percent>. It is also worth noting there is a lot more turnover in the top income earners as opposed to the wealthiest Americans (when factoring in years of higher or lower wages, retirement, and the like). Tami Luhby, *No One Stays in the Top 1% for Long*, *CNN Money* (Jan. 7, 2016, 8:15 AM), <http://money.cnn.com/2016/01/07/news/economy/top-1/index.html>; Kerry A. Dolan, *Billion-Dollar Bloodlines: America's Richest Families 2015*, *Forbes* (July 1, 2015, 9:45 AM), <http://www.forbes.com/sites/kerryadolan/2015/07/01/billion-dollar-bloodlines-americas-richest-families-2015/#24ca14b47c74>.

⁵ See Piketty, note 1, at 22-25 (noting that “[t]he top decile share in US national income dropped from 45-50 percent in the 1910s-1920s to less than 35 percent in the 1950s . . . ; it then rose from less than 35 percent in the 1970s to 45-50 percent in the 2000s-2010s”).

⁶ Edward J. McCaffery, *The Oxford Introductions to U.S. Law, Income Tax Law*, at xix, 12-15 (Dennis Patterson ed., 2012).

⁷ See generally Piketty, note 1.

II. PRELIMINARIES

A. *A Tale of Two Januaries*

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

Clinton's 4% plan would not raise much revenue.¹³ Most tellingly, it would not affect at all those already wealthy individuals living off

⁸ See Noam Scheiber & Patricia Cohen, For the Wealthiest, a Private Tax System That Saves Them Billions, N.Y. Times (Dec. 29, 2015), <http://www.nytimes.com/2015/12/30/business/economy/for-the-wealthiest-private-tax-system-saves-them-billions.html>; Josh Barro, Thanks, Obama: Highest Earners' Tax Rates Rose Sharply in 2013, N.Y. Times: The Upshot (Dec. 30, 2015), <http://www.nytimes.com/2015/12/31/upshot/thanks-obama-highest-earners-tax-rates-rose-sharply-in-2013.html>; see also Edward J. McCaffery, Opinion, U.S. Tax System: Why Do the Rich Just Keep Getting Richer?, CNN (Jan. 12, 2016, 2:03 PM), <http://www.cnn.com/2016/01/12/opinions/mccaffery-wealthy-taxes>.

⁹ Elizabeth Bruenig, The Democratic Debate Highlighted the Biggest Divide Between Sanders and Clinton, New Republic (Oct. 14, 2015), <https://newrepublic.com/article/123117/biggest-divide-between-sanders-and-clinton> (noting that in a post-debate interview, Bernie Sanders said "income and wealth inequality is the biggest economic issue, the biggest moral issue" of our day).

¹⁰ John Harwood, Clinton to Propose Further Tax Increases on Wealthy Americans at Buffett Event, CNBC (Dec. 17, 2015, 12:07 PM), <http://www.cnbc.com/2015/12/16/hillary-clinton-to-propose-further-tax-increases-on-wealthy-americans-at-buffett-event.html>.

¹¹ Jeanne Sahadi, Here's How Much Hillary Clinton's Tax Plan Would Hit the Rich, CNN Money (Aug. 11, 2016, 11:21 AM), <http://money.cnn.com/2016/08/11/pf/taxes/hillary-clinton-taxes/> ("[Clinton] would impose the so-called Buffett Rule, requiring those with adjusted gross incomes over \$1 million to pay a minimum of 30% of their income in taxes. On top of that, she would impose a 4% surcharge on adjusted gross income over \$5 million.").

¹² See Dunn, note 4.

¹³ According to a campaign official who asked not to be named, Hillary Clinton's 4% surcharge on taxpayers with income of over \$5 million annually would affect two out of every 10,000 taxpayers (raising \$150 billion over a decade). Jennifer Epstein, Clinton Tax Plan Would Place 4% Surcharge on Incomes Over \$5 Million, Bloomberg, <http://www.bloomberg.com/politics/articles/2016-01-11/clinton-tax-plan-would-place-4-surcharge-on-incomes-over-5-million> (last updated Jan. 11, 2016, 3:38 PM). It has been independently reported: "The surcharge, firstly, would affect very, very few people. In 2013, about 34,000 tax returns out of 147 million (or about 0.02 percent) had an adjusted gross income of \$5 million or more, per IRS statistics." Danielle Kurtzleben, Clinton Would Raise Taxes on the Wealthy. Here's What You Need to Know, NPR (Jan. 13, 2016, 5:09 PM), <http://www.npr.org/2016/01/13/462944798/hillary-clinton-s-new-tax-proposal-likely-wont-affect-you>.

their capital, using Buy/Borrow/Die. Clinton's 4% plan nonetheless had what seems to have been its main intended effect all along: It got headlines.¹⁴ Within days of Clinton's announcement, Sanders released his own tax plan featuring a marginal rate bracket taking effect at \$10 million of reported income.¹⁵ Given the outcome of the 2016 presidential election, nothing much became of Clinton's 4% plan or Sanders' \$10 million bracket. But these were, most definitely, *not* serious attempts to tax wealth seriously in any event.¹⁶

The prior January (2015), President Obama had rolled out something in his State of the Union speech that was shocking for its rarity in America: a practical approach to taxing wealth seriously.¹⁷ Obama proposed taxing previously untaxed capital gains on death. This is an approach that Canada has long had in place.¹⁸ Obama's proposal if enacted and effectively implemented would have ended one of the great tax breaks still standing in America, the well-named "Angel of Death" benefit.¹⁹ It would strike a fatal blow to the final step of Buy/Borrow/Die.

¹⁴ See, e.g., Greg Sargent, Opinion, It Begins: Hillary Clinton Rolls Out New Plan to Tax Super-Rich, Wash. Post: The Plum Line (Jan. 11, 2016), <https://www.washingtonpost.com/blogs/plum-line/wp/2016/01/11/it-begins-hillary-clinton-rolls-out-new-plan-to-tax-super-rich>; see also Colin Campbell, Hillary Clinton Just Proposed a New Tax on the Richest Americans, Bus. Insider (Jan. 11, 2016, 3:01 PM), <http://www.businessinsider.com/hillary-clinton-fair-share-surcharge-tax-2016-1>.

¹⁵ Alan Cole & Scott Greenberg, Details and Analysis of Senator Bernie Sanders's Tax Plan, Tax Found. (Jan. 28, 2016), <http://taxfoundation.org/article/details-and-analysis-senator-bernie-sanders-s-tax-plan>.

¹⁶ This Article was substantially completed in the summer of 2016, before the fall presidential campaign season between Hillary Clinton and Donald Trump. Nothing in that campaign, however, changed the main point in the text, as neither candidate made serious proposals to effectively tax wealth.

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

¹⁸ Income Tax Act, R.S.C. 1985, c 1, § 70(5) (Can.) ("Where in a taxation year a taxpayer dies, (a) the taxpayer shall be deemed to have, immediately before the taxpayer's death, disposed of each capital property of the taxpayer and received proceeds of disposition therefor equal to the fair market value of the property immediately before the death"); see Jamie Golombek, Death and Taxes: Leave Your Assets to Your Heirs Instead of the CRA, Fin. Post (Oct. 25, 2013, 11:00 PM), <http://business.financialpost.com/personal-finance/debt/death-and-taxes-heres-what-happens-to-your-assets-when-you-die> ("The general rule for non-registered assets is that a taxpayer is deemed to have disposed of all his or her property, such as stocks, bonds, mutual funds and real estate immediately before death at their fair market value (FMV).").

¹⁹ Len Burman, President Obama Targets the "Angel of Death" Capital Gains Tax Loophole, Forbes (Jan. 18, 2015, 7:04 PM), <http://www.forbes.com/sites/beltway/2015/01/18/president-obama-targets-the-angel-of-death-capital-gains-tax-loophole/#13262256783e>.

There was much to applaud in the President's gambit. Piketty's *Capital in the Twenty-First Century* remained wildly popular.²⁰ Piketty's tome extensively chronicles how the United States and other advanced capitalist economies have reached and are soon to exceed levels of both wealth and wealth inequality not seen since the Belle Époque era at the turn of the twentieth century, before massive wars and other social cataclysms leveled much of that wealth.²¹ Obama's proposal was timely and sensible, a potential capstone to eight years of a presidency initially premised on great progressive hope. Unlike Clinton's 4% plan, Obama's capital-gains-on-death proposal would address an essential plank in Buy/Borrow/Die. It would have affected many taxpayers and raised significant revenue.²²

Only there was no applause, no blaring headlines. Obama's proposal was declared dead on arrival. Nothing happened. In his final State of the Union speech in January 2016, just days after Clinton's 4% plan and Sanders' \$10 million bracket were announced, Obama said very little about tax, and nothing at all about the capital-gains-on-death proposal from the prior January.²³

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

B. A Joke

There is an old joke about a drunken sailor, searching for his lost wallet late one night beneath a lamp post. A well-meaning passerby tries to help and asks the sailor where he last saw his wallet. "Over there," the sailor replies, pointing far off into the darkness. "Then

²⁰ Marc Tracy, Piketty's "Capital": A Hit That Was, Wasn't, Then Was Again, *New Republic* (Apr. 24, 2014), <https://newrepublic.com/article/117498/pikettyps-capital-sold-out-harvard-press-scrambling>.

²¹ Piketty, note 1, at 369, 372.

²² Cong. Budget Office, Pub. 4308, *The Distribution of Major Tax Expenditures in the Individual Income Tax System* 6 tbl.1 (2013), https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/43768_DistributionTaxExpenditures.pdf (showing the budgetary effect of capital gains on assets transferred at death as \$644 billion from 2014 to 2023).

²³ Transcript of Obama's 2016 State of the Union Address, *N.Y. Times* (Jan. 12, 2016), <https://www.nytimes.com/2016/01/13/us/politics/obama-2016-sotu-transcript.html>. See Section VIII.C for an update on the capital-gains-on-death proposal.

why are you looking here?” asks the puzzled Samaritan. “Because this is where the light is,” replies the inebriated seaman.

Like that drunken sailor, liberals, progressives, and all those troubled by rising economic inequality in the United States continue to look to *income* inequality, because that is where they presume the light to be: the alluring beacon of the federal income tax, blessed by the Sixteenth Amendment, ratified in 1913, a crowning glory of the progressive era movement.²⁴ Clinton’s 4% plan and even Obama’s capital-gains-on-death proposal both center on the *income* tax. The media plays along, needing content for its stories: The data we see in print is what can be seen under the lamp post.

This reliance on income taxation to carry the weight of redistribution has proven to be a disastrous mistake. The income tax’s century has been a century of rising, not diminishing, inequality.²⁵ The income tax, as is, is a highly limited tool for addressing social and political concerns over economic inequality, in theory as well as in practice, constrained by economic facts, political realities, popular perceptions, and more. Wealth inequality is greater, more enduring, and more problematic than income inequality. And the U.S. tax system is a significant *contributor* to wealth inequality. The income tax allows those with capital to get richer, while making it harder for those living off labor returns, or wages, to get capital in the first place. This is at a time when the rich are getting richer *anyway*, because, as Piketty points out, the return on assets is higher than the overall growth rate: Economic forces are generating greater returns to capital than labor.²⁶ Attempting both to finance the modern state and to address economic inequality through the income tax has done considerable collateral damage to the progressive agenda, leading to a conservative ascension personified by Ronald Reagan and fueled by an anti-tax fervor, one that has left liberals such as Barack Obama, when they have been able to obtain power at all, hand-tied from advancing any form of meaningful egalitarian agenda.²⁷

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

²⁴ See, e.g., Sheldon D. Pollack, *Origins of the Modern Income Tax, 1894-1913*, 66 *Tax Law.* 295 (2013).

²⁵ Piketty, note 1, at 493-514.

²⁶ *Id.* at 25-26.

²⁷ Edward J. McCaffery, *Distracted from Distraction by Distraction: Reimagining Estate Tax Reform*, 40 *Pepp. L. Rev.* 1235, 1244-45 (2013) [hereinafter *Distraction*]; Edward J. McCaffery, *The Missing Links in Tax Reform*, 2 *Chap. L. Rev.* 233, 233-35 (1999); see Michael Tanner, *Obama’s Class Warfare*, *Nat’l Rev.* (Jan. 21, 2015, 4:00 AM), <http://www.nationalreview.com/article/396775/obamas-class-warfare-michael-tanner>.

C. An Embarrassment

In the darkness, offstage from practical policy proposals, lies the surprising fact that the United States does not tax wealth much. Wealth is our lost wallet. We tax “income:” *some* income, mainly the income that comes from labor in the form of wages. Our “income” tax is not and never has been a true income tax. It systematically fails to reach income from capital, which, with labor, is one of the two great factors of production in a capitalist economy. No other tax comes anywhere close to making up for the omission.²⁸ As a result, those Americans wealthy enough to live off existing stocks of wealth are let altogether off the social hook for having to pay for the privileges of civilization. At the same time, the working classes must bear an ever-greater tax burden to finance an ever-growing public sector, making it harder for them to cross over to the capital side of the street. All of the attendant problems from this embarrassment—and there are many—are getting worse, relegated to the darkness of our sociopolitical life.

Understanding tax, which few do, only deepens the sense of embarrassment. It turns out to be shockingly easy to avoid all taxation if one already has financial wealth, as the top 1%, with average fortunes of over \$8 million, do.²⁹ The three basic steps of Buy/Borrow/Die provide a roadmap for those with existing stores of financial wealth to avoid all major taxes.

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

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

²⁸ Staff of the Joint Comm. on Tax’n, Overview of the Federal Tax System as in Effect for 2016, at 1, 26 (2016), <https://www.jct.gov/publications.html?func=startdown&id=4912> (summarizing the federal tax system in the United States and projecting that, for individuals, wages and salaries provide 68% of gross income while capital gains, dividend income, and interest income provide 9.4%).

²⁹ Dunn, note 4.

D. An Example

Part IV explains the legal bases for Buy/Borrow/Die. To motivate further reading, consider an example developed further below, if only because there is some light here, in the form of publicly available data.

Warren Buffett, then the world's third wealthiest person according to *Forbes'* annual survey,³⁰ publicly revealed that he paid \$6.9 million of income tax in 2010, on reported taxable income of \$39.8 million.³¹ Although Buffett's tax bill was more than most Americans will ever earn in their lifetimes, his income taxes were only some 17% of his *reported* income—an effective tax rate, as Buffett himself famously pointed out, below that of his secretary.³² The Wizard of Omaha kindly lent his support to the “Buffett Rule,” whereby millionaires such as he would pay tax at an effective, flat rate of 30%.³³ Such a rule would have raised Buffett's taxes to just under \$12 million, again a significant sum. Hillary Clinton's 4% plan would add another \$1.4 million to her booster's tax bill.

Yet public records indicate that Buffett's personally held Berkshire Hathaway shares, *alone*, rose by \$8 billion—with a “b”—in the calendar year of 2010.³⁴ The year 2013 was even better, with a \$12.7 billion rise in value,³⁵ but this is staying where the light is, and Buffett disclosed his 2010 tax return.³⁶ This “mere appreciation” need not, under very longstanding tax laws, be *reported* as income on any tax return (the “Buy” step). Yet, it was available for all the world to see, and certainly increased Buffett's borrowing powers (the “Borrow”

³⁰ Kerry A. Dolan & Luisa Kroll, *Forbes 2016 World's Billionaires: Meet the Richest People on the Planet*, *Forbes* (Mar. 1, 2016, 8:25 AM), <http://www.forbes.com/sites/luisakroll/2016/03/01/forbes-2016-worlds-billionaires-meet-the-richest-people-on-the-planet/#679b10e641cb>.

³¹ Janet Novack, *Warren Buffett's Effective Federal Income Tax Rate Was Just 11%*, *Forbes* (Oct. 12, 2011, 4:59 PM), <http://www.forbes.com/sites/janetnovack/2011/10/12/warren-buffetts-effective-federal-income-tax-rate-is-just-11/#4af75ed6132b>.

³² *Id.*; Chris Isidore, *Buffett Says He's Still Paying Lower Taxes Than His Secretary*, *CNN Money* (Mar. 4, 2013, 11:20 AM), <http://money.cnn.com/2013/03/04/news/economy/buffett-secretary-taxes/index.html>.

³³ Warren E. Buffett, *Stop Coddling the Super-Rich*, *N.Y. Times* (Aug. 14, 2011), http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html?_r=0; see Nat'l Econ. Council, White House, *The Buffett Rule: A Basic Principle of Tax Fairness 1* (2012), https://www.whitehouse.gov/sites/default/files/Buffett_Rule_Report_Final.pdf.

³⁴ See David Miller, *The Buffett Rule or the Income Tax?*, *Huffington Post: The Blog* (Apr. 30, 2012), http://www.huffingtonpost.com/david-miller/the-buffett-rule_b_1308188.html.

³⁵ Dan Weil, *Warren Buffett Made \$37 Million a Day in 2013*, *Newsmax.com* (Dec. 18, 2013, 1:17 PM), <http://www.newsmax.com/Finance/Economy/Buffett-billion-money-2013/2013/12/18/id/542611/>.

³⁶ Matthew Campione, *Warren Buffett's Tax Return and What Congress Already Knew*, *Forbes* (Oct. 14, 2011, 3:44 PM), <http://www.forbes.com/sites/matthewcampione/2011/10/14/warren-buffetts-tax-return-and-what-congress-already-knew/#307b4d6578e8>.

step). (While Buffett's tax lifestyle makes him a poster child for the "Buy" step, Donald Trump's financial situation well illustrates the tax advantages of the "Borrow" step.³⁷)

Buffett's tax rate on his *real* income, including the gain in value of Berkshire stock, was 0.08625%, less than one-tenth of 1%. This is equivalent to a wage-earner, such as a young law associate, earning \$100,000 (which also happens to be Buffett's salary as CEO of Berkshire)³⁸ and paying annual taxes of \$86.25. Buffett could have brought his taxes down to zero by following Buy/Borrow/Die more relentlessly, but he did well enough.

E. No Easy Way Out

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

The argument runs as follows: A modern capitalist economy needs some savings. The poor have nothing to save, and the laboring classes, burdened by taxes among other costs of modern life, have a hard time saving much at all. Governments at all levels and places have demonstrated fiscal irresponsibility, running up massive deficits—that is, dissaving—of all sorts. This leaves the rich, like Buffett, as the last element standing, the last hope for providing a social pool of capital. For just these reasons, John Maynard Keynes lauded the wealth inequality of England at the turn of the nineteenth century as an important element in the nation's rise to worldwide power, arguing that unequal wealth, and the wealthy's lessened tendency to consume out of capital, provided the needed financial backing to fuel the empire.³⁹ Perhaps this happy tale of noblesse oblige masks the urgency to venture forth into the darkness to find our wallet.

Alas, the analytics of the U.S. tax system take away this slim reed of hope. There is no reason, under the current tax system, for the wealthy to continue to save to enjoy tax-free living. Our tax system is not simply held hostage to our profligate society's need for savings,

³⁷ See Edward McCaffery, *Trump Is the King of Debt But Not of Taxes*, CNN.com (Sept. 2, 2016), <http://www.cnn.com/2016/09/02/opinions/trump-king-of-debt-but-not-taxes-opinion-mccaffery/>.

³⁸ Dave Manuel, *What Is Warren Buffett's Net Worth?*, <http://www.davemanuel.com/net-worth/warren-buffett/> (last visited Nov. 29, 2016) ("Warren Buffett takes a \$100,000 salary per year from Berkshire Hathaway.").

³⁹ 2 John Maynard Keynes, *A Treatise on Money: The Applied Theory of Money* 144-45 (Macmillan for the Royal Economic Society 1971) (1930) (explaining that unequal wealth may benefit society "*so long as wealth and its fruits are not consumed by the nominal owner but are accumulated*").

such that we must refrain from taxing accumulated wealth as a matter of principle, or necessity, or both. A deeper problem of Buy/Borrow/Die is that it provides a roadmap for *spending* financed by capital to escape taxation.⁴⁰ If Buffett borrowed \$8 billion and spent it all, perhaps to run for president, he would pay *no* tax at all on his very good adventure. *Neither the income nor the consumption of the propertied class need bear any significant tax burden.*

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

III. REAL VERSUS REPORTED INCOME AND OTHER MATTERS OF DEFINITION

I continue with some simple terms and concepts. I hope that this Article has a wide readership, and so this Part sets out basic definitions for readers without a tax law background.

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

Theory presents a different definition, which is important to consider to understand the gap between real and reported income. In the celebrated Haig-Simons definition, “income” is the “algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in value of the store of property rights between the beginning and end of the period in question.”⁴¹ Fancy words, but the simple point is to connect “income,” which is about *inputs* or *sources*, with *uses* or *outputs*. All income is either spent (“the market value of rights exercised in consumption”⁴²), or not (“the change in value of the store of property rights”⁴³). The Haig-Simons definition of income becomes $\text{Income} = \text{Consumption} + \text{Savings}$, or $I = C + S$, in simple algebraic terms.

⁴⁰ Edward J. McCaffery, Fair Not Flat: How to Make the Tax System Better and Simpler 19-20 (2002); Lawrence Zelenak, Debt-Financed Consumption and a Hybrid Income-Consumption Tax, 64 Tax L. Rev. 1, 1-3 (2010).

⁴¹ Henry C. Simons, Personal Income Taxation 50 (1938); Robert M. Haig, The Concept of Income—Economic and Legal Aspects, in The Federal Income Tax 1, 7 (Robert M. Haig ed., 1921), reprinted in Am. Econ. Ass’n, Readings in the Economics of Taxation 54 (Richard A. Musgrave & Carl Shoup eds., 1959).

⁴² Simons, note 41, at 50.

⁴³ Id.

The Haig-Simons definition helps to show that an income tax is supposed to be a “double tax” on savings, as John Stuart Mill famously pointed out in 1848.⁴⁴ This is because the yield to savings is taxed, even though the initial receipt of the saved value was *also* taxed.⁴⁵ This is problematic, in part because America wants savings, on both national and individual levels. So the income tax, as is, is riddled with exceptions like preferential provisions for retirement savings that move it far from a pure “income” tax and into a mish-mosh, a hybrid of income and consumption tax elements, often producing wholly counterproductive results.⁴⁶

Stepping back in the flow of funds, income ultimately must come from *labor*, in the form of wages, fringe benefits, bonuses, and the like, or from *capital*, in the form of interest, rents, royalties, and the like, or from some combination of capital and labor, one’s own or someone else’s (to sweep in gifts and various forms of support).⁴⁷ The returns to capital (*K*) and labor (*L*) lead to one’s income (*I*), which, as Haig-Simons informed us, equals one’s consumption (*C*) plus nonconsumption or savings (*S*). In simple algebraic terms:

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

We can have a *consumption tax* in one of two ways. One, we could ignore *K*, not taxing the returns to capital on the sources or left-hand side, which leads to a wage tax. Two, we could ignore *S*, by not taxing savings on the uses or right-hand side, which leads to a spending tax.⁴⁸ Under certain standard assumptions, the two approaches lead to the same place.⁴⁹

The critical point is that reported income does not include *unrealized appreciation*, which is the change in value of an asset being held before there is some *realization event*, such as a sale, to make it taxa-

⁴⁴ John Stuart Mill, *Principles of Political Economy*, bk. V, ch. I, § 4, 544-46 (J. Laurence Laughlin ed., D. Appleton & Co. 1884) (1848) (“Unless, therefore, savings are exempted from income-tax, the contributors are twice taxed on what they save, and only once on what they spend. To tax the sum invested, and afterward tax also the proceeds of the investment, is to tax the same portion of the contributor’s means twice over.”).

⁴⁵ Alvin Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?*, 89 Yale L.J. 1081, 1099-100 (1980).

⁴⁶ Edward J. McCaffery, *A New Understanding of Tax*, 103 Mich. L. Rev. 807, 885-86 (2005).

⁴⁷ *Eisner v. Macomber*, 252 U.S. 189, 207 (1920) (“Income may be defined as the gain derived from capital, from labor, or from both combined.” (quoting *Stratton’s Indep., Ltd. v. Howbert*, 231 U.S. 399, 415 (1913); *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918))).

⁴⁸ See Edward J. McCaffery, William D. Andrews ’55: On the Right Side of the Equation, Harv. L. Bull. (July 1, 2007), <http://today.law.harvard.edu/windfalls-realized-two-giants-of-tax-law-retire/> (discussing a series of articles by William Andrews examining the right-hand, or uses side, of the Haig-Simons income formula).

⁴⁹ McCaffery, note 46, at 824-25; McCaffery, note 6, at 8-9.

ble.⁵⁰ This “mere appreciation,” such as the \$8 billion rise in Buffett’s holdings in 2010, *is* included in the Haig-Simons definition of income, as the “change in value of the store of property rights between the beginning and end of the period in question.”⁵¹ Thus, *real income* can be defined as reported income plus unrealized appreciation, ignoring other differences. Buffett’s tax rate of 17% on his *reported* income in 2010 became 0.08625% of his *real* income.

There are many tax law concepts and terms meant to ensure that “mere appreciation” *eventually* gets taxed. *Basis* refers to one’s after-tax cost of acquiring or holding an asset. Suppose that *Jane* buys a share of Berkshire Hathaway for \$200,000. She gets a basis of \$200,000 in the stock.⁵² If the stock rises in value to \$1 million without any sale or dividend, *Jane* pays no tax. The difference between the *fair market value* of the stock, \$1 million, and *Jane*’s basis, \$200,000—that is, \$800,000—is yet untaxed or *built-in gain*. If *Jane* were to sell the stock, \$800,000 would become *realized gain*.⁵³ In simple form:

$$\begin{aligned} \text{Realized gain} &= \text{fair market value of property received} \\ &\quad - \text{basis of asset sold.} \end{aligned}$$

Realized gain is typically taxed at a *capital gains rate*, a lower rate than what falls on *ordinary income* such as, paradigmatically, wages.⁵⁴

The tax law generally acts to preserve built-in gain so that it eventually will be taxed. If *Jane* were to gift her share of Berkshire Hathaway to her friend *Dick*, for example, *Dick* would take the stock with a *carryover basis* of \$200,000, *Jane*’s basis, such that the built-in gain would be preserved in *Dick*’s hands.⁵⁵ But assets held until death and then passed on to heirs receive a *stepped-up basis*, to fair market value, meaning that the built-in gain disappears on death—never to be taxed.⁵⁶ It was this “Angel of Death” provision, the death step of Buy/Borrow/Die, that Obama’s capital-gains-on-death proposal would have changed.

IV. A ROAD MAP TO EMBARRASSMENT

This Part explains Buy/Borrow/Die in all of its elegant, if embarrassing, simplicity.

⁵⁰ IRC § 1001(a).

⁵¹ Simons, note 41, at 50.

⁵² See IRC § 1011 (defining adjusted basis), § 1012 (defining basis in property as cost).

⁵³ See IRC § 1001(a) (computation of gain or loss).

⁵⁴ See IRC § 1221 (defining the term “capital asset”), § 1(h) (imposing preferential tax rates for net capital gain).

⁵⁵ See IRC § 1015 (providing carryover basis for gifts).

⁵⁶ IRC § 1014.

A. *Tax Planning 101: Buy/Borrow/Die*

Step one is to *buy*. Not just any asset, but one such as land, growth stock (Berkshire Hathaway definitely counts),⁵⁷ art—assets that appreciate without producing taxable cash flows. This is owing to the realization requirement under the income tax from, among other sources, the celebrated 1920 U.S. Supreme Court case of *Eisner v. Macomber*.⁵⁸ The realization requirement holds that the change in value of an existing asset is not income until and unless the gain is “realized” through a sale or other disposition.⁵⁹ The requirement is key to the gap between real and reported income; Buffett’s \$8 billion gain in 2010 was real enough, but was not reported on his form 1040, perfectly legally.

William Andrews has called the realization requirement the “Achilles’ Heel” of the income tax.⁶⁰ The key step to convert the realization requirement of *Macomber* into Buy/Borrow/Die, a means of tax-free living, is to follow some very basic, simple financial advice: Never sell. Follow—as Buffett most certainly has—a simple “buy and hold” financial strategy. As long as Buffett never sells his Berkshire Hathaway stock—and he certainly never sells much of it—he pays no tax on his “mere” appreciation.⁶¹

Given the tax incentive to hold capital-appreciating assets, it is not surprising that Wall Street and other financiers should produce many such opportunities. Growth stocks rarely pay dividends. Wall Street even tried to give the wealthy their cake, in the form of risk-free returns, and allow them to eat it, tax-free, too, by designing relatively risk-free bonds that simply rolled up all the periodic interest payments to pay in a single lump sum on the ultimate expiration of the bond term.⁶² Congress legislated an end to this particular game,⁶³ under-

⁵⁷ Berkshire Hathaway has only paid dividends once under Buffett’s reign, in 1967. “I must have been in the bathroom when the decision was made,” Buffett is often quoted as saying. John Maxfield, *Why Warren Buffett Doesn’t Pay Dividends*, *Motley Fool* (Apr. 30, 2013 10:28 AM), <http://www.fool.com/investing/general/2013/04/30/why-warren-buffett-doesnt-pay-dividends.aspx>.

⁵⁸ 252 U.S. 189 (1920).

⁵⁹ IRC § 1001(a).

⁶⁰ William D. Andrews, *The Achilles’ Heel of the Comprehensive Income Tax*, in *New Directions in Federal Tax Policy for the 1980s*, at 278, 280 (Charles E. Walker & Mark A. Bloomfield eds., 1983).

⁶¹ See Manuel, note 38 (describing Buffett’s current net worth, including his Berkshire Hathaway holdings).

⁶² These instruments came to be known as zero coupon (because interest payments were once reflected in physical coupons clipped from the physical bond, and the new-fangled bonds had no interest payments) or original issue discount bonds (because you could sell a ten-year bond with a face amount of a \$1000, say, for \$500, today, the difference—the original issue discount—being the interest to accrue over the term of the bond; govern-

scoring that *Macomber*'s requirement is not constitutionally based. It is a habit, not a necessity.

We do not need tax tomes to understand the point. Robert Kiyosaki, author of the popular best seller *Rich Dad Poor Dad*, gives it to his readers as "Rule #1:"

You must know the difference between an asset and a liability, and buy assets.

If you want to be rich, this is all you need to know. It is rule number one. It is the only rule. . . .

. . . [I]t sure beats saving \$100 a month, which actually starts out as \$150 because it's after-tax income for 40 years earning low interest. And again, you're taxed on the interest. That is not too intelligent. It may be safe, but it's not smart.⁶⁴

Kiyosaki is mocking wage-earners like his (poor) dad. These "not smart" individuals—most of us—must try and save out of labor earnings. Because these are taxed—at a 33% rate, in this passage—\$150 shrinks to \$100 after taxes. If you were to save this \$100 in a simple bank account, paying 5% interest, or \$5 a year, *that* "change in value of the store of property rights,"⁶⁵ being "realized," is taxed, again at the ordinary income tax rate of 33% (in this example), barely if at all keeping the wage-earner/saver ahead of inflation. Wage earners pay Mill's double-tax on savings—when they do not just try to skip the whole savings thing, and attempt to go straight to Rich Dad's status by playing the lottery.⁶⁶ "That is not too intelligent" either.

Step one, all in, is to buy assets that will appreciate *without* paying interest or dividends, which payments would be taxed under the realization requirement. Then you do whatever you want to help the assets grow in value—which, in the case of most investments, like growth stocks, means doing nothing at all. You never sell, with the exception of assets with built-in losses—that is, where the fair market value has dropped below the basis, leading to a tax loss.⁶⁷

ment savings bonds work this way). See Jeff Strnad, *The Taxation of Bonds: The Tax Trading Dimension*, 81 Va. L. Rev. 47, 48, 87-88 (1995).

⁶³ See IRC §§ 1271-1275 (implementing the original issue discount (OID) rules).

⁶⁴ Robert T. Kiyosaki, *Rich Dad Poor Dad: What the Rich Teach Their Kids About Money That the Poor and Middle Class Do Not!* 45, 102 (2011).

⁶⁵ Simons, note 41, at 50.

⁶⁶ Edward J. McCaffery, *Why People Play Lotteries and Why It Matters*, 1994 Wis. L. Rev. 71, 72-74 (1994).

⁶⁷ The tax benefit of the loss may be deferred under the capital loss offset rule, IRC § 1211.

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

Step two is to *borrow*. Debt or borrowing is not “income” under the basic definition of income. It never has been. When one borrows, there is no “change in value of the store of property rights.”⁶⁸ Under case law, *Macomber*’s rather unhelpful definition of “income” (as the “gain derived from capital or from labor or from both combined”⁶⁹), was replaced by the Supreme Court some thirty-five years later, in *Glenshaw Glass*, which held that “income” is “undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.”⁷⁰ *Glenshaw Glass*’s definition of “income” retains the realization requirement (“clearly realized”). The new and improved definition also underscores the nontaxation of debt under even a pure income tax. Borrowing is *not* an “undeniable accession to wealth.” The cash borrowed is offset by a liability to repay the debt, such that there is, in fact, no change in value of the store of property rights, and no change in one’s net worth. Under the income tax, one can borrow—even borrow using an asset with unrealized appreciation, built-in gain, as security⁷¹—and spend away, tax-free.

This gets us to a deep problem: *Consumption financed by debt is income-tax free*.⁷² The existence and persistence of Buy/Borrow/Die is not a principled response to a need for more savings. It is a roadmap to a tax-free lifestyle for the rich and propertied.

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

Step three is to *die*: the last thing all of us will do on earth, however we plan. The built-in gain that had been allowed to grow untaxed under the realization requirement disappears on death under the stepped-up basis rule of § 1014. This is a rule that Michael Kinsley

⁶⁸ Simons, note 41, at 50.

⁶⁹ *Eisner v. Macomber*, 252 U.S. 189, 207 (1920).

⁷⁰ *Commissioner v. Glenshaw Glass*, 348 U.S. 426, 431 (1955).

⁷¹ See *Woodsam Associates, Inc. v. Commissioner*, 16 T.C. 649, 649-52 (1951), *aff’d*, 198 F.2d 357 (2d Cir. 1952) (describing a taxpayer who took out several mortgages on the same property tax-free). This concept ought to be easy to understand for the many millions of Americans who have tax-free home equity loans.

⁷² Zelenak, note 40, at 1-3.

famously dubbed “the angel of death.”⁷³ It traces back to 1921.⁷⁴ On two occasions since then, Congress has passed a law providing for a carry-over basis for assets acquired after a death⁷⁵—the same rule as for gifts. Both times, in 1980 and again in 2010, Congress later retroactively repealed the repeal of stepped-up basis, without its ever meaningfully taking effect.⁷⁶ Under stepped-up basis, the heirs take an asset, income-tax free under § 102, *and* with a basis equal to the asset’s fair market value at date of death under § 1014. The kids can sell the asset and pay off the parents’ debts—all tax-free. The circle is complete.

Why do we have the stepped-up basis on death rule? Part of the stated explanation for the rule is that the gift and estate tax or wealth transfer tax system serves as a “backstop to the income tax.”⁷⁷ Only, well, it does not. After the adoption of Tax Reform Act of 2012,⁷⁸ 99.7% of Americans will leave estates *not* subject to the estate tax.⁷⁹ Yet 100% of decedents will be allowed to leave assets with stepped-up bases to their heirs, who will get the assets tax-free. And even the top 0.3% have plenty of planning opportunities to reduce or eliminate their estate tax, as I consider below.

That is it. Buy/Borrow/Die avoids all federal taxes. It avoids the income tax because of the three doctrines just noted. It avoids the

⁷³ Michael Kinsley, Eight Reasons Not to Cut the Capital-Gains Tax, *Slate* (Feb. 23, 1997, 3:30 AM), http://www.slate.com/articles/briefing/articles/1997/02/eight_reasons_not_to_cut_the_capitalgains_tax.html.

⁷⁴ See Lawrence Zelenak, Taxing Gains at Death, 46 *Vand. L. Rev.* 361, 363 n.7 (1993).

⁷⁵ Tax Reform Act of 1976, Pub. L. No. 94-455, § 2005, 90 Stat. 1520, 1872-79 (adopting carry-over basis for property acquired from a decedent after December 31, 1976); Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, §§ 541-542, 115 Stat. 38, 76-86 (including provisions for the repeal of the estate tax for one year commencing January 1, 2010, with the adoption of modified carry-over basis for 2010).

⁷⁶ Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, § 401, 94 Stat. 229, 299-301 (repealing carryover basis provisions of the Tax Reform Act of 1976 to “apply in respect of decedents dying after December 31, 1976”); Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 301, 124 Stat. 3296, 3300-01 (repealing carryover basis provisions from the Economic Growth and Tax Relief Reconciliation Act of 2001).

⁷⁷ David Joulfaian, Estate and Gift Tax, Federal, in *The Encyclopedia of Taxation and Tax Policy* 117, 117 (Joseph J. Cordes, Robert D. Ebel & Jane G. Gravelle eds., 2d ed. 2005).

⁷⁸ 2010 Act, note 76, § 302, 124 Stat. at 3301-02 (modifying estate tax exclusion amount to \$5 million with inflation adjustments for decedents dying in a calendar year after 2011); see also American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 101, 126 Stat. 2313, 2315-16 (2013) (striking section that applied sunset provision to estate tax amendments in the 2010 Act).

⁷⁹ Howard Gleckman, The Estate Tax: Hit and Myth, Urban-Brookings Tax Pol’y Ctr.: TaxVox Blog (Apr. 2, 2009), <http://www.taxpolicycenter.org/taxvox/estate-tax-hit-and-myth> (“Overall, TPC figures that only about 8,000 bequests would be taxed under Obama’s generous estate tax rules. To put it another way, 99.7 percent of those who die in 2011 would be exempt from the tax.”).

increasingly important payroll tax system by the simple expedient of never actually working. It avoids the estate tax because that is a net tax, on assets minus liabilities held at death. If Buy/Borrow/Die is taken to its limits, or to within \$5.49 million of its limits per person,⁸⁰ there is no net estate to tax.

The principles of Buy/Borrow/Die are basic, unquestionable matters of tax law: Gains are not taxed until “realized;” borrowing is not “income;” assets get a stepped-up basis on death. While it is true that only the wealthy have significant enough stores of capital to live off the real—not reported—income from their wealth alone, the principles of Buy/Borrow/Die are available to all. Thus, for example, homeowners can borrow against their home equity tax-free, and all can borrow against cash value life insurance policies, whose “inside build-up” has also been allowed to grow tax-free. But my concern here lies with the wealthy, who can literally live a tax-free life using Buy/Borrow/Die alone.

B. The Realities of Buy/Borrow/Die

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

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

To begin, there are deep-seated instincts that simple advice is too good to be true, and that the tax planning of the wealthy must be complex and expensive to obtain.⁸¹ This is, of course, what many *want* ordinary citizens to think, whether they are professionals profiting from giving complex tax planning advice, politicians hiding from a difficult task that would alienate their wealthiest donors, or wealthy individuals happy enough to hide their wealth and tax planning strategies in the shadows. Understandable as they may be, these skeptical sentiments get in the way of taxing wealth seriously. This following Subsection briefly goes through some of them.

⁸⁰ Rev. Proc. 2016-55, 2016-45 I.R.B. 707 (“For an estate of any decedent dying in calendar year 2017, the basic exclusion amount is \$5,490,000 for determining the amount of the unified credit against estate tax under § 2010.”); IRC § 2010(c)(3) (defining the basic exclusion amount as \$5 million with inflation adjustments for decedents dying after 2011).

⁸¹ Piketty seems to believe this. Piketty, note 1, at 12.

1. *How Can Anyone Understand Buy/Borrow/Die?*

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

But it is not that hard to understand Buy/Borrow/Die as I have just laid it out: Each plank is part of any basic introduction to income taxation.⁸² The widespread ignorance of Buy/Borrow/Die cannot be pawned off on its intrinsic difficulty.

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

2. *What About the Interest on the Borrowing? (or, Debt Aversion, Part 1)*

Debt aversion is a perfectly sensible heuristic, as we have known at least since Shakespeare told us to “neither a borrower nor a lender be.”⁸³ Kiyosaki, in the passage quoted above, had chided his “poor Dad” readers for investing in a “safe” bank account that was “not too intelligent” given the tax laws. A reflexive distrust of “Borrow” keeps some from understanding Buy/Borrow/Die’s breadth. One common skeptical objection to Buy/Borrow/Die is that playing it requires paying interest, which ordinary citizens seem loathe to do, notwithstanding, and perhaps because of, the prevalence of consumer debt in society.⁸⁴

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

Suppose that *Dick* and *Jane* each hold a stock worth \$1 million with no basis, for simplicity, such that the full million dollars represents built-in gain. Suppose, again for simplicity, a tax rate of 40% on reali-

⁸² See, e.g., McCaffery, note 6, at 12-15 (explaining the steps involved in Buy/Borrow/Die).

⁸³ William Shakespeare, *The Tragedy of Hamlet, Prince of Denmark* act 1, sc. 3, 75-77 (Barbara A. Mowat & Paul Werstine eds., Simon & Schuster 2012) (1599-1602).

⁸⁴ Devon Douglas-Bowers, *Mounting U.S. Household Debt and Bank Overdraft Fees*, Global Research (Jan. 12, 2016), <http://www.globalresearch.ca/mounting-household-debt-and-bank-overdraft-fees/5500771>.

zation.⁸⁵ Both *Dick* and *Jane* want to go on a very expensive vacation. *Dick*, impatient and ignorant of tax, simply sells his stock for \$1 million pays his \$400,000 (40%) tax, and immediately spends \$600,000 on his trip. *Jane* plays Buy/Borrow/Die. She borrows \$600,000 and goes on the same trip as *Dick*.

Jane will, indeed, have interest to pay on her \$600,000 debt. But she will *also*, unlike *Dick*, still have her \$1 million asset. Playing Buy/Borrow/Die out to death means that she will have an additional \$400,000 over *Dick* to give to her heirs or to later borrow against. *Jane* will also have the return on the million-dollar asset to offset the interest on the \$600,000 debt. Economic theory, common sense, and reams of historical data suggest that, over time, the rate of return on a \$1 million appreciating asset will significantly outperform the interest on a secured debt of \$600,000.⁸⁶ The wealthy benefit from a long timeframe.

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

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

⁸⁵ This is not unrealistic considering capital gains in high-tax states like California are close to 40%, and, as noted in Section IV.C, the best explanation for a lower capital gains rate is the existence of Buy/Borrow/Die.

⁸⁶ For 1928 to 2015, the arithmetic average return on the S & P 500 index (of the 500 most valued companies trading on stock exchanges) was 11.41%; the average return on a three-month T-bill, a good proxy for the kind of interest rate that the wealthy could obtain, was 3.49%. Aswath Damodaran, Annual Return on Stocks, T.Bonds and T.Bills: 1928-Current, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html (last updated Jan. 5, 2016). The difference over time is astounding. If one had borrowed \$100 in 1928 at the T-bill rate, and invested the money in the S & P 500, letting the stock holdings ride and the interest accrue into the debt, the debt would have grown to \$1978, and the asset would have grown to \$294,061. In other words, borrowing \$100 and holding onto a \$100 stock portfolio, over the past eighty-seven years, would lead to a net gain of approximately \$294,000. The number is over \$29 million with an initial amount of \$10,000.

3. *What If Assets Go Down in Value? (or, Debt Aversion Part II)*

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

This is another misplaced objection.

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

This problem is overstated.

One, the problem is not a significant one for the *very* wealthy, because they have more than enough wealth to weather any financial storm. Surely Warren Buffett would not worry about using some of his \$8 billion in appreciation (or \$70 billion in total wealth), to help secure a \$600,000 loan. (Buffett's fellow billionaire, Larry Ellison, has a \$10 billion line of credit.⁸⁷) This is one of the many ways that Buy/Borrow/Die, while not only available to the wealthy, is certainly easier and better for them. The 160,000 U.S. households with an average net worth of \$73 million can all get favorable interest rates.⁸⁸

Two, even at *Jane*'s level, the debt aversion can be handled. Suppose *Jane* put a "stop loss" order on *any* decline in her million-dollar asset. This would mean that, if the stock falls even a penny below \$1 million her stockbroker, or her computer, is under orders to sell it. On sale, *Jane* would get \$1 million pay \$400,000 in taxes, and be left with \$600,000, which she would use to pay off her debt. *Jane* would then be in the same position as *Dick*—\$600,000 spent, no debt, no asset. But if there were *any* chance that the asset never falls below \$1 million *Jane* would be better off than *Dick*.⁸⁹

⁸⁷ See Julie Bort, *Larry Ellison Has Secured \$10 Billion Worth of Credit for His Personal Spending*, *Bus. Insider* (Sept. 26, 2014), <http://www.businessinsider.com/larry-ellison-has-a-10b-credit-line-2014-9>.

⁸⁸ Scott G. McNall, *The Problem of Social Inequality: Why It Destroys Democracy, Threatens the Planet, and What We Can Do About It* 37 (2015).

⁸⁹ One can simplify matters by putting *Dick*, after his trip, at zero. *Jane*'s financial position can be described as $(p)((1+r)1,000,000 - (1+i)600,000) + (1-p)0$ where p is the probability that the asset never falls below \$1 million ($1-p$) is the probability that it does fall below \$1 million, r is the rate of return on the \$1 million holding, and i is the interest rate on the (\$600,000) debt. This ignores transaction costs (including any interest paid prior to the asset's fall in value), which, if the strategy were set up by *Jane* online, would be modest in any event. Transaction costs aside, *Jane*'s strategy strictly dominates *Dick*'s in technical terms.

4. *It Is Unfair to Tax Mere Appreciation as There Is No Cash to Pay the Tax*

Since the government will not accept mere appreciation as a form of tax payment, what does a follower of Buy/Borrow/Die do at tax time? How could Buffett pay \$2.4 billion in cash on his 2010 “mere” appreciation?

Once again there are compelling responses to the objection.

One, it is a fact that, in a wide range of contexts, we do, as a matter of general tax principles, tax noncash receipts.⁹⁰

Two, we could also tax at least the borrowing secured by yet-un-taxed appreciation, because there is cash in these contexts.⁹¹

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

5. *Who Would Take Buy/Borrow/Die to the Limit?*

Skeptics often assert that it is too costly, or risky, or both to take Buy/Borrow/Die to its limits so as to pay no tax. Buffett, for example, paid nearly \$7 million in income taxes in 2010,⁹² which is a long way from nothing. Statistics of reported income continue to show that high income earners pay high taxes.⁹³ There are indeed significant sums of realized capital gains every year.⁹⁴ Scholars argue that capital does contribute some tax to the fisc.⁹⁵

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

⁹⁰ IRC § 61.

⁹¹ See *Woodsam Associates, Inc. v. Commissioner*, 16 T.C. 649, 649-52 (1951), *aff’d*, 198 F.2d 357 (2d Cir. 1952).

⁹² See note 31 and accompanying text.

⁹³ Laura Saunders, *Top 20% of Earners Pay 84% of Income Tax*, Wall. St. J. (Apr. 10, 2015, 9:59 AM), <http://www.wsj.com/articles/top-20-of-earners-pay-84-of-income-tax-1428674384>.

⁹⁴ Cong. Budget Office, *Actual and Projected Capital Gains Realizations and Tax Receipts in CBO’s January 2016 Baseline* (2016), <https://www.cbo.gov/sites/default/files/51138-2016-01-RevenueProjections.xlsx>.

⁹⁵ Roger Gordon, Laura Kalambokidis & Joel Slemrod, *Do We Now Collect Any Revenue from Taxing Capital Income?*, 88 J. Pub. Econ. 981, 987-90 (2004).

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

6. *Other Taxes Are Taking Care of Taxing Wealth*

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

Most important, the gift and estate or unified wealth transfer tax system is *not* taxing wealth seriously. The estate tax has long been essentially a “voluntary tax,” as it was dubbed in 1977.⁹⁶ It is easily avoided with fairly standard planning techniques.⁹⁷ George Cooper in the 1970’s discussed a case study of “how to zero-base budget for the estate and gift tax”—the du Pont family.⁹⁸ To take a more contemporary example—where a journalist shed some helpful light—the casino magnate and Republican party donor Sheldon Adelson was able to transfer nearly \$8 *billion* to his family, at a time when the estate tax exemption level or “zero bracket” was \$1 million or less, and the estate tax rate 50% or more, *altogether tax-free*.⁹⁹ That is not taxing wealth seriously. Today hundreds of billions of dollars sit in dynasty trusts, in South Dakota and elsewhere, *forever* out of the estate tax’s reach.

No other tax gets any closer to addressing the problem of wealth inequality. The corporate tax is largely a trick, because its incidence—who really, in the end, pays it—is unclear. Corporations themselves, as legal fictions, do not “really” pay taxes, even if they remit them. The money sent to the government must come out of someone’s pocket. It is easy to assert that this would be the corporation’s owners, the shareholders. But why would capitalists pay a tax when there

⁹⁶ George Cooper, A Voluntary Tax? New Perspectives on Sophisticated Tax Avoidance, 77 Colum. L. Rev. 161, 210, 221 (1977).

⁹⁷ Edward J. McCaffery, A Voluntary Tax? Revisited, in 2000 Proceedings of the 93rd Ann. Conf. on Tax’n, Nat’l Tax Ass’n 268, 268 (James R. Hines Jr. ed.).

⁹⁸ Cooper, note 96, at 212-21.

⁹⁹ Zachary R. Mider, Accidental Tax Break Saves Wealthiest Americans \$100 Billion, Bloomberg (Dec. 16, 2013), <http://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion>.

are nontaxable alternatives for their money? Most economists feel that the corporate tax is paid largely if not completely by labor.¹⁰⁰ There is also the fact that corporations have their own versions of Buy/Borrow/Die, typically involving international tax arrangements that substantially reduce the U.S. corporate tax sting.¹⁰¹ Berkshire Hathaway for example is able to avoid or defer significant corporate taxes.¹⁰²

Property taxes are local and limited primarily to real estate and certain forms of tangible property. Sales and other forms of consumption tax are relatively low and flat. The taxes most raised by President Obama are excise ones such as on cigarettes and cell-phones.¹⁰³ These do not even try to tax wealth seriously. And so on.

7. *We Should Never Tax Wealth/It Is Double Taxation to Do So*

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

As a preliminary matter, there is nothing, generally, wrong with “double taxation”—many dollars in the flow of the economy are taxed multiple times. To give an easy example, a salaried employee pays both payroll taxes and income taxes on her earnings. So the argument tends to be that the same tax cannot tax the same wealth twice, and, since the initial receipt of wealth has been taxed by an income tax, its yield should not be. This is Mill’s point.¹⁰⁴

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

First, windfalls. There are two forms of consumption taxes that are single taxes on wealth. One is the wage tax model—tax earnings as they come in, and never again, like a payroll tax. The other is a spending tax model—tax wealth as it is converted into spending, wherever the spendable resources came from (wages, capital, borrowing), but not when wealth first comes into a household.¹⁰⁵ It is a well-known

¹⁰⁰ Arnold C. Harberger, The ABCs of Corporation Tax Incidence: Insights into the Open-Economy Case, in *Tax Policy and Economic Growth* 51, 54-66 (Am. Council Capital Formation ed., 1995).

¹⁰¹ See Edward A. Kleinbard, Stateless Income, 11 *Fla. Tax Rev.* 699, 724 (2011).

¹⁰² Morris Propp, Warren Buffett’s Nifty Tax Loophole, *Barron’s* (Apr. 11, 2015), <http://www.barrons.com/articles/warren-buffetts-nifty-tax-loophole-1428726092>.

¹⁰³ Edward J. McCaffery, Why You Pay Hidden Cell Phone Tax, *CNN* (Aug. 21, 2013), <http://www.cnn.com/2013/08/21/opinion/mccaffery-mobile-charges>.

¹⁰⁴ See note 44.

¹⁰⁵ McCaffery, note 6, at 5-6. Of course, for those (many) wage earners who do not save, the two types of consumption taxes come to the same end. Recall the Haig-Simons definition of income, $\text{income} = \text{consumption} + \text{savings}$. If $\text{savings} = 0$, then $\text{income} = \text{con-}$

result in the tax policy literature that these two types of tax are equivalent under certain specified conditions. But they are *not* equivalent if there are “windfalls,” or outsized returns to savings.¹⁰⁶ Simply put, wage taxes do not fall on windfalls but spending taxes do. This is easy enough to see in a simple case of a worker who wins millions on a \$1 lottery ticket. A wage tax like the payroll tax would not affect her; a spending tax would, as she consumes her good fortune.

To those concerned with taxing wealth seriously, the fact that the initial savings were at some point taxed is hardly consolation. Suppose that *Jane* had earned \$2000 in 1964, paid income taxes of \$1000, and used the remaining \$1000 to buy shares of Berkshire Hathaway stock. By 2014, that thousand dollars would have grown—altogether tax-free under Buy/Borrow/Die—to \$10.5 million.¹⁰⁷ The government’s official inflation calculator reveals that \$1000 1964 dollars are equivalent to just over \$7636 by 2014;¹⁰⁸ hence the argument that capital appreciation should not be taxed because it represents mere paper or inflationary gains also misses the mark. Virtually *Jane*’s entire \$10.5 million reflects never-taxed real appreciation. That is a windfall.

It gets worse. If *Jane* were married, her full \$10.5 million could be placed in a dynasty trust on *Jane*’s death, held for *Jane*’s children, grandchildren, and so on, altogether tax-free under the gift and estate tax.¹⁰⁹ No subsequent generation need *ever* pay any tax, if the trust simply follows Buy/Borrow/Die. This is the problem of iteration.

Defending these facts with the argument that the initial \$1000 that *Jane* invested had been taxed, such that the government should be estopped from ever taxing *Jane* and her progeny again, is not taking taxing wealth seriously.

sumption. Equivalently, wages = spending, so a wage tax and a spending tax are equivalent.

¹⁰⁶ Technically, the textual statement holds only if the existence of windfalls is not related to the size of the after-tax investment pool. Consider the lottery example later in this paragraph. *Jane* makes \$2, loses \$1 to the income (or payroll) tax, and buys a lottery ticket with the other \$1, which turns into \$1 million, not taxed. If there is a spending tax, *Jane*’s \$1 million would be taxed as spent, leaving her worse off than with the wage tax. The (technical) question is if *Jane* had not been taxed initially, could she win \$2 million with her \$2 to spend on lottery tickets. That seems unlikely. See Edward J. McCaffery, Tax Policy Under a Hybrid Income-Consumption Tax, 70 Tex. L. Rev. 1145, 1152 n.24 (1992).

¹⁰⁷ Elena Holodny, Here’s What \$1,000 Invested with Warren Buffett at Different Times in the Last Fifty Years Is Worth Today, Bus. Insider (Aug. 14, 2014), <http://www.businessinsider.com/if-you-had-invested-with-warren-buffett-2014-8>.

¹⁰⁸ See Bureau of Labor Statistics, CPI Inflation Calculator, <http://data.bls.gov/cgi-bin/cpicalc.pl> (last visited Nov. 17, 2016).

¹⁰⁹ McCaffery, *Distraction*, note 27, at 1241-43.

8. *Where's the Data?*

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

A quick answer is that there is plenty of data: Piketty's data. America has great wealth and great wealth inequality. The problem of wealth inequality is getting worse, notwithstanding a tax system that is supposed to redistribute wealth. That America's top 160,000 have average net worth in excess of \$70 million, while most people have little or no financial wealth at all, is a problem. It is logically possible to argue, or assume, as Piketty himself seems to,¹¹⁰ that the problems would be worse without the tax system—that taxes are a cure, just a partial cure. Understanding the analytic facts of Buy/Borrow/Die makes such beliefs, however, rather heroic, at least when it comes to wealth as opposed to income inequality. Without the yoke of heavy taxation around their necks, the rich can get richer, while ever-greater burdens fall on workers, who struggle to save at all. Such a tax system would *predict*, from first principles, a world of unequal wealth, and of wealth inequality more severe than income inequality. Piketty demonstrates that we have such a world. Why not connect these dots?

There is little data on the very wealthy and their tax planning because they are relatively few, and relatively secretive, and neither the press nor the people have much time or appetite for understanding their strategies in any event. We know about Warren Buffett because he helpfully disclosed his tax return data for 2010. Few Americans do that, and none really have to.¹¹¹ We know about the du Ponts from the work of George Cooper¹¹² and Sheldon Adelson's \$8 billion tax-free transfer of wealth because a reporter did a yeoman's job uncovering it.¹¹³ We know about the hundreds of billions of dollars in dynasty trusts in places like South Dakota because of some academic research.¹¹⁴ These are intriguing tips of the iceberg, but not enough data points to satisfy the empiricists crying for statistical significance.

But we know more. The analytic facts show that Buy/Borrow/Die is widely available, and has been so for nearly a hundred years. Why would the wealthy—some, most, or all of them—not take advantage of its perfectly legal steps? Why would professional advisers not seek out the wealthy, and explain to them the tax savings available? Popular best sellers such as *Rich Dad/Poor Dad* contain the essence of the

¹¹⁰ Piketty, note 1, at 208.

¹¹¹ See Edward J. McCaffery, A "Tax Day" Americans Could Love?, CNN (Dec. 3, 2014), <http://www.cnn.com/2014/11/26/opinion/mccaffery-finland-tax-day>.

¹¹² See Cooper, note 96.

¹¹³ See Mider, note 99.

¹¹⁴ Max M. Schanzenbach & Robert H. Sitkoff, Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo L. Rev. 2465, 2466-68 (2006).

advice, and Warren Buffett and Berkshire Hathaway live it out for all to see. If the wealthy do not know that selling valuable assets with large levels of built-in gain produces tax, they will find out soon enough, at tax time, after their first sale. It defies logic, common sense, and every major tenet of rational choice social theory that individuals would not take advantage of a perfectly legal tax strategy that could save them millions or billions of dollars.

9. *If Buy/Borrow/Die Is a Problem, It Is a Small Problem*

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

Yet again, these are dangerously poor arguments. They take the absence of data, just considered, and use it to aid a lazy presupposition that what we do not see cannot hurt us. Freud among others should have taught us otherwise. While some may disagree that wealth inequality is a problem, the project of taxing wealth seriously assumes that it is, and aims to go about correcting it. And there are good reasons to conclude that Buy/Borrow/Die is indeed a big problem.

To start, even if we were only talking about a single person or two, Buy/Borrow/Die would be a significant social concern. Buffett now has a net worth of about \$70 billion; his good friend Bill Gates comes in at \$80 billion.¹¹⁵ Under Buy/Borrow/Die, both billionaires *can* spend it all and die broke—and tax-free. The fact that neither Gates nor Buffett seem inclined to do so—both have demonstrated a solid commitment to philanthropy¹¹⁶—is wonderful news. But it is also a fortuity. Gates, Buffett, or any other billionaire could change his or her mind and go on a massive spending spree, perhaps by running for elected office. This is a problem lurking in the darkness that we had best check out.

Although we are not all Buffetts, some 160,000 households with average net wealth of \$70 million does not seem like something to ig-

¹¹⁵ Tanza Loudenback, Bill Gates Is Again the Richest Person on Earth, with a Net Worth of \$87 Billion, *Bus. Insider* (Jan. 27, 2016), <http://www.businessinsider.com/bill-gates-richest-2016-1>; see also Manuel, note 38.

¹¹⁶ Marqui Mapp, Make Billions, Then Give It Away: Gates, Buffett Talk Philanthropy, *CNBC* (May 10, 2015), <http://www.cnn.com/2015/05/08/bill-gates-and-warren-buffett-talk-philanthropy.html>.

nore. At a spending rate of 5% a year, such households can consume \$3.5 million a year altogether tax-free, while their net worth keeps increasing. Piketty, while not extensively engaging in moral or political theory, suggests many of the problems that come when a “rentier class”—one that can live off financial capital and its returns, alone—roams the land. Workers become discouraged, students abandon education to hatch schemes to get rich, the propertied class has not much incentive to do anything. Our tax system encourages exactly this pattern.¹¹⁷ The social fabric is at risk of breaking down; class warfare looms. As a matter of history, real wars and crises follow.

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

C. *Beyond Buy/Borrow/Die*

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

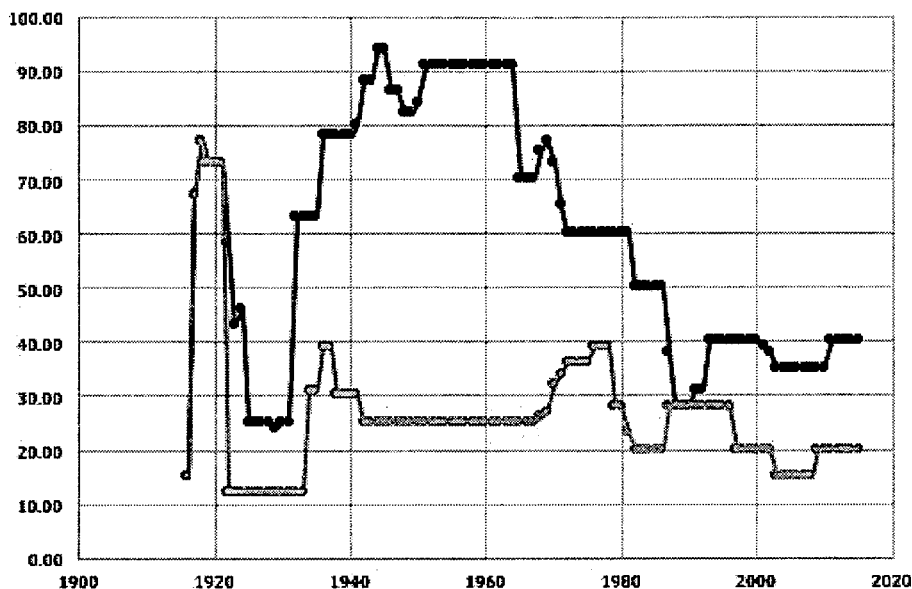
The most important instance of this effect is the persistence of low capital gains tax rates. When *Jane* sells an asset that she has held for over a year, like a share of Berkshire Hathaway stock, she pays tax at a rate that is one-half or less of the rate she pays on her labor earnings.¹¹⁸ Throughout history, the capital gains rate was typically set at 40% of the “ordinary” rate, so we have seen 90/36, 70/28, and 50/20 as pairs of highest ordinary and capital gains rates.¹¹⁹

¹¹⁷ See Piketty, note 1, at 22-27; Michael Simkovic, *The Knowledge Tax*, 82 U. Chi. L. Rev. 1981, 1982-83 (2015).

¹¹⁸ Compare IRC § 1(a) (maximum rate), and IRC § 1(h) (maximum 20% rate).

¹¹⁹ Historic Highest Marginal Income Tax Rates, Urban-Brookings Tax Pol’y Ctr. (Feb. 19, 2015) http://webarchive.taxpolicycenter.org/taxfacts/Content/PDF/toprate_historical.pdf [hereinafter *Highest Income Tax Rates*]; Capital Gains and Taxes Paid on Capital Gains, Urban-Brookings Tax Pol’y Ctr. (Nov. 20, 2012), <http://www.taxpolicycenter.org/statistics/historical-capital-gains-and-taxes> (last visited Dec. 5, 2016).

FIGURE 1
ORDINARY VERSUS CAPITAL GAINS RATES, 1913-PRESENT¹²⁰



Things are a bit harder to see now—the politics of salience suggests many hidden tax rates, as arise from “phase-outs” of benefits and so on¹²¹—but 40/20 is a rough estimate of the current top ordinary and capital gains rates in 2016.¹²² Why do we favor capital gains, notwithstanding the fact that Buy/Borrow/Die already hugely favors capital, and that capital is winning the day in the macroeconomy, as well? The

¹²⁰ Highest Income Tax Rates, note 119; Office of Tax Analysts, U.S. Treasury Dep’t, Taxes Paid on Long-Term Capital Gains, 1977-2014 (2016), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/Taxes-Paid-on-Long-Term-Capital-Gains.pdf>.

¹²¹ Edward J. McCaffery, Cognitive Theory and Tax, 41 UCLA L. Rev. 1861, 1875-76 (1994).

¹²² Capital gains are also subject to the “net investment income tax” of 3.8%, a part of the so-called Obamacare taxes. IRC § 1411. The lower capital gains rate factors into the ongoing discussion of carried interest, a technique that hedge fund managers, among others, employ to get their compensation in the form of capital (that is, an equity ownership interest in the fund), with which they can play Buy/Borrow/Die and eventually get capital gains rates. Although this issue has been around for a while, with a legislative proposal to end the break from Charles Rangel (D-NY) dating back to 2007, politicians today make hay with it. See H.R. 3996, 110th Cong. (2007); see also Michael S. Knoll, The Taxation of Private Equity Carried Interests: Estimating the Revenue Effects of Taxing Profit Interests as Ordinary Income, 50 Wm. & Mary L. Rev. 115, 159 (2008). Even Donald Trump has vowed to crack down on Wall Street by addressing this problem. James B. Stewart, Trump Lands Blow Against Carried Interest Tax Loophole, N.Y. Times: Common Sense (Sept. 17, 2015), http://www.nytimes.com/2015/09/18/business/with-trump-as-foe-carried-interest-tax-loophole-is-vulnerable.html?_r=0. Of course, it is a problem for high-wage earners, like hedge fund managers. It would not cost Warren Buffett a penny.

paradoxical answer is that we must have lower capital gains rates *because of Buy/Borrow/Die*.

The realization requirement creates a “lock-in” effect under which asset holders are discouraged from selling.¹²³ Consider again *Jane* with her \$1 million stock. If there were no capital gains preference, she would face a 40% income tax rate on sale. If the stock (or other asset, like undeveloped land) was only worth \$700,000 to *Jane*, but *Dick*, who could put the asset to a higher and better use, would happily pay \$1 million for it, a sale will not happen, because *Jane*’s after-tax amount from any sale would be \$600,000—the \$1 million sales price reduced by a \$400,000 tax. The asset would stay in *Jane*’s hands and the wealth of the world would suffer.

If taxpayers are not flocking to advisers to avoid rather modest capital gains tax rates, why would they not do so if rates increased—bearing in mind that the highest ordinary income rate bracket under the income tax has exceeded 90%? One would predict that Buy/Borrow/Die gets used more at higher tax rates. Indeed, evidence shows that the government *gets* revenue when it cuts the capital gains rate, opening up sales that are good both for the economy and the fisc.¹²⁴ The pattern has not gone unnoticed by capitalists or by politicians, and so we could plausibly expect even some future Democratic president to do what the first Clinton did, and cut the capital gains rate as a means to collect taxes on her, or his, watch.¹²⁵

The simple point is that once you have made it easy for a great deal of capital appreciation to escape tax, as Buy/Borrow/Die does, it is both difficult and questionable policy to keep *any* capital in the tax base directly, at all. Thus, we see a very light hand on the capital side of the capital-labor divide. Once you have that, if you are a government that needs vast sums to feed itself—and what government these days does not?—you had better be very mindful about maintaining a *heavy* hand on the labor side of the divide, or you have nothing left to tax. This is in fact what we see in tax today, and have for a long time.

¹²³ See James Wetzler, Capital Gains and Losses, in *Comprehensive Income Taxation* 115, 135-40 (Joseph A. Pechman ed. 1977).

¹²⁴ Daniel J. Mitchell, The Overwhelming Case Against Capital Gains Taxation, *Forbes* (Nov. 7, 2014), <http://www.forbes.com/sites/danielmitchell/2014/11/07/the-overwhelming-case-against-capital-gains-taxation/#34f0f2016074>.

¹²⁵ Charles Kadlec, The Dangerous Myth About the Bill Clinton Tax Increase, *Forbes* (July 16, 2012), <http://www.forbes.com/sites/charleskadlec/2012/07/16/the-dangerous-myth-about-the-bill-clinton-tax-increase/#b449776772c7> (“In 1997, Clinton signed a reduction in the . . . capital gains tax rate to 20% from 28%.”).

V. A CENTURY OF EMBARRASSMENT:
NOT TAXING WEALTH SERIOUSLY

The Sixteenth Amendment was ratified in 1913, allowing Congress to reinstate a federal income tax that had been declared unconstitutional in 1894.¹²⁶ Shortly thereafter, Congress acted,¹²⁷ and we have had an income tax—in name at least—ever since.

But the tax has never been all that effective in living up to its progressive roots. Canvassing a century of history, we see certain recurrent themes. The income tax was initially conceived, as Carolyn Jones has put it in a seminal law review article, as a “class tax” on the wealthy.¹²⁸ Yet the income tax has since its beginning been highly limited in that end. With wartimes, World War I and World War II especially, the tax expanded dramatically to help finance the war efforts, becoming, again in Jones’s phrase, a “mass tax.”

As the tax expanded, things changed. The theoretical commitment of an income tax to doubly taxing savings became problematic, leading to a panoply of ad hoc deviations.¹²⁹ More fundamentally, the seeds of Buy/Borrow/Die were firmly planted by the 1920 Supreme Court case, *Macomber v. Eisner*. These elements of tax have never been seriously questioned, occasional quirks such as Obama’s 2015 capital-gains-on-death proposal being inconsequential exceptions proving the rule. Coming out of World War II, nominally high tax rates persisted—they reached a peak of 94% for the top bracket in 1944 and 1945¹³⁰—but high earners were able through tax planning to soften the brunt of these high tax rates. Wealthy earners used features available on the capital side, from Buy/Borrow/Die—often, and generally, using debt to get into the game¹³¹—to generate tax losses that “sheltered” their wage incomes from taxation. By the 1980’s, the system got around to shutting down these “loopholes,”¹³² as part of a grand compromise under Ronald Reagan that dramatically lowered marginal tax rates while tightening the base of the income tax—as a

¹²⁶ *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429 (1895), *aff’d on reh’g*, 158 U.S. 601 (1885) (declaring a tax on interest, dividends, and rents to be in violation of the prohibition against unapportioned direct taxes provided in Article I, Section 9 of the Constitution); Office of Art & Archives, The Ratification of the 16th Amendment, <http://history.house.gov/Historical-Highlights/1901-1950/The-ratification-of-the-16th-Amendment/> (last visited Jan. 28, 2016).

¹²⁷ Tariff Act of 1913, Pub. L. No. 63-16, 38 Stat. 114.

¹²⁸ Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 *Buff. L. Rev.* 685, 685 (1989).

¹²⁹ McCaffery, note 46, at 856, 899-903; McCaffery, note 6, at 17-18.

¹³⁰ Highest Income Tax Rates, note 119.

¹³¹ McCaffery, note 46, at 891; see also Calvin H. Johnson, *What’s a Tax Shelter?*, 68 *Tax Notes* 879 (Aug. 14, 1995) (arguing, in part, that policy changes targeting tax shelters should have included debt in their definition of a tax shelter).

¹³² See, e.g., IRC § 469.

wage tax.¹³³ Since then, rates have crept up a bit, but the base has remained primarily as wage, or labor income.

As this income tax story has been running its course, the payroll tax has arisen as the major tax for most Americans, and a close rival to the income tax in total revenue for the fisc.¹³⁴ And the payroll tax, by design, only ever applies to wages—and drops off dramatically at about \$118,000 of salary.¹³⁵ That is a regressive, not progressive, tax.

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

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

Jones opens her account in the prewar, Depression era 1930's: "During the 1930s, no more than five percent of Americans were income taxpayers. The tax was viewed as a 'class tax' directed toward the rich—those President Roosevelt referred to as 'economic royalists.'"¹³⁶

The income tax radically expanded in World War II, both as a much-needed means to finance the war effort and to curtail "excess" consumer purchasing power that might otherwise have fueled inflation: "The result was that the income tax rolls increased from about 7 million taxpayers in 1940 to more than 42 million in 1945. The income tax became in Treasury Secretary Henry Morgenthau, Jr.'s words, 'a people's tax.'"¹³⁷

Jones' rich account of the transition of the income tax from class to mass tax rewards a careful rereading. Her main scholarly focus is on how the official rhetoric—"propaganda"—surrounding the tax had to change, because the tax had been "sold" to the public as a check on the wealthy prior to its wartime transformation.¹³⁸ Three sub-themes in Jones' narrative deserve emphasis.

One, the initial income tax was rather modest in its rates and application. Figure 1 shows the history of the highest marginal rates under the income tax. An initial rate of 7% was increased, during World War I, to as high as 77%, presaging World War II moves, and then fell to 25% by 1925. But there is reason to believe that few if any were in

¹³³ Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085.

¹³⁴ Staff of the Joint Comm. on Tax'n, note 28, at 30 tbl.A-6 (listing total income tax revenue of \$1.4 billion, as compared to \$1 billion from payroll taxes in 2016).

¹³⁵ IRC § 3101 (payroll tax withheld from wages), § 3121(a) (excluding wages above the contribution and benefit base); Stephen Miller, 2016 Payroll Tax Unchanged; Tax Brackets Nudge Up, Soc'y for Human Res. Mgmt. (Oct. 15, 2015), <http://www.shrm.org/hrdisciplines/compensation/articles/pages/fica-social-security-tax-2016.aspx>.

¹³⁶ Jones, note 128, at 685 (footnote omitted).

¹³⁷ Id. at 686 (footnote omitted).

¹³⁸ Id. at 687-88.

the highest rate bracket.¹³⁹ In 1932, Ogden Mills, Secretary of the Treasury under Hebert Hoover, told the Senate Finance Committee: “We have become accustomed . . . to high exemptions and very low rates on the smaller taxable incomes. That is our fixed conception of an income tax and it is very difficult as a practical matter to change fixed conceptions of this character.”¹⁴⁰

Jones goes on to note the narrow coverage of the tax: An average of 5.6 percent of the total population were covered by taxable returns in the period from 1918 to 1932, with a maximum coverage of 11.4 percent in 1920 and a low of 2.5 percent of the population in 1931; the low was attributable to economic vicissitudes during the Depression.¹⁴¹

The income tax had a relatively low yield during the 1930’s. It accounted for only 10-20% of federal revenues during a time of much smaller nominal government than today.¹⁴² Normalizing against gross domestic product (GDP), the income tax took up 0.9% of GDP in 1940, on its way to 9.4% by 1944, an astonishing expansion.¹⁴³ It is evident from these numbers, as well as from Mill’s public description of the tax and ample case studies of planning opportunities available to the very rich, that the income tax prior to World War II was hardly a “leveling” tax. Meantime, the flat 2% payroll tax with a ceiling of \$3000—approximately \$50,000 in 2015 dollars—took in *twice as much* revenue as the income tax did in 1940.¹⁴⁴

Two, politicians—even “progressive” politicians such as Roosevelt—used the *appearance* of high taxes on the rich to suit their political ends. These ends at first were mainly symbolic—make it look as if we were taxing wealth seriously. The ends later became “real,” when the fisc actually needed money, and then the appearance of high tax rates on the rich was used to make income taxation of the masses more acceptable.¹⁴⁵ In political moves strongly evocative of the present era, “[i]ncome tax proposals [of the Roosevelt Administration in the mid-1930’s] were directed at taxpayers with over \$1 million of tax-

¹³⁹ Id. at 688.

¹⁴⁰ Id. (quoting Revenue Act of 1932: Hearings on H.R. 10236 Before the Senate Comm. on Finance, 72d Cong. 3 (1932)).

¹⁴¹ Id. at 688.

¹⁴² Id. at 685-86.

¹⁴³ See Source of Revenue as Share of GDP, Urban-Brookings Tax Pol’y Ctr. (Feb. 4, 2015), <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=205>.

¹⁴⁴ Office of Mgmt. & Budget, Exec. Office of the President, Fiscal Year 2017 Historical Tables tbl.2.1, <https://www.whitehouse.gov/omb/budget/Historicals> (last visited Nov. 16, 2016).

¹⁴⁵ Jones, note 128, at 690-99.

able income,” this at a time when “only 10 percent of families had incomes of \$3,200 or over” and a “subsistence or adequate income for a family of four was variously set at between \$800 and \$2,000.”¹⁴⁶ Recall Clinton’s 4% plan and Sanders’ \$10 million bracket.

When Congress raised the top marginal rate to 79% in 1936, it applied to incomes over \$5 million.¹⁴⁷ According to the Bureau of Labor’s inflation adjuster, \$5 million in 1936 is equivalent to more than \$85 million in 2015 dollars¹⁴⁸—far more than even Warren Buffett shows on his tax returns. Little wonder, then, that, as Jones writes “[f]or three years thereafter only John D. Rockefeller qualified for this most stratospheric of tax brackets.”¹⁴⁹

The highest marginal rate bracket under the income tax is highly “salient,” or prominently seen and noticed.¹⁵⁰ Less salient is the number of taxpayers actually in the top bracket—not to mention how marginal tax rates even work.¹⁵¹ Altogether nonsalient, obscured in the darkness, is Buy/Borrow/Die, which keeps many of the truly wealthy altogether out of the top bracket because their real income need not be reported.

When these “progressive” moves were put in place, they were meant to serve a rhetorically populist agenda.¹⁵² Later, in World War II, the appearance of high rate brackets on the rich helped to sell the lower rates for the masses.¹⁵³ Irving Berlin wrote a song, quoted by Jones, *I Paid My Income Tax Today*, opening with the stanza:

I said to my Uncle Sam
 “Old Man Taxes here I am”
 And he—was glad to see me
 Lower Brackets that’s my speed
 Mr. Small Fry yes indeed
 But gee—I’m proud as can be.¹⁵⁴

¹⁴⁶ Id. at 690.

¹⁴⁷ Revenue Act of 1936, Pub. L. No. 740, § 12, 49 Stat. 1648, 1653-55.

¹⁴⁸ Bureau of Labor Statistics, note 108.

¹⁴⁹ Jones, note 128, at 691.

¹⁵⁰ See generally David Gamage & Darien Shanske, Three Essays on Tax Salience: Market Salience and Political Salience, 65 Tax L. Rev. 19 (2011) (describing tax salience as the presentation of tax prices and discussing how it affects taxpayer behavior); see also Edward J. McCaffery, Behavioral Economics and the Law: Tax, in The Oxford Handbook of Behavioral Economics and the Law 599, 608 (Eyal Zamir & Doron Teichman eds., 2014).

¹⁵¹ See Deborah H. Schenk, Exploiting the Salience Bias in Designing Taxes, 28 Yale J. on Reg. 253, 269 (2011).

¹⁵² Jones, note 128, at 690-92.

¹⁵³ Id. at 693-95.

¹⁵⁴ Id. at 685 (quoting Irving Berlin, *I Paid My Income Tax Today* (1941)).

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

Three, the more progressive aspects of tax actually *weakened* during the darkest days of the Depression, in part at least due to a "supply-side" rhetoric of jobs creation.¹⁵⁵ In Jones's words, again:

Despite the vivid contrasts drawn between Herbert Hoover and Franklin D. Roosevelt by historians and in popular culture, FDR did little from 1933 to 1939 to expand the boundaries of individual income taxation articulated by the Hoover administration. The persistence of hard times made such expansion difficult, and memories of tax revolts during 1932 rendered such expansion politically unwise. From 1933 to 1939, an average of 3.7 percent of the total population was covered on taxable returns. As a result, the individual income tax accounted for a lower percentage of federal revenue during the pre-war period of Roosevelt's presidency than it had from 1925 to 1932. Corporate income and excess profits taxes also represented a smaller portion of federal tax receipts under Roosevelt than they had under the previous seven years of Republican administrations. *The ground lost by Roosevelt in the income tax arena was regained by excise taxation and regressively structured social security taxes.*¹⁵⁶

Once again, history will repeat itself: At the fiscal cliff fix from the wee early hours of 2013, President Obama went along with a package that paired largely symbolic tax increases on the upper income with a large increase in "regressively structured social security taxes."¹⁵⁷

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

¹⁵⁵ Id. at 689, 692.

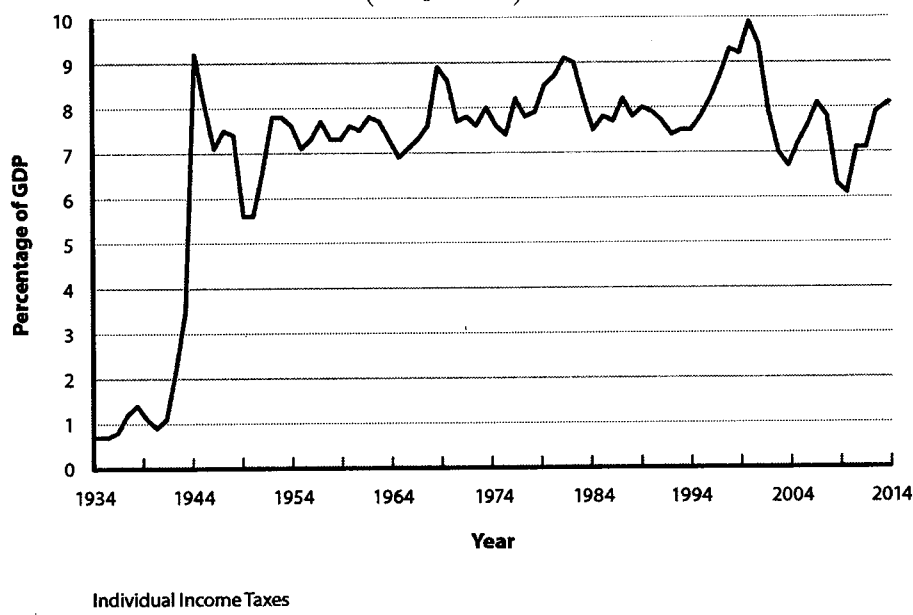
¹⁵⁶ Id. at 689 (footnotes omitted) (emphasis added).

¹⁵⁷ 2012 Act, note 78; Matt Smith, Obama Signs Bill Warding Off Fiscal Cliff, CNN Politics (Jan. 3, 2013, 2:17 AM), <http://www.cnn.com/2013/01/02/politics/fiscal-cliff/>.

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

America awoke from World War II with the income tax as a significantly expanded “people’s” tax. The tax was here to stay, but it continued to evolve. It did not do so as a total source of revenue, however: The war years more or less maxed out the capacity of the income tax. It would not be until 1998, more than half a century later, that the individual income tax would exceed the 1944 level of 9.2% of GDP; for most of the post-World War II era, the tax swung in a fairly narrow bandwidth between 7-9% of GDP.¹⁵⁸

FIGURE 2
INCOME TAX AS PERCENT OF GDP, 1934-2020
(PROJECTED)¹⁵⁹



Still, the high marginal tax rates put in place during World War II endured, during an initial post-war phase from 1945 until 1981. This was also a period that Piketty has labeled a “catch up” phase, during which the wealth that had been decimated during the first half of the twentieth century returned, in unequal shares, as the Baby Boom generation got to work.¹⁶⁰ John F. Kennedy brought the top marginal rate down from 91%, where it had been since 1950,¹⁶¹ to 70% by

¹⁵⁸ See Source of Revenue, note 143; see also Figure 2.

¹⁵⁹ Office of Mgmt. & Budget, note 144, tbl.2.3. Graphic by Connor Mitchell.

¹⁶⁰ Piketty, note 1, 96-97, 187-88.

¹⁶¹ Revenue Act of 1950, Pub. L. No. 81-814, § 101, 64 Stat. 906, 910-11.

1965,¹⁶² where it essentially stayed until Ronald Reagan, in the Economic Recovery Tax Act of 1981 (ERTA), cut it to 50%, effective 1982.¹⁶³

Rate brackets were not indexed for inflation. Workers were entering higher rate brackets—and their taxes were going up—because of increases in their *nominal* salaries, to keep pace with inflation, as opposed to *real* wages that gave real purchasing power. The failure to index the rate brackets was not addressed until ERTA in 1981, and was not made effective until many years later.¹⁶⁴ Hence, during this period, taxes naturally increased on all Americans without the need for congressional action. Except for some small quirks in 1968-1970,¹⁶⁵ the highest marginal rate under the income tax was not raised from 1950 until 1990, a forty-year period of significant government expansion. High tax rates applied to more taxpayers as the U.S. economy took off, and yet the income tax as a percent of GDP stayed more or less constant, certainly within a narrow bandwidth.

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

Publicly, with revenues rising due to a growing economy and nonindexation—which alone meant automatic tax increases—Presidents and Congresses could play the role of beneficent uncle. Without rate cuts, the changes needed to keep the overall yield of the tax within acceptable political bounds came on the base side,¹⁶⁶ with a panoply of exclusions for fringe benefits including employer-provided health care and pension plans, mortgage interest (and, indeed, a general interest) deduction, charitable contribution deductions, and more.¹⁶⁷ An important piece of the post-World War II “peace dividend” was spent in 1948 in moving married couples to a system of joint returns that had the—intended—effect of discouraging secondary-earner participation in the workforce.¹⁶⁸

On the other side of the coin, private taxpayers were taking tax-avoidance matters into their own hands. Buy/Borrow/Die played a

¹⁶² Revenue Act of 1964, Pub. L. No. 88-272, § 111, 78 Stat. 19, 19-23.

¹⁶³ Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 101, 95 Stat. 172, 176-82.

¹⁶⁴ Id. § 104, 95 Stat. at 188-89; see Stephen J. Entin, Tax Indexing Turns 30, Tax Found.: Tax Pol’y Blog (Mar. 11, 2015), <http://taxfoundation.org/blog/tax-indexing-turns-30>.

¹⁶⁵ Revenue and Expenditure Control Act of 1968, Pub. L. No. 90-364, § 102, 82 Stat. 251, 251-54 (creating a temporary income tax surcharge on individuals); Tax Reform Act of 1969, Pub. L. No. 91-172, § 701, 83 Stat. 487, 657-59 (temporarily extending income tax surcharge).

¹⁶⁶ McCaffery, note 6, at 3; see Edward J. McCaffery & James R. Hines Jr., The Last Best Hope for Progressivity in Tax, 83 So. Cal. L. Rev. 1031, 1040 (2010).

¹⁶⁷ See McCaffery & Hines, note 166, at 1051-52, 1071.

¹⁶⁸ Revenue Act of 1948, Pub. L. No. 80-471, § 303, 62 Stat. 110, 115-16; see Edward J. McCaffery, Taxing Women 19 (1997).

lead role, albeit in the shadows. Not only was Buy/Borrow/Die in full force and effect throughout the post-World War II period, but other provisions, such as a nearly unlimited deduction for interest, made it easy for those *without* existing stores of financial capital to avoid the need to pay much, if any, taxes. Tax shelters that took advantage of Buy/Borrow/Die's planning opportunities were almost trivial.¹⁶⁹ As more wage earners entered higher rate brackets because of their nominally higher salaries, tax shelters and their promoters headed downstream, to the growing number of laboring class members facing high income tax rates.¹⁷⁰

Consider a simple, stylized idea. Take a wage earner, such as a young associate in a law firm, earning \$100,000 a year. Suppose she borrows \$1 million at 10% interest, and uses the \$1 million to follow Rich Dad's Rule No. 1: She buys assets. The assets, say some Berkshire Hathaway stock, go up in value by 10%, or \$100,000. Our associate has spent \$100,000, in the form of interest payments, to make \$100,000, in the form of the rise in value of Berkshire stock. But the appreciation in value is not taxed. With an unlimited interest deduction, the associate could deduct the \$100,000 interest from her salary, pay *no* income tax, and play Buy/Borrow/Die with her assets.¹⁷¹ Other tax shelters used debt to buy assets generating depreciation deductions to offset ordinary salary, or invested in offsetting financial positions (straddles) and systematically sold their losses while holding their winners, and so on.¹⁷²

There are of course risks and transaction costs in all such plans. But marginal tax rates of 70% or 90% gave plenty of incentive, and cushion, for high earners to try their hand at tax planning. The failure to index made more workers consider tax shelters—and gave an incentive to promoters, accountants, and lawyers to provide them. Plenty of evidence exists that such shelters were common.¹⁷³ Note that it was high wage earners who were sheltering in this time period. Buy/Bor-

¹⁶⁹ McCaffery, note 6, at 181-201.

¹⁷⁰ See Eugene Steuerle, *The Tax Decade: How Taxes Came to Dominate the Public Agenda* 33, 90 (1992) (noting that many of the investors in tax shelters were middle-class wage earners, such as doctors, lawyers, and other professionals); see also Dennis J. Ventry Jr., *Tax Shelter Opinions Threatened the Tax System in the 1970s*, 111 *Tax Notes* 947 (May 22, 2006) (discussing Treasury's efforts to curtail tax shelter activity in the 1980's).

¹⁷¹ Clever and aggressive tax planners even took this basic idea to an abusive limit where the same entity "lent" the initial sum, handled the "investment" (an annuity), and facilitated the borrowing against the investment—all to a spectacular tax result, albeit one ultimately struck down by the Supreme Court. *Knetsch v. United States*, 364 U.S. 361, 367-69 (1960).

¹⁷² McCaffery, note 6, at 183-84.

¹⁷³ See Ventry, note 170, at 947; see also George Michaels & Daniel Tilkin, *Tax Implications of Straddles*, G2 Fintech 1 (2012), http://g2ft.com/papers/Tax%20Implications%20of%20Straddles_G2FinTech.pdf.

row/Die was in full force. Shelters were for executives, doctors, lawyers, and other highly compensated individuals. The real rich, like Warren Buffett—who started the Buy/Borrow/Die of Berkshire Hathaway fame by buying shares in 1962¹⁷⁴—have never needed them.

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

Ronald Reagan, swept into office in no small part on an anti-tax agenda,¹⁷⁵ inherited a tax system with nominally high rates (a top rate bracket of 70%), a porous tax base, all the elements of Buy/Borrow/Die in place, and a tax shelter industry bringing the goodies of capital-based tax avoidance to the working classes. Reagan changed *some* of this: each element except Buy/Borrow/Die.

In terms of the radical transformation of the income tax, Reagan effected a two-step. His major individual income tax acts, ERTA in 1981¹⁷⁶ and the Tax Reform Act of 1986 (TRA 1986),¹⁷⁷ slashed the top marginal tax rate from the 70% he inherited to 28%.

Meanwhile, in the second step, the base was broadened—and other taxes, such as the “regressively structured social security taxes,”¹⁷⁸ were raised¹⁷⁹ in a move reminiscent of Roosevelt’s policies during the Great Depression.

The great Reagan reforms also significantly shut down the tax shelter games, by patching up a Maginot Line that was needed to keep the capitalist techniques from the laboring masses.¹⁸⁰ A general strategy of “netting,” or creating baskets of types of income that have to be separately toted up, was expanded to shore up the gaps in the line.¹⁸¹ Thus, investment interest as an expense can only be subtracted from investment income;¹⁸² capital losses can only be deducted (except for an odd \$3000 quirk) against capital gains;¹⁸³ and, most systematically,

¹⁷⁴ See Shawn Allen, *Why Did Warren Buffett Buy Berkshire Hathaway in 1965?*, InvestorsFriend (Jan. 4, 2014), <http://www.investorsfriend.com/why-warren-buffett-bought-berkshire-hathaway/>.

¹⁷⁵ William Schneider, *The New Shape of American Politics*, The Atlantic (Jan. 1987), <http://www.theatlantic.com/magazine/archive/1987/01/the-new-shape-of-american-politics/303363/>.

¹⁷⁶ ERTA, note 163.

¹⁷⁷ 1986 Act, note 133 § 101, 100 Stat. at 2096-97 (lowering the top marginal tax rate to 28%).

¹⁷⁸ Jones, note 128, at 689.

¹⁷⁹ See, e.g., Social Security Amendments of 1983, Pub. L. No. 98-21, §§ 121, 123, 97 Stat. 65, 80, 87.

¹⁸⁰ Steuerle, note 170, at 50-51.

¹⁸¹ McCaffery, note 6, at 61, 190-91.

¹⁸² IRC § 163(d).

¹⁸³ IRC § 1211.

in a hallmark of the 1986 Act, losses from passive activities, such as rental real estate, can only be deducted from gains from such activities.¹⁸⁴ These moves generally, and fairly systematically, block those who are earning *wage* income from generating tax losses by playing games with *capital*, typically someone else's capital—a classic trait of a tax shelter.

But Reagan and his great tax reforms made no effort to take away the games of the propertied classes. In particular, *no* step was taken to shut down Buy/Borrow/Die. The realization requirement was left unchecked. The nontaxation of borrowing was left unchecked. The stepped-up basis on death rule was left unchecked. Indeed, as to the final prong, Jimmy Carter had enacted a rule for carry-over basis for assets acquired on death, in 1976, but the effective date of the rule was postponed, and then retroactively repealed.¹⁸⁵

Rates went up from their lows in the 1980's, from a top marginal rate of 28% to 31% after 1986.¹⁸⁶ George H.W. Bush's quivering lips on tax increases led to his departure from the White House.¹⁸⁷ Bill Clinton raised the top marginal income tax rate to 39.6% percent but also cut the capital gains tax rate to 20%.¹⁸⁸ George W. Bush inherited a large fiscal surplus in 2001, and spent all of it on two major tax-cutting bills, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)¹⁸⁹ and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA).¹⁹⁰ These Acts cut ordinary income tax rates by 15%, bringing the top marginal rate bracket down to 35%,¹⁹¹ where it stayed throughout Obama's first term, until the fiscal cliff crisis—brought on in significant part by EGTRRA and JGTRRA—discussed below. These rates essentially only apply to wages. Taxes on capital, when they came due at all, went down—capital gains fell to

¹⁸⁴ IRC § 469.

¹⁸⁵ Tax Reform Act of 1976, Pub. L. No. 94-455, § 2005, 90 Stat. 1520, 1872, postponed by Revenue Act of 1978, Pub. L. No. 95-600, § 515, 92 Stat. 2763, 2884, repealed by Crude Oil Windfall Profit Tax Act of 1980, note 76, § 401, 94 Stat. at 299.

¹⁸⁶ Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11101, 104 Stat. 1388, 403-04.

¹⁸⁷ David E. Rosenbaum, *The Push and Pull Over Taxes*, N.Y. Times (Dec. 8, 1992), <http://www.nytimes.com/1992/12/08/business/the-push-and-pull-over-taxes.html?pagewanted=1>.

¹⁸⁸ Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13202, 107 Stat. 312, 461; Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 311, 111 Stat. 788, 831.

¹⁸⁹ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38.

¹⁹⁰ Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 751.

¹⁹¹ EGTRRA, note 189, § 101, 115 Stat. at 41-41, accelerated by JGTRRA, note 190, § 105, 117 Stat. at 755.

15% under JGTRRA.¹⁹² Corporate dividends were added to this low-rate category,¹⁹³ also to be raised at the fiscal cliff.¹⁹⁴

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

D. On Parallel Tracks

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

In the late 1930's, as World War II dawned, the payroll tax was a flat 2% of payroll, up to a maximum of \$3000 of wages—less than \$50,000 in 2015 dollars.¹⁹⁵ Yet this simple “regressively structured” tax brought in twice as much revenue as the “class tax” of the income tax in 1940.¹⁹⁶ The contrasting histories and structures of the payroll and income tax have much to do with their relative salience. The payroll tax has long been labeled a “contribution,” a fact that helps it rhetorically—in marked contrast to the highly salient income tax.¹⁹⁷ The payroll tax relies on flat rate taxes, as opposed to the confusing marginal rate bracket structure of the income tax, with its highly salient top marginal rate bracket. Payroll taxes also do not require taxpayers to fill out and submit an annual form, a task that makes the income tax's salience saliently painful.¹⁹⁸

The payroll tax began under FDR as part of the actuarially funded Social Security system, meaning that an individual's taxes were tied to his or her personal benefits. That link was broken in the late 1930's, a few years after the payroll tax began. Roosevelt moved the Social Security system to a “pay as you go” model, meaning that revenues from the payroll tax were simply available to the federal government to meet its general spending needs, not set aside in some dedicated account for each particular wage earner or “contributor.”¹⁹⁹ That situation persists today. The tax was structured as a 1% employee “con-

¹⁹² JGTRRA, note 190, § 301, 117 Stat. at 758.

¹⁹³ *Id.* § 302, 117 Stat. at 706.

¹⁹⁴ 2012 Act, note 78, § 102, 126 Stat. at 2318.

¹⁹⁵ Payroll Tax Rates, Urban-Brookings Tax Pol'y Ctr. (Jan. 11, 2016), <http://www.taxpolicycenter.org/statistics/payroll-tax-rates>.

¹⁹⁶ Office of Mgmt. & Budget, note 144, at tbl.2.1.

¹⁹⁷ McCaffery, note 121, at 1876.

¹⁹⁸ *Id.* at 1876-77.

¹⁹⁹ Bruce Bartlett, Tax Withholding Still Controversial After 70 Years, N.Y. Times: Economix (Oct. 22, 2013), http://economix.blogs.nytimes.com/2013/10/22/tax-withholding-still-controversial-after-70-years/?_r=0.

tribution” “matched” by an equal, 1%, employer share.²⁰⁰ Economists simply assume that the employer “share” actually comes out of the employee’s pocket, for the simple reason that an employer must pay this cost when it hires a worker, and hence the worker must be worth her salary *plus* the required tax, such that, if the tax were simply repealed, the employer could, and should, give the prior taxed amount to the employee in the form of wages, rather than to the government.²⁰¹

The payroll tax has always had a simple structure. It has a flat rate. It has no “zero bracket,” meaning that the first dollar of wages is taxed at the flat rate, and then it has a ceiling, or cap, after which the tax simply stops. There are no deductions, for anything, and no accommodation for marriage, family size, or anything else. In 1937, this simple tax was set at a flat 2% on wages up to \$3000 per person,²⁰² and *this* tax was the major source of federal revenue, until the income tax rates were increased by the Revenue Act of 1942.²⁰³ The tax, except for the 2011-2012 period,²⁰⁴ has steadily increased. In 1966, a similarly structured payroll tax, for Medicare’s hospital insurance program, was added.²⁰⁵ In 1980, before Ronald Reagan was elected, the combined rate for these two taxes was 12.26%; by 1990 it reached its present level of 15.3%.²⁰⁶ Reagan was following in the footsteps of one of his heroes, FDR.

It is hard to overemphasize certain facts that have been left in the darkness, removed from the sometimes blinding light of the income tax. The payroll tax, a flat 12.4% wage tax up to wages of \$118,500, and a 1.45% rate above that level (the Medicare component having been uncapped), is, for some 90% of Americans, the highest tax they pay.²⁰⁷ The payroll tax accounts for almost as much total revenue as the income tax. In 2010, for example, the individual income tax ac-

²⁰⁰ Social Security Act of 1935, Pub. L. No. 74-271, ch. 531, §§ 801, 804, 49 Stat. 620, 636, 637.

²⁰¹ See, e.g., Don Fullerton & Gilbert E. Metcalf, Tax Incidence, in 4 Handbook of Public Economics 1787, 1821-22 (Alan J. Auerbach & Martin Feldstein eds., 2002).

²⁰² Office of Mgt. & Budget, note 144, tbls.2.1, 2.3; Social Security Act of 1935, note 200, §§ 801, 804, 811, 49 Stat. at 636, 637, 638-39.

²⁰³ Pub. L. No. 77-753, § 103, 56 Stat. 798, 802.

²⁰⁴ See, e.g., Lewis Warne, The Payroll Tax Holiday, NCPA (Dec. 18, 2012), <http://www.ncpa.org/pub/ba780> (describing the payroll tax cut enacted and temporarily extended during the 2011-2012 period); John W. Schoen, End to Payroll Tax Holiday May Weigh on Economy, CNBC (Oct. 22, 2012), <http://www.cnbc.com/id/49506640/>.

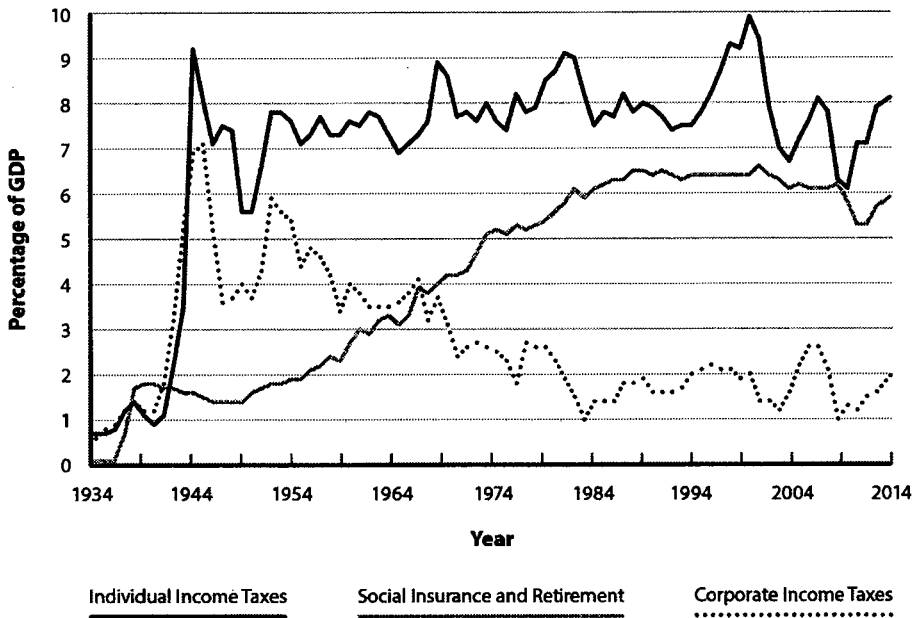
²⁰⁵ Social Security Amendments of 1965, Pub. L. No. 89-97, § 321, 79 Stat. 286, 394-96.

²⁰⁶ Tax Found., Social Security and Medicare Tax Rates, Calendar Years 1937-2009 (2009), https://files.taxfoundation.org/legacy/docs/soc_security_rates_1937-2009-20090504.pdf.

²⁰⁷ Michael J. Graetz, 100 Million Unnecessary Returns: A Fresh Start for the U.S. Tax System, 112 Yale L.J. 261, 268-72 (2002-2003).

counted for 42% of federal revenues; the payroll tax added 40%.²⁰⁸ Put another way, the payroll tax, which by that time had yet to *ever* be cut in its seven decades of history, had risen to account for 95% as much revenue as the highly salient, much debated, frequently cut income tax. The corporate income tax came in as a distant third, at 9%.²⁰⁹

FIGURE 3
INCOME, CORPORATE INCOME AND PAYROLL TAXES AS
PERCENT OF GDP, 1934-2020 (PROJECTED)²¹⁰



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

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

²⁰⁸ Office of Mgmt. & Budget, note 144, tbl.2.2.

²⁰⁹ *Id.*

²¹⁰ *Id.*

VI. MODERN TIMES: BRINGING THE EMBARRASSMENT TO THE PRESENT

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

A. Fact and Fiction in the Buffett Rule

In mid-October 2011, the time to file tax returns of choice for the wealthy, after the automatic six-month extension from April’s initial tax day,²¹¹ Warren Buffett disclosed that his 2010 tax return included \$62.9 million of adjusted gross income and \$39.8 million of taxable income.²¹² Buffett had just paid tax of \$6.9 million, for a federal effective tax rate of 17.3% on his taxable income and just under 11% on his adjusted gross income.²¹³ Buffett graciously pointed out that this effective tax rate was lower than his secretary, who had not earned quite so much money.²¹⁴ There was much gnashing of teeth.

After yet another measure to raise tax rates on the rich had failed—and after Republican presidential candidate Mitt Romney had disclosed that his own effective tax rate, on an income in excess of \$20 million a year, was 14%²¹⁵—President Obama proposed the “Buffett Rule,” applying an effective tax rate of 30% on millionaires like Buffett.²¹⁶ By using an effective as opposed to a marginal tax rate,²¹⁷ the Buffett Rule would moot the progressive marginal rate brackets for high earners, essentially subjecting them to a flat-rate tax. The liberal Citizens for Tax Justice claimed optimistically that the rule would raise \$50 billion a year, and that it would affect only the top 0.08% of taxpayers.²¹⁸ The Buffett Rule came up to a vote in the House in April,

²¹¹ IRS, Extension to File Your Tax Return, <https://www.irs.gov/filing/extension-of-time-to-file-your-tax-return>.

²¹² Stephanie Condon, Warren Buffett Doubles Down on Tax Return Challenge, CBS News (Oct. 12, 2011) http://www.cbsnews.com/8301-503544_162-20119497-503544.html.

²¹³ *Id.*

²¹⁴ *Id.*

²¹⁵ Edward J. McCaffery, Why Do the Romneys Pay So Little in Taxes?, CNN (Sept. 25, 2012), <http://www.cnn.com/2012/09/24/opinion/mccaffery-romney-tax/>.

²¹⁶ President Obama’s State of the Union Address, N.Y. Times (Jan. 25, 2012), http://www.nytimes.com/interactive/2012/01/24/us/politics/state-of-the-union-2012-video-transcript.html?_r=0#.

²¹⁷ Adam Zoll, Understanding Marginal vs. Effective Tax Rates, Morningstar (June 22, 2015), http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=701059&cul_ture=en-CA.

²¹⁸ Citizens for Tax Justice, CTJ Calculates Buffett Rule Would Raise \$50 Billion in One Year and Affect Only the Richest 0.08 Percent of Taxpayers, Tax Justice Blog (Jan. 27,

2012—tax time, of course—only to go, predictably enough, nowhere.²¹⁹

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

Except that, well, it would not. By far the largest component of Buffett's "income," in an economic sense, came from the untaxed appreciation in his asset and wealth holdings. This meant that Buffett's *reported* income was a small drop in the bucket of his *real* income. Buffett is a poster child for the "buy" step in Buy/Borrow/Die. Again, Buffett's Berkshire Hathaway shares rose by \$8 billion in 2010.²²⁰ Even a tax of \$18 million—the Buffett Rule applied to its fullest plausible measure, AGI—makes up far, far less than 1% of Buffett's real income: 0.225%, to be exact. The Buffett Rule, which, politically, went nowhere in any event, was far more symbolic than real, because it applied to the easily manipulable measure of reported taxable income, not to real, economic income. Buffett still would have made over \$8 billion *after* taxes in 2010 had the most onerous version of the Buffett Rule been in place.

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

2012), http://www.taxjusticeblog.org/archive/2012/01/ctj_calculates_buffett_rule_wo.php#.W1laLVsfww; Michael Kinsley, Op-Ed, A "Buffett Rule" for Tax Equality?, L.A. Times (Feb. 3, 2012), <http://articles.latimes.com/2012/feb/03/opinion/la-oe-kinsley-column-buffett-rule-20120203>; Editorial, Mr. Obama and the "Buffett Rule," N.Y. Times (Apr. 10, 2012), http://www.nytimes.com/2012/04/11/opinion/mr-obama-and-the-buffett-rule.html?_r=0.

²¹⁹ Paying a Fair Share Act of 2012, S. 2230, 112th Cong. (2012); 158 Cong. Rec. S2313 (daily ed. Apr. 16, 2012) (rejecting cloture motion to close debate and proceed to vote on S. 2230); see Edward J. McCaffery, The Buffett Rule Is Going Nowhere, CNN (Apr. 16, 2012), <http://www.cnn.com/2012/04/16/opinion/mccaffery-buffett-rule/>.

²²⁰ See Miller, note 34, and accompanying text; see also Berkshire Hathaway Inc., Yahoo! Finance, <http://finance.yahoo.com/echarts?s=BRK-A+Interactive#symbol=BRK-A;range=5y> (providing historical stock data for Berkshire Hathaway, Inc.).

*B. The Hidden Tax Increase of the Fiscal Cliff Fix*²²¹

As the nation careened toward its self-created fiscal cliff, the press was full of leaks and rumors of impending deals and the state of negotiations between the Obama Administration and the Democrats, on one side, and the House Majority Leader John Boehner and the Republicans on the other.²²² Both sides faced a problem, and a strictly rhetorical one: how to “score” the tax changes being considered.

The Bush tax cuts of 2001 and 2003 were each set to expire on January 1, 2013, meaning that there would be a return to the brackets and rates that existed in the year 2000. Given that both parties clearly and consistently agreed that “no taxpayer earning less than \$250,000” should see a tax increase—the definition of a Small Fry in 21st Century America—there was no chance that what Congress would ultimately enact would be anything other than a tax cut, on balance.²²³ As the law stood, all income taxpayers were set to face a tax increase. Since all political roads were leading to a resolution in which only *some* taxpayers would get the increase that what was due under the law—that is, the “rich” or “high income”—then the new law cutting the taxes of most while leaving in place the already legislated tax increases of a few would have to be a tax decrease. This is indeed how the Congressional Budget Office officially “scored” the 2012 Act.²²⁴ Only that would not do, politically.

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

²²¹ A version of this case study appears in McCaffery, note 150, at 615-17.

²²² See, e.g., Connie Cass, *Fiscal Cliff: Why Can't Democrats and Republicans Agree?*, USA Today (Dec. 29, 2012, 3:18 PM), <http://www.usatoday.com/story/news/politics/2012/12/29/fiscal-cliff-guide/1798027/>; Ashley Killough, *Fiscal Cliff: Lawmakers Divided Over Final Talks*, CNN: Politics (Dec. 30, 2012), <http://politicalticker.blogs.cnn.com/2012/12/30/fiscal-cliff-lawmakers-divided-over-final-talks/>.

²²³ McCaffery, note 150, at 615-17.

²²⁴ Cong. Budget Office, *Estimated Revenue Effects of The Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. 8, the “American Taxpayer Relief Act of 2012,”* as Passed by the Senate on January 1, 2013 (2013), <https://www.jct.gov/publications.html?func=startdown&id=4497>.

Taxes on January 1, 2013 were also set to go up by virtue of the expiration of the payroll tax holiday that President Obama had gotten enacted for 2011 (replacing the Making Work Pay credit),²²⁵ and which Congress had extended, in late 2011, for 2012.²²⁶ The “holiday” was a 2% break from the 6.2% employee share of the Social Security payroll tax, applicable to earnings (in 2012) up to approximately \$110,000 per individual.²²⁷ The “holiday” could thus save an individual over \$2000—\$4000 for a couple each of whom earned \$100,000. This provision was set to expire, just like the income tax rate cuts of EGTRRA. Only both sides, Democrats and Republicans, quietly agreed to let it die²²⁸—*unlike* the income tax rate cuts of EGTRRA.

The resolution of the rhetorical embarrassment was to use a 2012 baseline and measure increases off it. This same accounting construct—measuring changes from 2012’s law—would allow President Obama to count the tax increases from the payroll tax holiday’s expiration as tax increases. This would seem to be a *good* thing, as politicians were scrambling to meet proposed revenue-raising targets. More specifically, President Obama had led with a proposed revenue-raising target of \$1.6 trillion over ten years. Republicans had countered with \$800 billion.²²⁹ Both sides seemed to be inching towards the obvious and inevitable compromise figure of \$1.2 trillion.

Only there was a problem: “Counting” the payroll tax holiday’s expiration as a tax increase would undercut the government’s rhetorical claims about the progressivity of the fiscal cliff deal. The optics of redistribution suggested not counting it, in order to maintain a rhetorical claim about the “top 2%” bearing all of the new burdens. There was no political doubt that the payroll tax holiday was going to expire. Yet the Obama Administration did not “count” the tax increases from the tax holiday’s expiration as part of the aggregate revenue increase. This meant, logically, that the numbers used to explain the new law

²²⁵ 2010 Act, note 76, § 601, 124 Stat. at 3309 (enacting a temporary payroll tax holiday for 2011).

²²⁶ Temporary Payroll Tax Cut Continuation Act of 2011, Pub. L. No. 112-78, § 101, 125 Stat. 1280, 1281-82.

²²⁷ 2010 Act, note 76, § 601, 124 Stat. at 3309.

²²⁸ Sudeep Reddy, Payroll Tax Cut Expires; How Much More Will You Pay?, Wall St. J.: Real Time Econ. (Jan. 1, 2013), <http://blogs.wsj.com/economics/2013/01/01/payroll-tax-cut-expires-how-much-more-will-you-pay/>.

²²⁹ Zachary A. Goldfarb & Lori Montgomery, Obama to Open Fiscal Talks with \$1.6 Trillion Plan to Raise Taxes on Wealthy, Wash. Post (Nov 13, 2012), https://www.washingtonpost.com/business/economy/obama-to-open-fiscal-talks-with-plan-to-raise-taxes-on-wealthy/2012/11/13/9984cd78-2dc1-11e2-89d4-040c9330702a_story.html; Lori Montgomery, Boehner, House GOP Leaders Offer “Fiscal Cliff” Counterproposal, Wash. Post (Dec. 3, 2012), https://www.washingtonpost.com/politics/boehner-house-gop-leaders-offer-fiscal-cliff-counter-proposal/2012/12/03/694dbc1e-3d84-11e2-a2d9-822f58ac9fd5_story.html?utm_term=.dc3401406bec.

could only be described as “tax increases over a 2012 baseline, but not including matters not addressed in a new law.” The Republicans, not eager to tout any tax increase, readily played along.²³⁰ The missing optics of redistribution prevailed.

What are the dollars and cents of all this? Official releases and the mainstream media reported tax increases from the 2012 Act ranging from \$600 to \$700 billion—a sum below even the Republicans’ opening bid—almost all falling on the “rich” in some sense.²³¹ Here is an illustrative description, from the progressive group, Center for American Progress:

The American Taxpayer Relief Act of 2012—the fiscal cliff legislation agreed to in a deal between President Obama and Senate Minority Leader Mitch McConnell (R-KY)—will raise approximately \$617 billion in higher revenues from 2013 to 2022, compared to what the tax code would have generated if we had simply extended all the Bush tax cuts, which were scheduled to expire at the end of 2012. *More than 90 percent of the increase will come from households making at least \$1 million a year.*²³²

As for the expiration of the payroll tax holiday? This was estimated to bring in an additional \$100 billion a year,²³³ meaning \$1 trillion over a decade: all from a 2% increase in this “regressively structured social security tax.” Obama and his colleagues in Congress were following a bipartisan script written by FDR and played out by Ronald Reagan.

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

²³⁰ See McCaffery, note 150, at 617.

²³¹ White House, Office of the Press Secretary, Fact Sheet: The Tax Agreement: A Victory for Middle-Class Families and the Economy (Jan. 1, 2013), <https://obamawhitehouse.archives.gov/the-press-office/2013/01/01/fact-sheet-tax-agreement-victory-middle-class-families-and-economy> (noting that the tax agreement raises \$620 billion in revenue); Jonathan Weisman, Senate Passes Legislation to Allow Taxes on Affluent to Rise, N.Y. Times (Jan. 1, 2013), <http://www.nytimes.com/2013/01/02/us/politics/senate-tax-deal-fiscal-cliff.html>.

²³² Michael Linden & Michael Ettlinger, Revenue from the Fiscal Cliff Deal in Context, Ctr. for Am. Progress (Jan. 3, 2013), <http://www.americanprogress.org/issues/economy/news/2013/01/03/48872/revenue-from-the-fiscal-cliff-deal-in-context/> (emphasis added).

²³³ Richard Rubin, Roxana Tiron & James Rowley, Bipartisan House Backs Tax Deal Vote as Next Fight Looms, Bloomberg (Jan. 2, 2013), <http://www.bloomberg.com/news/articles/2013-01-02/bipartisan-house-backs-tax-deal-vote-as-next-fight-looms>.

Roughly 62.5% of the scored aggregate tax increase in the fiscal cliff package came from a tax that applies to wage earnings, only, and which had a floor of zero and a ceiling of \$110,000.²³⁴ This major tax increase was not listed in the official reports or scoring, in order to maintain a rhetorical claim that 90% of the tax increases would fall on millionaires only.²³⁵

*C. Still Breathing (?): The Nondeath Death of the Death Tax*²³⁶

The 2012 Act and the wider fiscal cliff deal loudly raised *income* tax rates on the top income earners, and quietly raised payroll tax rates on just about everybody. That Act also quietly continued the slow death of the wealth transfer tax system: the gift, estate, and generation-skipping taxes. The estate tax at first blush would appear to be a significant means of taxing wealth seriously. But just as with the nominally high income tax rates during World War II, the estate tax has long been little more than a symbol, much ado about rather little. Its salience leads people to believe that we are doing something about inherited wealth, but its avoidability leads to a very different reality.²³⁷

Even a quick look at estate tax reform shows political and perceptual games in full force and effect, all the while propping up and shaping a tax that raises little if any revenue for the fisc. EGTRRA had gradually weakened the gift and estate tax, raising its exemption levels and lowering its rates, until 2009, when the exemption was set to be \$3.5 million per donor (spouses could double this) and the rate 45%.²³⁸ In 2010 the estate tax was set to expire, with an unlimited exemption and, importantly a *carry-over basis* for assets passed on death—that is, EGTRRA had built within it a repeal of the stepped-up basis rule.²³⁹ EGTRRA itself was set to expire after 2010, bringing, in 2011, a return to a \$1 million exemption and a 55% tax rate for the estate tax.²⁴⁰ As EGTRRA played itself out, the law seemed headed to a place considered unimaginable to many: a year without an estate tax at all. Surely, something would have to happen to prevent that extreme result from obtaining.

²³⁴ See McCaffery, note 150, at 617.

²³⁵ *Id.*

²³⁶ A version of this case study appears in McCaffery, note 27, at 1237-45.

²³⁷ See generally Cooper, note 96 (documenting pervasive estate tax avoidance).

²³⁸ EGTRRA, note 189, §§ 511, 521, 115 Stat. at 70-71; see Edward J. McCaffery & Linda R. Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 N.C. L. Rev. 1159, 1208 (2006).

²³⁹ EGTRRA, note 189, §§ 501, 541-42, 115 Stat. at 69, 76-86; see McCaffery & Cohen, note 238, at 1208 n. 165.

²⁴⁰ EGTRRA, note 189, § 901, 115 Stat. at 150; see McCaffery & Cohen, note 238, at 1208-09, 1209 n. 166.

Only it did not. There was no bill at the end of 2009 to prevent 2010's year of no estate tax. That change came only at the end of 2010, when EGTRRA was about to expire, leaving us within a strengthened estate tax. The 2010 Act retroactively gave estates for decedents who died in 2010, like George Steinbrenner, a choice: Accept the no estate tax/carryover basis regime provided for by EGTRRA or instead choose a \$5 million exemption and a 35% rate with stepped-up basis.²⁴¹ The overwhelming majority of families, of course, were not subject to an estate tax at all at these exemption levels, and happily chose to keep stepped-up basis.²⁴² Buy/Borrow/Die was in the house.

This set the stage for the "fiscal cliff" slated for January 1, 2013, when EGTRRA, which had been extended by TRA 2010 for another two years,²⁴³ was set to expire. Insofar as the estate tax was concerned, the law as written meant a return to the \$1 million exemption and 55% rate of pre-EGTRRA times. Some practitioners, aided by the media, stirred up fears that this would indeed happen, leading to aggressive planning under the large gift tax exemption in place for 2012.²⁴⁴ This was precisely the situation that could not obtain under the initial ten EGTRRA years, because the gift tax exemption had stayed frozen at \$1 million.²⁴⁵

In point of fact, a full return to year 2000 levels never seemed to be in the cards, even though the fiscal cliff fix was supposed to involve taxing the rich. Discussions around the 2012 Act vis-a-vis the estate tax were exclusively about exemption levels and rates. Obama, as he had in his 2008 campaign platform, consistently staked out a position at a \$3.5 million exemption and a 45% rate—the 2009 status quo.²⁴⁶ Republicans countered with a \$5 million exemption and a 35% rate: the 2012 status quo.²⁴⁷ In December 2012, Obama reiterated his

²⁴¹ 2010 Act, note 76, § 301(c), 124 Stat. at 3300; see Scott E. Vincent, Overview of 2010 Tax Relief Act, 67 J. Mo. B. 56, 59 (2011) ("After a one-year hiatus, the 2010 Act reinstates the estate tax for 2011 and 2012, with a top rate of 35 percent. The exemption amount will be \$5 million per individual in 2011 and will be indexed to inflation in following years. Estates of people who died in 2010 can choose to follow either 2010's or 2011's rules.").

²⁴² See Robert N. Gordon, David Joulfaian & James Poterba, Choosing Between an Estate Tax and a Basis Carryover Regime: Evidence from 2010, 69 Nat'l Tax J. 981 (2016).

²⁴³ 2010 Act, note 76, § 101, 124 Stat. at 3298.

²⁴⁴ McCaffery, note 27, at 1240-48.

²⁴⁵ Bob Seaberg, Gift and Estate Taxes in 2012: The "Clock" Is Ticking, Morgan Stanley 2 (Oct. 2012), <http://www.morganstanleygc.com/public/projectfiles/0854b1a2-8b48-4a20-b51d-fbd6c0035d1b.pdf>.

²⁴⁶ Kim Dixon, Obama Estate Tax Push Undercut by Discord Among Democrats, Huffington Post (Nov. 30, 2012, 6:59 AM) http://www.huffingtonpost.com/2012/11/30/obama-estate-tax_n_2216992.html.

²⁴⁷ Robert Frank, Next Battle on the "Cliff's" Edge: Estate Taxes, CNBC (Dec. 10, 2012), <http://www.cnbc.com/id/100296248>.

stance,²⁴⁸ and commentators “scored” the proposal as raising \$119 billion over ten years, from the 2012 baseline.²⁴⁹ Senator Max Baucus, the *Democratic* chair of the Senate Finance Committee, however, came out in dissent, supporting the Republican position for a perpetuation of the status quo—a \$5 million exemption, indexed off 2011, and a 35% rate.²⁵⁰ It appears that is what would have happened, with a late leak suggesting that there was a deal brokered by Vice President Biden and Senator Mitch McConnell at a \$5 million exemption and 35% rate.²⁵¹ The same purported fiscal cliff deal featured a return to the top pre-EGTRRA marginal *income* tax rate of 39.6% for individuals/married couples earning more than \$400,000/\$450,000.²⁵² At this point Senator Tom Harkin, objecting from the left, took to the floor of the Senate and stated that the purported deal was too much of a giveaway to the rich, with its \$400,000/\$450,000 floor on tax rate increases for singles and married couples, and its \$5 million, 35% rate on estates: more specifically, that he could accept one, but not both, of these levels.²⁵³ The next the public heard, the deal was struck with the Senate overwhelmingly approving the 2012 Act with an estate tax exemption of \$5 million, a rate of 40%, and the income tax rate levels as leaked.²⁵⁴ Senator Harkin was among the eight Senators voting “no.”²⁵⁵

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

²⁴⁸ Meg Massey, The Estate Tax: McCain vs. Obama, CNN: Money (Aug. 6, 2008), http://money.cnn.com/2008/08/06/smallbusiness/estate_tax.fsb/; Siobhan Hughes, Plan to Raise Estate Tax Divides Democrats, Wall St. J. (Nov. 30, 2012), <http://www.wsj.com/articles/SB10001424127887324020804578151430887301890>.

²⁴⁹ Richard Rubin, Buffett Joins Soros in Renewed Effort to Increase Estate Tax, OnWallStreet (Dec. 11, 2012, 12:33 PM), <https://www.onwallstreet.com/news/buffett-joins-soros-in-renewed-effort-to-increase-estate-tax>.

²⁵⁰ *Id.*; see also Frank, note 247.

²⁵¹ Ramsey Cox & Alexander Bolton, Dem Sen. Harkin Criticizes Possible Tax Compromise in “Fiscal Cliff” Talks, The Hill (Dec. 31 2012), <http://thehill.com/video/senate/274975-harkin-this-is-one-democrat-who-doesnt-agree-with-tax-cuts-for-the-wealthy>.

²⁵² *Id.*; see also The Fiscal Cliff: A Primer, Tax Found. (Nov. 13, 2012), <http://taxfoundation.org/article/fiscal-cliff-primer> (providing potential tax rate increases during the fiscal cliff).

²⁵³ Cox & Bolton, note 251.

²⁵⁴ Joseph Henchman, Details of the Fiscal Cliff Tax Deal, Tax Found: The Tax Policy Blog (Jan. 1, 2013), <http://taxfoundation.org/blog/details-fiscal-cliff-tax-deal>.

²⁵⁵ *Id.*

each year, by 5% in absolute terms.²⁵⁶ While all this was happening, no one of any great importance was noticing that stepped-up basis was staying for yet another day. Yet, in terms of any matter of *principle*, stepped-up basis on death can best be understood only as an accommodation for the fact of an estate tax. Since the wealthy are paying a “death tax” for assets passed on death, the heirs should get a stepped-up basis to avoid a “double” tax. But the 2012 Act left us in a world in which 99.7% of decedents’ families will not face an estate tax and yet 100% will get a stepped-up basis for assets held at death.

D. Presidential Politics and Posturings

The changes effected at the fiscal cliff crisis in the wee early hours of 2013 left us with where we have been over the entire century of the income tax: with a wage tax. The once-more increased payroll tax added to the income tax makes for a fairly burdensome and fairly flat tax on income from labor. Warren Buffett and other capitalists dodge a bullet yet again—the *appearance* of higher tax rates under the income tax masking the reality of increased burdens on all wage earners under the payroll tax. Every element of Buy/Borrow/Die remains fully in place—indeed, the stepped-up basis rule informing the “die” step remains for all even as the gift and estate tax was killed for all but 0.3% of us. Meanwhile, a panoply of other “regressively structured” taxes—excise taxes on cigarettes and cellphones, for two quick examples, keep adding up to help balance the books.²⁵⁷

Perhaps President Obama realized that his liberal or progressive tax policies were not doing much about growing inequality in America, except possibly making things worse. For whatever reason, Obama decided to do something. And so the President announced in his 2014

²⁵⁶ See Urban-Brookings Tax Pol’y Ctr., T12-0318—Estate Tax Returns and Liability Under Current Law and Various Reform Proposals, 2011-2022 (Dec. 13, 2012), <http://www.taxpolicycenter.org/model-estimates/estate-tax-tables-2012/estate-tax-returns-and-liability-under-current-law-and> (providing numbers of estate tax returns as well as projected death figures). The number of estate tax returns under the law in 2012 would have been 8300, and the number of projected deaths was 2,636,000. *Id.* Thus only 0.3% of all decedents in 2012 would have been required to file an estate tax return.

²⁵⁷ See, e.g., Thomas A. Briant, Obama Proposes Cigarette Tax Increase, CSP Daily News (Feb. 4, 2015), <http://www.cspnet.com/category-news/tobacco/articles/obama-proposes-cigarette-tax-increase>; Nat’l Ctr. for Pol’y Analysis, Task Force on Taxing the Poor, Taxing the Poor: A Report on Tobacco, Alcohol, Gambling, and Other Taxes and Fees That Disproportionately Burden Lower-Income Families (2007), <http://www.ncpa.org/pdfs/st300.pdf> (describing regressive taxes borne by low-income taxpayers); J.D. Foster, Tax Found., The Telephone Excise and the E-Rate Add-On Tax (July 1999), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/2d4d6cf9bb9d64d62f23b50560766cad.pdf>.

State of the Union a renewed attack on *income* inequality.²⁵⁸ But no doubt burned by actually trying to address any form of inequality through tax reform, Obama trained his sights on . . . the minimum wage.²⁵⁹ This may or may not be a good idea, but it is not taxing wealth seriously.

After the fiscal cliff crisis and fix, proposals kept circulating on tax reform. Dave Camp, Republican chairman of the House Ways and Means Committee, where federal tax legislation originates, released his own tax plan in early 2014.²⁶⁰ The “tax decade” of the 1980’s²⁶¹ had left us with a wage tax with a few personal deductions hanging around—for charitable contributions, state and local taxes, home mortgage interest, qualified retirement plans, employer-provided health care. What do we see in contemporary reform proposals? Attacks on these remaining breaks for *wage-earners*. Thus, Camp’s plan featured lower rates, in a “distributionally” and “revenue” neutral way, which means, necessarily, expanding the base.²⁶² The Obama Administration, and Max Baucus on the Senate Finance Committee side, came up with their own plans, along similar general lines.²⁶³ What are the main talking points for base expansion? Limiting personal deductions, raising capital gain rates, capping retirement plan contributions, closing certain “loopholes.”²⁶⁴ What do *all* of these ideas have in common? They do nothing about Buy/Borrow/Die, and

²⁵⁸ Barack Obama, President, United States of America, President Barak Obama’s State of the Union Address (Jan. 28, 2014), available at <https://www.whitehouse.gov/the-press-office/2014/01/28/president-barack-obamas-state-union-address>.

²⁵⁹ See Dave Jamieson, Obama and the Democrats Raise Their Minimum Wage Proposal to \$12, *Huffington Post* (Apr. 30, 2015), http://www.huffingtonpost.com/2015/04/30/12-minimum-wage_n_7183780.html.

²⁶⁰ Tax Reform Act of 2014, H.R. 1, 113th Cong. (2014), available at <https://www.congress.gov/113/bills/hr/1/BILLS-113hr1ih.pdf>; see James R. Nunns, Amanda Eng & Lydia Austin, Urban-Brookings Tax Pol’y Ctr., Description and Analysis of the Camp Tax Reform Plan (July 8, 2014), <http://www.taxpolicycenter.org/UploadedPDF/413176-Camp-Plan-Description-and-Analysis.pdf>.

²⁶¹ See generally Steuerle, note 170 (discussing tax developments during the 1980’s).

²⁶² 2014 Act, note 260.

²⁶³ S. Fin. Comm., 113th Cong., Tax Administration Discussion Draft (Comm. Print 2013), <http://www.finance.senate.gov/newsroom/chairman/download/?id=d4c102fd-4e69-405a-8d66-826393f3f36e>; S. Fin. Comm., 113th Cong., Summary of Staff Discussion Draft: Cost Recovery and Accounting (Comm. Print 2013), <https://www.finance.senate.gov/imo/media/doc/Chairman's%20Staff%20Discussion%20Draft%20on%20Cost%20Recovery%20and%20Accounting%20Summary.pdf>; Treas. Dep’t & The White House, The President’s Framework for Business Tax Reform (2012), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-Report-Business-Tax-Reform-2012.pdf>; Lori Montgomery, Sen. Max Baucus Moves to Reshape Tax Code, *Wash. Post* (Apr. 8, 2013), https://www.washingtonpost.com/business/economy/sen-max-baucus-moves-to-reshape-tax-code/2013/04/08/e7f3435a-9dff-11e2-9a79-eb5280c81c63_story.html.

²⁶⁴ See, e.g., Laura Meckler, Hillary Clinton Proposes Sharp Rise in Some Capital-Gains Tax Rates, *Wall St. J.* (July 24, 2015), <http://www.wsj.com/articles/clinton-to-propose-rise-in-capital-gains-taxes-on-short-term-investments-1437747732>.

thus continue a very long trend of shoring up the income tax as a tax on the laboring classes.

The two Januaries discussed at the start of this Article confirm and continue the trend. In January 2015, President Obama's capital-gains-on-death proposal was an attempt to tax wealth seriously. It took direct aim at the "angel of death" provision for stepped-up basis on death.²⁶⁵ But it was the proposal that died. Sanders and Clinton each launched their presidential campaigns in 2015, Sanders in particular talking about economic inequality as a major theme, but neither candidate was quick to roll out any kind of specific tax plan. In late 2015, two stories appeared in the *New York Times*: one discussing how effective tax rates on top reported income earners had indeed gone up in 2013, the first year for which the \$400,000/\$450,000 rate bracket was in effect, the second suggesting that a "private tax system" exists for the truly high wage earners because of tax professionals and their aggressive tax advice.²⁶⁶ Soon thereafter, Clinton rolled out her 4% plan.²⁶⁷ Bernie Sanders released his own tax plan shortly after Clinton's, including the \$10 million bracket.²⁶⁸ Sanders' plan featured a panoply of taxes, most of which would continue the theme of this Article, by applying higher tax rates to high-wage earners. Unlike Clinton, however, who repeatedly distanced herself from anything like a capital-gains-on-death plan, Sanders showed a willingness to consider repealing stepped-up basis.²⁶⁹

As for the Republicans? When they were not spouting words of hell-fire and damnation against any and all taxes, looking to slash rates largely under the income tax, they showed moderation by attacking Wall Street *wage earners*. Thus, Donald Trump pledged to shut down the "carried interest" loophole whereby highly compensated hedge fund managers—many of them Democrats—have been able to have their wages taxed as if they were capital gains.²⁷⁰ There is nothing wrong with the proposals to shut down this particular planning gimmick. But it is not a serious attempt to tax wealth; it makes no attack on Buy/Borrow/Die.

²⁶⁵ Leonard E. Burman, President Obama Targets the "Angel of Death" Capital Gains Tax Loophole, Urban-Brookings Tax Pol'y Ctr.: Tax Vox (Jan. 18, 2015), <http://www.taxpolicycenter.org/taxvox/president-obama-targets-angel-death-capital-gains-tax-loophole>.

²⁶⁶ Barro, note 8; Scheiber & Cohen, note 8.

²⁶⁷ See note 11.

²⁶⁸ See note 15.

²⁶⁹ Paul C. Barton, Clinton Stays Silent on Step-Up Controversy, 150 Tax Notes 506 (Jan. 22, 2016). See Section VIII.C for a change in Clinton's position.

²⁷⁰ See Jeff Cox, Trump Tax Plan Has Big Implications for Wall Street, CNBC (Aug. 8, 2016), <http://www.cnbc.com/2016/08/08/trump-tax-plan-has-big-implications-for-wall-street.html>.

VII. PROBLEMS, PROBLEMS, PROBLEMS

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

I considered above some of the reflexive responses to Buy/Borrow/Die—skeptical objections to the idea that saving taxes can be so easy.²⁷¹ These misconceptions help keep Buy/Borrow/Die in the darkness. There are many more reasons to believe that the task of taking taxing wealth seriously will be hard, and no reason to deny the difficulties. Indeed, serious reform must take these problems, arising from many different aspects of the situation and combining and conspiring to create a tangled web of inertia, seriously.

A. *Problems of Theory*

Neoclassical economics theory follows a bifurcated strategy, separating out matters of allocation or efficiency from those of distribution or equity.²⁷² The two welfare theorems suggest the path. The first holds, in essence, that free markets reach welfare-maximizing or, equivalently, “pareto optimal” allocations of resources. The second holds that a redistribution of resources can lead to different positions along the social optimum or paretian frontier.²⁷³ In other words, policymakers on behalf of the state or society should, one, make the social pie as large as possible and then, two, slice it up to make all as happy as possible.

Practitioners of law and economics, most extensively Louis Kaplow and Steven Shavell, have used these two theorems to develop a comprehensive agenda for law reform.²⁷⁴ First, the private laws of con-

²⁷¹ See Part IV.

²⁷² See Edward J. McCaffery, *Bifurcation Blues: The Perils of Leaving Redistribution Aside* 1-3 (Jan. 29, 2013), available at http://www.law.nyu.edu/sites/default/files/ECM_PRO_074659.pdf.

²⁷³ See, e.g., Robin W. Boadway & Neil Bruce, *Welfare Economics* 115-17 (1984); Joseph E. Stiglitz, *Economics of the Public Sector* 59-61 (2000). For a more general discussion of the two welfare theorems and an application to income tax policy, see Kyle Logue & Ronen Avraham, *Redistributing Optimally: Of Tax Rules, Legal Rules, and Insurance*, 56 *Tax L. Rev.* 157 (2003).

²⁷⁴ Kaplow and Shavell first proposed that the tax system be used as the exclusive means for redistribution. Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient Than the Income Tax in Redistributing Income*, 23 *J. Legal Stud.* 667, 667-69 (1994) [hereinafter *Redistributing Income*]; see also Louis Kaplow & Steven Shavell, *Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income*, 29 *J. Legal Stud.* 821 (2000) [hereinafter *Legal Rules*]. Economists had long been making similar arguments. See, e.g., Arnold C. Harberger, *On the Use of Distributional Weights in Social Cost-Benefit Analysis*, 86 *J. Pol. Econ.* s87 (1978). For criticisms of the Kaplow-Shavell argument, see Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 *Cornell L. Rev.* 1003, 1056-70 (2001); Chris William Sanchirico,

tracts, property, tort and so on should be arranged so as to maximize social welfare, that is, broadly, to serve “efficiency.” Second, the tax system—specifically, the income tax system—should be used to redistribute social resources so as to maximize the sum of individual well-being, that is, again broadly, to serve “equity.”²⁷⁵

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

Having been given the task of redistribution, of addressing inequality, what does income tax *theory* have to say about the responsibility? The elegant mathematical models of optimal income tax analysis, for which the British economist James Mirrlees was awarded a Nobel Prize in Economics, give a set of answers.²⁷⁶ It turns out that optimal tax has its *own* bifurcation strategy and its own limits. Optimal income tax theory ends up further kicking the can of redistribution down the road to darkness.

It is worth reading Mirrlees’ seminal paper from 1971-1972, on which much of the modern tax reform movement, with its base broadening and rate reduction themes, draws inspiration and from which it claims a certain intellectual legitimacy: The Reagan and Bush tax rate

Taxes Versus Legal Rules as Instruments for Equity: A More Equitable View, 29 J. Legal Stud. 797, 799-800 (2000); Logue & Avraham, note 273, at 190-206; Ronan Avraham, David Fortus & Kyle Logue, Revisiting the Roles of Legal Rules and Tax Rules in Income Redistribution: A Response to Kaplow & Shavell, 89 Iowa L. Rev. 1125 (2004). For one among several replies by Kaplow and Shavell, see Legal Rules, *supra*.

²⁷⁵ See generally Kaplow & Shavell, Redistributing Income, note 274 (arguing that redistribution through legal rules is less efficient than redistributing through the income tax system); see also Chris William Sanchirico, Progressivity and Potential Income: Measuring the Effect of Changing Work Patterns on Income Tax Progressivity, 108 Colum. L. Rev. 1551, 1598 (2008) (“The income tax is generally regarded not only as a source of government revenue, but also as a means of reducing economic inequality.”).

²⁷⁶ James A. Mirrlees, An Exploration in the Theory of Optimum Income Taxation, 38 Rev. Econ. Stud. 175 (1971); see also Joseph Bankman & Thomas Griffith, Social Welfare and the Rate Structure: A New Look at Progressive Taxation, 75 Cal. L. Rev. 1905 (1987) (describing an optimal tax model under a welfarist framework, balancing progressivity and gains from redistribution); Peter A. Diamond, A Many-Person Ramsey Tax Rule, 4 J. Pub. Econ. 335 (1975); McCaffery & Hines, note 166.

cuts followed along with Martin Feldstein's footprints.²⁷⁷ To begin with, Mirrlees' *An Exploration in the Theory of Optimum Income Taxation* is, explicitly, about a tax on labor income only—no problem with Buy/Borrow/Die or wealth inequality here. To end with, Mirrlees himself writes, at the conclusion of his paper, that “[t]he income-tax is a much less effective tool for reducing inequalities than has often been thought,” and that, “therefore, [i]t would be good to devise taxes complementary to the income-tax, designed to avoid the difficulties that tax is faced with.”²⁷⁸ Despite these express disavowals by the seminal figure in the field, drunken sailors everywhere continue to look to the income tax, which has become a wage tax, exactly as it is in Mirrlees' model, to do all the work of redistribution.

Why is Mirrlees himself so pessimistic about the redistributive possibilities of the income tax? As a branch of neoclassical welfare economics theory, optimal income tax is concerned with allocative questions as well as distributive ones. Efficiency losses come from high marginal rates, particularly and especially on the “top” of the income distribution scale. While there is great disagreement about the precise contours of the rate curve—such that Arthur Laffer, famously, could reduce it to a simple single-peaked curve²⁷⁹—there is little argument that marginal tax rates end up declining over the upper income range, quite possibly to zero (or below zero, in an analysis done by Joseph Stiglitz).²⁸⁰ Matti Tuomala, a prominent proponent of the optimal tax tradition, has put it simply that: “[O]ne of the main conclusions to be drawn from the Mirrleesian optimal non-linear income tax model is that it is difficult (if at all possible) to find a convincing argument for a progressive marginal tax rate structure throughout.”²⁸¹

Mirrlees included simulations in his seminal paper that featured peak (that is, highest tax rates, typically on the lower-middle income class) and highest end (that is, tax rates for the highest income) marginal tax rates of 26% and 16%; 20% and 15%; 28% and 19%; 34% and

²⁷⁷ See Oliver Landmann, *The US Economy Under the Influence of the Reagan Experiment*, 19 *Intereconomics* 207, 212-13 (1984) (describing the goals and consequences of tax cuts made during the Reagan Administration).

²⁷⁸ Mirrlees, note 276, at 208 (emphasis added).

²⁷⁹ Arthur B. Laffer, *Reaganomics: What We Learned*, *Wall St. J.* (Feb. 10, 2011), <http://www.wsj.com/articles/SB10001424052748704364004576132473777840938>.

²⁸⁰ McCaffery & Hines, note 166, at 1053 n. 58; Joseph E. Stiglitz, *Self-Selection and Pareto Efficient Taxation*, 17 *J. Pub. Econ.* 213, 215 (1982).

²⁸¹ Matti Tuomala, *Optimal Income Tax and Redistribution* 14 (1990); see also Alan J. Auerbach & James Hines Jr., *Taxation and Economic Efficiency*, in 3 *Handbook of Public Economics* 1347, 1382-84 (Alan J. Auerbach & Martin Feldstein eds., 2001); Louis Kaplow, *On the Undesirability of Commodity Taxation Even When Income Taxation Is Not Optimal*, 90 *J. Pub. Econ.* 1235 (2006); Louis Kaplow, *Optimal Policy with Heterogenous Preferences*, 8 *B.E. J. Econ. Analysis & Pol'y*, no. 1, 2008, at 1.

20%; 39% and 21%; and 60% and 49.45%.²⁸² These peak-highest end rate pairs show not only the considerable range of possible outcomes under an optimal tax analysis, but also the general pattern of peaking then falling.²⁸³

The U.S. tax rate structure today looks a lot like these optimal income tax rate models. Because of the phase-out of the earned income tax credit—the “workfare” that replaced “welfare as we knew it” under Bill Clinton—combined with payroll taxes, income taxes, and other phase-outs of other benefits, the working *poor* in America face marginal tax rates of 90% or more.²⁸⁴ The top wage earners face marginal rates of 40% or so. The top real income earners, like Warren Buffett, face tax rates approaching zero. The poverty and marriage traps created by this structure are severe, and problematic—a story for another day.²⁸⁵ The point for taxing wealth seriously is that the high theory of optimal tax suggests a rate structure that does *not* rise steeply at the top end, and one that only applies to wages. We have this: It is the structure that emerged from the third phase of the history set forth above, beginning with Ronald Reagan.

Things get worse. Under Mirrlees and his fellow travelers, once the government has its money from labor taxes, it can then move on to the second prong of bifurcation, redistribution. Optimal income tax theory suggests giving the revenues raised back to all citizens, including the poor, via what the literature has come to call “demogrants.”²⁸⁶ Demogrants are simply lump-sum grants to all citizens—the “lump sum” component meaning that the grant does not vary with anything that the citizen does or does not do and so, by design, does not distort any prices, or affect any incentives. The *net* of taxes and transfers is then progressive, or redistributive.²⁸⁷

²⁸² Mirrlees, note 276, at 202-04 tbls.II, IV, VI, VIII, X & XII.

²⁸³ Later analysis pushed the case out to finding a zero rate—even, in the case of one model advanced by the Nobel laureate Joseph Stiglitz, a negative rate—for the highest earner/most able citizen. Stiglitz, note 280, at 213; see also Jesús K. Seade, On the Shape of Optimal Tax Schedules, 7 J. Pub. Econ. 203 (1977).

²⁸⁴ Edward J. McCaffery, Opinion, Americans’ 90% Tax Rate, CNN (Feb. 8, 2013), <http://www.cnn.com/2013/02/08/opinion/mccaffery-marginal-tax-rates/>; Daniel N. Shaviro, Effective Marginal Tax Rates on Low-Income Households, 85 Tax Notes 1191, 1192 (Aug. 23, 1999).

²⁸⁵ See Edward J. McCaffery, The Burdens of Benefits, 44 Vill. L. Rev. 445 (1999) (describing how benefits programs, including structural aspects of the tax system, burden nontraditional families).

²⁸⁶ See, e.g., Bankman & Griffith, note 276.

²⁸⁷ Edward Kleinbard, in his important book *We Are Better Than This*, in line with many contemporary reform proposals, suggests a similar path in the United States: raise income tax rates inframarginally—that is, below the highest bracket levels, à la Mirrlees—and then achieve redistribution through expenditures. See Edward Kleinbard, *We Are Better Than This: How Government Should Spend Our Money* 366 (2015).

When this all plays out on the public political stage, however, politicians and the masses go along with the efficiency-oriented analysis of the allocative prong: We get lower tax rates on high earners under a wage tax. The government of any political stripe wants this allocative prong to be followed, because a government of any political stripe wants revenue. The elegant findings of optimal income tax theory merge with a more popular sense of things, aided by such public intellectuals as Arthur Laffer and Martin Feldstein, that high marginal tax rates on the upper income levels are not wise. But neither the masses nor the government go along with the distributive prong of optimal tax theory. We do not have nor do we want anything like a demogrant.²⁸⁸ A simple analytic fact is that optimal tax theory, *stripped of its commitment to giving lump-sum demogrants to redistribute income*, still provides a roadmap for how governments can raise the maximum amount of revenue.²⁸⁹ Governments need the revenue because, in essence, they have already spent whatever could go to demogrants. High theory becomes part of the problem, not part of the solution.

Within the ivy-covered walls of the academy, more traditional tax law scholars continue to develop the centuries old income-versus-consumption debate.²⁹⁰ But Buy/Borrow/Die has little to do with that debate. Certainly, as a fact of the matter, the planks in Buy/Borrow/Die did not emerge from a conscious embrace of consumption taxation, a deliberate nontaxation of savings. “Buy” follows from the mistake of *Macomber*, and has stayed with us ever since. “Borrow” follows from the choice of an income tax, which is *supposed* to double tax savings. “Die” can only be plausibly understood as part of a pair with estate taxation—the estate tax playing catch up with the realization requirement—and has, somehow, survived a world in which there is not much of an estate tax. Buy/Borrow/Die allows the propertied class to avoid all taxes on *both* their income, which comes through “mere” appreciation, *and* their consumption (which comes through borrowing). The income-versus-consumption tax debate is beside this point.

Still, the advocates for darkness can invoke elements of the income-versus-consumption debate to serve their ends, or to deepen the misconceptions that block understanding Buy/Borrow/Die. Any attempt to tax capital or the income from capital under the income tax is met with a barrage of criticism for being a “double tax.” Yet, the problem

²⁸⁸ See McCaffery & Hines, note 166, at 1086.

²⁸⁹ Kleinbard, note 287, at 352-52.

²⁹⁰ See, e.g., Louis Kaplow, *The Income Tax Versus the Consumption Tax and the Tax Treatment of Human Capital*, 51 *Tax L. Rev.* 35 (1995); Michael S. Knoll, *Designing a Hybrid Income-Consumption Tax*, 41 *UCLA L. Rev.* 1791 (1994).

of iteration, within and across generations, makes this critique almost embarrassing for the very wealthy.

Meanwhile, across the hall from the tax law academics, the rest of the academy, like the rest of us, dwells in the darkness. There is no general widespread understanding of Buy/Borrow/Die: of how simple it is for those with capital to avoid tax, of how deep the structural problem runs. Piketty, for example, seems variously to believe both that the U.S. tax system is an admirable and effective antidote to inequality²⁹¹ and that the wealthy avoid taxes by using complex devices. Neither of these claims rings true once we understand Buy/Borrow/Die.

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

B. *Problems of Practice*

When it comes to the fisc, neither the money nor the light suggests taxing wealth all that seriously. There are a series of practical problems in even attempting to do so. High marginal tax rates on labor discourage labor, and so we are left with a fairly high but fairly flat wage tax system, the government extracting revenues at a 30%-50% rate, all in, on income from labor. Changing gears to tax wealth will not be easy. Capital is highly mobile. “Exit taxes” that attempt to prevent the rich from simply folding up their tents and moving elsewhere—as U.S. *companies* have effectively done for decades—are complex to write and enforce, and comparatively easy to evade.²⁹² And wealth can be hidden.

Simple back-of-the-envelope calculations suggest that a 1% wealth tax could replace the individual and corporate income taxes and the gift and estate tax as well.²⁹³ But good luck with that. Old taxes are good taxes, as Adam Smith taught us—“good” in the sense that people have become used to them, and the government has learned how to collect them.²⁹⁴ Initiating a new tax on wealth, directly, would raise large questions of valuation and administration, and would invoke massive planning opportunities to escape, evade, or mitigate its bur-

²⁹¹ Thomas Piketty, Emmanuel Saez & Stefanie Stantcheva, *Taxing the 1%: Why the Top Tax Rate Could Be Over 80%*, VOX (Dec. 08, 2011), <http://www.voxeu.org/article/taxing-1-why-top-tax-rate-could-be-over-80>.

²⁹² See, e.g., IRC § 877; see also Robert W. Wood, *Ten Facts About Tax Expatriation*, *Forbes* (Mar. 23, 2010), <http://www.forbes.com/2010/03/23/expatriation-exit-tax-limbaugh-obamacare-personal-finance-robert-wood.html>.

²⁹³ Daniel Altman, *Opinion, To Reduce Inequality, Tax Wealth, Not Income*, *N.Y. Times* (Nov. 18, 2012), <http://www.nytimes.com/2012/11/19/opinion/to-reduce-inequality-tax-wealth-not-income.html>.

²⁹⁴ Adam Smith, *The Wealth of Nations*, Book V, ch. II, 1104 (ElecBook 2000) (1776) (describing the importance of certainty in taxation).

dens. The long century of the gift and estate tax has shown how difficult it is to tax the wealthy, especially outside of market transactions to show the tax collector some light.²⁹⁵ Meanwhile a century of not taxing wealth seriously, at all, has led to a large build-up of wealth.²⁹⁶

Then there is the unfortunate fact that we need savings, and there are not many savers except the rich left. Taxing wealth directly not only encourages the rich to flee the jurisdiction, or at least to hide their wealth overseas, it also discourages them from having such wealth in the first place. A modest wealth tax, at say a 1% rate, sounds at first blush to be responsive to these concerns, but the rich could well think that, once the government had created the apparatus to tax wealth seriously, that it would be just a matter of time before rates spiked up—after all, this happened with the income tax. There is no point denying that rich dads are smart. Taxing wealth will be practically difficult, and may not in the end raise much revenue.

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

C. Problems of Perception

The story of the failure to tax wealth seriously can be told as a matter of perception or salience. Salience refers to the mental or psychic impact that some fact of interest has on a target population—it refers to what we pay attention to.²⁹⁷ The income tax, with its high marginal tax rates and dreaded annual forms, is the most salient of taxes.²⁹⁸ FDR in the Jones account was able to take advantage of this salience;²⁹⁹ Clinton in her 4% plan and Sanders with his \$10 million bracket learned the lesson. Other taxes are hidden to various degrees—partly hidden, such as the employer's share of the payroll tax, or fully hidden.³⁰⁰ Attempts to tax the rich in contrast are, almost by

²⁹⁵ See Cooper, note 96, at 200-03 (describing estate tax planning strategies that involve the use of personal holding companies); see also McCaffery, note 97.

²⁹⁶ See generally Piketty, note 1.

²⁹⁷ Salience, Merriam-webster.com, <http://www.merriam-webster.com/dictionary/salience> (last visited Dec. 30, 2016).

²⁹⁸ See McCaffery, note 121, at 1886-87.

²⁹⁹ See Jones, note 128, at 732-34.

³⁰⁰ See McCaffery, note 121, at 1875-76.

definition, highly salient. Other things being equal, democratic politics favors low-salient taxes and high-salient expenditures, the latter being a major part of the problem that has us constantly staring over some fiscal cliff, and legislating under the pressing exigencies of the present.

Problems of perception abound. Many studies have shown that people routinely confuse average and marginal tax rates.³⁰¹ Thus, people *think* that being in a 39.6% bracket means that *all* of one's income is taxed at that rate. This confusion has several effects. It leads people, even the media, to ignore or neglect the inframarginal benefits that upper-income taxpayers get, as in the 2012 Act, by the perpetuation of lower inframarginal rate brackets. It leads people to believe that Act, with its restoration of the pre-Bush era rate of 39.6% on incomes over \$400,000,³⁰² was more progressive and redistributive than it was.³⁰³ More generally, it leads many people to accept their own tax burdens, such as the increase in payroll taxes effective January 1, 2013,³⁰⁴ as being tolerable, because it appears as if the upper-income have been hit even harder. Small Frys everywhere can be happy.

Behavioral perspectives also suggest that bifurcations that are logical in theory have unintended consequences in practice. The experimental decision theorist Jon Baron and I looked at what happens when a tax system is split in two.³⁰⁵ We asked people what their preferred tax system on labor earnings would be. Then we told them that there were in fact two means of taxing wages—through a payroll tax and an income tax. We stated each tax raised half of the total amount. Then we gave them rate structures, sometimes for the payroll tax, sometimes for the income tax. We asked them to set the other tax, and sometimes to restate the total. We found that, very consistently, subjects did not re-add the two systems together. Confronted with a flat or regressive wage tax, that is, they did not compensate by making the income tax more progressive. This illustrates what we call an *isolation effect*—people look at things in isolation, as if with blinders on. They have intuitions at how progressive a tax system should be, and,

³⁰¹ Bob Schmidt, Confused About Marginal Tax Rates? You're Not Alone, Tax Found.: Tax Pol'y Blog (Aug. 20, 2008) <http://taxfoundation.org/blog/confused-about-marginal-tax-rates-youre-not-alone>.

³⁰² 2012 Act, note 78, § 101(b), 126 Stat. at 2316.

³⁰³ See *id.*

³⁰⁴ Reddy, note 228.

³⁰⁵ Edward J. McCaffery & Jonathon Baron, The Political Psychology of Redistribution, 52 UCLA L. Rev. 1745 (2005).

whatever tax they happen to be looking at, they want it to have their preferred pattern.³⁰⁶

Much redistribution, as Richard Bird and Eric Zolt and others have noticed, is effected through spending programs.³⁰⁷ In the real world, such programs play out the role given by theory to demogrants. When those spending programs are cut, then, there is not only an allocative effect (government gets out of the business of providing the good or service) but also a redistributive one. Baron and I tested whether subjects, prompted to do so, would “correct” for the level of redistribution in the residual tax system following a spending cut or “privatization.” We found that ordinary subjects could not. Interestingly, they by and large did correct the tax system to make it more progressive, but not by nearly enough to keep the level of redistribution constant by replacing the “masked” with transparent redistribution.³⁰⁸

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

D. Problems of Politics

U.S. politics gives little reason to hope for taxing wealth seriously. There is no need to repeat here a discussion of the special interest model of politics in general, or tax policy in particular. Suffice it to say that the rich are far better able than the rest of us to form groups to lobby for tax breaks or against tax increases. Linda Cohen and I have written about the politics of estate tax reform, arguing that Congress has an interest in teeing up matters of high stakes to small groups, and then stringing them along to get campaign contributions.³⁰⁹ Our model of “ex ante rent extraction” suggests that Congress *wants* wealthy citizens who are insulated from taxation in order to generate campaign contributions: Politicians, that is, have a narrow self-interest in not taxing wealth seriously. There is plenty of evidence of such effects in the ongoing stories of the Taxpayer Relief Act of 2012, estate tax reform, and more.

All of the problems begin to work together. There is not much money to be had in “soaking the rich,” given the practical difficulties

³⁰⁶ Id. at 1752-57.

³⁰⁷ See generally Richard M. Bird & Eric M. Zolt, *Fiscal Contracting in the Americas*, 67 *World Dev.* 323 (2015) (describing the growth and redistributive nature of social spending in Latin America and the United States).

³⁰⁸ McCaffery & Baron, note 305, at 1768-72.

³⁰⁹ McCaffery & Cohen, note 238, at 1165-67.

of taxing wealth seriously. Politicians both want to keep their wealthy donors happy and to pay the bills to keep the lights on in government offices. Optimal tax theory suggests doing so by a wage tax with declining marginal rates for the highest end. This is the easiest thing to do anyway. There is no market or other arbitrage mechanism to help ameliorate the pervasive perceptual biases in tax; indeed, we have seen, repeatedly, that politicians take advantage of and help to exacerbate misperceptions.³¹⁰ Politicians want to spend saliently and tax nonsaliently: They have an incentive, that is, to keep Buy/Borrow/Die hidden. As long as the general citizenry hangs out under the lamp post with the drunken sailor, there is no pressure on politicians to change.

E. Problems of Professionals

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

F. The Problem of Problems

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

Start with theory, which leaves redistribution to the income tax. Theory suggests that income taxation is a limited tool to that end. It tells us to hand out demogrants to solve problems of inequality. We do not and will not do that. Politicians need revenues, fast. They do not want to antagonize their wealthy patrons. They grope for low-salient taxes, which take small sums from the masses as a strategy. Ordinary citizens understand little of this, and no one has any incentive to educate them. In fact, tax professionals have reasons to obfuscate, to perpetuate the idea that tax planning is difficult and costly—requiring their helpful services. People are skeptical of Buy/Borrow/

³¹⁰ McCaffery & Baron, note 305, at 1789; McCaffery, note 150, at 602-03.

Die anyway. Meanwhile, capital continues to grow, in magnitude and unequal holdings, and becomes ever more powerful and mobile.³¹¹

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

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

VIII. A LIGHT IN THE DARKNESS: GETTING SERIOUS ABOUT TAXING WEALTH

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

This Part briefly sketches out the possibilities for taxing wealth. My main point is that addressing any one of the planks in Buy/Borrow/Die goes a long way toward taxing wealth seriously. Future real-world oriented policy and analysis ought to focus on developing these ideas. At the end of a lengthy article, I do not intend to repeat the details of the many specific reform proposals and fine scholarship that have been set forth by academics and others. Instead I mean here only to list and situate various reform strategies within the analytic framework of Buy/Borrow/Die.

The Article's prior analysis, of history, politics, and economic theory, among other disciplines, sheds a surprising light on the likely best path forward. The various proposals to address the "Buy" step seem unlikely to advance very far. In fact, their very mention can impede understanding of the deep problems Buy/Borrow/Die poses, and of other realistic hopes for reform. The possible steps to address "Die" in contrast seem most feasible in any kind of near term, and, indeed, we have seen at least talk of change here from politicians, including Obama, Clinton, and Trump. Changing "Die" could be quite effective. Perhaps counter-intuitively, however, it is the "Borrow" step that holds out the best promise for systematically taxing wealth seriously.

³¹¹ See Piketty, note 1.

A. *Rethinking “Buy”*

There are two broad avenues for attacking the “Buy” prong of Buy/Borrow/Die, built up under the realization requirement. One acts within the income tax; the other steps outside to develop a new, “complementary” wealth tax, as Mirrlees among others has suggested.³¹² Unfortunately, neither track seems all that promising.

1. *Repealing the Realization Requirement*

In terms of income tax reform,³¹³ eliminating “buy” means repealing or at least radically reforming the realization requirement, which is not constitutionally required. There are at least three ways to consider doing this.

First, we could “simply” repeal the realization requirement and force taxpayers to “mark to market” their holdings every year, reporting the “change in value of the store of property”³¹⁴ rights on their tax returns. Scholars have considered just such proposals.³¹⁵ It is fairly easy to countenance such a reform for assets with readily ascertainable market values, such as publicly traded stocks. But other assets, such as land or real estate, would be difficult to value without a sale. Unless capital held in non-publicly tradable forms was captured in the tax base, there would be a strong incentive to remove assets from public exchanges, with inefficiencies and inequities resulting.

Second, we could keep the realization requirement, but take away its *benefits*, by adjusting the tax due on any ultimate sale or exchange to reflect the deferral allowed by *Macomber*. This is the idea of retrospective capital gains developed by Alan Auerbach and others.³¹⁶ Combined with marking to market publicly traded securities, above, this step could help to sweep more capital appreciation into the tax base. To make it effective, the “die” step, stepped-up basis on death, would also have to be repealed, as I consider below. *If* the plan could

³¹² James Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles & James Poterba, *The Mirrlees Review: A Proposal for Systematic Tax Reform*, 65 Nat'l Tax J. 655, 670-74 (2012).

³¹³ I discuss in Section VIII.C the idea of taxing capital gains on death, which could be understood as a partial repeal of the realization requirement or as making death a realization event.

³¹⁴ Simons, note 41, at 50.

³¹⁵ Joseph Bankman, *A Market-Value Based Corporate Income Tax*, 68 Tax Notes 1347 (Sept. 11, 1995); David J. Shakow, *A Wealth Tax: Taxing the Estates of the Living*, 57 B.C. L. Rev. 947 (2016); David A. Weisbach, *A Partial Mark-to-Market Tax System*, 53 Tax. L. Rev. 95 (1999); David S. Miller, *Opinion, The Zuckerberg Tax*, N.Y. Times (Feb. 7, 2012), http://www.nytimes.com/2012/02/08/opinion/the-zuckerberg-tax.html?_r=0.

³¹⁶ See generally Alan J. Auerbach, *Retrospective Capital Gains Taxation*, 81 Am. Econ. Rev. 167 (1991) (describing retrospective capital gains taxation, in which capital gains are taxed on realization, with interest charges added).

be implemented in a seamless fashion, this would mean that there would be no benefit from buying and holding, because ultimately a tax would come due, and one that compensated for its delay in its magnitude.

Third, we could keep the realization requirement in place, but broaden the scope of realization events, specifically to include borrowing. An easy step vis-a-vis debt would be to tax borrowing secured by appreciated property. But this would only create an incentive to design unsecured debt, or to use unappreciated property to secure debt. It may not be wise to add on some realization events to the list, while keeping the basic doctrine in place.

These various steps to reverse the effects of *Macomber's* realization requirement—at least during life—all seem like political long-shots.

2. *A Freestanding Wealth Tax*

A second tack on attacking the Buy step is to adopt a meaningful wealth tax, an idea with some currency. Bruce Ackerman and Anne Alstott considered such a tax in *The Stakeholder Society*,³¹⁷ and the idea has been invoked by multiple scholars³¹⁸ and commentators.³¹⁹ Designing an altogether new tax will not be easy, of course, along any dimension—politically or practically.

Still there are good reasons to suspect that taxing wealth directly, whether under the income tax or in a separate complementary tax, is *not* the best approach to the challenges of taxing wealth seriously. Certainly a century of estate taxation provides a cautionary tale for the efficacy of any such tax. So, too, does the history of the corporate tax. The twin facts that we need capital and that capital is highly mobile in today's global economy conspires against hope here.

B. *Rethinking "Borrow"*

For going on two decades, I have argued for a particular form of taxing wealth seriously: moving to a progressive spending tax.³²⁰ In this Article, I am concerned with the curious failure to see the roots of the issue or to take taxing wealth seriously for more than a century. I

³¹⁷ Anne Alstott & Bruce Ackerman, *The Stakeholder Society* 94-112 (2000).

³¹⁸ See, e.g., Piketty, note 1; Deborah H. Schenk, *Saving the Income Tax with a Wealth Tax*, 53 *Tax L. Rev.* 423 (2000); Shakow, note 315.

³¹⁹ See, e.g., Douglas Hopkins, *A Business Case for a Wealth Tax*, *Inst. for Pol'y Studies* (Mar. 2, 2016), www.inequality.org/business-case-annual-wealth-tax/; Ronald McKinnon, *Commentary, The Conservative Case for a Wealth Tax*, *Wall St. J.* (Jan. 9, 2012), <http://www.wsj.com/articles/SB10001424052970203462304577139232881346686>.

³²⁰ Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 *Yale L.J.* 283, 345-5 (1994); see generally McCaffery, note 40, at 26.

will not repeat at length my sense of the ideal solution. But it is worth noting.

Recall the Haig-Simons definition of income: $I = C + S$. A simple rearrangement shows that $C = I - S$. In other words, we can have a consumption tax “simply” by adding up all aspects of “income” and systematically subtracting all savings. We could have a consistent, “cash flow” consumption tax using annual returns, like the 1040, and featuring unlimited savings accounts. This is an idea that harkens back at least to the British economist Nicolas Kaldor in 1955,³²¹ picked up and developed in America by William Andrews.³²²

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

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

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

A progressive spending tax does more than attack the “borrow” step: It helps us to rethink “taxing.” It is easy to think that the right approach to wealth inequality is to tax wealth: Piketty and scores of others motivated to tax wealth seriously have thought thus. But “tax-

³²¹ Nicholas Kaldor, *An Expenditure Tax* (1957).

³²² William D. Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 Harv. L. Rev. 947 (1975); see Treasury Dep’t, *Blueprints for Basic Tax Reform* 9-12 (1977).

ing” does not have to mean “taking.” A progressive spending tax works by having unlimited savings accounts as featured in an actual proposal, the Nunn-Domenici “USA Tax” from the 1980’s. (“USA” stood for “unlimited savings accounts.”)³²³ The actual proposal was fatally flawed by its noninclusion of debt: If there is an unlimited deduction for savings, but no inclusion for debt, a taxpayer like *Jane* can earn \$100,000, save \$100,000, pay no tax, and borrow whatever she needs—and we could expect financiers to help her do just that.³²⁴

The USA Tax or similar ideas allow us to make a deep point. The unlimited savings accounts, like IRAs under current law or trust accounts in theory, allow us to *change the meaning of capital*. Among other things, a progressive spending tax can support higher tax rates, even under optimal income tax theory, than a wage tax.³²⁵ This is because such rates need not deter labor; for people motivated to save and pass their wealth intergenerationally—as hundreds of billions of dollars in dynasty trusts suggest that many want to do—the progressive spending tax need not deter work or savings.

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

A progressive spending tax changes the meaning of wealth—it changes what one can do with one’s money.³²⁶ The progressive spending tax builds on a longstanding modern tendency to separate ownership and control. We allow the wealthy to keep their wealth, to manage and invest and grow it, but when and as the wealthy attempt to spend the wealth on themselves, we subject them to high tax rates for the privilege. This is an exciting way to begin to think about taxing wealth seriously.

³²³ See Murray L. Weidenbaum, *The Nunn-Domenici USA Tax: Analysis and Comparisons*, in *Frontiers of Tax Reform* 54-69 (Michael J. Boskin ed., 1996).

³²⁴ See Laurence S. Seidman, *The USA Tax: A Progressive Consumption Tax* 75-78 (1997) (considering the ramifications of excluding borrowing from the USA Tax).

³²⁵ See McCaffery & Hines, note 166, at 1032 (describing the merits of a progressive spending tax).

³²⁶ Edward J. McCaffery, *The Meaning of Capital in the Twenty-First Century* (USC CLASS Research Paper No. 16-10, 2016), https://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2741315.

C. *Rethinking “Die”*

The simplest step in Buy/Borrow/Die is the last step, and this also would seem as the easiest fix to the failures to tax wealth seriously.³²⁷ There are two clear paths forward, each with a history of legislative proposals in the United States. One, we could make death a realization event, as Canada has done and as Obama proposed in 2015.³²⁸ Indeed, before the presidential election in November, 2016, both major party candidates had come around to endorse some form of taxing capital gains on death, each stopping well short of a full repeal of § 1014, the “angel of death” provision.³²⁹ In September, 2016, Clinton revised her tax reform proposals and promised to raise the estate tax rate, then 40%, to 65%—on estates over \$500 million.³³⁰ Once again, this looks like FDR’s “symbolic tax bracket” technique, hardly an attempt to tax wealth seriously. At the same time, Clinton vowed to repeal stepped-up basis for many: Her campaign made references to exemptions and further provisions to soften the sting of the reform, but did not spell out any details.³³¹

Trump, meantime, proposed altogether abolishing the gift and estate tax, a staple of Republican party platforms and orthodoxy for decades.³³² But Trump, like Clinton, also proposed a partial modification to the “Die” step, advocating that estates pay tax (or, possibly, not receive a full stepped-up basis) on previously untaxed appreciation in excess of \$10 million, at the 20% capital gains rate.³³³ Viewed in isolation, this is something of a movement towards taxing wealth seriously. But viewed not in isolation, Trump’s suggestions look more simply like estate tax reform—replacing the existing 40% tax on all assets with a 20% tax on unrealized appreciation, alone. Furthermore, without a gift tax—or even with a gift tax at its current

³²⁷ See, e.g., Zelenak, note 74, at 370-71 (advocating taxation of unrealized gains at death, based on both simplicity and revenue effects); see generally Michael J. Graetz, *Taxation of Unrealized Gains at Death: An Evaluation of the Current Proposals*, 59 Va. L. Rev. 830 (1973).

³²⁸ See Golombek, note 18; Peter J. Reilly, *Opinion, President Obama Would Make Death a Taxable Event*, *Forbes* (Jan. 19, 2015), <http://www.forbes.com/sites/peterjreilly/2015/01/19/president-obama-would-make-death-a-taxable-event/#7176253956ed>.

³²⁹ See Charlie Douglas, *When It Comes to Estate Tax, Clinton and Trump Surprisingly Agree*, *Trusts & Estates* (Oct. 5, 2016), <http://www.wealthmanagement.com/estate-planning/when-it-comes-estate-tax-clinton-and-trump-surprisingly-agree>.

³³⁰ Kerri Anne Renzulli, *Hillary Clinton Wants to Raise Top Rate for Estate Taxes to 65%*, *Time.com* (Sept. 22, 2016), <http://time.com/money/4504737/hillary-clinton-wants-to-raise-top-rate-for-estate-taxes-to-65/>.

³³¹ See *id.*

³³² See Douglas, note 329.

³³³ See *id.*

high exemption level of nearly \$5.5 million per person—it would not be difficult to plan around a capital-gains-on-death provision.³³⁴

Two, we could enact a carryover basis rule for assets passed on death. This step would still allow wealthy families who need not sell assets after death—like Sheldon Adelson’s family, or the thousands of Americans who hold dynasty trusts—to defer taxes for a very long time. More worrisome, it is worth noting again that carryover basis on death has been enacted into law twice—and retroactively repealed each time.³³⁵ The very proposals for a modest capital-gains-on-death tax, just considered, may moot discussion of a carryover basis regime.

All of this suggests that modifying the “Die” step, as analytically simple as this is to imagine, may not be the most promising permanent path to taxing wealth seriously. Yet in a world without any very good reason for the persistence of stepped-up basis—a world in which almost no one will be paying an estate tax—this would seem like an easy first step, a down payment on taxing wealth seriously. The fact that we cannot even seem to do this seemingly simple step underscores how poorly we have thought for years—how much we have not taken taxing wealth seriously.

D. *Ending the Joke*

It is time—past time—to give our drunken sailor some light, any light other than the income tax, to search for America’s lost wallet. The income tax does some things well—it did help to finance war efforts, after all, and it has long been the major source of funds for a democratic capitalist state that still, all things considered, is better than most alternatives. But specifically in terms of the progressive agenda manifest at the dawn of its creation—the quest to chip away at “economic royalists” as FDR called them,³³⁶ or, at a minimum, to get the wealthy to contribute *something* to the general welfare—the income tax has been a failure. Buy/Borrow/Die moots it for the propertied class.

At the end of the day, the critique of the income tax along these lines is no more complex than the common saying that, if one is not part of the solution, she is part of the problem. The income tax, as it has evolved over a century, is not part of the solution to the problem of wealth inequality in America. If we believe that that is a prob-

³³⁴ The grantor retained trust or GRAT transaction that Sheldon Adelson used to transfer some \$8 billion to his children comes to mind—such transactions use gifts and carryover basis to avoid estate taxation. They would avoid capital gains on death, as well. See Mider, note 99.

³³⁵ See text accompanying notes 75-76.

³³⁶ Jones, note 128, at 685.

lem—and if it is, it is getting worse by the minute—it is time to look for real solutions, not jokes. Fortunately, Buy/Borrow/Die itself provides a view to the cures, pathways to taxing wealth seriously. And this view strongly suggests that it is the “Borrow” step—the one that allows for tax-free living among the billionaire class—that ought to change. Whatever the future holds, the facts of the present underscore the importance of taxing wealth seriously.

