

SYMPOSIUM: CLASS IN AMERICA

PLAYING FAIR: DISTRIBUTION, ECONOMIC GROWTH, AND FAIRNESS IN FEDERAL AND STATE TAX DEBATES

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Intuitions of fairness drive many federal and state tax policy decisions. But these intuitions, however strongly felt, can be exceedingly difficult to operationalize and implement without unforeseen consequences. This Article examines several salient examples of such policies, including the estate tax, the Bush tax cuts, the Alternative Minimum Tax, the Buffett Rule, and state millionaires' taxes. In doing so, this Article attempts to reveal flaws in the redistributive impulse for taxation policy by assessing some of its political and economic ramifications as well as the unreliable measurements of fairness that form the foundation of these policies.

“[T]he present tax code contains special preferences and provisions, all of which narrow the tax base (thus requiring higher rates), artificially distort the use of resources, inhibit the mobility and formation of capital, add complexities and inequities which undermine the morale of the taxpayer, and make tax avoidance rather than market factors a prime consideration in too many economic decisions.”

—President John F. Kennedy¹

I. INTRODUCTION

In May 2012, presidential candidate Mitt Romney confidentially told guests at a fundraiser that “[47%] of Americans pay no income tax” and that “they will vote for this president no matter what.”² Secretly recorded and released in September of that year, the videotaped comments severely, perhaps fatally, damaged Romney’s chances of defeating President Barack Obama.³

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¹ President John F. Kennedy, Special Message to the Congress on Tax Reduction and Reform (Jan. 24, 1963), available at http://www.jfklibrary.org/Asset-Viewer/Archives/JFK_POF-052-007.aspx, archived at <http://perma.cc/0AbNuh5Uo1r>.

² MOTHER JONES, *Mitt Romney on Obama Voters*, YouTube (Sept. 17, 2012), <http://www.youtube.com/watch?v=XnB0NZzI5HA>, archived at <http://perma.cc/062UCnkGsVF>.

³ See, e.g., *Romney Relays Disappointment over Loss, Admits Mistakes, in First Sitdown Since 2012 Election*, FOX NEWS (Mar. 3, 2013), <http://www.foxnews.com/politics/2013/03/03/>

Romney's comment and the outrage about it are but the latest example of a century-old debate about using the tax system to promote fairness. Its beginnings are in 1909, when British Chancellor of the Exchequer Winston Churchill unveiled the budget proposal of the David Lloyd George government. This "People's Budget" was a watershed in history: a tax increase for the purpose of redistribution. The budget sought to increase the income tax from 3.75% to 5% on income over £2000 (about \$235,000 in today's money) and 7.5% on income over £3000 for those who earned over £5000 (about \$585,000 in today's money).⁴ The proposal also included new taxes on luxury purchases, a higher inheritance tax, and a tax on increases in land valuation, all used to fund new welfare programs and additional defense spending. After a year of political wrangling, Parliament enacted the plan (minus the land tax) and began Britain's modern welfare state.

Lloyd George and Churchill were taking aim at Britain's upper classes, the titled gentry who inherited their name and their money to pass them on undiminished, doing nothing particularly productive in the meantime. But today, of course, the richest people in the world are not lifetime dukes or earls but CEOs, technology wunderkinds, and hedge fund managers. Although these recent additions to the rich often gain and lose wealth with some volatility, they are nonetheless just as much targets of tax policy. The actors have changed, but the story has not: taxes often embody an intuition that fairness dictates a redistribution of wealth.

The influence, if not the primacy, of that intuition has had significant ramifications. In today's tax debates, pro-tax advocates define fairness crudely, relying on effective tax rates on a distributional table. The imperative of moving towards a hazy concept of fairness crowds out discussion of equally important questions: whether these taxes drag down economic growth, whether these taxes make revenue collection unacceptably volatile, whether lifetime analysis of tax burdens rather than one-year snapshots are more appropriate, whether it causes greater political conflicts and demands for tax carve-outs, and indeed, whether it works at reducing inequality. This Article contends that redistributive tax policy suffers from serious and potentially fatal flaws in its political and bureaucratic implementation. These flaws undermine the case in favor of redistribution, especially when greater agreement exists regarding the costs of such policies.

romney-still-disappointed-over-loss-admits-mistakes-critical-obama-second-term/, archived at <http://perma.cc/0poVWvEkbZ2> ("There's no question that hurt and did real damage to my campaign."); Josh Barro, *Today, Mitt Romney Lost the Election*, BLOOMBERG VIEW (Sept. 17, 2012), <http://www.bloomberg.com/news/2012-09-17/today-mitt-romney-lost-the-election.html>, archived at <http://perma.cc/0dYW4xDMrjk> ("You can mark my prediction now: A secret recording from a closed-door Mitt Romney fundraiser, released today by David Corn at Mother Jones, has killed Mitt Romney's campaign for president.").

⁴Gregory Clark, *What Were the British Earnings and Prices Then? (New Series)*, MEASURINGWORTH (last visited Oct. 22, 2013), <http://www.measuringworth.com/ukearnpci>, archived at <http://perma.cc/0mq8vrYSXdT>; CPI Inflation Calculator, BUREAU OF LABOR STATISTICS (last visited Oct. 22, 2013), http://www.bls.gov/data/inflation_calculator.htm, archived at <http://perma.cc/0cVmdmmoQoK>.

Part II of this Article reviews several major components of the U.S. tax system, explains that debates about these components often reach impasses due to underlying disagreement about the propriety and effectiveness of using tax policy for distributive purposes, and examines the political consequences of those continuing disagreements. Part III looks at an equally important consequence of tax policy, the general effect on economic growth, and distributive tax policy's particularly negative effects on growth and improvements in the standard of living. Part IV questions how those who support distribution through the tax code have conventionally defined their goal and discusses serious deficiencies in the dominant method of measuring tax policy fairness, the distribution table. Part V concludes the Article with some thoughts on more suitable objectives of tax policy.

II. DISTRIBUTION IN FEDERAL AND STATE TAX DEBATES

As this Part attempts to demonstrate, irreconcilable views about the proper goals of public policy have enflamed and prolonged political and academic disagreements over income taxes. No putative goal has done more to expose these fault lines than redistribution of wealth. Five salient examples of tax policy help to demonstrate this point: (1) whether to repeal or reinstate the estate tax; (2) whether to extend some or all of the Bush tax cuts; (3) whether to patch the Alternative Minimum Tax ("AMT"); (4) whether to enact a Buffett Rule; (5) whether to enact millionaire taxes at the state level. Some of these tax measures still precipitate ideological battles in government and academia, but even those measures that have achieved some measure of acceptance have typically done so only after experiencing significant, and potentially harmful, swings in their implementation.

A. Redistribution as Progressivity

When asked about the use of the federal income tax for "redistribution," 52% of Americans strongly or somewhat support that use, 31% strongly or somewhat oppose it, 10% are neutral, and 7% are not sure.⁵ What each American thinks when hearing the term "redistribution," though, is far from clear, and so a short explanation of common concepts can be helpful. Generally, pursuing redistribution means pursuing tax progressivity, but what is tax progressivity? It can be defined one of three ways:

- *Progressivity in Tax Payments.* Under this definition of progressivity, tax payments should go up as a person's income goes up. As Adam Smith explained, "The subjects of every state ought to contribute to-

⁵ Matt Moon, *Special Report No. 166: How Do Americans Feel About Taxes Today?*, TAX FOUND. 14 (Apr. 2009), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr166.pdf>, archived at <http://perma.cc/0P6BkMvgmBz>.

ward the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.”⁶ Tax liability goes up with income under essentially all types of taxes.⁷ Pennsylvania, for example, has a 3.07% flat income tax, which results in a higher-income person paying proportionally more dollars than a lower-income person despite paying an identical tax rate.⁸

- *Progressivity in Statutory Tax Rates.* Under this definition of progressivity, tax rates should go up as a person’s income goes up. As a person earns more money, they “fall into” higher tax brackets. For example, Rhode Island imposes a 3.75% income tax on the first dollar of income up to \$58,600; a 4.75% income tax on income above that up to \$133,250; and a 5.99% income tax on income above that level.⁹ The tax rate is a *marginal* tax rate, applying to income above the threshold only. Thus, a person in Rhode Island earning \$60,000 would pay \$2278 in state income tax: a 3.75% rate on the first \$57,150 (\$2143 in tax) and a 4.75% rate on the \$2850 in income above that (\$135 in tax). It is a common misconception that a person in the 35% tax bracket pays 35% on all of his or her income; in fact, he or she only pays that rate on the amount of his or her income that exceeds the income level at which the tax bracket is triggered.¹⁰
- *Progressivity in Effective Tax Rates.* Under this definition of progressivity, the percentage of each person’s income being paid in taxes goes up as a person’s income goes up. The effective tax rate is how much someone pays divided by his or her income and can potentially be negative due to refundable tax credits. For example, taxpayers with income between \$15,000 and \$30,000 pay an average effective tax rate of –5%, despite being in the 15% tax bracket.¹¹ A person in the 15% income tax bracket is likely not paying 15% of his or her income in taxes, due to the standard deduction (a set amount exempt from

⁶ ADAM SMITH, *THE WEALTH OF NATIONS* 777 (Edwin Cannan ed., The Modern Library 1937) (1776).

⁷ One exception was the Swiss canton of Obwalden in 2006–07, which imposed a 6% tax on income up to SFr300,000 and a 1% tax rate on income in the top bracket. See Joseph Henchman, *Swiss Court Strikes Down Degressive Tax*, TAX FOUND. (June 4, 2007), <http://taxfoundation.org/blog/swiss-court-strikes-down-degressive-tax>, archived at <http://perma.cc/0291sKMUyp>.

⁸ *State Individual Income Tax Rates 2000–2013*, TAX FOUND. (Apr. 1, 2013), http://taxfoundation.org/article_ns/state-individual-income-tax-rates-2000-2013, archived at <http://perma.cc/0LoWpcVvDm2>.

⁹ *Id.*

¹⁰ See Joseph Henchman, *The West Wing Wisdom on Paying Fair Share of Taxes*, TAX FOUND. (Sept. 9, 2011), <http://taxfoundation.org/blog/west-wing-wisdom-paying-fair-share-taxes>, archived at <http://perma.cc/0aKfuHjY87G>.

¹¹ *Putting a Face on America’s Tax Returns: A Chart Book*, TAX FOUND. 5 (2012), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/PuttingAFace2013.pdf>, archived at <http://perma.cc/0g8WtmGnrkZ>.

tax), personal exemptions (a set amount per person exempt from tax), tax-exempt income categories, and a number of deductions and credits that reduce tax liability. Effective tax rates can even be negative, due to refundable tax credits like the Earned Income Tax Credit. The top 1% of income earners pays an effective federal income tax rate averaging 23.4%, all taxpayers average 11.8%, and the bottom 50% pay just 2.4%.¹²

By all three measures, our federal income tax system is progressive: the average top income earners pay a significant share of total income tax collections, fall into high tax brackets, and pay a greater share of their income in income tax than lower-earning Americans. Of course, there are individual taxpayers with tax-free income sources or enough credits and deductions to escape relatively higher income taxes, but these people represent exceptions to the general rule. But the progressivity of the tax system as a whole—including state sales taxes, federal payroll taxes, property taxes, and business taxes—is less clear. For instance, lower-income people pay a greater share of their income in sales and payroll taxes than higher-income people,¹³ and no consensus exists regarding exactly who “pays” or bears the economic burden of property taxes (i.e., landlords or renters) and business taxes (i.e., shareholders, consumers, or workers).¹⁴ The inherent difficulty in operationalizing progressivity across so many situations motivates much of the discord over the following tax policies.

B. Estate Tax

The estate tax is a tax on the transfer of large amounts of wealth at death. A feature of the federal tax system since 1916, it has been supplemented by related taxes: a gift tax (adopted in 1924, repealed in 1926, and readopted in 1932) on large wealth transfers occurring at times other than death and intended to prevent avoidance of the estate tax by making large gifts before death; a generation-skipping tax (adopted in 1976) on wealth transfers to trusts for grandchildren if the trust avoids the estate tax; and state-level inheritance taxes, paid by heirs on the receipt of wealth transferred at death.¹⁵

¹² *Facts & Figures: How Does Your State Compare?*, TAX FOUND. tbl.10 (2013), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/ff2013.pdf>, archived at <http://perma.cc/0bnjbZiR6Vd/>.

¹³ See Chuck Marr & Chye-Ching Huang, *Misconceptions and Realities About Who Pays Taxes*, CTR. ON BUDGET & POL'Y PRIORITIES 5–6 (Sept. 17, 2012), <http://www.cbpp.org/files/5-26-11tax.pdf>, archived at <http://perma.cc/0s2GSWdJV8r>.

¹⁴ See Benjamin H. Harris, *Corporate Tax Incidence and Its Implications for Progressivity*, TAX POL'Y CTR. (Nov. 2009), http://www.urban.org/uploadedpdf/1001349_corporate_tax_incidence.pdf, archived at <http://perma.cc/0TsArqM762q>.

¹⁵ See I.R.C. §§ 2001, 2501, 2601 (2012) (codifying the estate tax, gift tax, and generation-skipping transfer tax); *Facts & Figures: How Does Your State Compare?*, TAX FOUND.

The federal estate tax began at a relatively modest level with a maximum tax rate of 10% on estates over \$50,000 (about \$1 million today), before it peaked from 1942 to 1976 at a maximum rate of 77% on estates over \$60,000.¹⁶ From then on, Congress routinely lowered the maximum rate and raised the exemption level, and by 1998, the tax stood at 55% on estates over \$625,000.¹⁷

After that period, though, there began a decade and a half of constant change to the estate tax accompanied by continual debates about whether the tax should exist at all. In 2001, the Economic Growth and Tax Relief Reconciliation Act began an eight-year reduction in the estate tax and generation-skipping tax.¹⁸ Under this law, the estate tax would be repealed completely in 2010, but due to Senate budget rules, the tax would reappear in 2011 at the higher pre-2001 rate of 55%.¹⁹ Even though few people, if anyone, desired a one-year repeal followed by the bounce-back at the higher rate, this scenario actually played out, with congressional inaction on the Bush tax cuts leading to the estate tax's disappearance in 2010. For 2011 and 2012, Congress enacted a temporary two-year patch reviving the tax at a lower rate and higher exemption. This patch was finally made permanent in early 2013.²⁰

Taxing wealth transfers between generations is justified primarily as a mechanism for redistribution. No less a personage than Winston Churchill backed estate taxes as “a certain corrective against the development of a race of idle rich.”²¹ Warren Buffett has argued that “[a] progressive and meaningful estate tax is needed to curb the movement of a democracy toward plutocracy.”²²

On the other side of the debate, critics challenge whether an estate tax achieves that goal. Tax avoidance is an obvious problem. Buffett, for example, intends to shield his fortune from estate tax by giving it to the Gates

tbl.34–35 (2013), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/ff2013.pdf>, archived at <http://perma.cc/0bnjbZiR6VdI>.

¹⁶ See Patrick Fleenor, Gerald Prante, & Andrew Chamberlain, *Special Report No. 142: Death and Taxes: The Economics of the Federal Estate Tax*, TAX FOUND. 4 (June 2, 2006), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr142.pdf>, archived at <http://perma.cc/0rCfoLRZ3bV>.

¹⁷ See *id.*

¹⁸ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (codified as amended in scattered sections of 26 U.S.C.).

¹⁹ See *The Fiscal Cliff: A Primer*, TAX FOUND. 1–5 (Nov. 13, 2012), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr204.pdf>, archived at <http://perma.cc/0tc97gf7TPs>.

²⁰ Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296 (codified as amended in scattered sections of 26 U.S.C.); American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (Jan. 2, 2013) (codified as amended in scattered sections 2, 7, 16, 26, 42, 45, 46 U.S.C.A.).

²¹ See *The Case for Death Duties*, THE ECONOMIST (Oct. 25, 2007), <http://www.economist.com/node/10024733>, archived at <http://perma.cc/02tYktKRYas>.

²² See Alex Crippen, *Buffett Joins Call for ‘Strong’ Estate Tax*, CNBC (Dec. 11, 2012), <http://www.cnbc.com/id/100301732>, archived at <http://perma.cc/0YFIKXSXqH5G>.

Foundation.²³ Critics also argue that the estate tax imposes enormous compliance and deadweight losses on the economy. As Tax Foundation economist Scott Drenkard summarizes:

Nobel laureate economist Joseph Stiglitz. . . argued that the estate tax actually increases inequality by reducing savings and driving up returns on capital (which largely benefit wealthy holders of capital).

Economist Larry Summers, former Treasury Secretary under President Clinton, co-authored a paper in 1981 that showed that the estate tax has severe impacts on the accumulation of privately held capital. Using Summers' methodology, a July 2012 study by the Joint Economic Committee Republicans showed that since its inception, the estate tax has reduced the capital stock by approximately \$1.1 trillion.

. . . .

Perhaps the worst aspect of the estate tax is how uneven its impact is in practice. By utilizing careful estate planning, many wealthy taxpayers are able to shield much of their income from taxation upon their death. The people that tend to get hit the hardest are those that die unexpectedly, or, like farmers, have their assets tied up in illiquid holdings.

The estate planning industry has grown in size over the years as estate law becomes more complex. Three studies have even found that the compliance costs associated with the collection of the estate tax are actually higher than the amount of revenue the tax brings in!²⁴

Ultimately, though, despite mounting evidence of these efficiency costs, the estate tax debate has remained mired in disputed notions of fairness. Opponents of the tax believe that wealthy people who earned their money should be able to dispose of it as they wish, including by leaving it in full for their heirs. The tax's defenders believe that in the interest of discouraging intergenerational accumulation of wealth and achieving wealth transfers from the rich to others, part of these estates should be taxed away. Because the advocates of each position have largely maintained their ideological commitments, the two sides have not meaningfully converged towards a consensus on fairness. Only after years of futile political battles did compromise finally occur when neither could gain the upper hand, but most

²³ See, e.g., James Freeman, *Will Buffett Avoid the Buffett Rule?*, WALL ST. J. (Jan. 29, 2012), <http://online.wsj.com/article/SB10001424052970204661604577187414062083978.html>, archived at <http://perma.cc/02MUqNAiybi>.

²⁴ Scott Drenkard, *Why Progressives Should Want to End the Estate Tax, Too*, HUFFINGTON POST (Sept. 13, 2012), http://www.huffingtonpost.com/scott-drenkard/estate-tax-repeal_b_1882227.html, archived at <http://perma.cc/0JZsriHn8YG>.

likely due more to exhaustion with the fight than with a true desire for coordination.²⁵

C. Bush Tax Cuts

In light of a projected federal surplus at the time of nearly \$1 trillion, George W. Bush campaigned for the presidency on a promise to return the money to taxpayers in the form of sweeping tax cuts.²⁶ Bush presented his proposal as a way to “starve the beast” by taking excess money out of government coffers in order to prevent future spending.²⁷ Additionally, the tax cuts were justified as an insurance policy against an economic slowdown.²⁸ Commentators countered that the tax cuts would use nearly the entire surplus in only five years and would primarily benefit wealthier taxpayers.²⁹

The Bush tax cuts refer to a series of temporary tax relief measures enacted in 2001 and 2003.³⁰ The cuts lowered all federal income tax rates (with the top rate falling from 39.6% to 35%), reduced the marriage penalty, provided for the gradual elimination of the estate tax, lowered the tax rate on dividend income, lowered the tax rates on capital gains, increased the child tax credit from \$500 to \$1000 per child, eliminated the phase-out on personal exemptions for higher income individuals, and eliminated the phase-out on itemized deductions.³¹ These sweeping changes were projected to reduce federal revenues by approximately \$150 billion per year.³²

There has been spirited debate across the political spectrum over the impacts of the Bush tax cuts. Specifically, this debate has centered on distribution and whether higher-income Americans disproportionately benefited. The Bush tax cuts were a centerpiece of the 2012 presidential election. President Barack Obama campaigned on a pledge to let the tax cuts expire for households with income over \$250,000.³³ Presidential candidate Mitt Rom-

²⁵ See text accompanying *supra* notes 18–20.

²⁶ See John W. Lee III, *Class Warfare 1988–2005 Over Top Individual Income Tax Rates: Teeter-Totter from Soak-the-Rich to Robin-Hood-in-Reverse*, 2 HASTINGS BUS. L.J. 47, 83, 156–157 (2006).

²⁷ *Id.*

²⁸ *Id.* at 83.

²⁹ *Id.* at 84–85.

³⁰ Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107–16, 115 Stat. 38 (codified as amended in scattered sections of 26 and 29 U.S.C.); Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108–27, 117 Stat. 752 (codified as amended in scattered sections of 26, 42, and 46 U.S.C.).

³¹ MARGOT L. CRANDALL-HOLLICK, CONG. RESEARCH SERV., R42485, AN OVERVIEW OF TAX PROVISIONS EXPIRING IN 2012 2–3, 8–11 (2012), available at <http://www.fas.org/sgp/crs/misc/R42485.pdf>, archived at <http://perma.cc/0qUYUVrkrbR>.

³² See D. Mark Wilson & William W. Beach, *The Economic Impact of President Bush's Tax Relief Plan*, HERITAGE FOUND. (Apr. 27, 2001), <http://origin.heritage.org/research/reports/2001/04/the-economic-impact-of-president-bushs-tax-relief-plan>, archived at <http://perma.cc/0t83XTtmxBK>.

³³ Mark Trumbull, *Obama vs. Romney 101: 5 Ways They Differ on Taxes*, CHRISTIAN SCI. MONITOR, (Sept. 4, 2012, 10:40 AM), <http://www.csmonitor.com/USA/DC-Decoder/2012/>

ney, on the other hand, ran, in part, on a campaign promise to extend the tax cuts for all Americans.³⁴

Academics and policy analysts also disagree over the distributive consequences of the Bush tax cuts, specifically whether the cuts benefitted high-income earners more than other taxpayers. One defender of the tax cuts, the Heritage Foundation, reported that between 2000 and 2004, the share of total income taxes paid by the top 20% of tax filers increased from 81.2% to 85.3% and increased slightly for the second-highest 20% of taxpayers from 13.5% to 13.8%.³⁵ At the same time, the shares of total income taxes paid by the middle 20%, the second-lowest 20%, and the bottom 20% all decreased.³⁶ Heritage concedes that the wealthy received a larger tax break in total dollar terms but contends that this is only because 40% of Americans already pay little or no income taxes.³⁷ Heritage argues that even though lower income Americans pay almost no income taxes, they still benefited from the Bush tax cuts because many received a tax refund.³⁸

Among those critical of the Bush tax cuts, the Center on Budget and Policy Priorities (“CBPP”) argues that the wealthy benefited more than lower income Americans both in terms of the total share of the tax cuts received and in the percentage increase in after-tax income.³⁹ CBPP reports that the top 1% of earners received 24.2% of the total share of the tax cuts, compared with 8.9% for the middle 20% of taxpayers.⁴⁰ In addition, CBPP reports that the top 1% of earners increased their after-tax income by 5.3%, compared to 2.3% for the middle 20% of taxpayers, as a result of the tax cuts.⁴¹ In the same report CBPP argues that the top 1% of the income spectrum earned an average tax cut of \$34,992 in 2004 versus an average tax cut of just \$647 for the middle 20% of taxpayers.⁴²

After President Barack Obama’s re-election, there was a dramatic stalemate with Congress over the looming expiration of the Bush tax cuts in December 2012.⁴³ The two sides were entrenched: President Obama and his supporters favored extension of the tax cuts for all except those earning over \$250,000 and Republicans favored extension of the cuts for all income levels. Again, neither could gain the advantage, and at the last minute, com-

0904/Obama-vs.-Romney-101-5-ways-they-differ-on-taxes/Bush-era-tax-cuts, archived at <http://perma.cc/0Y06SsL4HYw>.

³⁴ *Id.*

³⁵ Brian M. Riedl, *Ten Myths about the Bush Tax Cuts*, HERITAGE FOUND. (Jan. 29, 2007), <http://www.heritage.org/research/reports/2007/01/ten-myths-about-the-bush-tax-cuts>, archived at <http://perma.cc/0yU6LFQm75t>.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ Isaac Shapiro & Joel Friedman, *Tax Returns: A Comprehensive Assessment of the Bush Administration Tax Cuts*, CTR. ON BUDGET & POL’Y PRIORITIES, at vii–viii (Apr. 2004), <http://www.cbpp.org/files/4-23-04tax.pdf>, archived at <http://perma.cc/0VQQU8ppNLz>.

⁴⁰ *Id.* at viii.

⁴¹ *Id.*

⁴² *Id.*

⁴³ See *The Fiscal Cliff: A Primer*, *supra* note 19, at 1–2.

promise was reached: Congress extended the Bush tax cuts for incomes up to \$400,000 for individuals and \$450,000 for married couples filing jointly.⁴⁴ For income above that level, the Bush tax cuts expired, raising the top rate from 35% to 39.6%.⁴⁵ In addition, the capital gains and dividend tax rates for those incomes increased from 15% to 20%.⁴⁶ Congress also kept the expanded provisions of the child tax credit.⁴⁷ Once again, the impasse over redistribution generated outsized political costs for all sides over the course of a long-running, back-and-forth legislative struggle, and, though some solution was ultimately reached, there is no guarantee that the same political battles will not be refought by different parties over the same ground.

D. Alternative Minimum Tax

The Alternative Minimum Tax (“AMT”) exists due to outrage that some rich taxpayers escape taxation under the regular income tax. Congress enacted the AMT in 1969 following testimony by the Secretary of the Treasury that 155 people with adjusted gross income above \$200,000 had paid zero federal income tax on their 1967 tax returns.⁴⁸ In inflation-adjusted terms, those 1967 incomes would be over \$1.2 million in today’s dollars.⁴⁹ This tax avoidance by a few high-income taxpayers (primarily through investing in tax-exempt bonds) was widely perceived as unfair.⁵⁰

But rather than directly addressing the problem by eliminating the deductions and credits in the tax code that were leading to the tax avoidance, Congress laid an additional layer of complexity over the regular income tax in the form of the AMT. A full explanation of the AMT is not necessary here, but, in brief, a taxpayer determines her normal tax liability and that under the AMT and then pays the greater of the two.⁵¹ About four million taxpayers must currently pay the AMT.⁵² Expansion of the tax is a threat

⁴⁴ Joseph Henchman, *Details of the Fiscal Cliff Tax Deal*, TAX FOUND. (Jan. 1, 2013), <http://taxfoundation.org/blog/details-fiscal-cliff-tax-deal>, archived at <http://perma.cc/0Ym2XZVgLSi>.

⁴⁵ Jessica Yellin, Dana Bash & Jeanne Sahadi, *Fiscal Cliff Deal Stops Many Tax Hikes, But Leaves Big Issues Pending*, CNN MONEY, (Jan. 2, 2013, 10:53 AM) <http://money.cnn.com/2013/01/01/news/economy/fiscal-cliff-senate-bill/index.html>, archived at <http://perma.cc/0m9oEJSng6b>.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ Patrick Fleener & Andrew Chamberlain, *Fiscal Fact No. 26: Backgrounder on the Individual Alternative Minimum Tax*, TAX FOUND. (May 24, 2005), <http://taxfoundation.org/article/backgrounder-individual-alternative-minimum-tax-amt>, archived at <http://perma.cc/0QTfsAYQBss>.

⁴⁹ See CPI Inflation Calculator, *supra* note 4.

⁵⁰ Fleener & Chamberlain, *supra* note 48.

⁵¹ *Id.*

⁵² See Letter from Steven T. Miller, Acting Internal Revenue Serv. Comm’r to Senator Orrin Hatch 1 (Nov. 13, 2012), available at www.finance.senate.gov/newsroom/ranking/download/?id=a7afb471-8370-4fe3-bdb1-6c0e3fafd294&ei=cUJIUuyhDrbH4APLm4HYDw&usg=AFQjCNH9IuoAWrV9ww0p3yAqRttLg6_hMg&sig2=a_ENaQ5g5XjO2e0nl4_oQg&bvmbv.53217764.d.dmg, archived at <http://perma.cc/0KaPMYxCs5V>.

primarily because, unlike the regular income tax, the AMT's parameters are not indexed for inflation. That means that, over time, economic growth and inflation cause a steady increase in the number of taxpayers drawn into the AMT. As nominal incomes rise along with inflation, the AMT's standard deduction shrinks in relative terms, affecting more middle-income taxpayers. According to Congressional Budget Office estimates, taxpayers earning between \$50,000 and \$500,000 will be hardest hit by the expanding reach of the AMT, especially those living in expensive areas with high per-capita incomes and high state and local taxes.⁵³ Congress has routinely "patched" the AMT to protect another twenty million taxpayers from this sudden jump in tax liability.⁵⁴

The 2001 and 2003 income tax cuts in particular threatened to increase AMT liability dramatically because many upper-income people (roughly those with between \$150,000 and \$1 million in income) would be swept into the AMT by, of all things, a tax cut.⁵⁵ The AMT thus essentially nullified some of the Bush tax cuts, pitting federal tax policy against itself and adding only unnecessary complexity.

The AMT jumbles usual partisan expectations. Democrats were among the strongest supporters of patching the AMT, even though the patch would mean lower taxes for many rich Americans. This is likely because the AMT is primarily paid by high-income earners who pay high state and local taxes and rely on income from government bond interest.⁵⁶ Such individuals are heavily concentrated in "blue" states: New Jersey (6.4% of taxpayers paying the AMT), Connecticut (5.6%), the District of Columbia (5.4%), New York (5.3%), Maryland (4.9%), Massachusetts (4.7%), California (4.5%), Virginia (3.7%), Minnesota (3.0%), Illinois (2.8%), Rhode Island (2.8%), and Pennsylvania (2.6%).⁵⁷ Almost 50% of AMT revenue comes from taxpayers in California, Massachusetts, New Jersey, and New York.⁵⁸ The AMT spares "red" states because most are not high-wealth or high-population, and neither of the two "red" states with these characteristics (Florida and Texas) have state income tax.

⁵³ See *The Individual Alternative Minimum Tax: Hearing Before the S. Comm. on Taxation and I.R.S. Oversight*, 109th Cong. 4, 6 (2005) (statement of Douglas Holtz-Eakin, Dir. of Cong. Budget Office), available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/63xx/doc6370/05-23-amt-testimony.pdf>, archived at <http://perma.cc/06DPtMsKfEY>.

⁵⁴ See *id.*

⁵⁵ See *id.* at 1–2.

⁵⁶ See IRS TAXPAYER ADVOCATE SERV., 2012 ANNUAL REPORT TO CONGRESS 27 (2012), available at <http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Most-Serious-Problems-Alternative-Minimum-Tax.pdf>, archived at <http://perma.cc/0whhYUYKAwB>.

⁵⁷ See William McBride & Ed Gerrish, *Fiscal Fact No. 325: How States Would Be Affected by Extension of the Bush Tax Cuts and Other Provisions*, TAX FOUND. (Aug. 1, 2012), <http://taxfoundation.org/article/how-states-would-be-affected-extension-bush-tax-cuts-and-other-provisions>, archived at <http://perma.cc/04aVLwtDXov>.

⁵⁸ Veronique de Rugy, *The Facts About the Alternative Minimum Tax*, REASON FOUND. (June 10, 2011), <http://reason.org/news/show/the-facts-about-the-alternative-min>, archived at <http://perma.cc/0qW4KWuhabU>.

So while Democrats strongly support taxing the rich, many Democrats oppose this tax on the rich for effectively targeting their own constituents. But this has produced some odd policy consequences. For example, Rep. Charles Rangel (D-NY) proposed repealing the AMT and replacing it with an income tax surcharge on high-income earners,⁵⁹ and other Democrats have proposed repeal bills as well.⁶⁰ Because of some technical quirks of the AMT, the revenue-neutral Rangel bill would have spread the tax liability from 4 million people in primarily blue states to many more people across the country.⁶¹ On the other side, Republicans and their supporters who generally criticize targeting tax burdens on the rich are not always as vocal about the AMT since they view it as a tax on liberal states.⁶²

The AMT quite possibly holds the distinction of achieving the least redistributive benefit at the greatest cost of political attention and effort. Until 2013, Congress resisted a permanent “patch” to the AMT because congressional budget rules would score it as a large tax reduction, running afoul of budget-neutrality requirements.⁶³ This, of course, meant that Congress had to take up the details of the AMT each year. In 2010, for example, Congress set an exemption level of \$48,450 (\$74,450 for couples) for calendar year 2011, preventing the automatic fall of the exemption level for 2011 to just \$33,750 (\$45,000 for couples).⁶⁴ As it became apparent that the general fiscal cliff agreement in late 2012 would extend many tax cuts and ignore congressional budget rules, Democrats successfully made sure a permanent AMT patch was a part of the agreement.⁶⁵ Both sides praised this resolution, which keeps the AMT focused on very high income earners concentrated in blue states without a threat of it expanding much beyond that.⁶⁶ But it does not seem comforting that a policy, enacted out of perceived unfairness and later lamented by many of the most ardent proponents of redistribution, could only be finally “fixed” under threat of a serious crisis. The

⁵⁹ See Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong. (2007).

⁶⁰ See, e.g., Individual AMT Repeal Act of 2007, H.R. 1366, 110th Cong. (2007).

⁶¹ See, e.g., Gerald Prante, *Fiscal Fact No. 94: Questions and Answers on the Alternative Minimum Tax*, TAX FOUND. (July 21, 2007), <http://taxfoundation.org/article/questions-and-answers-alternative-minimum-tax>, archived at <http://perma.cc/08RRtip31Gc>.

⁶² See, e.g., Daniel Gross, *Bush's Secret Tax on Democrats*, SLATE (Apr. 13, 2004), http://beta.slate.com/articles/business/moneybox/2004/04/bushs_secret_tax_on_democrats.html, archived at <http://perma.cc/0ATawfKBEe3> (“Most of the victims of the AMT live in places where Bush and many Republicans can’t compete.”).

⁶³ See, e.g., Gerald Prante, *supra* note 61 (“First, unless the new [budget] rules are waived by the Congress or spending is cut dramatically, the repeal must be ‘paid for,’ i.e., taxes must be raised elsewhere to offset the AMT relief.”).

⁶⁴ See Nick Kasprak, *2012 Likely to Be First Year Without an AMT Patch*, TAX FOUND. (Dec. 28, 2012), <http://taxfoundation.org/blog/2012-likely-be-first-year-without-amt-patch>, archived at <http://perma.cc/0GvTdfgii9v>.

⁶⁵ American Taxpayer Relief Act of 2012, Pub. L. No. 112–240, sec. 104, § 55(d), 126 Stat. 2313 (2013) (codified as amended in 26 U.S.C.).

⁶⁶ See, e.g., Kim Dixon & Patrick Temple-West, *Republicans See Some Leverage in Fiscal Cliff Talks*, REUTERS, Dec. 4, 2012, available at <http://www.reuters.com/article/2012/12/04/us-usa-fiscal-amt-idUSBRE8B311O20121204>, archived at <http://perma.cc/0tc63Foz16x/>.

tricky details of implementing such a sweeping policy ultimately swallowed the redistributive intuition behind it.

E. Buffett Rule

Similar to the AMT, the so-called “Buffett Rule” is pushed by advocates of tax redistribution as a way of ensuring all rich taxpayers pay a fair share of their income in tax. As outlined in President Obama’s 2014 budget proposal, the rule would ensure that high-income households pay at least 30% of their income in taxes.⁶⁷ The rule would be phased in for income over \$1 million to \$2 million and would apply fully to income above that.⁶⁸ The rule would also be indexed to inflation.⁶⁹

Proponents of the Buffett Rule argue that as a matter of fairness, lower and middle-income individuals should not pay a higher percentage of their income in federal taxes than high-income individuals.⁷⁰ This view is inspired by Warren Buffett, CEO of Berkshire Hathaway, who famously complained that it was unfair that he pays a lower percentage of his income in federal taxes than his secretary.⁷¹ Much of Buffett’s income is dividend income, which is taxed at both the corporate and the shareholder level.⁷²

This claim of unfairness, of course, has failed to persuade large segments of the population. Republican opponents criticize Buffett’s proposal as another punitive tax on the rich, with Congressman Paul Ryan (R-WI) lambasting the proposal as “class warfare” that would harm job creation and investment.⁷³ House Speaker John Boehner (R-OH) argued that capital gains are taxed at lower rates in order to spur investment and to allow for the quick movement of capital, which would be harmed if the Buffett Rule were

⁶⁷ Braden Goyette, *What Is the Buffett Rule? Obama’s Proposal to Create a Minimum Tax for Millionaires, Explained*, N.Y. DAILY NEWS (Apr. 11, 2012), <http://www.nydailynews.com/news/politics/buffett-rule-obama-proposal-create-minimum-tax-millionaires-explained-article-1.1059672>, archived at <http://www.perma.cc/ODCb6fc4sFE>.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ See *The Buffett Rule Explained*, THE WHITE HOUSE, <http://www.whitehouse.gov/economy/buffett-rule> (last visited Oct. 10, 2013), archived at <http://www.perma.cc/0vTCc4Bkj7K>.

⁷¹ See Warren E. Buffett, *Stop Coddling the Super-Rich*, N.Y. TIMES, Aug. 15, 2011, at A21, available at <http://www.nytimes.com/2011/08/15/opinion/stop-coddling-the-super-rich.html>, archived at <http://www.perma.cc/0w1HsBp5m8L>.

⁷² See, e.g., Leonard E. Burman, *The Buffett Rule: Right Goal, Wrong Tool*, N.Y. TIMES (Apr. 16, 2012), http://www.nytimes.com/2012/04/16/opinion/the-buffett-rule-right-goal-wrong-tool.html?_r=0, archived at <http://www.perma.cc/03W6at8GC5p> (“The tax is sometimes called the Buffett Rule, after the billionaire investor Warren E. Buffett, who pointed out that he pays a lower tax rate than his secretary because most of his income comes from lightly taxed capital gains and dividends.”).

⁷³ *Republicans Accuse Obama of Waging ‘Class Warfare’ with Millionaire Tax Plan*, FOX NEWS (Sept. 18, 2011), <http://www.foxnews.com/politics/2011/09/18/rep-ryan-accuses-obama-waging-class-warfare-with-millionaire-tax-plan/>, archived at <http://www.perma.cc/0Bzw9UHr3Q1>.

passed.⁷⁴ Interestingly, if the details of the rule, including the 30% tax rate, were more widely known, there might be even greater opposition: poll respondents' average response to the question "What is the maximum percentage of a person's income that should go to taxes—all taxes, state, federal, and local?" hovers around 15%.⁷⁵

Moreover, the policy does not seem particularly effective at achieving its own goals. According to a Congressional Research Service study, the Buffett Rule would affect only about 94,500 millionaires (approximately one in four) who pay a lower federal tax rate than taxpayers who earn less than \$100,000.⁷⁶ Thus, similar to the AMT, while there are some who take advantage of available tax credits and deductions to reduce their tax bill, the vast majority of high-income people already pay over 30% of their income in taxes. If enacted, the Buffett Rule would raise about \$47 billion over ten years,⁷⁷ a sum that seems relatively modest as far as federal revenues go.

So why does the rule attract support despite these problems? Simply put, the Buffett Rule allows politicians to tap intuitions of fairness for their own gain without having to proffer extensive policy justifications. As columnist Dana Milbank explains:

Obama argued that his plan [will] make sure that those earning north of \$1 million a year don't pay a lower tax rate than average Americans Obama[] claim[s] that the Buffett Rule "is something that will get us moving in the right direction toward fairness"

. . . .

The populist Buffett Rule polls well. This explains its inclusion in countless presidential speeches and statements. White House reporters, tiring of the theme, have proposed a Jimmy Buffett Rule (three-drink minimum) and a Buffet Rule (Newt Gingrich would be an obvious candidate).

The politics of the Buffett Rule—it has no chance of passing when the Senate takes it up next week—are so overt that Obama's remarks Wednesday were virtually indistinguishable from a section of his campaign speech⁷⁸

⁷⁴ See Leigh Ann Caldwell, *Obama Details "Buffett Rule," Says Millionaires Should Pay at Least 30 Percent Tax Rate*, CBS NEWS (Jan. 25, 2012), http://www.cbsnews.com/8301-503544_162-57365416-503544/obama-details-buffett-rule-says-millionaires-should-pay-at-least-30-percent-tax-rate/, archived at <http://www.perma.cc/0BjA13zpaMf>.

⁷⁵ Moon, *supra* note 5, at 11.

⁷⁶ See THOMAS L. HUNGERFORD, CONG. RESEARCH SERV., R42043, AN ANALYSIS OF THE "BUFFETT RULE" (2012), available at <http://www.fas.org/sgp/crs/misc/R42043.pdf>, archived at <http://www.perma.cc/0ptxzZtcSeg>.

⁷⁷ See Goyette, *supra* note 67.

⁷⁸ Dana Milbank, *Rebuffing Obama's Gimmicky 'Buffett Rule,'* WASH. POST, Apr. 11, 2012, at A02, available at http://www.washingtonpost.com/opinions/rebuffing-obamas-buffett-rule/2012/04/11/g1QA7m4HBT_story.html, archived at <http://www.perma.cc/0KFMTHaHWxP>.

F. State Millionaire Taxes

State tax policy has historically been more about revenue generation than affecting distribution, but recent policy initiatives have increasingly taken on a distributive tone. The most significant examples of these initiatives are the “millionaires’ taxes” on high-income earners. During the 2008 to 2009 period, ten states enacted higher income tax on individuals with large incomes.⁷⁹ Although these have been dubbed “millionaires’ taxes” because the first proposals were triggered at \$500,000 or \$1 million of income, more recent proposals begin at substantially lower income levels: for instance, \$125,000 (Oregon) or even \$60,000 (Delaware).⁸⁰ In some respects, these taxes resemble state-level variations of the Buffett Rule, with all of its motivations and potential problems, but to understand the distinct import of these new taxes, one first needs to understand their historical context.

While the federal tax system is steeply progressive, state and local tax systems are much flatter. State and local taxes have historically focused more on revenue generation and stability, and less on tax-side redistribution. The Institute on Taxation and Economic Policy, for example, estimates that the lowest quintile of earners pay an average of 11.1% of their income in state and local taxes, the middle quintile pay 9.8%, and the top quintile an average of 8.7%.⁸¹

State and local taxes are flatter in part due to a reliance on a broader mix of taxes. State and local governments collect individual income taxes (\$260 billion), property taxes (\$442 billion), sales taxes (\$285 billion), excise taxes (\$168 billion), and user fees (\$410 billion).⁸² Income taxes are progressive in nature, while sales taxes can be regressive. The distributional impact of property taxes and business taxes is not always clear and often depends on whether the economic burden of the tax falls on the person who pays it (property owner or business owner) or is passed on to subsequent people (renters, customers, etc.). Polls on tax fairness have found people rate taxes that they pay (property taxes, gasoline taxes) as “unfair” and taxes that others pay (cigarette taxes, corporate taxes) as “fair.”⁸³ When states face

⁷⁹ See Joseph Henchman, *Fiscal Fact No. 313: Trend 1: Millionaires’ Taxes*, TAX FOUND. (June 15, 2012), <http://taxfoundation.org/article/trend-1-millionaires-taxes>, archived at <http://perma.cc/0bcKPfZr5A6>.

⁸⁰ See *id.*

⁸¹ *Who Pays? A Distributional Analysis of the Tax Systems in All 50 States? 4th Edition*, INSTITUTE ON TAXATION & ECONOMIC POLICY 3 (Jan. 2013), <http://www.itep.org/pdf/whopays-report.pdf>. Note that these figures subtract the “federal offset,” the ability of taxpayers to deduct certain state and local taxes from their federal income tax, which the Institute on Taxation & Economic Policy includes but is a feature of the federal tax code, not state and local tax codes.

⁸² See Elizabeth Malm & Ellen Kant, *Sources of State and Local Tax Revenues*, TAX FOUND. (Jan. 28, 2013), <http://taxfoundation.org/article/sources-state-and-local-tax-revenues>, archived at <http://perma.cc/0ww1XCC6kS8>.

⁸³ Matt Moon, *Special Report No. 166: How Do Americans Feel About Taxes Today?* TAX FOUND. 13 (Apr. 8, 2009), <http://taxfoundation.org/article/how-do-americans-feel-about-taxes->

budget shortfalls, they tend to turn first to a toolbox of “accounting tricks” to increase revenue. These “tricks” include moving payments into the next fiscal year, moving revenue up into this fiscal year by changing tax withholding or holding tax amnesties, delaying bill payments, banning employee travel, and furloughing employees.⁸⁴ Only after these methods prove inadequate do states generally turn to taxes, and then only popular taxes like cigarette excise taxes or user fees.⁸⁵ Only as a last resort do states turn to sales tax increases and then, finally, income tax increases.⁸⁶

The 2008–09 recession upset the usual pattern, with some states willing to raise income taxes, or at least income taxes designed to affect only a small subset of high-income earners.⁸⁷ The income level at which the new top rate applies often represented a sharp jump from where the top rate previously began. As this unprecedented wave of high-earner taxes progressed, the dollar threshold at which these new rates applied fell lower and lower.

- New York in 2003–05 created two new top tax brackets, with a top rate of 7.7% on income over \$500,000. For 2009–11, New York added back the top brackets, with a higher top rate of 8.97% on income over \$500,000. Slightly lower rates were adopted in 2011.⁸⁸
- New Jersey in 2004 adopted an 8.97% top rate on income over \$1 million. This rate was boosted for 2009 only to 10.75%.⁸⁹
- California in 2004 created a 10.3% top rate on income over \$1 million. This top rate was increased to 10.55% in 2009 and to 13.3% in 2013.⁹⁰
- Maryland in 2008–10 had a 6.25% top rate on income over \$1 million.⁹¹
- Connecticut in 2009 added a top rate of 6.5% on income over \$500,000, and increased it further in 2011 to a top rate of 6.7% on income over \$250,000.⁹²
- Delaware in 2009 added a top rate of 6.95% on income over \$60,000, which was reduced to 6.75% in 2011.⁹³

today-tax-foundations-2009-survey-us-attitudes-taxes-government, *archived at* <http://perma.cc/0Eud17ABZzo>.

⁸⁴ See Joseph Henchman, *Special Report No. 164: State Budget Shortfalls Present a Tax Reform Opportunity*, TAX FOUND. 5, 10 (Feb. 2009), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr164.pdf>, *archived at* <http://perma.cc/0ykwrSGcZZr>.

⁸⁵ *Id.* at 6.

⁸⁶ *Id.* at 6–7.

⁸⁷ See Henchman, *Fiscal Fact No. 313: Trend 1: Millionaires’ Taxes*, *supra* note 79.

⁸⁸ *Id.* at 2.

⁸⁹ *Id.* at 2–3.

⁹⁰ *Id.* at 2.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

- Hawaii added three top brackets for 2009–15, including a tax rate of 11% on income over \$200,000.⁹⁴
- Maine added a top rate of 6.85% on income over \$250,000, although this was repealed by voters.⁹⁵
- North Carolina in 2009 adopted a two-year surtax of 2% on income over \$60,000 (\$100,000 for couples), and 3% on income over \$150,000 (\$250,000 for couples).⁹⁶
- Oregon voters in 2009 approved a three-year 11% top tax rate on income over \$250,000, followed by a permanent 9.9% top rate on income over \$125,000.⁹⁷
- Wisconsin added a top rate of 7.75% on income over \$225,000.⁹⁸

The trend ended for the most part after Washington voters rejected a millionaire's tax (or, at least, a high-earner's tax) in 2010.⁹⁹ The Washington ballot initiative "would have imposed a tax of 5% on income over \$200,000 and 9% on income over \$500,000, affecting just 1.2% of the population."¹⁰⁰ The initiative's advocates pointed to the state's relatively regressive income tax structure as a problem necessitating the tax, but the putative benefits apparently could not convince voters to undermine one of the state's key competitive advantages.¹⁰¹

To the extent that these new taxes help states fill budgetary gaps over the short-term, they have at least a more plausible non-redistributive justification than the Buffett Rule. However, these taxes have a clear redistributive goal in addition to revenue, and, as state coffers begin to recover after the recession,¹⁰² these taxes may well outlive their usefulness, in part because they inevitably function as covert business taxes (which can produce distinct redistributive consequences through their effect on job-creation) and in part because in many states they have taken the progressivity of the tax code from high to extreme.¹⁰³ Unsurprisingly, some state governments and constituencies beyond Washington have started to balk at these taxes for fear of

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ See Joseph Henchman, *Special Report No. 186: Washington Voters to Consider High-Earner Income Tax*, TAX FOUND. 1 (Oct. 26, 2010), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/sr186.pdf>, archived at <http://perma.cc/0jGqimYWzVe>.

¹⁰⁰ Henchman, *Fiscal Fact No. 313: Trend 1: Millionaires' Taxes*, *supra* note 79, at 3.

¹⁰¹ *Id.*

¹⁰² See Jake Grovum, *State Tax Collections Continue Rebound*, PEW CHARITABLE TRUSTS (Sept. 24, 2013), <http://www.pewstates.org/research/analysis/state-tax-collections-continue-rebound-85899507114>, archived at <http://perma.cc/09iSo3voQ63>.

¹⁰³ See Steven Sloan, *States Are Rejecting Millionaire Taxes*, BUSINESSWEEK (June 9, 2011), http://www.businessweek.com/magazine/content/11_25/b4233035888791.htm, archived at <http://perma.cc/08nU3fNqpva/>.

their collateral consequences.¹⁰⁴ Perhaps most worrying is that the recent use of these taxes will make them the first choice of future policy makers seeking a small fillip to revenue. The very novelty of these taxes means that no one knows for certain whether they will ultimately undermine broader sources of revenue over the medium- or long-term.¹⁰⁵ It may very well be that the redistributive impulse behind these taxes eventually comes into conflict with the revenue justification. This, of course, is a general criticism of redistributive tax policy that is taken up in the next Part.

III. TAXES, MIGRATION, AND ECONOMIC GROWTH

Do taxes matter? To what extent do individuals and businesses make their location, employment, and investment decisions on the basis of national and state taxes? In other words, do progressive tax policies cause long-term economic harm? This Part provides some very high-level analysis of these questions and concludes that, while the exact magnitudes may not be known, the negative consequences on growth are becoming increasingly clear.

There are, of course, extreme opinions at both ends of this debate. Nicholas Johnson and Elizabeth McNichol of CBPP assert that “[e]conometric studies find that the effect of state taxes on economic growth is typically quite small”¹⁰⁶ Their colleague Michael Mazerov claims that “there is just no relationship between state personal income tax levels and the decisions of people in a state to start a business and of would-be entrepreneurs to move to the state.”¹⁰⁷ Another CBPP analyst, Jon Shure, called tax flight—people who flee due to tax increases—“a myth.”¹⁰⁸ Professor Robert Tannenwald more modestly asserts that “[a]lthough tax flight has pinned some revenue losses on high-tax states, those losses have been small compared with revenue gained.”¹⁰⁹

At the other end, some overstate the impact of tax policy. For instance, when analyzing a 2011 Oklahoma proposal to phase out the state income tax, one report gave unprecedentedly (and incredibly) high estimates of the

¹⁰⁴ *Id.*

¹⁰⁵ See Adam Nagourney, *Two-Way Rise Tests Wealthy in California*, N.Y. TIMES, Feb. 7, 2013, at A1 (providing conflicting assessments of tax avoidance and relocation from California’s high-earner tax).

¹⁰⁶ Elizabeth McNichol & Nicholas Johnson, *The Texas Economic Model: Hard for Other States to Follow and Not All It Seems*, CTR. ON BUDGET & POL’Y PRIORITIES 2 (Apr. 3, 2012), <http://www.cbpp.org/files/4-3-12sfp.pdf>, archived at <http://perma.cc/0bJhep8N7BR>.

¹⁰⁷ Michael Mazerov, *Cutting Personal Income Taxes Won’t Help Small Businesses Create Jobs*, 67 STATE TAX NOTES 687 (Mar. 2013).

¹⁰⁸ James B. Stewart, *The Myth of the Rich Who Flee From Taxes*, N.Y. TIMES (Feb. 15, 2013), available at http://www.nytimes.com/2013/02/16/business/high-taxes-are-not-a-prime-reason-for-relocation-studies-say.html?pagewanted=all&_r=0, archived at <http://perma.cc/0AKwnoJsqTP>.

¹⁰⁹ Robert Tannenwald, *Adieu Departieu: The Tax Flight Debate*, 68 STATE TAX NOTES 135 (Apr. 2013).

effects of repeal: doubling the state's GDP growth, creating hundreds of thousands of new jobs, and recapturing 50% of the revenue loss from increased economic growth.¹¹⁰ The study's co-author, economist Art Laffer, is famous for popularizing the eponymous Laffer curve, which theorizes that high income tax rates can have diminishing economic and revenue returns and that consequently the revenue-maximizing income tax rate is somewhere well below 100%. However, this ideal tax rate is difficult to determine, and the Laffer Curve is less applicable to taxes with low elasticity, such as excise taxes—many of which exceed 100% rates—or property taxes.¹¹¹ In the experience of one of the authors, state legislators frequently ask whether any tax cut will recover all of the lost revenue; the author usually gives Milton Friedman's response: "If a tax cut increases government revenues, you haven't cut taxes enough."¹¹²

The real magnitude of tax avoidance and impact on revenue-generating sources is most likely somewhere between the denialist and Laffer camps. Many factors affect individual and business location decisions, including housing prices, location of family and friends, educational opportunities, infrastructure such as airports or ports, the weather, the cost of living, and even area restaurant quality or where family members of the CEO wants to live.¹¹³ But taxes are part of that equation and, indeed, directly or indirectly affect many of those factors. Significant recent examples abound of wealthy people moving due to high taxes, such as golf champions Phil Mickelson and Tiger Woods, actor Gerard Depardieu, and businessman Tom Golisano.¹¹⁴ Migration effects from international tax policy are demonstrably

¹¹⁰ OKLA. COUNCIL OF PUB. AFFAIRS & ARDUIN, LAFFER & MOORE ECONOMETRICS, ELIMINATING THE STATE INCOME TAX IN OKLAHOMA: AN ECONOMIC ASSESSMENT 1 (Nov. 2011), available at http://s3.amazonaws.com/assets.ocpa.com/assets/images/334/original/OCPA_ALME_Income_Tax_FINAL.pdf, archived at <http://perma.cc/09TLwU9WBn8>.

¹¹¹ See Zsolt Besci, *The Shifty Laffer Curve*, FED. RES. BANK OF ATLANTA ECON. REV., Sept. 2000, at 54.

¹¹² Mark Skousen, *Milton Friedman's Last Lunch*, FORBES (Nov. 24, 2006), <http://www.forbes.com/forbes/2006/1211/056a.html>, archived at <http://perma.cc/0G1HRLQNwA7>.

¹¹³ See, e.g., Tannenwald, *supra* note 109 ("Starting in 2007, when the housing bubble burst in Florida, Arizona, and Nevada, net migration into those states fell abruptly."); Eilene Zimmerman, *To Relocate or Not? It's More Than Math*, N.Y. TIMES, Mar. 9, 2013, at BU8, available at <http://www.nytimes.com/2013/03/10/jobs/deciding-to-relocate-involves-more-than-just-the-pay.html>, archived at <http://perma.cc/0kA2pEVgy4H> ("Beyond housing costs, include the stuff of everyday life, like the price of groceries, restaurant meals and gasoline, she says. Find out if the new city has a local income tax in addition to state tax."); Adam Bruns, "Out of the Way" Place May Get Its Own BRAC Boost, SITE SELECTION MAGAZINE, Mar. 2009, available at <http://www.siteselection.com/features/2009/mar/maryland/>, archived at <http://perma.cc/0RSCeawRprx> ("No matter how great the tax structure is, or how much the city or county is willing to give away," she says, "if the CEO's wife thinks it's a dump, that company is probably not going to locate there.").

¹¹⁴ See, e.g., Robert W. Wood, *Tiger Woods Moved Too, Says Mickelson Was Right About Taxes*, FORBES (Jan. 23, 2013), <http://www.forbes.com/sites/robertwood/2013/01/23/tiger-woods-moved-too-says-mickelson-was-right-about-taxes/>, archived at <http://perma.cc/0U8TepEeBsg> ("In fact, Woods went beyond that and confessed that he left California in the mid-nineties in part over the Golden State's high tax rates."); *The Mickelson Vote*, WALL ST. J. (Jan. 22, 2013), <http://online.wsj.com/article/SB1000142412788732394000457825801154148>

large, and migration effects from state tax policy are real enough that states are seeking to crack down on the practice.¹¹⁵

The academic evidence also supports the view that taxes affect economic growth. Tax Foundation economist Dr. William McBride reviewed twenty-six peer-reviewed academic studies on the empirical relationship between taxes and economic growth, with all but three finding a negative effect of taxes on growth.¹¹⁶ McBride further concludes, “Of those studies that distinguish between types of taxes, corporate income taxes are found to be most harmful, followed by personal income taxes, consumption taxes, and property taxes.”¹¹⁷ CBPP subsequently responded, contending that “no . . . consensus exists” in the academic literature but conceding that “some studies by reputable economists . . . find that above-average state and local taxes have a measurable and consistently adverse impact on state economic performance.”¹¹⁸ CBPP’s contention notwithstanding, the consequences of overly redistributive policy seem reasonably clear: tax avoidance, relocation, and lower growth will begin to appear beyond the short-term.¹¹⁹ And higher tax rates will affect decisions about investment, entrepreneurship, and production at the margin, and those effects can have serious implications for growth.¹²⁰ These costs need to be kept in mind when such policies—estate

7142.html, archived at <http://perma.cc/0Dx3d3zU7xL> (“After a brilliant round Sunday at a tournament in La Quinta, California, Mr. Mickelson hinted that new tax burdens might drive him out of the state, out of professional golf, and perhaps even out of the country.”); Joseph Henchman, *Gerard Depardieu Responds to Critics of His Leaving France Due to High Taxes*, TAX FOUND. (Dec. 17, 2012), <http://taxfoundation.org/blog/gerard-depardieu-responds-critics-his-leaving-france-due-high-taxes>, archived at <http://perma.cc/0DuJLKig7xs> (“I leave after paying, in 2012, 85% tax on my income.”); Associated Press, *Rochester billionaire Tom Golisano changes address to Florida to avoid New York taxes*, SYRACUSE.COM (May 15, 2009), http://www.syracuse.com/news/index.ssf/2009/05/rochester_billionaire_tom_goli.html, archived at <http://perma.cc/02TxxqY165q> (“Three-time gubernatorial candidate and billionaire B. Thomas Golisano is changing his home address to Florida to escape New York income taxes he says cost him nearly \$14,000 a day.”).

¹¹⁵ See, e.g., Margaret Collins, *States Crack Down on Top Earners Who Flee as Taxes Rise*, BLOOMBERG NEWS (Mar. 19, 2013), <http://www.bloomberg.com/news/2013-03-13/states-crack-down-on-top-earners-who-flee-as-levies-rise-taxes.html>, archived at <http://perma.cc/0FebFyayu4i>; Henrik Kleven, Camille Landais, & Emmanuel Saez, *Taxation and International Migration of Superstars: Evidence from the European Football Market* 29 (Nat’l Bureau of Econ. Research, Working Paper No. 16545, 2010), available at <http://www.nber.org/papers/w16545>, archived at <http://perma.cc/0B8dUJaxkmv> (“[T]he overall location responses to the net-of-tax rate is positive and large . . .”).

¹¹⁶ William McBride, *Special Report No. 207: What Is the Evidence on Taxes and Growth?*, TAX FOUND. (Dec. 2012), <http://taxfoundation.org/article/what-evidence-taxes-and-growth>, archived at <http://perma.cc/0LuvmUAfe2u>.

¹¹⁷ *Id.*

¹¹⁸ Michael Mazerov, *Academic Research Lacks Consensus on the Impact of State Tax Cuts on Economic Growth: A Reply to the Tax Foundation*, CTR. ON BUDGET AND POL’Y PRIORITIES 10 (June 2013), <http://www.cbpp.org/cms/?fa=view&id=3975>, archived at <http://perma.cc/0i4hybQAbU9>.

¹¹⁹ See, e.g., Mark Robyn & Joseph Henchman, *Fiscal Fact No. 169: The Price of Paradise: Hawaii Becomes Fifth State to Adopt New Income Tax Brackets on High-Earners*, TAX FOUND. 6 (May 12, 2009), <http://taxfoundation.org/sites/taxfoundation.org/files/docs/ff169.pdf>, archived at <http://perma.cc/04hHJzqCnWP>.

¹²⁰ *Id.*

taxes, higher federal income taxes, patching the AMT, and state millionaires taxes—are considered.

IV. MEANINGFULLY MEASURING FAIRNESS

Whatever the political and economic consequences of redistributive taxation, any justification of such policies should surely demonstrate that they effectively address their motivating intuition that something is inherently unfair about the preexisting distribution of wealth. This Part argues, however, that the dominant method of measuring tax fairness is deeply flawed and prevents a clear picture of just how successful redistribution is on its own terms.

The accepted measure of tax fairness is the tax distribution table, a snapshot of income distributions at a particular moment in time. Congress and commentators rely on these tax distribution tables to assess how a particular tax policy change will affect individuals in different income groups.¹²¹ As a snapshot, these tables may not accurately portray changes in income levels over time or how a tax change affects individuals over time. This would not be a major problem as long as the tables acknowledged what is not being shown in their findings, but without those acknowledgements, distribution tables can lead policymakers to draw inaccurate conclusions from the data.¹²²

For instance, the Joint Economic Committee (“JEC”) found that tax distribution tables ignore the decreasing share of federal income taxes paid by the bottom 50% of taxpayers and the increasing share of taxes paid by the top 1%. Since 1980, the share of federal income taxes paid by the bottom 50% fell from 7.1% to 2.4%.¹²³ At the same time, the share paid by the top 1% almost doubled from 19.1% to 37.4%.¹²⁴ In addition, 41% of all filers for 2010 had zero or negative tax liability.¹²⁵ If non-filers are included, then slightly more than one-half of all tax units had zero or negative tax liability.¹²⁶ This can make the use of average tax liability in distribution tables misleading because of the large number of outliers at both ends of the income spectrum skewing the data. According to the JEC, this means that the median would be a more accurate snapshot of tax liability.¹²⁷

The study also notes that tax distribution tables also do not take into account the mobility of taxpayers over time. For example, nearly 60% of

¹²¹ Jason J. Fitchner, *A Comparison of Tax Distribution Tables: How Missing or Incomplete Information Distorts Perspectives*, HERITAGE FOUND. (Nov. 9, 2004), <http://www.heritage.org/research/reports/2004/11/a-comparison-of-tax-distribution-tables-how-missing-or-incomplete-information-distorts-perspectives>, archived at <http://perma.cc/0BamYECandm>.

¹²² *Id.*

¹²³ JOINT ECON. COMM. REPUBLICAN, *HOW TAX DISTRIBUTION TABLES MISLEAD* 3 (2013).

¹²⁴ *Id.*

¹²⁵ *Id.* at 6.

¹²⁶ *Id.* at 5.

¹²⁷ *Id.*

taxpayers in the lowest income quintile in 1999 moved to a higher quintile by 2007.¹²⁸ At the same time, almost 40% of tax payers in the highest income quintile moved to a lower quintile over the same time period.¹²⁹ The JEC study argues that a more dynamic analysis is needed; this approach would show the effects that a proposed tax change would have on taxpayer mobility over time based on changes in economic opportunity, as well as mobility expected to occur due to factors like age, marital status, and work experience.¹³⁰

The JEC study also criticizes tax distribution tables for focusing on pre-tax income, which ignores existing tax distributions that would have been reflected in post-tax income numbers; thus, the tax system looks less progressive than it actually is.¹³¹ Another recommendation by the JEC is for distribution tables to estimate dynamic factors along with economic mobility in order to more accurately determine the economic effects of a tax change.¹³² For instance, the tables should try to account for how proposed tax changes will affect investment, saving, wages, productivity, and other things that are affected when taxes go up or down.

Another key flaw in tax distribution tables is that they do not take government spending into account. As one possible example, Medicaid (government-financed health care for low-income individuals) transfers wealth in the form of health services from rich to poor, but these transfers would likely be ignored in the typical tax-focused distribution table. If these and other transfer payments are added into the distributional analysis, the tax and benefit system in the U.S. is even more progressive than our tax code appears to be at first glance.¹³³ Indeed, Professor Louis Kaplow argues that, for the poor in particular, government transfer payments are the *primary* governmental influence on disposable income.¹³⁴ He therefore believes it makes more sense to integrate the analysis of tax and transfer policy.¹³⁵ Similarly, Professor Michael Graetz notes that distributional tables are misleading in the case of payroll taxes used to finance old age, survivors, and disability insurance benefits, and health insurance benefits under Part A of Medicare.¹³⁶ Graetz states that while the Social Security payroll tax is regressive when viewed alone, it is very progressive after benefits received later in life are taken into

¹²⁸ *Id.* at 12–13.

¹²⁹ *Id.*

¹³⁰ *Id.* at 15.

¹³¹ *Cf. id.* at 2.

¹³² *Id.* at 13.

¹³³ Greg Mankiw, *Five Observations about Progressivity*, GREG MANKIW'S BLOG (Jan. 19, 2012), <http://gregmankiw.blogspot.com/2012/01/five-observations-about-progressivity.html>, archived at <http://perma.cc/0pPEHxUiams>.

¹³⁴ Louis Kaplow, *Taxation and Redistribution: Some Clarifications*, 60 TAX L. REV. 57, 60–61 (2007).

¹³⁵ *Id.* at 73.

¹³⁶ Michael J. Graetz, *Paint-by-Numbers Tax Lawmaking*, 95 COLUM. L. REV. 609, 658 (1995).

account.¹³⁷ This is symptomatic of a wide problem; tax distribution table estimates of tax burdens and changes since 1977 routinely include payroll taxes without taking into account the benefits that they finance.¹³⁸

Distribution tables also fail to account for the impact of non-tax regulations and government mandates. For example, during legislative consideration of the Clean Air Act of 1990, no distributional tables were constructed regarding regulations that would control emissions from electric utilities.¹³⁹ The costs to the utility companies of complying with the regulations might ultimately have been passed on to the consumer. In any fair result, then, distributional tables for this regulatory scheme should show the changes to be quite regressive if the higher electricity prices were distributed to income taxes in a similar manner to that of an excise tax on electricity.¹⁴⁰

Distributional tables can also be selectively chosen for rhetorical effect.¹⁴¹ For example, a defender of the Bush tax cuts might want to show the effects of the Bush tax cuts by income class compared to previous tax burdens, as the results would show the tax cuts favor low and middle income Americans the most.¹⁴² That same person might also highlight the change in the share of total federal taxes paid, as the cuts still appear to benefit low and middle income Americans more than those with higher incomes.¹⁴³ Similarly, those who opposed the Bush tax cuts would use distributional measures showing changes in after-tax income that show the tax cuts as benefiting higher income Americans more than those with lower incomes.¹⁴⁴ And, indeed, this is largely what happened in the debates over the tax cuts.¹⁴⁵

V. CONCLUSION

We may be in a period of slow economic growth, on the order of 2% or 3% a year; as the pie grows less, conflicts over dividing it up are likely to become fierce. With a tradeoff between distributive tax policy and economic growth, policymakers should consider what they can do to ratchet up economic growth so that there will be the resources to promote equality and opportunity. That obligation means moving beyond crude measures of fairness and understanding that distributive goals must be weighed against harmful economic effects. When the possibility of redistributive success is

¹³⁷ *Id.* at 658.

¹³⁸ *Id.*

¹³⁹ *Id.* at 661–62.

¹⁴⁰ *Id.*

¹⁴¹ See David Kamin, *What is a Progressive Tax Change?: Unmasking Hidden Values in Distributional Debates*, 83 N.Y.U. L. REV. 241, 243–45 (2008) (arguing that debates over the proper progressivity of the tax code have become disconnected from any meaningful sense of fairness, in part because of flawed reliance on distributional tables).

¹⁴² *Id.* at 248.

¹⁴³ *Id.* at 248–249.

¹⁴⁴ *Id.* at 250.

¹⁴⁵ See discussion *supra* Part II.C.

imperiled by incessant political wrangling and misleading metrics of progressivity, the redistributive intuition should face serious scrutiny.¹⁴⁶

It is beyond the scope of this Article to map out the contours of an alternative system, but a better approach might be to focus tax collectors on what they are good at—collecting revenue—and to leave questions of distribution to safety net spending programs, promoting better educational outcomes, and charity. Rather than using the tax system for distribution and measuring success by effective tax rates and then calling it a day, policy-makers should measure success by outcomes: are the poor becoming richer? If not, what government programs are failing and how can they be fixed? If the working poor cannot afford the cost of necessities, how can that be fixed in a targeted and effective manner? These questions may not admit of easy answers, but the challenges may be far less than attempting to implement flawed intuitions of fairness into an ever more complex and shifting tax code.

¹⁴⁶ See, e.g., Alvin Rabushka, *A Simple Solution to the Tax System: Adopt a Flat Tax and Get the Tax Form on a Postcard*, 48 EMORY L.J. 841, 844–45 (1999) (challenging the notion that redistribution equates to fairness).