

Adam Smith and the Search for an Ideal Tax System*

“The middling and superior ranks of people, if they understood their own interest, ought always to oppose all taxes upon the necessaries of life, as well as all direct taxes upon the wages of labour” Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*

ABSTRACT

Increasing inequalities in income and wealth undermine the capitalist promise of universal prosperity and political liberty. To explore that growing tension, this article examines the key role of taxation in the original vision and extensive writings of Adam Smith -- the father of capitalism. Comparing that vision to the current United States tax system reveals many important inconsistencies, particularly the current penchant for simultaneously taxing wages and exempting (or delaying) taxes on wealth and wealth appreciation. The article proposes several ways in which the U.S. tax system could more closely align with Smith's capitalist vision. These ways of more closely adhering to a capitalist ideal include exempting a portion of wages (equal to the earnings of almost half of the United States population) from all forms of taxation and introducing a wealth tax on amounts greater than needed for working people to enter the housing market.

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I. Introduction -- a call for a comprehensive wealth tax

This article uses the writings of the father of capitalism,¹ Adam Smith, in order to imagine an ideal 21st Century United States tax system. Based on Smith's extensive writings on taxation, the article concludes that Smith's capitalist ideals, the federal government's administrative capacity and 21st Century American notions of political, cultural and social fairness are all well served by adding a wealth tax with a large exemption amount and a flat rate to an income tax with a refundable feature up to the Living Wage.² In addition to supporting capitalist ideals, this combination along with a consumption tax on luxuries, could support social justice agendas such as a living wage, class based affirmative action, a flat proportional rate and reparations for slavery.³ These additional aspects of combining a comprehensive wealth tax and an income tax with a generous refundable Earned Income Tax Credit (EITC) are a direct reflection of the capitalist ideals of universal prosperity and political liberty which serves as the foundation for American politics.⁴

¹ The following citation form is used for Adam Smith's works: All of the citations for WEALTH OF NATIONS are to ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (R. H. Campbell & A. S. Skinner eds., Glasgow Edition of the Works and Correspondence of Adam Smith, Indianapolis: Liberty Fund 1981) [hereinafter WN V.i.a.3 (Book, Chapter, Section, Paragraph)]. All of the citations for LECTURES ON JURISPRUDENCE are to: ADAM SMITH, 5 LECTURES ON JURISPRUDENCE (R. L. Meek, D. D. Raphael & P. G. Stein eds., Glasgow Edition of the Works and Correspondence of Adam Smith, Oxford: Clarendon Press 1976) [hereinafter LJ 531 (LJ, page number)].

² Although the vast majority of United States tax scholarship centers on the income tax, there are many other types of taxes used throughout the United States and the rest of the world. These taxes are distinguished amongst themselves by what they tax (i.e. the tax base), what event causes the laying of the tax (i.e. the tax trigger), and the rate the tax employs. These taxes are also distinguished by whether they are direct taxes (a tax on the thing itself) or indirect taxes (a tax on a transaction in the thing). See RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 219–26 (McGraw-Hill 4th ed. 1984) (discussing the various types of taxes and their incidence). See also BLACKS LAW DICTIONARY (West 8th ed. 2004) (defining tax base as “the total property, income, or wealth subject to taxation in a given jurisdiction”); *id.* (defining tax rate as “a mathematical figure for calculating a tax, usually as a percentage”); 1 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 847–49 (John Eatwell, Murray Milgate & Peter Newman eds., Macmillan Press Limited 1987) [hereinafter THE NEW PALGRAVE] (defining direct taxes); 2 *id.* at 787–88 (defining indirect taxes).

An income tax is a direct tax on income. If the tax is only on a specific type of income (e.g., wages) then it is a specific income tax such as the Social Security wage tax in the United States. 42 U.S.C.A. §301 et seq. If the tax tries to reach all income then it is a comprehensive income tax. See *infra* note 71. See also 4 THE NEW PALGRAVE, *supra*, at 604–06 (defining and discussing the taxation of income).

³ A wealth tax is a direct tax on wealth. If the tax is only on a specific type of wealth (e.g., land or securities) then it is a specific wealth tax. If the tax tries to reach all forms of wealth then it is a comprehensive wealth tax. See 4 THE NEW PALGRAVE, *supra* note 2, at 606–08 (defining and discussing the taxation of wealth).

⁴ See MICHAEL BEAUD, A HISTORY OF CAPITALISM 1500–2000 (Monthly Rev. Press 5th ed. 2001); PAUL BOWLES, CAPITALISM (2007); FREDERIC JAMESON, THE CULTURAL LOGIC OF LATE CAPITALISM (1991); ALAIN LIPIETZ, TOWARDS A NEW ECONOMIC ORDER: POSTFORDISM, ECOLOGY AND DEMOCRACY (1992). For various perspectives on how United States tax laws serve to further political ideals, see, for

A natural question (and section II of this article) is why the United States Congress might consider Adam Smith as its consultant on adding a comprehensive wealth tax with a large standard deduction to the progressive hybrid income/consumption tax in use today? The answer this article proposes in section III is that the present federal tax system falls short of a capitalist ideal because it is burdened by 18th and 19th Century cultural and political constraints. The article then goes on in section IV to show how a flat rate, comprehensive wealth tax with a large standard deduction is both well suited to 21st Century administrative capacity as well as contemporary political, cultural and social constraints. Section V discusses how a comprehensive wealth tax with a large standard deduction when combined with an income tax that shelters a Living Wage provides social justice benefits through the application of basic capitalist principles. Finally section VI gives a short comparison of a wealth tax, a consumption tax and a hybrid income/consumption tax in order to illustrate the social benefits conferred by the addition of a wealth tax to the federal tax system.⁵

II. Smith as a Guide to a 21st Century Tax

This section introduces Adam Smith as a guide to a 21st Century Congress in search of an ideal tax system. Smith's fit as congressional consultant arises from his search for the roots of universal material prosperity, the specific role he sees for taxation in that project, and his real world tax experience as reflected in both his idealistic and prescriptive writings.⁶

A. Why Adam Smith?

example, BRUCE ACKERMAN & ANNE ALSTOTT, *STAKEHOLDER SOCIETY* (1999); Marjorie Kornhauser, *Choosing a Tax Rate Structure in the Face of Disagreement*, 52 *UCLA L. REV.* 1697 (2005).

⁵ For two other discussions of the role of wealth taxes in promoting social justice concerns, see ACKERMAN & ALSTOTT, *supra* at note 4; MELVIN L. OLIVER & THOMAS M. SHAPIRO, *BLACK WEALTH, WHITE WEALTH: A NEW PERSPECTIVE ON RACIAL INEQUALITY* (1995).

⁶ Adam Smith was a prominent member of the 18th Century Scottish Enlightenment that included such other notable figures as Dr. James Anderson, Adam Ferguson, David Hume, Francis Hutcheson, Lord Kames, John Millar, Thomas Reid, William Robertson, Sir James Steuart, and Dugald Stewart. See Alexander Broadie, *Introduction* to *THE CAMBRIDGE COMPANION TO THE SCOTTISH ENLIGHTENMENT* 2 (Alexander Broadie ed., 2003); Alexander Broadie, *Introduction* to *THE SCOTTISH ENLIGHTENMENT: AN ANTHOLOGY* 3–31 (Alexander Broadie ed., 1997); Knud Haakonssen, *Introduction* to *THE CAMBRIDGE COMPANION TO ADAM SMITH* 3 (Knud Haakonssen ed., 2006); DANIEL SOMMER ROBINSON, *THE STORY OF SCOTTISH PHILOSOPHY* (1961) (discussing nine pre-eminent Scottish philosophers that include Francis Hutcheson, David Hume, Adam Smith, Thomas Reid, Dugald Stewart, Thomas Brown, Sir William Hamilton, James Frederick Ferrier, and James McCosh). For a discussion of enlightenment thinkers and taxation, [see, e.g.] David G. Duff, *Private Property and Tax Policy in a Libertarian World: A Critical Review*, 28 *CAN. J. L. & JURIS.* 23, 24–28 (2005) (Locke and taxation); Edward J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 *YALE L.J.* 283 (1994).

Scholars from both the right and left opine that capitalism is a precursor to democracy.⁷ As a democratic institution, Congress is well served by a tax consultant whose philosophy established a necessary precondition to its own existence. Adam Smith is widely acknowledged as the father of both capitalism and modern economics.⁸ Beyond his contribution to the social sciences and humanities, Smith is a proponent of social justice whose entire project, from his exploration of the development of moral responsibility and sympathy in *The Theory of Moral Sentiments*, to his examination of the role of law and government in guiding human behavior in *The Lectures on Jurisprudence*, to his investigation of the cause of different economic outcomes across nations in *An Inquiry into the Nature and Causes of the Wealth of Nations*, is a search for the necessary components of universal material prosperity and natural political liberty.⁹ Although Smith is thought of as a conservative economist whose work is available to

⁷ See, e.g., PAUL BOWLES, CAPITALISM, *supra* note 4, at 42–47; ROBERT B. REICH, SUPERCAPITALISM 9 (2007) (arguing that capitalism is almost certainly a precondition for democracy); MILTON FRIEDMAN, CAPITALISM AND FREEDOM 9 (1962) (“The kind of economic organization that provides economic freedom directly, namely, competitive capitalism, also promotes political freedom because it separates economic power from political power and in this way enables the one to offset the other”).

⁸ See, e.g., *Smith, Adam (1723–1790)*, in 3 ENCYCLOPEDIA OF ACTIVISM AND SOCIAL JUSTICE 1292–93 (Gary Anderson & Kathryn Herr eds., 2007); ADAM SMITH AND THE WEALTH OF NATIONS, 1776–1976: BICENTENNIAL ESSAYS (Fred R. Glahe ed., 1978); ADAM SMITH’S WEALTH OF NATIONS: NEW INTERDISCIPLINARY ESSAYS (Stephen Copley & Kathryn Sutherland eds., 1995).

For bibliographies on Adam Smith, see A CATALOGUE OF THE LIBRARY OF ADAM SMITH, AUTHOR OF THE ‘MORAL SENTIMENT’ AND ‘THE WEALTH OF NATIONS’ (James Bonar ed., 2d ed. 1932); A CRITICAL BIBLIOGRAPHY OF ADAM SMITH (Keith Tribe & Hiroshi Mizuta eds., 2002); ADAM SMITH’S LIBRARY: A CATALOGUE (Hiroshi Mizuta ed., rev ed. 2000).

In addition to his contribution to economics, Smith draws on so many other sources that his research is a model for the 21st century university with its emphasis on interdisciplinary work. Smith is both a humanist and an empiricist who grounds his work in philosophy, history, and empirical observation. Henry J. Bittermann, *Adam Smith’s Empiricism and the Law of Nature: I*, 48 J. POL. ECON. 487 (1940); Henry J. Bittermann, *Adam Smith’s Empiricism and the Law of Nature: II*, 48 J. POL. ECON. 703 (1940); David Lieberman, *Adam Smith on Justice Rights, and Law*, in THE CAMBRIDGE COMPANION TO ADAM SMITH, *supra* note 6, at 228 (discussing the interdisciplinary nature of Smith’s work).

In addition to economics, Smith constantly mines history—ancient, medieval, and modern—to illustrate his views. For a discussion of Smith’s limitations as a historian, see *General Introduction to AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, *supra* note 1, at 50–60. Smith is also an internationalist, a believer in free trade and in the free flow of ideas who was influenced by the French and other foreign sources. EMMA ROTHSCCHILD, ECONOMIC SENTIMENTS: ADAM SMITH, CONDORCET, AND THE ENLIGHTENMENT 52–71 (2001).

⁹ See, e.g., ROBERT L. HEILBRONER, THE WORLDLY PHILOSOPHERS: THE LIVES, TIMES, AND IDEAS OF THE GREAT ECONOMIC THINKERS 53 (Simon & Schuster 7th ed. 1999). Smith’s three works made such an impact on the modern academy that some credit Smith with pioneering three modern social sciences: economics, political science and sociology. Albert Salomon, *Adam Smith as Sociologist*, 12 SOC. RES. 22 (1945).

attack social legislation, Smith actually believes in capitalism as a path to a better life across social class.¹⁰

In the endless balance between the selfish and the sympathetic, private property -- when properly distributed -- allows for a level of prosperity for the working classes that rivals the riches of royalty in less well managed societies.¹¹ The balance between the selfish and the sympathetic that allows for the proper distribution of private property, as well as the creation and protection of that property, is dependent on the interplay of market and government. Therefore, although government does not contribute directly to successful economic activity it provides many of the prerequisites to that activity. Government -- properly formed and managed -- contributes to universal prosperity by helping to protect from outside oppression, provide justice at home and balance market distortions including through providing goods that are too diffuse for private financing.¹² Just as there is a role for government in Smith's ideal world, there is a role for the taxes that support government.

Smith's familiarity with taxation includes both his father's work as a customs clerk and his own work as a tax collector and consultant to the Chancellor of the Exchequer.¹³

¹⁰ Because Smith believes that government activities that burden the proper working of the market system distort prices to the detriment of the people, he also believes that all government impediments to the proper working of the market must be abolished. This wish to prevent government from distorting the market has been misinterpreted:

But because any act of the government -- even such laws as those requiring the whitewashing of factories or preventing the shackling of children to machines -- could be interpreted as hampering the free operation of the market The Wealth of Nations was liberally quoted to oppose the first humanitarian legislation. Thus, by a strange injustice, the man who warned that the grasping eighteenth-century industrialists "generally have an interest to deceive and even to oppress the public" came to be regarded as their economic patron saint. Even today, in blithe disregard of his actual philosophy, Smith is generally regarded as a conservative economist, whereas in fact he was more avowedly hostile to the motives of businessmen than are most contemporary liberal economists."

HEILBRONER, *supra* note 9, at 70.

¹¹ ADAM SMITH, *Introduction and Plan of the Work* ¶ 4 to 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, *supra* note 1, at 50–60 ("[A] workman, even of the lowest and poorest order, ... may enjoy a greater share of the necessaries and conveniences of life than it is possible for any savage to acquire.").

¹² Wealth of Nations Book V concerns three major topics: Public Expenditure, Taxation, and Public Finance. Within the context of the Sovereign's duties and their finance, Smith identifies the Sovereign's duties as protecting the people from outside oppression, "Of the Expence of Defence," WN V.i.a, domestic justice, "Of the Expence of Justice," WN V.i.b, and the creation and provision of diffuse benefits, "Of the Expence of publick Works and publick Institutions," Primarily these benefits consist of education and the protection of domestic and foreign commerce. The facilitation of domestic commerce includes facilitation of some transportation through the production of roads, canals and bridges. WN V.i.d.1

¹³ In addition to consulting with Lord Townsend, Smith was also the personal tutor to the Chancellor of the Exchequer's step son. HEILBRONER, *supra* note 9, at 48. Moreover, in 1778, two years

Smith wrote extensively about taxation in *The Wealth of Nations* and, to a lesser extent, in his other works as well. Unlike some philosophers, Smith has a specific role for taxation within his overall scheme for universal prosperity.¹⁴ Universal prosperity is a heartening ideal at a time when many Americans face declining affluence.¹⁵ In order for the tax system to fully contribute to his larger project, Smith's tax directives for the 21st Century United States suggest an income tax with a standard deduction large enough to support a Living Wage, a wealth tax with a standard deduction large enough to maintain a Living Wage during momentary economic downturns, and a consumption tax on luxuries.

B. Why a comprehensive wealth tax?

after the publication of *Wealth of Nations*, Smith was appointed Commissioner of Customs of Edinburgh. *Id.* at 50; see also IAN SIMPSON ROSS, *THE LIFE OF ADAM SMITH* 223, 305 (1995). As a person who both administered taxes and advised others on tax administration, Smith showed a fine sense for the wide array of taxes available both within and outside of Britain, their advantages, faults, and incidence. "British taxes, at the time of the publication of *The Wealth of Nations*, were of four principle sorts. There were taxes on land, stamp duties, duties of customs and duties of excise." Emma Rothschild & Amartya Sen, *Adam Smith's Economics*, in *THE CAMBRIDGE COMPANION TO ADAM SMITH*, *supra* note 6, at 354 (citing WN V.iii.69). "William Pitt introduced the first, temporary income tax in Britain only in 1799." *Id.* (citing P.K. O'Brien, *The Political Economy of British Taxation, 1660–1815*, 41 *ECON. HIST. REV.* 1 (1988)). Thus, although all of Smith's works strive to draw on practical experience and to provide realistic guidance Smith's own extensive familiarity with tax administration is worthy of note in an examination of Smith's writings on taxation.

¹⁴ Many fields claim Smith. Philosophers point out that Smith employs philosophical method when he examines other authors' ideas as if they were present, alive and fully engaged in the argument because an essential part of the Philosopher's faith is that reasoning can rise on occasion above the prejudice and concerns of historical time. SAMUEL FLEISCHACKER, *ON ADAM SMITH'S WEALTH OF NATIONS: A PHILOSOPHICAL COMPANION* xvi (2004). Among the Enlightenment's opponents, Smith's rejection of a social order derived from Heaven and its replacement by human reason and empirical observation as the means of ordering human affairs helped gain economists the reputation as the ultimate Enlightenment thinkers. See ROTHSCHILD, *supra* note 8, at 17–18. Although Smith used reason he did not believe in reason as the sole basis for explaining the social world. See Salomon, *supra* note 9, at 22–42, 28. In addition to reason Smith's expansive examination of morality, justice and government was grounded in extensive historical and empirical observation. See Bittermann, *Adam Smith's Empiricism and the Law of Nature: I*, *supra* note 8; Bittermann, *Adam Smith's Empiricism and the Law of Nature: II*, *supra* note 8.

¹⁵ REICH, *supra* note 7, at 105–14 (showing the shift in increases in overall income from the bottom 20% to the top 1%); see also CONGRESSIONAL BUDGET OFFICE, *HISTORICAL EFFECTIVE TAX RATES 1979 TO 2005* (2007), available at <http://www.cbo.gov/ftpdocs/88xx/doc8885/12-11-HistoricalTaxRates.pdf> (showing that incomes of the top 1 percent of Americans from 2003 to 2005 exceeded the total income of the poorest 20 percent of Americans); CHUCK COLLINS & FELICE YESKEL, *ECONOMIC APARTHEID IN AMERICA* (New Press 2000); SHELDON DANGIGER & PETER GOTTSCHALK, *AMERICA UNEQUAL* 124–50 (1995) (increases in income inequality); Reuven S. Avi-Yonah, *Why Tax the Rich? Efficiency, Equity, and Progressive Taxation*, 111 *YALE L.J.* 1391, 1398 (2002) (book review); Andrew Hacker, *The Underworld of Work*, *N.Y. REV. BOOKS*, Feb. 12, 2004, at 38, 40 (citing 2002 Bureau of the Census data to show that 40% of full time workers in 2000 earned less than \$30,000 a year); Gretchen Morgenson, *Explaining (or Not) Why the Boss Is Paid So Much*, *N.Y. TIMES*, Jan. 25, 2004, at Section C, pg. 1 (noting that the pay American CEOs receive is 531 times greater than that of the average employee, whereas the differential in Great Britain is only twenty-five, twenty-one in Canada, and ten in Japan); David Cay Johnston, *Report Says that the Rich are Getting Richer Faster, Much Faster*, *N.Y. TIMES*, Dec. 15, 2007, at Section C, pg. 3.

At the risk of stating the completely obvious -- people don't like taxes. In fact, antipathy to taxes is so high that laying taxes is difficult to justify. Many theorists rationalize taxation through benefits.¹⁶ Smith is a benefit theorist because he explicitly ties taxes to benefits.¹⁷ In part, Smith joins taxes and benefits because he believes that those who both benefit from and pay for government services are more likely to properly regulate their collection and use.¹⁸ In part Smith sees binding taxes to benefits as a way of avoiding political unrest because reasonable people are willing to pay for well priced government goods and services.¹⁹ At base, Smith connects taxes to benefits because of his theory of the relationship between private property and government.

Although Smith identified many types of government benefits in his analysis of tax systems, these items are mere proxies for what Smith believes is the true purpose of

¹⁶ See generally LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* (2002); Roy Blough, *Basic Tax Issues*, in *CONFERENCE PAPERS ON THE HISTORY AND PHILOSOPHY OF TAXATION* 17 (1955); Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 *TAX L. REV.* 399 (2005); C. Lovell Harriss, *the Role of Taxation in a Free Enterprise System*, in *CONFERENCE PAPERS ON THE HISTORY AND PHILOSOPHY OF TAXATION* 17 (1955); Marjorie Kornhauser, *supra* note 4 (choosing a rate structure involves fundamental questions about the nature of government and distributive justice); D. T. Krauss, *The Benefit Theory of Taxation*, 11 *TENN. L. REV.* 226 (1933); Michael A. Livingston, *Blum and Kalven at 50: Progressive Taxation, Globalization, and the New Millennium*, 4 *FLA. TAX REV.* 731 (2000); Leo P. Martinez, "To Lay and Collect Taxes": *The Constitutional Case for Progressive Taxation*, 18 *YALE L. & POL'Y REV.* 111 (1999); Herwig J. Schlunk, *Double Taxation: The Unappreciated Ideal*, 102 *TAX NOTES* 893, 895 (Feb. 16, 2004); Jeffrey A. Schoenblum, *Tax Fairness or Unfairness - A Consideration of the Philosophical Bases for Unequal Taxation of Individuals* 12 *AM. J. TAX POL'Y* 221 (1995); Klaus Vogel, *The Justification for Taxation: A Forgotten Question*, 33 *AM. J. JURIS.* 19 (1988).

¹⁷ For example, Smith tells us that local people should pay taxes for local benefits such as lights, water, and sewage, WN V.i.i.3. Litigants should pay taxes for part of the administration of justice through stamp taxes and filing fees, WN V.i.i.2. Students should pay a portion of the cost of education through a direct payment of teachers' salaries, WN V.i.i.5. Transporters should pay the cost of highways, bridges, and canals and then pass the cost onto consumers who benefit from the overall drop in prices that better transportation affords, WN V.i.d.4. Ground rents should be set at higher rates than other types of taxes because ground rents are unique riches brought on by government services, WN V.ii.e.11

¹⁸ "The expence of government to the individuals of a great nation, is like the expence of management to the joint tenants of a great estate...." WN V.ii.b.3

¹⁹ "Nothing can be more reasonable than that a fund which owes its existence to the good government of the state, should be taxed peculiarly, or should contribute something more than the greater part of other funds, towards the support of that government." WN V.ii.e.11. "It seems not unreasonable, that the extraordinary expence, which the protection of any particular branch of commerce may occasion, should be defrayed by a moderate tax upon that particular branch; by a moderate fine, for example, to be paid by the traders when they first enter into it, or, what is more equal, by a particular duty of so much per cent upon the goods which they either import into, or export out of, the particular countries with which it is carried on. The protection of trade in general, from pirates and freebooters, is said to have given occasion to the first institution of the duties of customs. But, if it was thought reasonable to lay a general tax upon trade, in order to defray the expence of protecting trade in general, it should seem equally reasonable to lay a particular tax upon a particular branch of trade, in order to defray the extraordinary expence of protecting that branch." WN V.i.e. 3

government: the protection of the rich and their property from the poor and their envy. Smith sees people balanced between opposing forces: selfishness on the one hand and the need for approval on the other. Self love and self advancement -- which pre-Enlightenment thought condemned as self aggrandizing, anti-Christian and anti-social -- Smith sees as advancing the cause of universal prosperity by providing the motivation to constantly strive for better conditions.²⁰ Smith believes that before the creation of private property the negative consequences of self love were balanced by the countervailing need for esteem and that, absent private property, reason and external esteem mediate between individuals without State intervention. However, once private property is introduced into human society, reason and esteem can no longer restrain envy.²¹ Private property creates the motivation for the dangerous behavior government defends against. Thus private property and civil government are twins born in the same moment.²² The interplay between the selfish pursuit of one's own interests and the

²⁰ *General Introduction to 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, *supra* note 1, at 9–18.

For Smith, man was an active being, disposed to pursue certain objectives which may be motivated by a desire to be thought well of by his fellows but which at the same time may lead him to take actions which have hurtful consequences as far as others are concerned. It is indeed one of Smith's more striking achievements to have recognized the social objective of many economic goals in remarking:

It is chiefly from this regard to the sentiments of mankind, that we pursue riches and avoid poverty. For to what purpose is all the toil and bustle of this world? What is the end of avarice and ambition, of the pursuit of wealth, of power and pre-eminence? ... what are the advantages we propose by that great purpose of human life which we call bettering our condition? To be observed, to be attended to, to be taken notice of with sympathy, complacency, and approbation, are all the advantages which we can propose to derive from it.

Id. at 9–10; WN I.ii.2.I.

²¹ *General Introduction to 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, *supra* note 1, at 11–12:

Smith ... argue[s] that ...wealth ...opens up an important source of dispute....[W]here people are prompted by malice or resentment to hurt one another, and where they can be harmed only in respect of person or reputation, then men may live together with some degree of harmony; the point being ...'the greater part of men are not very frequently under the influence of those passions; and the worst men are so only occasionally' ..[b]ut in a situation where property can be acquired ...we find a situation which tends to give full rein to avarice and ambition.

²² "Property and civil government very much depend on one another. The preservation of property and the inequality of possession first formed it, and the state of property must always vary with the form of government." It is this basic thesis of Smith's -- that property and civil government, and therefore positive law (which is the creature of civil government), are closely intertwined -- which is the greatest interest to us. He put the same point another way: "Till there be property there can be no government, the very end

contribution to the public benefit that private property provides is mediated in the market and by the State which supplies the necessary preconditions for private ownership.²³ Thus, property (or, in other words, wealth) is the ultimate government benefit and, therefore, the proper base for a comprehensive tax system.²⁴ Property is also the basis for liberty because property creates a counterbalance to government.²⁵ Thus, a tax system directed at property ownership that also promotes ownership at least up to the amount needed to support a Living Wage reflects the capitalist ideals that helped found this nation. Although government is born of the need for the rich to protect themselves against the poor, it turns out that the best way to gain a stable society that encourages wealth creation is through the wide dispersion of material and cultural goods. Smith's writings on taxation offer a way to match a tax system to the underlying ideals of the government that the tax system supports.

Smith is explicit about his preference for a wealth tax. In *Lectures on Jurisprudence*, Smith opines that all taxes are either taxes on possessions (which Smith identifies as land, stock or money) or taxes on commodities (such as salt, cloth or alcoholic beverages).²⁶ According to Smith, taxes on commodities either increase the cost of labor, thereby indirectly increasing prices or decreasing supply.²⁷ As between possessions and

of which is to secure wealth and to defend the rich from the poor." Neil MacCormack, *Adam Smith on Law*, 15 VAL. U. L. REV. 243, 250 (1981) (citing LJ 401, 404).

²³ *General Introduction* to 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, *supra* note 1, at 17–18.

²⁴ “Wherever there is great property, there is great inequality. For one very rich man, there must be at least five hundred poor, and the affluence of the few supposes the indigence of the many. The affluence of the rich excites the indignation of the poor, who are often both driven by want, and prompted by envy, to invade his possessions. It is only under the shelter of the civil magistrate that the owner of that valuable property, which is acquired by the labour of many years, or perhaps of many successive generations, can sleep a single night in security. He is at all times surrounded by unknown enemies, whom, though he never provoked, he can never appease, and from whose injustice he can be protected only by the powerful arm of the civil magistrate continually held up to chastise it.” WN V.i.b.2.

²⁵ FRIEDMAN, *supra* note 7, at 9

²⁶ “All taxes may be considered under two divisions, to witt, taxes upon possessions and taxes upon consumption. These are the two ways of making the subjects contribute to the support of government. The land tax is of the former kind, and all taxes upon commodities is of the latter.” LJ 531; *see also* R. A. Musgrave, *Adam Smith on Public Finance and Distribution*, in *THE MARKET AND THE STATE: ESSAYS IN HONOUR OF ADAM SMITH* 308 (Thomas Wilson & Andrew Skinner eds., 1976).

²⁷ “When taxes are laid upon commodities, their prices must rise, the concurrence of tradesmen must be prevented, an artificial dearth occasioned, less industry excited, and a smaller quantity of goods produced.” LJ 531.

Yet, although Smith prefers to tax possessions, he is faced with cultural restrictions concerning privacy and political restrictions in the form of a lack of administrative capacity that leaves land as the only plausible possession for the 18th century British government to tax. In contrast, the challenge of taxing either stock or money in the same administrative environment left those possessions virtually exempt from taxation. “Possessions are of three kinds, to witt, land, stock and money. It is easy to levy a tax upon land

commodities Smith prefers a wealth tax on possessions. However, Smith's preference for a wealth tax was only partially satisfied in 18th Century Britain because the central government's administrative capacity was better suited to taxing commodities.²⁸ In the present day United States, the hurdles that kept Britain from a comprehensive wealth tax are resolved by superior capacity.²⁹

C. Why a large standard deduction?

There are two reasons why Smith would advocate a large standard deduction in the context of a comprehensive wealth tax: his theory of price and his belief that everyone should benefit from his (or her) country's prosperity.³⁰ As explained below, these two factors are intertwined in Smith's view of the market and social justice. There is a third reason for a large standard deduction that receives more attention in the upcoming section on the tax rate, i.e., that a large standard deduction turns a flat rate tax into a mildly progressive tax for property owners while completely exempting those without property from tax liability.³¹

(1) Smith's theory of price

Smith's theory of the market posits two prices: market price and natural price. Natural price reflects the value embedded in an object by labor. Market price is influenced by other concerns such as supply and demand.³² Goods become widely available at a fair price when natural price and market price match. Unfortunately there are a number of factors that can upset the balance between natural and market price including a poorly designed tax system.³³

because it is evident what quantity every one possesses, but it is very difficult to lay tax upon stock or money without very arbitrary proceedings." LJ 531.

²⁸ Nevertheless, a large part of 18th Century British revenue did come from a wealth tax on land. *See infra* note 72.

²⁹ For a discussion of limits on the federal government's ability to lay wealth taxes, see Mark L. Ascher, *Curtailing Inherited Wealth*, 89 MICH. L. REV. 69 (1990–1991). For arguments against using a wealth tax as a means of addressing societal ills, see Eric Rakowski, *Can Wealth Taxes Be Justified?*, 53 TAX L. REV. 263 (2000). For discussions of the practicalities of taxing wealth, see, for example, ACKERMAN & ALSTOTT, *supra* note 4; David G. Duff, *Taxing Inherited Wealth: A Philosophical Argument*, 6 CAN. J. L. & JURIS. 3 (1993).

³⁰ A standard deduction is an amount that is completely exempt from taxation without the taxpayer having to produce any proof of how the amount was used. In the current Internal Revenue Code, the standard deduction is based on the taxpayer's filing status (married, single, head of household). I.R.C. § 63 (2008).

³¹ *See discussion infra* notes 50–53.

³² *General Introduction* to 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, *supra* note 1, at 20 (citing LJ 552–53); *see also* WN I.vii.

³³ *General Introduction* to 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS, *supra* note 1, at 20 (citing LJ 555) (Smith opines that when market price is not in line with

According to Smith, a direct tax on labor distorts the match between natural price and market price because the cost of labor is already reflected in natural price so that government actions that increase the cost of labor (for example a direct tax on wages) increase natural price and adversely affect supply.³⁴ For Smith, indirect taxes on labor are even worse than direct taxes because of the additional costs associated with collection.³⁵ The cost associated with both direct and indirect taxes on wages are eventually borne by the consumer through higher prices.³⁶ Accordingly, either direct or indirect taxes on labor hurt the public good.³⁷

Continuing with his theme that the ideal tax has the smallest possible effect on prices, Smith devotes a full section of Book V to a discussion of the taxation of consumable commodities.³⁸ Smith divides consumable commodities into either necessities or luxuries.³⁹ In Smith's view, all taxes are paid out of one of three sources: rents, profits or wages and, for each of these three sources of tax revenues, the ideal tax system separates compensation for risk taking from actual profit.⁴⁰ Accordingly, the ideal tax system exempts the minimum compensation needed to take on the risk of capital to the capitalist

natural price then labor shifts out of the field where the market is below the natural price and into the field where the market price is above the natural price.)

³⁴ *Id.* (“Progressing logically from this point, Smith proceeded to show that any policy that prevented the market price of goods from coinciding with their supply price ... would tend to diminish public opulence and derange the distribution of stock between different employments.”)

³⁵ “The taxes on consumptions are not so much murmured against, because they are laid upon the merchant, who lays them on the price of the goods, and thus are insensibly paid by the people.” LJ 583.

³⁶ WN V.ii.k.9.

³⁷ On the other hand, for Smith, surplus profit is open to taxation subject to his four tax ideals and several other themes that he develops in Book V. These additional themes include the directions that: 1) Taxes should be laid so that they have the least effect on prices; 2) Taxes are justified by government benefits; and 3) Tax systems should specifically identify and tax those whom government benefits. For example, Smith approves of taxes on the weight of wagons that use the public highways because the tax has the least effect on the cost of goods. According to Smith, the tax will actually be passed onto the consumer. However, because the roads make it cheaper to bring the goods to market, the decrease in price created by the roads more than offsets the increase in price caused by the tax that is used to support the roads. WN V.i.d.4. Smith also likes the highway tax because the tax is tied directly to the use. In other words, the tax is used to maintain the roads which are then used by the people who pay the tax and their payment of the tax by weight is a good proxy for the actual stress that the taxpayer/transporters put on the roads. WN V.i.d.4. Once again the highway tax fits the ideal by matching the beneficiary to the cost. WN V.ii.f.4–7.

³⁸ WN V.ii.k.

³⁹ WN V.ii.k.2.

⁴⁰ WN V.ii.c (Taxes upon Rent); WN V.ii.f (Taxes upon Profit); WN V.ii.i (Taxes upon Wages); WN V.ii.f.1 (The revenue or profit arising from stock naturally divides itself into two parts: that which pays the interest, and which belongs to the owner of the stock; and that surplus part which is over and above what is necessary for paying the interest).

while it also exempts the cost of necessary commodities (in Smith’s parlance, “necessaries”) for the working class.⁴¹ Since most of what workers earn goes to necessities, Smith sees direct taxes on both necessities and wages as inevitably resulting in either an increase in the cost of labor or a decrease in the availability of employment.⁴²

Smith’s definition of “necessaries” includes both those things that are needed for life (for example, heating fuel in the winter) and those things that “... [t]he poorest creditable person of either sex would be ashamed to appear in publick without them.”⁴³ What the poorest person needs for human dignity is highly dependent on historical and cultural conditions.⁴⁴ Thus, as countries become richer their populations should prosper so that everyone, including the poor, experiences rising standards of living. In order to include the poor and working classes in the universal prosperity that capitalism promises, a nation must avoid all direct and indirect taxes on wages and necessities.⁴⁵ For example, the sales taxes that many American States employ have no place in Smith’s ideal tax system because, taxing necessities (as opposed to luxuries) is substantially equivalent to taxing wages which then creates a gap between market and natural price and harms the entire society.⁴⁶ Further, Smith’s aversion to all taxes on wages (whether direct or indirect) argues against both the United States federal income tax and the social security wage tax both of which fall heavily on labor.⁴⁷

(2) Sharing society’s riches

Smith’s depiction of the poor and the working classes is in marked contrast to the two prevailing views of his time. One view was based on traditional notions of social hierarchy and was reinforced by common economic theories about labor and motivation. Under that view, poverty was an eternal and deserved state best left undisturbed. The second view was based on Christian ethics. It held that the rich had a duty to treat the poor with kindness and compassion and to aid them in times of stress.⁴⁸ Smith rejected

⁴¹ WN V.ii.f.2; WN V.ii.k (“Taxes upon Consumable Commodities”).

⁴² “[S]uch heavy taxes upon [necessaries] must increase somewhat the expence of the sober and industrious poor, and must consequently raise more or less the wages of their labour.” WN V.ii.k.11; *see also* WN V.ii.i.1.

⁴³ WN V.ii.k.3; WN V.ii.k.12.

⁴⁴ WN V.ii.k.3.

⁴⁵ WN V.ii.k.3 and 5.

⁴⁶ WN V.ii.k.5; *see also* WN V.ii.k.9 (“Taxes upon luxuries have no tendency to raise the price of any other commodities except that of the commodities taxed.”).

⁴⁷ The social security system is supported exclusively by taxes on wages. For social security wage limits, *see infra* note 166; Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807, 909–13 (2005) (discussion of social security).

⁴⁸ FLEISCHACKER, *supra* note 14, at 203.

both these traditional notions by disputing that the poor are inherently inferior or lacking in moral judgment and work ethic. Rather, Smith asserted that the poor have the same natural talents as the most exalted and that their problems arise not from laziness but from overwork. In fact, given poor and working peoples' contributions to society, it is only equitable that they have access to the goods they produce.⁴⁹

Part of Smith's three part project is a theory of natural justice.⁵⁰ Part of Smith's theory of natural justice involves human dignity. Smith's understanding of necessities is based on his belief that the material aspects of human dignity are time and culture specific.⁵¹ Thus in Smith's view, the size of the tax exemption for necessities would shift with each society's fortunes allowing everyone (including the poor) to enjoy a rising standard of living.

An income tax with a refundable credit up to the Living Wage combined with a wealth tax with a large enough exemption to protect the wealth needed to sustain a Living Wage in times of economic stress avoids both direct and indirect taxes on wages and necessities. In addition, the large standard deduction transforms a proportional rate into a progressive tax.⁵² Given Smith's belief that natural justice and human dignity are dependent on cultural and political context, the standard deduction (and an additional refundable credit in the income tax) could, in the early 21st century United States, support a universal living wage.⁵³

D. Why a flat rate?

In addition to tying taxes to benefits and ensuring that market and natural price converge by exempting amounts earned from labor or needed to sustain a minimum level of subsistence, Smith's ideal tax system reflects four concerns: (1) tax rates set in proportion

⁴⁹ "In the context of the eighteenth century, then, Smith presents a remarkably dignified picture of the poor, a picture in which they make choices every bit as respectable as those of their social superiors -- a picture, therefore, in which there really are no 'inferiors' and 'superiors' at all." *Id.* at 207.

⁵⁰ See, e.g., *id.* at 203–26 (discussing distributive justice); Knud Haakonssen, *Introduction to THE CAMBRIDGE COMPANION TO ADAM SMITH*, *supra* note 6, at 3 (discussing justice as the foundation of natural jurisprudence); Lieberman, *supra* note 86, at 216–21 (discussing natural justice). Smith was at the intersection of three different philosophical trends: (i) the science of *jus naturae* (natural justice); (ii) the shift in British philosophy from reflection on moral goods to analysis of moral acts; and (iii) the religion of nature of deism. Salomon, *supra* note 9, at 22, 23. "Smith standardly combined the normative goal of natural jurisprudence with the dense explanatory narrative of social and political history. The critical normative argument served to identify institutionalized failures of 'natural justice,' whereas the historical material served to illuminate the explanatory contexts for these failures." Lieberman, *supra*, 6at 228.

⁵¹ WN V.ii.k.3.

⁵² WALTER J. BLUM & HARRY KALVEN, JR., *THE UNEASY CASE FOR PROGRESSIVE TAXATION* 4–5, 90–100 (1953) ("[A]ny exemption in an otherwise proportionate tax introduces an element of progression in the effective rate.").

⁵³ See *infra* Part V.A–B on the Living Wage.

to revenue;⁵⁴ (2) transparency as to the amount due;⁵⁵ (3) convenient time and manner of payment;⁵⁶ and (4) appropriately constrained costs in relation to collections.⁵⁷ This section explores why Smith's four foundational tax principles lead to a flat rate wealth tax combined with a consumption tax on luxuries and an income tax with a refundable credit up to the Living Wage.

All taxes need a rate. On the question of appropriate rate and whether that rate is flat, proportional or progressive, Smith is not a model of clarity. On the one hand, several of Smith's foundational principles argue for a flat tax. In fact, Smith's first tax ideal is that the rate should be in proportion to revenue.⁵⁸ In addition to clearly violating Smith's first ideal of proportional taxation, progressive tax rates complicate the Code beyond measure.⁵⁹ Tax complexity violates Smith's second tax ideal (transparency) which, for Smith requires that the amount owed "ought all to be clear and plain to the contributor, and to every other person,"⁶⁰ This sort of transparency is difficult for complicated tax systems to achieve.⁶¹ Progressive rates also violate Smith's fourth admonition to constrain the cost of tax administration.⁶²

⁵⁴ WN V.ii.b.3.

⁵⁵ The amount due "ought all to be clear and plain to the contributor, and to every other person." WN V.ii.b.4.

⁵⁶ WN V.ii.b.5.

⁵⁷ WN V.ii.b.6.

⁵⁸ Proportional taxation is a tax which takes the same proportion of each taxpayer's income, often called a "flat tax." RICHARD A. WESTIN, *WG&L TAX DICTIONARY* 559 (2000). A proportional tax is based on a single rate (usually combined with one exemption) so that, although there is a mild progressive feature to the proportional tax, the rate only rises once at the end of the exemption. *See generally* Barbara Fried, *The Puzzling Case for Proportionate Taxation*, 2 *CHAP. L. REV.* 157 (1999).

⁵⁹ BLUM & KALVEN, *supra* note 52, at 14–15 ("The first consideration is the price paid for progression in terms of complicating the structure of the income tax, expanding the opportunity for taxpayer ingenuity directed to lawfully avoiding taxes, creating very difficult questions of equity among taxpayers, and obscuring the implications of any given provision in the tax law."); *see also* Deborah Paul, *The Sources of Tax Complexity: How Much Simplicity can Fundamental Tax Reform Achieve?*, 76 *N.C. L. REV.* 151 (1997); Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 *YALE L. J.* 259, 269–73 (1983) (explaining that the estate tax is a small net contributor to progressive taxation).

⁶⁰ WN V.ii.b.4.

⁶¹ To illustrate: if gasoline is subject to a \$1 excise tax, then each gallon purchased will carry with it one dollar in tax and everyone buying or selling gasoline will know this cost across transactions. A transparent gasoline excise tax imparts a high level of general knowledge at the cost of an easy computation. In contrast, how many taxpayers under our present progressive income tax understand their own tax affairs even after spending considerable time and expense on compliance? Consider further the information that the complex process of tax calculation masks. For example, how capital gains undercuts horizontal and vertical equity. *See, e.g.*, Haskell Ward, *Book Review*, 65 *ETHICS* 1, 68–70 (1954) (criticizing BLUM & KALVEN, *supra* note 52, for not discussing how the capital gains tax undercuts progressive rates); *see also* Nancy C. Staudt, *The Hidden Costs of the Progressivity Debate*, 50 *VAND. L. REV.* 919 (1997).

Nevertheless, although three of Smith's four tax ideals seem to support proportional taxation, Smith was not the model of consistency in his selection of rates. In fact, Smith moves between proportional and progressive taxation with ease. Smith begins his discussion of tax rates with a hard stand for proportional rates in his instruction that: "The subject of every state ought to contribute towards 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"⁶³ Then, throughout the rest of Book V, Smith quickly undercuts his strong proportional tax position with a series of equally strong progressive tax exceptions.⁶⁴

Why is Smith so open to the rich paying higher taxes in the face of his first principle -- taxes in proportion to revenues? Perhaps Smith's fear was that 18th century British taxes inaccurately matched government cost to benefit. Recall that Smith's ideals argue for taxing possessions, that is to say wealth, but those ideals are forced to operate within an administrative structure that is generally better at taxing commodities than possessions leading the 18th century British to rely heavily on customs, stamp, and excise taxes. Customs, stamp, and excise taxes are all regressive taxes that, according to Smith, become even more regressive as their ultimate cost is borne by working people and consumers.⁶⁵ In order to balance the regressive nature of the tax system brought about by cultural, political and administrative factors Smith introduces progressive tax rates in order to ensure that those who benefit most from government pay as much as those who benefit less. In a comprehensive wealth tax this accommodation of higher rates in exchange for a less reliable base becomes less important particularly when balanced against Smith's other tax ideals.

E. An additional consumption tax on luxuries

⁶² The cost of administration should be modest. "[T]axes are frequently so much more burdensome to the people than they are beneficial to the sovereign." WN V.ii.b.6.

⁶³ WN V.ii.b.3.

⁶⁴ For example, Smith tells us that: "A tax upon house rents, would in general fall heaviest upon the rich, and in this sort of inequality there would not, perhaps be anything very unreasonable. It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion." WN V.ii.e.6. In fact, Smith even approves of taxes on rents that are slightly higher for noblemen and lower for those without titles while he strongly disapproves of land taxes that exempt noblemen's holdings. WN V.ii.c.25. Smith believes that a road tax based on weight is an ideal tax because the tax due is based on the weight of the vehicle using the road so that the cost of the benefit is matched to the beneficiary. WN V.ii.d.4. Nevertheless, Smith still allows that: "When the toll upon carriages of luxury, upon coaches, post-chaises, &c. is made somewhat higher in proportion to their weight, than upon carriages of necessary use, such as carts, wagons, &c. the indolence and vanity of the rich is made to contribute in a very easy manner to the relief of the poor, by rendering cheaper the transportation of heavy goods to all the different parts of the country." WN V.i.d.5.

⁶⁵ For a discussion of progressive and regressive rates with various examples, see ROBIN L. EINHORN, AMERICAN TAXATION, AMERICAN SLAVERY appendix (2001).

Smith is not a friend of the rich or of conspicuous consumption.⁶⁶ For example, although Smith opposed all taxes on necessities, he was more than comfortable with luxury taxes.⁶⁷ Each time that Smith advocates a higher tax on the rich he is using the tax system as a way of lightly punishing excessive consumption. The higher rates for consumption also help modify any disparities between government cost and benefit brought about by poor 18th century British tax administration. Smith's desire to punish excessive consumption suggests that Smith would endorse a consumption tax on luxuries as part of an ideal tax system.⁶⁸

III. How did the United States come to adopt an income tax?

Smith teaches us that all tax systems are a product of the administrative, political, cultural and social constraints of their time and place.⁶⁹ Our present hybrid income/consumption tax is no exception. As demonstrated below, the present United States tax system was born from concerns that are now both distant and obsolete. These concerns include lack of administrative capacity, the fear that Congress would use the tax system to destroy slavery and general cultural notions of fairness and privacy that might lead to insurrection if violated.

⁶⁶ See *supra* notes 47–49 and accompanying text. “A man of large revenue ... thinks he ought to live like other men of large revenues; and to spend a great part of his time in festivity, in vanity, and in dissipation.” WN V.i.g.42.

⁶⁷ WN V.ii.k.9.

⁶⁸ “It is not very unreasonable that the rich should contribute to the public expence, not only in proportion to their revenue, but something more than in that proportion.” WN V.ii.e.6.

⁶⁹ One need only look to the many comparisons between nations that Smith employs in his discussion of taxation in Book V of the *Wealth of Nations* to understand how important culture and politics are in Smith's understanding of taxation. For example, Smith opines that tax systems should be structured to protect privacy interests so that, in constructing a land tax, Smith prefers to use the number of windows as a proxy for value rather than the number of hearths because windows are visible from the street while hearth taxes require the collector to enter the taxpayer's home. WN V.ii.e. 16-17. Another violation of privacy that Smith identifies is a tax that requires a merchant to open his books because public knowledge of the merchant's finances might expose the taxpayer to public shame. WN V.ii.f.5. “[B]y subjecting the people to the frequent visits, and the odious examination of the tax-gatherers, it may expose them to unnecessary trouble, vexation, and oppression; and though vexation is not, strictly speaking, expence, it is certainly equivalent to the expence at which each man would be willing to redeem himself from it. WN V.ii.b.6 On the other hand, Smith believes that land values are public and well known and so Smith has no objection to a land based wealth tax. LJ 531;WN V.ii.f.5-6. These examples show Smith's sensitivity to political and cultural constraints in his evaluation of tax systems and Smith's read of his own culture and its notions of privacy in fiscal matters.

For more contemporary discussions of the importance of politics and culture in taxation, see Kornhauser, *supra* note 4; Beverly I. Moran, *Setting an Agenda for the Study of Tax and Black Culture*, 21 U. ARK. LITTLE ROCK L. REV. 779 (1999); Beverly I. Moran, *Income Tax Rhetoric (or Why Do We Want Tax Reform?)*, 1992 WIS. L. REV. 2063.

A. American Colonies

British taxation in the American colonies illustrates how successful tax systems work in tandem with politics, culture and administrative capacity. In terms of administrative capacity, taxation in the American Colonies mirrored taxation in the British motherland. At home the British government faced two challenges: political constraints that forced it to raise revenues from taxes (as opposed to, for example, the sale of natural resources or plunder from war) and such a lack of administrative capacity that privateers and local counties collected taxes on behalf of the central government.⁷⁰ Britain's limited administrative capacity could not sustain a comprehensive tax of any type either at home or abroad.⁷¹ Instead of using a comprehensive tax base the British relied on specialized taxes on readily identifiable targets such as wealth taxes on land and commodities taxes on goods.⁷²

Britain's lack of administrative capacity followed it to the American colonies. Considered in a vacuum removed from social, cultural and political constraints, a stamp tax on imported goods was a good solution to Britain's need to raise revenues.⁷³

⁷⁰ JOHN BREWER, *THE SINEWS OF POWER: WAR, MONEY AND THE ENGLISH STATE 1688–1783*, at 91–95 (Harvard Univ. Press 1990). Later, as the central government's capacity increased, collection moved from private tax farming to state collection agencies. *Id.*

⁷¹ A comprehensive tax tries to identify and tax everything within its defined tax base. A specific tax targets a sub set of a larger tax base. For example, a comprehensive wealth tax tries to tax wealth in all of its forms. A specific land tax taxes wealth in the form of land. *See* WN.V.ii.b.1 (a comprehensive tax reaches all sources of private revenue of individuals including rents, profits, and wages); WN.V.ii.b.3 (specific taxes are unequal because they fall on only one of the three types of private revenue of individuals).

⁷² In addition to being on the verge of industrialization, 18th Century Britain was an expanding military power supported by an aggressive system of public finance based on a combination of taxes and debt. Although throughout most of human history governments raised revenues without using either debt or taxes (as, for example, through the sale of natural resources or by conquest through war) the political realities of 18th Century Britain limited that government's revenue raising options. In fact, the aggressive revenue policy needed to fund military expansion, combined with the political need to raise revenues through taxes or debt, meant that early 18th Century British taxes were significantly higher than taxes in other European countries. Britain commonly raised these taxes as stamp, customs, excise, and land taxes. Although the century ended with the excise tax raising 40% of Britain's revenues, the land tax was preeminent in the early 1700s and continued to play a significant role throughout the 18th century. The 18th Century British shift from land taxes to excise taxes reflected changes in the nation's administrative and political capacities. One reason that the land tax remained robust throughout the century was that it represented the power of the Parliament and local government over the central executive. This emphasis on legislative and local control was built into the British laws governing land taxes (which required that Parliament set both the tax and the rate each year) and in the administrative structure of land tax collection (which was housed in local county boards). In contrast, the excise and customs required more sophisticated administrative collection systems. *See* BREWER, *supra* note 70, at 89–114; *see also* Musgrave, *supra* note 26, at 296–319; THOROLD ROGERS, *THE ECONOMIC INTERPRETATION OF HISTORY* 461–64 (1889); Rothschild & Sen, *supra* note 13, at 354.

⁷³ The Stamp Act of 1765 taxed goods that came into the Colonies by ship because one of the few parts of the Colonies that the British controlled completely were ports and large public markets. For background discussion of the importance of the port of New York City to the British government in the

However, as the British discovered, no tax is exempt from social, cultural and political concerns. Thus, the Stamp Act of 1765 so conflicted with the politics and culture of the American Colonies that the Boston Tea Party helped fuel a rebellion and establish the United States.⁷⁴

B. Early United States

Another illustration of the importance of politics and culture to taxation comes from early American history when the new Congress confronted the same administrative, cultural and political challenges that the British faced during the Colonial period. In terms of administrative capacity, Congress (like Britain before it) faced a complicated series of local governments with multiple currencies and porous borders.⁷⁵ In addition, the central government's scarce administrative capacity meant that the early United States Congress was limited to enacting specific rather than comprehensive taxes.

In terms of politics, Congress faced the same population with its decidedly anti-tax bias that caused Britain to lose its American colonies. Unlike the British colonial experience however, where the colonists had no voice in their taxation, the new country's anti-tax bias was expressed in its Constitution which severely limited Congress' ability to lay direct taxes.⁷⁶ As a result of the constitutional restriction on direct taxes, British style land taxes were not available to the United States.⁷⁷

colonial period, see HENDRIK HARTOG, *PUBLIC PROPERTY AND PRIVATE POWER* (1983). The fact that the merchandise was inspected and stamped before unloading meant that the subject of the tax could be held in a confined and easily controlled space thus reducing the need for large numbers of revenue agents. The stamp on the packaged tea proclaimed that the goods were properly taxed as they traveled through interior markets thereby further reducing enforcement costs. See BREWER, *supra* note 70, at 176 (discussing the difficulty the British had in effectively taxing its American colonies). See generally EDMUND S. MORGAN & HELEN M. MORGAN, *THE STAMP ACT CRISIS* (1953); P. D. G. THOMAS, *BRITISH POLITICS AND THE STAMP ACT CRISIS* (1975). For a discussion of political reactions in the American colonies to the Stamp Act of 1765, see GORDON S. WOOD, *THE AMERICAN REVOLUTION* 24–44 (2002).

⁷⁴ See generally RICHARD D. BROWN *REVOLUTIONARY POLITICS IN MASSACHUSETTS* 1970). See also EVARTS B. GREENE, *REVOLUTIONARY GENERATION 1763–1790*, at 198–230 (1943); WOOD, *supra* note 73, at 38–44.

⁷⁵ See generally Joseph Ernst, "Ideology" and an Economic Interpretation of the Revolution, in *THE AMERICAN REVOLUTION* 159–85 (Alfred F. Young ed., 1976); GREENE, *supra* note 74, at 337–56; Gary J. Kornblith & John M. Murrin, *The Making and Unmaking of an American Ruling Class*, in *BEYOND THE AMERICAN REVOLUTION* 50–54 (Alfred F. Young ed., 1993).

⁷⁶ The 18th Century United States Constitution gave Congress a limited power to tax. For example, the Apportionment Clause, U.S.CONST. art. I, § 2, cl. 3, prohibits direct taxes unless apportioned by population. In the early United States economy, the significant distinction between a direct tax (which Congress was prohibited from enacting without apportionment) and an indirect tax was that a direct tax reaches non-market transactions while an indirect tax only reaches market transactions. In other words, because an indirect tax requires a transaction, a person who does not engage in transactions (for example a farmer who produces all his own food and other necessities) is essentially completely exempt from tax.) See *NationsBank of Texas, N.A. v. U.S.*, 269 F.3d 1332, 1335 (Fed. Cir. 2001) (Tax is "direct tax," within meaning of apportionment clause, "if it is levied directly upon property; it is not direct if levied on transfer of property from one person to another."); *Kohl v. U.S.*, 226 F.2d 381, 384 (7th Cir. 1955) (Direct taxes

Without regard to cultural ideals of fairness, Congress' poor administrative capacity and the constitutional limits on its ability to lay direct taxes made a presumptive tax on alcohol production attractive.⁷⁸ Like the Stamp Act of 1765 which allowed the British to target a small area (i.e. ports large enough to hold ocean going ships) the Whiskey Tax allowed Congress to target readily identifiable points of production, i.e., whiskey producing stills. Making the tax even easier to administer was its presumptive rate which calculated the amount owed based on the presumption that each still would: (1) produce at full capacity, (2) offer all its alcohol for sale (as opposed to personal use) and (3) sell for the same price throughout the nation.⁷⁹

“bear directly upon persons, upon their possession and enjoyment of rights, whereas indirect taxes are levied upon happening of an event, such as an exchange or transmission of property.”). *See generally* Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895). *See also* discussion *infra* note 81.

⁷⁷ A tax on land value—a tax laid in almost every county in the United States and a significant part of 18th Century British taxation—is a direct wealth tax. A land tax is also a specific tax because it is laid on only one type of wealth. In contrast, a comprehensive wealth tax reaches all forms of wealth. For a general discussion of real property taxes in the United States, see Nikolai Mikhailov & Jason Kolman, *Types of Property Tax and Assessment Limitations and Tax Relief Programs* (Lincoln Institute of Land Policy 2001), available at http://www.lincolnst.edu/subcenters/valuation_taxation/dl/mikhailov.pdf; CLARENCE Y.H. LO SMALL PROPERTY VERSUS BIG GOVERNMENT: SOCIAL ORIGINS OF THE PROPERTY TAX REVOLT (Univ. of Cal. Press 1990).

⁷⁸ As the first Secretary of the Treasury, Alexander Hamilton supported the excise tax on distilled spirits as part of the Excise Tax of 1791. *See* Excise Act of March 3, 1791, ch. 15, 1 Stat. 199, 199–214 (1791). The Act is officially titled "An Act repealing, after the last day of June next, the duties heretofore laid upon Distilled Spirits imported from abroad, and laying others in their stead; and also upon Spirits distilled within the United States, and for appropriating the same." *See generally* RICHARD BROOKHISER, ALEXANDER HAMILTON: AMERICAN 117–20 (1999); RON CHERNOW, ALEXANDER HAMILTON 342–43 (2004); JACOB ERNEST COOKE, ALEXANDER HAMILTON 146–57 (1982).

⁷⁹ The presumptive tax rate was based on a sales price that was higher than the prevailing price for alcohol in the Western Territories, but lower than the sales prices received in the Eastern States. *See* EINHORN, *supra* note 65; William HOGELAND, THE WHISKEY REBELLION: GEORGE WASHINGTON, ALEXANDER HAMILTON, AND THE FRONTIER REBELS WHO CHALLENGED AMERICA'S NEWFOUND SOVEREIGNTY 60–70 (2006); THOMAS P. SLAUGHTER, THE WHISKEY REBELLION: FRONTIER EPILOGUE TO THE AMERICAN REVOLUTION (1986). The higher than Western market presumptive sales rate inflamed regional tensions by taxing Westerners at a higher rate than Easterners. For example, if Abraham owned a still in the Western territory of Pennsylvania with the capacity to produce 100 gallons, Abraham was taxed as though he sold 100 gallons for a statutorily defined price (for example \$2.50 a gallon or \$250 in total). Because the rate was based on a presumption rather than on actual sales, Abraham was taxed on this \$250 even if he kept 20 gallons for personal use and even if the sales price for alcohol in the Western territory was only \$2 a gallon instead of \$2.50. On the other hand, if James owned a still in Vermont which could also produce 100 gallons, then James would be taxed on the same \$250 as Abraham even though alcohol might sell for \$4 a gallon in Vermont and James might sell his entire 100 gallons. The presumptive tax rate was a good fit for the 18th Century United States government's capacity because the tax calculation required little manpower. All that was needed was an annual visit from a revenue agent who ascertained a still's capacity and calculated the tax based on the presumption that the still would produce at full capacity and sell at a presumed price

Unfortunately for the young republic, no matter how suited to Congress' constitutional and administrative constraints, the Whiskey Tax so violated the early American sense of fairness that it almost destroyed the nation.⁸⁰ The Whiskey Rebellion demonstrates once more that successful taxes fit political and cultural expectations as well as administrative capacity.

C. 18th and 19th Centuries

Throughout the 18th and 19th Centuries Congress' ability to tax was limited by the Apportionment Clause which made direct taxes almost impossible.⁸¹ The American antipathy to taxation continued in this period fueled by slave holding elites who protected their property from the non-slave holding majority by developing and circulating a version of United States history that claimed federal taxation was antidemocratic.⁸² Taxes

⁸⁰ Although well suited to the 18th Century government's capacity, the presumptive tax offended 18th Century American cultural and political sensitivities as reflected in Constitutional restrictions on the central government's power to tax contained in the Apportionment Clause. U.S.CONST. art. I, § 2, cl. 3. By not distinguishing between personal consumption and commerce the alcohol production tax reached people that the 18th Century U.S. Constitution meant to exempt when it limited Congress' ability to lay direct taxes. The reaction against the tax became violent in 1794 when Pennsylvania farmers protested the excise tax on distilled spirits "waving banners denouncing tyranny and proclaiming 'Liberty, Equality, and Fraternity.'" George Washington was forced to send 15,000 troops into Western Pennsylvania in order to quell the Whiskey Rebellion. W. ELLIOT BROWNLIE, *FEDERAL TAXATION IN AMERICA: A SHORT HISTORY* 23 (Cambridge Univ. Press 2d ed. 2004); Marjorie E. Kornhauser, *Legitimacy and the Right of Revolution: The Role of Tax Protests and Anti-Tax Rhetoric in America*, 50 *BUFF. L. REV.* 819 (2002).

⁸¹ The Apportionment Clause, U.S.CONST. art. I, § 2, cl. 3, served a number of different purposes. One purpose, discussed *supra* note 76, was to prohibit the federal government from taxing people not engaged in commerce.

Another reason for the apportionment requirement was that it protected the wealthy land and slave holding political minority from the non-slaveholding political majority. Because Representatives are assigned to each State based on population, States with large populations could exercise control over wealthy land and slave holding minorities who lived in States with small white male populations. One way to shift the balance of power was contained in Article 1, section 2, clause 3's apportionment rule, which prevented direct taxes on land and slaves. Another protection for the slave holding minority was the rule also contained in the Apportionment Clause counting slaves in the number of people needed to acquire a Representative (the so called three fifth's rule). *See* EINHORN, *supra* note 65, at 138–45 (discussing the three-fifths rule); *see also id.* at 160 n. 5 (citing Bruce Ackerman, *Taxation and the Constitution*, 99 *COL. L. REV.* 1 (1999); Erik M. Jensen, *The Apportionment of 'Direct Taxes': Are Consumption Taxes Unconstitutional?*, 97 *COL. L. REV.* 2334 (1997); Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul Up in the Core of the Constitution*, 7 *Wm. & Mary Bill Rts. J.* 1 (1998) and *Hylton v. United States*, 3 U.S. 171 (1796) in discussing direct taxation); *see also* Barry Matsumoto, *Commentary: One and (An) Other*, 1 *J. GENDER, RACE & JUST.* 253 (1997).

⁸² In *AMERICAN TAXATION, AMERICAN SLAVERY*, *supra* note 65, Professor Einhorn describes how large southern planters created a rhetoric that made taxation itself seem anti democratic. This rhetoric was created in order to protect their land and slave holding interests from the non slave holding majority. For a more contemporary description of how another wealthy class shaped public opinion in order to protect itself from taxation, see Marjorie E. Kornhauser, *Shaping Public Opinion and the Law in the 1930s: How a 'Common Man' Campaign Ended a Rich Man's Law* (Tulane Public Law Research Paper No. 06-02), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=880383. Professor Kornhauser describes how the wealthy created a public relations campaign against a proposed amendment to the Internal

during this period were on slaves, whiskey and other commodities.⁸³ These taxes were all both indirect and specific. Neither direct taxes nor comprehensive tax systems occurred on the federal level until the early 20th Century. The first hundred years of United States public finance were centered on great public land sales and transfers.⁸⁴ During its first century the United States, like many developing countries, took most of its revenues from non tax sources.⁸⁵

D. 20th Century Income tax -- Before World War II

By the time World War I became an important part of the federal budget, there were fewer natural resources to sell, the South had lost the fight over slavery, a national economy was emerging from a previously more regional configuration and the federal government was beginning to build capacity across a broader range of activities. The prevailing wisdom was that government should avoid creating market distortions, the decline in rural wealth from the 18th to the 20th Century gave less force to feared threats to the agrarian ideal and an identifiable (albeit small) class of individuals and companies emerged from the Civil War with significant annual income.⁸⁶ These factors taken together meant that by the beginning of the 20th Century the federal government was equipped to administer a small scale comprehensive income tax and so, in 1913, the 16th

Revenue Code that would have required public disclosure of assets. According to Professor Kornhauser, the public relations campaign succeeded in the same way described by Professor Einhorn, i.e., by again making taxes seem anti democratic and the disclosure rule a threat to the entire population when, in fact, the disclosure rule only threatened the limited economic interests of the wealthiest taxpayers.

⁸³ Before the Civil War, taxes were primarily raised by tariffs, and on the sale of whiskey, land, carriages, and slaves. EINHORN, *supra* note 65, at 117–56. After the Civil War, excise taxes on tobacco, beer and whiskey, tariffs on imported goods and sales of natural resources paid for governmental expenses. RANDOLPH PAUL, *TAXATION IN THE UNITED STATES* 1–29 (1954); BROWNLEE, *supra* note 80, at 13–57.

⁸⁴ For a discussion of federal land grants, see LLOYD J. MERCER, *RAILROADS AND LAND GRANT POLICY: A STUDY IN GOVERNMENT INTERVENTION* (1982); JAMES W. ELY, JR., *RAILROADS AND AMERICAN LAW* 43–69 (2001). For a discussion of the limited use of income taxes in developing countries, see Richard M. Bird & Eric M. Zolt, *Redistribution Via Taxation: The Limited Role of Personal Income Taxation in Developing Countries*, 52 *UCLA L. REV.* 1627 (2005).

⁸⁵ The public finance measures employed by the United States resembled public finance measures of resource rich developing countries today. For example, present day Russia and its sales of natural gas. See World Bank, *Russian Economic Report #14*, *WORLD BANK IN RUSSIA: ECON. REV.* (June 2007), available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDS/IB/2007/09/26/000020439_20070926155710/Rendered/PDF/409510ENGLISH0RU0RER141eng1full01PUBLIC1.pdf; Andrew Kramer, *Russia Wrestles with Its Windfall from Oil*, *INT'L HERALD TRIBUNE*, Nov. 15, 2005, at Finance Sec., pg. 17.

⁸⁶ Specific taxes tend to be easier to administer than comprehensive taxes because the state can target those items that are easiest for it to identify and value. Because specific taxes only target limited types of economic activity specific taxes are said to have a distorting effect on economic relations as people move away from activities that are taxed in order to invest in activities that are not taxed. Smith acknowledges this problem at WN V.ii.b.3 Thus, one reason in favor of a comprehensive tax base is that comprehensive taxes avoid targeting one set of economic relationships over another by treating every item in the tax base equally.

Amendment lifted the Constitutional restriction on Congress' ability to lay direct taxes on income.⁸⁷ The resulting income tax purported to be comprehensive and universal but it actually required only about two percent of the population to participate.⁸⁸

E. 20th Century Income tax -- World War II and Beyond

The income tax remained small until World War II. Its expansion was made possible by the earlier creation of the Social Security old age pension system which allowed the government to identify income from wages.⁸⁹ Throughout the rest of the 20th Century the income tax grew to reach most of the population but not all income, at least not with equal force.⁹⁰ In the hybrid income/consumption tax system used today property values often escape tax for long periods and sometimes altogether.⁹¹

⁸⁷ U.S.CONST. art. I, § 2, cl. 3, states, “[D]irect taxes shall be apportioned among the several states ... according to their respective numbers” The meaning of this constitutional prohibition is that when the federal government is involved in laying direct taxes, such as taxes on wealth or income, the revenues raised must be apportioned by population state by state. The income tax is a direct tax and is therefore unconstitutional under this provision. The income tax was made constitutional by the 16th Amendment which states that: “The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.” U.S. CONST. amend. XVI; *see also supra* note 76 (citing judicial decisions regarding the constitutionality of direct taxes without apportionment).

For a discussion of the intellectual foundations of the income tax, see, for example, JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* (1985); RICHARD J. JOSEPH, *THE ORIGINS OF THE AMERICAN INCOME TAX* 1–29 (2004) (purpose of the income tax was to redistribute tax burden not wealth); Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807 (2005) (income tax was meant to reach capital in addition to wages); Ajay K. Mehrotra, *Edwin R. A. Seligman and the Beginnings of the U.S. Income Tax*, 109 TAX NOTES 933 (Nov. 14, 2005); Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundation of the U.S. Income Tax*, 52 UCLA L. REV. 1793 (2005).

For a discussion of the income tax's shift from a small tax on the wealthy to a large tax on the entire population, see 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 (1988–1989), and Beverly I. Moran, *Welcome to the Funhouse: The Incredible Maze of Divorce Taxation*, 26 HARV. J. ON LEGIS. 117 (1989) (discussing the explosion in income taxation as a result of World War II).

⁸⁸ Brownlee, *supra* note 80, at 57. *See also* Ackerman, *supra* note 81 (income tax was made politically possible by the concentration of income in the North Eastern States).

⁸⁹ 42 U.S.C.A. §401 SUBCHAPTER II—FEDERAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE BENEFITS. The Social Security Act was enacted in 1935 under the New Deal programs of the Franklin D. Roosevelt administration. *See generally* JOHN MAJOR, *THE NEW DEAL* (1967); BASIL RAUCH, *THE HISTORY OF THE NEW DEAL 1933–1938* (1944); MARY POOLE, *THE SEGREGATED ORIGINS OF SOCIAL SECURITY: AFRICAN AMERICAN AND THE WELFARE STATE* (2006); Beverly I. Moran, *Income Tax Rhetoric (or Why Do We Want Tax Reform?)*, 1992 WIS. L. REV. 2063 (discussing social security as a precursor to expanding the income tax).

⁹⁰ The way that the income tax was (and is) structured favors property ownership over wage labor by providing lower rates and deferred taxation for most property ownership while requiring yearly taxation at higher rates for earned income. Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751 (discussing the aspects of the income tax that favor property over

F. A 21st Century tax?

The history of taxation in the United States from the Colonial period to the present illustrates that every United States tax system reflected the political and cultural ideals of its time. In the 18th and 19th Centuries the ideal of self sufficient agrarian production over commercial trading protected large land and slave holding elites by prohibiting direct taxes without apportionment. In the 20th Century, reduced access to non tax revenue combined with increased need for funds brought about by two World Wars, the improved government capacity to track wages by Social Security numbers, and the belief that comprehensive taxes are less harmful to market transactions led to a comprehensive income tax. At the beginning of the 21st Century, the United States uses income as its tax base as much for 20th Century administrative convenience and 18th Century needs to protect slavery as because the income tax base represents some ideal. If every tax is a function of its place and time then it is appropriate to ask: If writing on a clean slate, how would the United States Congress construct a tax today?

IV. Issues in the United States context

A comprehensive wealth tax added to an income tax that provides a refundable EITC up to the Living Wage meets Smith's basic beliefs about an ideal tax system, i.e., tying

earned income). The statutory exemption from tax for unrealized gains contained in the Internal Revenue Code differs from the definition of income offered by Henry Simons in his book *PERSONAL INCOME TAXATION*:

Personal income may be defined as the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question. In other words, it is merely the result obtained by adding consumption during the period to "wealth" at the end of the period and then subtracting "wealth" at the beginning.

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

Although the original Tariff of 1913, the predecessor to the Internal Revenue Code, taxed income from savings, over the 20th Century the Internal Revenue Code moved to a hybrid income/consumption tax model with such consumption tax features as protection for retirement savings, I.R.C. §§ 401–420; college savings, I.R.C. §§ 529–530; medical savings, I.R.C. §§ 105–106, etc. *See generally* Edward J. McCaffery, *Tax Policy under a Hybrid Income-Consumption Tax*, 70 TEX. L. REV. 1145 (1992); William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1128 (1974); Alvin C. Warren, Jr., *Fairness and a Consumption-Type or Flow Through Personal Income Tax*, 88 HARV. L. REV. 931 (1975).

⁹¹ *See* I.R.C. § 163(h)(3) (mortgage interest deduction); I.R.C. § 121 (exclusion of gains on the sale of a principal residence); I.R.C. § 102 (exclusion for bequests and gifts); *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 560 (1991) *Eisner v. Macomber*, 252 U.S. 189 (1920); *see also* Mary Louis Fellows, *A Comprehensive Attack on Tax Deferral*, 88 MICH. L. REV. 722 (1990) (discussing the deferral of taxation on unrealized gains in stock).

benefits to beneficiaries. Another Smith ideal is transparency. A flat tax rate meets Smith's call for transparency because flat rates are easier for the general public to calculate and harder to distort through hidden benefits. A large standard deduction allows the income tax to exempt wages and necessities, effectively becoming a progressive tax and, when combined with a wealth tax, addressing some of the societal ills currently under discussion in the United States such as the conflict between affirmative action for class or for race, reparations and the living wage. What then are some of the specific conditions in the United States that might stand in the way of a comprehensive wealth tax?

A. Benefit theory revisited in the context of the Welfare State

Benefit theory ties tax costs to government benefits. What is a government benefit and who benefits is not static. For example, as opposed to the early 21st century United States, 18th century Britain employed virtually no transfer payments. Thus:

Smith never faced the problem that was to cause such intellectual agony for later generations of whether the government is weakening or strengthening that system when it steps in with welfare legislation. Aside from poor relief, there was virtually no welfare legislation in Smith's day -- the government was the unabashed ally of the governing classes and the great tussle within the government was whether it should be the landowning or the industrial classes who should most benefit. The question of whether the working class should have a voice in the direction of economic affairs did not enter any respectable person's mind.⁹²

Given that Smith operated in a very different world it is fair to ask whether the primary government benefit Smith identified in 18th Century Britain, i.e. wealth, is the same government benefit enjoyed today. Do the poor get more from government in a welfare state than the rich?

In answer to the question of whether government benefits are no longer limited to the creation, preservation, and protection of property consider that Smith ties government and wealth together in ways that modern day benefit theorists on either side of the spectrum might dispute. For example, although Smith concedes that public education benefits the working classes by providing escape from dull lives of repetition brought on by the division of labor, for Smith the real benefit of public education goes to the wealthy who receive a prophylactic against revolution.⁹³ Thus Smith sees free universal public

⁹² HEILBRONER, *supra* note 9, at 70.

⁹³ "The state ... derives no inconsiderable advantage from ... instruction [of the working classes]. The more they are instructed the less liable they are to the delusions of enthusiasm and superstition, which, among ignorant nations, frequently occasion the most dreadful disorders. An instructed and intelligent people, besides, are always more decent and orderly than an ignorant and stupid one. They feel themselves, each individually, more respectable and more likely to obtain the respect of their lawful superiors, and they are therefore more disposed to respect those superiors. They are more disposed to examine, and more capable of seeing through, the interested complaints of faction and sedition, and they are, upon that

education and other transfer payments as government benefits to the rich. Imagine what life would be like for middle class Americans if their cities were filled with the sort of aggressive beggars and thieves that Dickens portrays and then ask who benefits from government transfer payments.⁹⁴

B. Different Administrative Structures and Capacities

In comparing Adam Smith's tax ideals to the 21st century United States it is important to acknowledge that Smith is not writing about an income tax. *The Wealth of Nations* was first published in 1776 and Britain did not see its first income tax until 1799.⁹⁵ In fact, Smith specifically condemned certain aspects of an income tax, for example, a direct tax on wages.⁹⁶

The fact that the United States has a robust income tax that reaches a large majority of the population is a testament to the advanced state of this country's bureaucracy over Smith's Britain. Nevertheless, although 18th century Britain cannot compare with the governmental infrastructure and technology available today, it did manage to raise a remarkable amount of tax revenues.⁹⁷ In fact, 18th century Britain raised more taxes than its contemporaries and more than some of today's developing countries as well.⁹⁸ Thus, although Smith could not have imagined the administrative structures that support the present day federal tax system he did have something to say about the cost of tax administration in relationship to an ideal tax system.

In the present day context, Smith might opine that the United States tax system's greatest administrative strength -- its ability to reach out and touch the entire population -- is also its greatest flaw. In terms of matching the administrative cost of collection to the

account, less apt to be misled into any wanton or unnecessary opposition to the measures of government. In free countries, where the safety of government depends very much upon the favourable judgment which the people may form of its conduct, it must surely be of the highest importance that they should not be disposed to judge rashly or capriciously concerning it." WN V.i.f .61; WN V.i.f.50 (benefits education confers on the working classes).

⁹⁴ See, e.g., PAUL JARVIE, *READY TO TRAMPLE ON ALL HUMAN LAW : FINANCIAL CAPITALISM IN THE FICTION OF CHARLES DICKENS* (2005); GRACE MOORE, *DICKENS AND EMPIRE : DISCOURSES OF CLASS, RACE AND COLONIALISM IN THE WORKS OF CHARLES DICKENS* (2004); DANIEL BORN, *THE BIRTH OF LIBERAL GUILT IN THE ENGLISH NOVEL: CHARLES DICKENS TO H.G. WELLS* (1995).

⁹⁵ Rothschild & Sen, *supra* note 13, at 354. The British income tax was progressive from its inception until today.

⁹⁶ "The middling and superior ranks of people, if they understood their own interest, ought always to oppose all taxes upon the necessities of life, as well as all direct taxes upon the wages of labour." WN V.ii.k.9.

⁹⁷ BREWER, *supra* note 70, at 88; see also *supra* note 72.

⁹⁸ BREWER, *supra* note 70, at 89; see also 6 *NEW CAMBRIDGE MODERN HISTORY, THE RISE OF GREAT BRITAIN AND RUSSIA 1688–1715*, at 285 (J. S. Bromley ed, 1971); see *supra* note 72.

revenues generated -- Smith's fourth tax ideal -- the great cost of keeping low income taxpayers in the system rather than focusing on enforcement among the wealthy, is nonsensical.⁹⁹ In contrast, a flat rate comprehensive wealth tax with a large standard deduction augmenting an income tax with a refundable credit up to the Living Wage would exempt a large portion of the population from federal taxation with the remaining taxpayers having enough wealth to invest in the sort of compliance activities that are essential to a well run tax system.¹⁰⁰ The resulting administrative agency would shift from an emphasis on outreach to a greater involvement in monitoring and regulating complicated transactions. Although the total administrative cost might remain the same, the potential return would increase while federal taxation would disappear for a significant portion of the population.¹⁰¹

C. Differences in tax burdens

Although 18th century Britain raised as much revenues as some 21st century developing countries, Smith had no experience of the tax burden imposed by the United States or contemporary European nations. What Smith saw was a government that could not

⁹⁹ In fact, because of a congressional mandate, a significant amount of audits are targeted at the poorest Americans. *See, e.g.,* Leslie Book, *EITC Noncompliance: What We Don't Know Can Hurt Them*, 99 TAX NOTES 1821 (June 23, 2003).

¹⁰⁰ *See* MEIZHU LUI ET AL., *THE COLOR OF WEALTH: THE STORY BEHIND THE U.S. RACIAL WEALTH DIVIDE* 75 (2006) (discussing the factors in American history that have created the large wealth gap between whites and people of color who live in America).

The racial wealth gap has widened, according to the Federal Reserve Bank's most recent Survey of Consumer Finances, which found that African Americans were 13 percent of the U.S. population in 2001, but owned only 3 percent of the country's assets.

Data examined to determine median net worth—that number at which half the population is above and half below—show that in 1989 whites had a median net worth of \$97,800, and blacks, \$5,300. A little over a decade later in 2001, whites had a median net worth over \$120,000, while that of blacks was under \$20,000. While both levels had increased, given the sorrowfully low overall level for African Americans, too little changed.

Mean net worth—the average calculated by adding everyone's wealth together and dividing by the number of households—is even more unequal. African Americans' average of \$75,748 in 2001 is only one-sixth of whites' average of \$482,534. For every dollar the average white family has, in other words, the average black family has less than 17[cents].

Id.;
see also infra text and notes Parts V.A–B on the Living Wage, income and wealth.

¹⁰¹ For a discussion of valuation in the context of a wealth transfer tax, see Joseph M. Dodge, *Redoing the Estate Tax Along Easy to Value Lines*, 43 TAX L. REV. 243 (1988).

sustain any sort of comprehensive tax system and was reduced instead to targeting specific commodities and land. In contrast, the United States has already demonstrated the capacity to reach all sorts of income at home and abroad.¹⁰² There is no reason to believe that the present United States bureaucracy lacks the capacity to tax wealth in addition to income.¹⁰³

D. Constitutional Objections to a Wealth Tax

At the same time that the 18th century Adam Smith was analyzing tax systems across space and time, the 18th century United States Constitution was written to prohibit wealth taxes. The restriction on wealth taxes was achieved by Article 1, section 2, clause 3 which requires apportionment of direct taxes by population. The constitutional restriction on direct taxes shows that the political dilemma associated with wealth taxes in the United States was not equivalent to the 18th century British problem. According to Smith, 18th century Britain's problem with a wealth tax was that wealth was hard to identify, value and tax.¹⁰⁴ In contrast, the political problem in the 18th century United States was that wealth was all too readily identifiable and easy to tax.

In the 18th century United States most wealth was held either in land or slaves, both easy targets for taxation. The wealthiest Americans -- those with the largest acreage and slave holdings -- resided in states with the smallest white male populations. Their low white male populations, especially in relation to large tracks of land, put these wealthy Planter States at a numerical disadvantage in the House of Representatives when compared to States with larger white male populations and smaller acreage. A tax on land -- the most significant form of 18th century American wealth -- would have shifted the cost of government away from the highly populated small states of the North East and toward the slave holding South. A direct tax on slaves would have targeted an isolated political minority and might have made slavery financially prohibitive. At least two adjustments were placed in the United States Constitution in order to avoid these outcomes. One provision was the counting of slaves as 3/5ths of a man for purposes of allocating Representatives.¹⁰⁵ The second provision was the prohibition against direct taxes without apportionment which effectively made a federal wealth tax unconstitutional.¹⁰⁶

¹⁰² See I.R.C. §§ 871–989 (internal revenue statutes providing the laws for the treatment of foreign income).

¹⁰³ See Dodge, *supra* note 101; ACKERMAN & ALSTOTT, *supra* note 4.

¹⁰⁴ See *supra* note 27 (discussion of the difficulty of identifying sources of wealth).

¹⁰⁵ U.S. CONST. art. I, § 2, cl. 3 (Representatives and direct taxes shall be apportioned among the several states which may be included within this union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three fifths of all other Persons).

¹⁰⁶ Ascher, *supra* note 29.

Both the 18th century British and American objections to a wealth tax have less appeal today. After the Civil War, the United States developed a more national outlook that is less focused on inter state rivalries. Thus, individual States have less to fear from a federal tax on their citizens' wealth as opposed to their income. In addition, although 21st century American wealth holdings are far more sophisticated than their 18th century British counterparts, the United States' ability to track wealth is more sophisticated as well.¹⁰⁷ Further, like 18th century Britain, the 21st century United States already has sophisticated, albeit local, agencies that annually value one significant source of 21st century American wealth – land and buildings.¹⁰⁸ Thus neither the constitutional argument against a comprehensive wealth tax nor the administrative argument is compelling in light of present realities.

F. Smith's three objections to a British wealth tax in the American context

Smith believed that 18th century Britain could not implement a comprehensive wealth tax for at least three reasons: 1) cultural expectations; 2) capital flight; and 3) unstable values. In the United States context these concerns are less compelling.

(1) Cultural expectations

If Smith is an accurate reporter, then the 18th Century British were much more concerned with their privacy than 21st Century Americans. For example, when Smith critiques a house tax he prefers a tax that measures wealth by the number of windows rather than by the number of fireplaces because a tax collector can count windows without entering a home.¹⁰⁹ How could Smith understand a culture filled with reality television and government agencies capable of monitoring billions of telephone calls? In the face of the greatly reduced expectations of privacy that prevail today, Smith's privacy concerns surrounding a wealth tax become less compelling.¹¹⁰ Indeed, in the context of the 21st Century United States, a comprehensive wealth tax with a large standard deduction is actually less intrusive to the population as a whole because the large standard deduction reduces the size of the taxpaying public thereby conferring greater privacy on a large number of former taxpayers.¹¹¹

(2) Capital flight

¹⁰⁷ Dodge, *supra* note 101.

¹⁰⁸ *See supra* note 77.

¹⁰⁹ *See supra* note 69.

¹¹⁰ *But see* Marjorie E. Kornhauser, *Doing the Full Monty: Will Publicizing Tax Information Increase Compliance?* 18 CAN. J.L. & JURIS. 95 (2005) (arguing that people demand high levels of privacy regarding their tax information).

¹¹¹ *See discussion infra* Parts V.A–B on Living Wage.

As Smith noted, capital is mobile both in search of profit and to escape taxation. Because income is similarly mobile, the United States presently imposes its federal income tax on its citizens' worldwide income.¹¹² Thus Americans are not ignorant of (or adverse to) comprehensive and worldwide tax bases. Of course, declaring that a government is empowered to reach world wide income or wealth and actually taxing foreign based revenue are two different matters. The United States has demonstrated an ability to reach a substantial portion of overseas income even in the face of elaborate tax avoidance mechanisms.

A comprehensive wealth tax with a large standard deduction augmenting an income tax that exempts a Living Wage would create a prosperous taxpayer population with a higher average ability to engage in elaborate tax avoidance. In turn, this smaller but more sophisticated taxpayer population would force shifts in the regulating administrative agency. One of those shifts would include more sophisticated work in identifying wealth both domestic and foreign. Surely incentives exist for capital flight under a wealth tax to the same extent as they now exist for income flight under the income tax. In comparison to income, however, wealth remains less mobile even in our increasingly technological society. For example, one significant part of a wealth base is land.¹¹³

(3) Instable property values

That land remains a significant source of wealth in this country also goes to Smith's questions concerning the instability of valuation. As compared to 18th century Britain, the 21st century United States has ways of tracking wealth in land, stocks and other types of property both tangible and intangible that were impossible to imagine in the 18th Century.¹¹⁴ That these values might rise and fall over time is not of great moment. Income also changes over time and yet the annual accounting periods are able to handle these fluctuations.¹¹⁵

V. Race and Wealth

A happy consequence of a comprehensive wealth tax with a large standard deduction is that it lessens the tax burdens on those who receive the least from society by shifting the tax burden to those who benefit most. Three areas that demonstrate the wealth tax's

¹¹² I.R.C. SUBCHAPTER N: TAX BASED ON INCOME FROM SOURCES WITHIN AND WITHOUT THE UNITED STATES; *see also* Graetz, *supra* note 59, at 269–73.

¹¹³ For a discussion of the problems with the taxation of wealth, see Ascher, *supra* note 29. For Smith's view of the greater ease of taxing land than other types of wealth, see *supra* note 27. For a discussion of the advantages of taxing wealth in addition to income, see ACKERMAN & ALSTOTT, *supra* note 4.

¹¹⁴ *See also* Fellows, *supra* note 91.

¹¹⁵ OFFICE OF TAX ANALYSIS, U.S. DEP'T OF THE TREASURY, HOUSEHOLD MOBILITY DURING THE 1980S: A STATISTICAL ASSESSMENT BASED ON TAX RETURN DATA (1992) (showing a great deal of mobility between income quintiles).

social justice appeal when combined with an income tax with an exemption large enough to shelter a living wage are: (1) the Living Wage (2) the debate between class based and race based affirmative action and (3) black reparations. As the sections below also note, although none of these benefits flow exclusively to blacks, all three of these aspects of an Adam Smith style wealth tax are apt to redress the historical American tendency to direct government benefits away from blacks and towards similarly situated whites.¹¹⁶

A. What is a Living Wage?

There are a number of ways to calculate a minimum material standard of living threshold. In the contemporary United States four frequently used ceilings are:

- The poverty threshold for a family of four (\$20,650);¹¹⁷
- The salary that two adults working full time at minimum wage earn after factoring in the EITC and the social security wage tax (\$23,848);¹¹⁸
- The amount that a married couple filing a joint return with two children can earn before completely losing eligibility for the EITC (\$39,783);¹¹⁹

¹¹⁶ See *infra* note 154.

¹¹⁷ Gordon M. Fisher, *The Development and History of the U.S. Poverty Thresholds – A Brief Overview*, GSS?SSS Newsletter (Newsletter of the Gov't Statistics section and the Social Statistics section of the American Statistical Ass'n), Winter 1997, at 6–7, available at <http://aspe.os.dhhs.gov/poverty/papers/hpt.gssiv.htm>; Gordon M. Fisher, *The Development and History of the Poverty Thresholds*, SOCIAL SECURITY BULLETIN, Winter 1992, at 3–14; Gordon M. Fisher, *The Development of the Orshansky Poverty Thresholds and Their Subsequent History as the Official U.S. Poverty Measure* (Poverty Measurement Working Papers May 1992, partially rev. Sept. 1997, available at <http://www.census.gov/hhes/www/povmeas/papers/orshansky.html>).

See also 42 U.S.C. § 9902(2):

(2) Poverty line

The term “poverty line” means the official poverty line defined by the Office of Management and Budget based on the most recent data available from the Bureau of the Census.

See also ECONMICS AND STATISTICS ADMINISTRATION, U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, CURRENT POPULATION REPORTS, P60-232, THE EFFECT OF TAXES AND TRANSFERS ON INCOME AND POVERTY IN THE UNITED STATES: 2005 (Mar. 2005), available at <http://www.census.gov/prod/2007pubs/p60-232.pdf> [hereinafter U.S. CENSUS BUREAU].

¹¹⁸ Calculated as \$5.85 @ hour x 40 hours a week x 52 weeks @ year x 2 workers = \$24,336 + \$2950 for the earned Income Tax Credit minus [3438 social security] = \$23,848. This is the earned income tax credit for 2006 assuming no other outside income or deductions. See IRS Form 1040 Schedule EIC and Publication 596 (2006) Earned Income Tax Credit. The amount of the social security tax is taken from one half of the self employment tax from Form 1040 SS (self employment United States income). School breakfasts and lunches, food stamps, bus passes, and subsidized housing move the family further from the poverty threshold. See *infra* note 121 for programs that use various methods for determining eligibility.

¹¹⁹

- The projected Living Wage for a two parent family of four (\$45,000).¹²⁰

Each of these four income thresholds for identifying people in need of government assistance reflect on other aspects of income, wealth, and race¹²¹. For example, the

Income Caps for Earned Income Tax Credit, Tax Year 2007		
Families With the Following Number of Qualifying Children	Family Head Filing Individually	Married Filing Jointly
0	\$12,590	\$14,590
1 child	\$33,241	\$35,241
2 or more children	\$37,783	\$39,783

Administration for Children and Families, U.S. Dept. of Health & Human Services Appendix B: Earned Income Tax Credit and Federal Poverty Information
<http://www.acf.hhs.gov/assetbuilding/projectbuilder/pdf/AFIGuidebook2006AppB.pdf> (last visited December 30, 2007).

¹²⁰ When Living Wage advocates try to calculate the income needed to provide hunger security, a decent home, transportation, education and access to basic news sources through television, radio and the internet, the income needed to support a family of four rises to about \$45,000, a number that would change based on family location and other factors. JEROLD L. WALTMAN, *THE CASE FOR THE LIVING WAGE* 56–61 (2004). Amounts that were included in one calculation of a living wage are listed in Table 4-2 on page 59 as: food, transportation, health care, housing, child care, other necessities, and taxes. The \$45,000 for a family of four comes close to the median income for a family of four calculated under four different scenarios including with government transfer payments based on entitlements not connected to income. U.S. CENSUS BUREAU, *supra* note 117, at 3 Table 1 (Median Income of households by income definitions (4 types of income, money income, market income, post-social insurance income and disposable income)); OREN M. LEVIN-WALDMAN, *THE POLITICAL ECONOMY OF THE LIVING WAGE: A STUDY OF FOUR CITIES* (2005); STEPHANIE LUCE, *THE LIVING WAGE? BUILDING A FAIR ECONOMY* (1998); STEPHANIE LUCE, *FIGHTING FOR THE LIVING WAGE* (2004); WILLIAM P. QUIGLEY, *ENDING POVERTY AS WE KNOW IT: GUARANTEEING A RIGHT TO A JOB AT A LIVING WAGE* (2003).

¹²¹ The HHS poverty guidelines, or percentage multiples of them (such as 125 percent, 150 percent, or 185 percent), are used as an eligibility criterion by a number of federal programs, including those listed below. For examples of major means-tested programs that do not use the poverty guidelines, see the end of this footnote.

- Department of Health and Human Services:
- Community Services Block Grant
- Head Start
- Low-Income Home Energy Assistance Program (LIHEAP)
- Community Food and Nutrition Program
- PARTS of Medicaid (31 percent of eligibles in Fiscal Year 2004)
- Hill-Burton Uncompensated Services Program
- AIDS Drug Assistance Program
- State Children’s Health Insurance Program
- Medicare – Prescription Drug Coverage (subsidized portion only)
- Community Health Centers
- Migrant Health Centers
- Family Planning Services

Health Professions Student Loans — Loans for Disadvantaged Students
Health Careers Opportunity Program
Scholarships for Health Professions Students from Disadvantaged Backgrounds
Job Opportunities for Low-Income Individuals
Assets for Independence Demonstration Program
Department of Agriculture:
Food Stamp Program
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
National School Lunch Program (for free and reduced-price meals only)
School Breakfast Program (for free and reduced-price meals only)
Child and Adult Care Food Program (for free and reduced-price meals only)
Expanded Food and Nutrition Education Program
Department of Energy:
Weatherization Assistance for Low-Income Persons
Department of Labor:
Job Corps
National Farm worker Jobs Program
Senior Community Service Employment Program
Workforce Investment Act Youth Activities
Department of the Treasury:
Low-Income Taxpayer Clinics
Corporation for National and Community Service:
Foster Grandparent Program
Senior Companion Program
Legal Services Corporation:
Legal Services for the Poor

Most of these programs are non-open-ended programs — that is, programs for which a fixed amount of money is appropriated each year. The only open-ended or “entitlement” programs that use the poverty guidelines for eligibility are Food Stamps, the National School Lunch Program, certain parts of Medicaid, and the subsidized portion of Medicare – Prescription Drug Coverage.

Some state and local governments have chosen to use the federal poverty guidelines in some of their own programs and activities. Examples include financial guidelines for child support enforcement and determination of legal indigence for court purposes. Some private companies (such as utilities, telephone companies, and pharmaceutical companies) and some charitable agencies also use the guidelines in setting eligibility for their services to low-income persons.

Major means-tested programs that do not use the poverty guidelines in determining eligibility include the following:

Temporary Assistance for Needy Families (TANF) and its predecessor, Aid to Families with Dependent Children (AFDC) (in most cases)
Supplemental Security Income (SSI)
Earned Income Tax Credit (EITC)
State/local-funded General Assistance (in most cases)
Large parts of Medicaid (69 percent of those eligible in Fiscal Year 2004)
Section 8 low-income housing assistance
Low-rent public housing

See U.S. Dep’t of Health & Human Services, Frequently Asked Questions related to the Poverty Guidelines and Poverty <http://aspe.hhs.gov/poverty/faq.shtml#programs> (“What programs use the Poverty Guidelines?”) (last visited December 30, 2007)

median household income for black families is \$32,372 which places more than half of black families below both the Living Wage and the EITC income threshold and above the poverty threshold and the full time minimum wage for two workers.¹²² On the other hand, non-Hispanic whites' median income of \$52,375 puts more than half of all white households above all four income measures (poverty threshold, minimum wage, EITC and LivingWage).¹²³

According to Smith's theory of price, the \$45,000 needed to sustain a Living Wage for a two parent family of four is best left tax exempt so as to avoid double counting the cost of labor in the natural price of commodities which Smith predicts harms consumers by either increasing the cost of labor or shrinking its supply. Yet the income needed to sustain a Living Wage (in Smith's parlance--to fund necessities) is taxed in the United States at 15.3%, for social security wage taxes and Medicare, 18.4 cents on every gallon for the federal excise tax on gasoline, and up to 7% state wide on most purchases even if no federal income tax is owed.¹²⁴ Even with a wide array of transfer payments, most families' cash income is subject to some combination of state, local and federal taxes.

B. The Living Wage and Wealth

In order to support a Living Wage, a two parent family of four needs more than the \$45,000 a year stream of income from labor. The family also requires a cushion against hard times. Whether due to illness, plant closing, or need to take care of a relative, there are times when people are forced to drop out of the labor force. When an unanticipated shock to the income stream occurs, those families with assets are in a better position to sustain themselves during bad times and to recover as the economy recovers.¹²⁵ What is the amount of wealth needed to make that difference? Because housing is such an important part of most Americans' wealth portfolio, one simple standard to use is the cost

¹²² BRUCE H. WEBSTER JR. & ALEMAYEHU BISHAW, U.S. CENSUS BUREAU, AMERICAN COMMUNITY SURVEY REPORTS, ACS-08, INCOME, EARNINGS, AND POVERTY DATA FROM THE 2006 AMERICAN COMMUNITY SURVEY 3 (2007), available at <http://www.census.gov/prod/2007pubs/acs-08.pdf>. The American Community Survey collects detailed social, economic, housing and demographic information from every county in the country.

¹²³ *Id.* at 3. The American Community Survey. It replaces the census bureau long form for the decennial survey. For information about sample design, see American Community Survey Office, U.S. Census Bureau, <http://www.census.gov/acs/www> (last visited January 6, 2008).

¹²⁴ Using a standard deduction and no child care credit a family of four earning \$45,000 a year would owe \$2178 in federal income taxes. With a child care credit for two children based on \$6,000 of expenses and each parent having earned income of \$22,500, the federal tax liability for 2006 is eliminated. This family is not eligible for the Earned Income Tax Credit because its average income exceeds the income limits for the EITC. *See supra* note 119.

¹²⁵ *See infra* text and notes 143–147 (discussion of Dalton Conley's construction of two families one with a house and the other renting an apartment and the differences in outcomes because of the differences in their assets). DALTON CONLEY, BEING BLACK LIVING IN THE RED: RACE, WEALTH & SOCIAL POLICY IN AMERICA 1 (1999); Dalton Conley, *Wealth Matters*, in REPARATIONS FOR SLAVERY: A READER 290 (Ronald P. Salzberger & Mary C. Tucker, eds., 2004).

of entry into the housing market.¹²⁶ Fannie Mae opines that a family with \$45,000 of annual income can carry a \$190,000 house with an 80% mortgage.¹²⁷ The cost of entry into that housing is approximately \$45,500.¹²⁸ Add six months' salary in a cash account for emergencies and one wealth exemption amount is \$68,000.¹²⁹

Average (mean) value of Non-Hispanic white households' assets already far exceeds the minimum wealth needed to sustain a Living Wage. In fact, the Non-Hispanic white households' assets average value of \$198,383 is almost three times the minimum amount needed to enter the housing market on a Living Wage.¹³⁰ In contrast, average net worth of black household assets is \$35,284 or just over half way towards the amount needed to enter the housing market at the Living Wage with comfort.¹³¹ There are similar gaps for female heads of household.¹³²

B. Class based Affirmative Action

Since the introduction of race based affirmative action a countervailing story is that justice is best served when government benefits are based on class instead of race.¹³³ The

¹²⁶ The Fannie Mae web site offers a calculator for determining the size of a mortgage that a family can carry. At \$45,000 gross income and \$500 monthly debt the calculator allows for \$150,000 mortgage at 7% interest. Entry into this home would require a 20% down payment (\$38,000) plus closing costs estimated by Fannie Mae at \$7,511.18 for a total of \$45,511. Fannie Mae, How Much House Can You Afford? <http://www.mortgagecontent.net/scApplication/fanniemaef/affordabilityDispatcher.do> (last visited Dec. 29, 2007).

¹²⁷ *See id.* 126

¹²⁸ *See id.* 126.

¹²⁹ \$38,000 down payment on a \$190,000 home plus \$7,511 in closing costs, plus six months' salary of \$22,500 equals \$68,011. *See* ACKERMAN & ALSTOTT, *supra* note 4 (arguing that every American child should be endowed with \$80,000).

¹³⁰ HOUSING AND HOUSEHOLD ECONOMIC STATISTICS DIVISION, U.S. CENSUS BUREAU, WEALTH AND ASSET OWNERSHIP DETAILED TABLES 2000, TABLE 5: ASSET OWNERSHIP OF HOUSEHOLDS 2000, http://www.census.gov/hhes/www/wealth/1998_2000/wlth00-5.html (last visited Dec. 29, 2007).

¹³¹ *Id.* 130

¹³² For example, the census median income estimate for a female head of household in 2006 is \$31,818 which is lower than the amount needed to qualify for an earned income tax credit with even one child. *See* Census on Poverty Table One – Income and Earnings Summary Measures by selected characteristics. The median income for a married couple was estimated for 2006 at \$60,716 and for a male head of household at \$47,078. DENAVAS-WALT, CARMEN, BERNADETTE C. PROCTOR & JESSICA SMITH, U.S. CENSUS BUREAU, CURRENT POPULATION REPORTS, P60-233, INCOME, POVERTY AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2006 (2007), *available at* <http://www.census.gov/prod/2007pubs/p60-233.pdf>.

¹³³ LANI GUINIER & GERALD TORRES, THE MINER'S CANARY: ENLISTING RACE, RESISTING POWER, TRANSFORMING DEMOCRACY 52 (2002) (when presented by progressives as a political program, universalist arguments call for a focus on class in lieu of race); RICHARD D. KALENBURG, THE REMEDY: CLASS, RACE AND AFFIRMATIVE ACTION 83–182 (1996) (Chapter 4, the case for class based affirmative

class argument calls for targeting government benefits to people who live below a set income line often the poverty threshold itself, or 125% or 150%, of that threshold. Sometimes other income limits entirely unrelated to the poverty threshold stand in as a proxy for class.¹³⁴ In this regard, race and class measured by income are not unrelated.¹³⁵

Using the lowest measure by income -- the Census Bureau's poverty threshold -- 45% of the below poverty line population are white, 25% are black, 25% are Hispanic and 5% are "other."¹³⁶ That the forty-five percent of poor people who are white make up just 9.3% of the entire white population demonstrates the large population differences between blacks, whites and Hispanics in the United States.¹³⁷

Using the second most generous measure of poverty, the limits on the EITC, the highest, almost exclusively white income quintile enjoys over fifty percent of four types of income.¹³⁸ In contrast, Black and Hispanic median income figures place below the EITC limits.¹³⁹

Using the most generous Living Wage minimum, white families' median incomes meet the \$45,000 Living Wage under three out of four income measures.¹⁴⁰ Black and Hispanic median incomes do not reach the Living Wage in any of the four income measures.¹⁴¹

action); CAROL M. SWAIN, *THE NEW WHITE NATIONALISM: ITS CHALLENGE TO INTEGRATION* (Cambridge Univ. Press 200) (whites and blacks both prefer that colleges admit poor white applicants over middle class blacks); Richard H. Fallon, Jr., *Affirmative Action Based on Economic Disadvantage*, 42 *UCLA L. REV.* 1913 (1996); Richard D. Kalenberg, *Class-Based Affirmative Action*, 84 *CAL. L. REV.* 1037 (1996); Deborah C. Malamud, *Class-Based Affirmative Action: Lessons and Caveats*, 74 *TEX. L. REV.* 1847, 1850 (1996) (measures of class tend to be simplistic); Deborah C. Malamud, *Assessing Class-Based Affirmative Action*, 47 *J. LEGAL EDUC.* 452, 459–72 (1997) (class based affirmative action might not bring about income integration in higher education), Richard H. Sander, *Experimenting With Class-Based Affirmative Action*, 47 *J. LEGAL EDUC.* 472 (1997).

¹³⁴ See *supra* note 121.

¹³⁵ U.S. CENSUS BUREAU, *supra* note 117, at Table 4

¹³⁶ LEVIN-WALDMAN, *supra* note 120, at 61

¹³⁷ LEVIN-WALDMAN, *supra* at note 120.

¹³⁸ U.S. CENSUS BUREAU, *supra* note 117, at Table 3 (Share of Aggregate Household Income by Quintile and the Gini: 2005).

¹³⁹ *Id.* at Table 2 (Index of Median Household Income by Selected Characteristics and Income Definition: 2005). (Census Bureau report on income calculated using transfer payments and taxes)

¹⁴⁰ U.S. CENSUS BUREAU, *supra* note 117.

¹⁴¹ U.S. CENSUS BUREAU, *supra* note 117, at Table 2

Given the large gaps in median income by race and ethnicity, why is there such resistance to class based affirmative action? At least one reason is the overwhelming number of white people in the below poverty category. Poverty in the United States could be cut in half with programs that exclusively service white Americans. In fact, targeting whites for social benefits is a tradition in United States welfare transfer programs.¹⁴² Thus, one fear of class based affirmative action is that it will create a system that shuts blacks out.

Another fear is illustrated in Dalton Conley's contrast between two working class families -- one white and one black -- that each face income insecurity.¹⁴³ The white family's house, the product of a number of government transfer programs targeted to whites over several generations, allows that family to survive the sudden loss of income that destroys the black family which is forced to rent because neither its members nor its ancestors received the government benefits conferred on their white counterparts. Dalton Conley's story illustrates how class is often misunderstood as a function of income.¹⁴⁴ When income determines class the two families appear similarly situated and the black family's misery becomes inexplicable. In contrast, if class is understood as a function of ownership, then the two families share the same income but not the same class. The class difference between the two families reflects a wealth gap between whites and blacks that is significantly greater than other gaps between blacks and whites such as income and education.¹⁴⁵ In fact, the racialized wealth gap is so great that whites in the bottom quintile of income have more wealth on average than blacks in the top quintile.¹⁴⁶

To the extent that the tax system becomes a tool of class justice, defining class through property ownership contributes to race based affirmative action as well as class based affirmative action because wealth and race are so bound together in our society.¹⁴⁷ Taxing wealth in addition to income allows one government action -- taxation-- to counter balance another series of government actions -- depriving people of property today and in the past.

C. Reparations

¹⁴² See text *infra* note 154.

¹⁴³ See *supra* note 125.

¹⁴⁴ Malamud, *Class-Based Affirmative Action: Lessons and Caveats*, *supra* note 133, at 1850 (measures of class tend to be simplistic); Malamud, *Assessing Class-Based Affirmative Action*, *supra* note 133, at 459–72.

¹⁴⁵ William J. Collins & Robert A. Margo, *Racial Differences in Wealth: A Brief Historical Overview* and Elizabeth Kirkland & Sheila R. Peters, *Location, Location, Location: Residential Segregation and Wealth Disparity*, both in *RACE AND WEALTH DISPARITIES: A MULTIDISCIPLINARY DISCOURSE* (Beverly I. Moran, ed., forthcoming Univ. Press of America 2008); OLIVER & SHAPIRO, *supra* note 5, at 110–11.

¹⁴⁶ CONLEY, *supra* note 125, at 1; see also OLIVER & SHAPIRO, *supra* note 5, at 91–125.

¹⁴⁷ *RACE AND WEALTH DISPARITIES: A MULTIDISCIPLINARY DISCOURSE*, *supra* note 145.

Apology and restitution are difficult concepts.¹⁴⁸ As House Speaker Nancy Pelosi discovered when she tried to condemn an Empire that died in 1923, countries are loath to apologize for even their most distant relations.¹⁴⁹ In 21st Century America even mild attempts to apologize for slavery can provoke terrifying threats.¹⁵⁰ Yet, in the face of social and cultural obstacles, there are times when the United States has acknowledged responsibility and provided redress.¹⁵¹ Nevertheless, when the subject is American

¹⁴⁸ See, e.g., JENNIFER HARVEY, *WHITENESS AND MORALITY: PURSUING RACIAL JUSTICE THROUGH REPARATIONS AND SOVEREIGNTY* (2007); CHARLES P HENRY, *LONG OVERDUE : THE POLITICS OF RACIAL REPARATIONS* (2007); MICHAEL J BAZYLER, *HOLOCAUST RESTITUTION : PERSPECTIVES ON THE LITIGATION AND ITS LEGACY* (2006); MARY FRANCES BERRY, *MY FACE IS BLACK IS TRUE : CALLIE HOUSE AND THE STRUGGLE FOR EX-SLAVE REPARATIONS* (2005); ALFRED L. BROPHY, *REPARATIONS PRO & CON* (2006); ROY L BROOKS, *ATONEMENT AND FORGIVENESS: A NEW MODEL FOR BLACK REPARATIONS* (Univ. of Cal. Press 2004); RONALD P SALZBERGER, *REPARATIONS FOR SLAVERY : A READER* (2004); MICHAEL J.BAZYLER, *HOLOCAUST JUSTICE : THE BATTLE FOR RESTITUTION IN AMERICA'S COURTS* (2003); ROBERT SADAMU SHIMABUKURO, *BORN IN SEATTLE : THE CAMPAIGN FOR JAPANESE AMERICAN REDRESS* (2001); BORIS I. BITTKER, *THE CASE FOR BLACK REPARATIONS* (Beacon Press 2003); RANDALL ROBINSON, *THE DEBT: WHAT AMERICA OWES BLACKS* (2000); CLARENCE J. MUNFORD, *RACE AND REPARATIONS: A BLACK PERSPECTIVE FOR THE TWENTY-FIRST CENTURY* (1996); *WHEN SORRY ISN'T ENOUGH: THE CONTROVERSY OVER APOLOGIES AND REPARATIONS FOR HUMAN INJUSTICE* (Roy L. Brooks, ed., 1999) [hereinafter *WHEN SORRY ISN'T ENOUGH*].

¹⁴⁹ In 2007, House Speaker Nancy Pelosi introduced a bill condemning the Ottoman Empire for genocide against its Armenian population. For information on the bill introduced by the House Speaker, see Carl Hulse, *As Turks Object, Genocide Motion Falters*, N.Y. TIMES, Oct. 17, 2007, at P. 1.

For background information on the Armenian genocide, see DONALD BLOXHAM, *THE GREAT GAME OF GENOCIDE: IMPERIALISM, NATIONALISM, AND THE DESTRUCTION OF THE OTTOMAN ARMENIANS* (2005); RICHARD G. HOVANNISIAN, *LOOKING BACKWARD, MOVING FORWARD : CONFRONTING THE ARMENIAN GENOCIDE* (2003); MERRILL D. PETERSON, *STARVING ARMENIANS": AMERICA AND THE ARMENIAN GENOCIDE, 1915–1930 AND AFTER* (2004) J. M. WINTER, *AMERICA AND THE ARMENIAN GENOCIDE OF 1915* (2003).

For background information on the fall of the Ottoman Empire, see KEMAL H. KARPAT, *OTTOMAN PAST AND TODAY'S TURKEY* (2000); M. NAIM TURFAN, *RISE OF THE YOUNG TURKS: POLITICS, THE MILITARY AND OTTOMAN COLLAPSE* (1999).

¹⁵⁰ E. Gordon Gee, *Carpetbaggers and Conflagration: Vanderbilt University Makes New Enemies of Old Friends*, in *UNIVERSITY PRESIDENTS AS MORAL LEADERS* (David G. Brown, ed., 2006) (describing death threats received by the Chancellor and Vice Chancellor as a result of an attempt to change the name of a dormitory from “Confederate Memorial Hall” to “Memorial Hall”).

¹⁵¹ For discussions of reparations to Japanese Americans, see Eric K. Yamamoto & Liann Ebesugawa, *Report on Redress: The Japanese American Internment*, in *THE HANDBOOK OF REPARATIONS* (Pablo De Greiff, ed., 2006); BROPHY, *supra* note 148; BROOKS, *supra* note 148; ERIC K., YAMAMOTO, *RACE, RIGHTS, AND REPARATION: LAW AND THE JAPANESE AMERICAN INTERNMENT* (2001); MITCHELL T. MAKI, HARRY H.L. KITANO & S. MEGAN BERTHOLD, *ACHIEVING THE IMPOSSIBLE DREAM: HOW JAPANESE AMERICANS OBTAINED REDRESS* (1999); ERIC K. YAMAMOTO, *INTERRACIAL JUSTICE: CONFLICT AND RECONCILIATION IN POST-CIVIL RIGHTS AMERICA* (1999); PETER H. IRONS, *JUSTICE DELAYED: THE RECORD OF THE JAPANESE AMERICAN INTERNMENT CASES* (1989).

For discussions of Japanese internment during World War II, see NATSU TAYLOR SAITO, *FROM CHINESE EXCLUSION TO GUANTÁNAMO BAY : PLENARY POWER AND THE PREROGATIVE STATE* (2007);

slavery, reparations raise serious disagreements.¹⁵² In the context of the capitalist ideal of universal prosperity and political liberty, there is no doubt that slavery betrayed the United States' Enlightenment ideals by denying millions of people the ability to obtain wealth and pass that wealth down to future generations.¹⁵³ These restrictions on the

ERIC L. MULLER, *AMERICAN INQUISITION: THE HUNT FOR JAPANESE AMERICAN DISLOYALTY IN WORLD WAR II* (2007); TETSUDEN KASHIMA, *JUDGMENT WITHOUT TRIAL: JAPANESE AMERICAN IMPRISONMENT DURING WORLD WAR II* (2003); KAREN LEA RILEY, *SCHOOLS BEHIND BARBED WIRE: THE UNTOLD STORY OF WARTIME INTERNMENT AND THE CHILDREN OF ARRESTED ENEMY ALIENS* (2002); SCOTT P. CORBETT, *QUIET PASSAGES: THE EXCHANGE OF CIVILIANS BETWEEN THE UNITED STATES AND JAPAN DURING THE SECOND WORLD WAR* (1987).

For discussion of reparations and Native Americans, see Nell Jessup Newton, *Indian Claims for Reparations, Compensation, and Restitution in the United States Legal System*, in *WHEN SORRY ISN'T ENOUGH*, *supra* note 148.

¹⁵² For discussions of objections to the modern black reparations movement, see, for example Robert K. Fullinwider, *The Case for Reparations*; Stephen Kirshner, *The Case Against Reparations*, both in *REPARATIONS FOR SLAVERY: A READER*, *supra* note 125; JUAN WILLIAMS, *ENOUGH: THE PHONY LEADERS, DEAD-END MOVEMENTS, AND CULTURAL FAILURE THAT ARE UNDERMINING BLACK AMERICA – AND WHAT WE CAN DO ABOUT IT* 67–85 (2006) (listing several objections to the black reparations movement including that the movement is not serious in either a political or a cultural sense); Alfred L. Brophy, *Reconsidering Reparations*, 81 *IND. L.J.* 811, 814 (2006) (criticizing Posner & Vermuele below for using a too narrowly drawn definition of reparations); Louis Kaplow and Steven Shavell, *Fairness and Welfare*, 114 *HARV. L. REV.* 967 (2001); Eric A. Posner & Adrian Vermeule, *Essay: Reparations for Slavery and Other Historical Injustices*, 103 *COLUM. L. REV.* 689 (2003) (criticizing current writings on reparations as based on large-scale abstractions about justice and injustice); BROOKS, *supra* note 148, at 180–206 (listing objections to black reparations including African involvement with the slave trade, the universal acceptance of slavery during the 19th Century, reparations unfairly penalizes white Americans whose families immigrated after the Civil War, all the slaves are dead so there is no one to compensate, reparations is just an even more illegitimate form of affirmative action, white soldiers paid reparations for the entire nation by their deaths in the Civil War, slavery gave present day black Americans the opportunity to live in a prosperous country, class based reparations are more universal and fair, blacks need to contribute to racial reconciliation, there is so much mixed blood in the United States that everyone would be entitled to reparations, the amount of reparations is impossible to calculate); Brophy, *supra* note 148 (listing objections to reparations in addition to those listed by Brooks including: only a small minority of whites ever owned slaves, black reparations is based on race and not injury, blacks owe a greater debt to the United States than the country owes to blacks, reparations is just disguised separatism).

For a history of some of the calls for black reparations over the last 30 years, see, for example, John Torpey, *Legalism and its Discontents: The Case of Reparations for Black Americans*, in *THE LIMITS OF LAW* 75–108 (Austin Sarat, Lawrence Douglas & Martha Merrill Umphrey eds., 2005); Note, *Bridging the Color Line: The Power of African-American Reparations to Redirect America's Future*, 115 *HARV. L. REV.* 1689 (2002); ROBINSON, *supra* note 148 ; BITTKER, *supra* note 148 ; Robert Westley, *Many Billions Gone: Is it Time to Reconsider the Case for Black Reparations?* 40 *B.C. L. REV.* 429 (1998); Vincene Verdun, *If the Shoe Fits, Wear It: An Analysis of Reparations to African Americans*, 67 *TUL. L. REV.* 597 (1993); Rhonda V. Magee, *The Master's Tools, From the Bottom Up: Responses to African American Reparations Theory in Mainstream and Outsider Remedies Discourse*, 79 *VA. L. REV.* 863 (1993).

¹⁵³ For a discussion of the impact on modern law of the creation of people as property, see, for example, Patricia Williams, *Fetal Fictions: An Exploration of Property Archetypes in Racial and Gendered Contexts* 42 *FLA. L. REV.* 81 (1990); Patricia Williams, *On Being the Object of Property*, 14 *SIGNS J. WOMEN CULTURE & SOC'Y* 5 (Autumn 1988).

ability to accumulate and pass on wealth did not end with slavery. Instead, a series of government programs reinforced the wealth disparities between those citizens that arrived by migration and those who arrived in chains.¹⁵⁴ In addition to the other government programs that help maintain the wealth gap that began with slavery we can add our decision to tax income instead of wealth. Our federal tax laws continue to exacerbate the wrong started in slavery in a number of ways: First, by confiscating a portion of the earnings that could otherwise go towards accumulating wealth, the federal tax laws make it harder for each generation to make up for past lost opportunities. Second, government programs that created wealth for whites added to the black/white wealth gap. Third, by treating income from wealth much more favorably than earned income, the current system can result in working people paying higher rates than their wealthy employers.¹⁵⁵

For discussions of Enlightenment influences on the creation of the United States, see, for example, GARY L. MCDOWELL, *AMERICA AND ENLIGHTENMENT CONSTITUTIONALISM* (2006); JACK FRUCHTMAN, *ATLANTIC COUSINS: BENJAMIN FRANKLIN AND HIS VISIONARY FRIENDS* (2005); DARREN STALOFF, *HAMILTON, ADAMS, JEFFERSON: THE POLITICS OF ENLIGHTENMENT AND THE AMERICAN FOUNDING* (2005); GERTRUDE HIMMELFARB, *THE ROADS TO MODERNITY: THE BRITISH, FRENCH, AND AMERICAN ENLIGHTENMENTS* (2004).

For a discussion of the connection between reparations theory and critical legal studies, see Mari J. Matsuda, *Looking to the Bottom: Critical Legal Studies and Reparations*, 22 HARV. C.R.-C.L. L. REV. 323 (1987). See also A. LEON HIGGINBOTHAM, JR. IN *THE MATTER OF COLOR: THE COLONIAL PERIOD* (1978); Cheryl Harris, *Whiteness as Property*, 106 HARV. L. REV. 1709 (1993).

¹⁵⁴ In the context of social security, see Marc Linder, *Farm Workers and the Fair Labor Standards Act: Racial Discrimination in the New Deal*, 65 TEX. L. REV. 1335 (1987), legislative history of the Social Security Act shows that blacks were deliberately excluded from benefits under the domestic and farm worker provisions and that even blacks that were eligible for social security assistance received significantly lower benefits than whites. See also MEIZHA LUI ET AL., *supra* note 100, at 73–130 (discussing the historical events that have led to black wealth inequality in America including slavery, blacks inaccessibility to New Deal programs, and other state sponsored discrimination in the areas of employment and housing); POOLE, *supra* note 89.

For a discussion of the role of the federal government in denying black Americans access to wealth in housing, see, for example, DOUGLAS S. MASSEY & NANCY A. DENTON, *AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS* (1993); William J. Collins & Robert A. Margo, and Elizabeth Kirkland & Sheila Peters, *supra* note 145.

For racist policies in education meant to perpetuate a black underclass, see, for example, Reavis Mitchell & Roland Mitchell, *History and Education: Mining the Gap: Historically Black Colleges as Centers of Excellence for Engaging Disparities in Race and Wealth*, in *RACE AND WEALTH DISPARITIES IN THE UNITED STATES: A MULTIDISCIPLINARY DISCOURSE*, *supra* note 145.

For general discussions of the wealth gap between blacks and whites in the United States, see, for example, CONLEY, *supra* note 125, at 55–81; OLIVER & SHAPIRO, *supra* note 5, at 110–11; CHUCK COLLINS, BETSY LEONARD-WRIGHT, AND HOLLY SKALR, *SHIFTING FORTUNES: THE PERILS OF THE AMERICAN WEALTH GAP* (1999); Francine D. Blau & John W. Graham, *Black White Differences in Wealth and Asset Composition*, 105 Q. J. ECON. 321 (1990) (large differences in wealth acquisition that cannot be explained by income, education, region or marriage).

¹⁵⁵ Such rules as deferring the unrealized gains in wealth, often allowing those unrealized gains to completely escape tax through the date of death basis rules of I.R.C. § 1014, and taxing the income flowing from wealth at less than half the maximum rates for earned income I.R.C. § 1(h) have all led Warren Buffet

Thus, the federal income tax both shelters wealth for those who are already wealthy and attacks the means of obtaining wealth for those who are not wealthy. At least some of the objections to reparations and the flaws in our federal tax system are answered with a wealth tax.

First, a wealth tax eliminates the special benefits that the Internal Revenue Code now confers on property and its owners.¹⁵⁶ Thus the great gap in wealth between blacks and whites (and males and females) no longer acts through the tax system as a way of protecting white wealth to the detriment of blacks. Instead a wealth tax places the tax burden directly where Smith would recommend, i.e., on the greatest beneficiary of government largess, the property owner. Second, an income tax with an exemption up to the Living Wage shelters a great deal of income in the black community which relies on wages for income more than other ethnic groups.¹⁵⁷ Third, the protection of an amount of wealth needed to support necessities would excuse a large portion of the black population from taxation thereby providing a period of time for blacks as a group to build up their wealth base after centuries of restrictions on black wealth accumulation.¹⁵⁸ Finally, although government was a main force stripping blacks of their wealth for all these centuries, government was (and is) also the cause of black wealth. As Smith reminds us, all wealth flows from government. For example, the Civil War Amendments and the Civil Rights Laws are real sources of black wealth.¹⁵⁹ Without those government

(reportedly the third richest man on earth) to ask why he pays a lower tax rate than his secretary. Tom Bawden, *Buffet blasts system that lets him pay less than his secretary*, TIMES OF LONDON, June 28, 2007, at 1; *The Matthew Effect and Federal Taxation*, 45 B.C. L. REV. 993 (2004); Martin McMahon, *The Matthew Effect and Federal Taxation*, 105 TAX NOTES 1383 (Dec. 6, 2004); Moran & Whitford, *supra* note 90 (ways that the benefits for wealth create greater tax liabilities for black taxpayers).

¹⁵⁶ See, e.g., Moran & Whitford, *supra* note 90.

¹⁵⁷ See, e.g., Brown & Cornfield, *A Selective Review of Sociological Perspectives on the Relationship Between Race and Wealth*, in RACE AND WEALTH DISPARITIES: A MULTIDISCIPLINARY DISCOURSE, *supra* note 145 (discussing how various United States ethnic groups attempt to increase wealth with Koreans being the most likely to engage in entrepreneurship and blacks aided most by unionized labor).

¹⁵⁸ For general information about the growing gap between the rich and the poor in the United States based on income, see, for example, CONGRESSIONAL BUDGET OFFICE, *supra* note 15 (incomes of the top 1 percent of Americans from 2003 to 2005 exceeded the total income of the poorest 20 percent of Americans); Collins & Yeskel, *supra* note 15, at 39–67; BORN ON THIRD BASE: THE SOURCE OF WEALTH OF THE 1997 FORBES 400 (1997).

For specific information on the larger wealth gap between blacks and whites in the United States, see OLIVER & SHAPIRO, *supra* note 5; CONLEY, *supra* note 125; COLLINS & MARGO, *supra* note 145.

¹⁵⁹ The Civil War Amendments are: Amendment XIII (Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States ...); Amendment XIV (All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States.... No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws); Amendment XV (The right of citizens of the United States to vote shall not be denied or abridged by the United States or by any state on account of race, color, or previous condition

actions, blacks would have less wealth than they do today no matter how small a portion that wealth is in contrast to their white counterparts. With a wealth tax, blacks pay the tax that is most closely associated with the benefits that government conferred on them while also receiving the lower tax bills that come from the recognition that lower wealth rates are also a result of government action against them.

VI. Comparing three tax systems at the living wage

A capitalist tax system exempts the wages and necessities needed to support a minimum material standard from both direct and indirect taxes. Establishing the correct standard is dependent on time, place and culture. In the 21st Century United States, the differences between the poverty threshold, the minimum wage, the EITC limits and the various living wage calculations illustrate that the real cost of living an acceptable American life is hard to calculate. Of the four possibilities (poverty line, minimum wage, EITC or the Living Wage) the Living Wage is the most likely to completely eliminate the double tax on labor thereby better preserving the balance between natural and market price. In order to apply capitalist principles to taxation in support of Smith's universal prosperity project, this section uses the Living Wage as an exemption amount under three tax systems in order to illustrate how each system handles necessities and wages. The three systems are: (a) a consumption tax (b) a hybrid income tax/consumption tax, and (c) a wealth tax.

A. Consumption tax

From Smith's point of view, a consumption tax on necessities will always distort prices by double counting the cost of labor. In the comprehensive income tax system the flaw of taxing the wages needed to sustain a strong working class life is corrected through a large exemption. In the wealth tax, the wealth needed to sustain a Living Wage is also exempt. In contrast, a consumption tax is often collected through sales and excise taxes in which tax liability is on the purchaser but tax payments are bundled and paid by sellers. The attenuated tax collection that distinguishes consumption taxes from income taxes, hybrid income/consumption taxes, and wealth taxes makes it harder to protect wages through exemption amounts.

The consumption tax does have an advantage over the income tax or the hybrid income/consumption tax in terms of protecting low income savings. In the hybrid income/consumption tax interest on savings accounts are taxed while unrealized gains in property (e.g. stocks and bonds) are not taxed. The rules taxing interest but not unrealized gains place a heavier burden on low income people who are trying to save in order to

of servitude); *see also* Civil Rights Act of 1866, ch. 31, 14 Stat. 27; Civil Rights Act of 1957, Pub. L. No. 85-315, 71 Stat. 634 (codified at 42 U.S.C. § 1971); Civil Rights Act of 1960, Pub. L. No. 86-449, 74 Stat. 86 (codified at 42 U.S.C. § 1971); Civil Rights Act of 1964 Pub. L. No. 88-352, 78 Stat. 241 (codified at 42 U.S.C. § 2000); Civil Rights Act of 1968, Pub. L. No. 90-284, 82 Stat. 73 (codified at 42 U.S.C. § 3601); Civil Rights Act of 1991, Pub. L. No. 102-166, 105 Stat. 1071; Voting Rights Act Amendments of 1970, Pub. L. No. 91-285, 84 Stat. 314 (codified at 42 U.S.C. § 1971); Voting Rights Act Amendments of 1982, Pub. L. No. 97-205, 96 Stat. 131 (codified at 42 U.S.C. § 1971 note); Voting Rights Act of 1965, Pub. L. No. 89-110, 79 Stat. 437 (codified at 42 U.S.C. §§ 1971, 1973 et seq.).

enter the housing market than the burden that they place on higher income people who are already in the housing market and receiving the benefits of tax deferred appreciation. In contrast, the consumption tax shelters all savings thereby equalizing the treatment between those trying to enter the housing market and those already in owner-occupied housing.¹⁶⁰ However, low income people have the least discretion regarding savings and so they have limited access to the major tax shelter that a consumption tax offers.¹⁶¹

In kind benefits, which should be taxed under a comprehensive income tax and are generally tax exempt under the hybrid income\consumption tax, are included in a comprehensive consumption tax base. Thus, poor people find a larger portion of their income subjected to taxes under a pure income or a pure consumption tax than through a hybrid income\consumption tax which exempts free lunches, bus passes and subsidized housing.¹⁶² On the federal, State and local level, sales and excise taxes continue in a consumption tax system thereby ensuring that every portion of a poor person's income remains subject to some combination of state, local and federal taxes.

In the end, the fact that low income people will always have high consumption rates and that is hard to construct class based exemptions in a consumption tax make a consumption tax that reaches beyond luxuries a bad fit for Smith's capitalist ideal.

B. Hybrid income/consumption tax

The current hybrid income\consumption tax already shelters a Living Wage.¹⁶³ It also exempts some transfer payments while taxing other transfers.¹⁶⁴ The current hybrid income\consumption tax exempts most wealth accumulation especially wealth in excess of the amounts needed to support a Living Wage. The failure to tax wealth in excess of the amount needed to support a Living Wage and the failure to exempt the wealth needed to support a Living Wage violate both Smith's tax benefit ideal and his theory of price. In other words, our current hybrid income\consumption tax does not shift the tax burden to those who receive the most government benefit and it has features that distort the balance

¹⁶⁰ A pure consumption tax might even do more by taxing the consumption element of owner occupied housing as it would tax the rents used to support apartment living.

¹⁶¹ Different savings patterns also affect taxpayers by race because the proportion of assets held in white non-Hispanic households differs from black household assets. Blau & Graham, *supra* note 154, 321–39 (showing that blacks save at a higher rate than whites but that the form of savings is more likely to be taxed than the form of white household assets).

¹⁶² U.S. CENSUS, *supra* note 117.

¹⁶³ See *supra* note 124; CONGRESSIONAL BUDGET OFFICE, *supra* note 15, at 6 Summary Table 1 (Effective Federal Tax Rates, 2004 and 2005) (showing that households with less than \$37,000 paid a negative rate on the individual income tax and that households with less than \$58,000 paid an effective 3% rate in the individual income tax).

¹⁶⁴ Transfer payments that are subject to tax include social security retirement benefits and unemployment compensation. Benefits that are not subject to tax include school lunch programs.

between market and natural price. Although the present hybrid income\consumption tax is not able to separate out the wealth that should be taxed from the wealth that should be exempt, it can accept capitalist adjustments for wages in the form of a large exemption for the social security wage tax, a refundable Earned Income Tax Credit up to \$45,000 and the elimination of excise taxes on necessary commodities. In contrast, another significant problem within the system as a whole is the number of State, local and federal taxes in addition to income taxes that are either direct or indirect taxes on wages.¹⁶⁵ In order to truly exempt a Living Wage under the current United States tax system adjustments are required in:

1. The social security wage tax. The current tax applies a flat rate of 15.3% to all wage income up to a total of \$97,500. Protecting the Living Wage requires exempting the first \$45,000 of wages from the social security wage tax for a two parent family of four instead and then applying the flat rate to all wage income over that threshold.¹⁶⁶
2. The excise and sales tax systems. Elimination of state, federal and local sales and excise taxes so as to avoid taxing necessary commodities and thereby indirectly taxing wages. Replace these indirect taxes on wages with luxury consumption taxes.
3. The income tax. Increase the amount that a two parent family of four can earn and still be eligible for the refundable EITC up to the Living Wage amount of \$45,000.

¹⁶⁵ CONGRESSIONAL BUDGET OFFICE, *supra* note 15, at 6 Summary Table 1 (Effective Federal Tax Rates, 2004 and 2005) (showing that households with less than \$15,800 paid an 8% effective rate on social insurance taxes and a 2.3% effective rate on federal excise taxes).

¹⁶⁶ The maximum amount of earnings that are subject to Social Security tax rises in step with increases in national average wages. The maximum earnings for tax years 2006, 2007 and 2008 are:

Maximum Earnings Taxable			
Program	2006	2007	2008
Social Security	\$94,200	\$97,500	\$102,000
Medicare	No Limit for any year after 1993		

The Social Security tax rate is 6.2% on the employer and an additional 6.2% on the employee and the Medicare tax rate is 1.45% on the employer and an additional 1.45% on the employee. The total tax rate borne by wages up to the cap is 15.3%.

For the source of these calculations, see U.S. Social Security Administration, Find An Answer to Your Question, <http://www.socialsecurity.gov/> (follow “Frequently Asked Questions”; then follow Category “Taxes and Social Security”; then follow Sub-Category “General-Taxes”; then enter keywords “What is the Social Security tax rate?”) (last visited Dec. 29, 2007).

Some presidential candidates have toyed with the idea of applying the social security wage tax to the entire amount of wages but none have suggested exempting a base amount needed to protect a Living Wage. Joel Achenbach, *That's Rich -- but Maybe Not for Someone Else; Issue of Who's Really Wealthy Can Also Affect Political Debate*, WASH. POST, Nov. 26, 2007, at A02 (contrasting Hillary Clinton and Barack Obama on their views on lifting the cap on the social security wage tax).

Thereby continuing to use the tax system as an indirect welfare system for the working poor.¹⁶⁷

What the current hybrid income/consumption tax does not do is separate out the wealth that should be taxed from the wealth that should be sheltered. In fact, the current system is much more likely to tax the wealth that should be sheltered and shelter the wealth that should be taxed. For example, the start up funds needed to enter the housing market will most likely reside in an interest bearing account that is taxed annually. Once the family enters the housing market however, the appreciation in the house escapes federal tax for years if not forever. As a result of these distinctions between types of wealth, the family that needs the most help gets taxed and the family that is already secure avoids tax.

C. Comprehensive wealth tax

In a comprehensive wealth tax system the adjustments for the social security wage tax and state and local taxes under the hybrid income/consumption tax remain relevant because the Living Wage must escape both direct and indirect taxes. In addition, an amount of wealth needed to sustain a Living Wage household in hard times also requires exemption.¹⁶⁸ The standard deduction amount for a comprehensive wealth tax in the contemporary United States based on a cultural understanding of necessities for two adults with two children should include \$68,000 of wealth and \$45,000 annual income.¹⁶⁹

D. Who is left behind in a comprehensive wealth tax with a large standard deduction?

A system that relies on the Earned Income Tax Credit's refundable feature in order to get a family up to the Living Wage will not reach all the poor. Those without wage labor miss the income boost from the refundable credit.

An exemption large enough to support a house does not give a taxpayer a house but it does acknowledge that there is a sphere of political liberty and economic advantage that our government is meant to keep tax exempt.¹⁷⁰ In the 18th, 19th and 20th Centuries that sphere often included land transferred to white households and companies.

Farms and other enterprises that hold wealth that produces little income are strongly affected by a shift to a wealth tax. On the other hand, keeping debt out of the tax base creates less incentive to borrow in contrast to the present tax system which encourages

¹⁶⁷ Lawrence A. Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867 (2005).

¹⁶⁸ CONLEY, *supra* note 125, at 1.

¹⁶⁹ See discussion *supra* Parts V.A–B on the Living Wage.

¹⁷⁰ See Robert Nozick ANARCHY, STATE AND UTOPIA (1974) (taxation of wages is a kind of state sponsored slavery).

borrowing to acquire wealth, particularly wealth in real estate.¹⁷¹ In today's predatory lending climate, tax rules that discourage borrowing might provide economic as well as tax benefits.

VII. Conclusion

If a 21st Century United States Congress asked the father of capitalism to construct a new tax system for a new century, Adam Smith would advocate a comprehensive wealth tax with a large standard deduction and a flat rate, a consumption tax on luxuries, and an income tax with a refundable credit up to the Living Wage. Smith would advocate a comprehensive wealth tax because it supports his larger project of achieving universal prosperity and political freedom through capitalism, and because the administrative, political, and cultural conditions in the 21st Century United States make a comprehensive wealth tax feasible in ways that were once impossible. The 20th Century gave us an income tax because of the ideals and constraints of its time. After one hundred years of technological, political and cultural change, a federal comprehensive wealth tax -- unattainable in the 20th Century -- becomes both possible and compelling in the 21st Century.

The 20th Century income tax has costs based on controversies that are no closer to resolution than they were one hundred years ago. Although it is certainly true that any sophisticated tax in a complex society will produce similar costs, given that all sophisticated taxes are expensive to administer, is the price well spent on a system that responds to the past as much as the present? Is it time to consider another path not because the income tax is inherently flawed but because it was created for a different time and place? In the 21st Century when government has so much more access to information about assets and where the politics and culture are less protective of privacy, there is an opportunity to consider a tax system that not only raises revenues but is also part of a larger project. If that larger project is universal prosperity through capitalism then the father of capitalism would direct us to tax the rich while sheltering the poor and working classes.

¹⁷¹ I.R.C. § 163(h)(3) (qualified mortgage interest deduction), I.R.C. § 164(a)(1) (deduction for state and local property taxes), I.R.C. § 121(exclusion for gains from the sale of owner occupied housing), I.R.C. § 1014 (date of death basis). But see the Amount at Risk Rules of I.R.C. § 465 and the Passive Activity Loss Rules of I.R.C. § 469 for tax rules that limit the tax benefits of financed real estate.