COMMENTS

TWO STORIES OF TAXATION OF CAPITAL

by
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The discussion on whether and to what to degree to tax wealth and capital in the United States is as old as the country itself. This Comment analyzes the debate and its history through the lenses of two different general theories of property. The first is a Lockean ideal of the sanctity of private property and capital. The second focuses on the role of the community in the creation of capital and the ramifications that it has for taxation. Both stories can be traced from the very beginning of income taxation in the United States to current debates on capital gains and wealth transfer taxes. Through this Comment, I seek to better understand these theories and, through them, better understand the debates on taxation of capital in which they are used.

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I. INTRODUCTION

There are countless ways to approach the debate on whether, and to what degree, to tax wealth and capital in the United States. Although economists have tackled the problem with apparent scientific precision and wide-ranging methodologies, the larger debate is often viewed through the lens of one story or another.[1] The proponents of different views often couch their arguments in assumptions about the role of property in society as a whole, lending credibility to or discrediting opposing arguments in the process. Like many stories, the storytellers may not always be consciously aware that they are telling these stories—indeed, the less obvious and more natural a story feels to the listener, the greater weight it is likely to have in the debate.

In this Comment, I will examine two different stories. Although these two stories have both been popular (to varying degrees) over the past century, they are far from the only ways of viewing the debate. Each is only a single possible facet of the entire issue, and often will be blended with other arguments without explicit acknowledgment. Nonetheless, these two particular stories have become particularly important, and shades of one or the other are very common in debates on taxation. By isolating and understanding these stories in those debates, the listener (or even the teller) should be able to gain some clarity and direction in the winding, murky realm of tax policy. These stories can act as lodestones for both the seasoned and the uninitiated when wading into the rockier depths of serious economic theory, social

[1] I use the term "stories" here in the sense that Carol M. Rose referred to stories and narrative in her piece, *Property as Storytelling: Perspectives from Game Theory, Narrative Theory, Feminist Theory*, to refer to a plausible telling of the state of the world in order to tease out meaning and order. 2 YALE J.L. & HUMAN. 37, 38–39 (1990).

agenda, and countless other apparently unrelated disciplines that inevitably intersect with taxation.

The first story, one that has retained quite a bit of popularity over the centuries, is about the sanctity of private property. The story goes, in essence, that successful capitalists or investors earned or acquired their own wealth, so they know best how to put it to good use. It is, after all, *their* property, and labeling anything as "owned" has powerful implications. This story often overlaps with similar concepts, such as laissez-faire capitalism and market-efficiency arguments. The story generally advocates taxing capital as little as possible (if at all) in order to facilitate further and greater investment and reinvestment by the capitalists of their own accumulated wealth. I will refer to this story as the story of private capital.

The second story is about how certain types, or certain amounts, of wealth more rightly belong to the community as a whole rather than the individual. There are many variations on this story, but all of them are intentionally counter to the story of private capital. Some tellings focus on how particular methods of income, such as rents from land or returns from long-term investments, are gains from capital that should accrue to the people, not an individual. Other versions speak about large accumulations of wealth at some point being less the fruit of one individual's labor and more the product of the infrastructure and work force of the community supporting the individual's efforts. These stories generally advocate taxing capital or large accumulations of wealth more, reasoning that the profits do not belong entirely to the individual, or at least are owed back to the community in part. I will refer to this story as the story of community capital.

II. HISTORY

This Part lays the groundwork for these two stories of taxation of capital and wealth. No matter how much they wax or wane, the two stories have been heavily debated since the first days of the United States. The history is split broadly into four parts, with the 16th Amendment and major wars generally being the most significant catalysts of change. The first Section covers the beginning of the nation up to the ratification of the 16th Amendment, which enabled the modern income tax as we know it today. The second Section details the years following the ratification of the 16th Amendment, leading up to the Second World War, which saw enormous growth in both the income tax base and the progressivity of income taxation. The third Section touches briefly on the modern era, although it largely avoids the more recent, often complex, political and economic movements, as they are beyond the scope of this paper and do little to illustrate the foundations of the two stories of capital. Finally, the current state of capital and wealth will be briefly examined, although only with an eye toward giving context to where history has left us.

A. Before the 16th Amendment

Although income tax in the United States began before the ratification of the 16th Amendment in 1913,[2] it was a mere shadow of what it eventually became. Both before and during the Revolution, those taxes that were not imposed by England were imposed by the colonies.[3] Their methods and rates varied widely, although during the Revolution itself calls were made for more progressive systems, such as taxing property holdings (effectively taxing the wealthiest citizens more).[4]

The debts of the Revolution and desires to forge the foundation of a strong central government led to Article I, Section 8 of the Constitution: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts, and Excises . . . ."[5] The origin of the national income tax was born at this moment, even if the eventual extent of it would not be seen for quite some time. This power was checked by Article I, Section 9: "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census . . . ."[6] However, as historian W. Elliot Brownlee notes, while on the surface this appears to be tacit approval of "Lockean liberalism," in fact the limitation was placed out of concerns of federalism and the importance of local taxation.[7] More to the point, the drafters were afraid of granting too much power to the *federal* government, but most people at the time accepted the idea of effectively progressive property taxes.[8]

Thus, at the beginning of the nation, almost all taxes collected on a national level were from tariffs which, while inherently regressive due to rising costs of consumer items, had the political advantage of being nearly invisible.[9] These proved sufficient at the time to cover the expenses and debts of the fledging government.[10] By the early 19th

[2] Randy E. Barnett, *The Case for the Repeal Amendment*, 78 TENN. L. REV. 813, 815 & n.16 (2011). See Act of Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862), for an example of a pre-1913 income tax.

[3] *See* ROBERT A. BECKER, REVOLUTION, REFORM, AND THE POLITICS OF AMERICAN TAXATION, 1763–1783, at 4–7 (1980); Tax Analysts, *1777–1815: The Revolutionary War to the War of 1812*, THE TAX HIST. PROJECT (2012), http://www.taxhistory.org/www/website.nsf/Web/THM1777.

[4] W. ELLIOT BROWNLEE, FEDERAL TAXATION IN AMERICA: A SHORT HISTORY 14–15 (2d ed. 2004). *See generally* BECKER, *supra* note 3.

[5] U.S. CONST. art. I, § 8, cl. 1.

[6] *Id.* § 9, cl. 4.

[7] BROWNLEE, *supra* note 4, at 17–21.

[8] *See id.* at 20–21. The taxes were effectively progressive because most wealth at that time was held in real estate, and by taxing property (especially real property), the wealthiest individuals would pay substantially more tax than others. *Id.* at 19.

[9] *See id.* at 28; *see also* BECKER, *supra* note 3, at 6–7. Note that tariffs serve other purposes than merely raising revenue (as is true for many taxes)—namely promoting targeted domestic growth by discouraging foreign competition. *See* BROWNLEE, *supra* note 4, at 22.

[10] BROWNLEE, *supra* note 4, at 25; *see also* Henry Carter Adams, *Taxation in the United States, 1789–1816*, *in* INSTITUTIONS AND ECONOMICS 267, 270–71 (Johns Hopkins Univ. Studies in Historical and Political Sci. Ser. 2, Herbert B. Adams ed., 1884).

century, most states had begun taxing property in all forms—real property, personal property, and even intangibles such as stocks and bonds.[11] As Brownlee notes, "By the 1860s, in much of the nation, property taxation was the dominant source of state and local revenues,"[12] while the federal government still found trade tariffs sufficient.[13] The period following the War of 1812 saw a brief period of federal property taxation to make up for the drop in tariff revenues during the war, although it was apportioned to the states along population lines in accordance with Article I, Section 9 of the Constitution.[14]

The Civil War was the turning point. In addition to raising tariffs and vastly expanding excise taxes, the nation's first income tax was born. It created a simple 3% tax on all income above $800.[15] In 1865, the rates were raised to 5% on income above $600, and 10% on income above $5,000.[16] By the end of the war, the tax reached approximately the top 10% of all (Union) households, who collectively owned about 70% of the wealth in the nation.[17] Congressman Thaddeus Stevens approvingly said at the time:

> While the rich and the thrifty will be obliged to contribute largely from the abundance of their means, . . . no burdens have been imposed on the industrious laborer and mechanic; . . . the food of the poor is untaxed; and . . . no one will be affected by the provisions of this bill whose living depends solely on his manual labor.[18]

After the war, the regressive excise taxes were allowed to expire, but lobbying by the wealthiest taxpayers resulted in the income tax expiring as well in 1872.[19] Despite being effectively regressive, the tariff system and excise on alcohol and tobacco largely remained.[20] The groundwork had been laid, due in part to increased awareness of what income taxes could

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[11] BROWNLEE, *supra* note 4, at 26.

[12] *Id.* at 27.

[13] F.W. TAUSSIG, THE TARIFF HISTORY OF THE UNITED STATES 97 (5th ed., Ludwig von Mises Inst. 2003) (1910); Tax Analysts, *1816–1860: The Second American Party and the Tariff*, THE TAX HIST. PROJECT (2012), http://www.taxhistory.org/www/website.nsf/Web/THM1816.

[14] BROWNLEE, *supra* note 4, at 28–29.

[15] *Id.* at 34; *see also* Act of Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862); Tax Analysts, *1861–1865: The Civil War*, THE TAX HIST. PROJECT (2012), http://www.taxhistory.org/www/website.nsf/Web/THM1861. This was very close to the average annual family income of $900 in 1870. BROWNLEE, *supra* note 4, at 34 n.17 (citing 1 U.S. BUREAU OF THE CENSUS, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, at 41, 240 (Bicentennial Ed., 1975)).

[16] BROWNLEE, *supra* note 4, at 34; *see also* Act of March 3, 1865, ch. 78, § 116, 13 Stat. 469, 479.

[17] BROWNLEE, *supra* note 4, at 35.

[18] CONG. GLOBE, 37TH CONG., 2D SESS. 1577 (1862); *see also* Tax Analysts, *supra* note 15.

[19] BROWNLEE, *supra* note 4, at 36–37.

[20] *Id.* at 37–38.

accomplish—funding a nation-shaping war, new public works, and a revolutionary social insurance program for Union veterans and their dependents.[21] As Brownlee notes, although the taxes supporting them were regressive, the effects were viewed positively due to the distributions being largely progressive—at least among the veterans receiving them.[22]

In 1894, after more than a decade of increasing political attacks against more regressive forms of taxation, the income tax was reinstated.[23] It had a much higher exemption this time, taxing income over $4,000, but at a lower rate of 2%.[24] Importantly, this also applied to corporations' profits.[25] It was crafted specifically with taxing the wealthy in mind and reversing the trend of regressive tariffs and excise taxes. However, in 1895, the Supreme Court ended the new law's short life, declaring it unconstitutional for being a direct tax not allocated in proportion to the census of state populations.[26] In 1898 an estate tax was enacted, even garnering support from many wealthy taxpayers (Andrew Carnegie among them).[27] The tax was repealed in 1902, but support for income taxation was growing.[28]

B. After the 16th Amendment

In 1913, the 16th Amendment was ratified, making income taxation constitutional.[29] The first income tax under the amendment—the Revenue Act of 1913—was relatively mild, with rates ranging from 1% to 7% and an exemption amount which assured that only the top 2% of households paid anything.[30] Soon after, a combination of the United States' involvement in World War I, followed by the Great Depression, cemented progressive income taxation as a prominent feature of the country's taxation.

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[21] *Id.* at 38–39 (citing WILLIAM H. GLASSON, FEDERAL MILITARY PENSIONS IN THE UNITED STATES (David Kinley ed., 1918)).

[22] *Id.* It also helped popular support that the excise taxes were being levied on substances that were seen as "sinful." *Id.* at 40.

[23] *Id.* at 43–46.

[24] *Id.* at 47; *see also* Tariff of 1894, ch. 349, § 27, 28 Stat. 509, 553, *invalidated by* Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, *aff'd on reh'g*, 158 U.S. 601 (1895); Tax Analysts, *1866–1900: Reconstruction to the Spanish–American War*, THE TAX HIST. PROJECT (2012), http://www.taxhistory.org/www/website.nsf/Web/THM1866.

[25] BROWNLEE, *supra* note 4, at 47.

[26] *Pollock*, 157 U.S. 429.

[27] War Revenue Act of 1898, ch. 448, §§ 29–31, 30 Stat. 448, 464–66; BROWNLEE, *supra* note 4, at 49.

[28] War Revenue Repeal Act of 1902, ch. 500, § 7, 32 Stat. 96, 97; BROWNLEE, *supra* note 4, at 49.

[29] U.S. CONST. amend. XVI ("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.").

[30] Revenue Act of 1913, ch. 16, § 2, 38 Stat. 114, 166–67; BROWNLEE, *supra* note 4, at 56–57.

The Revenue Act of 1916 aggressively instituted these changes. The act doubled the tax on corporate income (to 2%).[31] Congress raised corporate income tax significantly more a year later by taxing "excess profits"—that is, profits beyond the deemed "normal" rate of return.[32] The 1916 Act also included an exemption amount explicitly designed to target wealthy taxpayers instead of normal wages and salaries.[33] The Act also removed the exemption on dividends, effectively taxing corporate capital as ordinary income and introducing double taxation of corporations.[34] The Act also included an estate tax collected at death, and the exemption assured that it only affected approximately the top 1% of decedents.[35] The result in 1918 was that only the top 15% of families paid income tax, and the top 1% accounted for 80% of the revenue.[36] The top 1% paid an average rate of about 15%, with marginal rates ranging from 15% to 77%.[37]

In 1920, political and business backlash resulted in political blocking and weakening of the progressive taxation of the World War I era. The excess profits tax was removed in 1921.[38] The top marginal rate was lowered in a series of steps, from 77% in 1920 to 25% in 1928.[39] The estate tax survived, but the top rate was reduced and the exemption increased such that it affected only the top half of 1% of the taxpayers.[40] More importantly, special deductions and loopholes for the wealthy became popular in Congress, which cut the effective tax rates of the rich nearly in half.[41] Taxes remained progressive, but far less so, and with severe inconsistencies due to carve-outs and varied deductions.

The Great Depression changed things yet again. Although a federal sales tax was suggested during the Hoover administration, its regressive nature killed the idea in Congress.[42] Instead, the Revenue Act of 1932

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[31] Revenue Act of 1916, ch. 463, § 10, 39 Stat. 756, 765; BROWNLEE*, supra* note 4, at 62; *see also* Tax Analysts, *1901–1932: The Income Tax Arrives*, THE TAX HIST. PROJECT (2012), http://www.taxhistory.org/www/website.nsf/Web/THM1901.

[32] Act of Mar. 3, 1917, ch. 159, §§ 200–06, 39 Stat. 1000, 1000–02 (imposing an 8% tax on net income greater than the sum of $5,000 plus 8% of invested capital).

[33] Revenue Act of 1916 § 7, 39 Stat. at 761 (exempting $3,000 in net income for single people and $4,000 for married couples and heads of household); *see also* Tax Analysts, *supra* note 31.

[34] Revenue Act of 1916 § 1(b), 39 Stat. at 757; BROWNLEE*, supra* note 4, at 62.

[35] Revenue Act of 1916 § 201, 39 Stat. at 777; BROWNLEE, *supra* note 4, at 63–64.

[36] BROWNLEE*, supra* note 4, at 63.

[37] *Id.*

[38] Revenue Act of 1921, ch. 136, § 301, 42 Stat. 227, 272; FRED S. MCCHESNEY, MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION 91 (1997); Roy G. Blakey, *The Revenue Act of 1921*, 12 AM. ECON. REV. 75, 75 (1922); Tax Analysts, *supra* note 31.

[39] BROWNLEE, *supra* note 4, at 73; MCCHESNEY, *supra* note 38, at 91.

[40] BROWNLEE, *supra* note 4, at 73; *see also* Revenue Act of 1921, §§ 400–09, 42 Stat. at 277–84.

[41] BROWNLEE, *supra* note 4, at 73–74.

[42] *Id.* at 82–83.

greatly increased the income tax (although it did also tax the sale of some items, such as gasoline).[43] It also breathed new life into the estate tax, expanding its reach and more than doubling its rate.[44]

After Roosevelt was elected in 1933, he faced the problem of raising revenue in the post-Depression economy without too heavily taxing the already impoverished. To fund his New Deal programs, but not raise the ire of wealthy business owners, he at first relied on increased tobacco, gasoline, and (after Prohibition ended) liquor taxes—which together amounted to 40% of the total tax revenue collected.[45] At this time, only about 6% of households paid any income tax.[46] This was also the era of Huey Long and his "Share Our Wealth" proposals, which incited much desire for increased progressive taxation.[47]

Roosevelt sought to attack concentrations of wealth, which he described as "unwholesome" and "sterile," and stated that "ownership of such wealth or riches represents a great public interest and a great ability to pay."[48] As Brownlee notes, Roosevelt "justified his tax-reform program in terms of both its inherent equity and its ability to liberate the energies of individuals and small corporations."[49] Many conservatives of the day, despite not favoring big government, saw progressive taxation as the right thing to do, and as a proper way to support the community.[50] However, after raising taxes on personal holding companies, seeking to raise taxes on capital gains, and seeking to increase corporate undistributed profits taxes, Roosevelt began to meet with stiff opposition from conservatives and business leaders.[51] Some of his more progressive taxes were removed by a shifting Congress, and Roosevelt decried the abandonment of taxation according to ability to pay "an important principle of American taxation."[52] Nonetheless, Roosevelt left a strong legacy on American taxation, focusing on taxing the wealthy at much higher rates and emphasizing general progressivity in rates.

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[43] Revenue Act of 1932, ch. 209, §§ 11, 617, 47 Stat. 169, 174, 266; BROWNLEE, *supra* note 4, at 83.

[44] Revenue Act of 1932 § 401, 47 Stat. at 243; BROWNLEE, *supra* note 4, at 83–84.

[45] BROWNLEE, *supra* note 4, at 87.

[46] *Id.* This is a growth from only about 1% of households paying taxes in 1913. *Higher Taxes on Top 1% Equals Higher Productivity*, THE REAL NEWS NETWORK (Jan. 1, 2011), http://therealnews.com/t2/index.php?option=com_content&task=view&id=31&Itemid=74&jumival=6000.

[47] BROWNLEE, *supra* note 4, at 88.

[48] *Id.* at 90 (quoting Letter from Franklin D. Roosevelt to Roy W. Howard (Sept. 2, 1935), *in* 4 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 354, 355 (1938); 79 CONG. REC. 9657, 9658 (1935) (message from the President)).

[49] *Id.*

[50] *Id.* at 90–91.

[51] *Id.* at 98–99.

[52] *Id.* at 99 (quoting Franklin D. Roosevelt, Address at Arthurdale, W. Va. (May 27, 1938), *in* 1938 THE PUBLIC PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 355, 364 (1941)).

C. *World War II and the Modern Era*

Like the Civil War and World War I, World War II served as another large stepping stone in the path toward a stronger, larger income tax. The impending war effort demanded increased revenue, allowing Roosevelt to once again lobby for progressive plans. In 1942, after the bombing of Pearl Harbor, Roosevelt said in a letter to Congress that "no American citizen ought to have a net income, after he has paid his taxes, of more than $25,000."[53] However, many in the government preferred to raise the necessary war funds through broader-based income taxation that would fall harder on wages and salaries, drawing from the success of the Social Security tax.[54]

A broad-based but still quite progressive income tax was eventually decided on, although it intentionally left loopholes for the wealthy and hamstrung the excess-profits taxes, bringing in far less revenue than was initially proposed.[55] The total number of taxpayers grew from 3.9 million in 1939 to 42.6 million in 1945, resulting in approximately 60% of the labor force paying income taxes.[56] The war softened the blow, however, along with strong propaganda detailing the patriotic nature of paying one's taxes, and a newly invigorated payroll deduction collection method.[57]

The income tax remained broad-based across the working class after the War, although its progressivity fluctuated with the political times. By the 1950s, effective tax rates for the most wealthy dropped to 25%.[58] However, by the 1970s and 1980s, the highest bracket was closer to 30%, while the portion of the labor force paying taxes increased to over 75%, due in part to steady inflation pushing many into higher brackets.[59] It was also in the late 70s that the now-common rhetoric of lowering taxes to decrease deficits was begun by Reagan, an argument very common in the modern private capital camp.[60]

Additionally, beginning in the 1970s, tax expenditures began to gain popularity,[61] which they retain to this day. Because of the largely hidden nature of tax expenditures, Congress was (and remains) able to hide many spending programs within the ever-growing Internal Revenue

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[53] 88 CONG. REC. 3722, 3723 (1942). According to various online calculators, $25,000 in 1942 would be worth around $320,000 in 2009. *See, e.g.*, *CPI Inflation Calculator*, U.S. BUREAU LAB. STAT., http://data.bls.gov/cgi-bin/cpicalc.pl?cost1=25000&year1=1942&year2=2009; *Purchasing Power Calculator*, MEASURING WORTH, http://www.measuringworth.com/ppowerus/.

[54] BROWNLEE, *supra* note 4, at 110.

[55] *Id.* at 111; *see also* Revenue Act of 1942, ch. 619, 56 Stat. 798.

[56] BROWNLEE, *supra* note 4, at 115.

[57] *Id.* at 116–18.

[58] *Id.* at 122.

[59] *Id.* at 126–27.

[60] *Id.* at 137.

[61] *Id.* at 129.

Code, effectively redistributing income or favoring certain constituents with little fanfare.[62] Some of these tax expenditures are progressive, but many are extremely regressive, favoring wealthy taxpayers and corporations. The outcomes of tax debates are now often tucked away in the labyrinthine folds of the Code, with the numerous other special provisions and preferences contributing to the very density that hides them. However, the core of the battle on taxation of capital and wealth remains largely unchanged, and the two stories of Private and Community Capital continue to play key roles.

D. *The Current State of Capital and Wealth*

The current trend is toward an increased disparity of wealth between the highest and the lowest brackets, with the wealthiest individuals earning the vast majority of their wealth from capital sources. The growing inequality of incomes has been dramatic over the past few decades. From 1979 to 2002, the bottom 20%'s share of the nation's pre-tax income fell by 27%, while the top 20%'s share rose by an average of almost 15%.[63] Capital gains are "heavily concentrated at the top 1%, which controls 33% of the nation's wealth."[64] The vast majority of short-term stock net gains are realized by individuals earning $1 million or more each year, accounting for over 64% of all long-term stock net gains.[65] Within the top 400 tax returns from 2007, nearly 70% of adjusted gross income came from capital gains on average, accounting for over 10% of the entire nation's capital gains in approximately 0.0002798% of the nation's returns.[66]

In addition, capital is generally taxed favorably today, and because the majority of the highest earners' wealth is in capital, they tend to reap the most benefits from this tax. The most visible favorable treatment of capital can be seen in the 15% rate on long-term capital gains and stock dividends,[67] although as a practical matter there are countless small favorable provisions throughout the Code.[68] This results in rates not

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[62] *Id.* at 129–30.

[63] Alice Gresham Bullock, *The Tax Code, the Tax Gap, and Income Inequality: The Middle Class Squeeze*, 53 HOW. L.J. 249, 252 (2010).

[64] *Id.* at 261.

[65] Janette Wilson & Pearson Liddell, *Sales of Capital Assets Reported on Individual Tax Returns, 2007*, STAT. INCOME BULL. Winter 2010, at 76. Note that an annual income in 2007 of $410,000 puts an individual within the top 1%. Statistics of Income Div., IRS, *Returns with Positive Adjusted Gross Income*, IRS (July 2010), http://www.irs.gov/pub/irs-soi/08in05tr.xls.

[66] Statistics of Income Div. IRS, *The 400 Individual Income Tax Returns Reporting the Highest Adjusted Gross Income Each Year, 1992–2007*, IRS, http://www.irs.gov/pub/irs-soi/07intop400.pdf.

[67] I.R.C. § 1(h)(1)(C) (West 2012); *see also id.* § (h)(3) (defining "adjusted net capital gain" to include qualified dividend income).

[68] *See, e.g.*, Howard Gleckman, Tax Pol'y Ctr., *What Would Happen if Congress Rewrote the Mortgage Interest Deduction?*, TAX VOX (Mar. 1, 2011, 4:52 PM),

actually being very progressive at all. To illustrate this, Warren Buffett famously stated in 2007 that his own effective tax rate was just over 17%, while his receptionist's was about 30% (he also compared his tax rate to his cleaning staff's, who pay an effective rate similar to his receptionist).[69] His point was not that he utilized loopholes and shelters, but that the vast majority of his wealth was in capital. While Mr. Buffett may be an extreme example, on the whole, tax rates are barely progressive at all—despite proclaiming to be—especially when one takes into account state taxes, which typically hit lower-income earners harder as a percentage of total income.[70]

It is for this reason that, perhaps more than any other time in history, the line between the capitalist and the simply wealthy is blurred. To be sure, the wealthiest have almost always invested heavily in capital, but at this point increasing the progressivity of tax rates is synonymous with taxing capital at higher rates. The two stories below often leave the line between capital and wealth indistinct for this very reason. However, this does not mean that the differences in wage and capital income should merely be used as a proxy for poverty and wealth. Their importance is far greater than that, although it is crucial to remember the connected nature of the two dichotomies.

III. THE STORY OF PRIVATE CAPITAL

In 1894, William Howard Taft said in a speech at the University of Michigan Law School's commencement that "[the wealthy capitalist's] sole motive has been one of gain, and with the destruction of private property that motive would disappear and so would the progress of society."[71] His statement reflects an age-old position in the debates regarding the taxation of capital. The capitalist earned his wealth, and by doing so, demonstrated his ability to put it to economically good use.

In truth there are two different stories tied up in this one. First, there is the core concept of the sanctity of private property—a Lockean ideal—that respect of private property is of the utmost importance. Second, there is the related, perhaps inextricably intertwined, story that those with the wealth know how best to use it. This second aspect of the story is often bound together with concepts of laissez-faire capitalism, trickle-

http://taxvox.taxpolicycenter.org/2011/03/01/what-would-happen-if-congress-rewrote-the-mortgage-interest-deduction/ (discussing the regressive nature of one of the largest capital-based expenditures: the mortgage interest deduction).

[69] Brent Baker, *Networks Embrace Buffett's Call for Higher Taxes on 'Mega-Rich,'* WALL ST. J. (Aug. 17, 2011), http://online.wsj.com/article/SB10001424053111903392904576512823989633638.html; Tomoeh Murakami Tse, *Buffett Slams Tax System Disparities*, WASH. POST (June 27, 2007), http://www.washingtonpost.com/wp-dyn/content/article/2007/06/27/AR2007062700097.html.

[70] *All Americans Pay Taxes*, CITIZENS FOR TAX JUST. (Apr. 15, 2010), http://www.ctj.org/pdf/taxday2010.pdf.

[71] William H. Taft, *The Right of Private Property*, 3 MICH. L.J. 215, 224 (1894).

down economics, and similar ideas advocating the building of wealth and capital as beneficial to everyone (not just the direct earner) in the end.

A. *Private Property Is Sacrosanct*

The first half of this story has to do with the nature of property itself, and the concept of ownership. This is an area of law and philosophy thick with opinions of great thinkers, and doing the field justice is far beyond the scope of this Comment, let alone this Section. Thankfully, a complete analysis is not necessary, as the important point for our purposes is the story and how it is applied to debates on taxation of capital and wealth. While the historical and philosophical underpinnings may help clarify the story, ultimately how the story is told and used will be most important. Andrew Carnegie did not cite any great thinkers when he boldly listed "Private Property" and "the Law of Accumulation of Wealth" as among "the highest result of human experience, the soil in which society, so far, has produced the best fruit."[72]

In truth, the idea of property ownership is bound up in, and often viewed as in conflict with, all types of income taxation, not merely income from capital. The plaintiff's attorney in *Pollock v. Farmers' Loan and Trust Co.*, where the Supreme Court declared the first income tax unconstitutional, successfully argued against an income tax by stating that "there are private rights of property here to be protected" and spoke of defending against the "communistic" attack.[73] As far as a Lockean view of the inviolability of one's own property is concerned, capital income is just as important as income from wages. The special place capital holds in this story is in the economy and society, discussed in Part III.B below. However, it is sufficient to note here that income from capital is at least among the personal property said to be sacred, and that reasoning is often used in defense of reduced taxation of capital.

1. *Locke's Contribution*

It is natural for many who tell this story to look to Locke, if not as its progenitor then at least as one of its messiahs. In a simplified summary, Locke espoused the idea that one owns his own body, and therefore an absolute property right to all the fruits of his own labor with that body.[74] Thus, all that an individual produces or earns is his and his alone according to nature itself.[75] It is no accident that Locke's arguments

[72] ANDREW CARNEGIE, *The Gospel of Wealth*, *in* THE GOSPEL OF WEALTH AND OTHER TIMELY ESSAYS 14, 19 (Edward C. Kirkland ed., Harvard Univ. Press 1962) (1900) The other two "highest result[s] of human experience" were "Individualism" and "the Law of Competition." *Id.*

[73] Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 532 (1895) (argument of Joseph H. Choate).

[74] JOHN LOCKE, TWO TREATISES OF GOVERNMENT 287–88 (Peter Laslett ed., Student ed. 1988) (1690).

[75] *Id.* It is worth noting that Locke spoke often of labor directly. Although he did (briefly) address agency theory, and subsequent proponents of his theories expanded

regarding the supposed pre-government state of nature support the idea of a minimalist government. These concepts go hand-in-hand: not only is the property you earn absolutely your own, but acceptance of that fact implicitly limits the role of government to protection of one's property, not confiscation.

Regardless of the historical accuracy of Locke's views, there is no denying that they have a certain intuitive appeal. One could argue that the "natural" feel of a "what's yours is yours" argument is simply due to the degree to which it has been embraced and internalized in our society. However, the reasons for the view's appeal are less important than its support of our story. Locke's view is a powerful one, and, unsurprisingly, a constant one throughout all the centuries of debates on taxation. Taft himself in the same speech at the University of Michigan, stated that, "[a]s soon as man raised himself above the level of beasts, and began to live in a social state with his fellows, he recognized as a principle of natural justice that one should enjoy what his labor produced."[76]

Likewise, it is only a small logical step further to allow Locke's views to support vast accumulations of wealth and capital. Following the above statement, Taft added:

> [T]he institution of private property is what has led to the accumulation of capital in the world. . . . Without it the whole world would still be groping in the darkness of the tribe or commune stage of civilization with alternating periods of starvation and plenty, and no happiness but of gorging unrestrained appetite.[77]

It is no surprise that the basic rationale of Locke has been used by the wealthy to justify their wealth and to argue against progressive taxation, if not taxation itself: Why should they pay more when they earned it just as anyone else did?

2. Earned Property or All Property

It is important to note that this story of private property's sanctity applies equally to earned income, so-called "unearned income," and even inherited wealth. At its foundation, the story cares less about Locke and the various great thinkers than it does about protecting the base idea of absolute private ownership. The story can, and does, diverge here.

a. Earned Property as Sacrosanct

Throughout history there have been those that vehemently argued for absolute respect for private property (for our purposes, the lowest taxes possible), but still held *earned* income higher than inherited wealth or unearned income (often both). In terms of taxation, this can be reflected in two principal ways: relatively higher taxation on certain

on it, what is really important here is how Locke's *perceived* ideas are worked into and relate to the story now told.

[76] Taft, *supra* note 71, at 220.

[77] *Id.* at 221.

methods of acquiring wealth—such as rent—and taxation of wealth itself—such as an estate tax. The former tends to lead to a conclusion at odds with the sanctity of private property (at least for some property), and is dealt with in more detail in Part IV below.

However, the latter, regarding taxes on wealth, is an interesting twist on the sanctity of property. In an essay titled "The Gospel of Wealth," Andrew Carnegie wrote:

> Of all forms of taxation[, estate taxation] seems the wisest. Men who continue hoarding great sums all their lives, the proper use of which for public ends would work good to the community from which it chiefly came, should be made to feel that the community, in the form of the State, cannot thus be deprived of its proper share.[78]

He continues on to imply that the State should, upon death, take for the public good all but "moderate sums to dependents."[79] Similarly, George F. Peabody (a wealthy philanthropist contemporary of Carnegie) stated in support of the estate tax that it offered "a way to restore [the] unearned increment without giving a shock to the general conscience by suggestion of 'confiscation.'"[80]

This view is still very Lockean in its genesis, in that it extols the importance of private property acquired by the fruits of one's own labor. It merely takes it to the logical extreme and declares that inherited wealth is not the fruit of one's own labor. The argument is much rarer nowadays than it was in Carnegie and Peabody's time, although, for example, Mark Ascher has stated in support of his near-total estate tax that "[c]urtailing inheritance . . . is consistent with Locke's vision of property, because healthy, adult children generally do not participate in the acquisition of the property they inherit."[81]

Even this view is still only a slight alteration on the core belief of the sanctity of private property. It merely circumscribes it with the limitation of use in life. Earlier in the same essay, after explaining the virtues and deserving place of the wealthy capitalist individual, Carnegie declared that "[o]ne who studies this subject will soon be brought face to face with the conclusion that upon the sacredness of property civilization itself depends—the right of the laborer to his hundred dollars in the savings-

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[78] CARNEGIE, *supra* note 72, at 22 (footnote omitted). It should be noted that Carnegie saw the estate tax as a necessary but unfortunate last resort to ensure that the wealthy used their fortunes for the public good. His primary goal was to encourage philanthropy from the very wealthy during their lives. *Id.*

[79] *Id.*

[80] BROWNLEE, *supra* note 4, at 63 (alteration in original) (quoting Letter from George Foster Peabody to Warren Worth Bailey (Mar. 22, 1916) (on file with Mudd Library, Princeton Univ.) (internal quotation marks omitted). The "unearned increment" he refers to here is a direct nod to Henry George's notion of forms of income (namely land value appreciation) that accrue to the wealthy through no effort of their own. *See* discussion *infra* Part IV.B.2.

[81] Mark L. Ascher, *Curtailing Inherited Wealth*, 89 MICH. L. REV. 69, 81 (1990).

bank, and equally the legal right of the millionaire to his millions."[82] Thus Carnegie fell squarely within the camp of the sanctity of private capital, despite his views on inherited wealth.

b. All Property as Sacrosanct

On the opposite side of this story's internal schism is the more common argument that property is property, all owned in the same fashion, and the method of acquisition is irrelevant (short of theft, of course).[83] A proponent of this view is Robert Nozick, who held that the best we can do for distributive justice is to assume that in the "beginning" (an arguably mythical point when we stepped from the state of nature) all ownership was proper. From that point, any legal transfer (that is, not theft) should take with it absolute ownership and, consequently, justice in the distribution of resources.[84] This is, after all, a logical extension of the Lockean idea that all property personally owned is yours to dispose of as you wish, including deciding where it goes upon your death.

Although in abstract this view appears extreme or even untenable, in practice it is common rhetoric in debates on taxation. In fact, this position is a core argument against any sort of wealth taxation. Although pure wealth taxes (that is, a tax on absolute wealth held at any given time) have rarely been seriously considered,[85] discussions on the propriety and policy of wealth *transfer* taxes (especially estate taxes, or the so-called "death tax") are legion. Justifications for the estate and gift taxes are numerous, but most arguments against them typically boil down to an extension of Nozick's argument of the justness of owning property justly acquired.

The rhetoric used in attacking the estate tax highlights the view its opponents hold for property rights. For example, in a recent Wall Street Journal editorial on the current federal and state estate taxes (or "death taxes" as the article termed it), the taxes are referred to as "confiscation," and about one state is said that "[t]he tax penalty for dying there is half of a lifetime's savings."[86] Similarly, an article addressing Andrew Carnegie's call for high estate taxes despite his own wealth, states:

> This is all fine as a matter of personal choice. The problem comes when the government tries to enforce that choice—tries to push

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[82] CARNEGIE, *supra* note 72, at 18.

[83] I suspect there are few, if any, who would disagree that the state has the power to "redistribute" stolen property back to its rightful owner in some degree or another—even if some would prefer it to be the state's *only* power. Indeed, without this ability to protect ownership, it seems questionable whether the very concept of "property" would truly exist.

[84] *See* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 150–52 (1974).

[85] See, for example, BRUCE ACKERMAN & ANNE ALSTOTT, THE STAKEHOLDER SOCIETY (1999), where the authors advocate for a tax on absolute wealth. For a detailed argument in response, see Eric Rakowski, *Can Wealth Taxes Be Justified?*, 53 TAX L. REV. 263 (2000).

[86] Editorial, *Death Tax Ambush,* WALL ST. J., Feb. 8, 2011, at A14.

> people not to give to their children, even if they want to. For it is a fact of human nature that some rich people do want to pass on wealth within their families. Why should they be punished, and severely at that, for this choice?[87]

The language frequently focuses on property rights and the ability of the owner of capital or wealth to do as they please with it.

While this rhetoric is clearest with regard to wealth-transfer taxes, hints of the same can often be found with regard to taxation of capital generally. The story applies almost equally to both. In remarks made at a forum on capital-gains taxation, Newt Gingirch called for a 0% capital gains tax, stating, "[h]uman freedom is tied to private property rights, the rule of law, free enterprise, technological advance, and the idea that free people pursuing new ideas to create wealth is the most powerful way to raise the standard of living," concluding, "[t]he lower the capital gains tax rate, the better off society is."[88] Indeed, if anything, protecting capital is more important than wages under this view, because it is through capital that the wealthy are able to reinvest for the benefit of all—or so the story of the next Section goes.

B. *Trust Those with the Capital*

The other half of this story is about how those with the wealth and capital know how best to use it for the good of all. There is a strong undercurrent of laissez-faire capitalism in this argument—that the unregulated market inevitably works the greatest good for society. This is often used as a (or even the) primary supporting justification for reduced taxation of capital. As long as it can be argued that the capitalist knows best how to use his own capital, it follows that taking it away in the form of taxes only hurts business, which in turn hurts everyone. This reasoning is also often used to argue that taxing capital hurts the economy generally, which, thanks to trickle-down arguments (and similar derivatives), also hurts everyone.

This is a very common view, and it is not surprising that wealthy capitalists are some of the staunchest supporters of it. This is what Taft was speaking of when he said, "[E]verything which weakens this security of corporate capital cannot but affect that of individual private property; and that if the present movement against corporate capital is not met and fought, it will become a danger to our whole social fabric."[89] Likewise, after noting the importance of a "modest" lifestyle, Carnegie wrote:

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[87] EDWARD J. MCCAFFERY, GRAVE ROBBERS: THE MORAL CASE AGAINST THE DEATH TAX 14 (Cato Inst. Policy Analysis No. 353, 1999), *available at* http://www.cato.org/pubs/pas/pa353.pdf.

[88] *Should We Lower the Capital Gains Tax?*, CATO POL'Y REP., Sept.–Oct. 1998, at 6–7, *available at* http://www.cato.org/pubs/policy_report/v20n5/cpr-20n5.pdf.

[89] Taft, *supra* note 71, at 231.

> This, then, is held to be the duty of the man of wealth: . . . to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer . . . in the manner which, *in his judgment*, is best calculated to produce the most beneficial results for the community—the man of wealth thus becoming the mere trustee and agent for his poorer brethren, bringing to their service his superior wisdom, experience, and ability to administer, doing for them better than they would or could do for themselves.[90]

While Carnegie here was hoping to inspire the wealthy to engage in philanthropy, the position lends itself well to reinvestment for personal gain so long as one accepts that greater investment by some becomes prosperity for all. This is how the story is often told: encouraging the wealthy to seek more wealth through reinvestment, thereby invigorating the economy and creating jobs. Taken to the logical extreme, this would seem to support not taxing the wealthy at all, or at the very least not taxing capital:

> Manifestly then it is to the interest of the laborer that capital should increase faster than the number of those who work. Everything which tends to legitimately increase the accumulation of wealth and its use for production will give each laborer a larger share of the joint result of capital and his labor. It will be observed that the laborer derives little or no benefit at all from wealth which is not used for production. Nothing is so likely to make wealth idle as insecurity of capital and property. It follows as a necessary conclusion that to destroy the guaranties of property is a direct blow at the interests of the working man.[91]

Unlike the first portion of this story, that personal property itself is sacred, this portion of the story leans on a purportedly socially moral justification for lesser taxation of capital. Following the argument's logic (and taking as valid its assertions), all of society benefits from the wealthy having the freedom to invest their money as they will. True, this will likely result in enormous inequalities of wealth, but even the lowest (the argument goes) are better off than they were.[92] Carnegie wrote:

> It is well, nay, essential, for the progress of the race that the houses of some should be homes for all that is highest and best in literature and the arts, and for all the refinements of civilization,

[90] CARNEGIE, *supra* note 72, at 25 (emphasis added).

[91] Taft, *supra* note 71, at 222.

[92] Mason Gaffney argues that the neo-classical economics approach is inherently one of "trade-offs": "Here are some dismal dilemmas that neo-classicals pose for us today. For efficiency we must sacrifice equity; to attract business we must lower taxes so much as to shut the libraries and starve the schools; to prevent inflation we must keep an army of unfortunates unemployed; to make jobs we must chew up land and pollute the world; to motivate workers we must have unequal wealth; to raise productivity we must fire people; and so on." Mason Gaffney, *Neo-classical Economics as a Stratagem Against Henry George*, *in* MASON GAFFNEY & FRED HARRISON, THE CORRUPTION OF ECONOMICS 29, 31–32 (1994).

> rather than that none should be so. Much better this great irregularity than universal squalor."[93]

He followed his support of inequality with an explanation of how it is the capitalist who has made possible this beneficial societal transformation.[94]

This concept of trickle-down economics was prevalent even as early as the debates surrounding the first income tax in the early 20th century. This is hardly surprising, given the enormous, concentrated fortunes amassed at the time, riding in the tidal wave of the industrial revolution. As Marjorie Kornhauser puts it, "[T]he conflict was between those congressmen who saw the accumulation (and the accumulator) of wealth as the moral bastion of civilization, progress for all, and national democracy; and those who saw great accumulations (and the accumulators) of wealth as morally wrong on an individual and a national level."[95]

However, this socially moral aspect is interestingly bundled with a concentration of hard economic science, purporting to objectively prove that lesser taxation of capital results in greater gains for society. It is this story in particular that attracts the most justifications via economic theory. This is because, if it can be conclusively proven that taxing capital or wealth less is better for the economy, half of the story will already be true. All that remains at that point is to convince the listener that the resulting inequality is a fair price to pay for those allegedly proven economic benefits.

Although this economic research may not be as conclusory as some might believe,[96] in this Comment I will resist the temptation to attack this argument head on. As noted, the scientific studies of economic theory and models only purport to prove whether reduced taxation of capital or wealth is beneficial to the economy. The moral justifications, founded in property theory, are still suspect and reasonably debatable, regardless of the accuracy of the economic analyses. Regardless, opponents of the story of private capital typically attack it on grounds of fairness and justice, as illustrated by the next Part.

IV. COMMUNITY CAPITAL

In a recent interview, economist Michael Hudson spoke about the mindset at the time of the early years of the income tax, with a top marginal rate near 90%, and an exemption that caused it to only affect

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[93] CARNEGIE, *supra* note 72, at 15.

[94] *Id.* at 15–19.

[95] Marjorie E. Kornhauser, *The Morality of Money: American Attitudes Toward Wealth and the Income Tax*, 70 IND. L.J. 119, 145 (1994).

[96] *See* James Surowiecki, *Tax Evasion: The Great Lie of Supply-Side Economics*, THE NEW YORKER (Oct. 29, 2007), http://www.newyorker.com/online/2007/10/29/071029on_onlineonly_surowiecki.

approximately the top 1% of taxpayers.[97] He noted that the idea focused on "unearned income" and the question was:

> [H]ow do you free market from income and prices that are not necessary[?] And what is unnecessary in prices? Well, you need to pay wages, you need to pay the cost of living, but you don't need to pay rent and interest. And the idea was that the government was initially to collect all of the higher rental income of land, that . . . *land rent was created by public prosperity, it belonged to the public*.[98]

This second story begins with the premise that income of certain quantities, or from certain sources, should be taxed more than income from wages. Like the story of private capital, this story has two possible parts, even if the line between them is less than distinct. The first part of the story is about ability to pay, and of the two is the rationale more commonly stated explicitly (despite both halves of the story frequently playing their part in the debate on taxation). The first Section is a direct answer to the taxation-of-wealth portion of the private-capital story. The second Section is about unearned income, and the idea that certain sources or methods of income accrue from, or at the expense of, the community at large. The second Section relates more directly to capital, although as noted in Part II.D above, the line between capital and wealth is not a distinct one.

A. *Benefit Gained and Ability to Pay*

The idea that taxes should be levied based on the individual taxpayer's ability to pay is a very old one, and is a primary reason given for progressive taxation. The core concept is relatively simple: the more net income an individual taxpayer has after paying for the necessities of life, the more that taxpayer should owe the government. A closely related principle of looking at what benefits an individual gains from the system is often tied into this story as a justification.

1. *Role in the Debates*

On a basic level there is an intuitive appeal to the story's apparently simple logic, similar in that way to Locke's role in the story of private capital. There is an element of basic fairness intrinsic in this portion of the story, which can be very captivating and convincing. For this reason an air of populism surrounds the argument, leading to monikers such as the "soak-the-rich" tax strategy.[99] It is not surprising that the proponents of this story have been the most clearly vocal about this portion, intentionally contrasting it with the assumed necessity of inequality in the story of private capital.

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[97] *Higher Taxes on Top 1% Equals Higher Productivity*, *supra* note 46.

[98] *Id.* (emphasis added).

[99] *See, e.g.*, Arthur Laffer & Stephen Moore, Op-Ed., *Soak the Rich, Lose the Rich*, WALL ST. J., May 18, 2009, at A17.

This portion of the debate's rhetoric even helped forge the nation's first income tax. After the Civil War, tariffs and excise taxes remained high to repay the debts amassed from the war efforts.[100] The consumption taxes, hitting the lower-income taxpayers proportionally hardest, effectively transferred wealth to high-income financiers and debt holders of the war.[101] This fact was not lost on the recovering working public, and resulted in political attacks highlighting the regressive nature of the tariffs. The late 19th and early 20th centuries saw growing resentment for the wealth held by monopolies—a resentment that became inherently tied to the increasingly polarized tax debates.[102] Calls for reinstating the income tax, with emphasis on progressivity and "ability to pay," became more common. In this way, "support for a radical progressive income tax had far more to do with the search for social justice in an industrializing nation than with the quest for an elastic source of revenue."[103] The result was the 16th Amendment and the nation's first true income tax.

2. *Meaning and Application*

The analysis and application of this portion of the story of community capital can be broken down into two steps. First is the assumption that government necessarily exists. Second is the meaning of ability to pay.

a. *Government Before Property*

The first core tenet is the assumption that some level of revenue must be raised from taxes, and that everyone should contribute if able. That is, this story begins with the needs of the government as a whole first, and asks how those needs necessarily affect private property second. This is a significant oversimplification, as the "needs of the government" are bound up with the definition of private property itself. However, the central concept is nonetheless an important one: government and its needs are assumed, with the question of taxation only important in determining how to support it. This is in sharp contrast to the Lockean-derived ideologies of the story of private capital, which begin by invoking the state of nature and establishing first that each owns their property, and only second requesting justification for violating that through, among other things, taxation.

Thus a foundational difference between the two is the story of community capital's assumption of a government in need of necessary revenues. This in turn assumes a government before property, or put another way, no property without government. In this way, this story fleshes out its tale that it is the institution of government itself which gives meaning to the concept of private property. This is intentionally at odds with Locke's concept of private property preceding government.

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[100] *See* discussion *supra* Part II.A.

[101] BROWNLEE, *supra* note 4, at 40–42.

[102] *Id.* at 42–43.

[103] *Id.* at 45.

b. Ability to Pay

The second step of this story's reasoning is that, not only should everyone contribute to this necessary government if able, but also *to the extent* they are able. The connection between the first and second steps is less tenuous than it seems. The story makes the connection by noting that the wealthiest individuals could not have attained their level of wealth without the protections and amenities of the state—everything from education of the workforce to a judicial system drawing lines of property ownership—and therefore should contribute more back to the state. This is sometimes referred to as the benefit theory of taxation.[104]

That same greater level of gain from the system also affords those who accumulate capital a greater ability to pay for the benefits received, as even the private-capital story admits inequality in accumulation. That is, those with more wealth generally have proportionally more discretionary income (income beyond that needed to pay for basic necessities)—an issue often termed "vertical equity."[105] This is then linked back with the core idea that some government system must exist, and to exist must be funded. Although the distinction may be a subtle one, it is not punishment for having wealth (as the story's opponents would term it), but a combination of proper and necessary payment for gains reaped.

In a recent statement of policy regarding the estate tax, the Citizens for Tax Justice stated:

> The massive fortunes that are accumulated by Americans who are industrious, clever or just lucky would never materialize if not for the infrastructure, educated workforce, public safety and stability that government provides. It is therefore reasonable that the extremely wealthy contribute more in taxes than the middle-class.[106]

This is far from a recent line of reasoning for the story, however. Centuries earlier, in 1776, Adam Smith succinctly summarized it by stating that "[t]he subjects 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."[107] While this telling of the story is one step removed from the core concept that there is no property without government, that underlying implication is still present. The wealthiest would not have attained their wealth without the government's support. Since they benefited the most, and these same

[104] *See generally* Richard A. Musgrave, *Equity and the Case for Progressive Taxation*, *in* TAX JUSTICE: THE ONGOING DEBATE 9, 10–12 (Joseph J. Thorndike & Dennis J. Ventry Jr. eds., 2002).

[105] RICHARD A. WESTIN, LEXICON OF TAX TERMINOLOGY 823 (1984).

[106] *Latest State-by-State Estate Tax Data Show Why We Need a Strong Estate Tax*, CITIZENS FOR TAX JUST. (Dec. 2, 2009), http://www.ctj.org/pdf/estatetax2009.pdf.

[107] ADAM SMITH, THE WEALTH OF NATIONS: BOOKS IV–V, bk. 5, ch. 2, pt. 2, at 416 (Andrew Skinner ed., Penguin Books 1999) (1776).

benefits allow them to pay the most without affecting their basic needs, they should contribute back the most.

B. *Unearned Income*

The flip side of the story that the wealthiest could not have attained their wealth without the government's support is that, to some degree (or at some point), that wealth is not even their own. This is the other half of the story of community property. While at first glance it seems to be simply stating the same idea in reverse, it is in fact implying something much stronger. The first portion of the story addressed in Part IV.A, the intertwined "benefit gained" and "ability to pay" concepts, still assumes that the wealthy capitalists own their property, but adds the caveat that they owe some of it back to the community. This second portion draws the logic of the first even farther, by concluding that, if the individual could not have earned the income without the government and community, then a portion of that income was never actually the individual's. In this portion of the story, steeply progressive income taxes or higher taxes on capital represent the community taking back what rightfully belongs to it .[108]

There are two directions to take this reasoning. The first is simply to tax the wealthiest at much higher rates. As a practical matter, when applied to actual tax policy, this overlaps almost indistinguishably with the concept of "ability to pay" in its effects. The second is the more interesting concept of taxing certain forms of income more than others because they are "unearned" and therefore belong to the community as a whole.

1. *Progressivity to Redress Unearned Income*

The first option for giving effect to this concept of unearned income is to simply create steeply progressive tax rates. The argument goes that, beyond a certain level of wealth, it is not feasible for an individual to actually earn the money they have acquired. Instead, at some level, the wealth is "earned" by the rest of the system—a principle most clearly illustrated by the oversimplified relationship between capitalist and laborer. As a practical matter, when applied to actual tax policy, this is often indistinguishable from the "ability to pay" portion of the story.

While progressive taxation is the simplest option to apply, it comes at the cost of being the clumsiest expression of the underlying story. This is not a flaw in progressive taxation itself—progressive taxation can serve many different policy goals, from the breaking up of "stagnate"

[108] If taken to its logical extreme, it would seem that this view could lead to powerful legal repercussions. If the property that you owe in taxes never really was "yours," is keeping it conversion or theft? That line of questioning does little to help us explore this story, however, both because tax compliance laws are unique and powerful in their own right, and because the moral underpinnings and justifications of the property theory are more pertinent for our purposes.

concentration of wealth,[109] to redistributing to those in need, to vertical equity and basic inequality issues.[110] It does not, however, do a flawless job of applying the idea of unearned income. This is because any cutoff at a certain income amount will necessarily seem an arbitrary decision of what is "earned" and what is "unearned." While the example of the capitalist and the laborer is an apt one, it is not because the capitalist is wealthy, but because he derives his income by investing in and owning the means of production, rather than producing. The next Section proposes an answer to these problems.

2. Unearned Forms of Income

Different methods of earning money have often been taxed differently, with the most obvious example being preferential rates for capital gains and stock dividends. This final portion of the story of community capital declares that certain forms of income are at least partially a product of the community or system, as opposed to the individual (traditionally seen as the "earner"). Despite how radical the view sounds, it is far from new.

a. The Growth of the Concept

Henry George was an early advocate of this story, although he had a very particular view of it. George, born in 1839 and reaching political fame in 1879 with a book on his theories, advocated taxing only the increase in land value.[111] His theory rested on the idea that increases in underlying land value are due to rising value of the surrounding and neighboring properties, not to any effort on the part of the owner of the land.[112] It was literally the community around the land, through the forces of urbanization and population growth, that created the increase in land value. Therefore, he believed that these increases should rightfully go back to the community by taxing them away.[113] They were, in his own words, "unearned" income in the sense that the owner of the

[109] *See* BROWNLEE, *supra* note 4, at 90 (discussing President Roosevelt's tax policy goal to break up wealth concentrations).

[110] The arguments for or against progressive taxation generally are vast, many (perhaps most) reaching beyond the property-theory focus of this Comment. For example, Richard G. Wilkinson has argued that smaller income differences between the rich and poor reduces inequality, which itself is a precursor for greater health, community involvement, and violence reduction. *See* Richard Wilkinson, *What Difference Does Inequality Make?*, MRZINE (Mar. 16, 2009), http://mrzine.monthlyreview.org /2009/wilkinson160309.html.

[111] *Henry George 100 Years Later: The Great Reconciler,* M. MASON GAFFNEY 1 (1997), http://www.masongaffney.org/essays/Henry_George_100_Years_Later.pdf.

[112] *Id.*

[113] HENRY GEORGE, THE CONDITION OF LABOR: AN OPEN LETTER TO POPE LEO XIII 12–14 (1891) [hereinafter THE CONDITION OF LABOR]; HENRY GEORGE, PROGRESS AND POVERTY 377–78 (1886) (1879) [hereinafter PROGRESS AND POVERTY].

property did nothing to earn those gains other than be fortunate enough to own property that had increased in value.[114]

To understand Henry George's focus on land, his writings have to be put into historical context. George focused on land because he saw land as the core of all wealth creation. He was writing in the mid- to late-19th century, and the legendary capitalists of American history, the Carnegies and the Rockefellers, had not yet come to prominence with the industrial revolution. George's infatuation with land-value increases had less to do with land itself, and more to do with the concept of unearned income. His theories are still widely followed today, and the repercussions of his works did not end with the rise of other forms of capital.[115]

There is no doubt that land is capital, and remains prominent in that regard. However, a vast amount of the world's wealth is now held in a cornucopia of financial instruments and investment methods, although corporate stock is perhaps the most visible. As noted in Part II.D above, the vast majority of the wealthiest individuals' wealth is in capital, and while much of that may be land, most of it is not. It would be incongruous these days to tax capital in the form of land while leaving other capital untouched.[116]

Deciding where to draw that earned–unearned line among income and wealth sources is not a new problem. The nation's first flirtations with an income tax, well before the ratification of the 16th Amendment, brought this to the fore as well. During the Civil War, the costs of running the government rose to levels never before seen, requiring a sudden overhaul of the taxation system.[117] The first move was to raise tariffs and vastly expand the breadth of excise taxes.[118] However, as consumption taxes are generally very regressive,[119] Congress sought to also bring in some revenue in a way that would appear more fair or balanced to lower-income taxpayers. The idea of taxes on real property was floated, but concern that it unfairly favored the wealthy who invested in intangibles immediately arose:

[114] THE CONDITION OF LABOR, *supra* note 113, at 12–14, 37, 43; PROGRESS AND POVERTY, *supra* note 113, at 377–78.

[115] For a look at the historical repercussions of George's works, see *New Life in Old Cities,* M. MASON GAFFNEY (Oct. 22, 2006), http://www.masongaffney.org/publications/2006_New_Life_in_Old_Cities.pdf.

[116] *See The Danger of Favoring Capital Over Labor*, M. MASON GAFFNEY 3 (2004), http://www.masongaffney.org/essays/The_Danger_of_Favoring_Capital_Over_Labor_Spring_2004.pdf (briefly discussing the issues of applying Henry George's concepts to modern conceptions of capital).

[117] *See supra* Part II.A.

[118] BROWNLEE*, supra* note 4, at 31–32.

[119] *See id.* Taxpayers with lower incomes spend proportionally more of their money on purchases of consumer goods, especially basic necessities (food, clothes, etc.). This effectively taxes lower income individuals at a higher percentage of their income than wealthy individuals. *See* Maya MacGuineas, *Tax Consumption, Not Work, in* NEW AM. FOUND., TEN BIG IDEAS FOR A NEW AMERICA 19, 20 (Feb. 1, 2007), http://www.newamerica.net/files/nafmigration/NAF_10big_IdeasComplete.pdf.

> Congressman Schuyler Colfax of Indiana declared, "I cannot go home and tell my constituents that I voted for a bill that would allow a man, a millionaire, who has put his entire property into stock, to be exempt from taxation, while a farmer who lives by his side must pay a tax."[120]

It was not an idle discussion, either. The alternative settled on was the nation's first income tax, progressively affecting only the top 10% of all taxpayers.[121]

b. Modern Application of Unearned Income

Bridging the gap between land and all types of capital is less of a logical leap than it may at first seem. It can be argued that even the stockholder enjoys an unearned increment of their income when the value of their stock rises. That is, after some point, the increase in value (and, therefore, income, at least when sold, if not immediately in the form of dividends) is not due to effort on the part of the capitalist investors themselves. They were wise or fortunate enough to have the money and to put it in the right place at the right time, but their personal involvement cannot necessarily account for all their gain. Put another way, it was the labor that created the surplus value, much in the same way that the local growth of the community generates the surplus land value for Henry George.[122]

Interestingly, this reasoning can be found even in Carnegie's essay quoted above, where he states:

> Of all forms of taxation[, estate taxation] seems the wisest. Men who continue hoarding great sums all their lives, the proper use of which for public ends would work good to the community *from which it chiefly came*, should be made to feel that the community, in the form of the State, cannot thus be deprived of its proper share.[123]

His reasoning is clearly premised on private capital's "trust those with the capital" reasoning. However, Carnegie attempts to blend that story with a community-capital one, in which the wealthy still owe back to the community proportionally more—but only once they are dead and are no longer there to be "trusted" with it. The important aspect of the quote, however, is the *reason* why the wealthy owe that back. It is not out

[120] BROWNLEE, *supra* note 4, at 33; (quoting CONG. GLOBE, 37TH CONG., 1ST SESS. 306 (1861)).

[121] *Id.* at 33–35; *see also* Act of Aug. 5, 1861, ch. 45, 12 Stat. 292, 309 (repealed 1862).

[122] *Henry George 100 Years Later: The Great Reconciler*, *supra* note 111, at 1. It should be noted, however, that this is not strictly true to Henry George's ideas. George focused as much on the "unearned" nature of land values rising as he did the dangers of speculation, hording, and false scarcity that the wealthy were able to engage in. *See* Ajay K. Mehrotra, *Envisioning the Modern American Fiscal State: Progressive-Era Economists and the Intellectual Foundations of the U.S. Income Tax*, 52 UCLA L. REV. 1793, 1846–47 (2005); *The Danger of Favoring Capital Over Labor*, *supra* note 116, at 1.

[123] CARNEGIE, *supra* note 72, at 22 (emphasis added).

of a sense of duty or charity, but because the wealth itself *came from the community*, and was not wholly generated through the wise capitalist's machinations.

The story of private capital would counter that acquiring wealth in this way is merely the nature of the investor, and that the value they add is precisely contributing that money at the right time and place—this is why we "trust those with the capital," after all. However (community capital would retort), that presumes an independent, self-sufficient system in which the investor merely makes accurate predictions, like a waterwheel builder divining where to place a wheel along an apparently unpredictable river. The story of community capital emphasizes that the river is not so wild, but is in fact the collective effort of all labor put into it—and at some point, those putting the labor in should owe less for their involvement than those merely profiting while standing on the banks. It is the wage laborer who generates the volume and speed of the river and, while the capitalist should not be demonized, this story advocates that he also not unfairly profit whenever that speed and volume increase.

V. CONCLUSION

It is hard to say whether there is a "right answer" in choosing between these two stories. In part this is because the stories themselves do not seek to give answers so much as provide guidance when approaching more dense tax policy issues. However, what these stories do attempt to provide is a grounding in property theory for the questions that will inevitably arise when discussing tax policy. One story argues that capital is simply another thing owned, regardless of how it was acquired or the role of the government, and respect of that ownership is paramount to the structure of our economy and society. The other argues that, when it comes to capital, the concept of ownership is not quite so simple, both due to the structure of modern governments and the role capital plays in modern economies and societies. The potential repercussions of either story on taxation is immense, and a wise listener will seek to identify which story is at the heart of every debate's murky, convoluted depths.