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EQUAL TAXATION: A COMMENTARY

*John A. Miller**

I. INTRODUCTION

A few years ago the smartest person in the world was asked what she thought of our tax system.[1] This person, Marilyn vos Savant, replied that it was "clearly unfair" to require some persons to pay more taxes than others.[2] In her view, one's payment of taxes is analogous to the purchase of a hamburger.[3] Why, she asked, should one person pay more than another person for a hamburger?[4] Thus, to Ms. vos Savant, seemingly, the fairest tax is the head tax.[5]

This has immediate appeal. In Ms. vos Savant's hamburger analogy, we hear crude echoes of Justice Holmes who once wrote, "[t]axes are what we pay for civilized society."[6] In Ms. vos Savant's analogy we also hear a basic appeal to the notion of equality. If we believe that all persons are created equal, and that we are all entitled to equal protection of the law, should not we all pay the same price for those rights and protections? There are difficulties, however, with comparing tax payments with the purchase of goods. Most taxes do not provide direct correlative paybacks. How do I measure the benefits (or detriments) to me of all the activities carried on by the federal government? How do I know that my neighbor and I receive the same

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1. *See* Marilyn vos Savant, *Ask Marilyn*, NEWSDAY (New York), Apr. 10, 1994, (Parade Magazine), at 12. According to *Parade Magazine*, Ms. vos Savant "is listed in the 'Guinness Book of World Records Hall of Fame' for '[h]ighest IQ.'" *Id.*
2. *See id.*
3. *See id.*
4. *See id.*
5. Under a head tax, "one's liability is fixed without regard to anything one does." Daniel N. Shaviro, *An Efficiency Analysis of Realization and Recognition Rules Under the Federal Income Tax*, 48 TAX L. REV. 1, 8 (1992).
6. Compañía Gen. de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 78, 100 (1927) (Holmes, J., dissenting).

benefits, especially if the benefits are measured over the course of a lifetime? Even if we look closer to home, the problem is daunting. What benefit does a person with no school age children derive from paying a school bond levy?[7] In the most immediate sense his or her benefits are not as great when compared to those of us who depend on the schools to educate our children. But arguably, even he or she benefits in some manner from good schools. If he or she is a local employer, for example, he or she may derive significant benefit from a well-educated workforce.[8] Many people would argue that those of us who are most secure in our property, our lives, and our prospects derive the most benefit from government.[9] Others might argue that those persons on the dole are the real beneficiaries of government.[10] I would simply argue that our individual benefits from government are not wholly, or even significantly, traceable to our contributions to it.[11]

In the modern era, we have largely ceased to judge the equity of taxing schemes by reference to these schemes' personal distributive justice, that is, to their individual payback.[12] An unfortunate aspect of this divorce of revenues from spending is that taxation has become an almost entirely negative topic from a political perspective. How can we draw any satisfaction from paying our taxes when we cannot correlate our payment to some benefit except in the most general sense? To the ordinary citizen, the field of taxation is a realm of sorrow, like crime and punishment.[13] I do not mean to imply that this *should* be the case. Our way of life depends on our government's ability to function. This ability to function depends in turn upon its revenues. Thus, ultimately our life and freedom depends on our tax system. Unfortunately, neither our

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7. School bond levies are taxes imposed on property owners who live within the area of a school district. *See, e.g.*, OKLA. STAT. ANN. tit. 70, § 4415 (West 1998 & Supp. 2001).

8. For a more expansive treatment of this and related points, see Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 MICH. L. REV. 465, 491-97 (1987).

9. *See* Richard J. Joseph, *Why Progressive Taxation?*, 70 TAX NOTES 313, 314 (1996). But do the rich benefit disproportionately from government? Jean-Jacques Rousseau thought so. *See id.* Joseph's article provides a most accessible summary of the major theories of tax equity as they relate to the issue of progressivity.

10. *See id.* at 314-15 (attributing this view to John Stuart Mill).

11. For some interesting ruminations on this issue, see Boris I. Bittker, *The Erwin N. Griswold Lecture*, 11 AM. J. TAX POL'Y 213, 221-22 (1994).

12. Richard Musgrave credits John Stuart Mill with the divorce "of tax equity from the expenditure side of the budget." Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113, 114-15 (1990). This essay provides a pleasingly concise summary of the major themes of tax equity literature over the past two hundred years or so.

13. *See* Leo P. Martinez, *Taxes, Morals, and Legitimacy*, 1994 BYU L. REV. 521, 543-46 (providing examples of taxpayers' negative views on taxation).

politicians nor our citizens are readily open to this connection.[14] The sad, even hateful, aspects of taxation have dramatic consequences. Among other consequences, the sorrowful nature of taxation leads our citizens to avoid taxes like the plague and, more significantly, causes them to conclude that morality is on their side in this endeavor.[15]

To this bleak view of taxation we must add another factor of importance. I refer to what John Rawls has called "[t]he fact of a plurality of reasonable but incompatible comprehensive doctrines."[16] Rawls was referring to something much broader than the immediate context, but the point is as relevant to taxation as it is to other aspects of our society. We are a diverse culture with differing philosophical, moral, social, and religious views that influence our perspectives.[17] We are economically diverse as well. Some methods of taxation are more burdensome for one group than for another.[18] Taking into account the essentially negative nature of taxation and our pluralist society, it is difficult to settle on a taxing scheme that is broadly acceptable. Each person or homogenous group of persons feels it in their interest to let someone else pay the freight. As Russell Long observed, our natural impulse is to say to our friends, "[d]on't tax you, don't tax me, [t]ax that fellow behind the tree."[19]

How then are we to achieve equity in taxation? Is tax equity even possible? Or is it just whatever the person in power says it is? The most basic criticism one may make of equity generally, is that it leaves too much discretion to the decision maker.[20] To believe in equity, one must

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14. *See id.* at 523-24 (describing how from the United States' earliest days, political commentators such as Oliver Wendell Holmes and William Blackstone have treated tax issues negatively).

15. *See generally id.* at 526-47 (explaining why citizens believe they do not have a moral obligation to obey tax laws).

16. JOHN RAWLS, POLITICAL LIBERALISM xvii (1993).

17. *But cf.* Marjorie E. Kornhauser, *Equality, Liberty, and a Fair Income Tax*, 23 FORDHAM URB. L.J. 607, 643-61 (1996). In this article, Professor Kornhauser has persuasively argued that Americans do share a core set of values that explains and justifies our reliance upon a mildly progressive income tax. *See id.* She identifies these core values as liberty from governmental interference, equal opportunity, and equality based on merit. *See id.* at 626-37.

18. For example, the progressive tax has been criticized as "lead[ing] to the majority[] irresponsibly voting [for] higher taxes for the minority, or 'soaking the rich.'" Kornhauser, *supra* note 8, at 471. Our progressive tax system is also not "marriage neutral," meaning that the tax burden for a couple changes once they become married. *See* Nada Eissa & Hilary Williamson Hoynes, *Explaining the Fall and Rise in the Tax Cost of Marriage: The Effect of Tax Laws and Demographic Trends, 1984-97*, 53 NAT'L TAX J. 683, 683 (2000).

19. George F. Will, *Morality and the 'Martini Lunch,'* NEWSWEEK, Oct. 17, 1977, at 120 (emphasis omitted).

20. *See, e.g.*, H. Jefferson Powell, *"Cardozo's Foot": The Chancellor's Conscience and Constructive Trusts*, 56 LAW & CONTEMP. PROBS. 7, 8 (1993).

first believe that objective principles of moral truth exist and can be discovered[21] or at least that there is a "shared morality of the community."[22] In the modern context, this faith in shared belief is more difficult to maintain than in the past.[23] We are more inclined than ever before to believe that we cannot judge objectively in a manner that takes us outside of our own inner landscapes.

Nonetheless, in days gone by, tax theorists offered two principles for just taxation. They contended that persons in like circumstances should be taxed equally (horizontal equity),[24] and that persons differently situated should be taxed differently (vertical equity).[25] Vertical equity was usually assumed to incorporate some element of progressivity.[26] The income tax was generally thought fairest on these counts, with

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21. *See, e.g.*, Musgrave, *supra* note 12, at 114 (agreeing with Louis Kaplow that tax equity must be grounded in certain principles).

22. Powell, *supra* note 20, at 22. In fact, Justice Cardozo encouraged lawyers to study "the wisdom of the past, for in a wilderness of conflicting counsels, a trail has there been blazed." *Id.* at 23 (internal quotation marks omitted).

23. *See id.* at 27.

24. *See* JOSEPH M. DODGE, THE LOGIC OF TAX: FEDERAL INCOME TAX THEORY AND POLICY 88 (1989). Another way of stating this principle is "[p]olicies that redistribute should levy identical taxes or provide identical transfers to all units with the same level of well-being." Robert Plotnick, *A Comparison of Measures of Horizontal Inequity*, *in* HORIZONTAL EQUITY, UNCERTAINTY, AND ECONOMIC WELL-BEING 239, 239 (Martin David & Timothy Smeeding eds., 1985). In the discussion that follows, I make no attempt to describe all the nuances of difference in meaning that have been ascribed to the term "horizontal equity." The economics literature, in particular, is laden with intricate descriptions of how we might seek to define and measure horizontal equity. *See, e.g.*, A.B. Atkinson, *Horizontal Equity and the Distribution of the Tax Burden*, *in* THE ECONOMICS OF TAXATION 3, 13-18 (Henry J. Aaron & Michael J. Boskin eds., 1980). There are also different ethical bases on which to justify horizontal equity as a tax principle. *See id.* Economists also debate whether it is an independent principle or whether it derives from other concepts, such as vertical equity. *Compare id.* at 14-17 (explaining the view that horizontal equity is an independent principle), *with* RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE: A STUDY IN PUBLIC ECONOMY 160 (1959) (viewing horizontal and vertical equity as "different sides of the same coin" and holding that horizontal equity is only useful when analyzed against the backdrop of vertical equity).

25. *See* Boris I. Bittker, *Equity, Efficiency, and Income Tax Theory: Do Misallocations Drive Out Inequities?*, *in* THE ECONOMICS OF TAXATION, *supra* note 24, at 19, 19; John B. Shoven & Paul Taubman, *Saving, Capital Income, and Taxation*, *in* THE ECONOMICS OF TAXATION, *supra* note 24, at 203, 204.

26. Vertical equity may be described as the principle that unequals should be treated differently. *See* Bittker, *supra* note 25, at 19; Shoven & Taubman, *supra* note 25, at 204. As has been pointed out by others, this need not require a progressive tax structure. *See, e.g.*, Paul R. McDaniel & James R. Repetti, *Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 FLA. TAX REV. 607, 610 (1993). In practice, some degree of progressivity is often assumed to be appropriate. *See* Musgrave, *supra* note 12, at 120. Our income tax system has employed progressive rates from its inception more than eighty years ago. *See* Kornhauser, *supra* note 17, at 607 ("The progressive income tax system . . . was established over 80 years ago . . . .").

consumption taxation as a near rival.[27] In more recent years, support for both forms of equity has declined (though not in tandem).[28] Indeed, progressivity has drastically fallen from favor in some circles,[29] though it retains stout support in other quarters.[30] Horizontal equity continues to receive lip service, but in the offhand way that suggests other matters are of more consequence.[31]

As I have indicated, until recently the principle of taxing equals equally has been regarded as the first principle of taxation.[32] Writing about horizontal equity in 1950, Henry Simons asserted that "[e]quity in this primary sense must, in an advanced nation, predominate over, if not

27. *See* Kornhauser, *supra* note 17, at 607 (describing the progressive income tax system as "the ideal tax" over the flat, proportionate or consumption-based tax systems).

28. *See* McDaniel & Repetti, *supra* note 26, at 620-21, 621-22.

29. *See generally* Kornhauser, *supra* note 8 (discussing the arguments against progressivity); *see also* Michael L. Roberts & Peggy A. Hite, *Progressive Taxation, Fairness, and Compliance*, 16 LAW & POL'Y 27, 30 (1994) (citing one 1988 study that found that upper income taxpayers perceived the flat tax as more fair).

30. *See, e.g.*, Kornhauser, *supra* note 8, at 518-23 (concluding that there is a strong argument for progressive taxation); Martin J. McMahon, Jr. & Alice G. Abreu, *Winner-Take-All Markets: Easing the Case for Progressive Taxation*, 4 FLA. TAX REV. 1, 65-71 (1998) (advocating the progressive tax system). *But see generally* Donna M. Byrne, *Progressive Taxation Revisited*, 37 ARIZ. L. REV. 739 (1995) (unmasking the reasons why there is unease with the progressive tax system). For a look at the general public's thoughts on progressivity, see Roberts & Hite, *supra* note 29. As one might expect, Roberts and Hite found that taxpayer support for progressivity declines with increasing income. *See id.* at 44.

31. *See* McDaniel & Repetti, *supra* note 26, at 613.

32. In some circles, equity analysis has been supplanted by ability-to-pay analysis. *See, e.g.*, Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. 191, 191-92 (1992); Musgrave, *supra* note 12, at 114-15. The ability-to-pay principle looks to whether the tax interferes with our daily lives. *See* Kornhauser, *supra* note 17, at 618 & n.25. Of course, any tax does this to some extent. But an income tax or a consumption tax does this less than a head tax because a head tax that could support the costs of government would need to be too high for some people to pay (and for others to pay with comfort). *See* McMahon, Jr. & Abreu, *supra* note 30, at 65-66. Those persons would be driven into poverty, a great interference indeed. The ability-to-pay principle may be thought to encapsulate both the equality principle and the progressivity principle. Equality is satisfied because if taxation is based on ability-to-pay, then logically, persons with equal abilities to pay will be taxed equally. *See* Musgrave, *supra* note 12, at 115. Progressivity is satisfied under an ability-to-pay analysis because as one's income increases so does one's ability-to-pay at a higher rate. *See id.* An additional assumption must be made in order for this to be true. That is, we must accept as true the idea that money carries a declining margin of utility as our income grows. *See id.* If we have less need for our last dollar earned than for our first dollar earned, then we are able to pay a higher rate of tax on that last dollar. *See* Kornhauser, *supra* note 17, at 618 (stating that "most people agree that marginal utility [of money] declines"). But at its heart, an ability-to-pay analysis rests on practical concerns as much as equity concerns. Ability-to-pay analysis recognizes that you cannot get blood from a turnip, you get it from living breathing bodies. It is not simply a theory of equity, it is a theory of revenue raising (or bloodletting). *But cf.* DODGE, *supra* note 24, at 92-93 (distinguishing "material well-being" principle from the "ability-to-pay" theory). For a more comprehensive discussion of general theories of taxation, see Kornhauser, *supra* note 17, at 615-20.

wholly override, all other objectives."[33] In the late 1950s, Richard Musgrave wrote that "[p]erhaps the most widely accepted principle of equity in taxation is that people in equal positions should be treated equally."[34] Less than twenty years ago, Princeton economist Joseph Stiglitz wrote, "so basic is the notion of horizontal equity that it is incorporated in the Constitution of the United States in the '[E]qual [P]rotection [C]lause.'"[35] Musgrave has drawn a similar comparison.[36]

The virtue of horizontal equity as a guiding principle is subject to challenge on several fronts. In this commentary, I address the two most significant challenges.[37] The first challenge is the assertion that equality is an empty idea that really tells us nothing.[38] The second challenge is that market efficiencies will solve equality problems whether or not we consciously adopt horizontal equity as the basis for formulating our tax systems and, thus, we need not concern ourselves with equality.[39] Both of these challenges are serious and possess merit. Both challenges are also, I believe, potentially misleading.

II. THE EMPTY IDEA OF EQUALITY

In an article titled *The Empty Idea of Equality*, Professor Peter Westen has argued with some cogency that equality "is an idea that should be banished from moral and legal discourse as an explanatory

33. HENRY C. SIMONS, FEDERAL TAX REFORM 11 (1950).

34. MUSGRAVE, *supra* note 24, at 160; *see also* SIMONS, *supra* note 33, at 8; Michael J. Graetz, *Legal Transitions: The Case of Retroactivity in Income Tax Revision*, 126 U. PA. L. REV. 47, 79 (1977); Joseph E. Stiglitz, *Utilitarianism and Horizontal Equity: The Case for Random Taxation*, 18 J. PUB. ECON. 1, 1-2 (1982). More than two hundred years ago Adam Smith put it this way, "[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." ADAM SMITH, THE WEALTH OF NATIONS 777 (Edwin Cannan ed., 1965). There are subtleties in Smith's view of horizontal equity such as his apparent endorsement of an income tax as the fairest tax. *See id.* at 779 (noting that "[a]ll nations have endeavoured . . . to render their taxes as equal as they could contrive" both in time of payment, proportion to revenue, and with as little burden as necessary).

35. Stiglitz, *supra* note 34, at 1.

36. *See* Musgrave, *supra* note 12, at 113. In light of the United States Supreme Court's recent decision in *Nordlinger v. Hahn*, 505 U.S. 1 (1992), this sort of comparison takes on an irony that neither Stiglitz nor Musgrave could have intended. The essence of the state initiative at issue in *Nordlinger*, Proposition 13, was the abandonment of horizontal equity in property taxation. *See* John A. Miller, *Rationalizing Injustice: The Supreme Court and the Property Tax*, 22 HOFSTRA L. REV. 79, 126-27 (1993). The essence of the Supreme Court's decision in *Nordlinger* was to hold that the Equal Protection Clause sanctions such abandonment of horizontal equity. *See id.* at 124, 140-41.

37. I leave for another occasion the merits of vertical equity.

38. *See infra* Part II.

39. *See infra* Part III.

norm."[40] Professor Westen's conclusion that we should abandon equality rests upon two propositions. First, Westen contends "that statements of equality logically entail (and necessarily collapse into) simpler statements of rights."[41] Second, he asserts "that the additional step of transforming simple statements of rights into statements of equality not only involves unnecessary work but also engenders profound conceptual confusion."[42] Professor Westen was not writing in the tax context,[43] but tax scholars, Paul McDaniel and James Repetti, have relied upon and echoed his views in reference to horizontal and vertical equity.[44] Professors McDaniel and Repetti assert that horizontal equity and vertical equity lack any normative content.[45] Further, absent normative content, they assert that these terms are largely meaningless.[46] They agree that we can inject normative meaning into these terms by assuming the existence of a particular tax structure, such as an income

40. Peter Westen, *The Empty Idea of Equality*, 95 HARV. L. REV. 537, 542 (1982). Westen's article has drawn many replies. Two notable ones are Erwin Chemerinsky, *In Defense of Equality: A Reply to Professor Westen*, 81 MICH. L. REV. 575 (1983) and Kent Greenawalt, *How Empty Is the Idea of Equality?*, 83 COLUM. L. REV. 1167 (1983).

41. Westen, *supra* note 40, at 542.

42. *Id.*

43. Most of Westen's examples are drawn from the constitutional law field.

44. *See* McDaniel & Repetti, *supra* note 26, at 611. McDaniel and Repetti presented their thoughts on horizontal equity as part of an effort to sound the final note in a debate between two other notable scholars, Professors Richard Musgrave and Louis Kaplow. *See id.* at 607. Through several essays and over several years Musgrave and Kaplow have debated the question of the relative importance of horizontal and vertical equity. *See* Kaplow, *supra* note 32; Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139 (1989); Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993); Musgrave, *supra* note 12. According to McDaniel and Repetti, Kaplow takes the position that the principle of treating equals equally derives from the principle of treating unequals differently. *See* McDaniel & Repetti, *supra* note 26, at 610. In other words, Kaplow contends that horizontal equity is subsumed by the more fundamental principle of vertical equity. *See id.* at 611. Musgrave disagrees and seeks to prove the independence of horizontal equity by reference to its widespread acceptance and by an analysis of the trade-off between horizontal equity and vertical equity in second best settings. *See id.* at 613. Both Musgrave and Kaplow accept that there is merit in analyzing tax schemes in terms of their horizontal and vertical equity. *See id.* This is where McDaniel and Repetti differ with both Musgrave and Kaplow. Using the main points of the Musgrave/Kaplow debate as a staging area, and relying on Westen's rationale about the emptiness of equality, they downgrade the importance of *both* horizontal and vertical equity. *See id.* (calling horizontal and vertical equity "at best . . . surrogates to describe consistency with or departures from the underlying decisions about the tax base and rate structure").

45. *See id.* at 621.

46. *See id.* at 622. On this point McDaniel & Repetti cite Musgrave, who noted that horizontal equity depends on "[a]n objective index of equality or inequality" for its incorporation into a particular tax system. *Id.* at 608 (quoting RICHARD A. MUSGRAVE, THE THEORY OF PUBLIC FINANCE 160 (1959)).

tax.[47] But once we do so, horizontal equity, though present, is irrelevant.[48] This is because once we have adopted a tax on income, it follows logically that under the rules adopted, persons with the same income will pay the same tax.[49] From this perspective the idea of equality adds nothing to the analysis. For this reason McDaniel and Repetti conclude that "it is not likely that [horizontal equity] and [vertical equity] add anything to the need to analyze tax changes in terms of basic tax policy objectives and indeed may conceal problems or lead policymakers astray as particular tax changes are considered."[50]

The conclusions offered by McDaniel and Repetti are sound *in a narrow pedantic sense.* My concern is that their analysis fails to allow for the more primitive and malevolent possibilities of human existence. They assume a societal rationality and rule mindedness that assures equality even without relying on the principle of equality. Belief in the importance of the principle of equality, on the other hand, assumes that humanity possesses a limitless propensity for persecution and arbitrariness. It is in the context of an irrational and discriminatory world that equality's meaning and utility stand out.

A simple example may show my point. Suppose we enacted an income tax system that taxed all salary income based on one's salary in the first year of employment at a particular job. As long as the same employer employed the taxpayer, his or her taxable income could not increase even if the taxpayer's actual salary income increased. But, if the taxpayer changed jobs, her new salary would become the tax base until she changed jobs again.[51] Thus, if Angela, a long time executive for a large corporation, began her career by earning $25,000 annually and ten years later was earning $75,000, she would pay the same amount of income tax in each of the ten years of her employment. Such a system appears to result in gross violations of horizontal equity, since persons of equal pre-tax salaries would be taxed unequally. For instance, suppose Angela has a next door neighbor, Bob, who started a new job earning $75,000 annually. While Angela was earning $75,000 and paying income taxes computed on a salary of $25,000, Bob would be earning $75,000 and paying income taxes computed on a salary of $75,000.

47. *See id.* at 611.

48. *See id.* at 620-21.

49. *See id.*

50. *Id.* at 622.

51. I choose this system because, though it is fanciful, it is not beyond the pale of reason. It is drawn by analogy to the acquisition-value property tax system employed in California. *See* CAL. CONST. art. XIII A, § 2.

Thus, even if the system employed a flat or proportionate rate income tax, Bob would pay three times as much tax as Angela.

It seems to me that the best and most direct way to criticize the acquisition-income tax is to argue that it fails to treat equals equally. A tax such as I have just described should be deemed to violate the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution.[52] There may be other grounds on which it could be attacked, but its basic inequality seems as sound a ground as any for doing so.

The inequality of the acquisition-income tax arises from the criteria chosen for determining individual tax liabilities. McDaniel and Repetti might argue that the notion of equality does not automatically tell us whether a particular criteria, such as acquisition-income, treats equals unequally. I agree with this assertion to the extent that it is a recognition that determinations of equality or inequality depend on the exercise of human judgment. But, I believe most persons in our society who viewed an acquisition-income tax through Rawls' "veil of ignorance"[53] would agree that it is inequitable. Any attempt to achieve justice through the application of law to facts involves judgments, and the difficulty of making judgments does not make the principles we look to in making them meaningless or unworthy of respect.[54]

McDaniel and Repetti particularly warn against the use of horizontal equity or vertical equity analysis for tax expenditures.[55] They reason that a tax expenditure is, in effect, a subsidy that occurs outside of traditional tax equity analysis.[56] That is one way to look at it. But, one can as easily look at it from a contrary standpoint. Consider for instance, the home mortgage interest deduction.[57] This may be viewed as a major

52. The Supreme Court's decision in *Nordlinger v. Hahn*, 505 U.S. 1 (1992), casts some doubt about this. *See id.* at 18 (upholding the California tax scheme that taxes property at its acquisition cost).

53. JOHN RAWLS, A THEORY OF JUSTICE 12 (1971) ("Among the essential features of this situation is that no one knows his place in society, his class position or social status, nor does any one know his fortune in the distribution of natural assets and abilities, his intelligence, strength, and the like.").

54. I addressed the inescapable need for judgment in application of law in some detail in an earlier article. *See* John A. Miller, *Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation*, 68 WASH. L. REV. 1, 74-76 (1993).

55. *See* McDaniel & Repetti, *supra* note 26, at 621. McDaniel made this argument more fully in an earlier article. *See* Paul R. McDaniel, *Identification of the "Tax" in "Effective Tax Rates," "Tax Reform" and "Tax Equity,"* 38 NAT'L TAX J. 273, 277-78 (1985).

56. *See* McDaniel & Repetti, *supra* note 26, at 621.

57. I.R.C. § 163(a), (h) (West 2000).

tax expenditure item.[58] Does not equity analysis have something to say about this item? Take, as an example, two individuals, our friends Bob and Angela, with otherwise identical taxable incomes of $75,000 annually. Bob rents his home for $1000 per month and Angela owns her home with a mortgage that produces $1000 per month in tax deductible interest. Thus, if we take thirty percent as the marginal tax rate, applicable to them both, Angela pays $3600 less in income taxes than Bob annually. Does not horizontal equity challenge us to justify this disparate treatment? I think it does.[59] We may ultimately conclude that there are good policy reasons supporting tax subsidy of home ownership in this manner,[60] but horizontal equity analysis leads us to the question of whether this is so.

It has been asserted that horizontal equity is devoid of normative content.[61] This is true in the sense that it does not require any particular measure of equality. But on another level it is highly normative.[62] It says, "Very well, you may drain me of my life's blood, *if you are willing to drain your own life's blood as well.*"[63] There is a moral structure there. It is the morality of vengeance, the morality of an eye for an eye. It is the morality of Samson pulling down the pillars of the temple on his

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58. This is especially true when, as is presently the case, not only is the imputed income from home ownership untaxed but so is the gain upon sale of the home. *See id.* Still, some may question the view that the home mortgage interest deduction is a tax expenditure. *See* Boris I. Bittker, *Accounting for Federal "Tax Subsidies" in the National Budget*, 22 NAT'L TAX J. 244, 248 (1969). If so, this points out the inherent problem with the tax expenditure concept, which is the lack of an agreed starting point. *See id.* at 248-49 (noting various ways to define tax expenditures). Arguably, the tax expenditure concept is as devoid of meaning as is the idea of equality. That is, the tax expenditure concept only takes on meaning after we have defined the normative structure in which it is to operate. *See id.* at 248; *see also* Douglas A. Kahn & Jeffrey S. Lehman, *Tax Expenditure Budgets: A Critical View*, 54 TAX NOTES 1661, 1661 (1992) (arguing that the concept of tax expenditures assumes the existence of a normative rule of federal income taxation). But this does not mean it is without value.

59. *But see infra* Part III (discussing market efficiency). If the home market has adjusted to the tax subsidy afforded homeowners, then a case can be made that there is no inequity between the treatments afforded Angela and Bob illustrated in the main text.

60. For example, tax subsidies for home ownership foster desirable activity and control undesirable activity. *See* Feldstein, *supra* note 57, at 121. It may also be considered a more efficient means of taxing individuals. *See id.*

61. *See* McDaniel & Repetti, *supra* note 26, at 610.

62. Joseph Dodge takes the view that "the horizontal equity norm in taxation is incomplete, because it leaves unspecified the index of comparison." Joseph M. Dodge, *A Combined Mark-to-Market and Pass-Through Corporate-Shareholder Integration Proposal*, 50 TAX L. REV. 265, 275-76 n.42 (1995). But still, he disagrees with McDaniel and Repetti on the ground that horizontal equity acts as a normative restraint on the utilitarian tax policy approach. *See id.*

63. This statement is reminiscent of "sacrifice theory." Under this principle, each taxpayer pays a tax in an amount such that each loses the same amount of utility. *See* Kornhauser, *supra* note 17, at 616-17.

enemies and on himself. The lack of specificity leaves this moral structure subject to uncertain interpretation. However, no value system can escape this difficulty.

The appeal of equality is rooted in notions of suspicion and mistrust. It arises from the capability we each possess to harm or even kill another.[64] It derives from the pain we feel upon receiving lesser treatment than another.[65] It derives from the threat we feel when someone claims to himself or herself rights and rewards superior to those we possess.[66] It is predicated on the notion of limited resources and upon the consequent sense that one person's gain is another's loss.[67] Our commitment to equality is the compromise we make between our appetites and our fears.[68]

This essentially negative view of equality is often supplemented by a view of humanity's inherent social connectedness.[69] Samuel Pufendorf called this "an *equality of right*, which has its origin in the fact that an obligation to cultivate a social life is equally binding upon all men, since it is an integral part of human nature as such."[70] Whether we are rich or poor, well kept or ill kept, we are obliged to treat each other respectfully because our sociable natures requires this of us. "[I]f a man wishes to avail himself of the assistance of other men for his own advantage, he must in his turn lend his own talents to their accommodation. 'Hand washes hand' is the old proverb."[71]

Pufendorf also supports the principle of equality by reference to the many samenesses of our span on earth.[72] We are all subject to the whims of fortune. Our flesh is the same, our body shapes are the same, we all are born in the same fashion, and we all die in the same fashion.[73] In

64. *See* THOMAS HOBBES, DE CIVE 45, 46 (Howard Warrender ed., Oxford Univ. Press 1983) (1642).

65. *See id.* at 46.

66. *See id.*

67. *See id.* at 47-48, 49.

68. *See id.* at 49.

69. *See, e.g.*, SAMUEL PUFENDORF, 2 DE JURE NATURAE ET GENTIUM LIBRI OCTO 330 (James Brown Scott ed., C.H. Oldfather & W.A. Oldfather trans., Oceana Publ'ns Inc. 1964) (1688). Modern feminist legal theory develops the theme of our interconnectedness to great effect. *See, e.g.*, Kornhauser, *supra* note 8, at 508-14.

70. PUFENDORF, *supra* note 69, at 333.

71. *Id.* at 335.

72. *See id.* at 334.

73. *See id.* at 333-34. *But cf.* RAWLS, *supra* note 53, at 507 ("There is no natural feature with respect to which all human beings are equal . . . ."). While Rawls views the basis for equality as rooted in his concept of justice as fairness, he does agree that "[e]quality is supported by the general facts of nature . . . . Those who can give justice are owed justice." *Id.* at 510.

short, in our essentials we are more alike than we are different. If this is so, why should we not be treated alike?

Equality is also supported by reference to its venerable position in a range of cultures. Some readers will doubtless recall the biblical injunction, "[s]o whatever you wish that men would do to you, do so to them; for this is the law and the prophets."[74] Confucius stated the idea this way, "do not impose on others what you yourself do not want."[75] Kant's take on this was the categorical imperative, "[a]ct only according to that maxim by which you can at the same time will that it should become a universal law."[76] Aristotle expressed the thought in this way, we should behave to our friends "'[a]s we should wish them to behave to us.'"[77] Across the ages, and across a broad range of cultures, the equality principle stands as a fundamental axiom for daily living. Both its venerability and its wide acceptance have readily discernible bases in everyday human experience. What parent has not heard the plaintive cry of a child "It's not fair!" when favors are dispensed unequally?

While McDaniel and Repetti may be correct to assert that equality is too crude a principle to rely upon in the details of tax policy analysis, they are wrong to think it should be, or can be, banished from the conversation. The equality principle is deeply rooted and cannot be expelled from human discourse by merely naming it empty. Moreover, it serves the limited, but crucial, purpose of checking that ordinary human impulse to let the other person carry the lion's share of the tax burden. If we are only able to "tax that fellow behind the tree" by imposing an equally heavy burden on ourselves, a profound restraint may overtake us. Since the fellow behind the tree is subject to the same restraint, an allegiance to horizontal equity protects me from him as well as he from me. In our society a strong allegiance to horizontal equity serves as a way to avoid deep and abiding strife with respect to taxation. In short, the equality principle is the key to the respectability of any taxing scheme. The further we get away from it the more open to moral challenges our tax laws become.

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74. *Matthew* 7:12 (King James version).

75. THE ANALECTS OF CONFUCIUS: A PHILOSOPHICAL TRANSLATION 189 (Roger T. Ames & Henry Rosemont, Jr. trans., 1998) (internal quotation marks omitted).

76. IMMANUEL KANT, FOUNDATIONS OF THE METAPHYSICS OF MORALS 39 (Lewis White Beck trans., 1959) (1785). Pufendorf expressed a similar idea nearly one hundred years earlier. "And it is eminently proper that one should himself practice the law which he has set up for others." SAMUEL VON PUFENDORF, 2 DE OFFICIO HOMINIS ET CIVIS JUXTA LEGEM NATURALEM LIBRI DUO 42 (James Brown Scott ed., Frank Gardner Moore trans., Oceana Publ'ns Inc. 1964) (1682).

77. 1 DIOGENES LAERTIUS: LIVES OF EMINENT PHILOSOPHERS 465 (T.E. Page et al. eds., R.D. Hicks trans., 1950).

III. THE EFFICIENT MARKET

A rival of equity for the hearts and minds of tax theorists is efficiency.[78] Efficiency analysis looks to overall social welfare as a measure of a tax's virtue.[79] Thus, if it could be shown that by taxing rich people at a lower rate than middle income people, then we could make everyone better off;[80] that lower rate for the rich would be justified under an efficiency analysis, even though it might violate horizontal equity.[81] Interestingly, efficiency analysis comports with Ms. vos Savant's wish to correlate taxes with a payback. However, by focusing on aggregate, rather than individual, social welfare it ultimately fails to satisfy her sense of fairness.

Equity and efficiency principles will often coincide.[82] Thus, a tax system that violates equity principles may also be inefficient. To consider this idea, let us go back to the example of an income tax system that taxed all salary income based on one's salary in the first year of employment at a particular job.[83] Recall that as long as the same employer employed the taxpayer, the taxpayer's taxable income could not increase even if his or her actual salary income increased. But, if the taxpayer changed jobs, his or her new beginning salary would become the tax base until he or she changed jobs again. Thus, in our example, Angela began her career by earning $25,000 annually, and ten years later was earning $75,000 in the same job, but she paid the same amount of income taxes in each of the ten years of her employment. Recall also that Bob was newly employed with a salary of $75,000 annually. Such a

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78. *See* Bittker, *supra* note 25, at 19.

79. As in other matters, I simplify things that are rather complex. For a more detailed treatment of efficiency analysis, see McMahon, Jr. & Abreu, *supra* note 30, at 39-65.

80. More often this view may be expressed in the negative. That is, the superior tax is the one that has the least aggregate welfare cost. *See, e.g.*, Musgrave, *supra* note 44, at 355, 359.

81. *See* Daniel N. Shaviro, *Commentary: Uneasiness and Capital Gains*, 48 TAX L. REV. 393, 394 (1993). The horizontal equity principle acts as a normative restraint on efficiency in such circumstances. *See* Dodge, *supra* note 62, at 275-76 n.42 ("The ethical command that likes should be treated alike is similar to concepts of 'rights' in imposing limits on the utilitarian approach."). In saying this I recognize that I am tending to muddle horizontal and vertical equity together. Some would say that vertical equity restrains utilitarianism in the situation described in the main text. I would argue that horizontal equity restrains utilitarianism from imposing more heavy taxes on middle income persons than on rich persons. Vertical equity, then, would justify taxing the rich more heavily than the middle class. For a discussion of the relative merits and importance of horizontal and vertical equity, see the articles that reflect the Musgrave/Kaplow exchange *supra* note 44.

82. This depends in some measure on what assumptions one makes about such issues as the diminishing marginal utility of money and the impact of taxation on total productivity. *See* McMahon, Jr. & Abreu, *supra* note 30, at 32-37, 43-46.

83. *See supra* note 51 and accompanying text.

system appears to result in gross violations of horizontal equity since persons of equal pre-tax salaries would be taxed unequally. In our example we noted that a flat tax rate would cause Bob to pay three times as much tax as Angela, even though their salaries were the same.

Not only is such a scheme inequitable, it is also inefficient because it misallocates resources relative to a tax neutral market. Any person who has received a significant salary increase since becoming employed would have a tax disincentive to make otherwise sensible job changes. The size of the disincentive would deter many job changes. If the tax rate was a flat thirty percent, Angela would pay $7500 in taxes under our imaginary scheme.[84] In order for Angela to change jobs and receive any increase in her after tax income, Angela's new job would have to pay at least $97,000 annually.[85] In short, she has to increase her salary by almost $22,000 just to break even because of the tax increase she would suffer if she changes jobs. Unless Angela is an extraordinary individual, it seems unlikely that she will find many employers willing to hire her away from her present employer with a salary offer that she will find enticing. Moreover, her present employer will have an advantage in the competition for her services since it can always offer her a greater post-tax salary than its competitors at a lower pre-tax cost to itself.

But, is it possible that the misallocation of resources just described renders moot our equity concerns? Arguably, the employment market will correct the inequities in an acquisition-value income tax.[86] Perhaps starting salaries will be inflated in order to compensate for the large initial tax bite and then subsequent raises will be smaller because of the lack of tax cost to the employee.[87] This might result in post-tax horizontal equity between persons of equal employment value. Thus, if Angela and Bob are of equal employment value in a tax neutral market, the acquisition-income market might pay Bob $97,000 pre-tax in order to place him in the same post-tax position as Angela.[88] One difficulty

84. $25,000 multiplied by 0.30 equals $7500.

85. Her present after tax income is $67,500 ($75,000 minus $7500 equals $67,500). If her salary were $97,000 in a new job, her after tax income would be $67,900 ($97,000 multiplied by 0.30 equals $29,100, and $97,000 minus $29,100 equals $67,900). Thus, Angela would have a net gain of $400 as a result of a $22,000 increase in her salary.

86. *See* Bittker, *supra* note 25, at 21-22 (describing how taxpayers may adjust their economic conduct to take advantage of tax allowances).

87. A more complex market response can readily be imagined. Perhaps starting salaries would be driven down in response to an acquisition-value income tax in order to reduce the tax cost of labor; subsequent raises could then be greater.

88. In our example, Angela's post-tax salary is $67,500. If Bob has a pre-tax salary of $97,000, all of which is taxable at the rate of thirty percent, his post-tax income will be $67,900. *See supra* note 85.

with this view is that the difference in employment costs to the employer of the two employees—for example a $75,000 salary for Angela and a $97,000 salary for Bob—may be taken as an indication that they are not of equal value to the employer.[89] On the other hand, Angela's employer might be willing to pay her a salary of $97,000 but simply feels no market pressure to do so. This lack of market pressure arises because the acquisition-income tax prevents Angela from realizing any after tax benefit if she changes jobs for a salary of $97,000 or less. In effect, the tax system is subsidizing Angela's employment by her present employer in the amount of $22,000.

What conclusions can we reach about this fanciful tax system? First, even if the market corrects the inequity to Bob, the system still *appears* inequitable. That is, Bob may compare his tax situation with Angela's and conclude that the acquisition-income tax is unfair since his pre-tax income is greater than hers and yet his after-tax income is the same. Bob may believe he is being penalized for changing jobs even though a more sophisticated analysis may show that in fact Angela's employer is being subsidized by the tax system. Though misguided, Bob's belief in the unfairness of the tax system may have real consequences.[90] For instance, Bob may develop such contempt for the tax system that he cheats on his taxes.[91]

A second conclusion we can reach is that even if the market corrects the initial inequity of the acquisition-income system, there is a second level of inequity created by that correction. This is because Bob's employer is obliged to pay more than Angela's employer for services which we have assumed are of equal value. In general, we can say that start-up businesses are indirectly taxed more heavily—through higher labor costs—than established businesses.[92] A fairness issue arises here because the employers, like the employees, are taxpayers with claims to equal treatment under the law.[93] Do the market forces that arguably

89. From Bob's point of view then, the tax violates vertical equity since unequals are taxed equally. For a definition of vertical equity, see *supra* note 25 and accompanying text.

90. *See generally* Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861 (1994) (discussing the usefulness of cognitive theory, such as psychology, in the study of taxation). The confusion Bob experiences is the sort of situation that McDaniel and Repetti warn us about with respect to using equity principles to analyze tax expenditures. *See* McDaniel & Repetti, *supra* note 26, at 620-21.

91. *See* Martinez, *supra* note 13, at 544.

92. There is a general understanding that new companies have higher labor costs. *See, e.g.*, *Outback Steakhouse, Inc. Announces Fourth Quarter Earnings Outlook and Comparable Store Sales*, PR NEWSWIRES, Jan. 9, 2001, *available at* http://www.prnewswire.com.

93. There is also an efficiency issue, of course, because the tax system, by refusing to recognize higher labor costs, is discouraging new business formations and expansions because it is

eliminate the inequity at the employee level have the same effect at the employer level?

The answer to that last question may be yes, if we take a long view of what constitutes equity. This brings us to a third conclusion we may offer concerning the acquisition-income taxing scheme. That is, the market correction of the inequity, if it occurs, will occur over a protracted time span as the start-up company matures into an established business and as the employees of the earlier established businesses quit, die off, or retire. This matter of timing points out the limitations of the market as a solution for inequities in a tax system. Markets take time to operate. Thus, an initially horizontally inequitable system will produce some inequities that the market will not cure.[94]

A fourth and related point is that horizontal equity is more appealing and more useful as a guiding principle when it contains a visible temporal component. In other words, most of us want equality *now*, not ten years from now. We would prefer a version of horizontal equity that treats equals equally today in a way that is readily observable.[95] Perhaps this is why the general public views the sales tax with more favor than any other tax.[96] The sales tax *happens* every *time* we make a purchase, and it applies in equal proportion to all purchases. What is more, it is precisely equal with respect to equal purchases such as the purchase of Ms. vos Savant's hamburger. It is the most visibly equal of all the taxes.

IV. CONCLUSION

The idea of equality has the momentum of centuries behind it. For that reason alone it cannot be dismissed. It is a social fact. Additionally, we should not do away with it as a guiding principle, even if we could do so. It remains an ethical pole star in a sky that is fading to black. Even so, it is true that the principle that we should treat like persons alike provides no objective criteria for determining likeness. This lack of criteria for determining likeness renders the principle subject to manipulation. For example, since we are all human, one can argue that a head tax treats like persons alike. However, we can also agree that a millionaire is differently situated than a person living below the poverty

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reducing their ability to compete with existing businesses. Similarly, the tax system is also favoring automation over the hiring of workers (but any income tax does this to some extent).

94. *See* Calvin H. Johnson, *Inefficiency Does Not Drive Out Inequity: Market Equilibrium & Tax Shelters*, 71 TAX NOTES 377, 377 (1996).

95. *See* Kornhauser, *supra* note 17, at 644.

96. *See id.*

level. Even if the poor person could pay the same tax as the millionaire, we can agree that their different circumstances justify making the millionaire pay more taxes. The problem of determining *relevant* likeness is a nettlesome one. But we should not exaggerate the difficulty. All of our major tax schemes have found ways to determine likeness (or difference) that are generally recognized as fair.[97] Gross deviations from fair standards of likeness are relatively easy to spot.[98]

Most tax scholars, whether they are economists or legal academicians or both, approach tax issues with relatively little concern for the political process.[99] Their theories of taxation assume some degree of purity of analysis.[100] This is not to say that those scholars are naive or oblivious to the influences of politics on the law of taxation. But they do not see it as their role to factor politics into their analysis. They seek the ideal with some knowledge of its corruptibility. The principle of horizontal equity has an explicitly political basis. It assumes corruptibility, venality, and partisanship. More significantly, it offers a practical check on those forces. It prevents irrational or abusive tax schemes by rendering the makers of such schemes subject to them.

The view that equality is an empty idea rests on an unrealistic and exaggerated view of the level of precision required in order for equality to have meaning. The idea that we should rely on market efficiencies to resolve equity concerns is a second best solution. Broad acceptance of either view may serve to unwisely loosen the restraints on tax policy that are at the core of a politically and morally acceptable tax system.

97. *See id.* at 609-10.

98. But they are also sometimes deeply entrenched. The most notable example is the acquisition-value property tax in California, which has now also taken root in Florida. *See* Miller, *supra* note 36, at 142.

99. *See* Shaviro, *supra* note 81, at 403.

100. For example, Musgrave makes an argument about vertical and horizontal equity "in a first best setting where" political and other constraints do not exist. *See* Musgrave, *supra* note 44, at 354-56.