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### Recommended Citation

Charles O'Kelley, Tax Policy for Post-Liberal Society: A Flat Tax Inspired Redefinition of the Purpose and Ideal Structure of a Progressive Income Tax, 58 *S. CAL. L. REV.* 727 (1985).  
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# TAX POLICY FOR POST-LIBERAL SOCIETY: A FLAT-TAX-INSPIRED REDEFINITION OF THE PURPOSE AND IDEAL STRUCTURE OF A PROGRESSIVE INCOME TAX

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A flat rate comprehensive federal income tax could be achieved by replacing graduated rates with a single rate that applies to all taxpayers, eliminating many currently available deductions and credits, and treating as taxable income types of economic gain presently excluded from the tax base.<sup>1</sup> The fact that Congress is seriously considering such radical changes<sup>2</sup> makes it appropriate for tax scholars to reconsider longheld be-

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1. Congressional hearings and the introduction of a number of flat rate bills show wide support for a flat rate comprehensive income tax. See, e.g., *Flat Rate Tax: Hearings Before the Senate Comm. on Finance*, 97th Cong., 2d Sess. (1982) [hereinafter cited as *Flat Tax Hearings*]. For a brief description of bills representing possible approaches to a flat rate comprehensive income tax, see *id.*, pt. 1, at 37-39 (testimony of Rudolf Penner, American Enterprise Institute). For survey data from 1982 indicating that Americans by a margin of better than two to one favor a flat rate comprehensive income tax, see *id.*, pt. 1, at 272-73 (testimony of Louis Harris, Chairman, Louis Harris and Associates, Inc.). For the leading popular explanation and defense of a flat rate comprehensive tax, see R. HALL & A. RABUSHKA, *LOW TAX, SIMPLE TAX, FLAT TAX* 32-52 (1983). Nine flat rate comprehensive tax bills were introduced in 1983: S. 1421, H.R. 3271, 98th Cong., 1st Sess. (1983); S. 557, 98th Cong., 1st Sess. (1983); H.R. 3516, 98th Cong., 1st Sess. (1983); H.R. 2520, 98th Cong., 1st Sess. (1983); H.R. 2137, 98th Cong., 1st Sess. (1983); H.R. 1770, 98th Cong., 1st Sess. (1983); H.R. 1664, 98th Cong., 1st Sess. (1983); H.R. 542, 98th Cong., 1st Sess. (1983); H.R. 170, 98th Cong., 1st Sess. (1983). Twelve bills were introduced in 1982: S. 2887, 97th Cong., 2d Sess. (1982); S. 2817, H.R. 6944, 97th Cong., 2d Sess. (1982); S. 2376, 97th Cong., 2d Sess. (1982); S. 2200, 97th Cong., 2d Sess. (1982); S. 2147, 97th Cong., 2d Sess. (1982); H.R. 6741, 97th Cong., 2d Sess. (1982); H.R. 6628, 97th Cong., 2d Sess. (1982); H.R. 6352, 97th Cong., 2d Sess. (1982); H.R. 6070, 97th Cong., 2d Sess. (1982); H.R. 5868, 97th Cong., 2d Sess. (1982); H.R. 5513, 97th Cong., 2d Sess. (1982); H.R. 4821, 97th Cong., 2d Sess. (1982).

2. For a suggestion that these radical changes are foreshadowed by recent legislation, see Graetz, *The 1982 Minimum Tax Amendments as a First Step in the Transition to a "Flat-Rate" Tax*, 56 S. CAL. L. REV. 527, 550-54 (1983).

heifs about the ideal structure of an income tax.<sup>3</sup> This Article analyzes the characteristics and underlying rationale of a progressive flat rate comprehensive income tax and reconsiders the nature and purpose of a progressive income tax.

Part I of this Article describes how adopting a flat rate comprehensive income tax that uses a personal exemption could result in tax burdens substantially more progressive than occur under the current system. Part II explores the nature of individual entitlement to income in our post-liberal society and the purpose of the income tax. In addition, Part II presents an argument for a personal exemption equal in amount to the minimum wage. Part III examines the proper role of shared living arrangements in determining tax liability and concludes that a flat rate comprehensive income tax, properly designed and understood, produces appropriate tax burdens for both married and unmarried individuals. Part IV develops a case for integration of the income tax and the social security system, which builds on the argument for linking the personal exemption to the minimum wage.

## I. THE FLAT RATE COMPREHENSIVE INCOME TAX AND PROGRESSIVITY

Viewed from the standpoint of horizontal equity,<sup>4</sup> simplicity,<sup>5</sup> and

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3. Mainstream scholars have traditionally favored a progressive tax imposed on a comprehensive tax base. The leading work supporting this view is H. SIMONS, *PERSONAL INCOME TAXATION* (1938). For more recent debates concerning the comprehensive tax base ideal, see Bittker, *Comprehensive Income Taxation: A Response*, 81 HARV. L. REV. 1032 (1968); Bittker, *A Comprehensive Tax Base as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925 (1967); Bossons, *The Value of a Comprehensive Tax Base as a Tax Reform Goal*, 13 J. LAW & ECON. 327 (1970); Galvin, *More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR*, 81 HARV. L. REV. 1016 (1968); Musgrave, *In Defense of an Income Concept*, 81 HARV. L. REV. 44 (1967); Pechman, *Comprehensive Income Taxation: A Comment*, 81 HARV. L. REV. 63 (1967). For the most thorough review of the case for progressivity, see W. BLUM & H. KALVEN, *THE UNEASY CASE FOR PROGRESSIVE TAXATION* (1953).

4. Horizontal equity exists when similarly situated taxpayers bear similar tax burdens. Unlike the current income tax, a comprehensive tax base would not treat one taxpayer's income differently from another's based on its source. Furthermore, the comprehensive tax base would not favor certain uses of income, such as charitable contributions or housing expenditures, over other uses. If, as is generally believed, the source and the use of income are irrelevant factors in determining the relative tax burdens of taxpayers, a more comprehensive tax base is preferable to the existing system.

5. A complex tax is expensive to administer and difficult to understand. The degree of structural complexity determines how much difficulty the ordinary taxpayer will have in filling out a return. If a more comprehensive tax base were instituted by eliminating most currently allowed deductions, the structural complexity would be greatly reduced and taxpayers would spend less time and money computing and reporting their taxes. Moreover, there would be fewer opportunities for taxpayers to take advantage of loopholes or uncertainties in the tax structure. This would reduce the need for regulatory and enforcement activities. However, a truly comprehensive tax base that rigor-

the productivity of our national economy,<sup>6</sup> a flat rate comprehensive income tax seems preferable to our current income tax. Assessed in terms of vertical equity—the requirement that individuals who are not similarly situated should bear fair *relative* tax burdens—the case for a flat rate tax appears less convincing. However, the vertical equity issue is not whether the income tax should extract a proportional amount of each taxpayer's income or instead, whether it should be progressive and take an increasing percentage of income as income increases. This is so because there is tacit agreement, even among supporters of a flat rate tax, that the income tax should be progressive. Most advocates of a flat rate tax favor or accept the inevitability of a personal exemption—a deduction from gross income shielding a fixed amount of each taxpayer's income from taxation.<sup>7</sup> Introducing a personal exemption into a flat rate system makes an income tax progressive.<sup>8</sup>

For example, consider *A*, *B*, and *C*, individuals who have comprehensive annual incomes of \$10,000, \$25,000, and \$50,000, respectively. A 20% flat rate comprehensive tax allowing no personal exemption would take the same percentage of *A*'s, *B*'s, and *C*'s incomes and would not be progressive. However, if a \$5,000 personal exemption is introduced, then the effective rate of tax<sup>9</sup> for *A*, *B*, and *C*, respectively, is 10%, 16%, and 18%. If a \$10,000 personal exemption is introduced instead,

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ously sought to include in income all employee fringe benefits, unrealized gain on capital assets, and imputed rental income from owner-occupied or owner-used capital goods, would substitute a large amount of complexity for that eliminated. Perhaps this is why none of the bills before Congress seeks to do more than eliminate current deductions and exclusions. *Flat Tax Hearings*, *supra* note 1, pt. 1, at 37-39. Even if the tax base were not made more comprehensive, introduction of a flat rate might substantially reduce the number of transactions entered into, and the number of aggressive reporting positions taken, solely to avoid the impact of high marginal tax rates. This would reduce the cost of administering and enforcing the tax. See R. HALL & A. RABUSHKA, *supra* note 1, at 2-14.

6. As marginal tax rates increase, the relative cost of work versus leisure increases. The relative cost of present consumption versus saving for future consumption also increases. Empirical studies suggest that greater amounts of work and investment would result under a flat rate tax than under a graduated rate tax. *Flat Tax Hearings*, *supra* note 1, pt. 1, at 179-80 (statement of John E. Chapoton, Assistant Secretary of the Treasury for Tax Policy). Moreover, the combination of high marginal rates and deductions that would be eliminated in a more comprehensive tax base, for example, the capital gains deduction and percentage depletion, funnel resources into less productive uses. See R. HALL & A. RABUSHKA, *supra* note 1, at 53-60.

7. All of the bills introduced in the 97th Congress provide a personal exemption, or a tax credit performing the same function, in amounts ranging from \$1,000 in H.R. 4821, 97th Cong., 2d Sess. (1982), to \$17,500 in S. 2557, 97th Cong., 2d Sess. (1982). See also R. HALL & A. RABUSHKA, *supra* note 1, at 35, 121.

8. For the best discussion of this point, see W. BLUM & H. KALVEN, *supra* note 3, at 4, 90-100.

9. The effective rate of tax is obtained by dividing the tax paid by the comprehensive income. In other words, the effective rate is the rate of tax that would generate the actual tax paid if no deductions were allowed.

then the effective rate of tax for *A*, *B*, and *C*, respectively, is 0.0%, 12%, and 16%. Thus, a flat rate tax using a personal exemption is progressive, with the degree of progressivity increasing as the amount of the personal exemption increases.

The vertical equity issue then becomes a matter of determining the preferable *type* of progressivity. The answer to this question requires an understanding of the different types of progressivity that result from flat rate and graduated rate structures. The difference can be illustrated by again considering *A*, *B*, and *C*, individuals who have comprehensive incomes of \$10,000, \$25,000, and \$50,000. These individuals may be thought of as representatives of the lower, middle, and upper income classes. Chart I shows their relative tax burdens and after-tax incomes under a 20% flat rate comprehensive income tax. It also shows their burdens under a graduated rate comprehensive income tax that extracts 5% of the first \$10,000 of taxable income, 35% of taxable income between \$10,000 and \$30,000, and 60% of taxable income in excess of \$30,000. Both tax schemes allow a \$5,000 personal exemption, but no other deductions.

CHART I						
Taxpayer	Gross Income	Taxable Income	Tax (Flat Rate <sup>a</sup> )	Tax (Graduated Rates <sup>b</sup> )	After-Tax Income (Flat Rate)	After-Tax Income (Graduated Rates)
<i>A</i>	\$10,000	\$5,000	\$1,000	\$ 250	\$9,000	\$9,750
<i>B</i>	25,000	20,000	4,000	4,000	21,000	21,000
<i>C</i>	50,000	45,000	9,000	16,500	41,000	33,500
a. 20% of taxable income. b. 5% of first \$10,000 of taxable income; 35% of taxable income between \$10,000 and \$30,000; 60% of taxable income in excess of \$30,000.						

Chart I shows that if the amount of the personal exemption and the revenue needs of government are assumed to be equal under either rate structure, then a graduated rate system will always extract less tax from the lower class and more tax from the upper class than will a flat rate tax. Moreover, a flat rate tax, unlike a graduated tax, will not take a substantially larger share of income from the upper class than it did from the middle class. In other words, under the stated conditions, a graduated tax will reduce the pretax inequality in income between the upper and middle classes and between the upper and lower classes to a greater extent than will a flat rate tax.

This analysis may present a false picture for two reasons. First, it is

premised on the belief that the political process will produce the same personal exemption under a flat rate tax as under a graduated tax. However, when considering a flat rate tax in which the personal exemption is the only progressive element, Congress may adopt a larger personal exemption than would be politically feasible under a graduated rate tax. Second, the analysis presupposes that the progressivity effects of a graduated rate comprehensive income tax are relevant to the vertical equity issue.<sup>10</sup> A comprehensive tax base has been advocated by scholars, the American Bar Association, and the Treasury<sup>11</sup> without any success, probably because the resulting tax would be too progressive. It may be, then, that a more comprehensive tax base can be achieved only by changing from graduated to flat rates.<sup>12</sup> If this is so, then the proper comparator for any proposed flat rate comprehensive tax is not a theoretical graduated rate comprehensive tax, but, instead, the existing income tax, which is riddled with loopholes and exclusions and is considerably less progressive than its ideal version.

Chart II compares the progressivity of the present income tax<sup>13</sup> and three possible versions of a flat rate comprehensive income tax. Plans A, B, and C allow personal exemptions of \$5,000, \$10,000, and \$20,000, respectively, and extract tax from resulting taxable incomes at the rate of

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10. See *supra* note 7 and accompanying text.

11. See U.S. DEP'T OF TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 3-8 (1977) [hereinafter cited as BLUEPRINTS]; Graetz, *supra* note 2, at 529-30.

12. A comprehensive tax base would increase the tax burden of the wealthy relative to others. *Flat Tax Hearings*, *supra* note 1, pt. 2, at 10 (statement of Joseph A. Pechman, Director of Economic Studies & John K. Scholz, Research Assistant, Brookings Institution). This detriment could be offset by the substitution of a flat rate for the present graduated rates. In the minds of members of Congress subject to re-election pressures, any drastic change in the present system would have to be offset in some way so that no substantial number of taxpayers would feel aggrieved. Typical are the comments of Senator Dole, Chairman of the Senate Finance Committee:

Let's take mortgage interest. . . . There will have to be some transition rules, or you would have to demonstrate that in our proposal or whichever proposal we might seriously look at, that assuming the deduction was denied, that you still had a better deal because of the lower rate.

*Flat Tax Hearings*, *supra* note 1, pt. 1, at 127.

13. The effective tax rates under present law displayed in Chart II are interpolated from data set forth in Table 8 of a statement prepared for the Senate Finance Committee, *Flat Tax Hearings*, *supra* note 1, pt. 2, at 25 (statement of Joseph A. Pechman, Director of Economic Studies & John K. Scholz, Research Assistant, Brookings Institute). Comprehensive income in that study is:

adjusted gross income as defined in the Internal Revenue Code modified to include sick pay, all savers interest, nonitemizers charitable contributions, excludable dividends, interest on life insurance, excluded capital gains, all unemployment benefits, state and local bond interest, 50 percent of social security benefits, workman's compensation, veterans payments, tax preferences reported on the minimum tax form, one-third of employer provided life insurance, employer provided life insurance, 1981 IRA provision rescinded.

*Id.*, pt. 2, at 23.

15%, 25%, and 40%, respectively.<sup>14</sup> All taxpayers are assumed to be single, living alone, without dependents.<sup>15</sup>

CHART II				
Comprehensive Income	Effective Tax Rates			
	Present Law <sup>a</sup>	Plan A <sup>b</sup>	Plan B <sup>c</sup>	Plan C <sup>d</sup>
\$ 5,000	2.35%	0%	0%	0%
10,000	5.00	7.50	0	0
20,000	8.40	11.25	12.50	0
30,000	10.00	12.50	16.67	13.33
50,000	12.63	13.50	20.00	24.00
100,000	16.34	14.25	22.50	32.00
300,000	23.00	14.75	24.17	37.33
750,000	26.40	14.90	24.67	38.93

a. Effective tax rate under 1984 law.<sup>16</sup>  
 b. 15% of comprehensive income less \$5,000 personal exemption.  
 c. 25% of comprehensive income less \$10,000 personal exemption.  
 d. 40% of comprehensive income less \$20,000 personal exemption.

Chart II reveals the strikingly different distributions of tax burdens possible under the four structures. To test the relative progressivity of these structures, I postulate that one tax is more progressive than another if it imposes a greater tax burden on higher income citizens and a lesser tax burden on lower income citizens than does the comparator tax. Under this premise, Plan C is substantially more progressive than present law. Moreover, Plan C is more progressive than Plans A or B, and Plan B is more progressive than Plan A.<sup>17</sup> However, whether Plan A and Plan B are more or less progressive than present law is not immediately clear.

14. The hypothetical rates are the result of an intuitive, partially informed guess about the rates necessary to produce current revenues, under a more comprehensive definition of income with the suggested personal exemption. Plan A seems consistent with the assertion of a Treasury Department official that current revenues could be raised by using a rate of 16% and a \$5,000 personal exemption for a family of four. Plan B seems consistent with the same official's assertion that current revenues could also be raised by using a rate of 20% and a \$10,000 personal exemption. *Flat Tax Hearings*, *supra* note 1, pt. 1, at 159 (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Dep't of the Treasury). Plan C is purely a guess.

15. This assumption defers the problem of proper allocation of tax burdens among individuals with different lifestyles. See *infra* notes 70-105 and accompanying text.

16. See *supra* note 12.

17. This is necessarily true since the degree of progressivity is a function of the level of the personal exemption.

Under Plan A, the least advantaged citizens—individuals with incomes of \$5,000 or less—and the most advantaged citizens—individuals with incomes of \$100,000 or more—are taxed more favorably than under present law.<sup>18</sup> On the other hand, Plan A favors individuals with incomes from \$10,000 to \$50,000 less favorably than does the present law. If one's primary motivation is a concern for the least advantaged, then Plan A might be preferred to present law. However, individuals with incomes between \$5,000 and \$10,000—disfavored under Plan A—might properly be considered members of the least advantaged group. Moreover, the most advantaged citizens' tax burdens are significantly reduced under Plan A. Accordingly, most advocates of progressivity would conclude that a permanent substitution of Plan A for present law would not be a positive step.

Both Plan B and Plan C are more progressive than the present law. For individuals with incomes over \$300,000, tax burdens would be slightly lower under Plan B than under present law; for individuals with incomes under \$10,000, tax burdens would be substantially lower under Plan B than under present law. As a result, many scholars favoring a progressive tax would be willing to replace present law with Plan B. Under Plan C, the lower income class that fares better than under present law is expanded further, and the burden imposed on higher income taxpayers relative to present law is significantly increased. Presumably Plan C would be favored over present law by most progressive tax scholars and citizens.

Suppose, however, that Congress would seriously consider only Plan A. It might seem obvious that progressive tax scholars and citizens—those who favor a more equal distribution of society's consumable goods, and particularly those who favor a greater distributive share for lower income taxpayers—should fight against the adoption of Plan A and continue to advocate progressive changes to the existing graduated tax. Incremental progressive change is unlikely, however, due to the structural complexity of our present income tax.<sup>19</sup> Structural complexity makes it

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18. For purposes of the textual discussion of Chart II, it is unnecessary to define more precisely the break-even points at which individuals would be favored or disfavored by the substitution of Plan A, B, or C for present law. Instead, the important point is the relative treatment of lower, middle, and upper income taxpayers, loosely defined, under each alternative. If greater accuracy were necessary, it would appear, for instance, that the least advantaged group favored under Plan A would include individuals with incomes slightly above the personal exemption, who would also pay less tax under Plan A than under present law.

19. The history of income tax reform supports this point. Despite a number of striking changes in the code between 1946 and 1976 (for example, the minimum tax and the change from single filing to multiple rate structures) the effective rates of tax on inflation-adjusted income classes and between



impossible for the nonexpert to understand exactly who is favored or disfavored by the present tax code. Moreover, because each code provision or administrative procedure that authorizes a deviation from a comprehensive tax base has its own policy rationale, each deviation must be evaluated in light of that particular policy. The basic question of the relative tax burden to be borne by low and high income taxpayers is obscured by these policy rationales and by the structural complexity.

Additionally, graduated rates divide taxpayers into income subclasses, each subject to taxation at different rates.<sup>20</sup> Members of each income subclass have a direct interest in reducing the rates to which they are subject, but have no direct interest in the rate structure applicable to other income subclasses. As a result, the tax burdens that the existing structure produces do not promote solidarity among lower income taxpayers. Instead, lower income taxpayers see the present income tax as an incomprehensible monolith whose sole purpose is to generate revenues for government bureaucracies. Discontent with the present system, therefore, does not manifest itself in the form of coherent demands or support for incremental progressive reform, but instead results in cross-class sentiment that taxes are too high and should be cut across the board.

Therefore, even if initially less progressive, a flat rate comprehensive income tax may be preferable to our present system because it requires a political and societal focus on only two items—the level of the personal exemption and the rate of tax. Under a comprehensive flat rate tax, the personal exemption divides society into two clearly identifiable economic classes—those with comprehensive incomes at or below the personal exemption who pay no tax, and those with comprehensive incomes above the personal exemption. Individuals with incomes below, equal to, or slightly above the personal exemption might eventually perceive their common interest and support increases in the level of the personal exemption. Accordingly, Congress might be persuaded over a period of time to increase the personal exemption, and thereby make the income tax substantially more progressive than the present tax.<sup>21</sup>

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married and single taxpayers has changed very little. See Cohen, *Reflections on the U.S. Progressive Income Tax: Its Past and Present*, 62 VA. L. REV. 1317, 1326 (1976). There is thus no historical basis for assuming that some latent progressive tendency in the present income tax will soon manifest itself.

20. For example, married couples are divided into 16 rate classes. I.R.C. § 1(a) (1982).

21. Under this view a true flat rate tax would also be preferable to the Bradley-Gephardt Bill, S. 2817, H.R. 6944, 97th Cong., 2d Sess. (1982), and to similar bills. Bradley-Gephardt proposes a more comprehensive tax base, a flat rate of 14%, and then graduated surtaxes from 6% to 14% on adjusted gross incomes above \$25,000 for individuals and the same surtaxes on adjusted gross in-

Implicit in the suggestion that a flat rate tax may be the better mechanism for achieving a more progressive income tax is a particular view of social and political reality. Most of us believe that needed change can be obtained by peaceful means.<sup>22</sup> Therefore, we must believe that the legislative process works in a principled manner. We assume that Senators and Representatives enact legislation that a majority of citizens strongly demand. Moreover, we believe that citizens will not strongly or in great numbers press for personally advantageous legislation absent a firm belief that they are entitled to the advantage in question. Nor will Congress enact or preserve legislation that citizens strongly believe to be unjust. For example, Congress could not be persuaded to exempt from the income tax all married persons or all individuals occupying top-level positions in major American corporations. Nor would a significant number of married individuals or corporate executives support such legislation. The hypothetical proposals are not in response to any societally recognized entitlement, and would be widely viewed as unjust.

It follows, then, that merely educating lower income taxpayers about the economic benefits to them of a progressive flat rate tax will not generate strong support for its enactment. Moreover, even a progressive Congress will not be moved to act by a scholarly explanation of the advantages of a progressive flat rate tax.<sup>23</sup> Instead, a governing majority of Senators, Representatives, and citizens can be mobilized in favor of a progressive flat rate tax only if they can be convinced that the resulting after-tax incomes would be just, or at least significantly more just than the distribution of after-tax income under present law. Crucial, then, to an evaluation of the political viability and proper structure of a progressive flat rate tax is an understanding of what citizens perceive to be just.

## II. ENTITLEMENT-BASED ARGUMENTS FOR A PROGRESSIVE FLAT RATE INCOME TAX

### A. ENTITLEMENT TO AFTER-TAX INCOME

Individuals derive their notions of personal entitlement to property, social status, and political rights from life experiences. Moreover, in a

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comes in excess of \$40,000 for married couples. Bradley-Gephardt and similar bills require a political focus on a number of provisions, diverting attention away from the basic issue of the relative tax burdens to be borne by lower income and upper income taxpayers.

22. Indeed it can be argued that only through peaceful means can fundamental needed change be achieved. On this point, see Baker, *The Process of Change and the Liberty Theory of the First Amendment*, 55 S. CAL. L. REV. 293, 316-21 (1981).

23. Put more broadly, much of tax scholarship is probably utopian in that it advocates changes

relatively stable society such as ours there is widespread societal agreement about the extent and nature of these entitlements. This agreement is reflected in a governing ideological rationale—a set of beliefs justifying the existing distribution of rights and privileges.<sup>24</sup> The governing ideology constitutes a set of rules on which the vast majority of citizens of every class<sup>25</sup> rely to justify advantages they gain, and against which they measure the legitimacy of the advantages conferred on other citizens.<sup>26</sup> These rules explain the conditions under which most citizens feel no moral right to seize, or demand the seizure of, the income or property of more advantaged citizens, or to resist the taxes imposed on their own income or property. Fundamental to an understanding of this governing ideology, I suggest, is the fact that ours is a post-liberal society<sup>27</sup> characterized by a tension between the dominant mode of thought and value, termed liberalism or individualism,<sup>28</sup> and a subordinate perspective, termed altruism or communitarianism.<sup>29</sup> The governing ideology reflects

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that seem to be required by abstract maxims of efficiency or justice, but these changes would produce tax consequences inconsistent with the actual beliefs of a governing majority of citizens.

24. For a description of the nature of a governing ideology and its relationship to politics, see R. UNGER, *KNOWLEDGE AND POLITICS* 253-59 (1975).

25. For statistical evidence that the governing rules are the same for citizens of all economic and social classes, see R. COUGHLIN, *IDEOLOGY, PUBLIC OPINION AND WELFARE POLICY* 34-44 (1980). Coughlin did, however, find greater support for government intervention in lower socio-economic groups.

26. Of course, the existence of shared values and beliefs may not reflect universal human nature, but instead the dominance of one class. See R. UNGER, *supra* note 24, at 243.

27. The term "post-liberal society" is from R. UNGER, *LAW IN MODERN SOCIETY* 192-93 (1976).

28. By individualism or liberalism I mean the governing rationale of a society using the institutions of private property and a "free" market wherein each individual has the right and the desire to use natural and acquired talents to achieve maximum material benefit. Individualism places paramount importance on individual autonomy, on the responsibility of the individual for his or her situation, and on the virtue of the pursuit of individual self-interest. The view that temporarily or permanently unemployed persons are the responsibility of private charity is a fundamental example of the general theorems of individualism applied to a particular situation. For a detailed description of individualism, see Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685, 1713-16 (1976).

29. By communitarianism I mean the governing rationale of a social system in which individual talents are viewed as assets of the community and individual catastrophes as responsibilities of the community. In an ideal communitarian system unemployment would not be seen as primarily the result of individual failings. Instead, unemployment would be understood as primarily a community defect, to be best remedied by the community as a whole rather than left to individuals, the market, or private charity. Communitarianism thus places paramount importance on shared values and communal responsibility for the well-being of citizens. The paramount virtue is not the pursuit of self-interest, but the pursuit of the well-being of the individual understood as an integral part of the community. While individualists believe that the maximum well-being of society will result indirectly from the direct individual pursuit of narrow self-interest, communitarians contend that maximum individual well-being is a necessary coproduct of, and is indivisibly linked to, the direct pursuit of community well-being. For a detailed analysis of the ideal of community, see R. UNGER, *supra* note 24, at 249-76; Kennedy, *supra* note 28, at 1717-22, 1771-74.

society's ongoing attempt to accommodate these conflicting value systems and to legitimate and reconcile the related life experiences.

For post-liberal citizens, society is a cooperative venture for mutual advantage<sup>30</sup> in which the pursuit of ever greater levels of material well-being is a paramount, almost biologically compelled, life goal.<sup>31</sup> From one perspective most citizens would describe their working lives as a constant struggle with other workers, each pursuing his or her own narrow self-interest, in order to obtain larger or more secure shares of goods and services. At the same time, citizens realize that working in cooperation with others permits a division of labor so that each worker may become a specialist rather than a less efficient generalist. While specialization increases each worker's output, it makes each worker dependent both on goods and services produced by others, and on a market for the specialist's own product. Accordingly, post-liberal citizens understand that the level of their own material well-being is inextricably linked with the status of the national economy. For their own distributive share of goods and services to be maximized, the total social product<sup>32</sup> also must be maximized. Moreover, most citizens view material rewards as the reason for working and assume that the amount of goods produced by other citizens will be maximized by allowing them to pursue their own narrow self-interest. Thus, the competitive, materialistic life experiences of post-liberal citizens lead them to believe that the role of government should be limited to protecting private property and the workings of the free market so that individuals can with security and certainty calculate and pursue their own self-interest.

Post-liberal society is characterized by partial rejection of this individualist, laissez faire model. While individuals view competition and the pursuit of self-interest as a reality and a necessity, they also perceive that success is often predicated on market or bureaucratic imperfection, chance, or callous personal actions that would not be tolerated in a nonmarket or nonhierarchical relationship. Moreover, within the family and with friends, self-interest frequently yields to other human instincts. In these relationships individuals develop and nurture sympathy and concern for the well-being of others. These experiences reinforce the widely shared belief that a pure laissez faire system would produce intolerable individual and community suffering. Instead, it is felt, society

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30. See J. RAWLS, *A THEORY OF JUSTICE* 4-6 (1971).

31. H. MARCUSE, *AN ESSAY ON LIBERATION* 10-13 (1969).

32. The total social product is the total goods and services produced for personal consumption during a given period.

must be structured to insure a minimally acceptable level of individual and community well-being. In achieving this goal, post-liberal citizens expect their government to engage in "overt redistribution, regulation and planning."<sup>33</sup>

Accordingly, communitarian concerns sometimes require that the workings of the free market be supplemented or bypassed. For example, society accepts responsibility for the well-being of its least advantaged citizens and through transfer payments provides them with at least minimally sufficient resources so that they can avoid abject poverty without having to steal or beg.<sup>34</sup> In addition, society provides public goods, such as national defense and parks, to its citizens when the market cannot efficiently provide such goods.

Citizens acknowledge that providing for the least advantaged and financing public goods require government revenues and the levying of taxes.<sup>35</sup> Thus, post-liberal citizens recognize that their gross incomes are subject to taxation, and that taxes can legitimately be extracted to the extent of government's preclusive claim. Post-liberal citizens still, however, claim moral entitlement to their after-tax income.

From a limited perspective, entitlement to after-tax income can be justified because it represents the reward that society has promised each citizen for employing his or her skills and capital in ways valued by consumers and in accordance with society's rules. If these claims were not honored, society would be unable to function on a cooperative, voluntary basis. The result would be reduced liberty, fewer goods and services, or both.<sup>36</sup> Nonetheless, this justification alone is insufficient, for it provides no guidance about the proper design of the income tax. Instead, it suggests that any income tax is acceptable so long as the rules are made public, thereby enabling citizens to take them into account when calculating their own self-interest. Such a value-neutral formulation obviously

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33. R. UNGER, *supra* note 27, at 193.

34. The constant debate over the contours of public assistance programs centers on questions of defining need and determining the most efficient method of providing aid. No one seriously questions our commitment to provide basic assistance to the truly needy.

35. Public goods are to the advantage of society as a whole, yet cannot be sold to the beneficiaries. In part this is a free-rider problem. If we provide national defense, all will benefit even if some refuse to "buy" their share of this public good. Social services for the needy may also be thought of as a public good that all of us wish to have available, but that few of us would "buy" when not needy and none of us could "buy" if we were needy. Thus, public goods must be financed by tax revenues. See J. RAWLS, *supra* note 30, at 267-70.

36. On the importance of honoring claims to the social product acquired in accordance with the rules of a well-ordered society, see *id.* at 310-15.

provides no basis for choosing between a progressive flat rate tax, a graduated tax, or any other alternative.

Under a value-neutral formulation the income tax is only a revenue-raising device that, as a mere side effect, determines the amount of after-tax income to which a citizen is morally entitled. I will argue, however, that it is more consistent with the beliefs of post-liberal citizens to view the income tax as a device whose unique purpose is to determine the after-tax income to which citizens are morally entitled, and, further, that post-liberal citizens are entitled to the net after-tax income that would be produced by a progressive flat rate tax.

### B. THE ARGUMENT FOR FLAT RATES

The entitlement-based argument for a progressive flat rate income tax is derived from our ideological beliefs about the nature of society and the rights and duties of citizens. The argument will be illustrated by analyzing how post-liberal individuals, if drawn into a hypothetical "state of nature," would organize a simple society. This hypothetical will demonstrate how such a society might evolve into a complex society, and the role that the income tax would play at various stages of development.<sup>37</sup>

First, we shall consider a simple, pre-money society ("Nirvana") composed of citizens who possess overlapping and equally valuable talents. Each citizen is capable of providing for his or her own needs. Through cooperation, however, economies of scale and efficiencies from the division of labor can be achieved. This will result in an increased social product or a reduced amount of time spent working. Accordingly, the citizens of Nirvana coordinate and combine their work effort to produce collectively selected consumer goods. In addition to consumer goods, Nirvana needs certain public goods, such as roads, water, and sanitation systems. Because Nirvana is a voluntary association of equally

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37. This endeavor is analogous in some ways to Rawls' use of the original position device to justify his difference principle. *Id.* at 118-83. Professor Nozick also uses a hypothetical state of nature to justify certain libertarian principles of justice. See R. NOZICK, *ANARCHY, STATE, AND UTOPIA* 277-94 (1974). I use a similar device, a hypothetical Nirvana, populated with post-liberal individuals fully aware of the technological capacities and social realities of present society. My purpose is to develop arguments and ideological myths that are congruent with, and appealing to, the average citizen's sense of justice. Often I state broad ethical premises that may seem outlandish and in need of substantial support and explanation. These premises, though, are not offered as a higher truth. Instead, I view them as useful tools in determining the tax policy options that are politically viable. On the problems that underlying assumptions pose for legal scholars, see Gordon, *Historicism in Legal Scholarship*, 90 YALE L.J. 1017 (1981); Tushnet, *Legal Scholarship: Its Causes and Cure*, 90 YALE L.J. 1205 (1981).

talented individuals for mutual advantage, each citizen must be extended equal rights, but also must accept equal responsibilities. Therefore, membership in society is conditioned on an individual's agreeing to contribute a collectively determined equal amount of time to the creation and rendering of public goods and services.

For simplicity, assume that citizens have identical preferences for work and for leisure, and that, pursuant to a collective decision, each citizen spends thirty hours per week producing consumer goods and ten hours per week producing public goods. The consumer goods produced must be distributed in kind to each citizen. Because each citizen is autonomous and cannot be forced to work, there is no just basis for requiring a citizen to share the fruits of his or her labor with others. In other words, a citizen is morally entitled to the consumer goods which he or she creates during time not devoted to public service (hereinafter called "private production time"). Thus, the total social product is divided in accordance with a collective determination of the value of each citizen's contribution, which in this case presumably results in an equal division.<sup>38</sup>

Now assume that Nirvana elects to take the advantages of cooperation one step further. It is decided that some citizens should specialize in the provision of public goods and others in the production of goods for private consumption, thereby increasing the efficiency by which both are produced. Even though some individuals are no longer directly involved in production for private consumption, their public sector work permits other citizens to devote additional time to production of private goods. Conversely, the increase in production of private goods due to the specialization of some workers permits other workers to devote their time to the production of public goods. Of course private-goods production specialists remain subject to an underlying obligation to contribute a socially determined equal amount of time to the creation and rendering of public goods and services (hereinafter called "public service time"), and a part of their work time will continue to be public service time. Therefore, private-goods production specialists have no moral claim to the goods and services which they produce during public service time. These consumer goods are divided among the public-goods production specialists because such goods represent the portion of the total social product to which public-goods production specialists are morally entitled as compensation for the private production time that they have devoted to the production of public goods. Thus, each citizen receives the value of his

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38. This assumes equally valuable or scarce talents, equal effort, and accurate valuation of labor performed.

or her contribution to the total social product, which is understood, however, as the value attributable to a citizen's private production time.

Now let us transform Nirvana into a society using money as the medium of exchange. Nirvana continues to collectively determine which products are produced, the price of such products, and the value of each citizen's contribution to the total social product. *A*, *B*, *C*, and *D* are representatives of Nirvana's citizens. *A* specializes in the production of public goods. *B*, *C*, and *D* produce goods for private consumption. The contributions of *A*, *B*, *C*, and *D* continue to be valued equally. The total value of consumer goods produced by *B*, *C*, and *D*—the total social product<sup>39</sup>—is \$120,000. However, *B*, *C*, and *D* are collectively morally entitled to only three-fourths of the total social product because one-fourth of their work is public service time. Thus, Nirvana distributes to *A*, *B*, *C*, and *D* gross incomes of \$30,000 apiece, representing both the value of their private production time and the value of their contribution to the total social product.

In the versions of Nirvana sketched to this point, each citizen has a moral claim to the entirety of his or her gross income because that amount represents the citizen's contribution to the total social product. If, however, we further transform Nirvana into a market society in which prices and gross incomes are determined by consumer choices in the market, rather than by collective decision, then the identity between gross income and contribution to social product disappears and an income tax will be required. In our market version of Nirvana we will assume that the total value of consumer goods produced by *B*, *C*, and *D* remains \$120,000 and that *A*, *B*, *C*, and *D* will each receive net incomes of \$30,000, representing the value of their contributions.<sup>40</sup> The market will cause *B*, *C*, and *D* each to receive gross incomes of \$40,000, incomes which equal the market value of the goods and services each produced. Thus, the gross incomes of *B*, *C*, and *D* include the value of both their public service time and private production time. Assuming Nirvana values *A*'s services as equal to *B*'s, *C*'s, and *D*'s, *A*, too, will receive a gross income of \$40,000.<sup>41</sup> In order to pay *A*'s salary, it will be necessary to extract \$10,000 in income tax from the gross incomes of *A*, *B*, *C*, and *D*.

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39. Because public goods are freely distributed or available, the total social product is comprised of those goods and services available for private ownership and consumption.

40. Again, this assumes equally valuable or scarce talents, equal effort, and accurate valuation, now by the market instead of by collective political decision.

41. Note that public service workers also receive gross incomes that include payment for the private production time foregone as well as the public service time that they are required to contribute, for which they are entitled to no additional portion of the total social product.



In a noncentrally administered market society the purpose of an income tax, then, is to extract from gross income the value of public service time—the portion of gross income which in a centrally planned economy would have been directly diverted to the public sector. Moreover, in such a market society, it is after-tax income which equals contribution to social product (represents the value of private production time), and, therefore, it is after-tax income to which a citizen is morally entitled.

In order to satisfy the moral claims of its citizens to the product of their private production time, Nirvana must use a flat rate comprehensive income tax—in this case with a rate of 25%—to divert revenues to the public sector. Each citizen was initially obligated to work ten hours per week producing public goods. For increased efficiency, Nirvana's private sector employees now allocate ten additional hours to their area of primary responsibility, as, in effect, do public sector employees. The gross money income received for work during public service time does not belong to the recipient. Instead, this income is a proxy for the ten hours of public service work required from each citizen, and must be extracted in order to provide the funds to pay public sector workers.<sup>42</sup>

If one agrees that a flat rate tax is the preferred and just method for raising revenues to finance public goods, the next step is to determine the proper method of extracting revenue to be used for the benefit of society's least advantaged citizens. Let us now add to Nirvana individual *E*, who is unemployable. Nirvana, like our post-liberal society, recognizes a societal obligation to provide, at least minimally, for citizens like *E*. The resulting safety net for the least advantaged is thought of as a public good equally available to all citizens and therefore should be financed in the

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42. Since all citizens work forty hours per week in Nirvana, a flat rate tax of 25% exactly captures the value of each citizen's ten public service hours per week. If preferences for work as opposed to leisure differed, then such a flat rate tax might arguably undertax the incomes of those who work less than forty hours per week and overtax the incomes of those who work more than forty hours per week. This concern can be answered in two ways. In the real world, most citizens devote similar amounts of time to work. Moreover, it would be administratively impractical to design a tax that adjusted the tax burden according to hours worked. Thus, a flat rate tax, without adjustment for over- and under-workers, is sufficiently close to the ideal to be acceptable. Furthermore, those who work less than forty hours per week arguably reap a correspondingly smaller advantage from participation in the cooperative venture for mutual advantage. As "part-time" members, their public service time should be reduced. As to those who work more than forty hours per week, it could be argued that they extract correspondingly greater advantage from the cooperative venture, and should put in more public service time as compensation. If this is so, then a person's public service obligation would be a set percentage of the total hours that the individual chose to devote to the production of consumer goods. The money earned during these public service hours would be a proxy for the public service time owed, and a flat rate tax would extract the value of this public service time whether the person worked more or less than the average citizen.

same way as other public goods. Central to post-liberal ideology is the belief that none of us deserves our good or bad fortune or our starting place in life. The founders of Nirvana would undoubtedly be concerned about their own future well-being or that of their friends or descendants. Because the identity of those who will be in need is unknowable in advance and is, ultimately, the result of chance or other morally arbitrary factors, the original citizens would agree as a condition to membership to devote an equal amount of time, as needed, to provide at least a minimal amount of consumer goods and rehabilitative services to the least advantaged.<sup>43</sup> On the conversion of Nirvana to a free market system, the money income earned by its citizens in the hours otherwise required to be spent providing goods and services for the least advantaged, stands as a proxy for such public service hours and must be extracted via a flat rate tax.

Now let us delete *E* from Nirvana and change the characteristics of *A*, *B*, *C*, and *D* so that their contributions to the social product are accurately, but unequally, valued. While *A* and *B* continue to receive gross incomes of \$40,000, *C* and *D* receive gross incomes of \$50,000 and \$30,000, respectively. The total social product continues to be \$120,000, and \$40,000 must be extracted to fund the public sector. Determining how to extract this tax from a viewpoint of ad hoc fairness, we might suggest that graduated rates be implemented so that *C* would bear a proportionately greater burden than lower income citizens. However, we have posited that the gross income of Nirvana's citizens accurately reflects the relative value of his or her contribution to the social product. In effect, graduated rates would require that *C* devote more time than *A*, *B*, or *D* to the production of public goods. This result is inconsistent with individual liberty and might even cause *C* to reduce her work effort in the future. In contrast, a flat rate tax recognizes the obligation of each member of society to provide an equal amount of time and effort to the production of public goods, and is consistent with the value that post-

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43. The inhabitants of John Rawls' original position are self-interested individuals without knowledge of what their actual stations in life will be. J. RAWLS, *supra* note 30, at 12. From this position of ignorance, Rawls argues that these original citizens would adopt the difference principle, allowing inequality, but only to the extent that the least advantaged were indirectly benefited, *id.*, at 75, 78, either by expanded job markets or increased transfer payments. My account assumes an original position inhabited by average post-liberal citizens, none presently unemployable, who are forming a new community. I believe my account of Nirvana and its citizens' agreement to assume some, but not total, responsibility for the economic well-being of least advantaged citizens, better describes the actual sense of justice of post-liberal citizens than does Rawls. Indeed, Rawls' difference principle can be criticized as equally flawed if viewed as a vision of what society's sense of justice should be, because it assumes that human beings are doomed forever to self-interested action.

liberal citizens place on individual liberty and noninterference with the pursuit of self-interest.<sup>44</sup>

### C. THE ARGUMENT FOR A PERSONAL EXEMPTION EQUAL TO THE MINIMUM WAGE

The personal exemption is a deduction that exempts a portion of each individual's gross income from the tax base. If the personal exemption could be increased significantly from present levels, then less advantaged citizens would be entitled to greater shares of after-tax income.<sup>45</sup> However, in tax policy literature the personal exemption is justified as a device to shield from tax only the amount of income required for a minimally acceptable level of subsistence.<sup>46</sup> If this view reflects the actual beliefs of post-liberal citizens, then the progressivity theoretically achievable with a substantial personal exemption cannot be transformed into reality. In this Section, I argue that post-liberal beliefs concerning entitlement to after-tax income suggest that the personal exemption should be an amount of income equal to the minimum wage, rather than an amount equal to the poverty level—the income required for basic subsistence.

The mainstream argument for a poverty-level personal exemption is founded on the maxim that taxes should be levied in accordance with taxpayers' relative ability to pay tax.<sup>47</sup> Applying this maxim, it seems clear that an individual with no discretionary income should pay no tax, but that every individual with discretionary income should pay at least some tax. Accordingly, the personal exemption should be set at the pov-

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44. This vision of society as a cooperative venture founded by autonomous individuals who voluntarily accept limited responsibility for the well-being of less advantaged citizens is similar, then, to Nozick's vision of the minimal state. See R. NOZICK, *supra* note 37, at 3-146. Unlike Nozick's, however, my vision assumes a shared concern for the well-being of others, which coexists with the basic rights to personal autonomy recognized by Nozick. Under Nozick's vision, taxes extracted for transfer payments constitute forced labor. *Id.* at 170. Under my vision, taxes extracted for transfer payments and other public goods are no more than a proxy for the equal commitment to society that every post-liberal citizen would gladly make if thrust back into a state of nature.

45. The present income tax allows each individual a \$1000 personal exemption. I.R.C. § 151 (1982). Unmarried individuals are allowed an additional \$2300 personal exemption because the first \$2300 of taxable income is subject to a zero rate. *Id.* § 1(c). Married individuals are collectively extended an additional \$3400 personal exemption because the first \$3400 of their joint taxable income is subject to a zero rate. *Id.* § 1(a).

46. See, e.g., R. GOODE, *THE INDIVIDUAL INCOME TAX* 215 (1976); L. SELTZER, *THE PERSONAL EXEMPTIONS IN THE INCOME TAX* 5, 6 (1968).

47. See BLUEPRINTS, *supra* note 11, at 8-9; Mieszkowski, *The Choice of Tax Base: Consumption versus Income Taxation*, in *FEDERAL TAX REFORM: MYTHS AND REALITIES* 27 (M. Boskin ed. 1978).

erty level to insure that taxes will be extracted only from discretionary funds.

However, arguments based on the "ability to pay" maxim lack credibility and are unpersuasive because the maxim can be used to justify tax policies which most citizens clearly would view as unjust. For example, wealth is arguably a better measure of ability to pay than is income, which suggests that a wealth tax should replace our income tax. Moreover, one could argue that the income tax should confiscate the entirety of incomes in excess of, for example, \$50,000, because to the extent of such excess the taxpayer has greater ability to pay than those with lesser incomes. Despite the asserted application of the "ability to pay" maxim neither of these arguments is persuasive because both a wealth tax and a confiscatory income tax are inconsistent with post-liberal beliefs about personal entitlement to after-tax income.<sup>48</sup> If an argument about the proper level of the personal exemption is to be persuasive, it must be based on the actual beliefs of post-liberal citizens.<sup>49</sup>

There is, of course, a communitarian concern in post-liberal society for the well being of the least advantaged citizen that underlies our societal commitment to provide at least a minimal amount of income to each citizen. If a personal exemption at the poverty level is to be justified, it is by reference to this societal concern and the beliefs and values that underlie it rather than to the "ability to pay" maxim. Moreover, viewed from the perspective of society's commitment to provide minimally for the least advantaged, a personal exemption at the poverty level has intuitive appeal.

To evaluate this justification for a poverty level personal exemption, let us return to Nirvana. Assume that \$5,000 is the amount of after-tax income needed for basic subsistence, and that *A*, *B*, *C*, and *D* earn gross incomes of \$5,000, \$6,300, \$20,000, and \$68,700, respectively. *C* represents the public sector, and thus *C*'s \$20,000 gross income equals the revenues that the income tax must raise. A 20% flat rate comprehensive income tax allowing no personal exemption will produce \$20,000 in revenue, but will reduce *A*'s after-tax income to below the poverty level.<sup>50</sup> To prevent this result, Nirvana must either exempt *A*'s gross income from tax via a \$5,000 personal exemption or provide a direct income subsidy

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48. For most citizens wealth is no more than deferred consumption—after-tax income saved for use at some later date. To extract taxes from the wealth of ordinary citizens would conflict with the average citizen's sense of entitlement to after-tax income.

49. See *supra* notes 37-44 and accompanying text.

50. Nirvana's total taxable income is \$100,000, and the total tax extracted at a 20% rate is \$20,000.

to *A* in the amount necessary to leave *A* with an after-tax income of \$5,000.<sup>51</sup>

If Nirvana uses the personal exemption mechanism and extends its benefits only to *A*, then the tax rate must be increased to 21.05%. *B*'s tax burden will then be increased to \$1,325, and *B*'s after-tax income will be \$4,975—\$25 below the minimally acceptable poverty level.<sup>52</sup> As a result, Nirvana must extend to *B* a personal exemption large enough to prevent *B*'s after-tax income from falling below \$5,000, and in turn the tax rate must be raised to extract from society's reduced aggregate taxable income the \$20,000 needed for public goods. *C* and *D* are not entitled to a personal exemption because their after-tax incomes are above the \$5,000 poverty level.<sup>53</sup>

If the personal exemption can only be justified as a deduction for taxpayers whose after-tax income would otherwise fall below the poverty level, then the across-the-board personal exemption in our present tax must be viewed as an unwarranted tax preference for higher income taxpayers to the extent that their incomes are shielded from tax. We are also required to view the personal exemption as merely a device that provides welfare payments to those whose own services to society do not produce a sufficient return—a perception that denigrates the worth of lower income citizens.

Instead of accepting these conclusions, a better explanation of the purpose and proper design of the personal exemption can be derived from a consideration of the nature, purpose, and justification of the minimum wage laws.<sup>54</sup> To illustrate the argument let us change the characteristics of Nirvana's citizens once again. *A* now represents the public sector and earns \$40,000 annually. *B*, *C*, and *D* have gross incomes of

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51. Nirvana's citizens accept and view the obligation to make welfare payments at the poverty level as a public good to be financed by requiring each working citizen to devote slightly more time on a pro rata basis to the production of the required goods and services. See *supra* note 43 and accompanying text. Thus, the increase in tax, made necessary by a personal exemption founded on welfare principles, is justified as a proxy for the additional public service time that each non-subsidized citizen must contribute to provide welfare assistance to the working poor.

52. Extending a personal exemption to *A* reduces Nirvana's total taxable income to \$95,000. Extracting tax at the rate of 21.05% yields the \$20,000 needed for public goods, yet leaves *A* with \$5,000 in after-tax income.

53. A personal exemption allowed only to taxpayers who otherwise would have after-tax incomes below the poverty level is a type of disappearing exemption. See L. SELTZER, *supra* note 46, at 10; Note, *A Proposed Flexible Exemption for the Federal Income Tax*, 18 STAN. L. REV. 1162 (1966).

54. By the minimum wage laws I mean the provisions of the Fair Labor Standards Act of 1938, as amended, which require employers to pay a specified minimum wage to employees. 29 U.S.C. § 206 (1983).

\$10,000, \$12,000, and \$98,000, respectively. *B* works a forty-hour week—the norm in Nirvana—and earns the minimum wage. If the minimum wage laws were not in effect *B*'s gross income would drop from \$10,000 to \$5,000—the poverty level for Nirvana—and the earnings of *A*, *C*, and *D*, collectively, would increase by \$5,000. Thus, the minimum wage is a redistributive mechanism<sup>55</sup> that must be justified by reference to the governing ideological rationale of post-liberal society.

The redistribution of income achieved by the minimum wage cannot be justified on the same grounds as welfare payments to those who are unable to work. Post-liberal society views nonworking citizens as entitled to public assistance at the poverty level because of their status as fellow human beings.<sup>56</sup> However, the minimum wage mandates gross incomes in excess of the poverty level.<sup>57</sup> Thus, post-liberal society perceives a fundamental difference between workers and nonworkers. The minimum wage is not viewed as an expression of societal sympathy or communitarian solidarity. Instead, low income workers are viewed as valuable participants in the cooperative venture for mutual advantage. They are entitled to receive the minimum wage by virtue of their work.

As a general rule society functions as if the value of a citizen's contribution to the social product is accurately measured by the gross income that he or she receives.<sup>58</sup> However, post-liberal society does not have complete faith in the efficacy of the market or the public and private sector bureaucracies. The market and bureaucratic measurement of each individual's contribution to the social product is imperfect. In the case of individuals whose skills are in overabundant supply, the market produces an unfairly low valuation of their contribution to society. To avoid charges of unfair competition with the private sector, the public sector accepts this wage scale. The minimum wage, then, represents society's judgment that the otherwise prevailing market and bureaucratic evalua-

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55. See Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472, 473 (1980).

56. This view is recognized and reflected in Nirvana's agreement to make welfare payments to those who through no fault of their own are below the poverty level.

57. See S. REP. NO. 1487, 89th Cong., 2d Sess. 3 (1966) ("It is imperative, if the act is to have real meaning, that the minimum wage provide earnings above the poverty level.").

58. As a general principle we believe in consumer sovereignty. The "vote" of the consumer best determines the value of things produced and of services provided. Ultimately this vote translates into each individual's gross income. This view finds an early expression in T. HOBBS, *LEVIATHAN* (M. Oakshott ed. 1972). "The value of all things contracted for, is measured by the appetite of the contractors: and therefore the just value is that which they be contented to give." *Id.* at 117. For a more recent formulation, see M. FRIEDMAN & R. FRIEDMAN, *FREE TO CHOOSE* 13-24 (1980). The belief that consumer sovereignty should determine the value of one's contribution to society is implicit in J. RAWLS, *supra* note 30, particularly at 270-74, 310-14.

tion of minimum wage workers' contributions to society is unfairly low.<sup>59</sup>

At this point a crucial judgment must be made. Should we view the minimum wage as the true value of the minimum wage worker's services or as the minimal claim against the social product to which the minimum wage worker is entitled by virtue of his or her services? If one believes that the actual value to society of the services rendered by low income workers is greater than indicated by their gross incomes, then the second view will seem preferable. It is clear that minimum wage laws are based on an awareness that markets and bureaucracies unfairly evaluate the contributions of individuals without scarce talents.<sup>60</sup> Furthermore, minimum wage laws are aimed at achieving at least a decent share of the social product for lower income workers. Nothing in the legislative history, however, suggests that Congress views the minimum wage as a true or accurate measure of services rendered. Instead, the debate over minimum wage legislation has focused on the resulting burden placed on the employer if the minimum wage is increased or the coverage of the minimum wage laws expanded.<sup>61</sup> It is fair to assume that Congress is unwilling to place American businesses at too great a competitive disadvantage relative to businesses in countries with lower wages. Thus, the minimum wage is a compromise intended to achieve the maximum well-being for low income workers consistent with the realities of international economic competition. The minimum wage, then, should be thought of as the base claim against the total social product to which each minimum wage worker is entitled. Accordingly, the personal exemption should equal the annual earnings of a full-time minimum wage worker since this represents an amount of after-tax income to which every worker is morally entitled.<sup>62</sup>

This point can be reached somewhat differently. Recall that in Nirvana each worker is morally entitled to the value of his or her contribution to the total social product available for sale on the market. In addition, every worker is obligated to contribute equal amounts of time

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59. Providing the protection of the minimum wage to the American worker has been an important element in our national policy for almost 30 years. Underlying this policy has been the recognition that some segments of our labor markets work imperfectly and that many workers are at a disadvantage in bargaining with their employers.

S. REP. NO. 1487, 89th Cong., 2d Sess. 18 (1966).

60. *Id.*

61. See H.R. REP. NO. 2182, 75th Cong., 3d Sess. 15 (1938) ("[M]inimum wages . . . shall be as nearly adequate as is economically feasible without curtailing opportunity for employment, to maintain a minimum standard of living necessary for health, efficiency, and general well-being.").

62. When I refer to the minimum wage, or to a personal exemption equal to the minimum wage, I mean an amount equal to the annual earnings of an individual working the average work week, and receiving 52 weeks' pay calculated at the minimum wage.

for the production of public goods and services. If Nirvana encourages the division of labor between and within the public and private sectors and uses money as the medium of exchange, then the tax extracted by a comprehensive flat rate income tax operates as a proxy for the public service time owed by each citizen, and the after-tax income represents the value of the citizen's contribution to the social product.<sup>63</sup> In effect, the minimum wage constitutes society's judgment as to the minimum real value of any worker's contribution to the production of private goods. The value of a minimum wage worker's public service time, therefore, must be viewed as distributed by the market among those citizens whose gross incomes exceed the minimum wage. As the income tax extracted from gross income constitutes a proxy for the public service time owed to society, the income tax can properly be extracted only from the portion of gross income which exceeds the minimum wage.

To better understand the rationale of an across-the-board personal exemption equal to the minimum wage, let us explore an alternative system. Consider *A*, *B*, *C*, and *D*, individuals whose actual market incomes are \$40,000, \$10,000, \$16,000, and \$94,000, respectively. *A* represents the public sector. Accordingly, \$40,000 in tax revenue must be generated. Nirvana's total gross income is \$160,000. Therefore, one-fourth of each worker's labor is public service time and three-fourths is private production time. A 25% flat rate comprehensive income tax will extract the required revenues.

Nirvana determines that \$10,000 is the minimum value of any worker's private production time, and, thus, the minimum amount of after-tax income that each worker should be guaranteed. Instead of explicitly second guessing the market and bureaucratic determinations of gross income only to the extent of adopting a minimum wage, Nirvana makes a determination as to the actual value of the services performed by each of its citizens. Nirvana then takes the excess income of workers whose labor is overvalued by the market and transfers it to those workers whose income is undervalued. By this process *A*, *B*, *C*, and *D* end up with gross incomes of \$40,000, \$13,333, \$18,667, and \$88,000, respectively. These adjustments reflect Nirvana's judgment that the market overvalued *D*'s labor by \$6,000, correctly valued *A*'s services, and undervalued the contributions of *B* and *C* by \$3,333 and \$2,667, respectively. After this initial redistribution, the gross incomes of *A*, *B*, *C*, and *D* reflect the true value of their private production time and public service time. Now Nirvana can extract the value of each worker's public service

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63. See *supra* notes 37-44 and accompanying text.



time through the simple mechanism of a 25% flat rate comprehensive income tax allowing no personal exemption.

Chart III shows the tax burdens and after-tax incomes which result if Nirvana uses market income and a 33 1/3% flat rate comprehensive income tax allowing a personal exemption equal to the \$10,000 minimum wage, or, alternatively, uses a two-step process of first redistributing market income as necessary to reflect the true value of labor performed and then extracting a 25% flat rate comprehensive income tax allowing no personal exemption.

CHART III						
Taxpayer	Market Income	Tax Paid (Plan A <sup>a</sup> )	After-tax Income (Plan A <sup>a</sup> )	True Value Income	Tax Paid (Plan B <sup>b</sup> )	After-tax Income (Plan B <sup>b</sup> )
A	\$ 40,000	\$10,000	\$ 30,000	\$ 40,000	\$10,000	\$ 30,000
B	10,000	0	10,000	13,333	3,333	10,000
C	16,000	2,000	14,000	18,667	4,667	14,000
D	94,000	28,000	66,000	88,000	22,000	66,000
Total	\$160,000	\$40,000	\$120,000	\$160,000	\$40,000	\$120,000
a. 33 1/3% flat rate comprehensive income tax; \$10,000 personal exemption.						
b. 25% flat rate comprehensive income tax; no personal exemption.						

A, B, C, and D have the same after-tax income under either regime. Both systems generate the \$40,000 in revenue needed to fund the public sector. We can see, therefore, that adopting a 25% flat rate comprehensive income tax allowing a \$10,000 personal exemption constitutes an implicit societal judgment that the true value of A's, B's, C's and D's private production time and public service time is represented by the gross income figures in Chart III, column five. Moreover, Chart III shows that interjecting a personal exemption linked to the minimum wage constitutes an implicit societal judgment that markets and bureaucracies overvalue the contributions of high income taxpayers and undervalue the contributions of low income taxpayers.<sup>64</sup>

64. This societal judgment is explicit, and, therefore, more politically sensitive in a graduated rate tax. Graduated rates are, then, a mechanism for redistributing undeserved income and must explicitly overcome

the difficulty of correlating the "undeserved" income with the rates under a progressive schedule. To obtain such correlation it is necessary that there be some general relationship between total income and undeserved income and that the undeserved component increase more rapidly than the total income. Almost nothing is known about the distribution of undeserved income, and guesses about its probable distribution seem to be a most precarious base on which to rest the tax structure.

W. BLUM & H. KALVEN, *supra* note 3, at 81.

Intuitively, it appears likely that the markets and bureaucracies in our society overvalue the services of most high income workers and undervalue the services of most low income workers. However, society would be unwilling to second guess directly the market and bureaucratic determinations of value beyond the second guess implicit in enactment of the minimum wage. Therefore, the best we can do is shield from tax the portion of every taxpayer's gross income that equals the minimum wage. As a society we can explicitly agree that each worker is morally entitled to after-tax income in that amount. A flat rate tax with a personal exemption equal to the minimum wage may be viewed, then, as an efficient and politically feasible mechanism for making implicit, progressive judgments about the true value of the private production time and public service time of taxpayers at various gross income levels.

#### D. THE PERSONAL EXEMPTION AND UNEARNED INCOME

The argument presented in the Article up to this point suggests that post-liberal citizens are morally entitled to income generated by private production time, yet owe to the government income generated by public service time.<sup>65</sup> However, it is unclear how unearned income—rent, interest or profit received as payment for the use of property, as opposed to income from one's own services—should be treated. Because unearned income is not a direct return for private production time, the preceding analysis does not establish a clear entitlement to receive this income without diminution by the income tax. On the other hand, since income tax is a proxy for the public service time owed by each citizen, it is not immediately clear why any portion of unearned income should be subject to the income tax. Eventually, a complete theory of the nature of unearned income and its relationship to the income tax must be developed. For purposes of this Article it will suffice to describe the basic features of this theory in order to explain the relationship of unearned income to the personal exemption.

The total social product—the sum of all goods and services for private consumption produced during a given period—is the product of human labor. Unearned income constitutes a claim against the total social product, diverted to the owner of capital in return for the use of money or property.<sup>66</sup> Because unearned income represents value created

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65. Recall that private production time is the time not owed to society for the production of public goods.

66. The total social product might be defined as the product of both labor and capital, rather than labor alone. See Warren, *Would a Consumption Tax Be Fairer Than an Income Tax?*, 89 YALE L.J. 1081, 1086 (1980). This view is mistaken because it confuses income with a right to compensa-

by labor, such income contains elements of both private production time and public service time.

For example, consider a simple Nirvana where *A*, *B*, *C*, and *D* each have gross incomes of \$100,000. *A* represents the public sector, and thus a 25% flat rate tax is required to generate the revenues needed by government.<sup>67</sup> The total social product produced during the year has a value of \$300,000—the total after-tax income of Nirvana's citizens. Now let us interject into Nirvana the phenomenon of private capital. Production of the social product requires buildings and machinery privately owned by individual *E*, who demands a gross income of \$100,000 for the use of the necessary property.<sup>68</sup> As a result, the distribution of gross income changes. *A*, *B*, *C*, and *D* now receive gross incomes of \$75,000. In effect, 25% of the value of their labor and of their private and public service time has been transferred to *E*. As the purpose of the income tax is to extract the value of the public service time owed by each citizen, the income tax must extract the value of the public service time transferred by *A*, *B*, *C*, and *D* to *E*, or 25% of *E*'s gross income.

*E*'s moral entitlement to the 75% of *E*'s gross income that represents the value of *A*'s, *B*'s, *C*'s, and *D*'s private production time must be based on the risk taken by *E* and the benefits to society flowing from this risk. *E*'s capital might represent after-tax money saved by *E* over a period of years, which *E* is morally entitled to consume. If, instead, *E* invests the money, *E* may reap substantial profits or lose some or all of the invested capital. In return for this risk, *E* may be entitled to tax-free receipt of the private production portion of gross unearned income.<sup>69</sup>

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tion that will have tax consequences. Thus the interest paid by a borrower represents social product created, and income earned, by the borrower, which is paid to the lender as compensation for foregoing present consumption of the money lent. Though the lender is entitled to compensation, it is not for products or services produced by the lender.

67. No personal exemption is necessary because all citizens are, presumably, equally talented and industrious, and their services are accurately valued.

68. Assume for simplicity that all property is nondepreciable.

69. It is beyond the scope of this Article to deal with problems posed by inflation. It is possible, however, to view the return on capital as not truly income to the extent the rate of return does not exceed the rate of inflation. See generally Kelley, Hall, Aronsohn & Hickman, *Indexing for Inflation*, 31 TAX LAW. 17 (1977). Treating the return on capital as I suggest necessarily implies a rejection of the position taken by advocates of a consumption-based definition of income that the return on capital should be exempted from taxation. For a direct consideration of the merits of a consumption tax, see BLUEPRINTS, *supra* note 11; R. GOODE, *supra* note 46; THE BROOKINGS INSTITUTION, WHAT SHOULD BE TAXED: INCOME OR EXPENDITURE? (J. Pechman ed. 1980); Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1974); Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 HARV. L. REV. 947 (1975); Kahn, *The Place of Consumption and Net-Worth Taxation in the Federal Tax Structure*, in BROAD-BASED TAXES: NEW OPTIONS AND SOURCES 133 (R. Musgrave ed. 1973); Klein, *Timing in Per-*

Under this analysis, a person is not entitled to a personal exemption with respect to unearned income. The function of the personal exemption is to shield from tax that portion of gross income that every working citizen is entitled to receive for his or her private production time. There is no minimum return for capital investment to which the owner of money or property is entitled. Instead, the recipient of unearned income is entitled only to that portion of gross unearned income which remains after extraction of the income tax. This can be illustrated by considering two hypothetical Nirvanas.

In the first situation, *A*, *B*, *C*, and *D* earn gross incomes of \$40,000, \$80,000, \$100,000, and \$180,000, respectively. *C* represents the public sector, and the annual minimum wage is \$25,000. To raise the \$100,000 needed to fund the public sector, Nirvana utilizes a 33 1/3% flat rate comprehensive income tax allowing each taxpayer a \$25,000 personal exemption.

Now interject individual *E*, who owns property needed to produce Nirvana's social product and who demands \$100,000 in return for the use of *E*'s capital. Let us hypothesize that this gross income will be obtained through a pro rata reduction of the gross incomes of *A*, *B*, *C*, and *D* and that the minimum wage will remain \$25,000. *A*, *B*, *C*, and *D* now have gross incomes of \$30,000, \$60,000, \$75,000, and \$135,000, respectively, and *E* has a gross income of \$100,000. In order to extract the value of the public service time from *A*, *B*, *C*, and *D*, including the portion of the value transferred to *E*, Nirvana will still use a 33 1/3% flat rate comprehensive income tax that allows a personal exemption equal to the lesser of \$25,000 or a taxpayer's earned income. As *E* has no earned income, *E* is not entitled to a personal exemption.

Chart IV depicts the tax burden borne by Nirvana's citizens in the hypothetical just described, and illustrates the nature of the tax burden imposed on unearned income under the suggested approach.

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*sonal Taxation*, 6 J. LEGAL STUD. 461 (1977); O'Kelley, *Rawls, Justice, and the Income Tax*, 16 GA. L. REV. 1 (1981); Warren, *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 HARV. L. REV. 931 (1975); Warren, *supra* note 66.

CHART IV						
Taxpayer	Gross Income Structure 1 <sup>a</sup>	Tax Structure 1 <sup>b</sup>	Gross Income Structure 2 <sup>c</sup>	Tax Structure 2 <sup>d</sup>	Value of Public Service	Time Transferred to E <sup>e</sup>
<i>A</i>	\$ 40,000	\$ 5,000	\$ 30,000	\$ 1,667	\$ 3,333	
<i>B</i>	80,000	18,333	60,000	11,667	6,666	
<i>C</i>	100,000	25,000	75,000	16,667	8,333	
<i>D</i>	180,000	51,667	135,000	36,667	15,000	
<i>E</i>	0	0	100,000 <sup>f</sup>	33,333	0	
Total	\$400,000	\$100,000	\$400,000	\$100,000 <sup>g</sup>	\$33,333 <sup>g</sup>	
a. Structure 1 is the world with publicly owned capital. b. 331/3% flat rate tax with \$25,000 personal exemption. c. Structure 2 is the world with privately owned capital d. 331/3% flat rate tax with personal exemption equal to lesser of \$25,000 or earned income. e. Column 3 minus column 5. f. Unearned income. g. Rounded.						

As Chart IV indicates, the total social product is \$300,000, whether capital is publicly or privately owned. Introducing private capital creates claims against the total social product by those owning private capital. These claims are paid by diverting a portion of the value of the public service and private production time of other citizens. Subjecting *E*'s earned income to a flat rate tax, without allowing an offsetting personal exemption, results in a recapture of the value of the public service time transferred to the owner of capital and embodied in his or her gross unearned income. Thus, the difference between the tax paid by *A*, *B*, *C*, and *D* in a publicly owned capital regime (column 3) and in a privately owned capital regime (column 5), totals \$33,333 (column 6), which is the tax extracted from *E*.

The inappropriateness of allowing unearned income to be offset by a personal exemption can be shown in another, more traditional, way. Suppose that *A* has invested \$200,000 in a savings account at a simple interest rate of ten percent per year, and that Nirvana has established a \$10,000 minimum wage and a personal exemption of the same amount. Further, suppose that *A* chooses to take a one-year leave of absence from *A*'s job and finances this vacation with the interest earned on the savings account. Instead of saying that *A* has a gross income of \$20,000 and is entitled to no personal exemption, Nirvana might allow *A* a \$10,000 personal exemption, but treat *A* as having a gross income of \$30,000. *A* has chosen not to work and thereby realizes imputed income from leisure enjoyed during the hours when most citizens work. There could be no objection by *A* if society attaches a \$10,000 value to such leisure. This is

the minimum value to society of *A*'s normal work time. Allowing a personal exemption only to the extent of an individual's gross earned income has the effect of imputing to the individual additional gross income equal to the difference between the minimum wage and his or her gross earned income. This difference represents the individual's income from leisure.<sup>70</sup>

### III. THE IMPACT OF SHARING ARRANGEMENTS

The argument in Part II assumes a series of hypothetical post-liberal societies populated by unmarried adults living apart. In this Part, I consider how the income tax should be designed in a post-liberal society populated by working and nonworking adults, some of whom live alone, and some of whom live with friends, lovers, or spouses. Tax policy scholars have identified the basic design questions.<sup>71</sup> What is the basic taxable unit—the individual, the family, or the household? Should the income tax take into account economies of scale achievable in sharing arrangements? How should the income tax adjust relative tax burdens to reflect the imputed income attributable to nonworking members of sharing units? Finally, is it possible simultaneously to achieve: (1) progressivity; (2) equal tax burdens for married couples or sharing units with the same total income; and (3) marriage or sharer status neutrality? I address these and related questions in this Part and argue that a comprehensive flat rate tax, properly understood and designed, yields an appropriate allocation of tax burdens among working and nonworking adults living together or alone.

#### A. THE TAXABLE UNIT AND ECONOMIES OF SCALE

Gross income can be broken down into two categories: income from labor, or "earned income," and income from property, or "unearned income." To this point, we have assumed that the individual is the proper taxable unit. However, the proper taxable unit and the income properly attributable to the individual becomes less certain when sharing arrangements are considered.

Consider, for example, *A* and *B*, the former earning \$100,000 annu-

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70. See *infra* notes 83-97 and accompanying text for the proposed treatment of imputed income from household services performed by nonworking spouses.

71. For comprehensive treatment of the basic issues, see Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389 (1975); Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 TEX. L. REV. 1 (1980); McIntyre & Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 HARV. L. REV. 1573 (1977).

ally, the latter deriving no market income from property or services. If *A* and *B* are married to each other and reside in a community property state, then *B* obtains a one-half interest in the income earned by *A*. If *A* and *B*, still married, reside in a noncommunity property state, then *B* obtains equitable claims against *A*'s income and property, which may ripen upon divorce or death. Likewise, if *A* and *B* are unmarried, but live together, *B* in some jurisdictions may obtain equitable claims against *A*'s property. If the individual is the proper taxable unit, it might seem appropriate to treat some of the working sharer's income as shifted to the nonworking sharer to reflect the legal and equitable claims that the nonworker possesses.<sup>72</sup>

Alternatively, it might seem appropriate to deal with sharing arrangements by abandoning the premise that the individual is the appropriate taxable unit.<sup>73</sup> It may be assumed that married individuals and others who live together pool their resources and make consumption decisions by reference to the needs and aspirations of each other and of the unit as a whole.<sup>74</sup> Moreover, it is impossible to assume that the standard of living or consumption decisions of *A* and *B* would depend on whether they resided in a community property state, or on whether their sharing arrangement was marital or nonmarital. Clearly, then, the benefits of income consumed by individual sharers cannot be traced in an administratively feasible way, or attributed to particular individuals with accuracy.<sup>75</sup> Thus, the sharing unit could be viewed as the appropriate taxable unit both because the combined income of sharers provides the only meaningful basis of assessing the relative well being of different sharing units and because the combined income of sharers must be viewed as

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72. It might seem appropriate also to shift a portion of a higher earning spouse's income to a lower earning spouse in the case of a two-worker couple. For the advantages and political problems of income splitting based on property rights, see Gann, *supra* note 71, at 58-65. For an argument for income splitting based on who actually benefits from joint income, see McIntyre, *Individual Filing in the Personal Income Tax: Prolegomena to Future Discussion*, 58 N.C.L. REV. 469 (1980); McIntyre & Oldman, *supra* note 71, at 1592-99.

73. See London, *The Family as the Basic Tax Unit*, 1 CAN. TAX'N, Winter, 1979, 4, 5; McIntyre, *supra* note 72, at 470-71; McMahon, *Expanding the Taxable Unit: The Aggregation of the Income of Children and Parents*, 56 N.Y.U. L. REV. 60, 61-62 (1981).

74. See ROYAL COMMISSION ON TAXATION NO. 10, TAXATION OF THE FAMILY 122-24 (1966); BLUEPRINTS, *supra* note 11, at 103.

75. It would be possible to apply an arbitrary attribution rule. See Coven, *The Decline and Fall of Taxable Income*, 79 MICH. L. REV. 1525, 1542-45 (1981); McIntyre, *Economic Mutuality and the Need for Joint Filing*, 1 CAN. TAX'N, Winter, 1979, 13, 15. However, such a mechanism would discriminate against those whose sharing patterns differ from the general rule. Moreover, there is little likelihood that agreement can be reached as to the "normal" level of income splitting. See Dulude, *Joint Taxation of Spouses—A Feminist View*, 1 CAN. TAX'N, Winter, 1979, 8, 9.

realized by the unit rather than its individual members.<sup>76</sup>

The argument for treating individuals as the appropriate taxable unit, but requiring that earned income be allocated among members of sharing units to reflect legal and equitable rights to such income, and the arguments for treating the family as the basic taxable unit, assume that the basic purpose of the income tax is to raise revenue in a horizontally and vertically equitable manner. If this assumption is correct, scholars are free to propose whatever tax structure appeals to the scholar's personal notions of justice or efficiency. Instead, as I argued in Part II of this Article, the primary purpose of an income tax is to extract taxes in a manner that takes into account the relative contribution to society of each worker.<sup>77</sup> More specifically, I argued that the purpose of the income tax is to extract the value of each worker's public service time, while leaving untaxed the income from a worker's private production time. Moreover, each worker is entitled to a personal exemption calculated by reference to his or her own income. If I am right about this, then in order to justly determine after-tax incomes, the income tax must be designed so that each individual is taxed on his or her own earned and unearned income.

Related to the basic taxable unit question is the issue of whether tax burdens should be adjusted to reflect the economies of scale in consumption achievable in sharing relationships.<sup>78</sup> By sharing facilities and household duties, two individuals who live together can achieve a given standard of living less expensively than they could if each lived alone. These economies of scale could be viewed as a type of wealth, income, or increased ability to pay tax, which should be taken into account for federal income tax purposes.

For example, consider *A* and *B*, who each earn \$10,000 per year, and who live together, sharing resources and household duties. Let us suppose that *A* and *B* could achieve the same standard of living apart only if they each had \$500 per year more to spend. If this is so, then it is irrelevant whether *A* and *B* use the extra \$1,000 for additional living space or services, or save \$1,000 for future consumption. Irrespective of how *A* and *B* choose to use their resources, they are still \$1,000 better off

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76. Income, in a sense, is not realized until it is consumed. Within families, then, income is realized when it is spent, and such realization cannot accurately be attributed to any particular member of the family unit. BLUEPRINTS, *supra* note 11, at 103-04.

77. See *supra* notes 24-70 and accompanying text.

78. See Bittker, *supra* note 71, at 1422-26; Coven, *supra* note 75, at 1541-45; Gann, *supra* note 71, at 29.



than two individuals, each earning \$10,000, but living apart.<sup>79</sup> This "income" from economies of scale theoretically can be taken into account under an individual filing system by imputing \$500 to each individual in a sharing arrangement, by reducing the personal exemption of each member of a sharing unit by \$500, or by increasing the personal exemption of individuals living alone by \$500. Alternatively, sharers and non-sharers could be required to use different rate schedules calibrated to impose tax burdens that take into account the economies of scale deemed available to sharers.

Designing the income tax to take into account economies of scale would, however, be inconsistent with the purpose of income taxation and with the underlying ideological rationale of post-liberal society. Since each individual is entitled to the product of his or her private production time, it is the function of the income tax to extract only the value of public service time. How a person chooses to use the resources at his or her command has no relevance to a determination of the value of a person's public service time. Thus, if an individual chooses to enter a sharing arrangement, thereby reducing his or her cost of living and freeing up resources for other uses, this resource allocation decision is irrelevant for income tax purposes.<sup>80</sup>

Put another way, it is consistent with the value that post-liberal society places on the family and on communitarian relationships generally to view the individual as the basic unit of society, and to refuse to take account of "income" from economies of scale. Taking into account economies of scale would penalize those who enter sharing arrangements because it imposes a heavier tax burden than if they lived apart. Such a tax discriminates against a sharing lifestyle in favor of the lifestyle of those who choose to live alone.

There is an additional, pragmatic reason for treating as irrelevant the economies of scale possible in sharing arrangements. If a penalty were thought appropriate, then fundamental fairness would demand that unmarried individuals who enter sharing arrangements bear an increased

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79. This income could be described as the product of the dual consumption financed by one spouse's income. This description suggests that some portion of the higher earning spouse's income should be attributed to the other spouse without allowing any offsetting deduction to the higher earning spouse. Coven, *supra* note 75, at 1541-44.

80. Those who believe that economies of scale should not be taken into account focus on two problems: the problem of fair relative tax treatment of married and unmarried individuals and the problem of measurement. See Bittker, *supra* note 71, at 1422-26; Gann, *supra* note 71, at 29. I am suggesting a deeper reason for ignoring economies of scale. Given the purpose of the income tax, the economic benefits from economies of scale in consumption do not constitute income, even in theory.

tax burden. The massive invasion of personal privacy necessary to enforce such a provision would be inconsistent with our societal belief in the sanctity of the home and the right to privacy.<sup>81</sup>

Finally, taking economies of scale into account or treating sharing units as taxable units is inappropriate because it implies that sharing arrangements, once created, are a basic irreducible social unit. Given the ease and frequency of divorce and the growing number of individuals who enter informal, easily terminated sharing arrangements,<sup>82</sup> sharing arrangements—marital or nonmarital—cannot fairly be viewed as either permanent or irreducible units. Instead, sharing arrangements can more accurately be described as an ongoing choice. So viewed, the ongoing resource allocation choices made by sharers and the resource allocation consequences of entering a sharing arrangement are as irrelevant for tax purposes as are other consumption choices made by individuals.

B. IMPUTED INCOME FROM HOUSEHOLD PRODUCTION, FAIR  
RELATIVE TAX BURDENS, AND DISINCENTIVES TO LABOR  
FORCE PARTICIPATION BY NONWORKING  
SPOUSES

One of the shortcomings of our present income tax system is its failure to impose relative tax burdens on one- and two-worker couples that adequately reflect the value of services performed by nonworking spouses for personal or family, rather than market, consumption.<sup>83</sup> The problem is easily illustrated. *A* and *B* are a married couple; each spouse works full-time and earns \$50,000 per year. *C* and *D* are also a married couple. *C* works outside the home, earning \$100,000 annually. *D* has no market income. Instead, during the normal working day *D* performs the couple's household-related chores.

Clearly, *C* and *D* are economically better off than *A* and *B* because during the normal workday *D* is able to perform the household duties that *A* and *B* must either (1) perform themselves, thereby reducing their leisure time relative to *C* and *D*; or (2) hire someone else to perform, thereby reducing their disposable income relative to *C* and *D*. Accordingly, the value of the services performed by *D* constitutes a form of

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81. See Bittker, *supra* note 71, at 1423.

82. Wolk, *Federal Tax Consequences of Wealth Transfer Between Unmarried Cohabitants*, 27 UCLA L. REV. 1240, 1240-41 n.1 (1980).

83. Unless the context indicates to the contrary, the term "nonworking spouse" includes non-working members of both marital and nonmarital sharing units.

nonmarket income that should result in a larger tax bill for *C* and *D*.<sup>84</sup>

A second, related flaw is the disincentive to labor market participation by nonworking spouses produced by the present income tax structure. If a nonworking spouse has a choice between performing household services worth \$10,000 annually or working outside the home for a \$10,000 annual salary, then the income tax is neutral only if it imposes identical tax consequences on income from either source.<sup>85</sup> Because the present income tax scheme fails to tax income from home production, it operates to keep those without scarce skills from joining the labor force.<sup>86</sup> Most nonworking spouses are women who are economically dependent on their husbands. Thus, what is in form a gender-neutral favoritism of home production may in fact be a form of sex discrimination that tends to keep women economically dependent on men.<sup>87</sup>

To illustrate the problem of discrimination, consider again *C* and *D*, the former earning \$100,000 annually and the latter, a nonworking spouse performing household services valued at \$10,000 annually. *D* is offered an entry-level job paying a salary of \$10,000. *D* would like to accept the job, and believes it would eventually lead to a better paying position. *D* will be reluctant to take the job, however, if it will adversely affect the standard of living *C* and *D* presently enjoy. Assume that Nirvana imposes a graduated rate comprehensive income tax that is similar to our own federal income tax system. Thus, Nirvana treats married couples as a taxable unit, requires that spouses combine their income for tax purposes, and extends a \$5,000 personal exemption to each marital unit, whether composed of one worker or two. The tax burden is 20% of the first \$50,000 of taxable income and 50% of taxable income in excess of \$50,000. Chart V shows the tax burden borne by *C* and *D* if only *C* is employed outside the home, or, instead, if both *C* and *D* are market workers.

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84. Bittker, *supra* note 71, at 1425-26.

85. Rosen, *Is It Time to Abandon Joint Filing?*, 30 NAT'L TAX J. 423, 425, 426 (1977).

86. For nonworking spouses with the ability to earn large incomes, such as lawyers or doctors, the income tax may play a relatively minor role in deciding whether or not to work.

87. See Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 BUFFALO L. REV. 49, 89-95 (1971); Gerzog, *The Marriage Penalty: The Working Couple's Dilemma*, 47 FORDHAM L. REV. 27, 36-37 (1978). Of course, in some cases the code would act as a disincentive to nonworking male spouses contemplating labor market participation. Therefore, it is important to view the imputed income problem as not solely an issue of sex discrimination. Rosen, *supra* note 85, at 426.

CHART V				
C's Gross Income	D's Gross Income	Total Taxable Income	Tax	After-Tax Income
\$100,000	\$ 0	\$ 95,000	\$32,500	\$67,500
100,000	10,000	105,000	37,500	72,500

If *D* accepts market employment, *D* receives no benefit from the personal exemption allowed to the marital unit because the couple's exemption has already been used to exempt a portion of *C*'s income from tax. In effect, all of *D*'s income is taxed at the marginal rate of 50% instead of the lower rate that would apply if *D* were the marital unit's only market worker. Accordingly, if *D* accepts the job offered, *C* and *D* will receive \$5,000 in after-tax income at the cost of \$10,000 in untaxed services formerly performed by *D*.<sup>88</sup>

Suppose, instead, that Nirvana adopts a filing system that requires each taxpayer to pay tax on his or her own earned income. The rate structure remains unchanged, but each taxpayer is allowed only a \$2,500 personal exemption. Chart VI shows the tax consequences of *D*'s decision to accept market employment under this individual filing system.

CHART VI						
C's Gross Income	C's Taxable Income	C's Tax	D's Gross Income	D's Taxable Income	D's Tax	Total After-Tax Income
\$100,000	\$97,500	\$33,750	\$ 0	\$ 0	\$ 0	\$66,250
100,000	97,500	33,750	10,000	7,500	1,500	74,750

If *D* accepts market employment, *C* and *D* will receive \$8,500 more in after-tax income at the cost of \$10,000 in household services formerly performed by *D*. Thus, individual filing (Chart VI) results in a larger after-tax return to the nonworking spouse entering the market than under joint filing (Chart V). However, single filing does not eliminate the tax bias in favor of home production.

88. The problem is not solely one of taxing *D*'s income at higher marginal rates than would result under separate filing. If Nirvana imposed a proportional tax at a 20% rate, required joint filing, and allowed married couples a \$5,000 personal exemption, then *C* and *D* would receive a total of \$8,000 in after-tax income from *D*'s job at the cost of \$10,000 in household services, even though *D*'s income was taxed at the same marginal rate as if *D* were unmarried.

Congress has acknowledged the tax relevance of household services performed by nonworking spouses by enacting Internal Revenue Code section 221. This section allows married couples to deduct either 10% of the lesser earning spouse's earned income, or \$3,000, whichever is less.<sup>89</sup> Under this provision, two-worker couples bear a greater tax burden than one-worker couples with the same total market income. Additionally, section 221 decreases the tax burden that would otherwise fall on the market income of a previously nonworking spouse. Section 221 clearly lessens the tax disincentives against labor market participation in favor of home production, and indirectly imputes income to all married taxpayers who do not qualify for the deduction. However, section 221 arrives at fair relative tax burdens between one- and two-worker couples and eliminates the bias in favor of home production only if (1) it imposes identical tax burdens on market and nonmarket income of equal value; or (2) it is impossible to impose identical tax burdens on market and nonmarket income of equal value and section 221 constitutes the fairest practical solution.<sup>90</sup> Thus, a criticism of the present system requires both a convincing objective explanation of imputed income from household services, and an administratively feasible way of taking this income into account.

Consider again *C* and *D*. Assume that *C* is a single adult, living alone, and unwilling to sacrifice leisure time in order to perform household services. Under this assumption, if *D* accepts market employment, *C* will hire someone to perform those services.<sup>91</sup> Moreover, the individual hired will obviously treat his or her wages as gross income. Thus, it seems accurate to view *D* as *C*'s employee for the limited purpose of determining the proper income tax consequences of *D*'s household services. In effect, then, *D* must be viewed as receiving present and future claims to *C*'s income in return for household services performed.

The purpose of the income tax is to determine the after-tax income to which each taxpayer is morally entitled. Once the quasi-employment nature of *C*'s and *D*'s relationship is recognized, it becomes imperative,

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89. Congress added I.R.C. § 221 to the Code as part of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 173 (1981).

90. I.R.C. § 221 was motivated in part by a desire to achieve equity between one- and two-worker couples and in part by a desire to eliminate the marriage tax "penalty," the rule that requires two-worker married couples to pay more tax than two otherwise similarly situated individuals whose sharing arrangement is nonmarital. I am concerned here with only the first objective. It is clear, however, that section 221 does not eliminate the marriage penalty. STAFF OF HOUSE COMM. ON WAYS AND MEANS, 97TH CONG., 1ST SESS., REPORT ON H.R. 4242, at 54 (Comm. Print 1981).

91. Assume, also, that *D* is equally unwilling to use normal leisure time to perform the services that *D* formerly performed.

as a matter of fairness to other taxpayers,<sup>92</sup> to value and tax *D*'s income. Furthermore, if my ideological myth is convincing, each taxpayer should owe a certain amount of public service time to the cooperative venture for mutual advantage of which we are all members.<sup>93</sup> Imputing income to "nonworking" spouses is required in order to extract from them the value of their public service time.

At the same time, imputing income to the nonworking spouse constitutes societal recognition of his or her status as a wage earner and a valuable contributor to the social product. Post-liberal society values workers more highly than nonworkers. As we have seen, low income workers are protected by the minimum wage, while those who cannot work are supported at a lower level.<sup>94</sup> Viewing "nonworking" spouses as valuable members of the labor force, therefore, should provide support for extending social security and other employment-related benefits to nonworking spouses on the same basis as these benefits are provided to market workers.<sup>95</sup>

Despite the theoretical advantages of this quasi-employment approach, there must also be an explanation of how the imputed income can be quantified. Initially, this problem may seem insuperable. Some nonworking spouses are married to wealthy individuals, others are not. Some one-worker couples equally divide the market earnings of the working spouse, while others divide this market income disproportionately. Clearly, there is no administratively feasible or societally acceptable method of assessing the actual practices of couples or the distributive impact of state laws.<sup>96</sup>

It is not necessary, however, to determine how much of the worker's income is actually redistributed to the nonworking spouse. While some nonworkers undoubtedly perform their household chores well, and others poorly, the value of basic household services is probably quite similar. Moreover, these basic chores can with minimal training be performed adequately by almost anyone. Consequently, individuals

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92. Otherwise, those whose contributions are rewarded in the market will pay tax and receive a lower after-tax reward than those who provide untaxed household services constituting an equally valuable contribution to the social product.

93. See *supra* notes 37-44 and accompanying text.

94. See *supra* text accompanying notes 56-57.

95. A central thesis of the civil and equal rights movements on behalf of women and various minorities is the thesis that equal performance should be equally rewarded. Properly characterizing the "work" of nonworking spouses would be a helpful step in achieving equal rights for such workers.

96. See, e.g., McIntyre & Oldman, *supra* note 71, at 1614-18 (estimates the patterns of imputed income from self-performed services of one- and two-job married couples).

performing household-related services—cooking, cleaning, laundering, and grocery and other shopping—are among the lowest paid workers in society. Thus, it is objectively justifiable to impute to each nonworking spouse an income equal to the minimum wage that society demands be paid to workers who are without scarce skills.

The great disparity in actual property rights and standards of living enjoyed by nonworking spouses should not be explained as the result of disparate quasi-salaries for household work. Instead, it is a result of the voluntary or state-mandated sharing of resources that occurs in marital and nonmarital sharing arrangements. This redistribution of property rights other than in return for household services that occurs in both one- and two-worker couples, constitutes no more than the use of after-tax income by the transferor and the receipt of a tax-free gift by the donee, and is irrelevant for tax purposes.<sup>97</sup>

Chart VII illustrates how *A*, *B*, *C*, and *D* would be taxed in Nirvana under a 20% flat rate comprehensive income tax that requires single filing, allows a personal exemption equal to the lesser of \$10,000 or the taxpayer's earned income, and imputes \$10,000—the minimum wage—to nonworking spouses.

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97. Scholars also miss the point when they suggest that no principled line can be drawn between types of imputed income from personal services that should be taxable and those that should not. Typical are the remarks of Professors McIntyre and Oldman:

For example, which if any of the following services should be taxable: Getting up in the morning? Doing exercises? Singing in the shower? Grooming oneself? Fixing breakfast? Chewing food? Processing it within the stomach? Walking to work? Baking bread? Growing roses? Fixing the car? Driving in the country? Watching T.V.? Reading a novel? Reading bedtime stories to one's children? Playing backgammon?

*Id.* at 1611. The purpose of the income tax is to extract taxes based on the relative contribution to the social product made by each taxpayer. Each citizen owes a certain amount of public service time to society. Imputing income to "nonworking" spouses is essential in order to extract from them the value of this public service time. The fairest way to arrive at a figure is to determine the market value of the household services that *would be purchased* by the working spouse in the absence of a nonworking spouse. Affection and sexual relations are not considered. Nor are services of the type that everyone performs for himself or herself.

CHART VIII					
Taxpayer	Market Income	Gross Income <sup>a</sup>	Personal Exemption	Tax	Total After-Tax Income
<i>A</i>	\$ 50,000	\$ 50,000	\$10,000	\$ 8,000	\$42,000
<i>B</i>	50,000	50,000	10,000	8,000	42,000
<i>C</i>	100,000	100,000	10,000	18,000	82,000
<i>D</i>	0	10,000	10,000	0	10,000

a. Includes imputed income.

*D*, the nonworking spouse, is entitled to a personal exemption equal to the minimum wage, resulting in no taxable income. *C* is not entitled to a deduction for the imputed wage paid to *D*, because this payment is not incurred in a trade or business or in connection with an income-producing activity. It constitutes an item of personal consumption for which no deduction is allowed.<sup>98</sup> There are, accordingly, no direct tax consequences to *C* and *D* as a result of *D*'s imputed income. However, *A* and *B*'s collective tax burden is \$2,000 less than *C* and *D*'s collective tax burden. Moreover, the difference in these tax burdens presumably results not from an ad hoc attempt to achieve greater fairness; instead, the difference is the natural product of a tax system—itself objectively justified—that treats the individual as the basic taxable unit and determines tax liability by reference to each individual's contribution to the social product.

It should also be clear that imputing the minimum wage to nonworking spouses will eliminate the present bias in favor of home production. If *D* accepts a full-time job at an annual salary of \$10,000, the tax consequences to *C* and *D* will be the same as illustrated in Chart VII. Since *D*'s normal work time is now devoted to labor force participation, *D*'s imputed income from home production is reduced to zero. However, *D*'s gross income remains \$10,000 because of the wages received from market employment. The tax imposed on *D* is the same whether *D* chooses to work in the home or outside the home for an equivalent income. Accordingly, an income tax that requires individual filing, imputes the minimum wage to nonworking spouses, and allows a personal exemption equal to the minimum wage, not only arrives at just relative tax burdens between one- and two-worker couples, but is neutral as to the choice between home and market production as well.

98. I.R.C. § 262 (1982).



## C. FLAT RATES, GRADUATED RATES, AND INSOLUBLE DILEMMAS

As illustrated in Part I of this Article, progressivity can be achieved under a flat rate tax through a personal exemption. Part II shows that a flat rate comprehensive tax with a personal exemption equal to the minimum wage is progressive and more consistent with the governing ideological rationale of post-liberal society than is a graduated rate tax. The first two Sections of this Part of the Article explain how a flat rate tax must be designed to achieve appropriate relative tax burdens among working and nonworking individuals. In this Section, I will explain how a flat rate tax of the type described is superior to a graduated rate tax when evaluated in terms of important tax policy maxims and design criteria.

It is generally assumed that an income tax cannot be designed to satisfy simultaneously three maxims of tax fairness:

1. The income tax should be progressive.
2. Married couples with the same total income should pay equivalent taxes.
3. The income tax should be marriage-neutral, so that tax burdens do not change as a result of marriage or divorce.<sup>99</sup>

To illustrate the impossibility of simultaneous satisfaction of these maxims, consider three Nirvanian married couples—*A* and *B*, *C* and *D*, and *E* and *F*—each having combined market incomes of \$100,000. *A* and *B* each earn \$50,000 per year, *C* earns \$75,000 and *D* \$25,000 per year. *E* earns \$100,000 annually, while *F* is a nonworking spouse. First, assume that Nirvana's income tax treats the individual as the basic taxable unit, allows each taxpayer a \$2,500 personal exemption, and extracts 20% of the first \$50,000 of taxable income and 50% of the taxable income in excess of \$50,000. Obviously such a tax system will be progressive and each individual will pay the same tax whether married or unmarried. However, as Chart VIII shows, this tax structure violates the maxim that married couples with identical total incomes should be similarly taxed.

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99. See BLUEPRINTS, *supra* note 11, at 102; Bittker, *supra* note 71, at 1395-96; McIntyre & Oldman, *supra* note 71, at 1589-92.

CHART VIII				
Taxpayer	Gross Income	Taxable Income	Tax	Couples' After-Tax Income
<i>A</i>	\$ 50,000	\$47,500	\$ 9,500	\$81,000
<i>B</i>	50,000	47,500	9,500	
<i>C</i>	75,000	72,500	21,250	74,250
<i>D</i>	25,000	22,500	4,500	
<i>E</i>	100,000	97,500	33,750	66,250
<i>F</i>	0	0	0	

Suppose, instead, that Nirvana treats the married couple as the taxable unit, extends a \$5,000 personal exemption to each marital unit, and uses the same rate structure—that described in the preceding paragraph—for marital units and unmarried individuals. Under this joint filing structure each of the couples will have taxable incomes of \$95,000 and pay \$32,500 in tax. Thus, joint filing achieves both progressivity and equal taxation of equal income couples. This system is not marital status neutral, however, because, as Chart VIII shows, the total tax burden borne by our three couples would not be the same were they unmarried.

Another problem with graduated rates can now be isolated. Assume that for political reasons it is essential to equally tax married couples with the same total income.<sup>100</sup> Given graduated rates, this means that we must impose a tax on the combined incomes of married individuals. Furthermore, depending on the rate structures applicable to individuals and marital units, married individuals will pay either more tax or less tax than they would if unmarried. Now compare married individuals *A* and *B*, who each earn \$50,000 per year, with unmarried individuals *G* and *H*, who each earn \$50,000 per year and who live together and share resources and duties in the same manner as *A* and *B*. Presumably post-liberal society is neutral as to the decision to marry or live together.<sup>101</sup> Accordingly, the income tax should impose similar tax burdens on simi-

100. Since 1948 the income tax has been calculated with reference to the combined income of married couples. This feature was intended to achieve equal treatment between married couples in community property jurisdictions and those in common law jurisdictions. Prior to 1948, community property spouses could split their total income and file as individuals. Similarly situated spouses in common law jurisdictions could not. See Bittker, *supra* note 71, at 1399-1414. Thus, it can be argued persuasively that Congress has never evinced a belief either that the family is the proper taxable unit, or that equal income married couples should be equally taxed. Instead, Congress has dealt pragmatically with perceived problems.

101. For an analysis of changes in the present structure to reflect neutrality toward lifestyle choice, see generally Wolk, *supra* note 82.

larly situated married and unmarried couples. However, if the tax system imposes a lesser burden on married and unmarried sharers than on two nonsharers with equivalent incomes, society must be prepared to invade the privacy of all married and unmarried individuals who claim sharer status to determine if they are, in fact, in a sharing arrangement. On the other hand, if the tax system imposes a greater tax burden on sharers than on nonsharers with equivalent incomes, the tax system must be prepared to invade the privacy of married and unmarried individuals who claim nonsharer status to make certain that they are not, in fact, a sharing unit. If instead we adopt a system that requires joint filing by married individuals only, then the problems of privacy invasion will diminish.<sup>102</sup> However, this system will discriminate against either married or unmarried sharers, depending on whether the tax burden imposed on individuals in marital units is more or less than the total burden that would result if the sharers were unmarried.

These dilemmas are inherent in a tax that uses graduated rates to achieve progressivity, but can be resolved by a progressive flat rate tax. Assume that Nirvana treats the individual as the taxable unit, uses a 30% flat rate comprehensive income tax, allows each taxpayer a personal exemption equal to the minimum wage of \$10,000, and imputes the minimum wage to all nonworking spouses. Chart IX illustrates the tax burdens borne by *A*, *B*, *C*, *D*, *E*, and *F* under such a system.

CHART IX				
Taxpayer	Gross Income	Taxable Income	Tax	Couples' After-Tax Market Income
A	\$ 50,000	\$40,000	\$12,000	\$76,000
B	50,000	40,000	12,000	
C	75,000	65,000	19,500	76,000
D	25,000	15,000	4,500	
E	100,000	90,000	27,000	73,000
F	10,000 <sup>a</sup>	0	0	
a. Imputed income from household services performed.				

The tax burdens of *A* and *B*, and of *C* and *D*, are unaffected by sharer status. These two couples have the same total income and pay the

102. Marital status is easily verifiable, although the potential for sham divorces or marriages exists.

same tax. Thus, a properly designed flat rate tax simultaneously achieves progressivity, sharer status neutrality, and equal tax burdens for equal income sharers. Chart IX also reminds us that *E* and *F* have a different total income than the other two couples because of the imputed income received by *F*, the nonworking spouse. Thus, a properly designed flat rate tax not only achieves equal taxation of equal income sharers, but also allows us to refine our definition of income to account for the economic benefits traceable to household services performed by nonworking spouses.<sup>103</sup>

Another problem that plagues graduated income taxes is intrafamily property transfers made to individuals with lower incomes and, thus, lower marginal tax rates.<sup>104</sup> These transfers lower the tax borne by the family unit even though the transferor may retain substantial control over the property transferred. For example, consider *A* with an annual salary of \$100,000 and an annual unearned income of \$100,000. *A* is married to *B*, a nonworking spouse. *A* and *B* have two nonworking minor children, *C* and *D*. Under a graduated rate tax that treats the individual as the basic taxable unit, *A*'s income-producing property can be transferred to *B*, *C*, and *D*. Thereafter, the unearned income will be taxed at the lower marginal rates that apply to *B*, *C*, and *D* given their lack of other income.

However, under a flat rate comprehensive income tax that requires individual filing and allows a personal exemption equal to the lesser of the minimum wage or the taxpayer's earned income, *A* will effect no reduction in total family tax burden by transferring income-producing property to *B*, *C*, and *D*. Because *C* and *D* have no earned income, they are entitled to no personal exemption.<sup>105</sup> Because *B* is deemed to receive imputed earned income equal to the minimum wage for household services performed, *B* is entitled to a personal exemption. However, the personal exemption must be used to offset *B*'s imputed income. Thus, all of the unearned income transferred to *B*, *C*, and *D* is subject to taxation. Moreover, in a flat rate tax system the marginal rate of tax will be the same for *A*, *B*, *C*, and *D*. Thus, under a progressive flat rate tax, intrafamily property transfers will leave tax burdens unchanged.

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103. I.R.C. § 221 indirectly achieves a minor imputation of income to nonworking spouses. See *supra* text accompanying note 90. However, this result cannot be viewed as an abandonment of the principle that equal income spouses should be equally taxed. Instead, it constitutes an attempt to redefine income so that equal income taxpayers can be identified.

104. For a careful analysis of tax-motivated intrafamily income shifting, see McMahon, *supra* note 73, at 62-86 (arguing for a taxable unit including both spouses and children).

105. See *supra* notes 65-70 and accompanying text.

## IV. SOCIAL SECURITY AND THE INCOME TAX

## A. A POST-LIBERAL CRITIQUE

To deal with the phenomenon of retirement from employment, almost every country provides retirement income to some or all of its citizens.<sup>106</sup> Obviously, a social security program requires a financing mechanism. This Section of the Article describes the nature of retirement in post-liberal society and develops an argument that the proper source of funds is a progressive flat rate tax allowing a personal exemption equal to the minimum wage.

Proponents of individualism believe that gross income belongs to the individual and that each individual is responsible for finding work and meeting his or her subsistence needs. Thus each person is responsible for his or her own retirement needs. Amounts of current income sufficient to meet these future retirement needs must be set aside by the individual.<sup>107</sup>

What is set aside by those who save, however, is merely a claim reducible to money in the future. Society does not concurrently set aside a corresponding amount of commodities. Thus, one who wishes to save commodities for future consumption must purchase the actual commodity and store it. This option, of course, is of limited practicality. Although saving money does give one a claim against goods that do not yet exist, there is no guarantee that sufficient goods will be produced or that the money being saved will be sufficient to purchase required commodities.<sup>108</sup>

If commodities are to be available in sufficient quantity and quality at the time of retirement, there must be sufficient productive capacity at that future date. The individualist asserts that a free market will assure this result. Self-interested individuals will reinvest enough capital into their businesses to insure their own future income.

Post-liberal society rejects total reliance on the free market and the individual pursuit of self-interest. It acknowledges the obligation of society as a whole to insure that future consumption needs can be met. Post-liberal society is actively concerned with monitoring and regulating the economy to ensure that sufficient agricultural and industrial capacity will

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106. OFFICE OF RESEARCH AND STATISTICS, SOCIAL SECURITY ADMIN., U.S. DEP'T. HEALTH, EDUC. & WELFARE, SOCIAL SECURITY PROGRAMS THROUGHOUT THE WORLD 1977, at iii (HEW Pub. No. 78-11805).

107. See M. FRIEDMAN & R. FRIEDMAN, *supra* note 58, at 119-24.

108. See Teeters, *Payroll Tax*, in BROAD-BASED TAXES: NEW OPTIONS AND SOURCES 87, 91-94 (R. Musgrave ed. 1973).

exist in the future. Post-liberal society, then, undertakes to ensure for its citizens what cannot be ensured by private savings or the accrual of claims to money income from social security. It undertakes to insure that a reasonable quantity of actual goods will be available in the future.

In addition to rejecting the individualist view that the market alone will function to ensure the future production of adequate commodities, post-liberal society rejects the individualist belief that each person is responsible for providing adequate funds for retirement. Instead, post-liberal society views its citizens as being engaged in a cooperative venture for mutual advantage. All citizens should work for a reasonable number of days during each year of their working lives. In return for past contributions to the social product, every individual is entitled to retire and receive a reasonable retirement income from the government. Thus, social security payments are earned to the same extent as wages received during work.<sup>109</sup>

To understand this point let us return to Nirvana. As noted in Part II of this Article, the founders of Nirvana would be concerned about their future well-being leading to their agreement to provide welfare assistance as a public good. The founders would also be concerned with the need to provide for retirement. At the outset Nirvana does not use money as a medium of exchange and does not have private ownership of the means of production. As a result, a worker's income is received in the form of an in kind distribution of perishable consumer goods. This makes it impossible to save for retirement. The consumption needs of retirees must instead be satisfied with goods and services produced by those who have not yet retired. Accordingly, Nirvana's founders would require as a condition to citizenship that each worker agree to spend a societally determined equal amount of time making or providing goods and services for retirees. Thus social security benefits are a public good and a portion of each worker's public service time is devoted to its provision. Nonetheless, each retiree is believed to be morally entitled to social security benefits as payment for past contributions to society.

This description of retirement and the nature of social security payments in post-liberal society suggests several criticisms of the present system. First, the existing system is flawed by its failure to include social security payments as gross income. The rationale of the existing system is not based on the grounds that social security payments are not income, but rather that these payments should be tax free. The better view is that

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109. For survey data on American attitudes towards social security, see R. COUGHLIN, *supra* note 25, at 57-60.

such payments should be tax free only to the extent of the minimum wage and, thus, offset by a personal exemption in the same amount.<sup>110</sup>

It can also be argued that the social security benefit should be designed as a part of the minimum wage. The social security payment, like the minimum wage, is earned by working, and the amount of the benefit is not based on a market valuation of the social product produced by the recipient. Instead, the social security benefit is the basic share to which all workers in society are morally entitled on retirement as a result of their participation in the work force. So viewed, the social security benefit can be described as the deferred portion of each individual's current income. It is a part of the minimum wage guaranteed by society to each productive individual.<sup>111</sup> Presumably, then, the minimum wage and the social security benefit should be equal in amount. It will also be remembered that nonworking spouses are valuable participants in the productive life of society as evidenced by the imputed income from household work. For the same reasons that make it appropriate to tax nonworking spouses on their imputed minimum wage incomes, a social security benefit equal to the minimum wage ought to be extended to non-working spouses.<sup>112</sup>

This analysis further suggests that the social security tax should be integrated with the income tax. Retirement is a current drain on society, not a future drain. The claims of retirees, though earned in the past, must be satisfied with currently produced goods, which must be purchased with current funds. These funds must be obtained by a tax on current incomes. Moreover, social security benefits constitute a public good available to each citizen on retirement. These benefits are a product of the public service time owed to society by each working citizen. The revenues needed to provide this public good should be raised, then, by a flat rate comprehensive income tax allowing a personal exemption equal to the minimum wage.<sup>113</sup> This is so because (1) the tax extracted under

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110. The Social Security Amendments of 1983, enacted April 20, 1983, added I.R.C. § 86, which is effective with respect to social security benefits received after December 31, 1983. Section 86 includes in gross income up to half of the social security benefits received by individuals with adjusted gross incomes in excess of \$25,000 and married individuals with adjusted gross incomes in excess of \$32,000. Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65 (1983). Prior to the enactment of section 86 social security benefits were not taxed.

111. Presumably a rational social security program would define a "productive worker" as one who has been employed at the minimum wage for the requisite number of years.

112. See *supra* notes 37-44 and accompanying text.

113. The same analysis applies to unemployment compensation. Unemployment compensation is earned by the employee in the same manner as social security benefits and should, therefore, equal the minimum wage. Likewise, unemployment benefits should be protected from federal taxation by a personal exemption equal to the minimum wage. Interestingly, unemployment benefits, like social

such a regime constitutes a proxy for the public service time owed by the taxpayer, and (2) such a regime will extract taxes only from gross incomes in excess of the minimum wage, thus protecting a retiree's moral entitlement to the portion of gross income representing his or her social security benefit.

The present social security tax can, accordingly, be criticized on four significant points. First, it fails to exempt from tax earnings below the minimum wage. Second, not all workers are subject to the tax.<sup>114</sup> Third, it exempts from tax, wages above a maximum level.<sup>115</sup> Fourth, it excludes nonwage income from the definition of taxable income.<sup>116</sup> In other words, the social security tax is a regressive income tax, inferior in design according to the basic tenets of post-liberal society.

### B. A LOOK AT CURRENT FIGURES

The implications of the foregoing analysis become clear when the present tax treatment of minimum wage workers is compared with the type of flat rate comprehensive income tax advocated in this Article. Based on a forty hour work week with fifty-two weeks' pay per year as the norm in our society, the present annual gross income of full-time minimum wage workers is \$6968.<sup>117</sup> The figure that will appear on the minimum wage worker's W-2 form is \$6968. However, the actual guaranteed minimum wage must be adjusted to reflect social security taxes paid by the employer. These taxes are a cost to the employer to the same extent as payments labeled "wages" on an employee's W-2 form, and affect the employer's determination of how many workers can be employed profitably. Put another way, every dollar the employer must pay in social security tax reduces dollar for dollar the wages the employer will willingly pay the employee.<sup>118</sup> For a worker employed at the stated

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security benefits, are excluded from gross income as a matter of administrative grace. I.T. 3230, 1938-2 C.B. 136. Also paralleling the treatment of social security payments, *see supra* note 110, unemployment compensation is taxed if adjusted gross income exceeds a base amount—\$12,000 for individuals and \$18,000 for joint returns. I.R.C. § 85 (1982).

114. 42 U.S.C. § 410(a) (1976). The Social Security Amendments of 1983, *supra* note 110, substantially narrowed the exclusions from coverage.

115. I.R.C. § 3121(a)(1) (1982); 20 C.F.R. §§ 404.1047, 404.1048 (1984).

116. *See* I.R.C. § 3121(a) (1982). Only wages are treated as taxable income. Thus the social security tax is imposed on a base that excludes realized gains from the disposition of property, windfall gains, and periodic return on capital.

117. The current minimum wage is \$3.35 per hour. 29 U.S.C. § 206(a) (1983).

118. *See* Brittain, *The Incidence of Social Security Payroll Taxes*, 61 AM. ECON. REV. 110, *passim* (1971); Kotlikoff, *Social Security, Time for Reform*, in *FEDERAL TAX REFORM: MYTHS & REALITIES* 122, 123 (M. Boskin ed. 1978) (virtually unanimous agreement among economists that burden of social security tax is borne solely by the employee).



annual minimum wage of \$6968, the employer pays \$466.86 in social security taxes.<sup>119</sup> Because the employee bears the actual burden of this employer-paid tax, the true pretax value of the minimum wage is \$7434.86—the sum of the stated minimum wage and the social security taxes paid by the employer.

The post-liberal ideal would be to integrate the present income tax and social security tax into one flat rate comprehensive income tax allowing a personal exemption equal to the true minimum wage. Chart X compares the tax treatment of three individuals under both the present and the post-liberal ideal. *A* is an unmarried minimum wage worker, and *B* and *C* are a married couple, each earning the minimum wage.

CHART X				
	<i>A</i> , Present System	<i>A</i> , Post-Liberal Ideal	<i>B</i> & <i>C</i> , Present System	<i>B</i> & <i>C</i> Post-Liberal Ideal
Real Gross Income	\$7,434.86	\$7,434.86	\$14,869.72	\$14,869.72
FICA Tax <sup>120</sup>	933.71	0	1,867.42	0
Income Tax <sup>121</sup>	462.00	0	1,089.00	0
After-Tax Income	6,039.15	7,434.86	11,913.30	14,869.72

These figures suggest that minimum wage workers, whether married or single, are currently overtaxed to a significant degree. Implementing the post-liberal ideal without an increase in the minimum amount that an employer would be required to expend on each employee would result in nearly a 25% increase in disposable income—an increase of over \$100

119. I.R.C. § 3101(a)(5) (1982) imposes on every employer an excise tax of 5.40% of the covered wages of an employee for Old Age, Survivors, and Disability Insurance ("OASI"). I.R.C. § 3101(b)(4) imposes on every employer an excise tax of 1.30% of the covered wages of an employer for Hospital Insurance. Though it could be argued that these taxes are separate, with only the former related to the provision of the retirement benefit guaranteed by post-liberal society, I take the contrary view. Thus, the social security tax in this Article is the combined OASI and Hospital Insurance levy of 6.70%.

120. I.R.C. § 3101(a)-(b) imposes a social security tax of 6.70% on the employee. Thus, the combined social security tax paid by employer and employee is 13.40% of gross wages. Recall that gross wages are calculated based on \$3.35 per hour, 40 hours per week, and a 52 week year. See *supra* note 117 and accompanying text. They do not include the employer social security contribution.

121. Income tax liability is computed under I.R.C. § 3 (1982) (tax tables prescribed by the Secretary of the Treasury applicable to unmarried individuals and married individuals filing jointly for tax year 1984). With respect to the present income tax it is assumed that *A*, *B*, and *C* are each entitled to a \$1000 personal exemption under I.R.C. § 151(b) (1982), but to no other deductions or credits. With respect to the post-liberal ideal it is assumed that the gross income of the minimum wage worker is offset by a personal exemption equal to the minimum wage.

per month—for each minimum wage recipient. Such an increase in disposable income would have a significant impact on the material well being of the minimum wage earner. The required modifications of our federal income tax and social security systems are consistent with the beliefs of post-liberal society. Publicizing this fact could make possible the mobilization of a sufficiently powerful political force to accomplish the suggested modifications. However, lower income citizens must first perceive their common interest in, and entitlement to, these changes. The ultimate purpose of the foregoing critique is to provide a rational and convincing basis for such perceptions.

### CONCLUSION

Our society reveres the myth of individualism—the view that each citizen is autonomous and through independent effort can carve out a happy, meaningful life. From this perspective, an income tax levied at graduated rates seems unfair—a penalty for the very success that we all seek and applaud. On the other hand, it is apparent that many above average incomes are the result of market imperfections, inherited wealth, or other unfair advantages. At the same time, our society is committed to providing a minimal level of goods and services to those who are disadvantaged. These conflicting perceptions form the basis of our individual and societal beliefs about the nature and extent of each individual's entitlement to income and the proper structure of our income tax.

In this Article, I have argued that a flat rate comprehensive income tax allowing a personal exemption equal to either the annual minimum wage or the taxpayer's earned income, whichever is less, is both progressive and consistent with our governing beliefs. It is consistent with our governing ideology to view society as a cooperative venture in which equal citizens have joined for mutual advantage. As a part of this ideology, each citizen would agree to contribute equal time to the creation of public goods. Each citizen, however, would retain a claim to the products or services that he or she produces during time not devoted to public service.

A flat rate tax extracts taxes that represent the value of the public service time owed to society by each citizen. A personal exemption equal to the minimum wage acknowledges each working citizen's moral claim to a base portion of the social product. Presumptively, this base share represents the value that the market will attach to all services performed by those without scarce talents. So viewed, the minimum wage is the proper measure of the imputed income received by nonworking spouses

for household services performed. Moreover, limiting the personal exemption to the lesser of the minimum wage or a taxpayer's earned income has the effect of imputing leisure income to those who do not work, but instead are supported by unearned income. Thus, a progressive flat rate tax properly identifies the after-tax income to which each working citizen is morally entitled. In so doing, it produces fair tax burdens between married and unmarried individuals living alone or with others.

Additionally, I have shown that the minimum wage, the personal exemption, and the provision of social security benefits can be understood as responses to related beliefs and concerns of post-liberal citizens. Viewed in this manner, the case for integrating the social security tax with a progressive flat rate tax seems compelling.

Finally, I have suggested that a flat rate comprehensive income tax has more potential for achieving progressive change than our present graduated tax. The advantage of the progressive flat rate tax described is its theoretical ability to unite low income workers in a common quest for an increased minimum wage and personal exemption. Linking the minimum wage and the personal exemption under a flat rate tax identifies a plausible route to achieving greater shares of after-tax income for low income taxpayers. Moreover, understanding the governing ideological rationale of society enables us to explain why low income workers should view this quest as just. It is in terms of this potential for achieving needed progressive change that a flat rate comprehensive income tax must ultimately be evaluated by progressive scholars and citizens.