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A Better Hope for Campaign Finance Reform

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Edward J. McCaffery

Abstract

There is too much money in American politics, and too much of it comes from too few citizens. Mega-donors like Sheldon Adelson or Tom Steyer make $100 million political expenditures every election cycle. Attempts to limit such large political contributions have failed at every level: judicially, legislatively, and administratively. Much of the academic literature has joined the real world's sense of despair. This Article takes a new tack. By changing our tax system from an income to a consistent progressive spending tax, the true cost of political expenditures by mega-donors could increase tenfold. By using a strategy of taxing that has been applied to such "bads" as alcohol and cigarettes for centuries, and by identifying high-end spending or consumption in general as such a social "bad," this Article offers hope for solving what seems to be a hopeless problem.

A Better Hope for Campaign Finance Reform

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1. The Problem, and a Possible Cure

Money, money, everywhere, but not a cure in sight.

The American political system, decades into the twenty-first century, seems badly broken. Money seems to be at the root of its worst evils. By almost any reasonable account,[2] there is too much money in American politics these days. The 2016 presidential and congressional election cycle saw an astonishing $6.5 billion in campaign contributions.[3] Looking at individual donors, Sheldon Adelson, the casino magnate from Nevada, gave $82 million along with his wife Miriam; the hedge fund manager and environmentalist Tom Steyer topped all donors with $90 million.[4] Things did not stop there; money-in-politics things never seem to stop anywhere. Adelson donated at least $100 million in the 2018 midterm elections,[5] while Steyer has pledged to spend $100 million on his own personal presidential campaign in 2020.[6] All of this is what is known and knowable: the rise of "dark money" in American politics has made the identity of many mega-donors and/or the extent of their giving

[2] For the record, Newt Gingrich appears to have believed otherwise. See also David French, *No, There is Not Too Much Money in Politics*, National Review, Feb. 26, 2019, available at: https://www.nationalreview.com/corner/no-theres-not-too-much-money-in-politics/.
[3] See Niv. M. Sultan, *Election 2016: Trump's Free Media Helped Keep Cost Down, But Fewer Donors Provided More of the Cash*, April 13, 2017, opensecrets.org, available at: https://www.opensecrets.org/news/2017/04/election-2016-trump-fewer-donors-provided-more-of-the-cash/
[4] *Id.*
[5] https://www.rollcall.com/news/politics/sheldon-adelson-breaks-all-time-spending-records-on-the-midterm-elections-surpassing-100-million
[6] See Alexander Burns, *Tom Steyer Will Run for President and Plans to Spend $100 Million on His Bid*, N.Y. Times, July 9, 2019.

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opaque.[7] Given all that cash, it is easy to trace the root of many of our most pressing social and political problems to the outsize role of money in politics.[8] Money in, money out, with no end in sight.

The problem is not new, nor are attempts to solve it. Campaign finance regulation has been an issue in American politics for nearly half a century, following the reforms of the post-Watergate era.[9] It does not appear to be working. Failures and limitations have haunted meaningful efforts to get money out of politics in all branches and at all levels of government. Judicially, *Citizens United v. FEC*,[10] going further than precedents such as *Buckley v. Valeo*,[11] which had held that strict political expenditure limits are unconstitutional, reaffirmed that political speech has first amendment protections and that such protections extend to corporations and other group entities such as labor unions.[12] Legislatively, Congress has so consistently failed to enact meaningful reforms to get money out of politics that leading scholars are beginning to accept the impossibility of ever doing so.[13] The executive branch has played its own role, as by no longer requiring non-profit "social welfare organizations" governed

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[7] See e.g., Jane Mayer, *Dark Money: The Hidden History of the Billionaires Behind the Rise of the Radical Right* (N.Y, N.Y.; Doubleday)(2016); see also Opensecrets.org, *Dark Money*, available at: https://www.opensecrets.org/dark-money

[8] See e.g., Martin Gilens, *Affluence and Influence: Economic Inequality and Political Power in America*, (Princeton; Princeton University Press)(2012); Larry M. Bartels, *Unequal Democracy: The Political Economy of the New Gilded Age - Second Edition*, (Princeton; Princeton University Press) (updated edition 2018).

[9] Beth Rowan, *Congress passes legislation to public confidence in government*, Infoplease, https://www.infoplease.com/us/government/elections/post-watergate-campaign-finance-reforms.

[10] 558 U.S. 310 (2010).

[11] 424 U.S. 1 (1976).

[12] For relevant critical commentary on *Citizens United* and the state of campaign finance regulation after it, see Richard L. Hasen, *Citizens United and the Illusion of Coherence*, 109 Michigan L. Rev. 581 (2011); Michael S. Kang, *The End of Campaign Finance Law as We Knew It*, 98 Va. L. Rev. 1 (2012). Note that the thought experiment and tax reform proposal discussed in this Article would not affect corporate political spending in the first instance, although tax-law changes could do so. See also Leo E. Strine Jr. and Nicholas Walter, *Conservative Collision Course: The Tension between Conservative Corporate Law Theory and Citizens United*, 100 Cornell L.Rev. 335 (2015).

[13] See for example Kang, *supra* note 12 at 52-53, asserting that due to a lack of preventative measures available, "the way forward for campaign finance reform … must come from outside campaign finance regulation as we know it," and concluding that "Campaign finance reform must shift to ex post measures to limit the influence of campaign money once it is already in the system, as opposed to ex ante regulation of money to limit its entry in the first place." Contrary to Kang's conclusion, this piece suggests that certain ex ante measures are still available.

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by Internal Revenue Code ("IRC") Section 501(c)(4) to disclose their donors,[14] facilitating the rise of dark money pouring into the metaphorical swamp of federal government politics. Administratively, partisan gridlock has rendered the Federal Election Commission ("FEC"), established in 1975 as the arbiter and enforcer of the post-Watergate campaign finance reforms,[15] virtually impotent.[16]

Hope for getting money out of American politics seems hopeless.

Yet it is always darkest before dawn. This Article has a plan, as some would say. It begins with the simple idea that political donors are rational. We shall consider throughout the case of a hypothetical mega-donor, whom we call *Sheldon*. When Sheldon spends $100 million in political contributions, he rationally expects benefits back of at least $100 million, the simple premise of rationality being that actors should incur marginal costs less than (or equal to) the expected marginal benefits of any action:

$$[1]\ mc \leq mb.$$

For small political donors, the benefits would rationally be expressive; for mega-donors like Sheldon, political contributions increasingly seem transactional, meaning that the contributor expects economic, or financial, benefits from and commensurate with his expenditures.[17]

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[14] Laura Davison & Bill Allison, *Many Political Tax-Exempts No Longer Required to Report Donors*, Bloomberg News (July 16, 2018), https://www.bloomberg.com/news/articles/2018-07-17/many-political-tax-exempts-no-longer-required-to-report-donors

[15] Federal Election Commission: Mission and History, https://www.fec.gov/about/mission-and-history/.

[16] For a background on the FEC's failure and interference with real campaign finance reform, see, Note, *Eliminating the FEC: The Best Hope for Campaign Finance Regulation?*, 131 Harv. L. Rev. 1421 (2018).

[17] The general problem of "rent seeking" in politics is generally attributed to Gordon Tullock, who considered it paradoxical that the costs of rent seeking are generally low compared to the gains. See Tullock, Gordon (1980), "Efficient rent-seeking", in Buchanan, J.; Tollison, R.; Tullock, G. (eds.), *Toward a theory of the rent-seeking society*, College Station: Texas A&M Press, pp. 97–112. For applications in the legal literature, see Richard L

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This Article is not about the right-hand side of the basic Equation [1] -- the marginal benefits to be obtained from out-sized contributions -- although a wider theory of campaign finance reform should indeed consider why it is that governments can extend such largesse to private actors as to justify $100 million in political contributions. We leave that for another day. Here we focus instead on the marginal cost or left-hand side of the basic equation. This Article proposes using the tax system to reduce campaign spending by raising the before or pre-tax costs of political expenditures. This is a standard public finance move: raising the costs of harmful activities by taxing them reduces their occurrence. A ready example is cigarettes, where taxes have proven more effective at reducing the undesired behavior than public education campaigns or warning labels.[18]

It is important to note from the outset, as we shall stress throughout, especially in Section 4, that the tax proposal being advanced is fully general: it is to move the tax system from its current status as a nominal "income" tax to a consistent consumption tax, what we shall come to call a progressive spending tax. This is an idea with a long lineage in the academic literature,[19] supported by people as diverse as the billionaire Bill Gates[20] and the economist and columnist Robert Frank,[21] and actually the basis of a serious legislative proposal put forth on the floor of the United States Congress, the

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Doernberg and Fred S. McChesney, *On the Accelerating Rate and Declining Durability of Tax Law Reform*, 71 Minnesota L. Rev. 913 (1987); Richard L. Doernberg and Fred S. McChesney, *Doing Good or Doing Well? Congress and the Tax Reform Act of 1987* (Reviewing Jeffrey H. Birnbaum and Alan S. Murray, Showdown at Gucci Gulch: Lawmakers, Lobbyists, and the Unlikely Triumph of Tax Reform (N.Y. Random House 1987), 62 NYU Law Review 891 (1987); Edward J. McCaffery and Linda Cohen, *Shakedown at Gucci Gulch: The New Logic of Collective Action*, 84 North Carolina L. Rev. 1159 (2006).

[18] See Mark Goodchild, Anne-Marie Perucic & Nigar Nargis, *Modelling the impact of raising tobacco taxes on public health and finance*, 94 *Bulletin of the World Health Organization* 250-257 (2016).

[19] See Nicholas Kaldor, *An Expenditure Tax* (1955); William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 Harvard Law Review 1113 (1974); Edward J. McCaffery, *Fair Not Flat: How to Make the Tax System Better and Simpler* (2002); Roberto Mangabiera Unger, *Democracy Realized: The Progressive Alternative* (New York: Verso)(1998).

[20] See Chris Matthews, *Bill Gates' Solution to Income Inequality*, Fortune, Oct. 15, 2014.

[21] See Robert Frank, *Luxury Fever: Why Money Fails to Satisfy in an Era of Excess* (1999).

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Nunn-Domenici USA Tax plan of 1995.[22] We shall explain the tax system to the extent needed for present purposes below. For now, the point to stress is that there would be no provision in the reformed tax system that is specific to political expenditures, other than provisions disallowing such expenditures as ordinary business deductions or as charitable contributions.

This is precisely the case as under the current income tax. The tax reform, that is, is not directed at campaign finance per se; this Article is taking no position on disclosure rules or the role, if any, for the FEC, for example. On account of its generality the proposal raises no significant First Amendment concerns such as those that have haunted and significantly crippled efforts to get money out of politics:[23] the present income tax *already* makes political contributions nondeductible and hence fully taxable, just as it generally does the purchase of books, newspapers and other speech-infused activities. The tax reform would act to generally tax the consumption of the rich, of which large political expenditures are but a particular type, at higher levels. The tax law changes are aimed at making the tax system more consistently apply to personal consumption, and then to raise marginal rates under it, precisely because the tax falls on and only on spending. All that is needed is for political contributions to be treated as non-deductible consumption -- as they are today, and always have been under the U.S. income tax -- to be swept into the effect.

That effect can be dramatic. Because political contributions are not deductible under current law, Sheldon's $100 million must come from money that Sheldon has available, after taxes. The rational question is, How much money does Sheldon need before taxes to be able to make $100 million in

[22] See Murray L. Weidenbaum, *The Nunn-Domenici USA Tax: Analysis and Comparisons*, Washington University Open Scholarship, Occasional Paper 152, 5-1-1995; Laurence Seidman, *The USA Tax: A Progressive Consumption Tax* (Cambridge, Mass: MIT Press) (1997).
[23] See Kathleen M. Sullivan, *Two Concepts of Freedom of Speech*, 124 Harvard L. Rev. 143 (2010).

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contributions after taxes? The best answer, under current law, to a first approximation, is $100 million. A plausible case can even be made that Sheldon is *saving* taxes, as much as $40 million, with his political expenditures: that $100 million in contributions really costs him and his family "just" $60 million. The current tax system thereby *encourages and even rewards* political mega-donors.

How much might Sheldon need to make the same $100 million political contribution under a progressive spending tax? A plausible answer is $1 *billion.* In other words, moving to a progressive spending tax -- a movement that is well justified on other, independent grounds -- could have the effect of increasing the cost of political contributions for the mega-donor class by *ten times* or more. Sheldon would have to pay the government $900 million in taxes for the privilege of being able to make $100 million in campaign contributions.

That should do something to get money out of politics.

The balance of this Article explains these analytic facts and adds in normative justification for the idea of a progressive spending tax as a response to the problem of too much money in American politics. In doing so, the Article sets forth a thought experiment. It does not proffer a detailed legislative policy proposal for tax reform. It aspires rather to get readers thinking differently about addressing perhaps the fundamental problem in American politics today: about specifying just what the problems of economic inequality are and about the tools available for a reasonable society to address those problems. The Article sees political spending as an example of the kind of outsized spending that is allowed unchecked and even encouraged under current laws. It sees the current tax system as a major part of the problem of mega-spending, and it envisions a future in which tax becomes a major part of a solution instead. The thought experiment is bi-directional. High-end political spending helps us to

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see the problems of the current tax system in a new light, and considering the tax helps us to think differently about curbing the role of money in politics. Tax brings hope to a cause that seems hopeless.

2. Political Contributions under the Current Tax System

2.1 A Touch of Tax Theory

Political contributions are not and never have been deductible under the U.S. income tax. Sheldon can get tax deductions for various business expenses he might incur, or investments he might make, under Section 162 of the Internal Revenue Code ("IRC"), but he cannot get a deduction for political expenditures under Section 162(e).[24] Sheldon can also get a deduction, under IRC Section 170, for contributions he might make to qualified charities under IRC Section 501(c)(3). But Section 501(c)(3) organizations, by virtue of the so-called Johnson Amendment, cannot engage in direct political activities.[25] Various other forms of nonprofit entities, such as "social welfare organizations" under

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[24] IRS 162(e)(1) provides:

> (e) **Denial of deduction for certain lobbying and political expenditures**
> (1) In general:
> No deduction shall be allowed under subsection (a) for any amount paid or incurred in connection with—
> (A) influencing legislation,
> (B) participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office,
> (C) any attempt to influence the general public, or segments thereof, with respect to elections, legislative matters, or referendums, or
> (D) any direct communication with a covered executive branch official in an attempt to influence the official actions or positions of such official.

[25] The relevant language of the Johnson Amendment is contained in the final clause of IRC Section 501(c)(3), which provides that in order for a charity to qualify as a Section 501(c)(3) non-profit, to which contributions would be tax deductible under IRC Section 170:

> .....no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

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IRC Section 501(c)(4) -- including for example the National Rifle Association ("NRA") and the American Civil Liberties Union ("ACLU")[26] --- *can* engage in political activities, and, under a Trump Administration rule need not disclose their donors.[27] But contributions to such organizations are not tax-deductible. This leaves political expenditures like Sheldon's $100 million in the residual category of non-deductible consumption under IRC Section 262, which provides quite generally that no deduction shall be allowed for "personal, family or living expenses." Political contributions are but an example of such nondeductible expenses.

That personal consumption is and must be generally nondeductible is in fact an essential part of what an income tax is, or is supposed to be. Consider the celebrated Haig-Simons definition of Income, which holds essentially that:

$$[2]\ Income = Consumption + Savings.$$ [28]

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This is a very simple statement, a tautology, which helps to show that all inputs (Income) lead to outputs, and that all outputs are either spending (Consumption) or non-spending (Savings). But Equation [2] still shows that an income tax *must* include consumption in its base. Imagine for a moment

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Note the similarities in the language to IRC Section 162(e), *supra* note 23. *See generally* IRS, Charities, Churches and Politics, available at https://www.irs.gov/newsroom/charities-churches-and-politics.

[26] Both the NRA and the ACLU have sister 501(c)(3) organizations, but the primary named entity is a 501(c)(4).

[27] See Laura Davison and Bill Allison, *Many Political Tax-Exempts No Longer Required to Report Donors*, Bloomberg, July 16, 2018, available at: https://www.bloomberg.com/news/articles/2018-07-17/many-political-tax-exempts-no-longer-required-to-report-donors.

[28] The full statement of the Haig-Simons definition of income is generally attributed to Henry Simons, *Personal Income Taxation: the Definition of Income as a Problem of Fiscal Policy.* (Chicago: University of Chicago Press, 1938), at p. 49 ("Income may be defined as the algebraic sum of the market value of rights exercised in consumption plus the change in value of the store of property rights between the beginning and the end of the period in question."). For a simpler statement, see Edward J. McCaffery, *Income Tax Law* (New York: Oxford University Press, 2012).

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if it did not: imagine, that is, that you could deduct from your income tax each year all the money you spent on food, clothing, shelter and fun. Many readers, certainly most students, and all of our children, would end up paying no tax at all because they spend more than they earn.

Once we classify political contributions as neither "business" nor "charitable" expenses, they are left as personal consumption, non-deductible under IRC Section 262, and hence fully taxable. Sheldon's $100 million of political contributions will be taxed the same way that it would be if Sheldon had spent the same amount on artwork, additional homes, a private jet, or a bunch of gold-plated toilets -- no deduction, meaning that the payment must come from post-taxed dollars.

2.2 Calculating Before Tax Costs of Political Expenditures

Because Sheldon will not get a tax deduction for his $100 million contributions, he must actually have $100 million available to pay over to politicians, independent of tax. Where did this come from? We need to calculate the amount of money, which we shall call ***B***, that Sheldon must have had before taxes to calculate what he will need to generate the $100 million in cash to give to candidates of his choice, after taxes have been taken into account.

On the initial amount, ***B***, Sheldon will have to pay tax, at the tax rate **t**, meaning that ***-tB*** will have to be paid over to the government. This will leave Sheldon with (1 - t) of his initial **B.** Adding the term ***A*** to describe Sheldon's after tax money, we arrive at:

$$[3] B(1 - t) = A$$

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This too is simple math. To put Equation [3] in a numeric example, imagine that the tax rate, **t**, is 40%, and you earned $100, which would be your ***B***. You would have to pay 40% of **B**, or $40, in taxes. You would keep (1 - t), or 60% of $100, or $60, after taxes, which is your ***A***.

In Sheldon's case, we know that the **A**, the actual contribution, is $100 million. What is Sheldon's **B**? For this, we simply rearrange Equation [3] to solve for *B*:

$$[4]\ B = A/(1 - t).$$

How much money does Sheldon need to start with to be able to spend $100 million? The answer turns on Sheldon's tax rate, t. Once we know that, we can solve for *B* simply enough using Equation [4].

2.3 The Before-Tax Cost of Political Expenditures under the Current Income Tax

2.3.1 Tax Rates on the Wealthy under the Current Income Tax

In order to calculate the amount that Sheldon needs to have to be able to make a $100 million political contribution, after taxes, we need to know what tax rate Sheldon faces on his wealth as it is being converted into funds for current consumption, under Equation [4]. There are, broadly speaking, three possible candidates under current law. We shall use simple, round numbers for the tax rates: actual tax rates vary, and the points this Article are making are general analytic ones. Precise details can wait.

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One candidate for Sheldon's *t* is 40%, which is approximately the top "ordinary income" rate imposed by IRC Section 1. This is the rate faced on labor income, or wages, today.[29] Facing a 40% tax rate would mean that Sheldon worked for a living to generate his $100 million sum, which was in turn sourced to his labor. But immediately we note that this is unlikely: it is almost certainly *not* the case that any real-world Sheldon would have $100 million *after paying ordinary income taxes* with which to make his political expenditures. Certainly, billionaires such as the late Steve Jobs, Warren Buffet, Bill Gates, and President Donald J. Trump do not ever show such large wages. In 2018, chief executives at Fortune 500 companies averaged $14.5 million in earnings:[30] almost 300 times what an average American worker earned, but still not enough to generate, after taxes, the ability to make $100 million campaign contributions every other year. (At a 40% tax rate, $14.5 million before taxes becomes $8.7 million after taxes. It would take 11.5 years to reach $100 million of cumulative after-tax income.) And much of CEO compensation is not taxed at ordinary income rates in any event.[31] Many high income earners, such as Wall Street hedge fund managers, rely on stock options, or report their "income" as capital gains, using a trick known as "carried interest."[32] The very richest of all, such as Buffet and Gates, do not even bother to show much income in the first place, relying instead on "unrealized appreciation," which is not taxable under the century old Supreme Court decision of *Eisner v Macomber*.[33] As Gates himself puts it: "In terms of revenue collection, you wouldn't want to just focus on the ordinary income rate, because people who are wealthy have a rounding error of ordinary

[29] See Edward J. McCaffery, *The Death of the Income Tax, Or, The Rise of America's Universal Wage Tax*, Indiana L. J. (forthcoming 2020).
[30] See Alexia Fernandez Campbell, *CEOs Made 287 Times More Money Last Year Than Their Workers Did,* Vox, June 26, 2019, available at: https://www.vox.com/policy-and-politics/2019/6/26/18744304/ceo-pay-ratio-disclosure-2018
[31] Id.
[32] See Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U.L. Rev. 1 (2008); Victor Fleischer, *Two and Twenty Revisited: Taxing Carried Interest as Ordinary Income Through Executive Action Instead of Legislation*, (September 16, 2015) available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2661623.
[33] 252 U.S. 189 (1920).

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income."[34] We listen to Gates and will not make the mistake of focusing on the 40% ordinary rate in our thought experiment.

A second candidate for Sheldon's *t* is 20%, approximately the rate faced on capital gains under IRC Section 1(h), which has historically been about one-half of the ordinary income tax rate just discussed. This would obtain if Sheldon met his $100 million mark by selling assets that he owned, such that his full consumption were sourced to capital. But again, this is unlikely. *If* Sheldon had to sell assets to generate his $100 million expenditure, and *if* the assets he sold had no tax law "basis" under IRC Sections 1011 and 1012, such that the full amount realized under IRC Section 1001 would be taxed, *then* Sheldon's ***t*** would indeed be the full 20%.[35] But studies have shown what common sense suggests: this is not what the rich do.[36] Because of the benefits of deferral and of the possibility of some basis offset, Sheldon would be highly unlikely to face the full 20% rate even if he did have to sell some of his assets to finance his $100 million of spending.[37] "Income realized for tax or survey purposes usually understates economic income for the wealthy because capital income recognition is often voluntary," as one recent study concluded.[38]

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[34] Tanza Loudenback, *Bill Gates Says the Politicians Proposing 70% Income Tax Rates for the Super Rich are "Missing the Picture",* Business Insider, Feb. 12, 2019, available at: https://www.businessinsider.com/bill-gates-taxes-income-tax-wealthiest-americans-2019-2

[35] Under IRC Section 1001, the amount of gain realized on any sale or other disposition of property measured by the fair market value of what is received minus the basis of the asset surrendered. "Basis" is a tax-law concept, initially referring to cost, IRC Section 1012.

[36] See Jenny Bourne, Eugene Steuerle, Brian Raub, Joseph Newcomb, and Ellen Steele, *More Than They Realize: The Income of the Wealthy*, 71:2 National Tax Journal 335 (2018).

[37] If for example Sheldon sold corporate stock to generate his $100 million, and he had basis in the stock of $60 million, Sheldon would have to pay capital gains tax on the difference, or $100 - 60, or $40, which would generate $8 million of taxes (20% of $40 million), for a total effective tax rate of 8% on the sale ($8/100 million). IRC Section 1001(a). Bourne *et al*, *supra*, show conclusively that the actual effective tax for the wealthy is far below the statutory rate.

[38] Bourne *et al.*, *supra*.

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This then leaves as the third, and most plausible, option for Sheldon's *t*: 0%. This would obtain if Sheldon simply borrowed to get the $100 million, making debt the source of his present consumption. Borrowing is tax-free under the current and, indeed, under any income tax, by definition: borrowing does not lead to a change in one's net wealth, the borrowed funds being offset by the obligation to repay the loan.[39] Combined with *Macomber's* realization requirement, the nontaxation of debt gives a way for billionaires to monetize their unrealized appreciation, tax-free.[40] There is abundant evidence that the wealthy take advantage of this strategy: for example, President Donald J. Trump, who is known to avoid taxes in most years, is the self-proclaimed "King of Debt;"[41] his fellow billionaire Larry Ellison has a personal line of credit of at least $10 billion.[42]

Later we shall discuss how this rough pattern of tax rates facing the wealthy as they finance present period consumption -- 40, 20 and 0 percent -- is not an artifact of a particular time. Rather such a rate structure is highly suggested, if not dictated, by the intrinsic structure of an income tax. In more formal economic terms, the rate structure on personal consumption is largely endogenous to the choice of tax system design.

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[39] Under the Haig-Simons definition, Equation [2] above, borrowing is both a source of Income, on the left-hand side, and some use -- either consumption or savings -- on the right-hand side. So this becomes a "wash" on which no income tax is due.
[40] See Lawrence A. Zelenak, *Debt-Financed Consumption and a Hybrid Income-Consumption Tax*, 64 *Tax Law Review* 1 (2010).
[41] See Edward J. McCaffery, *Donald Trump is the King of Debt but not of Taxes*, CNN on-line, Sept. 2, 2016, available at: https://www.cnn.com/2016/09/02/opinions/trump-king-of-debt-but-not-taxes-opinion-mccaffery/index.html
[42] On Ellison's line of credit, see Julie Bort, *Larry Ellison Has Secured $10 Billion Worth Of Credit For His Personal Spending*, Business Insider, Sept. 26, 2014, available at: https://www.businessinsider.com/larry-ellison-has-a-10b-credit-line-2014-9. For those who consider that any interest on the loan is a cost of this strategy, consider again. First, interest rates available for billionaires have been historically low for decades. Second, the borrowing strategy of this third approach compares with the asset sale of the second approach. In the borrowing example, *Sheldon retains his asset*. Thus, the (minor) interest charge on a $100 million is offset by the rate of return on *$125 million* of an asset, which would have to be sold, and taxes paid, to generate the $100 million needed. In these circumstances, borrowing dominates selling as a means to get liquidity for billionaires.

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2.3.2 Calculating the Before-Tax Cost

The prior section has given us a range of **t**'s to plug into Equation [4], above, in order to calculate how much Sheldon's $100 million would cost him, at the margin, taking into account any taxation imposed on the source of Sheldon's funds. **Table 1** presents the results:

Political Contribution (A)	Tax Rate (%)	Funds Needed to Finance Contribution (B)
100	40	167
100	20	125
100	0	100

Table 1: Costs of Sheldon's Contributions under Current Law, in millions of dollars

They key column is the far-right one, showing B, the funds needed ab initio to finance Sheldon's $100 million contribution. Table 1 illustrates that, in order for Sheldon to be able to write a check for $100 million in non-deductible political expenditures, he must have started with between $100 and $167 million under current law. The actual answer, in any real case, is almost certainly very close to $100 million; our Sheldon is no fool.

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2.4 A Further Twist: Political Expenditures as Tax Expenditures under the Estate Tax

Suppose, as would seem to be likely, Sheldon, like his fellow billionaires, has significant amounts of appreciated assets on hand,[43] and he simply writes a check for $100 million using some kind of margin account[44] to make his political expenditures. The prior section, using Equation [4], showed how this would cost Sheldon $100 million, before and after taxes. This is because Sheldon need pay no tax on the unrealized appreciation being used to finance his political payments, nor on using debt to monetize the non-taxed appreciation.[45]

In fact, Sheldon's after-tax situation may plausibly be seen as even better than this.

The reason is the existence of the estate tax. This is a tax on the net worth that someone leaves on his deathbed: on, that is, one's assets minus his or her liabilities post mortem. In Sheldon's case, the $100 million loan he used to make his political contributions would be a deduction from his taxable estate.[46] If Sheldon had $100 million cash on hand instead of needing to borrow, the result would be the same, with the actual cash being deducted from Sheldon's taxable estate.

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[43] See Bourne et al, *supra*.

[44] A margin account, as can easily be set up at investment houses such as Charles Schwab or Fidelity, allows the owner of a stock and securities account to simply write checks effecting a loan secured by the securities in the account. As long as the margin loan balance does not exceed a certain percentage of the account's value, say 50%, interest simply accrues on the margin loan balance. As discussed in a prior note, the return generated by the securities in the account pledged as collateral should be offset against the interest charged on the margin loan, such that the loan need not be paid off until after Sheldon's death, when his heirs would get a stepped-up basis in the securities pursuant to IRC Section 1014. On margin loans in general, see U.S. Securities and Exchange Commission, *Investor Bulletin: Understanding Margin Accounts*, May 14, 2018, available at: https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_marginaccount.

[45] The tax saving technique, all in, has been labeled Tax Planning 101, or the simple advice to buy/borrow/die. See Edward J. McCaffery, *Taxing Wealth Seriously*, 70 Tax Law Review 305 (2017); Edward J. McCaffery, *A New Understanding of Tax*, 103 Michigan Law Review 807 (2005).

[46] See IRC 2053.

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After President Trump's Tax Cut and Jobs Act of 2017,[47] very, very few Americans must worry about an estate tax following their death. The exemption level has been raised to over $11 million for an individual, $22 million for a married couple with proper planning, both numbers indexed for inflation.[48] At these numbers, according to a study prepared by the Tax Policy Foundation, "an estate tax return will be filed for only about 0.15 percent of decedents, and only about 0.07 percent will pay any estate tax."[49] In other words, 99.93% of Americans need not countenance their families facing an estate tax after their passing.

Sheldon, however, let us presume, is indeed in the 0.07% category that will face an estate tax. The $100 million which Sheldon has available to give to politicians in our running example, alone, would put Sheldon well into the estate tax range. We can also consider him a widower, so that his estate will not have the "marital deduction" of IRC Section 2056 to bail him out (having a spouse effectively doubles the exemption level, and postpones the moment of taxation until after the second death) The estate tax has a rather flat rate of 40%.

The relevance of all this? Imagine, again not implausibly, that a mega-donor such as Sheldon is elderly, and has plenty of funds available for his daily wants and needs, however luxurious. Sheldon is also not extremely philanthropic, preferring to leave whatever wealth he has left over on his deathbed to his children and other heirs. This would mean that Sheldon's next best use of his $100 million is simply to save it such that it will go to his heirs after his death. If this were true, Sheldon's "opportunity

[47] P.L. 115-97, 131 Stat. 2054 (2017).
[48] IRC 2010(c)(3)(C). The inflation adjustment made this exclusion amount $11.18 million for 2018 and $11.4 million for 2019.
[49] https://www.taxpolicycenter.org/briefing-book/who-pays-estate-tax

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cost" of the $100 million political expenditure would be a $60 million bequest -- what of the $100 million he could get to his heirs, given his status as being fully subject to a 40% estate tax after his death.[50]

To sum up: Suppose Sheldon lay on his deathbed, with a net worth of $1 billion dollars. Were he to pass then and there, this would be the amount of his taxable estate, and his family would pay a tax of $400 million at the 40% rate. But if Sheldon were to write one last check, for $100 million, which he financed out of available cash, *or* by selling an asset worth $100 million, *or* by borrowing, his taxable estate would fall to $900 million ($1 billion - $100 million, whether the $100 million came from cash, non-cash assets, or debt). The estate tax to be paid by his family would fall to $360 million, 40% of $900 million. The $100 million expenditure would lead to $40 million less in tax ($400 million minus $360 million), so would cost Sheldon and his heirs $60 million on net. This is tax expenditure analysis.

We do not want to overstate this point, because it is true, as with the income-with-realization tax, that Sheldon would have relatively simple tax-planning options available to get his children their cake while allowing them to eat it, tax-free, too.[51] But we make the point to underscore an analytic fact. Academics and policymakers have long referred to various deductions, credits, and exemptions under the income tax law as "tax expenditures."[52] The idea is simple to understand. An income tax is

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[50] There is no need to discount the future tax, here $40 million, to Sheldon's present, because the $100 million he is spending on political contributions, if not spent, would be expected to grow at least the inflationary or discount rate.

[51] For example, Sheldon Alderson was able to get nearly $8 *billion* dollars to his children and heirs, tax-free, when the exemption level was far below its current level, at $1 million (during lifetime, the gift tax is supposed to apply to wealth transfers, such that policy makers refer to the combined gift and estate tax systems as a single, unitary wealth transfer tax, applying to both *inter vivos* gifts and testamentary bequests.) See Zach Mider, *Accidental Tax Break Saves Wealthiest Americans $100 Billion*, Bloomberg News Magazine, Dec. 16, 2013, available at: https://www.bloomberg.com/news/articles/2013-12-17/accidental-tax-break-saves-wealthiest-americans-100-billion

[52] See Stanley S. Surrey and Paul McDaniel, *Tax Expenditures* (Cambridge, Mass.; Harvard University Press, 1985).

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supposed to tax all consumption plus all savings, as the Haig-Simons definition, Equation [2], showed. If Congress allows a deduction for something that it *could*, legally, tax under the definition of "income" -- all consumption plus all saving -- then it is forswearing the tax it could have collected on that amount. If in our running example Sheldon were allowed to deduct his $100 million in political contributions, this deduction would lower his taxable income by the full $100 million and thus save Sheldon taxes -- real money -- at his marginal tax rate. If that rate were 40%, Sheldon would see his taxes reduced by $40 million on account of the $100 million deduction. So, Sheldon's $100 million given out in political contributions would be partially offset by the $40 million in saved taxes, such that Sheldon's net out-of-pocket cost for the contributions would be $60 million. The government would be chipping in the remaining $40 million via taxes forsworn. Sheldon would be playing with house money, in significant part.

Here is the point of current relevance: Under a back-ended wealth tax like the estate tax, *all present consumption has the structure of a tax expenditure*. The tax base is one's net wealth on her deathbed. Any present expenditure that subtracts from this net wealth lowers the tax, hence saving the spender's family money at the estate tax's marginal rate, 40%, just as we went through above as Sheldon lay dying. This is why the simplest estate planning advice -- Estate Planning 101 as it were -- is to spend it all and die broke.[53] Sheldon's $100 million political contributions do save him, or his family, taxes -- under the estate tax, not the income tax.

A principal reason to set this forth is to give a look at how perverse the current tax system can be, especially once high-end *spending* is identified as an important social harm. We have seen, by the prior

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[53] See Stephen Pollan and Mark Levine, *Die Broke: A Radical Four Part Financial Plan*, (N.Y, N.Y: HarperBusiness)(first edition, 1997).

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section, that the current tax is not doing much at all to discourage Sheldon's political expenditures -- barely if at all raising their true net of tax costs. Adding in the estate tax as part of the status quo and the tax expenditure analysis just discussed shows how the current tax system is even worse on the score of discouraging large political contributions. America's tax system *encourages* the high-end consumption of the mega-rich, the very class of citizens whose spending habits ought to cause a reasonable democracy most concern. In both allowing vast sums of wealth to build up, tax free, under the simple planning steps suggested by *Macomber's* realization requirement, and in allowing those sums to be spent or consumed, *also* tax-free, America's tax system is clearly a major part of the problem of wealth inequality in the country today, and no part of a solution. A tax system that is supposed to tax all consumption does not: it misses the spending of the rich, very much including their outsized spending on politics.

2.5 Summing Up

In order to pay out $100 million in political contributions, Sheldon needs to spend no more than $100 million under the current income-with-realization tax. In other words, there need be no tax paid on this value, although it represents personal consumption meant to be fully taxable under a true, Haig-Simons, income tax. At worst, there might be some rounding error in capital taxation, or Sheldon is not quite optimally advised, such that it takes closer to $125 million to generate the $100 million after tax in contributions. Thus, the current tax system barely if at all *discourages* Sheldon from making the expenditures. And when the estate tax, a back-ended wealth tax, is factored in, a plausible case can be made that the current tax system, the income-with-realization-plus-estate tax, *encourages* Sheldon's contribution, which costs Sheldon's family "just" $60 million after the $40 million of house money, via the tax expenditure analysis, is taken into account.

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3. Political Contributions under a Progressive Spending Tax

3.1 A Tax Theory Twist

The tax reform proposal is for a consistent consumption tax. The academic literature has pointed out that there are different forms of a consumption tax,[54] all of which are single taxes on the flow of funds, as opposed to an income tax, which is supposed to tax savings twice (both as money is earned and when, having been saved, it generates a yield). The two types of consumption taxes are "prepaid" models, where a tax is levied upfront, and never again, like the payroll tax; and "postpaid" models, where the tax is not necessarily imposed upfront -- there is a deduction for savings -- but instead when money is used for personal consumption or spending, like a sales tax.[55]

The tax reform proposal here is for a postpaid consumption tax, one that is levied as funds are put to use in financing personal spending, so we call it a spending tax. And it shall feature progressive rates, so we shall call it a progressive spending tax.

A progressive spending tax of the sort being proposed is not a spending tax levied on particular purchases, at point of sale, like the familiar state and local sales taxes most Americans pay daily. A progressive spending tax would look very much like the current income tax: it would have an annual form, like the dreaded IRS Form 1040, to be filed each year, at least by those wealthy enough to have to do so. In the case of a progressive spending tax, the form would "simply" add up all sources of Income, and then equally simply subtract all forms of Savings, to arrive at the residual category of Consumption, or personal spending. A progressive marginal rate structure would then be applied to each household's spending for the year. Political expenditures would be included in Consumption,

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[54] See generally Edward J. McCaffery, *A New Understanding of Tax*, 103 Michigan L. Rev. 807 (2005).
[55] See Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, *supra* note 19.

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just as they are under the current income tax, as discussed above, here because political expenditures would not qualify for any deduction as Savings.

It may be easier to understand how a progressive spending tax works by returning to the Haig Simons definition, Equation [2] above:

$$[2]\ Income = Consumption + Savings.$$

A simple algebraic manipulation -- subtracting Savings from both sides of Equation [2] -- shows us how simply a consumption tax, along a cash-flow or spending tax model, can come to be:

$$[5]\ Consumption = Income - Savings.$$

In words, a spending tax can be had easily enough by adding up all sources of Income -- just as an income tax is supposed to do -- and systematically subtracting all Savings (as many have proposed that the income tax should do, and as the Nunn Domenici USA tax would automatically do.)[56] The residuum -- what resources you had available that you did not save -- is, by definition, consumption. The most important practical policy change from the status quo is the need to include debt, or the proceeds of borrowing, as income.[57] Debt that is used to save will end up as a "wash:" the inclusion for the debt being offset by the deduction for savings. Borrowing to consume will be taxable, just as it is in the case of the familiar state and local sales taxes that exist across America today.

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[56] See Seidman, *supra* note 22.

[57] The Nunn-Domenici USA Tax Plan from 1995, mentioned above, failed to include borrowing in its base; this would have proven to be a fatal flaw in the plan, as taxpayers could pretend to save all of their income, and then borrow to engage in present consumption. See Seidman, *supra* note 22.

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While a progressive spending tax faces the challenge of finding a way to report on and include taxpayer borrowing in its base, it would importantly and significantly simplify the tax system by removing any need to tax savings directly. Thus, a progressive spending tax needs no realization requirement, no tax-law concept of "basis" (since no savings has been taxed, savings do not need basis.). The rise in value of assets inside tax-favored savings accounts will not be taxed, just as today when gains inside pension plans or individual retirement accounts (IRAs) are not currently taxed. The difference will be that savings accounts will be unlimited in potential amount. Taxpayers will pay tax when and as they withdraw from the accounts to consume, or when they consume out of current income, or when they borrow to consume. Under a consistent consumption tax along the lines of Equation [5], the fact of consumption is what triggers tax, not the facts of work or savings.

The ultimate source of that consumption, whether it be from labor, capital, labor and capital combined, debt, gifts, bequests or anything else, is irrelevant. And this is how a reasonable society ought to think about political expenditures: *whatever* the source, the unchecked ability of individuals to give $100 million per campaign cycle is a significant and mounting social problem. The current tax system, by failing to consistently tax consumption -- it lightly taxes consumption funded by capital and ignores consumption financed by debt -- misses the high-end spending of the rich. It is that very high-end consumption that is precisely the target of a progressive spending tax.

3.2 Tax Rates under a Progressive Spending Tax

Although the one practical legislative proposal that has come closest to a progressive spending tax, the Nunn-Domenici USA tax plan from the 1980's (with "USA" standing for "unlimited savings

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accounts") featured progressive rates up to 40%,[58] most commonly known consumption tax models feature flat rates. This does not have to be so.[59] Indeed, there are compelling arguments, sounding in arguments both of economic efficiency and of normative fairness, that a spending tax can and should have *higher* tax rates than an income tax.[60] The potential for a different tax rate structure on high-end spending is a central part of this Article's thought experiment.

The efficiency argument for such a pattern of progressive rates is straightforward. The current income tax, with its realization requirement and overall light hand on the capital side of taxation, is mainly a wage tax.[61] Faced with a tax on work, a taxpayer's principal decision is to work or not. High tax rates under an income tax thus risk distorting labor effort, as taxpayers earning high incomes shift to leisure, or to various forms of non-wage compensation, such as stock options or carried interest. A consistent consumption tax along the lines of Equation [5], in contrast, leaves taxpayers with *two* decisions: to work or not, *and* to consume or not (that is, to save). A consistent spending tax need have no deterrent effect on the socially productive activities (work and savings) of the mega-wealthy who are already at maximum consumption and are happy to save their excess good fortune. A progressive spending tax can be, as Robert Frank has suggested, a "win-win" situation, since the rich subject to it can see their welfare improve simply by saving more.[62]

Normatively, arguments that a progressive spending tax can bear higher marginal tax rates than an income tax are also straightforward, if less mathematically demonstrable than the efficiency arguments

[58] See Seidman, *supra* note 22.
[59] See McCaffery, *Fair not Flat*, *supra* note 19.
[60] See Edward J. McCaffery and James R. Hines, Jr., *The Last Best Hope for Progressivity in Tax*, Southern California Law Review (2010).
[61] See McCaffery, *Death of the Income Tax*, *supra* note 29.
[62] See Frank, *Luxury Fever*, supra; see also Edward J. McCaffery, *The Tyranny of Money (Book Review of Robert Frank's Luxury Fever)*, 98 Michigan L. Rev. 2126 (2000).

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for such rates. The idea turns on the simple notion that we should tax "bads" rather than "goods." High-end consumption can be seen as a "bad" in various ways, as it skews the allocation of goods towards luxury tastes, incites envy, and represents a failure to save -- to maintain the social capital stock -- by the economic actors most able to do so.[63] Certainly, with the case of outsized political contributions in mind, it is easy to consider the harms of allowing billionaires unchecked spending power, while the case for the social harm of their productive activities, of generating income, is far less clear and is in fact highly contestable.

Return to the case of Sheldon, contemplating his $100 million of political expenditures in one particular year. What marginal tax rate might he face under a progressive spending tax? It is reasonable to assume that Sheldon is already spending well; a conservative estimate of billionaires' personal spending habits would put them at least $40 million a year, a mere 4% of $1 billion.[64] Under an income tax, there would be little reason to create a bracket above $40 million: few would be in it, and the high tax rate, as we have discussed, would only encourage those who were to work less, or to show less income -- things that are easy to do under current tax laws. Today's income tax rates, for example, reach their peak of 37% at around $500,000 of taxable income -- far short of the average billionaire's spending level.

A progressive spending tax is a different matter. It can justify higher marginal tax rates. Imagine, in our example, the same top rate of 40% we considered in the prior Section. Congress is considering adding in new marginal tax rates on personal spending-- what it is that a progressive spending tax

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[63] I explore these arguments in greater depth in Edward J. McCaffery, *Must We Have the Right to Waste?*, in Stephen Munzer, ed., *New Essays in the Legal and Political Theory of Property*, Cambridge Studies in Philosophy and Law (Cambridge, UK; Cambridge University Press) (2001).

[64] https://www.businessinsider.com/worlds-billionaires-spending-compared-to-average-people-2018-3

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taxes. Perhaps they will add new marginal rate brackets for spending above $1 million, and $10 million, and finally -- just to continue the thought experiment -- a bracket for those who, again, *spend* more than $50 million a year, which would certainly include any mega-donor like Sheldon who is making political expenditures, alone, of $100 million every two years. To have a visual, your task is to complete the following table:

Personal Spending	Marginal Tax Rate
Up to $1,000,000	No higher than 40%
$1,000,000 to $10,000,000	x
$10,000,000 to $50,000,0000	y
$50,000,000 and above	z

Table 2: Potential Marginal Tax Rates under a Progressive Spending Tax

Specifically, for Sheldon, given our thought experiment's focus on mega-political-donors, the question is what rate you will choose for **z**, the rate that *only* applies to personal spending in excess of $50 million per year. We will, in the following section, consider three:

1. 50%, which seems like a reasonable minimum for a tax rate on personal *spending* in excess of $50 million a year;

2. 70%, which is the highest tax rate under Robert Frank's proposal, and a tax rate that obtained under the income tax from the time of John F. Kennedy, in 1963, until Ronald Reagan, in 1981; and

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3. 90%, which is less than the highest marginal tax rate under the income tax that obtained from 1944 until 1963.

We calculate in the next Section what such tax rates under a consistent consumption tax would mean for Sheldon.

3.3 The Before-Tax Cost of Political Expenditures under the Current Income Tax

As always, Sheldon wants to make $100 million in political expenditures. The question is how much money he needs to start with in order to contribute that much under a consistent spending tax. As under the current income tax, there will be no deduction for the political expenditures as business expenses, savings, or charitable contributions. Once again, we will use Equation [4]:

$$[4]\ B = A/(1 - t).$$

Sheldon's $\boldsymbol{A}$ remains $100 million but now we consider the tax rates, **t's**, just discussed, of 50,70 and 90%. The results are set forth in **Table 2**.

Political Contribution (A)	**Tax Rate (%)**	**Funds Needed to Finance Contribution (B)**
100	90	1,000
100	70	333
100	50	200

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Table 3: Before Tax Costs of Sheldon's Contributions under a Progressive Spending Tax

In words, this means that, at a 50% tax rate (for personal spending in excess of $10 million per year), Sheldon will need $200 million in order to pay politicians $100 million. There will be no escaping this. Whether Sheldon simply writes a check from available funds, works and earns wages, sells appreciated assets, borrows money, or uses gifts from others, he will have to pay $100 million to the government for the privilege of making his $100 million political contribution: Sheldon will have to start with $200 million, which he can pull out of his unlimited tax-favored savings account. He will pay 50% of that amount, or $100 million, to the government, leaving $100 million for Sheldon's favorite politicians and political causes.

At a 70% rate, he would have to start with $333 million, paying $233 million, or 70%, for the privilege of the $100 million of personal consumption. And at a 90% marginal tax rate -- bearing in mind that this is simply, and only, on personal spending in excess of $50 million a year -- Sheldon would need to pull out $1,000,000,000, one billion dollars. Sheldon would have to pay $900 million, or 90% of the billion dollars, to the government, *before* he could give $100 million in political contributions. This would get done without specifically needing to list Sheldon's political gifts -- Sheldon would have spent money under a consistent spending tax without his spending qualifying for any kind of deduction. Sheldon's $100 million in political campaign spending will be taxed just the same way as spending on luxury houses, planes, cars or gold-plated toilets.

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3.4 Summing Up

In addition to taxing all consumption, however sourced, a progressive spending tax changes the discussion about possible marginal tax rates, allowing a return to a more progressive past without running into arguments against disincentivizing work or savings. A consistent progressive spending tax disincentives high-end spending, and only high-end spending. It can have peak marginal tax rates of 50, 70, or even 90%, as the actual income tax has had. Under these rates and a consistent spending tax, things change for Sheldon. A lot.

We have seen above how under the current income tax Sheldon would need $100 million to make his $100 million political expenditures. Under a consistent spending tax, with plausible rates in a rate bracket applying only to those American households *spending* more than $50 million a year, Sheldon would need between $200 million and $1 billion to afford the same $100 million contribution. That is a very big change, affecting Sheldon's marginal calculus.

4. The Generality of the Case

This Article began by noting the ever-growing problem of money in American politics, specifically the problem of outsized political contributions from America's billionaire class. It is a fact that individual Americans are now contributing sums as large as $100 million per electoral campaign cycle. It is also a fact that practical, meaningful solutions to the attendant problems have not been forthcoming, despite decades of thought and effort. Where there is money, there is influence. Where there is outsized money, there is outsized influence.

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Rather than taking aim directly at the problem in its most particular, readily observable instantiation, by attempting to develop rules specifically limiting mega political donations, the Article switched gears. It looked at the outsized personal consumption of the rich as a *general* problem. It then became easy to see that political expenditures are just an example of the spending patterns of the rich, and also that the current tax system's primary failure is its failure to reach high-end spending. This section adds a normative argument that supports this move. But first we pause to address a compelling skepticism.

4.1 On Comparing Apples and Oranges

We consider a plausible objection at this point, namely that we are comparing an apple, namely the present, highly-flawed income-with-realization tax system with an orange, a stylized, ideal progressive spending tax. This is true enough. But *any* income tax must include personal consumption in its base, as we have seen above. And how *any* income tax and *any* spending tax in fact tax consumption is not happenstance. The tax structure constrains their ability to reach high-end spending in particular.

There are two structural issues that separate any income tax from the progressive spending tax being proposed: (1) the taxation of the various *sources* for financing present period consumption, and (2) the nature of the marginal tax rate schedule. On each front, it is clear that the income tax is a highly restricted tool. We considered three sources of paying for spending: labor, capital, and debt. The current income tax struggles mightily with capital; there has been a century of failure to tax economic gains from capital beginning with *Macomber*.[65] There are indeed many proposals for a cure, but none have made the wealthy pay much of anything.[66] Taxing assets as they rise in value without market

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[65] See McCaffery, *Taxing Wealth Seriously*, *supra* note 45.
[66] Id.

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transactions is simply a difficult technical task. Worse, any income tax will *not* include debt, because borrowing is simply not income under the Haig-Simons or any other definition of "income."

A spending tax has no such difficulties with taxing the source of present consumption. There is not even much reason to belabor this analytic point: one can see it in the operation of a simple sales tax, another form of the orange. When you buy a good such as a cup of coffee subject to a sales tax, the cashier never asks you where you got the money. It does not matter if you pay with cash or credit card, does not matter if the cash came from your paycheck or the credit came from your parents. All money used to consume is taxed. Sources are irrelevant. This has always been one of the most attractive features of a "cash-flow consumed income tax," as the late Professor William D. Andrews called it,[67] building on the work of Nicholas Kaldor:[68] its source neutrality. Ironically, such neutrality has always been a rallying cry of income tax supporters who seek to tax, in the words of the XVIth Amendment, "all incomes, from whatever source derived,"[69] including, in the famous language of *Macomber*, the gains "derived from labor, or from capital, or from both combined."[70] But once we shift our gaze to focus on the particular social harm of high-end consumption, even an ideal income tax fails to pick up a major source, debt. A spending tax is fully, generally, source neutral.

This leads to the second structural issue, the nature of the marginal rate schedule. Once again, *any* income tax, because it falls fully on the gains to labor, wages, in the first instance, will face pressure to maintain moderate tax rates. This is a primary lesson of the optimal income tax literature of the late

[67] See Andrews, *A Consumption-Type or Cash Flow Income Tax*, *supra* note 19.
[68] See Kaldor, *An Expenditure Tax*, *supra* note 19.
[69] U.S. Constitution, XVI Amendment.
[70] *Eisner v, Macomber, supra* note 33.

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Nobel Laureate James Mirrlees[71] and others, popularized by the likes of Arthur Laffer. But, also once again, these arguments do not apply with the same force to marginal tax rates under a consistent spending tax. Because rates as high as 90% could be avoided by the wealthy's "simply" continuing to save, a social good, the purely economic efficiency losses under a progressive spending tax are muted.[72]

So while we are indeed comparing an apple to an orange, we are not doing so by sleight of hand. No apple could reach all personal spending, as any orange would. And while high rates under the apple might lead us to cut off our noses to spite our face -- might, that is, lead people to work and save less -- oranges give us hope for a win-win outcome. This Article follows that hope.

4.2 The General Problem of High-End Spending

The progressive spending tax works in a fully general way. There is no need, within the tax system, to particularly itemize political contributions. The money to make them had to come from somewhere, and all such "wheres" lead to Income under the rearranged Haig-Simons definition:

$$[5]\ Consumption = Income - Savings.$$

That is, whatever Sheldon uses as the proximate source of his $100 million, it has to come from some place: current period earnings, savings withdrawn from the universal tax-favored accounts, debt, gift. All sources are Income. And because political expenditures are not "Savings" allowed to take place within the tax-favored accounts (just as, today, one cannot make political contributions from within a

[71] Jame Mirrlees, *An Exploration in the Theory of Optimum Income Taxation,* 38 *Review of Economic Studies*, 175 (1971).
[72] See McCaffery & Hines, *The Last Best Hope for Progressivity in Tax*, *supra* note 60.

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tax-favored Individual Retirement Account ("IRA") or qualified pension plan), there is no deduction for them, and they end up in the residual, taxed, category of Consumption. This will also be true, for just the same reasons and in just the same way, for Sheldon's purchases of more homes, yachts, or gold-plated toilets.

The generality of the case helps to obviate the need even to consider First Amendment objections to the tax reform proposal for its -- potentially massive --- increase in the net cost of political expenditures. We would be taxing consumption, and much consumption -- not just or even paradigmatically political expenditures -- has a speech component. But this can hardly be made into a plausible Constitutional objection, especially given the simple fact that we are taxing consumption today, under the income tax.[73] We are just not taxing consumption very well, and loopholes allow mega-donors like Sheldon to avoid paying any tax on much particular consumption.[74] A consistent spending tax aims at all spending or, equivalently, consumption. Its rate structure can reflect this choice of focus. High end spending will be taxed at high end rates.[75] This will include but in no way be focused on political spending.

In terms of mounting any kind of challenge on the grounds that moving to a progressive spending tax somehow impermissibly infringes on protected First Amendment rights, it bears noting that there are only two changes needed to convert the present, flawed income tax into a consistent spending tax.

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[73] U.S. CONST. Amend. XVI. Also, McCaffery, *Death of the Income Tax*, *supra* note 29. By taxing income and allowing deductions for savings, the income tax has become a consumption tax for all except those who save more than $19,000 of payroll income each year, which is a very small portion of Americans.
[74] McCaffery, *Death of the Income Tax*, *supra* note 29.
[75] Historical marginal income tax rates have been as high as 94% in the past, so the suggestion of rates this high again on extreme consumption is hardly extreme of itself. *Historical Highest Marginal Income Tax Rates*, TAX POLICY CENTER (Jan. 19, 2018), https://www.taxpolicycenter.org/statistics/historical-highest-marginal-income-tax-rates.

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One, the spending tax must include debt as Income. Two, the deduction for Savings need be unlimited. The point, for now, is that neither one of these structural reforms is targeted at speech.

Still, the generality of the case, analytically helpful in sparing the need for extensive First Amendment analysis, requires normative defense. That is, if we are going to tax all of the high-end spending of the rich, and not just their political expenditures, at high-end rates, we should be willing to justify taxing all of the high end spending of the rich, and not just their political expenditures, at high end rates. Can we?

Yes, we can. As noted above, the adverse economic effects brought on by high marginal tax rates is muted in the case of a consistent spending tax on account of the second margin, the escape valve of allowing currently untaxed savings.[76] Indeed, that inducement towards savings is part of the appeal of a progressive spending tax: the system allows, even encourages, the wealthy to save, to provide for the private capital stock, in part in order to allow the non-rich to consume *more*, to lower their tax burdens and to back away from particular, and likely counterproductive, attempts to get the non-rich to save. These are, again, general arguments, for a tax system that will deter high-end consumption in part at the "cost," such as it is, of *encouraging* high end savings. The progressive spending tax allows private wealth to be built up but looks askance at the wanton use of such wealth.

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[76] See McCaffery & Hines, *supra* note 60.

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5. Final Thoughts, and Hopes

> [I]t is said that hunger and poverty make men industrious, and that laws make them good. There is no need of legislation so long as things work well without it, but, when such good customs break down, legislation forthwith becomes necessary.
>
> **Niccolo Machiavelli**, *Discourses on Livy*[77]

Human nature being human nature, many Americans have become spectacularly wealthy. And, human nature being human nature, many of these wealthy are spending huge sums to influence our nominally democratic politics -- to buy politicians or political offices or laws. There is little hope of changing these facts of human nature. People will continue to be rational, and rational people will continue to incur marginal costs to generate larger marginal benefits. That is what being rational means.

We cannot change the facts of human nature. But we can change the marginal costs of human natures' doing business, even as we wait for that business -- the business of governing our great democracy -- to become less prone to capture by the rich. When it comes to the nexus between money and politics, good customs have broken down. Things are not working well without legislation.

Legislation forthwith has become necessary. Rich people spending large sums of money on politics is a bad. Why not use the same legislative strategy against this bad that America has used, repeatedly, over centuries, against lower class "bads" like alcohol and tobacco? Why not, that is, tax high-end spending?

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[77] Niccolo Machiavelli, *Discourses on Livy*, Book 1, Discourse 3.

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Once we have come to see the extremely high-end political spending of billionaires as a problem, and as a subset of a problem of extremely high-end spending of any non-public-regarding sort, a legislative solution emerges. We can indeed change the costs of doing business, by raising taxes on -- and only on -- high-end spending. A progressive spending tax could increase the actual, bottom-line cost of political expenditures by the wealthy as much as ten-fold. That's a law that could make even the most industrious among us good.

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