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Do We Have The Tools For Achieving Distributive Tax Justice?

James Alm
Tulane University
jalm@tulane.edu

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By many accounts, income and wealth inequality has grown significantly in many countries in recent years, violating many peoples' standards of "distributive" tax justice. How can tax policies serve as a tool to promote distributive tax justice? There is no shortage of policies that have been suggested, but many have little prospect of implementation. The purpose of this study is to discuss several policies that research has shown are both feasible and effective in achieving distributive tax justice, focusing on specific tax reforms that apply to the United States but that also apply in some form to most other countries around the world. If implemented, these policies would increase the taxes paid by the rich, reduce tax evasion by the rich, and decrease the tax burdens by the gender, race, and ethnicity of taxpayers, all of which would lead to a fairer tax system. Unlike many other suggested reform policies, these policies all work through existing taxes, they are all administratively feasible and effective, none of these policies raises statutory marginal tax rates, these policies are all broadly consistent with the standard "Broad Base, Low Rate" approach to tax reform, and variants of all of these policies apply world-wide.

Keywords: dstributive tax justice, inequality, tax reform, tax compliance, unit of taxation
JEL codes: H20, H24, H26, D10, D63

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* Department of Economics, Tulane University, 6823 St. Charles Avenue, Tilton Hall, New Orleans, LA 70118-5698 (email jalm@tulane.edu; ORCID 0000-0003-4008-1637). This paper is based on my keynote address at the International Conference on Taxation, "Distributive Tax Justice in the Global Economy", held at the Department of Taxation of the University of Pretoria in Pretoria, South Africa in August 2023. I am grateful to conference participants and to conference organizers, especially Hanneke du Preez and Chris Evans, for many helpful discussions and comments. I am also grateful to the editor and to several anonymous reviewers for many useful suggestions.

1. Introduction

By many accounts, the scale of income and wealth inequality has grown significantly over the last several decades and even in the last 10 years, exacerbated by long-run trends in labor and product markets and by more recent events like the COVID-19 pandemic and other war- and climate-induced crises.[1] How can tax policy – and other government policies – serve as a tool to promote "distributive tax justice"?

The specific notion of distributive tax justice – or equivalent notions like "fairness" or "equity" in taxes – is far from resolved. It is common among tax specialists to define equity in terms of "ability to pay", such that those with equal ability to pay should pay equal taxes ("horizontal equity") and those with greater ability should pay greater taxes ("vertical equity"). These standards are derived from a philosophy of "utilitarianism" (Bentham, 1791; Mill, 1863), in which equity is defined in terms of the final distribution of household happiness (or "utility"). There are of course other possible views of equity. Rawls (1971) argued that individuals standing behind a "veil of ignorance" with no knowledge of their actual income would agree that a just distribution of income was one in which each person had an equal claim to basic rights and

[1] For example, see especially *Capital in the 21st century* by Piketty (2014), *The triumph of injustice – How the rich dodge taxes and how to make them pay* by Saez and Zucman (2019), and *CEQ – Estimating the impact of fiscal policy on inequality and poverty* by Lustig (2023) and her collaborators. See also various publications by the Center on Budget and Policy Priorities (https://www.cbpp.org/), the Economic Policy Institute (https://www.epi.org/), Oxfam (https://www.oxfam.org/en), ProPublica (https://www.propublica.org/), and the Tax Policy Center of the Urban Institute and the Brookings Institution (https://www.taxpolicycenter.org/), as well as the work of international organizations like the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), and the World Bank. These many publications make the argument that the income gains in the U.S. were widely and equally shared across income groups in the years immediately following World War II, that the income gains since 1980 have gone mainly to the top income groups (especially the top 1 percent of the income distribution, and that the result is that the income concentration at the very top of the income distribution has increased dramatically since 1980. These patterns also tend to hold for many other countries around the world. It should be noted that there is increasing evidence that the often-cited increase in income inequality, at least for the U.S., may be significantly overstated due to the use of flawed data that do not fully consider all taxes paid and all transfers (cash and in-kind) received. See especially Larrimore et al. (2021) and Auten and Splinter (2023). Examples of studies that make similar arguments about changes in the concentration of wealth include Kopczuk (2015), Bricker et al. (2016), Bricker et al. (2018), and Smith et al. (2023).

liberties, and in which inequality was only allowed if it increased the utility of the individual with the lowest utility, often termed the "maximin principle". Nozick (1974) instead argued that justice requires that each individual has a right to consume that which he or she produces (the "entitlement principle"); that is, any redistribution (other than redistribution that corrects past inequity) is unjust because it takes away from the individuals who produced that which is being redistributed. Notions of equity also relate to disparate tax treatment of taxpayers based on their race, ethnicity, or gender; that is, a fair tax system should not impost different tax burdens on individuals simply because of their race, ethnicity, or gender.

Despite these many notions of justice, fairness, and equity, the general notion of "distributive tax justice" seems to be a simple one: the burdens of taxation should be distributed across members of a society in a just or fair or equitable way, however this notion is actually applied. In practice, this operationalization has most always meant that taxes should be higher, both in absolute amounts and in proportions relative to income, on higher income individuals, and also that taxes should not differ across individuals based on their race, ethnicity, or gender. This is the interpretation that I take in this paper.

There is no shortage of tax policies that have been suggested to achieve distributive tax justice. In this paper, I briefly discuss the many tax reform proposals that have been made by many others for the specific case of the United States. I then focus on a different set of my own specific U.S. tax reforms that are, I believe, both feasible and effective in achieving distributive tax justice. If implemented, these policies would increase the taxes paid by the rich, reduce tax evasion by the rich, and decrease the disparate tax treatment of individuals that exists simply because of their race, ethnicity, or gender, all of which would lead to what I believe would be a fairer tax system. Admittedly, these policies emerge from a focus on the specific features of the

U.S. tax system, but I believe that these policies are applicable in some form to most other countries around the world.

My basic themes are that tax changes must be feasible and effective rather than simply aspirational but that even within this somewhat limiting framework much can be done. Specifically, these policies all work through existing taxes, they are all administratively (if not necessarily politically) feasible and effective, none of these policies raises statutory marginal tax rates, these policies are all broadly consistent with the standard "Broad Base, Low Rate" approach to tax reform[2], and variants of all of these policies apply world-wide. Finally, these policies do not preclude other tax reforms that can help achieve distributive tax justice.

In the next section, I outline the many tax policies that have been suggested by various individuals and organizations, all of which are intended to increase taxes on the rich. I then discuss in detiail my own "feasible and effective" tax policies, followed by my reasons for avoiding some of the other prominent tax reforms suggested by others (including taxes on wealth and on businesses). I conclude in the final section.

2. A general menu of suggested reforms

Policy makers have proposed a long list of tax reforms that could in principle promote distributive tax justice by imposing greater absolute and relative tax burdens on higher income individuals. This list is based on the proposals suggested by many analysts, including Kamin (2015), Batchelder and Kamin (2019), Saez and Zucman (2019), Sarin et al. (2019), Scheuer and Slemod (2021), World Bank (2022), Oxfam (2023), and Gale and Vignaux (2023); see also the recent 2023 issue of the *Oxford Review of Economic Policy*. This list is far from exhaustive.

[2] See Alm (2018) for a discussion – and a critique – of this approach to tax design and reform.

I list these many tax reform proposals, classifying them by their specific tax reform type (e.g., individual income tax, corporate income tax, wealth tax). For brevity, I do not go into the details of each proposal, even though these details are of course essential to their implementation and their impact.

For the individual income tax, these proposals include the following:

- Raise marginal tax rates on the rich
- Cap tax deductions for the rich
- End the pass-through deduction
- Eliminate the carried interest tax preference
- Close individual tax shelters
- Expand the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC)
- Raise marginal tax rates on (realized) capital gains
- Impose a minimum tax on the rich (e.g., the so-called "Buffett rule")
- Tax capital gains as they accrue.

For the corporate/business income tax, proposals include:

- Raise the corporate income tax rate
- Close corporate tax shelters
- Eliminate corporate tax preferences (e.g., accelerated cost recovery)
- Tax corporate income where consumers are located (e.g., the Base Erosion Profit Shifting (BEPS) 2.0 Pillar One)
- Enact a global minimum corporate income tax (the BEPS 2.0 Pillar Two).

Proposals for a wealth tax include:

- Enact an annual wealth tax
- Enact a one-time "billionaire wealth tax"
- Reform the estate and gift tax
- Expand local property taxes.

There are also proposals for new types of taxes, such as:

- Impose a value-added tax (VAT)
- Enact a financial transactions tax
- Enact a personal consumption tax.

There are many positive aspects of these many proposals. Even so, I believe that are other policies that are both feasible and effective in achieving distributive tax justice. In the next section, I discuss in detail three such reform proposals that meet these requirements of feasibility and effectiveness.

3. A specific menu of feasible and effective reforms

> "Let me tell you about the very rich. They are different from you and me...They think, deep in their hearts, that they are better than we are...They are different."
>
> F. Scott Fitzgerald

> "The rich and the poor are differentiated by their incomes and nothing else, and the average millionaire is only the average dishwasher dressed in a new suit."
>
> George Orwell

As suggested by these famous quotes, there may well be some differences between the "rich" and the rest of us, but a – and perhaps the – major difference relates to their income. Indeed, the main challenge of taxing the rich is that the rich really are different than the rest of us, at least in terms of the ways in which they earn income. However one defines the rich, they receive large amounts of their income from their ownership of capital, via the business income generated by this ownership and, especially, via the capital gains generated by this ownership. Recent statistics from the U.S. Internal Revenue Service (IRS) for the tax year 2020 shows that about 80 percent of the income of the bottom 95 percent of taxpayers (or those taxpayers with adjusted gross income (AGI) less than USD 200,000) is received in the form of wages and salaries, and only 3 (4) percent of their income is generated by capital gains (business income). For the top 5 percent (above USD 200,000), the top 1 percent (above USD 500,000), the top 0.1 percent (above USD 2 million), and the top 0.001 percent (above USD 53 million) of taxpayers, wages and salaries are a very small and rapidly decreasing percentage of their income, and

capital gains / business income are a dominant and increasing percentage of their income. For the top 0.001 percentile of taxpayers, wages and salaries account for slightly more than 10 percent of their income, while business income generates about 15 percent of their income and capital gains generate nearly 80 percent of their income.

How can the rich – and especially of the very rich – be taxed, given that so much of their income is in the form of income from capital income and, especially, income from capital gains?

There are, I believe, several ways of taxing the rich, ways that are feasible and effective. Remember again that these policies are probably more relevant for the U.S. and other developed countries. Even so, they are still applicable outside these countries.

In brief, these policies include:

(1) Make taxes more just by taxing now-untaxed income: *Tax capital gains by eliminating stepped-up basis at death.*

(2) Make taxes more just by making people pay legally due taxes: *Increase enforcement, especially on the rich.*

(3) Make taxes more just by reducing disparate tax treatment by race, ethnicity, and gender: *Move to the individual as the taxable unit in the individual income tax.*

And remember also that these policies all work through existing taxes, they are are all administratively (if not necessarily politically) feasible and effective, none of these policies raises statutory marginal tax rates, all of these policies are broadly consistent with the standard "Broad Base, Low Rate" approach to tax reform, and variants of all of these policies apply world-wide. They also do not preclude other tax reforms that can help achieve distributive tax justice.

Consider each of these policies in more detail.

(1) Tax capital gains by eliminating stepped-up basis at death

A “capital gain” occurs if a capital asset is sold or exchanged at a price higher than its “basis,” the original purchase price plus the cost of improvements less depreciation. In most all countries – and certainly the U.S. – when a person inherits an asset, the basis becomes the asset’s fair market value at the time of the owner’s death. This is called a “stepped-up basis” because the basis of the decedent’s asset is “stepped up” to market value.

This stepped-up basis approach to inherited assets was implemented largely because of the difficulty of valuing assets at the time of the enactment of the inheritance tax. Even so, the practicial effect of stepped-up basis on inheritances is to eliminate the individual income tax on any unrealized gain accrued by the decedent at the time of death. This means in turn that there are no capital gains taxes ever collected on the appreciation of capital assets if they are passed on to heirs.

And who benefits from this stepped-up basis policy? The evidence is overwhelming that these tax benefits go almost exclusively to higher income individuals (Kamin, 2015; Soled et al., 2019; Batchelder & Kamin, 2019; Sarin et al., 2019; Clausing & Sarin, 2023).

Here is a simple example that illustrates the operation of stepped-up basis. Suppose that I bought a share of stock many years ago for USD 100 and sold it today for USD 1000. Then I would owe capital gains tax on the realized capital gains of USD 900. However, if I bought the same share of stock for USD 100 and I died before I sold it, then my heirs are allowed to reset the value (or basis) of the stock to the USD 1000 price on day that I died. Thus, if they eventually sold the stock for USD 1000, the USD 900 in the stock’s appreciation over my lifetime would be entirely tax free.

There are several ways of eliminating this tax benefit. One method is by eliminating stepped-up basis and replacing it with an alternative called “carryover basis”, which would mean

that the cost basis of inherited stock for my heirs is the same USD 100 as it was during my lifetime. With carryover basis, the full amount of the capital gains (e.g., USD 900 on a stock sold for USD 1000) would be taxable when the stock is sold. It is this method that I recommend here. Alternatively, these unrealized gains could be taxed at death, just as if the stock had been sold, a policy called "constructive realization" because death is treated as an event equivalent to the sale of the asset.

There have been past efforts in the U.S. to eliminate stepped-up basis. The Tax Reform Act of 1976 would have imposed carryover basis on all inherited assets, but the provision was repealed before it could ever take effect. The Economic Growth and Tax Relief Reconciliation Act of 2001 curtailed stepped-up basis, but only for one year (or 2010). The act limited step-up to USD 1.3 million (plus an additional USD 3 million for surviving spouses) with any additional unrealized gains carried over. The Obama administration proposed repealing stepped-up basis (subject to several exemptions) through constructive realization. The U.S. Department of the Treasury estimated that, together with raising the capital gains rate to 28 percent, this proposal would have raise USD 210 billion over 10 years, and 99 percent of the revenue raised would come from the top 1 percent of households ranked by income. However, these proposals have never been implemented.

Eliminating stepped-up basis is, I believe, a far better way to tax assets than a direct wealth tax, for several reasons. First, the policy is (relatively) easy to administer. The U.S. already uses carryover basis (or fair market value) for gifts, and the law works well. In the past, critics argued that it was impractical to calculate cost basis for, say, long-held stock or privately-held companies. However, third-party reporting and improved technology have made it much easier to determine the basis for marketable securities. While valuing a privately-held business is

never easy, it is manageable, even required, when assets are transferred, and it is certainly less complicated than a wealth tax on the business, where a firm would have to be valued annually.

Second, eliminating stepped-up basis is a modest change to existing law. Because carryover basis already applies to gifts, expanding it to estates could be done by adding to the familiar framework of capital gains taxation. By contrast, a wealth tax is unfamiliar to most Americans (despite the common use of a local property tax).

Third, eliminating stepped-up basis taxes only inherited wealth, not earned wealth. One criticism of a wealth tax is that is does not distinguish between the assets of "trust fund babies" (who inherit their wealth) and those who became rich through hard work and risk-taking. Carryover basis does not directly tax entrepreneurs at all, although it may change their behavior if they are motivated by leaving bequests. It does tax their heirs, but only when they sell appreciated inherited wealth.

Fourth, eliminating stepped-up basis taxes mainly the very rich, as demonstrated by the above calculations from the U.S. Department of the Treasury.

Finally, eliminating stepped-up basis would generate a significant amount of additional tax revenues, estimated by the U.S. Department of the Treasury at USD 25-30 billion per year.

The main difficulty of this policy is political. As noted earlier, there have been several attempts over the years to eliminate stepped-up basis, and these attempts have failed. However, these previous attempts demonstrate that lawmakers have at least recognized that there are strong reasons to reform stepped-up basis. Without underestimating the political difficulties of implementation, I am hopeful that very different current circumstances may lead eventually to elimination – or least to mitigation – of stepped-up basis.[3]

[3] For further discussion of stepped-up basis, see Soled et al. (2017) and Soled et al. (2019).

(2) Increase enforcement, especially on the rich

The basic issue in tax administration – and in enforcing tax laws – has always been getting information on taxpayers and their many activities. For much of the last century tax administrations did not have full and useful information because: many transactions were in cash so that there was no "paper trail"; many types of transactions were not reported via third party information; many types of income were not subject to source withholding; many types of tax shelters were shrouded in secrecy; much income and many assets were hidden in offshore accounts (e.g., tax havens); and many multinational companies were able to shift profits to low-tax jurisdictions (termed "tax avoidance") via transfer prices that were hidden As a result, the "tax gap" – or the difference between what people should legally pay and what they actually pay – existed, persisted, and flourished in many places. Indeed, recent IRS estimates put the U.S. tax gap at roughly USD 500 billion per year, most from underreporting income in the individual income tax (IRS, 2022).

Technological changes have fundamentally affected these practices, in the process fundamentally changing who can and who cannot get away with tax cheating. These technological changes have occurred in multiple areas, including those driven most recently by "digitization", or the transformation of information storage into digital formats (e.g., a series of binary numbers) for use by computers. Computers have opened the doors to information retrieval and storage, information transmission, and information analysis. With the integration of digitization into most all aspects of everyday life, often termed "digitalization", there have been numerous additional technological innovations, creating what Gordon (2016) has referred to as the "Third Industrial Revolution".

Specifically and not exhaustively, these technological changes include:

- Electronic “cash”
- Electronic commerce
- Blockchain technology
- Supply chains
- Peer-to-Peer (P2P) networks
- Monopolization via technology
- Apps and disclosure of personal information
- Biometrics
- “Big data”
- “Deep learning” – including artificial intelligence (AI) and ChatGPT (or “generative pre-trained transformer”, a large language model that works by taking input text from multiple sources and using this input text to predict, repeatedly, the next word of text).

In short, these technological improvements offer the potential for government to generate: better information – more information, more timely information, and more precise information; better analysis of this information; and better systems and policies based on this improved information and enhanced analysis. Of course, these technological improvements are not limited to government. They also offer the potential for private individuals, firms, and organizations to abuse this improvements.. How will these changes in technology affect tax compliance, and how will they affect tax compliance of different income groups?

There are, I believe, conflicting effects of these innovations. There are some aspects of these innovations that will almost certainly lead to *more tax compliance*. In particular, these innovations allow greater government use of third-party information returns and more use of employer tax withholding (along with the shift of labor to “large” firms with better information reporting and employer withholding), they improve the ability of government to track transactions that leave an “electronic trail”, and they lead to a decline in use of cash and an increasing use of digital currencies. These innovations also improve the ability of government to retrieve and store information (e.g., the so-called “Panama papers”), they increase the efficiency

of information transmission (e.g., linked cross-agency governmental databases, linked international data bases and transparency agreements like Base Erosion Profit Shifting (BEPS) and the Foreign Account Tax Compliance Act (FATCA)), and they make possible better information analysis (e.g., cross-checking of VAT receipts, targeting audits, finding behavioral patterns with AI). Technology may also allow for the introduction of various policies that may well improve compliance, such as pre-populated tax returns, electronic filing, and presumptive taxes, all of which are being considered for introduction in the U.S. and some of which have already been introduced in several other countries.

As a result, certain forms of tax evasion will become increasingly more difficult. In particular, compliance will almost certainly increase for individuals with income mainly from wages, interest, and dividends. Put differently, individuals who engage in transactions that leave an electronic trail and who are subject to source withholding and/or third-party information reporting will find it virtually impossible to cheat on their taxes. Such taxpayers represent the vast bulk of taxpayers – both in developed and even in developing countries. These same considerations apply as well to firms.

However, these same technologies are also available to private agents, and so it is possible that these innovations will lead in some cases to *less tax compliance*. The ability of multinational firms to shift profits from high-tax to low-tax jurisdictions has likely increased due to their use of global supply chains, transfer pricing, the location of intangible assets, intra-group debt-shifting, treaty shopping, corporate inversions and headquarters re-locations, and tax deferral techniques. These activities generally benefit multinational firms by reducing their taxes. As discussed in more detail later, the corporate income tax is a somewhat unreliable tool for achieving redistribution because the ultimate incidence of the corporate income tax remains

controversial. Even so, however, there is little doubt that at least some of these benefits from reduced corporate taxes will accrue to the owners of these firms, many of whom are high-income individuals. Of perhaps more relevance for individual taxpayers, these innovations facilitate the use of tax havens, tax shelters, and money laundering, activities that are undertaken most frequently by high-income individuals. As a result, certain other forms of tax evasion will become increasingly easier. In particular, evasion will almost certainly become easier for high-income individuals with better ability to utilize these practices.

Indeed, recent evidence (mainly on corporate profit shifting) by Clausing (2016, 2020), Zucman (2013, 2015), and Torslov et al. (2018) demonstrates the growing extent of these practices by firms; for a somewhat more skeptical view on the growth of these pracitices, see Blouin and Robinson (2019). Of perhaps more interest here, there is also accumulating evidence for the U.S. and elsewhere that clearly indicates that tax evasion is greater – in absolute amounts and in amounts relative to income – at the top of the income scale. See DeBacker et al. (2020) for recent U.S. evidence; for other work, see Alm et al. (1991) for Jamaica, Johns and Slemrod (2010) for the U.S., Alstadsaeter et al. (2018) for Scandinavian, European, Gulf, and Latin American countries, Alstadsaeter et al. (2019) for Scandinavian countries, Saez and Zucman (2019) for the U.S., and Guyton et al. (2021) also for the U.S. All of these studies estimate patterns of greater tax evasion among the rich. These patterns are due largely to the inability of lower income taxpayers to cheat on their taxes because withholding and third-party information reporting applies to the vast bulk of their income, as well as to the ability of higher income taxpayers to cheat on their taxes because much of their income is not subject to withholding and third-party information. In fact, about one-half of the individual income tax gap in the U.S. accrues to income streams from proprietorships, partnerships, and S-corporations, where there is

either little or no information available to the IRS to verify the veracity of tax filings, and this income goes almost entirely to the rich. These same patterns exist in virtually all countries around the world.

Overall, then, it is mainly people at the very top who will be still able to evade, regardless of where these taxpayers reside. Most all other individuals will find it increasingly difficult to cheat on their taxes.

So what should be done? *Increase tax enforcement, especially on the rich.* This can be achieved by various actions that increase administrative enforcement actions, while targeting higher income taxpayers, such as:

- Increasing audit rates
- Increasing audit rates targeted at the rich
- Increasing audit rates targeted at known areas of abuse (e.g., tax shelters, income shifting, tax havens)
- Expanding third party information reporting (e.g., capital gains, partnership income, proprietorship income, rent income)
- Improving information sharing across countries
- Hiring skilled auditors
- Installing updated computer systems
- Utilizing better audit analytics

Indeed, the IRS has indicated that it plans to use the recent legislated increase of its funding – initially specified at USD 80 billion in the Inflation Reduction Act of 2022 but subsequently reduced to USD 60 billion as part of budget negotiations aimed at increasing the U.S. debt ceiling – to make precisely these types of targeted enforcement efforts (along with improved IRS service provision).

There is in fact strong recent evidence by Boning et al. (2023) that increasing enforcement – especially enforcement targeted at the rich – will reduce tax evasion by significant amounts, generating significant amounts of revenues that far exceed the budgeted amount. They estimate that a USD 1 increase in enforcement increases revenues by significantly more than

USD 1, and this “multiplier” is even higher for audits targeted at the rich, reaching as high as USD 6 for audits of the top 0.1 percent of taxpayers. In an especially striking result, Boning et al. (2023) find that the eventual payoff to targeted enforcement spending is even greater than its initial impact; that is, a USD 1 increase in enforcement spending generates even larger amounts of revenues across all income classes in the years following the initial audit, with a cumulative multiplier over the next decade or so that exceeds USD 5 across all income classes and that reaches USD 12 for enforcement spending targeted at the top 10 percent of taxpayers.

In short, the evidence is clear that greater enforcement spending leads to greater taxes paid by the rich, both in absolute amounts and in amounts relative to their income.[4] Indeed, as demonstrated by the work of Boning et al. (2023), the evidence is also clear that greater enforcement spending more than pays for itself, especially when enforcement focuses on the rich.

(3) Move to the individual as the taxable unit in the individual income tax

As noted in the Introduction, notions of distributive tax justice also relate to the ways in which individuals and households are taxed simply because of their race, ethnicity, or gender. In this regard, it is well-established that the U.S. individual income tax treats families differently. Some families face a “marriage penalty” (or “marriage tax”), where they pay more in taxes as a married couple than their combined taxes as singles, especially families in which the two spouses have comparable incomes. Other families receive a “marriage bonus” (or “marriage subsidy”), where married couples pay less in taxes than their combined single tax liabilities, especially

[4] See Alm et al. (2021) for a detailed discussion of the role of technology in tax administration and Alm (2021) for an analysis of the interactions of technology, tax evasion, and inequality. For a recent comprehensive survey of the tax evasion literature, see Alm (2019).

families in which one spouse earns most of the family income. These marriage penalties/bonuses vary by race, with Black couples more likely than white couples to face a marriage penalty, even when their household incomes and other tax-related characteristics are the same.

How can these race-based differences in taxes arise? The income tax code in the U.S. – and in most all other countries – is race-blind by design, and the IRS in fact resists any attempts to even collect racial information. However, despite the race-blind design of the tax code, the effects of the tax code may still disproportionately penalize Black households relative to white households, especially given the many ways in which the tax code interacts with the economic decisions of households.

These race-based differences in household taxes were first highlighted by the many important and pathbreaking publications of Dorothy A. Brown. Her insights have culminated in her recent book, *The whiteness of wealth: How the tax system impoverishes Black Americans – and how we can fix it* (Brown, 2021). For the income tax, Brown argues that Black households are far more likely to incur a marriage penalty than white households. More broadly, marriage penalties/bonuses arise because of the inherent conflict between competing goals of the individual income tax: to have marginal tax rates that increase with income (the goal of *Progressivity*), to have families with equal incomes pay equal taxes (*Horizontal Equity Across Households*), and to ensure that taxes do not change with marriage (*Marriage Neutrality*). It is well known that no individual income tax can achieve all three of these goals of taxation (Berliant and Rothstein, 2003; Alm and Melnik, 2005). Indeed, as emphasized by Steuerle (2006), the marriage penalty/bonus will exist as long as tax rates vary with income and taxes are imposed on joint household income.[5] In fact, scholars have identified many other areas of the tax

[5] To illustrate these difficulties, consider a simple progressive tax structure (roughly comparable with the tax code in the U.S. in 2000), where single individuals are taxed 15 percent on the first USD 30,000 of earned income, 25

code that may impose disparate impacts on minority households, such as the tax treatment of pensions (Brown, 2004), tax provisions for children (Brown, 2005; Jurow Kleiman et al., 2019), and audit procedures and enforcement (Bearer-Friend, 2019, 2022; Dean, 2022).

What is the source of these disparate racial impacts in a race-blind tax code? These disparate impacts occur because of the ways in which the tax code interacts with the economic decisions of households. As argued by Brown in her many publications, there are two main aspects of Black versus white labor market outcomes that contribute to these disparate tax impacts: the *relative* incomes of spouses in Black versus white households, and the *absolute* levels of these spousal incomes in Black versus white households. Brown argues that Black households are more likely to have *relative spousal earning structures* that increase the likelihood that Black households will experience a marriage penalty relative to white households because Black married women are more likely to work than white married women and their incomes are more likely to be closer to their partners' incomes across the income distribution. Because the marriage penalty is higher for equal earning spouses, Black households will likely face a greater (lower) marriage penalty (bonus) than white households. Brown also argues that the *absolute levels of income* in Black versus white married households matters, largely because the ratio of lower-earner to higher-earner income varies by income; that is, Black couples are

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percent on income between USD 30,000 and USD 60,000, and 35 percent on income above USD 60,000; married households are taxed 15 percent on the first USD 40,000 of combined income, 25 percent on income between USD 40,000 and USD 80,000, and 35 percent on income above USD 80,000. This tax structure results in higher earners bearing a higher tax burden, satisfying progressivity. Now consider two hypothetical families with the same total household income, USD 100,000, but different relative spousal earnings. In Household A, each spouse earns USD 50,000; in Household B, one spouse earns USD 100,000 with the other spouse earning USD 0. Filing jointly as a married household, each household faces the same tax liability of USD 23,000 (= 0.15 X 40,000 + 0.25 X 40,000 + 0.35 X 20,000), satisfying horizontal equity across married households. However, Household A faces a marriage penalty of USD 4,000 because taxes as a married household (USD 23,000) are greater than combined taxes as singles (USD 19,000 = 2 X [0.15 X 30,000 + 0.25 X 20,000]). In contrast, Household B receives a marriage bonus of USD 3,000 because taxes as a married household (USD 23,000) are less than combined taxes as singles (USD 26,000 = USD 0 + [0.15 X 30,000 + 0.25 X 30,000 + 0.35 X 40,000]). The goal of marriage neutrality is no longer achieved because marriage generates either a penalty or a bonus, depending on relative household incomes.

more likely to be at absolute income levels with similar ratios of lower-earner to higher-earner income, which again makes it more likely that Black couples wil face a greater (lower) marriage penalty (bonus) than white couples.

Both of these factors taken individually make it more likely that Black couples will face a marriage penalty; taken together, they further increase the likelihood that Black couples will face a marriage penalty. There is of course much heterogeneity across Black and white households. Even so, these two factors suggest that Black households are much more likely to face a marriage penalty, while white households are much more likely to receive a marriage bonus.

However, the existence and the magnitude of these marriage penalties/bonuses is an empirical issue. In very recent work, Alm et al. (2023) build on the work of Brown by quantifying the effects of race on the income taxes paid by married couples using individual micro-level data from the Current Population Survey data for the years 1992 to 2019 (corresponding to tax years 1991 to 2018). They also extend their analysis by calculating of the marriage penalty/bonus by ethnicity.

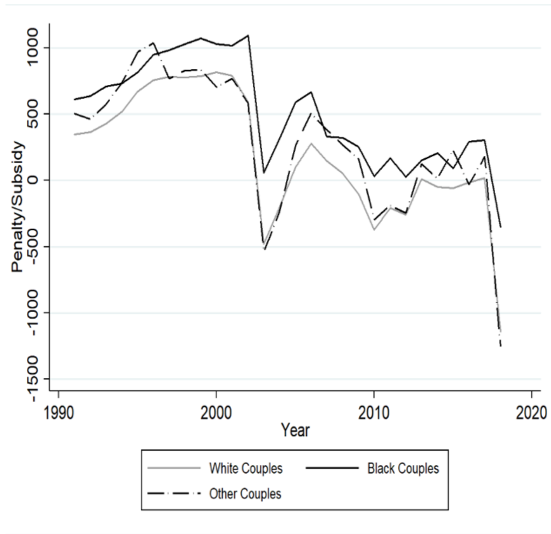
Alm et al. (2023) calculate the marriage penalty/bonus in three steps. First, they calculate the married couple tax liability. Second, they calculate the tax liabilities of each person in the household as if the couple was "divorced" and each person was "single", and they then add these two individual tax liabilities to get their combined tax liabilities as singles. Third, the difference in tax liability for the married couple when filing jointly versus the combined tax liabilities when filing as single persons (or head of household when claiming dependents) constitutes each couple's marriage penalty (if positive) or marriage bonus (if negative). They then estimate all tax liabilities across all households and all years of their sample using the National Bureau of

Economic Research (NBER) TAXSIM model. There are of course many other assumptions that go into these three seemingly “simple” steps.

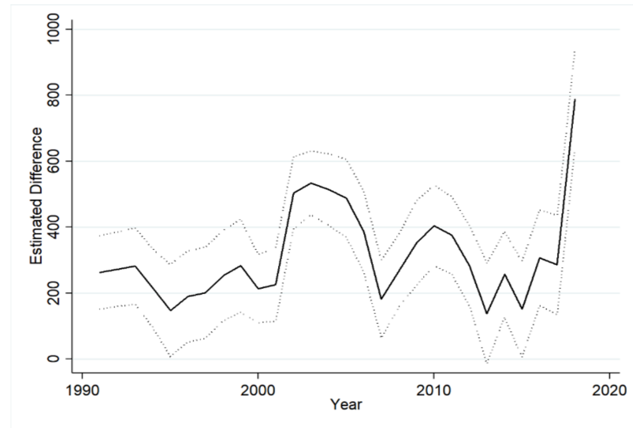
Alm et al. (2023) find that the U.S. income tax is not neutral by race.[6] Black married couples nearly always face an average marriage penalty, paying more in income taxes than white married couples with similar family income. This largely occurs because the incomes of Black married couples tend to be more evenly split between spouses than the incomes of white married couples. They also find that the U.S. income tax is not neutral by ethnicity. The average differences between non-Hispanic couples and Hispanic couples tend to be smaller than the differences between whites and Blacks, but nonetheless these differences are often present, with Hispanic couples also facing a larger marriage penalty in most years than non-Hispanic couples. See Figure 1 for Black versus white households and Figure 2 for Hispanic versus other households, as calculated by Alm et al. (2023). An implication of these results is that the income tax also imposes higher marginal tax rates on the family’s secondary earner, who is typically the woman.

[6] See also Holtzblatt et al. (2023) for broadly similar results using different data and methods.

Figure 1. Average Marriage Penalty/Bonus by Race

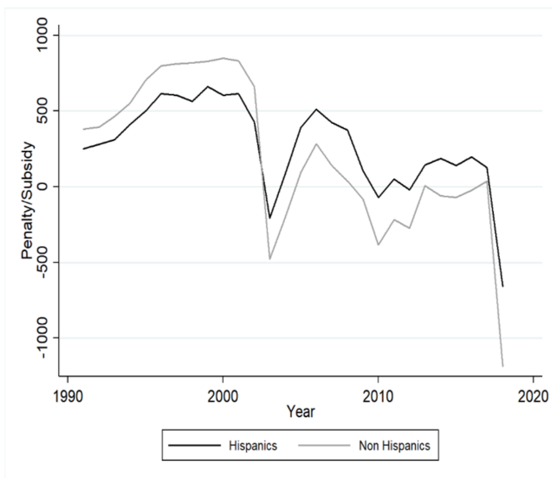


(A) Average Marriage Penalty/Bonus

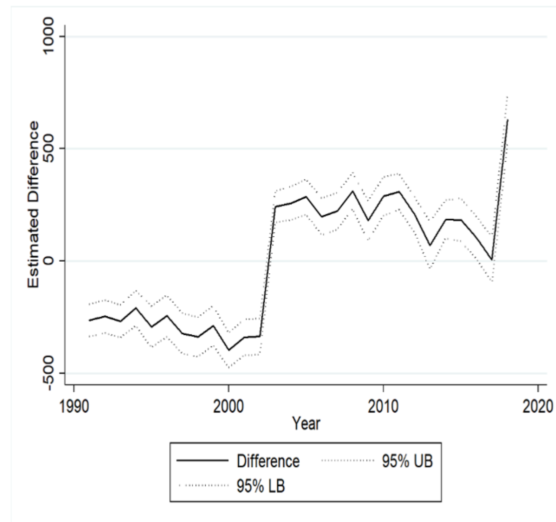


(B) Difference Between Black and White Couples

Figure 2. Average Marriage Penalty/Bonus by Hispanic Ethnicity



(A) Average Marriage Penalty/Bonus



(B) Difference Between Hispanic and Non-Hispanic Couples

What might be done to eliminate this disparate income tax treatment by race and ethnicity? One reform would be to make the individual the unit of taxation – a change that would also likely increase tax collections in the absence of other statutory tax changes; that is, *move to the individual as the taxable unit in the individual income tax*. Individual taxation is in fact the practice – and the trend – in many countries around the world (Alm and Melnik, 2005). Even so, this reform (and many others in the income tax) would only reduce marriage penalties and bonuses in the individual income tax, and there would still be marriage penalties and bonuses throughout other parts of the tax and transfer system. This reform would also raise many difficult issues: it would affect horizontal and vertical equity; it would require rules to allocate capital income, deductions, and dependents; it would add considerable complexity; and it would allow "creative" couples to find ways to shift certain forms of capital income to the partner facing the lower marginal tax rate, creating marriage subsidies or, more pointedly, singles penalties.

There are other possible reforms that would eliminate, or at least reduce, these disparate tax treatments. Couples could be allowed the choice of filing as a married couple, as singles, or (if children are present) as head of household. A secondary earner deduction or credit, to reduce the marginal tax rate on the secondary earner. A different type of reform would be to ensure that enforcement actions do not have disparate effects by race, as current IRS enforcement policies have been shown to do.

In any event, there are no easy solutions here, given the desire to have an income tax that achieves progressivity, horizontal equity across families, and marriage neutrality. Tradeoffs across these desirable but conflicting goals are inevitable.

4. What about other taxes?

There are of many other tax policies that have been suggested. Here I consider several of these more prominent proposals – and then I reject them.

Increasing taxes on businesses is a common policy prescription, such as via increasing the U.S. corporate income tax (CIT) rate, removing corporate tax preferences (e.g., accelerated cost recovery), establishing a global minimum corporate income tax, and perhaps even changing the practice of international taxation. For example, see recent work by Clausing et al. (2020) on a global minimum corporate income tax, and Avi-Yonah and Clausing (2019), Mason (2020), and Devereux et al. (2020) on comprehensive reform of international taxation. In all of these prescriptions, distributive tax justice has been the dominant framing for the CIT reforms. Typical statements of this sentiment include:

- "People are furious that, while they are working hard and paying their fair share, big corporations are cheating the system to avoid paying theirs. These companies enjoy the benefits of our public services and infrastructure, so they should make a fair contribution towards funding them" (OECD, 2013).
- "When the largest digital multinationals don't pay their fair share of tax, the rest of us end up paying more" (*Financial Times*).

Implicit in these sentiments is the belief that the burden, or the "incidence", of the CIT is on the owners of the corporations (or on the owners of capital more broadly), rather than on consumers of corporate products or workers of corporations. However, this belief is almost certainly incorrect.

The best and most recent available evidence suggests that the CIT is in fact not a very effective tool for progressive redistribution.[7] Suárez Serrato and Zidar (2016) conclude that firm owners bear roughly 40 percent of the incidence, while workers and landowners bear respectively 30-35 percent and 25-30 percent of the burden of the CIT. Similarly, Fuest et al.

[7] For a comprehensive review and assessment of the literature on the incidence of the corporate income tax, see Auerbach (2006).

(2018) write that "[w]e find that workers bear about one-half of the total tax burden [and] we show that low-skilled, young, and female employees bear a larger share of the tax burden." Most recently, Baker et al. (2023) conclude that the incidence of the CIT is shared almost equally by consumers, workers, and shareholders.

Given these recent results, Devereux et al. (2020) conclude that:

> "A tax on business profit (at least at a business level) [is] a weak instrument in the design of a fair and progressive tax system. In aiming for a fair and progressive tax system, it is less suitable than taxes levied directly on better off individuals—on their income, wealth, or transfers—as long as such taxes are feasible to implement and administer."

So I do not include corporate tax increases in my own policy menu.

Imposing a wealth tax, as proposed by Piketty (2014) and Saez and Zucman (2019), is also a common policy prescription. Senator Elizabeth Warren (who has been advised by Saez and Zucman) made a wealth tax a centerpiece of her unsuccessful 2020 U.S. presidential campaign, and other progressive politicians like Senator Bernie Sanders and Representative Alexandria Ocasio-Cortez have also called for a wealth tax. Relatedly, Saez and Zucman (2019) have called for a so-called "billionaire wealth tax" on the accrued but untaxed capital gains of individuals with estimated wealth in excess of USD 1 billion.

However, there is much evidence that a wealth tax would be ineffective as a tool for distributive tax justice. There are several reasons for this conclusion. A wealth tax has been tried, but then abandoned, in most OECD countries. There are many daunting administrative issues, especially valuation and liquidity – much wealth is in the form of non-marketable assets, so that annual valuation is difficult and taxes might require owners to sell assets due to illiquidity. There are family unit issues. There are also significant and negative efficiency effects. For example, there is much empirical evidence that a wealth tax will likely reduce investments, risk-taking, and business formation, and it will encourage gaming and other tax avoidance/evasion strategies.

Its revenues are almost certainly overestimated, given the range of possible behavioral responses. A wealth seems unlikely to have any real impact on the political influence of the rich. Finally, a wealth tax may not even be constitutional in the U.S., given the constitutional prohibition of direct taxes on individuals unless the direct tax is apportioned on the basis of the population of each state. Indeed, the U.S. Supreme Court has recently heard arguments on a case (*Moore v. United States*) that may decide the constitutionality of a federal wealth tax. Overall, then, I believe that there are better ways of taxing the rich and their wealth, and so I do not include a wealth tax in my own policy menu.

There are many other common policy prescriptions. Increasing marginal tax rates in the individual income tax is often suggested, sometimes to as high a level as 70 percent on top incomes. There are some compelling reasons for this policy, but there is also much empirical evidence that higher tax rates will have significant and negative efficiency effects, so that revenue projections are almost certain to be too optimistic given behavioral responses and tax avoidance/evasion strategies. Similarly, there are good reasons for increasing marginal tax rates on (realized) capital gains, but once again there is much empirical evidence that there will be negative efficiency effects and overly optimistic revenue projections. There are similar objections to reforming the estate tax (especially lowering the exemption level). As a result, I do not include any of these proposals in my own policy menu.

5. Conclusions

Improving distributive justice via tax and other policies is possible, but it requires the political will to do so. Still, I believe that some options are more feasible and more effective than others, especially those that do not require entirely new tax administration machinery, do not rest

on unrealistic assumptions regarding behavioral responses, and do recognize that redistribution occurs via multiple avenues, including some avenues that do not require changes in marginal tax rates and that address disparate tax treatments by race, ethnicity, and gender.

Recall again several things about my own policy menu of taxing capital gains by eliminating stepped-up basis at death, increasing enforcement, especially on the rich, and moving to the individual as the taxable unit in the individual income tax:

- These policies all work through existing taxes.
- These policies are all administratively feasible.
- None of these policies raises statutory marginal tax rates.
- These policies are all broadly consistent with the standard "Broad Base, Low Rate" approach to tax reform.
- Variants of all of these policies apply world-wide.

This last feature is especially important. My specific list of feasible and effective policies is U.S.-specific. However, the common elements of these policies, elements that apply everywhere, are finding some way to tax the capital gains of the rich, finding some way to ensure that everyone – especially the rich – pays their legally due taxes, and finding some way to eliminate disparate race/ethnicity/gender impacts because of the ways in which tax codes interact with economic decisions. It is certainly possible to find country-specific policies that achieve these goals.

My policy menu is admittedly a short one, and there are good reasons for expanding this menu to other policies. These policies include such things as: capping tax deductions at (say) a marginal tax rate of 28 percent; repealing the 20 percent pass-through deduction; closing the carried interest provision; reducing corporate individual tax shelters; and expanding local property taxation. All of these policies are estimated to generate considerable amounts of revenues, most all of which would be paid mainly by higher income taxpayers.

As always, there are some limitations to my recommendations. I have focused entirely on individual tax policies, with these taxes treated separately and independently. It is necessary to

consider the ways in which all taxes combined affect the tax liabilities of individuals, especially the rich. More importantly, it is necessary to remember that it is often via expenditure policies of the government budget that the most effective distributional policies exist, especially cash transfers like the Earned Income Tax Credit and the Child Tax Credit, as well as social safety net and social insurance programs. An obvious challenge is that quantifying the distributional effects of many government expenditure policies is very difficult. However, it is the incidence of this entire fiscal system – taxes and expenditures – that is of most importance for achieving distributive justice in a fiscal system.[8]

The challenges that we face are coming up with policy recommendations are twofold. Policies must be both feasible and effective. Policies must also be implemented via the political process. As I have argued and demonstrated here, there is no shortage of policies that pass the first hurdle. The second hurdle is the more difficult one, one that is far from ensured.

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[8] For a promising if still evolving methodology for performing expenditure incidence analysis, especially on government infrastructure projects, see Alm and Khan (2023).

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