CONSUMPTION TAXES AND THE CONSTITUTION

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ABSTRACT

In the aftermath of Moore v. United States*, there has been a modest rise in interest in U.S. consumption taxes, not only for revenue raising but as a response to inequality. This Article argues that these consumption tax proposals are not likely to be a satisfactory response to inequality, even if they may have other features to recommend them for more limited purposes. For example, to achieve inter-temporal neutrality, a cash-flow consumption tax requires one of three other conditions: (1) Taxpayers derive no utility from wealth or investment; (2) all utility from wealth or investment is taxed as imputed income as it is "consumed"; or (3) taxpayers receive no deductions for investments that provide consumption value. I argue that violations of condition 1 are large and important to household decision-making, especially among the very wealthy, while condition 3 is not administratively achievable in a world where condition 1 is widely violated. It is also well-known that a cash-flow consumption tax must tax borrowing.*

Consumption taxes thus must likely tax both borrowing and imputed income to function, but unfortunately, both these requirements face many of the same constitutional questions that critics raise with respect to wealth and mark-to-market taxes. Taxes on imputed income closely resemble, in both operation and potential administrative difficulties, a tax on wealth. District court opinions following Eisner v. Macomber *held that cancellation of indebtedness income was outside the Sixteenth Amendment definition, and there has been similar debate at times about the tax treatment of embezzlers.*

In short, it appears that consumption taxes do not offer an easy solution to contemporary inequality and would carry much the same constitutional risk as proposals that directly address the problem.

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INTRODUCTION

In the first half of 2025, U.S. tax policy lurched unexpectedly in a new direction. At the same time that traditional income, corporate, and estate taxes were slashed by more than $3.5 trillion, the administration imposed large new tariffs that it claimed would potentially generate trillions in replacement revenue.[1] As of this writing the legal fate of many of those tariffs is uncertain, but the larger policy question remains: Should the U.S. continue to move towards "consumption" taxes, such as tariffs, while continuing to whittle away at the tax burden on savings and investment?

Recent legal developments at the Supreme Court arguably offer a tailwind for the consumption-tax endeavor. In its 2024 decision in *Moore v. United States*, the Court suggested that taxes on investments might be unconstitutional if imposed at a time other than when the investment property is sold.[2] Yet a system that depends on sales is highly vulnerable to gaming and avoidance by wealthy households who can afford the luxury of waiting to cash in on their investment proceeds.[3] The Court's decision seems to potentially take off the table important alternatives that might

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1. CONG. BUDGET OFF., ESTIMATED BUDGETARY EFFECTS OF PUBLIC LAW 119-21, TO PROVIDE FOR RECONCILIATION PURSUANT TO TITLE II OF H. CON. RES. 14, RELATIVE TO CBO'S JANUARY 2025 BASELINE (2025), https://www.cbo.gov/system/files/2025-07/61570-pl119-21-2025 Recon-CLB.xlsx [https://perma.cc/H8JW-4Y4T].
2. 602 U.S. 572, 598–99 (2024).
3. Brian Galle, David Gamage & Darien Shanske, *Solving the Valuation Challenge: The ULTRA Method for Taxing Extreme Wealth*, 72 DUKE L.J. 1257, 1270–72 (2023).

address this problem, such as annual taxes on wealth. It might seem, then, that a fairer and more progressive system built using only instruments like tariffs—if one could be constructed—is now more likely to survive judicial scrutiny than an approach incorporating wealth taxes.

Some commenters, for instance, note that a value-added tax (VAT) would function as a tax on existing wealth, and would clearly be an "excise" tax that would not be subject to constitutional limits.[4] Others suggest that difficulties in taxing capital income might be a reason to move towards a cash-flow consumption tax (CFCT) with progressive rates, which resembles an income tax with deductions for savings but an income-inclusion for borrowed funds.[5] A CFCT can be collected either at the individual or firm level.[6] In the past, commentators have also suggested systems in which only wages are taxed, sometimes paired with various forms of entity-level tax on businesses to achieve greater progressivity (sometimes called the "X tax").[7]

This Article argues that these consumption tax proposals are not likely to be a satisfactory response to inequality, even if they may have other features to recommend them for more limited purposes. First, it argues that the CFCT is the most economically appealing of the various options. While a VAT may have considerable revenue potential, and may even be able to raise some funds efficiently and somewhat progressively when paired with rebates or progressive spending programs, it is ineffective as a tool of redistribution at the top. A VAT is a wealth tax only over many generations. Further, in a world today where very wealthy households get enormous personal satisfaction simply from owning and wielding their wealth, the VAT would miss a large portion of rich families' consumption and indeed would distort their choices away from purchases and towards wealth accumulation.

While the CFCT can achieve some degree of redistribution for top earners, it also has important limitations, and I argue that any realistic instantiation of a CFCT will probably fail to achieve the tax's key neutrality goals. That is, the strongest traditional argument for a CFCT is that it

4. Reuven S. Avi-Yonah, *Are We Trapped by Realization?*, 188 TAX NOTES FED. 255, 256 (2025); *see* David Gamage, John R. Brooks & Edward J. McCaffery, Moore *Questions, Some Answers: Fixing the Personal Tax System Despite Constitutional Constraints*, 28 FLA. TAX REV. 381, 424–27 (2025) (noting possibility of "supplementing" income tax with VAT in response to constitutional challenges).

5. *See* Gamage et al., *supra* note 4, at 421–22 (noting this is the solution preferred by Prof. McCaffery).

6. *See* Alan Auerbach, Michael P. Devereux, Michael Keen & John Vella, *Destination-Based Cash Flow Taxation* 11–15 (Oxford Univ. Ctr. for Bus. Tax'n, Working Paper 17/01, 2017) (analyzing a cash-flow tax imposed on business entities).

7. *E.g.*, David F. Bradford, *A Tax System for the Twenty-First Century*, *in* TOWARD FUNDAMENTAL TAX REFORM 11, 13–16 (Alan J. Auerbach & Kevin A. Hassett eds., 2005).

supposedly equalizes the cost of consumption across time periods, leaving households indifferent about whether to spend or save in any given period.[8] It's well-known that this claim holds only if borrowing is taxed as income. CFCT proponents also recognize that a CFCT must satisfy one of three other key requirements: (1) Taxpayers derive no utility from wealth or investment; (2) all utility from wealth or investment is taxed as imputed income as it is "consumed"; or (3) taxpayers receive no deductions for investments that provide consumption value. I argue that violations of condition 1 are large and important to household decision-making, especially among the very wealthy, while condition 3 is not administratively achievable in a world where condition 1 is widely violated. A CFCT thus has to tax both borrowing and imputed income to function.

Unfortunately, both these requirements face many of the same constitutional questions that critics raise with respect to wealth and mark-to-market taxes.[9] Even if condition 2 were administrable, it is unclear whether courts would consider imputed income to be within the original (or other) meaning of the Sixteenth Amendment, the provision at issue in the *Moore* case. Imputed income from owner-occupied housing was a common feature of world income-tax systems and was the law in the state of Wisconsin when the Sixteenth Amendment was adopted in 1913. Taxes on imputed income do not seem to accord with a rule that property gains can only be taxed at sale, however. Even if imputed income from housing were permitted as a sort of grandfathered exception, spending-period neutrality would also require a tax on many other sources of imputed income, especially the exercise of political power and influence. Such a tax would closely resemble, in both operation and potential administrative difficulties, a tax on wealth.

Borrowing, too, has *Moore* troubles. District court opinions in the early history of the modern income tax held that new indebtedness was outside the Sixteenth Amendment definition of income, and the Court seemed to initially agree, before reversing course without much explanation. In the 1960s, the Court similarly lurched back and forth about whether embezzlers have taxable income, with some justices again asserting that embezzled

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8. For discussion of these points, see *infra* Part V.

9. I discuss the points in this paragraph *infra* Section V.B. My arguments about the constitutionality of a CFCT are distinct from the claim by Erik Jensen that such a tax would not be a tax on "income." Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334, 2413 (1997). As best I can tell, the basis of that argument is that the CFCT omits too many elements of what Jensen considers to be income "in any generally accepted sense." *Id.* at 2410–12. I have earlier explained how that argument is both tautological and otherwise unpersuasive. Brian Galle, *The Taxing Power, the Affordable Care Act, and the Limits of Constitutional Compromise*, 120 YALE L.J. ONLINE 407, 417–19 (2011).

funds are not "income" in the constitutional sense, largely for the same reasons that early courts had found debt not to be taxable. Though these questions are thus technically settled law, they offer a path for the current Court to raise questions about whether a borrower can really have taxable "income" as a result of going into debt.

In short, it appears that consumption taxes do not offer an easy solution to contemporary inequality and would carry much the same constitutional risk as proposals that more directly address the problem. This does not mean surrender to the problems of an income-tax system that taxes only at sale. In other work, I argue that "retrospective" taxes that can mimic the economic impact of a wealth tax are likely the most appealing option.[10]

I. BACKGROUND: TAXING THE SAVINGS OF THE ULTRARICH

One of tax policy's most enduring debates is over whether tax systems should aim to burden investments and other wealth accumulation, or whether instead a tax system should solely draw on what households actually spend. This latter approach is usually called a "consumption tax." The most familiar example is a simple sales tax, but there are a number of other versions, as we will see.

The basic intuition in favor of consumption taxes over tax systems that would burden savings rests on the claim that we want to minimize the ways in which tax law changes private behavior. A tax on savings, the argument goes, changes households' decisions about when to spend their money.[11] A system that includes a tax on savings hits households twice: once when they earn money in the first place, and then again when they invest it successfully.[12] As a result, money spent out of invested dollars faces a higher effective tax rate than money that is spent immediately. Over long periods of time, in particular, the effective rate even for a modest tax on investments can be very substantial due to compounding.[13] Since it will be cheaper to spend now than later, these effects are said to encourage present consumption and discourage savings.[14]

As I develop at more length elsewhere, research over the past two decades has undercut what once was a fairly broad consensus behind

10. BRIAN GALLE, HOW TO TAX THE ULTRARICH 11–22 (2026).

11. Joseph Bankman & David A. Weisbach, *The Superiority of an Ideal Consumption Tax over an Ideal Income Tax*, 58 STAN. L. REV. 1413, 1422–27 (2006).

12. *Id.* at 1422.

13. Alan Auerbach, *Tax Reform in the Twenty-First Century*, *in* FUNDAMENTAL TAX REFORM: ISSUES, CHOICES, AND IMPLICATIONS 27, 30–31 (John W. Diamond & George R. Zodrow eds., 2008).

14. *Id.*

consumption taxes.[15] The claim that taxing savings is more economically damaging than consumption taxation rests on a number of factual assumptions, some of which do not seem to hold in many cases. Even if the predictions of the consumption-tax models prove true, other factors may weigh more strongly in favor of taxing savings anyway. For instance, the ability to accumulate savings, especially in massive quantities, may be the best marker we have for a household's ability to pay tax.

Another reason to tax wealth accumulation, I have argued, is because of its power to deliver unmatched social influence.[16] Today, massive wealth grants its owners the ability to shape both markets and the marketplace for ideas. With those tools, they can readily achieve personal or political goals that few others in society can. That fact has several key implications for tax system design. What I want to focus on here is the inference that sufficiently large stores of wealth supply their own "consumption": the power to get things the owner desires without even spending the funds. Traditional consumption taxes, such as the sales tax, do not reach this form of consumption.[17]

Unfortunately, it is difficult to effectively tax the wealth of the very rich in the U.S. today because of our reliance on the realization principle.[18] Realization is simply the convention under which we only tax increases in wealth at the time of a sale (or "other disposition").[19] Households rich enough to have the luxury of waiting to sell appreciated assets can thus readily delay tax or even eliminate it.[20] If we tried to reduce inequality by raising tax rates on investment gains, many wealthy households would likely respond simply by realizing less or realizing later.[21] In other work, therefore, I examine ways of taxing wealth without relying on the realization principle.[22]

II. REALIZATION AND THE CONSTITUTION

Recent legal developments might complicate the argument against consumption taxes. In 2024, the Supreme Court decided *Moore v. United States*, a case that commenters have read as raising serious questions about

15. GALLE, *supra* note 10, at 53–57.
16. *Id.* at 31–40.
17. *Id.* at 65.
18. Galle et al., *supra* note 3, at 1268–96.
19. I.R.C. § 1001.
20. Greg Leiserson, *Taxing Wealth*, *in* TACKLING THE TAX CODE: EFFICIENT AND EQUITABLE WAYS TO RAISE REVENUE 89, 93 (Jay Shambaugh & Ryan Nunn eds., 2020).
21. GALLE, *supra* note 10, at 42–43.
22. *Id.* at 111–27.

whether a realization-based tax system is constitutionally required.[23] If realization is required, taxing investment gains looks much more difficult. Perhaps, then, *Moore* tips the policy scales back towards consumption taxes, by making them not only economically but also legally appealing. To assess this possibility, let's first review what the Constitution and courts have had to say about taxation in the past, then dig into *Moore* and its implications.

A. Historical Background

The U.S. Constitution provides that "direct Taxes shall be apportioned among the several States . . . according to their respective Numbers . . . . No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census . . . ."[24] This rule of "apportionment" means that any tax that is classified as "direct" has to collect revenue pro rata by state population.[25]

As James Madison famously noted, the Constitution's drafters did not offer a precise definition of what the Constitution meant by the term "direct" tax.[26] An early Supreme Court decision in 1796, which was both argued and decided by men who had drafted the Constitution, held that there were very few taxes that would count as "direct" for constitutional purposes.[27] While not all the justices wrote to explain their views, the Court agreed that a tax on the use, rather than mere ownership, of carriages was not "direct."[28] Between 1869 and 1894, the Court would hold that line several more times, including in 1881 by rejecting the argument that the Civil War income tax was unconstitutional as an unapportioned direct tax.[29]

But the Court then shocked the country by deciding, in the case *Pollock v. Farmers' Loan & Trust Co.*, that the 1894 income tax bill indeed was an unconstitutional, unapportioned direct tax.[30] Taxes on the ownership of both land and other forms of property are direct, the Court decided, and since

23. 602 U.S. 572, 584 (2024); *see* sources cited *supra* note 4.

24. U.S. CONST. art. I, § 2, cl. 3; U.S. CONST. art. I, § 9, cl. 4.

25. Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 CONST. COMMENT. 295, 296 (2004).

26. 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 350 (Max Farrand ed., Yale Univ. Press rev. ed. 1966); *see* Conor Clarke & Ari Glogower, *Apportioned Direct Taxes*, 79 TAX L. REV. (forthcoming 2026) (manuscript at 13–14), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5314120 [https://perma.cc/4J26-TR5E].

27. Hylton v. United States, 3 U.S. (3 Dall.) 171, 175 (1796) (opinion of Chase, J.); *id.* at 180 (opinion of Paterson, J.); *id.* at 183 (opinion of Iredell, J.).

28. *See* Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1, 20–24 (1999) (summarizing and analyzing the *Hylton* opinions).

29. *Id.* at 28; Joseph M. Dodge, *What Federal Taxes Are Subject to the Rule of Apportionment Under the Constitution?*, 11 U. PA. J. CONST. L. 839, 879–82 (2009).

30. AJAY K. MEHROTRA, MAKING THE MODERN AMERICAN FISCAL STATE: LAW, POLITICS, AND THE RISE OF PROGRESSIVE TAXATION, 1877–1929, at 143–84 (Cambridge Univ. Press 2013).

income is "derived from" property, it too must be a direct tax.[31] Widespread anger and disbelief followed.[32]

In response, Congress drafted, and the states then ratified, the Sixteenth Amendment, which went into effect in 1913.[33] The Amendment aimed directly at *Pollock*'s holding, providing that Congress has the power to collect income taxes "from whatever source derived" without apportionment. That is, following the Sixteenth Amendment, there are two ways for a tax to skip the constitutional apportionment requirement. First, the tax needs no apportionment if it is not a "direct" tax imposed solely because of the ownership of property.[34] Second, even if the tax is direct, it doesn't have to be apportioned if it's a tax on "income."[35]

In the wake of the Amendment, only one tax provision has ever flunked the apportionment test. That provision was an income-tax rule that treated pro rata stock dividends as part of the recipient's income. The Court ruled in its 1920 decision in *Eisner v. Macomber* that such stock dividends are not "income" and so are not within the scope of the Sixteenth Amendment.[36] Although the opinion is fairly cryptic, commentators concluded that the core rationale was that, because a pro rata stock dividend doesn't change the recipient's economic wealth (it's just a stock split), the taxpayer "has not realized or received any income in the transaction."[37] Just what that meant wasn't clear. The next year, in applying the *Macomber* precedent, the Court said that it required that the taxpayer get "something of exchangeable value produced by . . . his investment . . . severed from it and drawn by him for his separate use."[38] Somewhat similarly, an individual had income under these rules if they received "an essentially different thing" in exchange for their existing property.[39]

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31. 158 U.S. 601, 618, 629–35 (1895).

32. SIDNEY RATNER, AMERICAN TAXATION: ITS HISTORY AS A SOCIAL FORCE IN DEMOCRACY 214 (1942).

33. *See* John R. Brooks & David Gamage, *Taxation and the Constitution, Reconsidered*, 76 TAX L. REV. 75, 119–26 (2022) (discussing history and early interpretation of the Sixteenth Amendment).

34. *Id.* at 109–10.

35. U.S. CONST. amend. XVI.

36. 252 U.S. 189, 199–201 (1920).

37. *Id.* at 212.

38. United States v. Phellis, 257 U.S. 156, 175 (1921).

39. Marr v. United States, 268 U.S. 536, 541 (1925). In the year before *Marr*, the Court ruled that as a statutory matter, the reincorporation of an entity in the same state does not trigger gains for the shareholders, though it relied on the same realization logic as in *Macomber*. Weiss v. Stearn, 265 U.S. 242, 254 (1924). Similarly, for a brief period the Court believed that cancellation or reduction in indebtedness was not "income," though it was not clear whether that holding was based in the Constitution or just an interpretation of the Internal Revenue Code. Bowers v. Kerbaugh-Empire Co., 271 U.S. 170, 175 (1926), *overruled by* United States v. Kirby Lumber Co., 284 U.S. 1, 3 (1931). Some lower courts did interpret that position as a constitutional holding, though. *E.g.*, Appeal of Meyer Jewelry Co., 3 B.T.A. 1319, 1322–23 (1926).

This is the proposition for which *Macomber* has long been known: An income tax can only be defined by "realized" income, such as from a sale or cash dividend, that provides the taxpayer with something of "exchangeable value" that is "severed from" his underlying investments.[40] Taken at face value, it would seem to rule out an unapportioned tax solely on annual changes in the value of unsold property.

The Court pretty quickly backed away from *Macomber*. By the early 1940s, a series of cases had found income in situations, such as cancellation of prior debts or the return of a rental property to its owner, that could not plausibly meet the *Macomber* definition of realized gains.[41] That led academics, and in 1943 three justices, to declare that *Macomber* was dead.[42] The Court's majority ducked the issue by ruling on statutory grounds, but agreed that these later cases had "undermined . . . the original theoretical bases" of *Macomber*.[43] Mark-to-market provisions imposing tax at times other than realization slowly proliferated in the Internal Revenue Code and consistently were upheld by U.S. courts of appeals.[44] In the 1990s the Court would call the concept of realization a matter of "administrative convenience," defer to the IRS's view of what it meant, and imply strongly that Congress could change it if Congress were so inclined[45]—hardly what you'd expect if realization were a core aspect of the constitutional definition of income.

B. The Moore *Case*

By 2017, essentially everyone but one or two academic gadflies thought that the realization principle was dead, as a constitutional matter. Most readers are probably familiar with what happened next: Congress enacted a tax on U.S. owners of active foreign businesses, with a taxable amount based on the profits of the business that had not yet been subject to U.S. tax.[46] Some individuals who paid the tax challenged it as outside the Sixteenth Amendment definition of "income" because, they said, it represented a tax on unrealized gains under *Macomber*.

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40. *Phellis*, 257 U.S. at 169; *see* Sloan G. Speck, *The Realization Rule as a Legal Standard*, 16 COLUM. J. TAX L. 1, 34 (2024).

41. Joseph M. Dodge, *The Story of* Glenshaw Glass*: Towards a Modern Concept of Gross Income*, *in* TAX STORIES 17, 20, 40 (Paul L. Caron ed., 2d ed. 2009); Alex Zhang, *Rethinking* Eisner v. Macomber*, and the Future of Structural Tax Reform*, 92 GEO. WASH. L. REV. 179, 210–28 (2024).

42. Helvering v. Griffiths, 318 U.S. 371, 404 (1943) (Douglas, J., dissenting).

43. *Id.* at 393–94 (majority opinion).

44. Moore v. United States, 36 F.4th 930, 935–36 (9th Cir. 2022), *aff'd*, 602 U.S. 572 (2024).

45. Cottage Savings Ass'n v. Comm'r, 499 U.S. 554, 559–62 (1991).

46. *Moore*, 602 U.S. at 579.

But the Supreme Court majority decided the *Moore* case not by resurrecting *Macomber*'s realization rule but instead by claiming *Macomber* did not apply to the taxpayers at all.[47] In an opinion by Justice Kavanaugh, the Court held that whether or not the Sixteenth Amendment definition of "income" requires realization, there in fact had already been a realization event for the Moores: when their corporation sold products and earned profits.[48] Thus, whether or not the Constitution in effect demands realization, taxing an equity owner would meet that demand, assuming the business entity itself has realized income.

Even so, the Court also signaled that it did not view realization as a dead letter. *Moore* holds that the government can define an individual's income to include the untaxed profits of a business entity in which the individual holds an equity stake.[49] That holding allowed the Court to take a pass on determining whether there is any constitutional realization requirement. The Court repeated several times, however, in several different ways, that a realization requirement could be a constitutional obstacle to wealth or mark-to-market taxes, and it was not deciding those questions.[50] Four justices argued that realization was constitutionally required.[51]

C. The Meaning of Moore

Where, then, does *Moore* leave efforts to tax unrealized wealth? In part the answer depends on what constitutional scholars sometimes call a "level of generality" problem.[52] As with shareholder-level taxation of corporate profit, there is a long history of mark-to-market provisions in the U.S. income tax, dating back to the Civil War.[53] Before 1913, farmers, insurance companies, businesses holding investment assets, and even homeowners in Wisconsin paid income tax based on unrealized gains or losses.[54] In any future challenge, the government could readily point to these provisions as evidence that at the time of the Sixteenth Amendment, realization was hardly a universal component of "income."

47. *Id.* at 588–89.
48. *Id.*
49. *Id.* at 598.
50. *Id.* at 598–99.
51. *Id.* at 608–12 (Barrett, J., concurring); *id.* at 620 (Thomas, J., dissenting).
52. *E.g.*, Reva B. Siegel, *The Levels-of-Generality Game: "History and Tradition" in the Roberts Court*, 47 HARV. J.L. & PUB. POL'Y 563, 565 (2024).
53. Brief of Amici Curiae Professors of Tax Law, Legal History, and Computational Science in Support of Respondent at 6–11, *Moore*, 602 U.S. 572 (No. 22-800); *see* Clint Wallace & Bret Wells, *The Past and Future of Taxing "Incomes"*, 104 N.C. L. REV. 1, 16–30 (2025).
54. Brief of Amici Curiae Professors of Tax Law, Legal History, and Computational Science in Support of Respondent, *supra* note 53, at 6–11.

Conceivably, though, Justice Kavanaugh might frame the historical question differently. He might ask, "Is there a long historical tradition of broad-based income taxation on a mark-to-market basis, as opposed to certain small special applications?" If that were the question, the answer would be "no." On the other hand, over the last fifty years, mark-to-market rules have evolved into an essential set of anti-abuse devices, particularly with respect to overseas assets and financial instruments.[55] If these were weakened, there would likely be a devastating run on U.S. mutual funds. Yet there are ways out of that dilemma for the Court. A rule that was framed not as "all mark-to-market rules have historical pedigree" but instead less generally as "narrowly applied anti-abuse rules have historical pedigree" would let the Court keep in place these economically vital provisions without blessing broad new efforts to tax unsold wealth. This framing would leave the majority justices with the discretion to decide which favored provisions count as permissibly narrow and which disfavored rules are impermissibly broad.

In short, there now is a fair bit of constitutional uncertainty about whether realization is necessary for an "income" tax. Narrow provisions that rely on mark-to-market principles in support of other income-tax rules might be safe, but more ambitious efforts to rearrange the timing of income taxation for large swathes of untaxed gains might not. Defenders of these provisions have yet more solid arguments to offer, such as the possible suggestion in *Moore* that, since *Pollock* was wrongly decided, income taxes are excises, not "direct" taxes, and so do not need to be apportioned.[56] But these arguments are as yet untested.

III. VALUE-ADDED TAXES

What, then, of consumption tax alternatives? Most countries, with the notable exception of the United States, impose a value-added tax.[57] The VAT resembles the U.S. retail sales tax, but it allows retailers to take a deduction for the costs of their inventory.[58] For example, a retailer who sells \$5 million worth of products but paid \$4 million to acquire those products

55. An especially important but little-known rule is I.R.C. § 1256, which imposes mark-to-market treatment for offsetting positions in options and futures contracts. Without this rule, a sufficiently liquid taxpayer could always wipe out their capital gains for the year at low cost by entering into offsetting positions, then selling the losing side on Dec. 31 and the winning side on Jan. 1.

56. Ari Glogower, *The Constitutional Limits to the Taxing Power*, 93 FORDHAM L. REV. 781, 796 (2024).

57. LIAM EBRILL, MICHAEL KEEN, JEAN-PAUL BODIN & VICTORIA SUMMERS, THE MODERN VAT 9–12 (2001).

58. *Id.* at 1–2, 15–19.

would be taxed on $1 million in net sales. There might be an argument that after *Moore* the U.S. should give more thought to introducing a VAT-type tax, as a classic example of an "indirect" tax that is exempt from the apportionment requirement.

A VAT can be a reasonably effective component of a fair tax system, as thoroughly explored in a careful review by a blue-ribbon UK commission in 2011.[59] It can be efficient to replace some income-tax revenue with a retail consumption tax, because (up to a point) that substitution can swap out highly distortive top income rates for relatively less distortive and lower-rate VAT charges.[60] While that could be true of any tax imposed at the register rather than the payroll, VATs outperform the simpler retail sales tax because they avoid multiple layers of tax on business inputs and incentivize each party in the supply chain to report transactions, facilitating enforcement.[61] This efficiency case is easier to make if the VAT treats all consumption equally, such as by fully taxing services and essentials, though that is uncommon in global VAT systems.[62]

Nonetheless, a VAT likely cannot meaningfully address massive inequality at the top because it does not raise much money from the wealthiest taxpayers.[63] A VAT is a flat tax, so that even with a large exemption amount or rebate it is quite regressive at higher income levels. Although a newly enacted VAT does in theory impose some tax burden on existing stores of wealth, it would take hundreds of years before extremely wealthy households paid any meaningful share of their wealth in VAT.

The ultra-wealthy may also expose an important gap in even the most broad-based VAT system. As I argue in more depth elsewhere, U.S. wealth offers routes to power and personal satisfaction without any express transactions or purchases—even if one counted campaign contributions as taxable transactions.[64] In technical economic lingo, wealth is "in the utility function" for the wealthy, even with zero identifiable consumption as such.[65]

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59. STUART ADAM ET AL., TAX BY DESIGN: THE MIRRLEES REVIEW 148–215 (2011).

60. John Brooks, Brian Galle & Brendan Maher, *Cross-Subsidies: Government's Hidden Pocketbook*, 106 GEO. L.J. 1229, 1249–55 (2018) (discussing the conditions under which it may be efficient to use consumption taxes with rates that vary across goods); Brian Galle, David Gamage & Yulia Kuchumova, *Tax Base Diversification as an Enforcement Tool*, 26 AM. L. & ECON. REV. (forthcoming 2026) (manuscript at 4), https://doi.org/10.2139/ssrn.5093851 [https://perma.cc/NU53-7Z5T] (modeling the claim that differentiated consumption taxes can be efficient).

61. EBRILL ET AL., *supra* note 57, at 15–18.

62. ADAM ET AL., *supra* note 59, at 216–30.

63. Auerbach, *supra* note 13, at 41.

64. GALLE, *supra* note 10, at 34–39.

65. *See* Pascal Michaillat & Emmanuel Saez, *Resolving New Keynesian Anomalies with Wealth in the Utility Function*, 103 REV. ECON. & STATS. 197, 198 (2021).

The fact that vast wealth provides consumption value without any direct spending has two key implications, both bad for the operation of a VAT. For one, it means that a VAT will be even more regressive, because it will tax the ways that most households use their money but fail to tax the unique influence that the very wealthiest can wield without spending. And it means that the wealthy will prefer influence over outright expenditures, since influence is not taxed. Thus, not only would a VAT fail to redistribute wealth at the top, but it would also push wealthy households to use their wealth for their own aggrandizement.

My point is therefore not that the VAT has no important tax policy uses but rather that it is not an effective tool for achieving redistribution at the top of the income range, and hence for addressing the core of modern inequality. Indeed, not only does the VAT fail to change the distribution of wealth among the very rich, but it also fails the supposed premise of a consumption tax, which is to leave taxpayers indifferent between spending and saving. The VAT could actually bend some top households towards further accumulation.

IV. THE WAGE TAX

Wage or "labor income" taxes offer a potential alternative path to a VAT for advocates of consumption taxes. Suppose every dollar a household earns is either spent (consumed) or saved. If so, Henry Simons famously argued, an income tax is just the sum of a tax on consumption plus a tax on savings.[66] With a little algebra, it's easy to then show that a tax on labor income—all income, less income from savings—is a tax on consumption. We'll see this equivalence turns on some key assumptions that are not always satisfied. For now, though, think of a wage tax as a way of taxing consumption through households' paychecks rather than at the register.

A key advantage of collecting a consumption tax through paychecks is that the wage tax is much easier than a VAT to implement with progressive rates. That is the central design element in the "X tax" proposal from David Bradford, later further developed by Robert Carroll and Alan Viard.[67] That

66. HENRY C. SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 50 (1938).

67. ROBERT CARROLL & ALAN D. VIARD, PROGRESSIVE CONSUMPTION TAXATION: THE X TAX REVISITED 34–35 (2012). Carroll & Viard also refer to their proposal as a "real-based" X tax, to distinguish it from a cash-flow consumption tax, which they call either a real-plus-financial tax or a personal expenditure tax. *Id.* at 33. Alan Auerbach calls these instruments an R tax and an R+F tax, respectively. Alan J. Auerbach, *The Future of Capital Income Taxation*, 27 FISCAL STUD. 399, 412 (2006). As the names imply, the "real" tax ignores financial flows such as borrowing and interest, while the R+F tax takes account of these flows as if they were no different from other sources of cash. I call the "real-based" X tax or R tax a "wage tax." I dub the "R+F tax" a "cash-flow consumption tax."

is, a wage tax can be made to look just like the familiar income tax but with an exemption for savings and investment. Top earners might pay tax at a 37 percent rate, each household can get an exemption amount or allowances for the cost of supporting children or elderly parents, and so on. These features would make the wage tax potentially rather more progressive than a VAT alone.

At first glance a wage tax also looks to have constitutional advantages over systems that might seek to tax investment returns. After all, if the Constitution limits "income" to mean realized income, there seems little doubt that salary paid to laborers is realized, the "fruit" of any "tree" of business profits (in *Macomber*'s awkward agricultural metaphor).

A. Defining "Wages": Economic and Legal Problems

This basic case in favor of the wage tax falls apart because it can be quite challenging to identify when labor income is actually paid, as we now know from more than 100 years of experience.[68] Carried interest is the famous example, but there are many others. In a typical carried interest arrangement, an investment fund manager selects investments for clients, and receives in exchange a right to a share (often 20 percent) of any resulting profits (or profits in excess of some threshold return, such as 8 percent).[69] If all these events transpired in one year, we'd have little difficulty concluding that the profits payments should be taxed as labor income. Current U.S. doctrine instead treats the entire profits interest as an investment asset of the manager, taxable only at capital gains rates and only when the fund eventually realizes gains.[70]

Another version of the same problem is the loophole in the Social Security payroll tax base for self-employed individuals. The Social Security tax is almost a perfect wage tax, imposed on "remuneration for employment."[71] But self-employed individuals can avoid it by paying out their business earnings as distributions of profits rather than salary.[72] Tax

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68. Wage-type taxes also offer a set of unique avoidance and arbitrage opportunities in addition to the basic question of what is a "wage." Although these have been known and potential government responses discussed for a long time, it is unclear how effective the anti-abuse rules would prove in reality. *See, e.g.*, Parthasarathi Shome & Christian Schutte, *Cash-Flow Tax* (IMF, Working Paper No. 1993/002, 1993), https://doi.org/10.5089/9781451841688.001 [https://perma.cc/2XUG-STFU].

69. Gregg D. Polsky, *A Compendium of Private Equity Tax Games* 1 & n.2 (UNC Legal Stud., Research Paper No. 2524593, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2524593 [https://perma.cc/DYG8-9XBH].

70. Victor Fleischer, *Two and Twenty: Taxing Partnership Profits in Private Equity Funds*, 83 N.Y.U. L. REV. 1, 10–15 (2008).

71. I.R.C. § 3121(a).

72. Karen C. Burke, *Exploiting the Medicare Tax Loophole*, 21 FLA. TAX REV. 570, 585–86 (2018).

law in theory treats at least a minimal portion of an entrepreneur's profits as a "reasonable" salary, but commentators all generally agree that the regime does not currently work.[73]

A third prominent set of examples centers around various forms of deferred compensation arrangements, such as stock options, "supplemental executive retirement plans," and life insurance policies with large embedded investment components.[74] Broadly speaking, these schemes allow workers who do not need immediate cash to convert some of their compensation income into various forms of investment assets, getting the benefits of tax deferral and often a lower tax rate to boot.[75] Individuals who work for themselves always have the option to simply leave wage earnings inside the firm and harvest them through sale of the firm's equity.[76]

How and when to tax these kinds of earnings is already a fairly agonizing problem under an income tax, where the stakes are relatively low, and a wage tax worsens the problem. With an income tax, the issue is mostly about the appropriate timing and rate to apply. Under a wage tax, though, classifying a payment as investment rather than wages results in full exemption, making each decision more valuable to the taxpayer and costlier for the government. That about guarantees that taxpayers would work even harder to reclassify "wages" as investments, and that both sides would sink more into resolving each dispute.[77]

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73. *See id.*; *see also* Joshua D. Blank & Ari Glogower, *The Tax Information Gap at the Top*, 108 IOWA L. REV. 1597, 1625–26 (2023).

74. *See* David I. Walker, *The Practice and Tax Consequences of Nonqualified Deferred Compensation*, 75 WASH. & LEE L. REV. 2065, 2068 (2018) (executive compensation); Gregg D. Polsky & Brant J. Hellwig, *Taxing the Promise To Pay*, 89 MINN. L. REV. 1092, 1134–37 (2005) (pension arrangements for non-employees); Susan Lorde Martin, *Corporate-Owned Life Insurance: Another Financial Scheme That Takes Advantage of Employees and Shareholders*, 58 U. MIAMI L. REV. 653, 674–76 (2004). After adoption of a complex series of reforms, many insurance arrangements taken out by employers on behalf of executives are now treated as compensation, at least in part, but can sometimes be converted to dividends when used by small-business owners. Blaise Sonnier, Machacek *and* McGowan*: Split Personality, Split-Dollar Life Insurance*, EST. PLAN., Apr. 2024, at 41, 41 (describing the regime and its interaction with rules for taxation of dividends); *see also* Treas. Reg. § 1.61-22(d)(1) (2003) (holding that benefit of receiving life insurance coverage may be treated as either compensation or a distribution to a shareholder).

75. Robert J. Jackson, Jr. & Colleen Honigsberg, *The Hidden Nature of Executive Retirement Pay*, 100 VA. L. REV. 479, 491–93, 506 (2014).

76. William A. Klein, *Timing in Personal Taxation*, 6 J. LEGAL STUD. 461, 463–64 (1977) (describing this strategy for owner-built assets generally). Founders can also take advantage of planning strategies usually reserved for investment gains. Victor Fleischer, *Taxing Founders' Stock*, 59 UCLA L. REV. 60, 72–74 (2011).

77. The incentive may be reduced in a system in which the wage tax is paired with a business-level tax, assuming that the business-level tax rate is equal to or higher than the individual rate. CARROLL & VIARD, *supra* note 67, at 73. Recent experience with the politics of American business "competitiveness" suggests that it is very unlikely we would see a business-level tax at rates approaching those currently paid by top-level earners.

As other commentators have recognized, this definitional problem suggests that a wage tax likely fails in its basic aspiration to achieve neutrality.[78] Everyone will want to earn (or claim that they have earned) "investment" opportunities, not salary. Presumably a sensible wage tax would treat at least some sales of compensatory equity interests as themselves compensation, but households will see a tax advantage if they can hold off selling "investment" assets longer.[79] And by widening the tax wedge between wages and investment even wider than under the income tax, the wage tax encourages even more wasteful and distortive tax planning.

B. Wage Taxes and the Constitution

The definitional problem also undermines what looked like a solid constitutional argument in favor of a wage tax. Again, it seems straightforward that a cash salary is realized income. But the legal rules for a wage tax regime cannot only tax cash on receipt, because then eventually a larger and larger share of the economy would shift away from cash salary into investments and "investments." Many potential legal responses to this problem would run quickly into constitutional *terra incognita*.

To see this, consider the very simple rule courts apply to efforts by the self-employed to evade the Social Security payroll tax. As I mentioned, the IRS has occasionally succeeded in arguing that an individual whose business earns substantial profit, but who reports no wage income, should be deemed instead to have earned a "reasonable" salary.[80] Usually what is reasonable is measured by looking at other similar businesses. But no cash has actually changed hands. Has the entrepreneur realized income, in the constitutional sense, when all of the relevant earnings happen only at the corporate level?

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78. *See* Emmanuel Saez & Stefanie Stantcheva, *A Simpler Theory of Optimal Capital Taxation*, 162 J. PUB. ECON. 120, 126 (2018) (arguing that capital should be taxed if taxpayers can readily recharacterize labor earnings as investment).

79. That is, even though wage-tax proponents often say that it ignores sales of financial assets, in practice the wage tax would likely have to treat the sale of assets acquired by work as compensation at least at the time of a realization event, as in the case of carried interest. *Cf.* CARROLL & VIARD, *supra* note 67, at 151 (noting that related-party transactions would require "strict rules").

80. *See* sources cited *supra* note 73. Carroll and Viard also propose this strategy for implementing their hybrid wage-tax proposal. CARROLL & VIARD, *supra* note 67, at 74. Another option, detailed by Ed Kleinbard, is to tax business owners each year as if they had earned a reasonable return on their investment, and then to adjust total taxes later at sale, along the lines of some Nordic countries. Edward D. Kleinbard, *The Right Tax at the Right Time*, 21 FLA. TAX REV. 208, 211–14 (2017). This deemed annual sale would likely face the same questions about whether it is consistent with the realization rule, since it applies even if no dollars actually change hands between the business and the shareholder.

Though there is a constitutional shortcut here in some cases, that shortcut will likely fail for many others. As we saw earlier, the Court faced a quite similar question in *Moore* and resolved it by holding that the realized income of the business could be attributed to the individual investor.[81] That is all well and mostly good for business owners. Presumably the Social Security "reasonable salary" approach would be constitutional under the same attribution theory with which the Court upheld the MRT, though it might run aground in years in which the underlying business lost money.[82] What, though, about Shohei Ohtani, whose $700 million contract with the Dodgers defers 90 percent of the payments until 2034?[83] What of CEOs who own no part of their company but instead stand to profit from "restricted stock units" that replicate the economics (but not governance rights) of an investment in the company?[84] Could a wage-tax system constitutionally treat any of these promises as wages in a year before they were paid?

To be clear, my argument is not that taxing Shohei or restricted-stock units prior to full payment is certainly unconstitutional but rather that these are precisely the same issues that confront a tax on non-compensatory investment income. Simply exempting investment income, or offering deductions for savings, does nothing to mitigate the constitutional challenge because taxpayers will constantly press the boundaries of the legal definition of "savings" in ways that will demand something other than simplistic response. There will be enormous pressure to in effect subject many forms of compensation to mark-to-market treatment, for the same reason that today there is pressure to subject all other investments to that treatment. While some of these approaches might survive as narrow anti-abuse rules, that path is inherently uncertain, as the borders of what is permissibly narrow seem entirely within the Court's discretion. The Constitution is not a reason to move towards a wage tax.

In sum, a wage tax has many unappealing economic features and no redeeming constitutional advantages. To be sure, the most sophisticated versions of a wage tax shore up some of its economic weak spots by combining it with other taxes. The X tax, for instance, adds on a cash-flow business tax. But while adding another tax might offer some complementary

81. Moore v. United States, 602 U.S. 572, 588–89 (2024).

82. That is, in years when a business shows net losses, there is no business income to pass through to the owner as "salary."

83. Fabian Ardaya, *Shohei Ohtani to Defer $68 Million Per Year in Unusual Arrangement with Dodgers: Source*, THE ATHLETIC (Mar. 25, 2024), https://www.nytimes.com/athletic/5129506/2023/12/11/dodgers-shohei-ohtani-contract-deferrals/ [https://perma.cc/NJ94-CF35].

84. *See* Walker, *supra* note 74, at 2097–98 (describing use of restricted stock units and other "notional" executive investments in their firm).

economic features, the wage tax component remains a wage tax, with all the legal challenges and resulting tax distortions that defining "wages" brings.

V. A CASH-FLOW CONSUMPTION TAX

A third option for taxing consumption is what I will call the cash-flow consumption tax (CFCT).[85] A CFCT starts with the traditional income-tax base, but the taxpayer can take a full deduction for all unconsumed funds, such as purchases of investment assets. The individual is then taxed on all later gross receipts from the sale or use of the investment.[86] This is the sense in which the tax is based on "cash flow": All dollars out—other than those used for immediate consumption—reduce tax while all dollars in increase it. Cash flow includes borrowed funds, which the debtor must include in their tax base.[87] The debtor then receives a deduction for any subsequent interest and principal payments.

Even though the CFCT appears to eventually tax investment earnings, the allowance for an upfront deduction has the economic effect of making the effective tax rate on some of those earnings zero.[88] Allowing immediate deductions for all investment expenditures is often known as "expensing."[89] Expensing is a mistake (in an income tax): It rewards taxpayers who buy equipment instead of renting by granting them deductions immediately rather than over time.[90] Under certain assumptions, the value of this excess reward exactly equals the tax burden imposed on average returns to capital.[91] Two tax wrongs then make a right (for consumption-tax advocates): Through expensing, the CFCT imposes no net tax on investment returns.

But the CFCT does not exempt super-normal returns, sometimes called "economic rents," such as from monopoly patent rights.[92] This differential

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85. Again, Carroll & Viard call this a personal expenditure or "real plus financial" tax, while Auerbach calls it "R+F." *See* sources cited *supra* note 67. McCaffery & Hines call it a "spending tax." Edward J. McCaffery & James R. Hines, Jr., *The Last Best Hope for Progressivity in Tax*, 83 S. CAL. L. REV. 1031, 1043–44 (2010).

86. William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1149 (1974).

87. Andrews proposed that for simplicity there would neither be income nor deductions for short-term consumer debt, which today would presumably include credit-card balances. *Id.* at 1150.

88. Daniel I. Halperin & Alvin C. Warren, Jr., *Understanding Income Tax Deferral*, 67 TAX L. REV. 317, 317–18 (2014).

89. *Id.*

90. *See* Alvin C. Warren, Jr., *Accelerated Capital Recovery, Debt, and Tax Arbitrage*, 38 TAX LAW. 549, 552–53 (1985).

91. *Id.*; *see* Halperin & Warren, *supra* note 88, at 320.

92. *See* Halperin & Warren, *supra* note 88, at 320 (explaining that expensing exempts only the normal return).

treatment is usually presented as an attractive feature of the CFCT. Taxes on rents are thought to be highly efficient, perhaps more efficient than taxes on labor, because they have relatively smaller impact on real economic decisions.[93] By definition, the taxpayer cannot earn super-normal returns through other choices, so taxes are less likely to affect the decision to seek rents. If Effie can earn a 3 percent return normally, or 10 percent by investing in Monopoly Co., it would take a very large tax to get her to abandon her Monopoly Co. position.

A. Defining "Consumption": Economic and Legal Challenges

A CFCT solves several of the legal (and other) problems of a wage tax. For one, a CFCT does not have to distinguish between wages and capital, which as we saw is also one of the key weak points of the modern income tax. Since all unconsumed funds are omitted from the tax base at the end of a year, the CFCT in effect gives every worker an unlimited IRA or tax-favored pension in which their compensation, of whatever form, can be tax-deferred as long as it is unspent. The CFCT therefore also does not need to rely on approximations of wage income that might be subjected to constitutional challenge.

Despite these possible advantages over a wage tax, the CFCT also has several debilitating weak points and a good handful of smaller but troublesome question marks. As with the wage tax, the biggest weaknesses end up being a stew of legal boundary-drawing, economic distortions that follow from the boundary difficulties, and then constitutional constraints on what the legal system can do in response.

The most important of these challenges is a CFCT's limited ability to distinguish consumption from investment. In our modern economy, owners of durable assets often get consumption value from what they own, as in the classic example of a homeowner who gets to live rent-free in the property.[94] If a CFCT allows deductions for purchases of assets that provide consumption value, it will fail in its basic mission because it will be favoring current purchases over later purchases of consumption services and favoring some kinds of consumption (those that can be delivered through durables) over others.

Cash-flow taxes can tackle this issue in one of two basic ways. One of course is by denying deductions for purchases that will provide

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93. Auerbach, *supra* note 67, at 411–12.

94. Richard Goode, *Imputed Rent of Owner-Occupied Dwellings Under the Income Tax*, 15 J. FIN. 504, 504, 507 (1960).

consumption value.[95] Alternately, the CFCT could allow a deduction initially but then include the consumption value of the asset in income each year.[96] Neither of these approaches works well.

Let's back up to first get a clearer picture of why a CFCT has to pick one of these two. Suppose that Effie buys ApplianceCo bonds. A CFCT would give her an immediate deduction in the amount of their purchase price. What if she instead buys an ApplianceCo refrigerator, with an expected useful life of ten years? In a sense, the refrigerator isn't much different from the bond: Durable goods are a form of savings. What Effie has purchased is ten years' worth of future food-cooling services.

But the CFCT should not provide a deduction for Effie's refrigerator purchase, assuming she is keeping it in her kitchen at home rather than using it in, say, a restaurant business. We want to tax her consumption, and so Effie should not be permitted to deduct purchases that provide her with consumption value. She would not get a deduction for the costs of renting an at-home refrigerator, no matter when she paid for it. So, too, she cannot get a deduction for buying the fridge, even though it will last beyond the current taxable year. Giving her an immediate deduction for buying the fridge would be the equivalent, in present-value terms, of giving her a deduction each year for her consumption of personal cooling services.

Another way to look at the transaction is as if the refrigerator were actually a savings account, where the money in the account is withdrawn each year to pay rent. In that case, the CFCT would give her a deduction in the year she puts her money on ice with ApplianceCo. But then each year, as she gradually withdraws those funds to pay ApplianceCo for annual refrigeration services, she would have to include the withdrawal as cash-flow income.

This concept of taxing the rental value of property the taxpayer owns is sometimes known as "imputed income," and has a long and politically fraught history in the United States.[97] In our imaginary alternative transaction, the tax on Effie's annual withdrawals is easy to calculate. We would see each year Effie's bank statement showing a withdrawal of a certain number of dollars and a payment of that amount in satisfaction of a

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95. Andrews*, supra* note 86, at 1155–56.

96. *Id.* at 1150, 1155. Andrews also suggests a kind of third option in the case of debt-financed consumer durables: ignoring both the loan proceeds and the interest payments. *Id.* at 1155–56. He argues that taxing the household on funds used to make annual interest payments would then be the equivalent of taxing the imputed income from the durable. *Id.*

97. *See* Dorothy A. Brown, *Shades of the American Dream*, 87 WASH. U. L. REV. 329, 338–39 (2009) (critiquing racial disparities in who benefits from omission of imputed income from housing); Lee Anne Fennell, *Homes Rule*, 112 YALE L.J. 617, 631–34 (2002) (book review) (critiquing the economic and political impact of excluding imputed income from housing).

rental agreement that specified an annual rent. In the real world, though, Effie buys a refrigerator, and we don't necessarily know what the annual rental value might be.

What if we did neither of these but simply allowed Effie to claim deductions for her refrigerator, her home, or indeed the cost of any asset lasting more than a year? Dollars consumed this year would not be deducted; dollars spent this year for consumption next year would be. In that case, we would be offering Effie a powerful incentive to change what and when she consumes—just the opposite of what a consumption tax is supposed to accomplish.

Contrary to the suggestion in Andrews, this is not just a small side-problem with refrigerators or vacation homes.[98] In an important sense, many of the most valuable assets in our economy provide substantial consumption value in later years. Andrews focuses, somewhat dismissively, on rare works of art or collectibles that the owner takes pride and pleasure in displaying.[99] Yet as I argue in more depth elsewhere, U.S. wealth accumulation today opens the door to many avenues of social control—the power to get what you want.[100] For instance, media companies, whether traditional or social, can be instruments for advancing the owner's ideological goals. If nothing else, great wealth offers its holders the opportunity to take satisfaction from the ability to transmit dynastic wealth and power, a lasting family legacy, to future generations.

Thus, rather than making taxpayers indifferent between spending today and tomorrow, the CFCT arguably overcorrects. By ignoring the imputed income from wealth, the CFCT excessively rewards accumulations that deliver these kinds of intangible benefits to their owners.[101] Recent U.S. experience suggests that massive accumulations of wealth and power by a handful of persons with outlier political views have become a central social problem that needs remedying, not worsening.

Once we see that the scope of the imputed income problem is so vast and pervasive, the simple response of denying deductions for durable assets with consumption value no longer seems plausible. When nearly any asset seemingly can offer great consumption value, if accumulated and deployed

98. *See* Andrews, *supra* note 86, at 1159.

99. *Id.* at 1159–60.

100. GALLE, *supra* note 10, at 34–39.

101. Andrews argues that a theoretically ideal income tax would also have to identify and tax imputed income from durable assets. Andrews, *supra* note 86, at 1160. Perhaps. But the entire premise of switching to a CFCT is to eliminate tax distortions of when households choose to consume. If it cannot achieve that, then the undesirable distributive effects and higher rates of a CFCT—relative to our imperfect current income tax—are hard to justify.

strategically, then it becomes unclear conceptually how we would categorize some goods as "consumption" and others as "investment."

Admittedly, these kinds of "utility from wealth" effects might be hallmarks mostly of great wealth, not the everyday savings working households can hold in their retirement accounts. If so, it may follow that a CFCT would apply different rules to different taxpayers. Households with fortunes large enough to grant power over their surroundings today, or the ability to transmit dynastic control, should face a different set of rules in which their wealth accumulations are not exempt from tax.

It appears, then, that a CFCT would struggle to distinguish investment from consumption at the time of purchase, but this leaves the possibility of imposing annual taxes on imputed income. American scholars regularly describe taxing imputed income as impractical or politically impossible, but it's not quite clear why.[102] Many other countries taxed imputed income from housing at the dawn of the U.S. income tax, and Wisconsin's forerunner state income tax did so as well.[103] Taxes on imputed income from housing remain a fairly common global feature today.[104]

A simple and roughly accurate imputed-income system would just be the mirror image of what we do today for depreciation. That is, because the purchase price of a consumption good generally should reflect the discounted value of the flow of future consumption, we might take the purchase price of the asset and spread that price out over the expected life of the asset, with an adjustment for the time value of money.[105] Andrews notes that this simple method may fail for long-lived assets, where interest rates or usage value may change during the life of the asset.[106] Taxes on imputed income also pose similar liquidity issues as a tax on unrealized gain. But those are often fairly easy problems to overcome.[107]

102. *See* TREASURY DEP'T, BLUEPRINTS FOR BASIC TAX REFORM 85–86 (1977); Noël B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A "Revolutionary" Approach to Ownership*, 47 TAX L. REV. 725, 800 (1992); *see also* Ethan Yale & Gregg Polsky, *Taxing Residential Solar*, 74 TAX L. REV. 69, 123 (2020) (making this point about certain home improvements but noting that denying deductions for debt-financed improvements produces net result similar to taxing imputed income).

103. *See* Goode, *supra* note 94, at 504, 522.

104. *See, e.g.*, *Tax Imputed Rents*, CTR. FOR ANALYSIS SOC. EXCLUSION, https://sticerd.lse.ac.uk/case/_new/research/Inequalities_and_Poverty/policy-toolkit/housing-tax-imputed-rents.asp [https://perma.cc/C7AE-JCLK] (identifying six European countries that tax imputed rent).

105. Andrews, *supra* note 86, at 1156.

106. *Id.* at 1157.

107. Galle et al., *supra* note 3, at 1297–1313.

B. CFCT and the Constitution

Unfortunately, an annual tax on imputed income faces constitutional questions under present law similar to those that a wealth tax would face. Indeed, perhaps the strongest argument against the constitutionality of a tax on imputed income is that, in form and operation, the two are relatively interchangeable. Imagine that the Court were to hold that taxes on imputed income were within the scope of the Sixteenth Amendment. It would then be fairly easy for architects of a wealth tax to draft a bill that achieves their goals but labels the resulting tax as imposed on the "imputed income" from a broad class of assets. As we have seen, they could even make a plausible argument that simple financial assets create imputed income in large-enough accumulations. This ready equivalence suggests that courts that are hostile to a wealth tax are unlikely to be more welcoming of taxing imputed income.

Precedent and available historical materials probably leave courts with the room to hold that imputed income is not "income" within the meaning of the Sixteenth Amendment. In *Eisner v. Macomber*, the Court said that income has to comprise "something of exchangeable value *proceeding from* property, *severed from* the capital . . . [and] *received or drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal."[108] It is unclear whether courts would say that the intangible consumption benefits arising from mere ownership—the satisfaction of owning a rare painting, say—are "severed" from the underlying property or "received by the recipient . . . for his *separate* use."[109] After all, by definition imputed income comes from owning the thing and can't be separated from that ownership.

The Court would later seemingly disavow *Macomber*'s reliance on the "severance" metaphor, but it's unclear whether its revised definition is friendlier to imputed income. In the case of *Helvering v. Bruun*, the Court decided that a taxpayer had income from the expiration of a lease, where the tenant had improved the rental parcel during the tenancy.[110] It rejected an earlier lower-court opinion by the famed Judge Learned Hand, in which Judge Hand argued that such improvements were not taxable because not "severable" from the underlying property.[111] Stanley Surrey, famously,

108. 252 U.S. 189, 207 (1920) (emphasis in original).
109. *Id.*
110. 309 U.S. 461, 469 (1940).
111. *See* Hewitt Realty Co. v. Comm'r, 76 F.2d 880, 884 (2d Cir. 1935) (Hand, J., concurring).

believed that this implied that realization was dead as a constitutional principle.[112]

Unfortunately, it seems at least four current justices, and maybe six, do not share Surrey's reading, leaving us to have to guess what they believe is left of *Macomber* today.[113] The plaintiffs in *Moore* argued that *Bruun* also noted that income in that case arose "as a result of a business transaction," the cancellation of the lease.[114] In *Bruun*, the Court found income from a "profit realized in the completion of a transaction."[115] What this tells us about realization is uncertain. We know that a transaction (whatever that is) can sometimes be sufficient to create realized income, but not whether it is necessary. Assuming it were necessary, as the *Moore* plaintiffs asserted, there would be some doubt about whether simply residing in a house or gazing on a favorite artwork could be described as a "transaction." "Non-material satisfactions," the Court has said (albeit when interpreting the Code, not the Constitution), "are not taxable as income."[116]

There is also probably room for debate about whether the Supreme Court would agree that broadly taxing imputed income is consistent with the original public meaning of the Sixteenth Amendment. Again, the state of Wisconsin and a number of other countries taxed imputed income from a personal residence at the time the Sixteenth Amendment was being ratified by the states. In my view this is evidence that the original public meaning of "income" included unrealized income, and thus that *Macomber* was wrong to say that "income" is limited to realized gains. Suppose, though, that five justices disagree with my view. What would they make of the historical evidence? Perhaps they would simply conclude that imputed income is realized, which would be a good result for CFCT proponents. The justices might, however, also assert that the original meaning of "income" generally requires realization, and that imputed income is unrealized, but that there is a narrow exception to the realization rule for owner-occupied housing. As a possible justification for the narrow exception, the justices might say that the status of imputed income from housing as realized or unrealized was unsettled in 1913, so that the Sixteenth Amendment does not require any particular treatment of housing wealth. That seems a largely unprincipled claim but one that, as a predictive matter, is hard to rule out as a possible outcome.

112. Stanley S. Surrey, *The Supreme Court and the Federal Income Tax: Some Implications of the Recent Decisions*, 35 ILL. L. REV. 779, 783, 791 (1941).

113. *See supra* Section II.B.

114. *Bruun*, 309 U.S. at 469.

115. *Id.* (citing, *inter alia*, Helvering v. Am. Chicle Co., 291 U.S. 426, 430 (1934)).

116. Helvering v. Stuart, 317 U.S. 154, 168 (1942).

Nor is imputed income the only constitutional vulnerability for the CFCT. Recall that the CFCT tax base includes borrowed funds. Borrowers must be taxed because the combination of expensing and tax-free borrowing offers taxpayers a return on leveraged investments that is actually better after tax.[117] That is, without a tax on borrowed funds, the CFCT would distort consumption and investment choices, favoring investment over consumption and encouraging debt over equity or retained earnings. That of course defeats the whole point of using a CFCT.

It's uncertain, though, whether the Court would see borrowing as a realization event. Traditionally, the U.S. income-tax system has not treated borrowing as income, at least when the borrower and lender have agreed on a binding commitment to repay: "When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. Because of this obligation, the loan proceeds do not qualify as income to the taxpayer."[118]

The rule that borrowing is not income is longstanding, though seemingly based on "the meaning of § [61]," not necessarily the Constitution.[119] Still, challengers to a rule taxing borrowing could cite this language at least as shedding some light on the constitutional meaning of "income."[120]

Historically, the exclusion for borrowing seems to have grown out of courts' struggle to reconcile an annual income tax with the reality that the ultimate economic outcome of a transaction might be unresolved by the end of the tax year. In the first decade or so of the individual income tax, courts seemed to suggest that borrowing was not taxed because it was uncertain whether the borrower would get to keep the proceeds or instead would have to repay.[121]

Uncertainty about whether the taxpayer would have to repay was the grounds on which the Supreme Court would initially say, in the *Wilcox* case, that embezzlers did not have taxable income.[122] In his dissent to *Wilcox*, Justice Burton pointed out that there was also a line of cases in which

117. Andrews, *supra* note 86, at 1127, 1138–39, 1154.

118. Comm'r v. Tufts, 461 U.S. 300, 307 (1983); *see also id.* at 319 (O'Connor, J., concurring).

119. Comm'r v. Wilcox, 327 U.S. 404, 408 (1946).

120. *Cf.* James v. United States, 366 U.S. 213, 249–53 (1961) (Whittaker, J., concurring in part and dissenting in part) (arguing that the Sixteenth Amendment does not permit taxation of borrowers until the time that they fail to repay). *But see* David G. Chamberlain, *Borrowing as Realization: Taxing Billionaires' Unlocked Gains*, 73 BUFF. L. REV. 281, 360 (2025) (arguing that use of loan proceeds meets the *Macomber* test because "[t]he funds are available for the borrower's separate use"); Anthony P. Polito, *Borrowing, Return of Capital Conventions, and the Structure of the Income Tax: An Essay in Statutory Interpretation*, 17 VA. TAX REV. 467, 485–86, 490 (1998) (same). For a substantive critique of the offsetting obligations theory, see Joseph M. Dodge, *Exploring the Income Tax Treatment of Borrowing and Liabilities, or Why the Accrual Method Should Be Eliminated*, 26 VA. TAX REV. 245, 260–65 (2006).

121. *E.g.*, Appeal of Indep. Brewing Co. of Pittsburgh, 4 B.T.A. 870, 874 (1926).

122. *Wilcox*, 327 U.S. at 408.

taxpayers were taxed immediately, even though they faced some risk of having to make a future repayment.[123] Burton would eventually prevail, as a decade later the Court held in the *Rutkin* case that the decision to impose tax before a final resolution of the underlying repayment obligation was an administrative choice open to Congress and the IRS to resolve, and thus that extortioners can be taxed despite the likelihood they may be caught and forced to repay.[124] As the dissenters noted, that result effectively overruled *Wilcox*,[125] and the Court made that overruling official in the subsequent *James* case.[126]

Three justices—Whittaker, Black, and Douglas—dissented from the *James* decision. They argued that embezzlers were like debtors and that the Court had always at least implicitly treated debts as outside the constitutional definition of income.[127] In particular, they claimed that cases treating cancelled debts as income only made sense if there was an underlying rule in which the initial debt was not taxable.[128]

The *James* dissenters are not persuasive. It's true that we wouldn't need a rule taxing cancellations of debt if the debts themselves were taxed, but that doesn't mean that both rules have to be part of the Sixteenth Amendment definition of income. Instead, we can think of the COD cases as answering the question: "Supposing that there were a rule of administrative convenience that ignored initial borrowing, would it be constitutional to trigger tax at the time of a later transaction in which that debt were cancelled?"[129] Further, even if it were true that borrowed funds are not Sixteenth Amendment "income," taxes on them still would not have to be apportioned. Recall that only "direct" taxes are limited by the Constitution; excises and other "indirect" taxes do not have to be apportioned. A tax on bond issuances or other new debt looks like a classic excise tax: a government upcharge on the sale of a financial instrument, though in the case of the CFCT collected from the buyer.[130]

My point then is not that a CFCT would certainly be unconstitutional but instead that there is at least a meaningful amount of risk that courts might see it that way. While *Rutkin* and *James* strongly suggest that borrowing can

123. *Id.* at 415 (Burton, J., dissenting).
124. Rutkin v. United States, 343 U.S. 130, 137 (1952).
125. *See id.* at 139–40 (Black, J., dissenting).
126. James v. United States, 366 U.S. 213, 221 (1961) (plurality opinion).
127. *Id.* at 250–52, 255–57 (Whittaker, J., dissenting).
128. *Id.* at 250–52.
129. The Court has answered "yes" to an almost identical question in the context of purchases of real estate financed by nonrecourse debt. Crane v. Comm'r, 331 U.S. 1, 15–16 (1947).
130. Edward G. Fox & Zachary D. Liscow, *No More Tax-Free Lunch for Billionaires: Closing the Borrowing Loophole*, 182 TAX NOTES FED. 647, 654 (2024); *see* Chamberlain, *supra* note 120, at 363–64 (citing Nicol v. Ames, 173 U.S. 509 (1899)).

constitutionally be taxed, there is no case that holds that directly. Skeptical judges could cite the standard language about why debts are not part of statutory income and could lean on the *James* dissenters for their constitutional rationale. They might distinguish *Rutkin* by saying that criminals who help themselves to someone else's money are in a different position than borrowers in a consensual relation to the creditor (though it's unclear exactly why consent matters from a tax perspective).[131] And they might respond to the excise-tax argument by noting that a true excise tax would not have rates that vary with the purchaser's income (though in other cases the Court has said that taking income into account does not by itself make a tax an income tax).[132]

Ultimately, although there are certainly some tradeoffs, a CFCT is probably the best of the comprehensive consumption tax proposals. It at least solves the fundamental legal puzzle that wage taxes pose. And yet it still faces deep and uncertain legal challenges of its own. It probably would have to tax both imputed income and borrowing, yet both of those routes have serious constitutional doubts.

CONCLUSION

There isn't any practical route to taxing only consumption that would still address the fundamental problem of massive top-end inequality. If anything, we've seen that starting from the logic of a cash-flow consumption tax, we quickly end up with a tax system that in fact would impose annual taxes on the holdings of the ultrarich. The Constitution does not offer any reasons to conclude otherwise.

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131. The Second Circuit took a similar route in its own treatment of embezzlement. Collins v. Comm'r, 3 F.3d 625, 632 (2d Cir. 1993). Alternately, courts might distinguish traditional debts from other contingent liabilities based on the relative likelihood of repayment. *See* Dodge, *supra* note 120, at 276–77.

132. Ari Glogower, *A Constitutional Wealth Tax*, 118 MICH. L. REV. 717, 768–79 (2020).