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# Horizontal Equity Revisited

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# FLORIDA TAX REVIEW

ARTICLE

HORIZONTAL EQUITY REVISITED

*James Repetti  
Diane Ring*

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## ARTICLE

### HORIZONTAL EQUITY REVISITED

*James Repetti*  
*Diane Ring*

*135*

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# FLORIDA TAX REVIEW

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## THE PROPER TAX BASE

Structural Fairness from an International and  
Comparative Perspective - Essays in Honour of  
Paul McDaniel

*edited by Yariv Brauner &  
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# FLORIDA TAX REVIEW

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## HORIZONTAL EQUITY REVISITED

by

*James Repetti and Diane Ring\**

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### I. INTRODUCTION

No tax policy analysis stands complete without examination of equity implications. But despite its role as a traditional pillar of tax policy analysis, equity itself remains a controversial concept.<sup>1</sup> What is meant by the term equity? How should it be measured? Is there more than one type of equity? What is the relationship of different types of equity to each other? For decades, scholars and policy makers have explored the possibility that equity is best understood as two distinct concepts — vertical equity and horizontal equity — both of which must be evaluated.<sup>2</sup> Horizontal equity

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\*Diane Ring is a Professor of Law at Boston College Law School. James Repetti is the William J. Kenealy, S.J. Professor of Law at Boston College Law School. This Article was originally published as Chapter 6 in *THE PROPER TAX BASE: STRUCTURAL FAIRNESS FROM AN INTERNATIONAL AND COMPARATIVE PERSPECTIVE—ESSAYS IN HONOR OF PAUL MCDANIEL* (Yariv Brauner & Martin J. McMahon, Jr. eds., Kluwer Law International, 2012), and is reprinted with permission.

1. Paul R. McDaniel & James R. Repetti, *Horizontal Equity and Vertical Equity: The Musgrave/Kaplow Exchange*, 1 FLA. TAX REV. 607 (1993) [hereinafter McDaniel & Repetti, *Horizontal Equity*].

2. RICHARD A. MUSGRAVE, *THE THEORY OF PUBLIC FINANCE* 160 (1959) [hereinafter MUSGRAVE, *PUBLIC FINANCE*]; Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139 (1989) [hereinafter Kaplow,

(HE) is defined to mean that equals should be treated alike.<sup>3</sup> Vertical equity (VE) is defined to mean that an appropriate distinction should be made in the treatment of people who are not alike.<sup>4</sup> Although disagreement exists, HE in our tax system has generally been thought to require that individuals with the same income should pay the same tax. VE has generally been thought to require a progressive rate structure that imposes progressively higher rates on individuals with higher incomes. Despite frequent reliance on both HE and VE in tax policy analysis over the years, scholars have engaged in an active and vibrant debate about whether HE has any significance independent of VE in designing a tax system. This dispute has been best captured by the debate between two economists, Richard Musgrave and Louis Kaplow.

Kaplow argued in 1989 that HE is not a useful tool for tax policy because it has no normative content and no significance distinct from VE.<sup>5</sup> Kaplow further asserted that the use of HE in tax policy analysis is harmful because “it will lead policymakers astray when they are encouraged to sacrifice other values in the pursuit of HE.”<sup>6</sup> Thirty years earlier, in 1959, Musgrave (Musgrave I) had also concluded that HE lacked normative content. He stated:

The requirements of horizontal and vertical equity are but different sides of the same coin. If there is no specified reason for discriminating among unequals, how can there be a reason for avoiding discrimination among equals? Without a scheme of vertical equity, the requirement of horizontal equity at best becomes a safeguard against capricious discrimination — a safeguard which might be

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*HE I*]; Louis Kaplow, *A Note on Horizontal Equity*, 1 FLA. TAX REV. (1992) [hereinafter Kaplow, *HE II*]; Richard A. Musgrave, *Horizontal Equity, Once More*, 43 NAT'L TAX J. 113 (1990) [hereinafter Musgrave, *HE*]; Richard A. Musgrave, *Horizontal Equity: A Further Note*, 1 FLA. TAX REV. 354 (1993).

3. Kaplow, *HE I*, *supra* note 2, at 140–41; MUSGRAVE, PUBLIC FINANCE, *supra* note 2, at 113.

4. Kaplow, *HE I*, *supra* note 2, at 140–41; MUSGRAVE, PUBLIC FINANCE, *supra* note 2, at 113.

5. Kaplow, *HE I*, *supra* note 2.

6. *Id.* at 140. See also, e.g., David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 YALE L. & POL'Y. REV. 43, 44–62 (2006) (arguing that it is possible to design a tax system that is both economically efficient and distributive but that “blatantly violates” HE). For example, this might occur because some variations of HE require that the order in which taxpayers are ranked by income be preserved in a tax reform. As discussed, in notes 47–80, the forms of HE that require pre-tax ordinal rankings to be preserved are really applying VE, not HE. Thus, the tension created by such regimes is in fact a tension between efficiency and the distributive justice goals specified by the particular tax system.

provided equally well by a requirement that taxes be distributed at random.<sup>7</sup>

Indeed, Musgrave's analysis went a step further. He argued, in Musgrave I, that both HE and VE were inadequate for formulating tax policy because both depended on a determination of some measure for distinguishing equals and unequals.<sup>8</sup> He reasoned, "An objective index of equality or inequality is needed to translate either principle into a specific tax system."<sup>9</sup> In other words, the notion that equals should be treated equally requires specification of the criteria used to determine who is equal and who is unequal, and that specification will in turn require appeal to some form of distributive justice.

However, in response to Kaplow's 1989 assertion, Musgrave reassessed his own views and decided that he had been wrong (Musgrave II). After surveying various forms of distributive justice, he concluded that HE has a normative basis that is firmer than VE, stating:

[T]he requirement of HE remains essentially unchanged under the various formulations of distributive justice, ranging from Lockean entitlement over utilitarianism and fairness solutions. That of VE, on the contrary, undergoes drastic change under the various approaches. While HE is met by the various VE outcomes, this does not mean that HE is derived from VE. If anything, it suggests that HE is a stronger primary rule.<sup>10</sup>

In their 1993 article, Paul McDaniel and James Repetti (M-R) reviewed this pivotal debate regarding the meaning of VE and HE, and ultimately agreed with Musgrave I and with Kaplow that both HE and VE lack independent significance and should be best understood as a single concept.<sup>11</sup> But HE has not died. In the intervening years HE has survived as a frequently articulated independent policy ground in the assessment of tax policy. Why? Was earlier analysis faulty, or is something else at work in the tax literature? Almost two decades later, this paper reexamines the appropriate role of HE in tax policy and the debate that has occurred subsequent to the 1993 M-R paper. In this paper, we agree with Musgrave I's original assessment and later determinations by Kaplow and M-R. HE does not serve a useful role in formulating tax policy. HE and VE are merely both sides of the same coin, because starting an analysis by asking what the

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7. MUSGRAVE, PUBLIC FINANCE, *supra* note 2, at 160.

8. *Id.* at 161.

9. *Id.*

10. Musgrave, *HE*, *supra* note 2, at 116–17.

11. See McDaniel & Repetti, *Horizontal Equity*, *supra* note 1.

appropriate criteria are to determine which persons are not alike yields the same result as starting the analysis by asking what criteria should be used to determine whether persons are alike. In addition, we agree with Musgrave I and M-R that VE also is not useful without appeal to a theory of distributive justice.

But there are important reasons why debate about the role of HE has persisted. Although HE is not a useful substantive tool for tax policy design, it may serve a useful role in: (1) establishing the process to be followed to design tax policy; and (2) assessing the administration of the resulting rules. The first two of these reasons mirrors the insight of Musgrave II. As urged above, equality (the core vision of HE) is not independently important in formulating tax policy because taxation is an algorithm that will always tax equally those defined as equals.<sup>12</sup> Equality does, however, define the process for designing a tax system by requiring that the government justify its selection of criteria to measure who is equal (and not equal).<sup>13</sup> HE lingers in the tax debate because, by starting with the notion that all should be treated equally, HE requires a government to articulate a justification for any tax policy that imposes “different” taxation. HE tells us that government should communicate the rationale for different treatment; however, it does not tell us what the treatment should be.

Moving to the level of administration of the tax system, some tax scholars have relied on HE to serve as a benchmark for assessing whether governmental administration of the tax law is fair. As Musgrave I observed (somewhat negatively), “[i]n the absence of vertical equity norms, the case for horizontal equity is reduced to providing protection against malicious discrimination, an objective which might be met more simply by a tax lottery.”<sup>14</sup> As considered more extensively below,<sup>15</sup> HE could be viewed as a safeguard against arbitrary enforcement of tax laws and, therefore, stays at the forefront of tax consciousness because arbitrary enforcement would be particularly pernicious in a system that does not usually make public

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12. This result is not avoided by employing a different definition for HE that looks to see whether “similar” taxpayers (rather than the “same” taxpayers) are taxed in a “similar” way (rather than the “same” way). Whatever criteria are used to identify taxpayers who are “similar” will result in such taxpayers being taxed in a “similar” way.

13. Kenneth W. Simons, *The Logic of Egalitarian Norms*, 80 B.U. L. REV. 693, 714 and 748–50 (1990) (arguing that a right to equality requires a decision-maker to provide a “rational explanation of a difference in treatment”) [hereinafter Simons, *Egalitarian Norms*].

14. Richard A. Musgrave, *ET, OT and SBT*, 6 J. PUB. ECON. 4 (1976).15. See *infra* test accompanying notes 56–62.

15. See *infra* test accompanying notes 56–62.

disclosures regarding each taxpayer's liability for taxes.<sup>16</sup> HE does not define the form of enforcement, but does require the government to justify why enforcement is not uniform.

Part II of this article describes why HE and VE lack normative content. Part III considers and rejects arguments that have been offered after the M-R article to defend the role of HE. Part IV suggests that while HE is not helpful in designing a tax system because it provides no guidance about what the system should look like, support for HE has persisted because of a shared belief that government should communicate the rationale for treating people differently. HE tells us that government should communicate the rationale for different treatment, but it does not tell us what that different treatment should be. Part IV further suggests that support for the role of HE may also be rooted in the notion that government should be even-handed in its enforcement of tax laws. Part IV observes, however, that HE is not helpful in insuring even-handed enforcement. In a world of finite resources, not every taxpayer can be audited. In deciding who should be audited, it is necessary to refer to something beyond HE. Part V concludes this article.

## II. WHY HE AND VE LACK NORMATIVE CONTENT

In their review of the Musgrave-Kaplow debate, M-R agreed with Musgrave I that VE, the notion that an appropriate difference should be made among taxpayers who are different, lacks normative content because a theory of distributive justice is required to determine the "appropriate" difference that should be made.<sup>17</sup> For example, VE, by itself, does not lead to the conclusion that we need a progressive income tax. It is necessary to refer to an underlying theory of justice and to make some key economic assumptions in order to conclude that a progressive rate structure is desirable.<sup>18</sup> We might, for example, justify the imposition of progressive tax rates on income based on a theory of justice that believes equal tax burdens should be imposed on all taxpayers and on a key assumption about the rate at which the utility of income decreases as income increases.<sup>19</sup> If the utility of income decreases at an accelerating rate as income increases, a progressive rate structure is required to impose equal burdens on taxpayers.<sup>20</sup> It is the reference to some

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16. Most tax returns are not publicly disclosed. Public charities, however, are required to publicly disclose their federal tax returns. I.R.C. § 6104(d).

17. McDaniel & Repetti, *Horizontal Equity*, *supra* note 1.

18. *Id.* at 610.

19. *Id.*

20. Technically, the rate will be "progressive, proportional, or regressive, depending on whether the elasticity of the marginal income utility with respect to income is [, respectively,] greater than, equal to, or less than [one]." RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, *PUBLIC FINANCE IN, THEORY AND PRACTICE* 200 (1973) [hereinafter *MUSGRAVE & MUSGRAVE, PUBLIC FINANCE*].

outside normative theory and economic assumptions, rather than reference to VE alone, that designs the tax system.

M-R also concluded, as had Kaplow and Musgrave I, that HE lacks independent significance for two reasons.<sup>21</sup> First, a theory of distributive justice that treats different taxpayers differently will always require that equals be treated equally. For example, a system that seeks to impose equal burdens on taxpayers will require that identical burdens be imposed on taxpayers with what has been determined to be equal income. Similarly, a system that imposes tax burdens based on the taxpayers' abilities to pay will impose the same burden on taxpayers that have the same ability to pay (i.e. that have the same income). HE adds nothing to the design of the system and indeed may distract from the proper consideration of the more fundamental issues of distributive justice that underlie the treatment of taxpayers.<sup>22</sup> This is particularly true in a tax system, where liability is calculated by mechanically applying an algorithm to the selected tax base. The focus should be on the selection of the tax base.

Second, and more broadly, the notion that equals should be treated equally requires specification of the criteria used to determine who is equal. Once the criteria for determining equality are selected, it follows that those with the same criteria should be treated the same.<sup>23</sup> But selection of the

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21. McDaniel & Repetti, *Horizontal Equity*, *supra* note 1, at 612–13.

22. *Id.* at 620–21. See Thomas D. Griffith, Should “Tax Norms” be Abandoned? *Rethinking Tax Policy Analysis and the Taxation of Personal Injury Recoveries*, 1993 WIS. L. REV. 1115, 1156–57 (1993); Anthony C. Infanti, *Tax Equity*, 55 BUFF. L. REV. 1191, 1196 (2008) (criticizing VE and HE as being concerned only with economic differences of taxpayers and consequently foreclosing “consideration of non-economic forms of difference (e.g., of race, ethnicity, gender, sexual orientation, or physical ability) when determining the appropriate allocation of societal burdens, even though these other forms of difference have served, and continue to serve, as the basis for invidious discrimination that already imposes heavy burdens on its victims.”); Leo P. Martinez, *The Trouble with Taxes: Fairness, Tax Policy, and the Constitution*, 31 HASTINGS CONST. L.Q. 413, 422–24 (2004) (observing that application of VE and HE require appeal to underlying notions of fairness); See also Elkins, *supra* note 6, at 86–87 (concluding that several possible justifications for horizontal equity can all be proved unsuccessful; and suggesting that “justification of horizontal equity depends upon the moral entitlement of each individual to his free-market holdings.”). Elkins’ conclusions about the relationship between HE and the taxpayer’s claim to keep the post-market/pre-tax holdings itself demonstrates that even this use of HE is predicated on a normative and distributive conclusion derived outside of HE.

23. In the related area of constitutional law, Peter Westen has argued that equality is a tautology because once the criteria for determining whether persons are the same have been established, it follows that they will be treated similarly. Peter Westen, *The Empty Idea of Equality*, 95 HARV. L. REV. 537, 547–48 (1982). As in the tax area, this view has stirred significant debate. See, e.g., Steven J. Burton,

criteria to measure equality requires that we once again refer to distributive justice. For example, should equality be based upon equal incomes or equal amounts of consumption? Those concerned about persons with few resources may be troubled by the distributive effect of a consumption tax and, therefore, may favor an income tax. Regardless of whether one believes that the criteria must reflect the overall vision of distributive justice in society<sup>24</sup> or alternatively can be more tightly linked to the tax system,<sup>25</sup> selection of the criteria to measure equality will always lead back to distributive justice with the result that HE will always be subsumed within VE.

M-R concluded, as had Musgrave I, that the use of VE and HE in designing a tax system is a poor proxy for the actual theory of distributive justice that underpins the design of the tax system and that questions about tax design should be directed to the specific theory of distributive justice. Subsequently, Liam Murphy and Thomas Nagel took the analysis a step further. They argued that forms of distributive justice frequently applied by tax theorists to design tax systems — determining the tax based on “benefit” received by taxpayers or requiring “equal sacrifices” by taxpayers — were also useless in designing a tax system that seeks to achieve justice.<sup>26</sup> They argued that identifying a just tax requires looking outside the tax system and focusing on the “broader principles of justice in government.”<sup>27</sup> They reason that the starting point of a tax, such as each taxpayer’s income, is itself the product of government policies. Evaluating an income tax based solely on the amount of taxes assessed ignores an important factor — the fairness of the pre-tax incomes earned by the taxpayers. Murphy and Nagel view the tax system as an instrument that helps achieve governmental objectives for justice. They assess the current state of tax policy analysis as inadequate, stating:

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*Comment on “Empty Ideas:” Logical Positivist Analyses of Equality and Rules*, 91 YALE L.J. 1136 (1982); Erwin Chemerinsky, *In Defense of Equality: A Reply to Professor Westen*, 81 MICH. L. REV. 575 (1983); Kent Greenawalt, *How Empty is the Idea of Equality?*, 83 COLUM. L. REV. 1167 (1983); Kenneth L. Karst, *Why Equality Matters*, 17 GA. L. REV. 245 (1983).

24. See, e.g., LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* 15, 25, 30 (2002) (asserting the unbreakable link between tax fairness and overall justice) [hereinafter MURPHY & NAGEL, *THE MYTH OF OWNERSHIP*].

25. See, e.g., Kevin A. Kordana & David H. Tabachnick, *Book Review: Tax and the Philosopher’s Stone*, 89 VA. L. REV. 647, 653–54 (2003) (challenging Murphy and Nagel’s rejection of tax system derived “fairness”). See *infra* text accompanying notes 33–35.

26. MURPHY & NAGEL, *THE MYTH OF OWNERSHIP*, *supra* note 24, at 16–19, 24–30.

27. *Id.* at 30.

[The] entire [current] approach is flawed in its foundations. If the distribution produced by the market is not presumptively just, then the correct criteria of distributive justice will make no reference whatever to that distribution, even as a baseline. Distributive justice is not a matter of applying some equitable-seeming function to a morally arbitrary initial distribution of welfare. Despite what many people implicitly assume, the justice of a tax scheme cannot simply be evaluated by checking that average tax rates increase fast enough with income . . . . [O]nce we reject the assumption that the distribution of welfare produced by the market is just, we can no longer offer principles of tax fairness apart from broader principles of justice in government.<sup>28</sup>

Again, even if one is not fully persuaded by their arguments that traditional tax theories, such as the benefits principle or the equal sacrifice principle, offer nothing to tax policy, their overarching point that tax system design fundamentally turns on decisions about distributive justice and moral principles accurately underscores the hollowness of both VE and HE.

### III. EFFORTS TO SUSTAIN A DESIGN ROLE FOR HE

This Part reviews arguments offered by scholars post M-R to revive and support HE's place in shaping substantive tax policy. In 2003, Kevin A.

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28. *Id.* For an earlier argument that tax analysis needs to take into account the conditions that gave rise to the distribution of the tax base, see PATRICIA APPS, *A THEORY OF INEQUALITY AND TAXATION* 4 (1981) (“[T]ax theory remains firmly grounded upon an innate or inherited endowments theory of inequality. The aim of the analysis here is to examine tax incidence and tax distortions taking account of the way in which institutional inequality is initiated and perpetuated.”) (footnote omitted). Many others also have noted that economic wellbeing is the result of many factors, including the individual's initial starting point, the efforts of others, and merit. See, e.g., Michael J. Graetz, *To Praise the Estate Tax, Not to Bury It*, 93 *YALE L.J.* 259, 275–79 (1983) (questioning “those who simply assume that the market distributes rewards to people who deserve them and denies rewards to people who do not”); Sagit Leviner, *From Deontology to Practical Application: The Vision of a Good Society and the Tax System*, 26 *VA. TAX REV.* 405, 415–18 (2006) (“[D]ifficulty with the view of the market as neutral or providing just rewards is that, in the real world, people do not enter the market with equal resources including identical or otherwise equivalent talents, skills, or backgrounds.”); Amartya Sen, *The Moral Standing of the Market*, in *ETHICS AND ECONOMICS* 1, 1–19 (Ellen Frankel Paul et al. eds., 1995).

Kordana and David H. Tabachnick suggested such a role for HE, but did not elaborate. They stated:

While it is true that there can be no blanket rule requiring horizontal equity, it does not follow that issues of uniformity do not count at all. From what we have argued above with respect to the benefit principle and the equal sacrifice principle, it should be clear that issues of uniformity can be relevant, if subordinate, to distributive aims.<sup>29</sup>

It is not clear to us exactly what role Kordana and Tabachnick (K-T) contemplate for HE because their discussion of the benefit principle and equal sacrifice principle did not discuss HE. Indeed, we believe that there is little they could have said. The benefit principle “requires that taxpayers contribute, via taxation, in proportion to the benefit they derive from government.”<sup>30</sup> The equal sacrifice theory states “that taxation should reduce each taxpayer’s welfare by an equal amount.”<sup>31</sup> Since K-T do not focus on HE, they did not consider the arguments of Musgrave I and Kaplow that HE would contribute nothing to the design of a tax system.<sup>32</sup> To apply the benefit or equal sacrifice doctrine, it is first necessary to determine how benefits and sacrifice should be measured. For example, should the determination of the amounts of benefits received and the sacrifices made in paying taxes be based on an assumption that the utility of money declines as income increases?<sup>33</sup> To decide this issue reference must be made to theories of welfare economics and theories of declining marginal utility. Once those decisions are made, it follows that those obtaining the same utility from benefits received or losing the same utility from taxes paid should be treated the same.

In their discussion of the benefit and the equal sacrifice principles, K-T examine Murphy and Nagel’s argument that such theories have no role in achieving justice because justice needs to be measured by directly

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29. Kordana & Tabachnick, *supra* note 25, at 663.

30. *Id.* at 653 (quoting MURPHY & NAGEL, *THE MYTH OF OWNERSHIP*, *supra* note 24, at 16).

31. *Id.* at 661.

32. HE collapses into VE because it is necessary to determine how benefits and sacrifice should be measured in circumstances where persons will have received different amounts of benefits and income. See, e.g., RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, *PUBLIC FINANCE IN THEORY AND PRACTICE* 239–42 (3d ed. 1980); James R. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 *VAND. L. REV.* 1129, 1137–41 (2008) [hereinafter Repetti, *Democracy*].

33. See, e.g., MUSGRAVE & MUSGRAVE, *PUBLIC FINANCE*, *supra* note 20, at 239–42; Repetti, *Democracy*, *supra* note 31, at 1137–41.

examining the theory of justice that is guiding all governmental functions (i.e. taxing and spending) K-T state:

For Murphy and Nagel, the benefit principle is subject to the charge of “myopia” — it ignores government spending, that is, the provision of public goods and redistribution, and gives guidance only about how to raise tax revenue. Their basic idea, we think, is that if one is committed to a theory of distributive justice, the achievement of the aims of that theory may be hampered by any attempt to comply with the benefit principle. If the overarching conception of distributive justice takes fairness into account but allows for justifiable inequalities, criticisms of resulting inequalities on the basis of fairness are ill-motivated (because the inequalities are justified by the overarching conception of distributive justice). The conception of distributive justice determines fairness in taxation; therefore, a tax policy that at first glance appears inequitable might, all things considered, be justified.

For example, a tax structure that is consistent with Rawls’s difference principle may allow for what would appear (under, for example, the benefit principle) to be inequities in tax policy. However, these inequities are, all things considered, justified if the inequities are necessary to maximize the position of the least well-off. Thus, the question of justice in taxation is not separable from the question of overall distributive justice. To the extent the benefit principle treats these two questions as separable and addresses only the issue of justice in taxation, it is, for Murphy and Nagel, objectionable.<sup>34</sup>

K-T respond to Murphy and Nagel in part by positing situations in which the government’s “overall distributive justice” may leave unanswered specific issues pertaining to the design of the tax system. For those specific design issues, traditional notions of tax equity can be the tie-breaker. They state:

If two or more economic schemes equally maximize the demands of the conception of distributive justice, and if one scheme contains a tax system that satisfies the benefit principle while the other(s) do not, one who held the benefit

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34. Kordana & Tabachnick, *supra* note 25, at 653–54.

principle could invoke it to adjudicate between schemes. Doing so is not inconsistent with the maximizing conception of distributive justice.<sup>35</sup>

We agree with this insight, but we do not see how it makes the case for an independent role for HE in the design of the tax system. Satisfaction of the benefit principle (that the tax burden correspond to the level of benefits received) will automatically require that those with equal benefits be treated the same, assuming that this does not conflict with the governmental scheme of “overall distributive justice.” Perhaps K-T envision a similar but independent tie-breaker role for HE, where such equivalences occur.<sup>36</sup> However, this possible construction of K-T’s defense of HE ultimately would not stand: (1) the tie-breaker reasoning they explicitly used in defense of the benefit principle was in their own terms a “rarely” applicable role,<sup>37</sup> and (2) unlike the benefit principle which provides some of its own content, HE, even in this limited setting, still has no independent principles to draw upon in breaking the tie (any principles it would recite would have already formed the basis of VE determinations of taxation). Thus, while K-T make the case for application of traditional theories of tax justice, such as the benefit theory, to the design of a tax system, their discussion of the benefit and equal sacrifice theories does not support a role for HE. In a subsequent portion of their article that discusses determination of the tax base, K-T do foreshadow an argument that has been employed by others (and examined below) to argue for the independence of HE on political process grounds. They assert that “uniform treatment is preferable . . . out of deference to a democratically made decision, or as a matter of equality or autonomy.”<sup>38</sup> The next Part examines how others have further articulated what could be termed a “process” role for HE.

#### IV. EFFORTS TO FIND OTHER ROLES FOR HE

##### A. *HE as a Process Requirement*

Despite the comprehensive and persuasive arguments that HE collapses into VE (and that VE requires the independent selection of norms and criteria grounded in distributive justice), assertions have persisted in the tax literature that HE should play an important role in the design of a tax system. As Jeffrey Kahn has observed, “[M]any persons do give weight to horizontal equity, and even those who do not frown on unequal treatment of

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35. *Id.* at 654–55.

36. *Id.*

37. *Id.* at 655.

38. *Id.* at 667–68.

the same item.”<sup>39</sup> In an effort to discern and specify the undeniable appeal of HE, scholars have carved out a role, but one that is not on par with VE and does not make claims on substantive tax policy design. Brian Galle, in a 2008 paper, defends HE as independent of VE, primarily by constructing a role for HE that we contend is best understood as one grounded in the context of political process and political theory, and not as an independent policy role.<sup>40</sup> The core of his argument is that HE can be understood as standing for the position that the pre-tax allocation of income (specifically the pre-tax ordinal ranking of taxpayers with similar amounts of income)<sup>41</sup> should receive deference from tax writing legislators because that allocation was generated under existing rules (tax and non-tax) approved by an earlier Congress:

I want to defend here the notion that our accumulations of cash or contentedness, as they stand prior to being subjected to tax, should have some weight. I begin with the idea that pretax distributions may be non-random, and, indeed, may be the deliberately chosen result of a perfectly just system of laws other than the tax laws. To disturb that distribution might then be an injustice, or, at a minimum, could imply that the moral judgment of the tax-law drafters is superior to the judgment of those who put in place the rest of society. HE, therefore, could represent the extent to which the tax system defers to explicit or implicit moral judgments made elsewhere in society or in government.

Put another way, suppose that we sit as lawmakers on a legislative committee with the authority to draft tax statutes, and we hold sufficient sway over our colleagues to obtain passage of whatever we enact. Let us posit that earlier this year, our colleagues enacted a farm subsidy bill whose distributive consequences we find appalling. Would it be legitimate or proper for us to enact a 100 percent tax on

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39. Jeffrey H. Kahn, *The Mirage of Equivalence and the Ethereal Principles of Parallelism and Horizontal Equity*, 57 HASTINGS L.J. 645, 652 (2006).

40. Brian Galle, *Tax Fairness*, 65 WASH. & LEE L. REV. 1323 (2008) [hereinafter Galle, *Fairness*].

41. *Id.* at 1359–61. The notion that HE requires the pretax ranking of taxpayers to be preserved is based on the idea that taxpayers who have “equal shares in the pre-tax distribution” should have “equal shares in the post-tax distribution.” Elkins, *supra* note 6, at 73. If the relative rankings of taxpayers changes after tax, that change may indicate that equal taxpayers are not being treated equally because they now have different shares. As discussed *infra*, text at notes 47–50, the use of such rankings to measure HE is very controversial.

receipt of that subsidy? It is arguable, I claim, that the answer is no. If that intuition is correct, then it follows that there are constraints on tax legislation that do not arise purely out of distributive justice norms, but that instead depend on political theories, such as an obligation, again, to defer to the reasonable judgments of others. (Citations omitted).<sup>42</sup>

Galle's argument here is specifically about tax reform — not the first tax law written at the start of society, government and the economy, but the tax reform contemplated in the midst of an ongoing legal, economic and tax system. He makes this distinction to move beyond Murphy and Nagel's claim that government and market cannot exist without taxation, and all must be contemplated as a totality.<sup>43</sup> But why grant deference to a prior Congress? To support this position, Galle envisions the tax writing function as a tripartite role — in which one of the roles lends itself to deference to prior Congressional determinations:

Why would we want, or be obliged, to grant such deference? I suggest here two possible lines of thought. Both lines depend on one prior assumption. I assume that the Tax Code comprises not one, but in fact three distinct governmental systems or modes: raising revenue, redistributing wealth, and enacting other policy goals. Each of these modes might have its own set of rules or norms. My claims about HE for the most part are limited to tax's revenue function, although the absence of HE can signal to us that we need to justify our tax decision by resorting to one of the other two modes.

Turning, then, to the two possibilities, I argue that HE can be justified both by the unique purpose of the revenue function as well as on welfare grounds. In order for revenue-raising to serve its basic function, and to command widespread popular acceptance, it must be open to any reasonable view of good government. It follows, albeit along a twisty path, that the principles underlying the revenue function should give significant weight to pre-existing distributions of societal goods (footnote omitted).<sup>44</sup>

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42. Galle, *Fairness*, *supra* note 40, at 1327.

43. *Id.* at 1335.

44. *Id.* at 1327–28.

Essentially, Galle's core claim (elaborated in more detail) is that the revenue function of tax legislation drafting does not by its own terms incorporate any normative component, and when exercising that function legislators should give deference to the prior, democratically determined choices that resulted in the current pre-tax distribution of resources:

In particular, I argue here that, because the sole purpose of revenue is to make possible a flourishing deliberative democracy, and because it is possible that allowing the revenue system [i.e. the revenue function of new tax legislation] to make its own policy judgments would interfere with deliberations elsewhere, the revenue process should simply accept as a given, any reasonably policy choice.<sup>45</sup>

Thus, in considering tax reform, legislators should not disturb the pre-tax ordinal ranking of taxpayers based on "income."<sup>46</sup> Galle recognizes one of the likely challenges to this articulation of an independent HE: that tax legislation is *not* exclusively a revenue function but includes redistribution and other policy goals on a regular basis and therefore this intertwined role provides no support for deference. In anticipation of this argument, Galle offers a separate justification for HE grounded in considerations of legislative efficiency:

For those who find this form of deontological reasoning unpersuasive, I also roughly model the circumstances in which we can expect respect for HE to increase overall societal welfare. Taking as given the justice of existing arrangements can reduce the costs of deliberating about alternative rules, as well as the transaction costs and transition costs that attend the political process. At times, though, these gains may be swamped by the inefficiency of separating redistributive "corrections" from the revenue process itself.<sup>47</sup>

We think that these are valuable insights, raising interesting and important questions about political process, particularly the iterative dimension of legislative drafting, but they do not defend HE as an independent concept of "fairness." We reach this conclusion for several

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45. *Id.* at 1346.

46. *Id.* at 1359–61 (noting that the pre-tax position of taxpayers reflects the "preferred ranking of individuals" by society reflected in prior legislation).

47. Galle, *Fairness*, *supra* note 40, at 1327.

reasons. First, Galle's core claim of HE — that we should preserve the rank order of taxpayers — really constitutes a claim about VE. In their 1993 article, M-R reviewed Kaplow's critique of economists who argued that HE was violated (and thus had an independent function) when a tax law change altered the pre-tax rankings of taxpayers. Kaplow makes a key observation: the process of ranking and protecting ranking actually constitutes assessments of and determinations about those who are not equal — which is the domain of VE.<sup>48</sup> Further, Kaplow notes in his discussion of the economists on ranking (and Galle essentially agrees) — if HE only requires preservation of ranking, it would do very little. Why? Consider an abbreviated version of Kaplow's hypotheticals.<sup>49</sup> In World #1, A has 100 and B has 95 of income before tax. HE is violated if, after tax, A has 94 and B has 95. However, in World #2, A has 100 and B has 95 before tax, but after tax A has 147 and B has 51. In this case, HE is not violated although the disparity between the taxpayer's income has increased significantly. Thus, consistent with Kaplow I and M-R, we would conclude that a meaningful application of HE here is essentially VE, and in any event is literally only about those who are exactly equal under the existing concept of VE.

Second, the initial concept of the pre-tax ranking of taxpayers (which Galle argues HE guides us to protect) implies that we know what to count — what goods, services, and benefits are relevant for determining the ranking. But to have a ranking, we must already have in place a concept of VE to define what should be counted (i.e. to define the tax base). This observation alone is not inconsistent with Galle's argument, but explicitly acknowledging this point helps clarify precisely what Galle is claiming. In urging that tax reform be particularly attentive to existing rankings he envisions that in this moment before tax reform there are in place both rules implementing a concept of VE (which defines the tax base and tax burden) and some non-tax legislation that together result in a “pre-tax reform” ordering of taxpayers. It is really the net result (i.e. ordering of taxpayers by income) of the existing tax and non-tax legislation combined that Galle urges be protected, given his attention is on tax reform.<sup>50</sup> Thus, Galle's HE is an assertion that Congress should not change its VE over time, at least not to the extent it could alter taxpayer ranking.

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48. Kaplow, *HE I*, *supra* note 2, at 141.

49. Kaplow, *HE II*, *supra* note 2, at 194–95.

50. Use of the phrase “pre-tax” here can be a bit confusing. It is possible that the world as it looks before tax reform produces the following result: under the combination non tax law and existing tax law taken together, certain taxpayers receive  $\$X$ , and others receive  $\$X + 1$ . We understand Galle to say that a problem then arises *if and when* Congress later seeks to implement *new* tax legislation that would change the net effect of what Congress had intended, to date, to be the ultimate rank order of taxpayers. *See generally*, Galle, *Fairness*, *supra* note 40, at 1346.

Why not change VE? The answer to this leads to our third concern with this articulation of an independent HE. The HE argument relies on isolating and examining only the revenue raising function of Congress (because the HE question is directed exclusively at the tax burden assigned to a particular tax payer — and not the totality of that taxpayers experience with the government). However, in reality there are no such constraints on Congress — it is free to act in any and all capacities simultaneously — and it does so. Legislation regularly reflects a mixture of revenue, redistribution and non-tax policy goals. Given this observation, an argument for HE grounded in only the revenue function provides no discernible guidance. Moreover, it begs the reverse question, “Is it undesirable for Congress to undo existing tax policy (rooted in its redistributed and other policy goals) through reforms outside the tax law?” Ultimately, the decisions of a later Congress on tax reform may be best understood as part of both the messy dynamics of the political process and the smoothing process of the republican form of government in which power shifts are meant to occur gradually through the different and overlapping electoral schedules of the President, Senate, and House of Representatives.

Finally, Galle’s grounding of HE in an efficiency analysis — suggesting costs savings can be generated by assuming the fairness of existing distributions and not engaging in additional tax reform — joins an active dialogue regarding legislative process and efficiency. But as with other efforts described earlier to secure a distinct place for HE, we do not consider this an example of HE used to prescribe a self-contained notion of fairness for taxpayers. Rather, it is use of HE terminology in a different conversation about efficiency-based assessments of the legislative process. By introducing the concept of efficiency as a method to evaluate that process, Galle is appealing to a different form of distributive justice in order to add content to HE.

While we disagree with Galle’s defense of HE, we think that he has insightfully pointed future debate about HE in the correct direction — one that connects the persistence of HE to the underlying theme of equality among citizens and the expectation that the government only make changes based on careful consideration and articulated reasoning. HE refuses to perish because it represents a presumption for equal treatment under the laws of an egalitarian society. In a related area, a debate about whether equality is an empty concept in the context of the Constitution has occurred.<sup>51</sup> Surprising agreement exists between those who view equality as an empty concept and those who do not that the government should be required to act for appropriate reasons. That is, even those who argue that equality is an

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51. See, e.g., Westen, *supra* note 23 at 547–48; see also, e.g., Burton, *supra* note 23; Chemerinsky, *supra* note 23; Greenawalt, *supra* note 23; Karst, *supra* note 23.

empty concept agree that persons should be protected from government acting for the wrong reason.<sup>52</sup> For example, Christopher Peters has argued that the case of *Yick Wo v. Hopkins*,<sup>53</sup> in which the plaintiff was denied a laundry license because of his race, should not be viewed as requiring equality of treatment, but rather requiring that the government correctly apply a substantive rule that privileges should not be granted or denied based on race or ethnicity. Peters asserts that equality is empty because it requires one to look to an underlying substantive rule, but once the substantive rule is identified (race is irrelevant) the government must correctly apply such rule. Similarly, Kenneth Simons, an advocate for equality having independent significance, argues that equality requires that the government explain why it is treating people differently.<sup>54</sup> He states that a “demand for reasons for inequality is one important type of equality right. . . .”<sup>55</sup>

Thus, there is surprising unanimity for a justificatory role for equality in a different area of law. Perhaps, the lingering (languishing) loyalty to HE in the tax literature reflects this role. HE remains in our collective tax consciousness because in a democratic society we expect an explanation for why people are being treated differently. HE tells us that government should communicate the rationale for different treatment; it does not tell us what that different treatment should be.

#### B. *HE as Even-Handed Enforcement*

Up to this point the strongest articulation of an independent role for HE is a secondary one: ensuring that the government demonstrates it has carefully considered tax laws that produce different taxation (i.e. different tax bills), given the broad-based commitment to equal treatment in the legal system. Thus, HE here is not doing the work comparable to VE, which serves (albeit indirectly) as the vehicle for framing our views on the appropriate burden borne by each taxpayer. Rather, HE should be seen as addressing another part of the regime — not the design of the system, but the process of design.

A careful review of the proponents of HE, however, reveals that many supporters of HE draw upon a role for HE in the administration of the tax law. Joseph Dodge has argued that HE serves as a check on the application of utilitarian welfare to individuals. He states:

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52. See, e.g., Christopher J. Peters, *Equality Revisited*, 110 HARV. L. REV. 1210, 1219–20 (1997).

53. *Yick Wo v. Hopkins*, 118 U.S. 356 (1886).

54. Simons, *Egalitarian Norms*, *supra* note 13, at 714, 748.

55. *Id.* at 748.

Horizontal equity derives from the command that likes should be treated alike, which is a maxim of civil justice whose origins predate, and are independent from, welfare economics. . . . Of course, the horizontal equity norm in taxation is incomplete, because it leaves unspecified the index of comparison (for example, ability to pay, standard of living, income and so on). . . . Theories of redistribution can be contractarian, utilitarian, or religion-based, but conventional welfare economics is utilitarian, since it inquires into the net social gains and losses from a given policy. It is characteristic (and perhaps a weakness) of utilitarian thinking that the welfare of the individual is readily subordinated to collective welfare. The ethical command that likes should be treated alike is similar to concepts of “rights” in imposing limits on the utilitarian approach.<sup>56</sup>

We interpret Dodge’s argument to mean that the right to equal treatment is not a principle of design but instead a principle of conduct that controls all governmental interaction with citizens. Indeed, in a subsequent article, Dodge describes HE and VE as “formal norms” that “equally-situated persons should be treated equally” and “unequally-situated persons should be taxed differently to an appropriate degree.”<sup>57</sup> He uses the term “formal norm” in the Rawlsian sense of meaning the process by which laws are administered.<sup>58</sup> He goes on to observe that “substantive norms” then provide a standard to measure equality:

The role of “substantive” tax fairness norms is to provide an index or standard of relevant equality and inequality. The

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56. Joseph M. Dodge, *A Combined Market-to-Market and Pass-Through Corporate-Shareholder Intergration Proposal*, 50 TAX L. REV. 265, 276 n.42 (1995).

57. Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 TAX L. REV. 399, 401 (2005) [hereinafter Dodge, *Theories of Tax Justice*].

58. *Id.* at 453 (“This idea of fairness — which otherwise can be referred to as ‘formal justice’ and (in its tax version) as horizontal equity — has considerable value in itself.”). At the end of this sentence Professor Dodge cites to Rawls. *Id.* at 453 n.222 (citing JOHN RAWLS, *A THEORY OF JUSTICE* 58–60 (1971)). In the pages referenced by Dodge, Rawls states, “If we think of justice as always expressing a kind of equality, then formal justice requires that in their administration laws and institutions should apply equally (that is, in the same way) to those belonging to the classes defined by them. . . . Formal justice is adherence to principle, or as some have said, obedience to system.” JOHN RAWLS, *A THEORY OF JUSTICE* 58 (1971).

most commonly cited substantive tax fairness norms include: (1) the equal-sacrifice norm, (2) the benefits-received-from-government norm, (3) the “well-being” (or “standard-of-living”) norm, and (4) the ability-to-pay norm.<sup>59</sup>

The notion that HE militates against the arbitrary enforcement of tax law has also been championed by John A. Miller. He has observed:

The conclusions offered by McDaniel and Repetti are sound in a narrow pedantic sense. My concern is that their analysis fails to allow for the more primitive and malevolent possibilities of human existence. They assume a societal rationality and rule mindedness that assures equality even without relying on the principle of equality. Belief in the importance of the principle of equality, on the other hand, assumes that humanity possesses a limitless propensity for persecution and arbitrariness. It is in the context of an irrational and discriminatory world that equality’s meaning and utility stand out.<sup>60</sup>

The role for HE proposed by Miller is similar to that proposed by Dodge and Musgrave. He views HE as a check on arbitrary or even pernicious application of tax laws to taxpayers. We believe that the common thread running through all of these articulations of an administrative role for HE could be stated perhaps more bluntly and with particular force in the case of the income tax system. HE plays a distinct, separate and effectively operational role. As a general concept, which could be applicable to government rules and actions beyond the tax arena, HE holds that although the concept of VE can comprehensively account for equity concerns<sup>61</sup> in the design of our substantive tax law, something more is needed to address the operational concern that the law (crafted under a vision of VE) need be *implemented* by government actors in a manner consistent with the terms of the tax law. Essentially, HE steps in at this secondary stage to serve as an explicit warning that the law should be applied uniformly. Perhaps this could be taken as an implicit expectation of any just and democratic government. But isolating this concern — particularly on behalf of individual members of society in their dealings with the arguably significant power of the state —

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59. Dodge, *Theory of Tax Justice*, *supra* note 57, at 401.

60. John A. Miller, *Equal Taxation: A Commentary*, 29 HOFSTRA L. REV. 529, 536 (2000).

61. Of course, as articulated above, VE lacks internal normative content and must draw upon some theory of distributive justice and morality.

can serve as a constant reminder to state actors that good laws are insufficient. Society demands good enforcement as well.

This secondary, administration-oriented role of HE may be singularly important in tax law. Although one could imagine a tax system with entirely transparent filings, audits and tax payments, that is not the U.S. system, nor is it common in other comparable tax systems. As a result, there is little opportunity to verify whether the tax law is being applied in a sufficiently consistent manner. Litigated cases can provide a limited window on tax enforcement, but they represent a small fraction of the many interactions between the government and taxpayers. Moreover, the primary facts available to the outsider are those the judge has chosen to include in the opinion. Thus, while case law can assist in understanding positions asserted by the government against taxpayers' interests (hence the litigation), it does little to quell the concern that the government may not be applying the law uniformly. The constant reminder regarding uniformity, framed in the compelling language of HE, implicitly elevates the standard for administration to the same level as the standard for substantive law design (VE). The prominence of HE promotes society's goals of norm building in the administrative state and constraining government actors with power and limited public scrutiny.

The difficulty with this analysis is that HE is not helpful in insuring even-handed enforcement. In a world of finite resources, not every taxpayer can be audited.<sup>62</sup> In deciding who should be audited, it is necessary to refer to something beyond HE. For example, such choices may seek to maximize utility — target the taxpayers from whom we can expect to obtain the greatest additional tax revenue (such as those engaged in cash businesses), or they may seek to reinforce progressivity — target high-income taxpayers to insure that they are bearing a progressively greater burden. HE does not guide us in selecting among these objectives. It is necessary to once again appeal to some other source to decide how to best accomplish enforcement.

## V. CONCLUSION

In the years since Musgrave's, Kaplow's and M-R's work evaluating the intellectual landscape on HE, the question has continued to generate controversy and debate. Perhaps one way to encapsulate the question after all this time is to ask — if we started with HE as our motivating concept in setting tax policy and burdens where would we be? If HE says treat equals the same, what does our tax system look like? The answer is — we don't know because the term has no independent meaning for fairness and

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62. The IRS examined 1.11 percent of returns filed by individuals in 2010. IRS, INTERNAL REVENUE DATA BOOK 2011, tbl. 9b (March 2012), <http://www.irs.gov/pub/irs-soi/11databk.pdf>.

equality. We must turn to some theory of distributive justice to determine equality and to determine an appropriate tax burden. At this point HE collapses into one concept, which is generally referred to as VE. The crucial point is not that this single concept is VE, but that VE and HE are together a *single* concept which *lacks normative content* and is itself only a *proxy* for theories of distributive justice and morality. It is a detour in history that led us to frame the issues of equality and fairness in the tax system in the language of VE and HE — a path which has both masked the emptiness of the concepts and overemphasized the possibility of two, distinct fairness inquires. We have been side-tracked from our larger task of tackling our disagreements over the underlying questions of distributive justice and morality, but perhaps can return now with renewed vigor to these intractable questions.

For those who remain committed to a gut sense that HE means something, we would say, “yes, but a different something.” While HE is not helpful in designing a tax system because it provides no guidance about what the system should look like, support for HE has persisted because of a shared belief that government should communicate the rationale for treating people differently. The difficulty is that while HE may tell us that government should communicate the rationale for different treatment, it does not tell us what that different treatment should be. Support for the role of HE may also be rooted in the notion that government should be even-handed in its enforcement of tax laws. HE is not helpful, however, in insuring even-handed enforcement since, in a world of finite resources, not every taxpayer can be audited. In deciding who should be audited, it is necessary to refer to something beyond HE. But perhaps the close link of tax policy to the process of tax policy creation and the administrative practice explains the unstated but visceral commitment to HE that has continued to spark debate over the past 20 years. We do not imagine the debate is over, but we look forward to a deepening inquiry into the driving questions of distributive justice and morality as pillars of our tax policy.