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America Needs an Alternative Maximum Tax

When do federal, state and local taxes indisputably start to harm the economy—at 50% of income? 60%? 70%?

By JOHN H. COCHRANE

They keep coming back, like the villains of a good zombie movie, chanting "more taxes, more taxes." Long ago, Congress passed the alternative minimum tax, or AMT—a simple flat rate to ensure that in an insanely complex tax code, no one escapes paying something. Now we need an alternative maximum tax as a simple, rough-and-ready way to limit the tax zombies' economic damage. Call it the AMaxT.

With Monday's deadline for filing tax returns looming, let's start a national conversation: How much is the most anyone should have to pay? When do taxes indisputably start to harm the economy and produce less revenue—when government takes 50% of people's income? 60%? 70%?



Chad Crowe

I like half, but the principle matters more than the number. Once the country settles on a number, each of us gets to add up everything we pay to government at every level: federal income taxes, yes, but also payroll (Social Security, Medicare, etc.) taxes, state, city and county taxes, estate taxes, property taxes, sales taxes, payroll taxes and unemployment insurance for nannies, household workers, or other employees, excise taxes, real-estate transfer taxes, and

so on and on, right down to your vehicle stickers and those annoying extra taxes on your airline tickets.

On April 15, once this total hits the alternative maximum tax, you've done your bit and federal income taxes can take no more. You compute federal income taxes as usual, but then you get to reduce the "tax due" that the total is less than the alternative maximum.

The zombies howl that the top federal tax bracket is still "only" 40%. Surely "the rich" can contribute a bit more? They forget that the economic damage of taxes comes from the total tax bite, not just the federal income tax.

Marginal taxes are a purer measure of economic damage. If you earn one more dollar, how much do you get to keep? Marginal rates are higher than average rates in a progressive system: If the government takes 100% of income above \$100,000, then somebody earning \$150,000 pays a 33% average tax rate but has no incentive to work at all after he reaches \$100,000. Ideally, we would limit marginal rates, but this is not practical in a simple backstop like the AMaxT.

American governments also like to hide taxing and spending by passing mandates and regulations, forcing people and businesses to spend on their behalf. Ideally, we would limit this economic damage as well, but this is also not practical in an alternative maximum tax.

However, both considerations mean that the true economic damage will be higher than the AMaxT rate, so we should leave some headroom in setting that rate.

Every cent of corporate taxes comes out of some person's pocket, in higher prices, lower wages, or lower returns to investors. For example, even the tax zombies don't dream that we stick it to the big oil companies by charging gas taxes. To limit this damage, every single cent of tax that government assesses, at all levels, should be assigned to somebody and count against that person's alternative maximum tax. It is easiest to assign all corporate taxes to shareholders. When corporations send you the annual 1099 dividend form, they also report all taxes paid by your shares, which count against your AMaxT. Some taxes could similarly be assigned to workers and reported on W2 forms.

Yes, there are details to work out. People get big tax bills in some years, such as when they pay estate taxes. Incomes fluctuate. Smart tax lawyers could game the system.

This isn't hard to fix. For example, we could use an average of several years' income or, better yet, scale the AMaxT limit to consumption rather than income.

Liberals might object to a maximum tax, since it leaves out all the benefits that we get from government. In setting the maximum level of taxation, shouldn't we consider the nice roads, free schooling, police, national defense, thoughtful regulation, and other benefits and services?

This is a valid consideration if one argues about what's "fair." But I propose the AMaxT entirely to limit the economic damage of taxation, a goal you must consider even if you think it's "fair" to take every cent of a rich person's income.

To limit economic damage, benefits are irrelevant. Suppose that the government levies a 100% income tax, but it is so good at providing services that each of us gets back twice the value of what we put in. Good deal? Yes. Functioning economy? No. Each person gets services whether they do or don't pay taxes. But with a 100% income tax, nobody works, nobody pays any taxes, and nobody actually gets any services.

How many people are really being taxed at outrageous rates? I don't know. The U.S. tax system is so complex, with so many layers of taxing authority, that *nobody* really

knows. Still, an alternative maximum tax is a win-win bet.

If there really are few people who pay an extraordinarily high percentage of their income, then liberals shouldn't object. They won't lose any revenue and will enjoy snickering "I told you so." If it turns out that there are lots of people being so taxed, then we will sharply reduce the unintended, multiplicative effect of taxation, and we will measure that fact. A canary in the coal mine is as valuable chirping as choking.

The disincentive effects of heavy taxation settle in gradually. For the first year or two, all people can do is hire smarter lawyers and work a little less hard. It takes years for businesses to retrench, close, never get started or fail to expand; for people and companies to move abroad; for students to give up investing in an expensive M.B.A., medical school or engineering degree; for people to stay put rather than follow lucrative opportunities, or to retire early. All this shows up slowly and gradually drags down an economy and its tax revenues.

So the AMaxT is most important for the backstop promise it makes to young people and entrepreneurs. Yes, start a company, go to school, work hard, invest, hire people. We guarantee you that no matter what happens, no matter how loud the zombies chant, no matter what clever "revenue enhancers" they come up with, you will get to keep some reasonable fraction of what you earn. Go for it.

Mr. Cochrane is a professor of finance at the University of Chicago Booth School of Business, a senior fellow of the Hoover Institution and an adjunct scholar of the Cato Institute.

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