SHOULD WE TAX THE "CLINTONS" AND OTHER FORMER SENIOR CIVIL SERVANTS MORE? YES, WE SHOULD

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ABSTRACT

This paper debates whether former civil servants should be taxed differentially. It argues that whenever public officials' post-retirement income in the private sector is derived from their previous office, an additional tax should be levied on them since, in such situations, the ability-to-pay principle is an insufficient horizontal equity criterion. This idea is grounded in equity propositions and may be justified by various liberal theories of equal opportunities and utilitarianism.

Although, as a rule, the paper supports the ability-to-pay principle given the common shortcomings underlining the benefit principle, it challenges the perception that all individuals with the same ability to pay should be taxed equally. It argues that a normative principle, such as the ability to pay, is apparently insufficient for horizontal equity where one's ability to earn is based on the benefit he obtained from using public resources inaccessible to other individuals.

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INTRODUCTION

This paper debates whether former civil servants should be taxed differentially. It argues that whenever public officials' post-retirement income in the private sector is derived from their previous office, an additional tax should be levied on them since in such situations the ability-to-pay principle is an insufficient horizontal equity criterion. This idea is grounded in equity propositions and may be justified by various liberal theories of equal opportunities and utilitarianism.

As a rule, the paper supports the ability-to-pay principle given the common shortcomings underlining the benefit principle. Nevertheless, this principle is not entirely divorced from the benefit rule since one's ability is dependent upon the resources and benefits granted by the state. Thus, part of the ability to pay doctrine is based on the benefit rationale. In some instances, where access to public resources is not open to all individuals, the ability-to-pay principle cannot be an exhaustive measure promoting horizontal equity. In order to elaborate this preposition, the paper focuses on the taxation of senior civil servants.

We need not look far for examples of former civil servants whose current revenues in the private sector are directly or indirectly related to their former positions. For example, after Bill Clinton's retirement from the presidency in 2001, he and his wife, former Secretary of State Hillary Clinton, began lecturing around the globe. Eloquent as they may be, this alone can hardly explain their rates,[1] averaging at $200,000 per lecture and reaching $7.7 million in some cases. In total, the Clintons' income from lectures amounted to $153 million for 729 speeches in a mere four months during 2001.[2] Based on the 24/7 Wall St. Survey, it appears that Bill Clinton is the richest living president.[3] The paper does not question Clinton's unique skills or integrity. According to the survey, however, after his time in the White House, "he earned a substantial income as an author and public speaker" – for his autobiography *My Life* he received a $15 million advance. Barack and Michelle Obama outdid the Clintons by receiving a $65 million advance.[4] Concerning lectures – a more recent example is the $400,000 charged by Barack Obama for a 2017 lecture in Wall Street.[5] Very few people in

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[1] *See* Robert Yoon, *$153 Million in Bill and Hillary Clinton Speaking Fees, Documented*, CNN, (Feb. 6, 2016), http://edition.cnn.com/2016/02/05/politics/hillary-clinton-bill-clinton-paid-speeches/.

[2] *Id*.

[3] This data is based on a survey made by the 24/7 Wall St. estimating the wealth of former and current American presidents. *See* Ashley C. Allen, Michael B. Sauter & Thomas C. Frohlich, *10 Richest US Presidents*, 24/7 WALL ST., (Oct. 10, 2016, 2:54 PM), http://247wallst.com/special-report/2016/10/10/10-richest-u-s-presidents/.

[4] Matthew Garrahan & David Bond, *Record-Breaking Auction for Obama's Book Deal Tops $65m*, FINANCIAL TIMES, (Mar. 1, 2017), http://www.ft.com/cms/s/0/6da8931a-fde2-11e6-96f8-3700c5664d30.html?ft_site=falcon&desktop=true#axzz4bqpOR3Na.

[5] *See* Jill Treanor, *Barack Obama to be Paid $400,000 for Speech at Cantor Fitzgerald Event*, THE GUARDIAN, (Apr., 26, 2017, 5:28 PM), https://www.theguardian.com/us-news/2017/apr/26/barack-obama-speech-wall-street-us-cantor-fitzgerald.

the private sector, if any, receive anywhere near that magnitude of payment in advance for their autobiographies or for their lectures. Even if they do, the paper argues that former senior civil servants should be levied more due to their unique status.

Obviously, this is not a uniquely American phenomenon. For instance, former Israeli Prime Minister, Defense Minister, Chief of Staff and decorated special-forces commander Ehud Barak, unquestionably a man of many talents, founded a business corporation using the former worldwide connections and knowhow accumulated during his various positions in the Israeli industrial-military complex.[6] An even more extreme example is that of politicians who earn additional fees during their public service, clearly an affront to due process even if those earnings are not in direct conflict of interests with their current position. Incumbent MP George Osborne earned £500,000 from speeches he gave during a two-month tour of the United States.[7]

The paper is not intended as an attack on politicians, but rather an analysis of the phenomenon, so one should not be confused by the title. It is also not aimed at naming all those former civil servants on one hand, questioning their genuine talents or scrutinizing the legality of their business ventures, but rather at criticizing the current state of affairs in which, as claimed, some of their gains are unequally taxed. At the same time, it does not claim that those former public servants received a benefice.[8] They may be highly intelligent and competent and may have contributed to the public during their time in office, but they are certainly not deserving of extra income in the private sector to compensate for that contribution retroactively. Rather, the paper targets the income of those former senior civil servants to the extent that it is linked to their former public position.

Although not every former public official capitalizes on his or her senior position upon retiring from civil service, the "revolving door" phenomenon is ubiquitous. It is not uncommon for senior officials with average salaries to resign their jobs and immediately receive a lucrative position in the private sector. In many instances, private corporations tempt incumbent public officers with rewarding jobs and induce them to resign, not necessarily because of their talent but because of their valuable connection to the public office. Those former public servants leap into the private market and suddenly receive a lucrative salary due

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[6] *See* Uri Blau, *Ehud Barak & Co.*, HAARETZ (Aug. 10, 2009, 10:45 PM), http://www.haaretz.com/ehud-barak-co-1.6448.

[7] Rowena Mason, *Osborne Earns £500,000 from New York Speeches*, THE GUARDIAN, (Dec. 8, 2016, 7:28 PM), https://www.theguardian.com/politics/2016/dec/08/osborne-earns-new-york-speeches-mp-wall-street.

[8] Benefice is a position granted in the Middle Ages by the clergy to individuals it favored. This position (usually given with an estate) yielded a lucrative income. *See* BARBARA W. TUCHMAN, A DISTANT MIRROR: THE CALAMITOUS FOURTEENTH CENTURY, Ch. 2 (New York: Alfred, 1979).

to the connections and knowhow they obtained during their public service. I do not think a concrete example is required should be given here, as I trust many names come to the mind of every reader while reading those lines.

This public-private shoulder rubbing raises the question of whether differential tax rules and principles should be applied. Let us examine this issue through a concrete example. Suppose Individual A was born and educated in a certain country, and established a security business. By the time he became 55 years old, his enterprise yielded him an annual income of $1 million. Individual B had a similar background, but after graduating from college, he joined the public sector, reached a high-ranking position, retired and entered the private sector. He established a similar enterprise as A and reached a similar income by age 55. In the private sector, B took advantage of knowledge and connections from his former public position, but both A and B had to pay around $350,000 in federal income tax.[9] We have been taught that individuals with the same ability to pay should pay the same taxes. The question is whether A and B truly have the same ability to pay or if the ability to pay is sufficient here for taxation.

The paper is based on the premise that B – the former senior civil servant – uses intangible public resources that, at this stage of his career, are not available to most other taxpayers. Even if we accept the rather unrealistic assumption that, in a democracy, the initial public position is officially open to all, depending on one's talent rather than status and social connections, this is certainly not true at higher ranks. The public resources available to B may include connections and accessibility to other key civil servants (particularly decision-makers), specific knowledge and information that can be gained exclusively at the public arena, etc. Sometimes, a cooling-off period for public servants is required by law[10] and has the potential of somewhat reducing the extra use of the public resources. However, first, this cooling-off period is not uniformly applied worldwide. Although most OECD countries require a cooling-off period, it varies in length and according to the seniority and nature of the public position.[11] Second, it is not relevant to all contexts, as discussed above with regard to the high fees former senior servants receive. The use of the public service resources is then a prerogative available only to a specific group, making public service a future value per se.

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[9] This is a simple calculation for married couples filing jointly in 2016 without itemized deductions etc. I.R.C. §§1(2014); I.R.C. 63 (2014).

[10] *See* OECD Guidelines for Managing Conflict of Interest in the Public Service Report on Implementation (2017), http://www.oecd.org/gov/ethics/39691164.pdf.

[11] *See* OECD, Government at a Glance 2015, Public Sector Integrity: Managing conflict of Interest: Pre- and Post-public Employment (2015), http://www.oecd-ilibrary.org/sites/gov_glance-2015-en/07/01/index.html?contentType=&itemId=%2fcontent%2fchapter%2fgov_glance-2015-33-en&mimeType=text%2fhtml&containerItemId=%2fcontent%2fserial%2f22214399&accessItemIds=.

This paper is organized as follows. Chapter I presents the lodestar principle in taxation – the equity principle. Next, the liberal and welfare-based approaches to benefitting from public resources are discussed. After refining the understanding of additional opportunities granted to individuals, we introduce taxation. Chapters III and IV deliberate on the overlap between the two prevailing equity principles – ability to pay and benefit. It commences by showing that the justification for international taxation is based on both principles and then explains the rationale of imposing an additional tax on the income or usage of those former senior civil servants on the national level. Chapter V completes the discussion with some policy recommendations, followed by conclusions.

I. THE EQUITY PRINCIPLE

Equity is one of the key principles in taxation. It may be traced back to Adam Smith,[12] who already in the eighteenth century formulated the four canons of good taxation.[13] According to Smith, taxes should be equal, certain, efficient in collecting, and convenient to pay.[14]

There is a consensus that taxes should be equal but dissensus prevails regarding what equality means and how it may be implemented.[15] Scholars agree that taxes should be equal, but disagree on the substance of this equality. Two main principles were developed to establish equity – the benefit and the ability-to-pay principle.[16] Although essentially distinct, both may be traced back to Smith's first canon.[17] The main idea behind the benefit principle is that citizens should pay tax in accordance with the benefits they receive from the state. Some scholars find the origin of this principle in the contrarian paradigm, and interpret it as an exchange relationship between citizens and the state. The latter provides public goods and services while the former pay taxes for them; thus, taxes reflect

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[12] LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP 12 (2002).

[13] Given their importance, Smith's principles are considered tax *canons*. For the use of the terminology of Adam Smith's tax canons, *See* HENRY GEORGE, PROGRESS AND POVERTY: AN INQUIRY INTO THE CAUSE OF INDUSTRIAL DEPRESSIONS AND OF INCREASE OF WANT WITH INCREASE OF WEALTH: THE REMEDY (Garden City, NY: Doubleday Page &Co., 1920), Book VIII Chapter III.

[14] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 825-28 (R.H. Campbell & A.S. Skinner eds., 1979).

[15] *See supra* note 13.

[16] *See* RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 218-19 (5th ed. 1989), and JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 61–66 (4th ed. 2008).

[17] *See* Richard A., *Horizontal Equity, Once More*, 43 NAT. TAX J. 113, 114 (1990) (discussing the contradiction between these two principles. For their similarity, see the discussion surrounding note 56 below).

the price of public goods and services.[18] According to this principle, the price (meaning the tax) should follow market rules and should not consider external factors as redistribution. This principle reflects a libertarian approach and is not commonly accepted; it also suffers from some practical flaws.[19] One cannot develop an objective criterion for measuring "benefits" and even if one could, governments cannot predict their future budget when it depends entirely on citizens' benefits.

Due to these and other flaws, scholars tend to support the ability-to-pay principle.[20] The premise of this principle is that individuals need to be taxed with accordance to their welfare: well-off individuals should pay more taxes than the poor (vertical equity), while individuals with the same ability to pay should pay equal taxes (horizontal equity).[21] Grounded in the diminishing marginal utility principle, ability to pay was translated into the equal sacrifice rule.[22]

II. USING PUBLIC RESOURCES: LIBERAL AND WELFARE-BASED APPROACHES

Equity is one of the core principles of good taxation and is mainly understood as one's ability to pay.[23] Prior to applying the ability-to-pay principle in taxation, however, we must acknowledge the complexity of the concept of "ability". Each person has a different capability to produce income, which is commonly taxed in accordance with one's ability to pay. If we consider only the first part of Marx's maxim – "from each according to his ability"[24] – individuals have different abilities and qualifications to earn income. Some of those abilities are natural skills but others depend on resources provided by the state. A geography teacher, for example, who has attended a public school and graduated from a public university, used some public resources to acquire his education in combination with some natural skills to become a teacher. His income as a

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[18] *See* Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles*, 58 TAX L. REV. 399, 401-4 (2005), (discussing the development of the benefit principle).

[19] See SLEMROD & BAKIJA, *supra* note 16, at 62-64, criticizing the benefit principle for its weaknesses, including the fact that it is impractical to measure benefit and the fact that it does not consider redistributive factors.

[20] See SLEMROD & BAKIJA, *supra* note 16, at 64, and MURPHY & NAGEL, *supra* note 12, at 20, for a discussion of the advantages of the ability to pay over the benefit principle.

[21] *See* SLEMROD & BAKIJA, *supra* note 16, at 87-89, 165-166 (discussing horizontal and vertical equity).

[22] John Stuart Mill interpreted Adam Smith's equal ability to pay as equal sacrifice – *see* Musgrave, *supra* note 17, at 115, MUSGRAVE & MUSGRAVE, *supra* note 16, at 228-231, and MURPHY & NAGEL, *supra* note 12, at 24.

[23] See the above discussion on the "ability to pay principle" in Chapter I. *See* MUSGRAVE & MUSGRAVE, *supra* note 16; *see also* SLEMROD & BAKIJA, *supra* note 16.

[24] The maxim continues ". . .to each according to his needs"; KARL MARX, CRITIQUE OF THE GOTHA PROGRAMME, part I (1875).

geography teacher derives in our example from free and high standard education on top of innate capabilities. Tax jurisdictions then tax this geography teacher and other individuals with accordance to their economic abilities to produce income. Taxation thus "intervenes" only in the last link of the chain of income, when the ability is exercised.[25]

The ability is accordingly connected to the use of public resources, which arises the next question if those public resources are open to all. The paper does not call for strict egalitarianism, but for a more comprehensive concept of distributive justice, including liberal egalitarianism and welfarism. Here, I would like to examine whether every individual has the same ability or opportunity to benefit from the specific public resources available to the former senior civil servant. On the one hand, we wish to live in a society that applies the equity principle in taxing our income, but on the other, we expect it to provide equal opportunities to produce that income. We wish to live in a society that promotes equal distribution of *benefits* within individuals' lifecycle. Such distributional justice maybe facilitated by taxation, but equal distribution should not be reduced to only equal distribution of goods and services. Ideally, this taxation would promote the equal distribution of *opportunities* as well.[26]

The question at stake is whether the former public servant benefits from more opportunities by utilizing (intangible) public goods that are not available to other individuals. This is the first phase. The second phase is introducing taxation and examining how taxes should respond to the additional opportunities discussed in the first phase.

Two leading representatives of liberal egalitarianism are John Rawls and Ronald Dworkin.[27] Dworkin explicitly differentiates between political power, which is "power over publicly or commonly owned resources",[28] and private resources. Dworkin claims that a "theory of equality must find a means of integrating private resources and political power".[29] While most former public

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25 This argument naturally ignores lucky earnings and focuses only on self-made earnings. Peter A. Prescott, *Taxing Luck*, 83 MISS. L.J. 117 (2014), discussing "lucky income."

26 There are various perspectives on equality that use different terms to refer to a similar concept, including inequality of "opportunities and not outcomes", "fair equality of opportunity", "equality of resources", "equality of opportunity for welfare" and "equality of fortune". For our present purposes, all reflect the same principle of liberal egalitarianism.

Equality of "opportunities and not outcomes" was suggested by Ackerman and Alstott; "fair equality of opportunity" by Rawls; "equality of resources" by Dworkin; "equality of opportunity for welfare" by Arneson and "equality of fortune" by Rakowski – *see* Daniel Shaviro, *Endowment and Inequality*, *in* TAX JUSTICE 123, 126 (Joseph J. Thorndike & Dennis J. Ventry eds., 2002); *see also* Dodge, *supra* note 18, at 455.

27 We begin with Dworkin, although he responded to Rawls' work whose notion on opportunity is presented next.

28 Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 PHIL. & PUB. AFF. 283 (1981).

29 *Id*. at 283.

servants do not have the "political power" referred to by Dworkin (since they are no longer officially in power), there is little doubt that they obtain an additional significant resource, which is not available to the general population. According to Dworkin, equality of resources depends on brute and option luck.[30] Are these additional resources a consequence of brute or option luck? "Option luck" requires a deliberate act while "brute luck" is a matter of pure and blind luck that is completely beyond the individual's control.[31] Since allocation of resources may be a consequence of different types of luck, Dworkin claims that it should be "ambition sensitive" in a way that reflects the costs and benefits individuals have selected for themselves.[32]

Following Dworkin's differentiation between ambition and endowment, we can theoretically claim that working in the public instead of the private sector indicates that the person has greater ambition, which may justify benefiting from additional resources and earning more income. First, even if we accept this claim, it does not tell us anything about the taxation of those resources. Second, in many countries, working at an early stage in the public sector does not require more ambition, skills or hard work than in the private sector – in fact, the opposite is often the case. Thus, having an extra opportunity at a later stage may require redistribution.

Rawls, who also supports a theory of liberal egalitarianism, advocates for the "fair equality of opportunity" under his two principles of justice.[33] The first part of his second principle requires not only that public positions should be offered to anyone according to their natural skills, but also that each individual should also have "a fair chance to attain them".[34] Since Rawls is aware that some social barriers hinder full equality of opportunities, he qualifies his argument by

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30 On the modern question of whether to tax "lucky income", *see* Prescott, *supra* note 25.

31 Dworkin, *supra* note 28, at 292.

32 "On the one hand we must, on pain of violating equality, allow the distribution of resources at any particular moment to be (as we might say) ambition-sensitive. It must, that is, reflect the cost or benefit to others of the choices people make so that, for example, those who choose to invest rather than consume, or to consume less expensively rather than more, or to work in more rather than less profitable ways, must be permitted to retain the gains that flow from these decisions in an equal auction followed by free trade. But on the other hand, we must not allow the distribution of resources at any moment to be endowment-sensitive, that is, to be affected by differences in ability of the sort that produce income differences in a laissez-faire economy among people with the same ambitions." Dworkin, *supra*, at 311.

33 JOHN RAWLS, JUSTICE AS FAIRNESS – A RESTATEMENT §13.1, at 42-43 (Erin Kelly, ed., 2001). The two principles of justice are as follows: "(a) Each person has the same indefeasible claim to a fully adequate scheme of equal basic liberties, which scheme is compatible with the same scheme of liberties for all; and (b) Social and economic inequalities are to satisfy two conditions: first, they are to be attached to offices and positions open to all under conditions of fair equality of opportunity; and second, they are to be to the greatest benefit of the least-advantaged members of society (the difference principle)."

34 RAWLS, *supra* note 33, Restatement §13.1 at 43 (2001).

setting a minimal threshold for the difference principle.[35] One of the possible criticisms against applying this type of equality of opportunities is that it has the power to interfere with individuals' choices and freedom. The well-known example of the educated person who prefers strolling along the beach[36] is inapplicable in our case, though. The beachcomber embodies the case of not exercising certain endowments or resources. It should be noted that the term "resources" as used in this paper is understood more narrowly as in the distributive justice discussion,[37] to refer only to public service resources. In our examples, the usage of public service knowhow means having more opportunities that at this stage are not accessible to all, producing inequality of resources at a relatively late stage in the career path.[38]

To conclude the first phase, liberal and welfare-based approaches may strive for equal opportunities in general; but when this goal is not attained, how are we to deal with the imbalance produced by years in public service? In other words, we turn to the second phase by introducing taxation and examining how taxes should respond to the additional opportunities discussed in the first phase. Welfarism is straightforward since it examines the level of welfare attributed to people: the relevant distribution criterion is the contribution of welfare. Clearly, the present analysis is consistent with utilitarianism – the main approach in welfare-based theory. Applying utilitarianism indicates that a former senior civil servant who receives additional value in return for his previous public workplace has more utility and should be taxed for it.

From a liberal standpoint such as Rawls', if everyone had a "fair equality of opportunity", there would be no need for a special and additional tax. We have to bear in mind, however, first, that Rawls does not conclude at this point and continues arguing for the least advantaged in society. Second, like Dworkin, Rawls may have unequivocally ignored the fact that certain public positions create a new class, which is not based on skills but on connections and access to other civil servants and, particularly, decision-makers. This new caste, if you will, creates a certain rare prerogative that is priced accordingly by the private sector. Thus, even if at the initial stage all positions have been equally open for individuals, at a later stage this prerogative should be taxed.

To conclude, based on a combination of utilitarian and egalitarian approaches, we should tax the senior civil servant to achieve equality on his

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35 For the Difference Principle *see* RAWLS, *supra* note 34.

36 *See* Shaviro, *supra* note 26, at 132.

37 *But see* Eric Rakowski, EQUAL JUSTICE 2 (2003) and Liam B. Murphy, *Commentary Liberty, Equality, Well-Being: Rakowski on Wealth Transfer Taxation*, 51 TAX. L. REV. 473, 481-82 (1996). Rakowski defines), defining "resources" more broadly and claims they "should be construed, for purposes of determining a person's entitlements, to include not only fungible material goods but also people's physical and mental capacities."

38 *See* Dworkin, *supra* note 28 (elaborating the discussion on public service as a resource).

additional welfare, but also for using more resources not available to other individuals. The opportunity to benefit from more public resources increases the former senior servant's welfare *and* his ability to pay.

III. "BENEFITS" IN INTERNATIONAL TAXATION: A COMPARATIVE PERSPECTIVE

The discussion so far accentuates that whenever former senior servants exercise the opportunity to *benefit* more from public resources, we should additionally tax them. The *benefit* of using public resources is also fundamental for understanding international taxation. The discussion on international taxation assists us in adumbrating the importance of the benefit in taxation and its linkage to one's ability to pay. Let us examine a variation on our previous example, where individuals C and D produce in our state the same income of $1 million. The only difference between them is that C was born and raised in our country, whereas D is a non-resident and only produces his income here. Should we tax them similarly? Apparently, our local law treats them equally since their ability to pay is the same, although in order to mitigate double taxation, the state of residence grants D a tax relief for the "foreign" taxes paid in the other jurisdiction. This tax relief is laid down either in a tax treaty[39] or in a local tax law.[40] The converse of this scenario is when individual C, the resident or citizen[41] of our state, earns income abroad. If our state applies the residential tax regime (instead of the territorial one),[42] C, despite earning his income abroad, is also subject to taxes in his state of residence.

These scenarios indicate that our state can tax D (a non-resident) in the first scenario and C (a resident/citizen) in the second. The power to tax is rooted in international tax doctrines. In 1923, the International Committee (1923))[43] established by the Financial Committee of the League of Nations, assigned four prominent economic scholars[44] to study the vexing issue of double taxation. Its

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[39] *See United States Model Income Tax Convention of Nov. 15, 2006*, 35 (Nov. 15, 2006), https://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf; *See also* Article 23 of the *OECD Tax Convention Model on Income and on Capital*, http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2014/article-23a-and-article-23b-exemption-method-and-credit-method_mtc_cond-2014-26-en#.WeMYL2hL9PY.

[40] *See* I.R.C. §§ 901-907, 960 (discussing United States foreign tax credit rules).

[41] *See* I.R.C. §§ 61 (1984); I.R.C. 901 (2010).

[42] The residential tax regime is also called "residence-based taxation" and "worldwide system". The territorial regime is also called "territorially-based jurisdiction" and "territorial system". REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME 27, 38 (2007). For more on the worldwide and territorial systems, see JOSEPH ISENBERGH, INTERNATIONAL TAXATION 14 (2010).

[43] PROFESSORS BRUINS, EINAUDI, SELIGMAN & SIR JOSIAH STAMP, REPORT ON DOUBLE TAXATION, LEAGUE OF NATIONS (Apr. 5, 1923). [hereinafter REPORT ON DOUBLE TAXATION].

[44] *See id*.

point of departure was that the "benefit principle" could not rationalize the problem of international double taxation.[45] According to the report, despite the prevalence of the ability-to-pay principle, one question remained unanswered in the international sphere: *Whose* ability to pay should be measured – and in which state?[46] The International Committee found the justification to tax international income in the doctrine of *economic allegiance*,[47] based on the following reasoning:

> [T]his doctrine is given quantitative expression by reference to terms of economic faculty or ability of the individual to pay. That is to say, the taxes, though measured by things, eventually fall upon persons and ought to fall upon them in the aggregate according to the total resources of the individual, leading to progressively larger sums being paid by the people who are richer. . . The problem consists in ascertaining where the true economic interests of the individual are found. It is only after an analysis of the constituent elements of this economic allegiance that we shall be able to determine where a person ought to be taxed or how the division ought to be made as between the various sovereignties that impose the tax.[48]

In the international arena, therefore, the states to whom the individual has economic ties have a general right to tax him, but it would be best if he were to be taxed only once. The International Committee adopted Seligman's theory of economic allegiance by stating:

> The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each.[49]

Thus, not one criterion prevails; individuals' ability to pay in the international arena should be in respect to each state that helps him attain that ability (or in

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45 *See id*. at 8.

46 *See* Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1305 (1996); *see also* REPORT ON DOUBLE TAXATION, *supra* note 43, at 18-20.

47 *See* REPORT ON DOUBLE TAXATION, *supra* note 43, at 20 ("The starting-point of the modern theory must therefore be the doctrine of economic allegiance.").

48 *Id.*

49 *See id.* This quote is similar to that of Professor Seligman. – EDWIN ROBERT ANDERSON SELIGMAN, ESSAYS IN TAXATION 110-11 (1895) ("The ideal solution is that the individual's whole faculty should be taxed; but that it should be taxed only once, and that it should be divided among the tax districts according to his relative interests in each.").

other words, wealth). The doctrine of economic allegiance has four elements: "[T]he acquisition of wealth, the location of wealth, the enforceability of the rights to wealth and the consumption of wealth."[50] The International Committee concludes that the source and residence jurisdictions are the more significant ones.[51]

The discussion on the international tax regime shows that both tax systems – the source and the residence – can be justified under the economic allegiance doctrine.[52] To return to our example, though, Individual D is a "guest" in our state; he may *use* or consume the host state's resources, and is thus required to pay taxes. This taxation is based not just on his ability but also on the *benefits* he receives from utilizing the host state's resources. Taxing a non-resident in the host state reflects primarily the principle of benefitting from economic resources.[53] This example illustrates that in the field of international taxation, the principles of ability to pay and benefit are intertwined and furthermore, that the benefit principle may even prevail.

The second example reinforces this conclusion with reference to international taxation. The main logic behind the residential tax regime is that individual C – a resident/citizen of our state – has not only succeeded in earning income thanks to the support of our state (education, infrastructure, etc.) but also continues enjoying its support (such as property protection) even when producing income abroad. Naturally, an individual who produces income and resides in a certain state benefits from its facilities and services. As stated by the International Committee:

> It is undeniable that the individual *owes some duty to the place where he lives*. He receives *benefits* from, and confers benefits upon, that community. He receives benefits in that he enjoys not only the protection of the laws but the various conveniences that are afforded by the community where he chooses to live.[54] [emphasis added]

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[50] REPORT ON DOUBLE TAXATION, *supra* note 43, at 23.

[51] *See* Avi-Yonah, *supra* note 46, at 1305-6; *see also* REPORT ON DOUBLE TAXATION, *supra* note 43, at 25.

[52] *See* text accompanying note 51.

[53] This economic reasoning was also used to "expand" the power to tax according to the territorial base regime in a case in the Israeli district court. *See* Income T.A. (TA) 1233/00 Beja v. Tax Commissioner Tel-Aviv Jaffa 5 (July 18, 2006), Nevo Legal Database (by subscription) (Isr.). The verdict was appealed to the supreme court. *See* C.A. 8570/06 Tax Commissioner Tel-Aviv Jaffa 5 v. Beja (Mar. 12, 2009), https://www.court.gov.il/NGCS.Web.Site/Viewer/NGCSViewerPage.aspx?DocumentNumber=6851310f7c734c18b1ad6cc82aa47b00.

[54] REPORT ON DOUBLE TAXATION, *supra* note 43, at 29. However, the committee goes on to qualify the benefit principle by stating that "the problem of economic allegiance is one not of benefits but of duties or obligations." *Id.* Tillinghast believes that both states (residence and

John Tiley adequately explains the right of the state to tax both its residents (Individual C in our example) and non-residents (Individual D) who produce income in the state, as follows:

> UK residents are taxed because, whether or not British subjects, they enjoy the *benefit* of our laws for the protection of their property; non-residents because, in respect of property in the UK, they enjoy the *benefit* of our law for the protection of that property.[55] [emphasis added]

In the international arena, a jurisdiction is entitled to levy tax not merely due to one's ability to pay but also due to benefits the individual receives from the taxing state. In other words, the ability-to-pay principle is based on the benefit one obtains from state services. In the residence-based regime, our residents who produce income abroad should be taxed in the residence state since their income is rooted in the resources they utilize in it. International taxation is thus based on one's ability that is dependent upon the benefits he receives from either the host or the residence state. The discussion in this Chapter on international taxation sharpens the assertion that ability to pay and benefit are not two unrelated principles. This combination of ability to pay and benefit in the international tax arena should be integrated in local taxation, as discussed in the next Chapter.

IV. INTEGRATING INDIVIDUAL ABILITY AND BENEFIT

The above discussion on the power to tax individuals in the international field and fair equality of opportunities is used here as an analogy that demonstrates how an individual's ability to pay and benefit may overlap. The congruence between ability and benefit is important for understanding how to tax those individuals also on a national level. Were it not for this overlap, we could have abandoned the "ability-to-pay" principle and focus solely on the benefit or vice versa. This facet of taxation is based on the preposition that when one individual benefits more than another from their government's resources, we should tax him with accordance to the benefit principle. However, taxing a person only for using more public resources, and in our case, his public service knowhow, may disregard the flaws of the benefit principle discussed in Chapter I above.

A plausible explanation is that the individual's ability to earn benefited more from using state resources, and thus their ability to pay is higher. This argument is rooted in Adam Smith's theory of taxation. While the two prevailing

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source) can tax an individual since he benefits from government services in both. *See David* R. Tillinghast, *A Matter of Definition: "Foreign" and "Domestic" Taxpayers*, 2 INT'L TAX & BUS. LAW 239, 242-44 (1984).

55 JOHN TILEY & GLEN LOUTZENHISER, ADVANCED TOPICS IN REVENUE LAW ¶13.2 (2013).

equity principles – ability to pay and benefit – are distinct, it seems that in our context (as in some others), they conflate and represent two sides of the same coin. Smith explains the equity principle as follows:

> The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective *abilities*; that is, in proportion to the revenue which they respectively *enjoy* under the protection of the state"[56] [emphasis added]

We can see that Smith applies both principles simultaneously by discussing both individuals' ability and their "enjoyment". Taxpayers with the higher ability to pay are at the same time beneficiaries who enjoy or benefit more from the state's protection. The first part of the statement addresses the ability-to-pay principle and the second addresses the benefit principle.[57] A person has an ability to pay thanks to the benefits he derives from the existence of the state.[58]

Normally, we take the position that tax should treat the equals equally (horizontal equity) and differentiate among the not-equals (vertical equity).[59] Applying this definition to income measurement means that individuals with the same ability to pay should pay equal tax (horizontal equity) and individuals with a higher ability to pay should pay more than those with a lower one (vertical equity). In this paper, we challenge this perception by examining the ability of former civil servants.

In our discussion, we assume that the former senior civil servant earns more thanks to knowhow and connections, and should thus pay more taxes. This example seems straightforward enough. What about our first scenario, however? A former senior civil servant (Individual B) earns a million dollars, but so does private-sector businessperson A. Horizontal equity requires us to tax them similarly, since apparently, they have the same ability to pay. To return to our example, let us assume that Clinton and John Doe have the same skills and the same family status, but naturally, a different life story. Most people would not be interested in reading John Doe's autobiography, but many would have an interest in *My Life*. The same applies to John Doe and Clinton's lectures. Even if we assume that they have the same income, the same ability to pay, the author of the latter should be taxed at a higher rate. The reason is that he has had the opportunity to benefit from public resources in a way that has been denied to the former.

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56 SMITH, *supra* note 14, at 825.
57 Edward J. McCaffery, *A New Understanding of Tax*, 103 MICH. L. REV. 807, 831 (2005).
58 *Id.*
59 Louis Kaplow, *Horizontal Equity: Measures in Search of a Principle*, 42 NAT'L TAX J. 139, 140 (1989).

Horizontal equity based on the ability to pay demands that we tax both authors equally. This discussion could suggest the independence of horizontal equity as a normative principle. However, Louis Kaplow, for example, argues that horizontal equity is not an independent normative principle.[60] Richard and Peggy Musgrave, on the other hand, believe that horizontal equity is not derived from vertical equity and stands solid no matter which distributive theory is adopted to explain vertical equity.[61] Following the Musgraves, different normative rationales (such as the ability-to-pay or benefit principles) would be applied differently to vertical equity. For example, applying the ability-to-pay principle to vertical equity requires progressive taxation, and applying the benefit principle may support regressive taxation (albeit not necessarily). Conversely, horizontal equity would always require applying the same principle. Accordingly, the Musgraves believe not only that horizontal equity is an independent norm that is not derived from vertical equity, but that it may be "a stronger primary rule".[62] Here, we discuss a circumstance where horizontal equity based on income can be a standalone principle somewhat in line with the Musgraves' second best solution.[63] The paper suggests that a normative principle, such as the ability to pay, is apparently sufficient for vertical equity but not necessarily for horizontal equity.

By linking the ability-to-pay and benefit principles, we can justify a higher taxation on former senior civil servants, primarily to achieve horizontal equity. Since those individuals with a higher ability to pay benefit more from the state's resources, a proper tax system should tax them more for utilizing these benefits. Part of the former public servant's ability to earn is based on the benefit he obtained from using public resources inaccessible to other individuals. On the other hand, we tax those individuals more since they have used those public resources – a benefit denied to most citizens. Thus, there is a direct link between those individuals' ability and benefit and it is more equitable to tax them accordingly.

V. IMPLICATIONS

On a theoretical level, this paper proposes that individuals who benefit disproportionately from the state's resources by virtue of having served in senior public positions should pay more taxes for their subsequent private sector

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[60] *Id.*

[61] Musgrave claims that "the requirement of HE [horizontal equity] remains essentially unchanged under the various formulations of distributive justice. . . While HE is met by the various VE [vertical equity] outcomes, this does not mean that HE is derived from VE." *See* Musgrave, *supra* note 17, at 116.

[62] *Id.*

[63] *Id*. at 117-20.

revenues. It remains to tackle the challenging task of translating that proposition into practical terms.[64]

This practical question is threefold. First, what may be the indicators of the hypothesized causal relationship between the former public position and the current income? So far, we assumed this causal connection but did not propose any guidance. Second, which tax should we apply – consumption or income tax? Third, if we apply the latter tax base, how do we classify this additional income?

As mentioned, this paper focuses on taxpayers benefitting from their former status as public officials, as opposed to other advantages such as education, health, etc. This group may be divided into two subcategories: an ordinary link to resources and a privileged link to rarely available resources as illustrated in the Clintons' example that opened the paper.

One plausible explanation for the fact that not all public officials capitalize on this access is mandatory cooling off periods, whether required by law or regulation, which reduce revolving door opportunities.[65] The example depicted in the preamble indicates an intense link to resources, but inevitably this link has a spectrum. Ideally, an algorithm would help classify former public officials at least into the two subcategories, but this is beyond the scope of this paper. Instead, we can offer a general – not exhaustive – list of indicators on the proximity to public connections: First, the seniority of the former public position; second, the length of public service; and third, the linkage between the new high private income and the former position. (If there is a sudden increase in revenues after serving in the public sector, this could indicate a significantly high correlation, as in the example of public servants switching from the military to the industrial side of the industrial-military complex). If, for example, a former antitrust officer receives a job with a very high salary in Hollywood as an actor, the link to the former position is obviously insignificant.

These indicators can be translated to different tax brackets or rates, and naturally, as any other tax rate, they may suffer from some bias. Here, we can only conclude that a person with a significant link to the former governmental position should be taxed more.

The next question is whether to apply a consumption or an income tax base as a better indicator of the ability to pay. The conclusion that we should tax the former senior public servant more remains valid in both cases. This view can be supported by both welfare and various liberal approaches. One way to look at the benefit enjoyed by former officials is to claim that we should impose a consumption tax for the usage of social resources,[66] since this would interfere

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64 For the attempt to measure endowment tax despite the difficulties involved, see Shaviro, *supra* note 26, at 135.

65 *See* text accompanying note 10.

66 McCaffery, for example, supports a progressive consumption tax without a tax on wealth transfer. He believes that this tax reform is better aligned with liberal egalitarian ideas. *See* Edward

with individual preferences less than an earnings tax.[67] It is an additional earning due to an additional use. The use distorts the allocation of resources and creates inequality. This is the problem of not taxing use from an egalitarian perspective: it "takes away from others"; it diminishes the "common store".[68] If some individuals benefit from public resources more than others, this can justify imposing a tax on their usage. Alternatively, we can consider this advantage as one that increases one's welfare, and this additional income should be taxed. Thus, both approaches – consumption and income taxation – can support this additional taxation. Although we leave it to future studies to determine which one is more efficient or feasible,[69] we shall mention one rationale that may support the income taxation method. Since use is somewhat abstract, and can be observed only when there is actual income, income taxation seems more visible and realistic.

If we opt for income taxation, the third question is, how should we classify this income? This question is naturally linked to the former. There are two approaches to tackling this issue that can be illustrated by the following examples. Let us consider two individuals, E and F. Both have the same legal education, but E works in the antitrust department of a private law firm while F has been working in the public sector in an antitrust authority for the same period. Let us assume that E and F earn the same salary and all other relevant factors are the same. Now, F resigns his job and receives a high position in the legal department of a private firm that represents a company in an antitrust dispute with the authorities. F's salary is doubled. How should we tax this extra income? One way is to look at the current tax brackets and decide that this is sufficient for taxation. This, however, would ignore the benefit individual F receives from having worked in the public arena.

Another way is to tax the extra income not as merely a salary but as a form of *royalty* on working in the public service. To return to our opening

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J. McCaffery, *The Uneasy Case for Wealth Transfer Taxation*, 104 Yale L.J. 283 (1994). For a criticism of McCaffery's work, see Eric Rakowski, *Transferring Wealth Liberally*, 51 TAX. L. REV. 419 (1996). For a criticism on Rakowski's paper, see Murphy, *supra* note 37. For a discussion on how liberal egalitarian scholars such as Rawls and Dworkin comprehend taxation, see McCaffery, *supra,* at 289-97.

67 McCaffery, *supra,* at 340.

68 *Id.* at 341.

69 The enduring debate on the pros and cons of consumption income tax can be traced to William D. Andrews who supports the imposition of a consumption tax. *See generally* William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1974). However, other scholars support the income tax. *See* Alvin C. Warren, Jr., *Fairness and a Consumption-Type or Cash Flow Personal Income Tax*, 88 HARV. L. REV. 931, 931 (1975). *See* also William D. Andrews, *Fairness and the Personal Income Tax: A Reply to Professor Warren*, 88 HARV. L. REV. 947, 947 (1975); Alvin C. Warren Jr., *Would a Consumption Tax be Fairer Than an Income Tax?*, 89 YALE L.J. 1081, 1082 (1980).

example, people come to listen to the Clintons because they are interested in what they have to say as former high-ranking officials. Their exorbitant fees are thus directly related to their public office and may be considered as royalties for using public resources. Therefore, if we accept the proposition that former senior civil servants' *income* should be taxed at a higher rate, we can classify this income as either salary income (or business income) or royalties. In both classifications – royalty and salary – the former senior civil servants increase their wealth by virtue of their former position.

CONCLUSIONS

It seems that different paths led us to the same conclusion. The state should impose an additional tax on former senior civil servants such as former leaders writing a book, giving lectures or establishing a security consulting company. Due to the inaccessibility of the public resources from which they benefit, taxing based on the ability to pay depends on the benefit, and equal consideration requires imposing a higher tax in this case.

In an ideal world where all public resources are equally available to all citizens, and the equity principle is maintained, it is sufficient to tax based on the ability-to-pay principle. However, in a world where some individuals may enjoy access to public resources that are definitely not accessible to all, it would be wrong to focus solely on the ability to pay. This paper focuses on former civil servants, though we can expand its proposition to other scenarios where public resources are not open to all.

The analysis was based, first, on the equity tax discourse of the ability-to-pay and benefit principles, second, on the international equitable criteria, and third, on the literature surrounding the opportunity to use public resources. It led us to the understanding that in certain circumstances, although the prevailing equity principle is the ability to pay, we cannot ignore the benefit principle when, as in this case, it is directly related to the benefit one receives from the state. This linkage of ability and benefit is important for determining these individuals' tax liability. In cases where public resources are not widely accessible, the equity principle of the benefit is the other side of the ability to pay, and must be taken into account in seeking horizontal equity. Therefore, taxing former officials for their extra use of relatively inaccessible public resources is consistent with the horizontal equity principle, which cannot be met strictly on the grounds of the ability to pay.

This paper suggests relevant factors indicating the link between the income of the former public servant and the outcome of using limited public resources. This paper is inconclusive as to whether tax jurisdictions should implement a consumption tax on using public resources or an income tax on the additional income, based on usage. The decision of whether to adopt a consumption or income tax has attracted extensive attention in the literature and is not at the center of this paper, which justified imposing an additional tax, whether we adopt a consumption or income tax. It seems that all analyses point to the same positive reply to the question posed in the title – Should we tax the "Clintons" and other former civil servants more?