

Constitutional Kreplach

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Recent federal healthcare legislation mandated that every “applicable individual” maintain healthcare insurance and it imposed (in new section 5000A(b)) a penalty to enforce that mandate. In a recent report (“Constitutional Decapitation and Healthcare,” *Tax Notes*, July 12, 2010, p. 169, *Doc 2010-11669*, 2010 TNT 133-6), Steven J. Willis and Nakku Chung argued that section 5000A(b) is unconstitutional.

This article responds to Willis and Chung by demonstrating that the section 5000A(b) penalty constitutes a valid exercise by Congress of its legislative powers under both the commerce clause and its taxing authority and that the penalty need only be defensible under one of those two lines to survive a constitutional challenge.

Fundamentally, and contrary to Willis and Chung’s argument, the section 5000A(b) penalty is not a tax on “not-doing.” Section 5000A(b) is a penalty (or tax) on the provision of healthcare *self-insurance*. This is not the same as a tax on simply existing, because healthcare self-insurance is an economic decision with real and immediate consequences. The federal government can properly tax (or regulate) self-insurance because healthcare self-insurers are not required to demonstrate financial capacity to absorb the possible costs of their insurance decision, and if that decision proves to be feckless or wise, the federal government will ultimately absorb a substantial portion of the costs.

The remainder of the article develops that argument then applies relevant case law to demonstrate that Congress’s interest in regulating healthcare self-insurance falls squarely within the legislative powers granted by the commerce clause. Alternatively, the penalty is a tax that is not a direct tax in the constitutional sense and therefore can be assessed without apportionment among the states.

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A. Introduction

In their recent special report, “Constitutional Decapitation and Healthcare,”¹ Steven J. Willis and Nakku Chung argue that section 5000A is unconstitutional. In their view, section 5000A is neither a valid exercise of the Congress’s commerce clause authority nor a constitutionally permitted federal tax. They are wrong in both dimensions, but need only be wrong in one for section 5000A to survive a constitutional challenge.

Section 5000A was enacted as part of the Patient Protection and Affordable Care Act.² Section 5000A(a) requires (for tax years ending after December 31, 2013) that an “applicable individual” maintain health insurance meeting specified minimum requirements for himself and his dependents. Section 5000A(d) in turn defines an applicable individual as any U.S. citizen or resident alien, other than an individual who qualifies for specified religious exemptions, or is incarcerated.

Section 5000A(b) imposes a “shared responsibility payment” on applicable individuals who do not maintain health insurance. This payment is described as a penalty. The amount of the aggregate penalty imposed for a tax year is the greater of a flat dollar amount and a percentage of the taxpayer’s income, but in no event more than the cost for that year of a specified health insurance policy. Penalty amounts must be included on a taxpayer’s federal income tax return for the year of the penalty. Finally, section 5000A(e) exempts low-income households, taxpayers found to be suffering a hardship and some other applicable individuals from the imposition of any penalty.

Willis and Chung’s principal argument is that the section 5000A(b) penalty is a tax on not doing. It is not a tax on a transaction, use of property or event, and further is not a tax on income, although it is measured by income. Section 5000A(b), they conclude, therefore is a tax imposed on an individual just by virtue of that individual’s existence. As such, section 5000A(b) can be described only as a “direct” tax (in the constitutional sense, not the sense of the word as employed by economists). And finally, once section 5000A(b) is understood as a direct tax, it must be unconstitutional, because section 5000A(b) as applied cannot possibly satisfy the

¹Steven J. Willis and Nakku Chung, “Constitutional Decapitation and Healthcare,” *Tax Notes*, July 12, 2010, p. 169, *Doc 2010-11669*, 2010 TNT 133-6.

²P.L. 111-148 (2010).

constitutional requirement that direct taxes be apportioned from state to state based on the relative populations of each state.³

This line of reasoning is false. The section 5000A(b) penalty can be defended either as a straightforward exercise of Congress's authority under the commerce clause, or as a tax. If analyzed as a tax, then (putting to one side the powerful argument that apportionment is no longer required of *any* direct tax other than a pure capitation tax) the penalty need not be apportioned and is applied uniformly. As such, it is plainly constitutional.

The rest of this short response briefly summarizes my reasoning.

B. Purpose of Section 5000A(b) Penalty

The fundamental error in Willis and Chung's report is their characterization of section 5000A(b) as a penalty imposed on not doing. This is incorrect. Section 5000A(b) is a penalty (or tax, take your pick) on the provision of healthcare *self-insurance*. This is not the same as a tax on daydreaming, or watching television, or breathing, for the simple reason that from the government's point of view an individual's healthcare decisions are a supremely economic activity.

Healthcare self-insurance is an economic decision with real consequences, because the government is the healthcare insurer of last resort. I impose no costs on others through my choice of what novel to read or television show to watch. But if an individual chooses to self-insure her healthcare costs, she does impose costs on others. The individual will not be left to bleed to death in the streets should she in fact be unable to pay for emergency room care, nor will she be denied all treatment should she be diagnosed with cancer and exhaust her personal resources. By self-insuring, an individual takes advantage (whether consciously or not) of this ultimate safety net. But that safety net is not free; it is extraordinarily costly, and the federal government in practice provides a substantial portion of those costs.⁴

The clear economic interest of the federal government in requiring universal healthcare coverage (and contributions) follows from our commitment as a country to provide the ultimate safety net of some minimum level of

public healthcare, which the federal government in turn helps fund. The federal government can properly tax (or regulate) self-insurance because healthcare self-insurers are not required to demonstrate financial capacity to absorb the possible costs of their insurance decision, and if that decision proves to be feckless or unlucky, the federal government will ultimately absorb a substantial portion of the costs.

This is the vital government economic interest that section 5000A(b) addresses. The payment encourages taxpayers to obtain commercial insurance from regulated insurance companies on whose credit the government reasonably can rely, and it compensates the government for some of the costs incurred by it on behalf of taxpayers who choose to self-insure their healthcare but who ultimately, for whatever reason, find themselves claiming benefits under the minimum public healthcare system that this country provides. It also addresses the free-rider problem that otherwise would be created by the new health insurance system, under which individuals could self-insure while they are healthy and opt into government-mandated third-party insurance regardless of preexisting conditions when they become chronically ill.

There is an analogy here to the ultimate safety net provided to "too big to fail" financial institutions. In each case there is an implied promise by the federal government to fund bad outcomes on which rational individuals and firms in the past have relied; the well-known phenomenon of moral hazard in turn means that those individuals and firms have behaved more recklessly than they would if they were certain that the implied (and costless) federal promise did not exist. Healthcare reform and financial services reform are parallel efforts to address these economic externalities.

We cannot as a country abandon the implied promise to provide some minimum level of public healthcare, but we do not have to hold this out as a free option to those who could have afforded to pay a genuine insurance premium. A tax (penalty) designed to address this problem is thus a rational response to an individual's economic act of self-insuring while still retaining access to both the public healthcare safety net and third-party insurance without regard to preexisting conditions. It is not a tax on not doing, or a mandate to change one's personal behavior, in the same way that a federal mandate to watch two hours of *Family Guy* reruns every evening would be. The commercial interests of the federal government as an insurer of last resort, and in protecting the new healthcare insurance system from being gamed, are overwhelmingly clear here.

C. Commerce Clause

The commerce clause analysis of section 5000A(b) follows inexorably from the determination that healthcare self-insurance is an economic decision in which the federal government has a direct interest, as a result of its role as an insurer of last resort and sponsor of a third-party insurance network available without regard to preexisting conditions.

Congress of course can impose penalties as part of a scheme to regulate some aspect of interstate commerce. Civil fines for violation of the securities laws are an

³For example, if State X has 10 percent of the country's population, a direct tax will be constitutional only if residents of State X pay 10 percent of the total revenues collected by the federal government. Erik M. Jensen, *The Taxing Power: A Reference Guide to the United States Constitution*, at 90-91 (2005); Joseph M. Dodge, "What Federal Taxes Are Subject to the Rule of Apportionment Under the Constitution?" 11 *U. Pa. J. Const. L.* 839, 843-845 (2009). In light of the great diversity across the states of their residents' occupations, age, income, and wealth, a direct tax cannot satisfy this requirement if the tax base is anything other than a simple capitation (head) tax, without imposing different rates on the residents of different states, and further imposing a very complex collection mechanism. *Id.*

⁴Even if the federal government were not to incur any direct costs for public healthcare systems funded at the state level, a self-insuring resident of one state could find herself using the public healthcare system of a different state (as a result, for example, of a traffic accident while engaged in interstate travel). That fact pattern creates a vital federal interest.

obvious example. Moreover, Congress may regulate purely local economic decisions under the authority of the commerce clause, if those decisions have a cumulative and substantial effect on interstate commerce. In *Wickard v. Filburn*, for example, the Supreme Court concluded that the commerce clause gave Congress authority to regulate wheat grown for consumption on the farmer's own farm, because the decision of many individual farmers to grow their own wheat had a cumulative effect on interstate commerce.⁵ In *Gonzales v. Raich*, the Supreme Court extended that reasoning to hold that Congress can regulate local behavior when that regulation "is an essential part of a larger regulation of an economic activity, in which the regulatory scheme could be undercut unless the intrastate activity were regulated."⁶ And as Justice Scalia pointed out in his concurrence, Congress's commerce clause regulatory authority extends even to noneconomic local activity, "if that regulation is a necessary part of a more general regulation of interstate commerce."⁷

Unpenalized healthcare self-insurance would undercut the regulatory scheme adopted by Congress in two respects. First, it would permit taxpayers with the ability to pay for insurance (remember that the penalty applies only to those above specified income levels) to rely on an alternative minimum public healthcare system, which is available even after a self-insuring taxpayer's personal resources are exhausted. Second, it would defeat the entire operation of the new regulatory scheme, under which insurance will be available regardless of a preexisting condition, because it would enable taxpayers to self-insure as long as their healthcare costs were modest and to then opt into the third-party insurance system whenever self-insurance became costly. Each instance would constitute a free option granted by the government, which would defeat the purpose of distributing healthcare costs equitably among the entire population. The government has a clear interest in regulating this behavior, by making it costly to rely on either free option, in order to protect the larger scheme to regulate interstate commerce in healthcare.

D. Taxing Power

1. Overview. Because it is possible to enjoy a long and successful career as a tax professional without dwelling on the constitutional foundations of the tax statutes one analyzes, it might be helpful to begin with a very brief summary of the constitutional limits imposed on Congress's taxing authority. Readers unfamiliar with the area will be surprised to see how limited those constraints are. In this respect, the Constitution can best be understood as contemplating that the principal remedy for harsh, oppressive, or stupid tax legislation is to vote the rascals out.

⁵*Wickard v. Filburn*, 317 U.S. 111 (1942). See also *Gonzales v. Raich*, 545 U.S. 1, 22 (2005).

⁶*Raich*, 545 U.S. at 23-24 (quoting *United States v. Lopez*, 514 U.S. 549, 561 (1995)). See also Jack Balkin, "The Constitutionality of an Individual Mandate for Health Insurance," 158 *U. Penn. L. Rev.* 102, 106-108 (2009).

⁷*Raich*, 545 U.S. at 37 (Scalia, J., concurring in the judgment).

Article I, section 8 of the Constitution grants to Congress the "Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States." Also, Congress is granted authority to "make all laws which shall be necessary and proper for carrying into execution" the powers enumerated in Article I, section 8.

Article I, section 2 provides that "direct taxes shall be apportioned among the several states," and Article I, section 9 further provides that no "capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken."⁸ While there have been many articles in recent years on what constitutes a direct tax and whether the apportionment requirement still survives, it is interesting to note that most of the debate relates to taxes that are laid on property or an incident of property ownership. The only example that the Supreme Court has ever offered of a direct tax on persons is the simple capitation tax, because that tax alone is imposed "without regard to property, profession or any other circumstances."⁹

In 1895 the Supreme Court, in its sharply divided opinion in *Pollock v. Farmers' Loan & Trust Co.*,¹⁰ held that an income tax on property (but not on labor) constituted a direct tax that could be implemented only through apportionment, which is universally understood to be infeasible (because it would require that residents of different states be subject to different federal income tax rates). The practical importance of *Pollock's* holding was eliminated by the 16th Amendment, which gave Congress the "power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

Pollock is an exceptional case. Its efforts to distinguish prior Supreme Court precedent upholding personal property taxes and the income tax as indirect taxes¹¹ are tortured and unconvincing, its holding was reversed by the people through the 16th Amendment, and its expansive reading of the meaning of direct tax has not been followed by subsequent Supreme Court cases.¹² Indeed, the Supreme Court some years later explicitly rejected *Pollock's* fundamental holding that imposing a tax on the

⁸The requirement of apportionment for direct taxes and uniformity for impost, duties, and excises, are "not so much a limitation upon the complete and all-embracing authority to tax, but in their essence [are] simply regulations concerning the mode in which the plenary power [is] to be exerted." *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1, 13 (1916) (citing *Veazie Bank v. Fenno*, 75 U.S. 533, 541 (1869)).

⁹*Hylton v. United States*, 3 U.S. 171, 175 (1796) (Chase, J.) (emphasis supplied). See Section D.4, below.

¹⁰*Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), on rehearing, 158 U.S. 601 (1895).

¹¹*Hylton*, 3 U.S. 171; *Springer v. United States*, 102 U.S. 586 (1880).

¹²*Dodge*, *supra* note 3, at 847. (In the aftermath of *Pollock*, "the Supreme Court reverted to its earlier propensity of holding contested unapportioned federal taxes to be excises.")

income from property amounted to a tax on the property itself, calling that reasoning “a mistaken theory.”¹³

The only important modern case on the meaning of direct taxes is *Murphy v. IRS*,¹⁴ a 2007 D.C. Circuit opinion almost as convoluted in its history and reasoning — and as controversial — as *Pollock*. In that case, the D.C. Circuit noted that the Internal Revenue Code characterized a damage award received for emotional distress as gross income; the court then held that, while the award might not constitute income in the 16th Amendment sense, it nonetheless could be labeled gross income and taxed as such, because the resulting levy was not a direct tax in the constitutional sense. The case is relevant here because the *Murphy* court concluded that a tax imposed directly on a person, without regard to any profession or other commercial activity, still did not constitute a direct tax. Instead, the court concluded that the tax either was on a transaction (the involuntary conversion of Murphy’s human capital) or an excise laid on the proceeds received from vindicating a statutory right through the medium of the legal system.¹⁵ Under either theory, *Murphy* fits squarely within the long history of case law (interrupted only by *Pollock*) that adopts a very narrow reading of the apportionment requirement.¹⁶

Article I, section 8 requires all “duties, imposts and excises” to be “uniform throughout the United States.” The Supreme Court has interpreted this clause to exact “only a geographical uniformity,”¹⁷ meaning “if a particular item is subject to tax, it must be taxed at the same rate throughout the United States, wherever it may be found.”¹⁸ As a result, the clause does little to limit the taxing power, and a provision that “might have dramati-

cally influenced the structure of the federal income tax . . . has shriveled away to a mere flyspeck.”¹⁹ An additional limitation on taxes and duties is found in Article I, section 9, which provides that no “tax or duty shall be laid on articles exported from any state.”²⁰

Beyond these very modest constraints, the Constitution imposes no express limitations on the taxing powers of Congress. The Supreme Court in 1983 summarized the situation by noting that “Congress’ power to tax is virtually without limitation.”²¹ As a result, “the courts in the United States almost invariably affirm the Government’s power to tax in the face of constitutional challenges.”²² In *Spencer v. Merchant*,²³ for example, the Court acknowledged the broad power of the Congress to impose taxes, even oppressive taxes:

The judicial department cannot prescribe to the legislative department limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons; but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected.²⁴

McCray v. United States, a slightly later case, citing *Spencer v. Merchant* with approval, forcefully reiterated the point:

The judiciary is without authority to avoid an act of Congress exerting the taxing power, even in a case where to the judicial mind it seems that Congress had in putting such power in motion abused its lawful authority by levying a tax which was unwise or oppressive, or the result of the enforcement of which might be to indirectly affect subjects not within the powers delegated to Congress.²⁵

¹³*Stanton v. Baltic Mining Co.*, 240 U.S. 103, 113 (1916).

¹⁴493 F.3d 170 (D.C. Cir. 2007), *Doc 2007-15777*, 2007 TNT 129-4.

¹⁵*Id.* at 185-186. The *Murphy* court relied in part in this respect on *Steward Mach. Co. v. Davis*, 301 U.S. 548 (1937) (employer’s share of employee wage taxes is a valid excise), and quoted a passage that has some relevance here: “Natural rights, so called, are as much subject to taxation as rights of less importance. An excise is not limited to vocations or activities that may be prohibited altogether. . . . It extends to vocations or activities pursued as of common right.” (Footnote omitted.) 301 U.S. at 580-581, quoted at 493 F.3d at 186.

¹⁶In doing so the *Murphy* court roundly rejected the argument, developed by Erik Jensen in particular, that indirect taxes are only those that can be shifted to others. 493 F.3d at 183-184.

¹⁷*Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1, 24.

¹⁸Boris I. Bittker, “Constitutional Limits on the Taxing Power of the Federal Government,” 41 *Tax Law* 3, 9 (1987-1988) (citing *Knowlton v. Moore*, 178 U.S. 41, 83-106 (1900)); see also Laurence H. Tribe, *American Constitutional Law* 842 (2000) (“This requirement is one of geographic uniformity only; so long as the tax structure does not discriminate among the states, it does not matter that a tax may not be ‘uniform’ as it applies to particular individuals.”). In *United States v. Ptasynski*, 462 U.S. 74 (1983), the Supreme Court upheld an exemption under the Crude Oil Windfall Profit Tax Act for specified oil produced in particular geographic locations, primarily in Alaska. The Court stated that the uniformity clause “does not require Congress to devise a tax that falls equally or proportionately on each state”; nor does it “prevent Congress from determining the subject of a tax by drawing distinctions between similar classes.” 462 U.S. at 82. See

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also Ronald D. Rotunda and John E. Nowak, *Treatise on Constitutional Law* (4th ed. 2007), section 5.4.

¹⁹Bittker, *supra* note 18, at 9.

²⁰One of the few Supreme Court cases in recent decades that held a federal tax unconstitutional involved a taxing statute that ran afoul of the export clause. *United States v. U.S. Shoe*, 523 U.S. 360 (1988).

²¹*Ptasynski*, 462 U.S. at 79.

²²Tracy A. Kaye and Stephen W. Mazza, “United States — National Report: Constitutional Limitations on the Legislative Power to Tax in the United States,” 15 *Mich. St. J. Int’l L.* 481 (2007); see also Leo P. Martinez, “The Trouble With Taxes: Fairness, Tax Policy, and the Constitution,” 31 *Hastings Const. L.Q.* 413, 437 (“For the sake of preserving this vital power to tax and the government’s fiscal health, the Court appears willing to defer to sovereign taxation powers and to sacrifice taxpayer concepts of fairness or fair play, even if this means allowing the government to shift its tax burdens and benefits in ways that are discriminatory and unfair.”); Richard A. Epstein, “Is the Bonus Tax Unconstitutional?” *The Wall Street Journal*, Mar. 29, 2009, at A11 (“Since the New Deal, if not earlier, the courts have allowed Congress and the states to decide which economic activities to tax and how.”).

²³125 U.S. 345 (1888).

²⁴*Id.* at 355; quoted with approval in *McCray v. United States*, 195 U.S. 27, 61 (1904).

²⁵195 U.S. at 63-64. Some 20 years later, the Supreme Court relied on the commerce clause to conclude that Congress could

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Boris Bittker relied on these early cases in his review of the taxing power:

This view of federal taxation as virtually immune to any constitutional restrictions is reminiscent of an 1867 Supreme Court opinion by Chief Justice Chase, summarizing the “very extensive” federal power to tax as follows: “[The power to tax] is given in the Constitution, with only one exception and only two qualifications. Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject, and may be exercised at discretion.”²⁶

In sum, with the exception of the 5-4 decision in *Pollock*, the courts traditionally have been extremely reluctant to read into the Constitution significant constraints on the taxing powers of Congress. Indeed, with the exception of *Eastern Enterprises v. Apfel*²⁷ (technically not a tax case) and *United States v. U.S. Shoe*,²⁸ I am unaware of any instance in the last 50 years when the Supreme Court has struck down any federal tax or comparable levy on the ground that the levy unconstitutionally burdened a taxpayer’s claim to his income, property, or similar economic rights (for example, as impermissibly retroactive, or excessively narrowly targeted to an identifiable set of taxpayers, or as arbitrary and irrational).²⁹

Nonetheless, the Constitution’s other general checks on the powers of Congress in extremely unusual cases can limit the taxing powers of Congress. A century ago, the Supreme Court explained:

not use its taxing power indirectly to regulate subjects that it could not regulate directly, but the Court reversed itself again in 1937. See *infra* note 32.

²⁶Bittker, *supra* note 18, at 4.

²⁷524 U.S. 498 (1998) (new obligation to fund retiree health benefits attributable to a plan from which the appellant had withdrawn decades earlier was held unconstitutional; plurality relied on takings clause).

²⁸523 U.S. 360 (harbor maintenance tax-burdened exports and thereby violated the export clause of Article I, section 9).

²⁹The Supreme Court has, however, invalidated some taxes when the design of those taxes burdened other fundamental rights. See, e.g., *Marchetti v. United States*, 390 U.S. 39 (1960) (registration requirement connected with excise tax on bookmakers violated Fifth Amendment privilege against self-incrimination; information made available to state authorities); *accord*, *Grosso v. United States*, 390 U.S. 62 (1968).

Lower courts in recent years have considered some interesting constitutional issues in noncommercial settings. *Murphy*, of course, is the best example. Another is *Moritz v. Commissioner*, 469 F.2d 466 (10th Cir. 1972), which held that section 214’s limitation of the dependent care deduction (as then in effect) in a manner that denied the deduction to men who had never married was unconstitutional as a violation of equal protection. And very recently, the U.S. District Court for the District of Massachusetts held that federal legislation banning same-sex couples married in Massachusetts from filing joint federal income tax returns was unconstitutional as applied to the plaintiffs in the case, on Fifth Amendment grounds. *Gill v. Office of Personnel Management*, No. 09-10309 (D. Mass. July 8, 2010), *Doc 2010-15303*, 2010 TNT 132-18.

If a case was presented where the abuse of the taxing power was so extreme as to be beyond the principles which we have previously stated, and where it was plain to the judicial mind that the power had been called into play not for revenue but solely for the purpose of destroying rights which could not be rightfully destroyed consistently with the principles of freedom and justice upon which the Constitution rests, that it would be the duty of the courts to say that such an arbitrary act was not merely an abuse of a delegated power, but was the exercise of an authority not conferred.³⁰

Examples of general constitutional constraints that might in theory be invoked to constrain the legislature’s taxing power in extraordinary cases include the Fifth Amendment’s due process clause, the prohibition on bills of attainder, and the Eighth Amendment’s restriction on “excessive fines.” None of these extraordinary circumstances is relevant to section 5000A(b).

2. Application to section 5000A(b). Section 5000A(b) appears to raise two constitutional taxing power questions. First, is it properly analyzed as a tax? And second, assuming that section 5000A(b) is a tax (and not otherwise defensible on commerce clause grounds), is it a direct tax that can be imposed only through apportionment among the states, which plainly is infeasible?³¹ Because the second is the topic to which most of the Willis and Chung report is addressed, I defer that for a few pages.

It is natural to have a visceral reaction that section 5000A(b) should not properly be characterized as a tax, because it is not primarily designed to collect revenue, but rather to compel behavior. Since 1937, however, the Supreme Court has rejected any invitation to distinguish between taxes designed to influence behavior and taxes designed to raise revenue, so long as the tax legislation “has some reasonable relation to the exercise of the taxing authority conferred by the Constitution.”³² This principle applies even when the revenue raised is “negligible.”³³ In

³⁰*McCray*, 195 U.S. at 64.

³¹If section 5000A(b) required apportionment, each state’s residents would pay a different rate of tax, in order to keep the tax collected proportionate to the state’s population, and no other factor.

³²*Sozinsky v. United States*, 300 U.S. 506 (1937) (upholding federal license tax on dealers in firearms). In *Sozinsky*, the Court stated, “Every tax is in some measure regulatory. . . . But it is not any less a tax because it has a regulatory effect. . . . Inquiry into the hidden motives which may move Congress to exercise a power constitutionally conferred upon it is beyond the competency of the courts.” *Id.* at 513 (citations omitted). See also Bittker, *supra* note 18, at 11-12.

Citing pre-*Sozinsky* case law to the contrary (e.g., *United States v. Butler*, 297 U.S. 1 (1936)) misses the point that the Supreme Court changed its mind and reversed its substantive due process line of cases beginning in 1937. *Bob Jones University v. Simon*, 416 U.S. 725, 741 n.12 (1974) (“It is true that the Court [in early cases] . . . drew what it saw at the time as distinctions between regulatory and revenue-raising taxes. But the Court has subsequently abandoned such distinctions.”).

³³*United States v. Sanchez*, 340 U.S. 42, 44 (1950) (“It is beyond serious question that a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the

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practice, then, a federal compulsory collection mechanism adopted as tax legislation usually is analyzed as a tax. It also follows from this that Congress's taxing power in commercial matters extends beyond that of the commerce clause, even when the tax in question unquestionably has a dominant regulatory agenda.

Section 5000A(b) thus can be analyzed as a tax, independently of any alternative analysis of the section as a component of a larger scheme to regulate healthcare in interstate commerce. Finding a constitutional basis for the provision under either line of analysis is sufficient to ensure its validity.

3. Section 5000A(b) as an income tax. On its face, section 5000A(b) functions as an income tax. It is a section of the Internal Revenue Code. Low-income taxpayers are exempt (section 5000A(e)(1)), the amount collected is measured as a percentage of income (section 5000A(c)(2)(B)) (subject to a floor and a ceiling), and the amount is includable on a taxpayer's federal income tax return. So why isn't it an income tax, and as such plainly constitutional?

To this Willis and Chung proffer a long and convoluted answer. As they argue from time to time in their report, this is a question of the substance of section 5000A(b), not its form, but in fact their argument relies much on form, particularly section 5000A(b)'s placement within the structure of the Internal Revenue Code; from this they conclude that section 5000A(b) payments must be analyzed as excise taxes. They seem to believe that a floor on the tax makes it a capitation (head) tax, but that overlooks the obvious point that the tax applies only to higher-income taxpayers. Exactly the same tax could be collected by describing this as a tax from which taxpayers with incomes below \$X are exempt, a tax at rate A on the first \$X of household income for taxpayers who have incomes above \$X, plus a tax at rate B on income above \$X. The capitation characterization thus dissolves.

Bizarrely, Willis and Chung then argue that section 5000A(b) does not tax income, because "it refers to no gains, receipts, accruals or accessions to wealth, other than to an arguably unimportant algebraic function of income."³⁴ Imposing mandatory government collections

activities taxed. The principle applies even though the revenue obtained is obviously negligible, or the revenue purpose of the tax may be secondary. Nor does a tax statute necessarily fall because it touches on activities which Congress might not otherwise regulate.") (Citations omitted). In fact, the Congressional Budget Office and the staff of the Joint Committee on Taxation have estimated that the section 5000A(b) penalty will collect some \$4 billion a year in revenue by 2017, and \$17 billion in total over the 10-year 2010-2019 period. Letter from Douglas W. Elmendorf to Nancy Pelosi, March 20, 2010, at Table 4, *Doc 2010-6145*, 2010 TNT 55-27.

³⁴Willis and Chung, *supra* note 1, at 187. An earlier article by Rodney P. Mock and Jeffrey Tolin, "Purchase or Else: The Health Insurance Tax," *Tax Notes*, Jan. 11, 2010, p. 224, *Doc 2009-28125*, 2010 TNT 8-6, the reasoning of which is similar in many respects to that of Willis and Chung, makes exactly the same argument: "The House bill labels this a tax, even though it is not based on income (the bill uses a taxpayer's AGI only as its measuring stick to determine the exact amount of the extraction)." *Id.* at 230. But how is this use of adjusted gross income as a measuring stick to determine the federal extraction different from the

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calculated as a percentage of household income, while perhaps an unimportant algebraic function, is exactly how an income tax operates.

Willis and Chung then embark on a long discussion of their theory of "derived income," a term not regularly used in the tax literature, by which they seek to demonstrate that the realization doctrine articulated by *Eisner v. Macomber*³⁵ is both broad in its reach and a constitutional imperative to an income tax. Those twin conclusions are inconsistent with the steady stream of Supreme Court and other decisions narrowing the application of the realization doctrine, are not widely shared in the literature,³⁶ and are inconsistent with many provisions of the Internal Revenue Code itself.³⁷ Regardless, the discussion also is inapposite, as the amount paid under section 5000A(b) in fact is measured by household income, determined in a manner that even the *Eisner v. Macomber* court would endorse.

Willis and Chung further seem to argue that the purpose of section 5000A(b) is suspect, in that it is motivated by a regulatory agenda, and therefore is attempting to do indirectly something that Congress could not do directly. But as discussed in the preceding section, that is no longer a basis for recharacterizing a tax as something else, so long as some revenue can be expected to be collected.

Finally, section 5000A(b) unquestionably is "uniform," in the sense that term is used by the Constitution, because it applies without geographical differences. Whether income taxes are subject to the uniformity requirement, and whether in turn the uniformity requirement is violated by local cost-of-living-type adjustments to a tax, are both interesting questions, but are not relevant to section 5000A(b) as it was adopted.

The closest (albeit imperfect) analogy to section 5000A(b) probably is the private foundation excise tax imposed by section 4942. Willis and Chung describe the section 4942 tax as one imposed on undistributed income, which is consistent with the section's heading, but in fact that tax basically requires a private foundation to distribute annually at least 5 percent of its wealth (not its realized income or its "derived" income) or face penalty taxes ranging up to 100 percent of the undistributed amount.³⁸ This is a tax that arguably is imposed on not

income tax, which does exactly the same thing after a brief stop to include personal exemptions and deductions? The authors do not provide an answer.

³⁵252 U.S. 189 (1920).

³⁶See, e.g., William A. Klein et al., *Federal Income Taxation* 225 (15th ed. 2009); Jensen, *supra* note 3, at 115-117 (summarizing the "vast majority" of modern commentators as agreeing with Michael Graetz that the case is "now archaic").

³⁷Thus, stock dividends are in fact includable in income in many cases (section 305(b) and (c)), and unrealized gains are taxed to cash method investors in various financial products under section 1256 (overlooked by Willis and Chung) as well as section 475(f) (whose reach Willis and Chung also fail to appreciate).

³⁸The tax is imposed on a private foundation's undistributed income, which section 4942(c) defines as the excess of the distributable amount over preceding qualifying distributions

(Footnote continued on next page.)

doing, is not measured by income, and is not really intended to raise revenue. It is a club wielded to compel private foundations to do something having nothing to do with taxation (distribute their wealth to worthy causes), and revenue collections are incidental to that purpose. Yet the tax (or penalty, or whatever label you wish to apply) has been part of the Internal Revenue Code for years, and the Tax Court upheld its constitutionality without difficulty.³⁹

4. Section 5000A(b) as a direct tax. Willis and Chung's argument ultimately boils down to the claim that section 5000A(b) is not a valid exercise of Congress's commerce clause authority and is a direct tax in the constitutional sense. There is general agreement that Congress has not provided (indeed could not provide, as a practical matter) for section 5000A(b) to be apportioned among the states according to their relative populations, which the Constitution is said to require of direct taxes.⁴⁰

There is an enormous modern literature on the meaning of the term "direct" taxes as used by the Constitution.⁴¹ Most analysts agree that a tax on the value of land is a direct tax, and all agree that a capitation tax — a tax imposed on a person simply by virtue of his existence — is a direct tax.⁴² Beyond that, there is not much agreement. Interestingly, the Founding Fathers shared our uncertainty as to the word's meaning. A famous passage from the record of the Constitutional Convention captures this

made for the same year. A private foundation's distributable amount is defined by section 4942(d) as basically equal to its minimum investment return, which in turn is defined by section 4942(e) as 5 percent of the value of the foundation's assets not held directly for use in the foundation's exempt activity. As a result, a private foundation must distribute 5 percent of the value of its investment portfolio each year, even if it realizes no gross income in respect of that portfolio. And to add insult to realization injury, the value of publicly traded securities for this purpose is calculated on a monthly mark-to-market basis. Section 4942(e)(2).

³⁹Stanley O. Miller *Charitable Fund v. Commissioner*, 89 T.C. 1112 (1987). Admittedly, section 4942 presents a relatively easy case from a constitutional perspective, because the tax is imposed on entities (private foundations), which in turn have been granted a privileged tax status. The section thus properly is characterized as an excise tax.

⁴⁰See below for the argument that the apportionment rule has been overruled by the 13th and 14th amendments.

⁴¹Dodge, *supra* note 3, is an exhaustive recent analysis. Dodge concludes: "My 'middle of the road' position is that apportionment is still alive, but (apart from requisitions and capitation taxes) is confined to federal taxes on real estate and tangible personal property. This position differs from the apparent state of current doctrine, which is that 'direct tax' also encompasses taxes on intangible personal property." *Id.* at 842-843. See also Jensen, *supra* note 3, at 220 for a list of modern articles on the topic current through 2004, which include several thoughtful articles by Jensen himself (with which, as it happens, I largely disagree). Jensen and Calvin Johnson have engaged in a long exchange of views on the topic. See, e.g., Erik M. Jensen, "The Apportionment of 'Direct Taxes': Are Consumption Taxes Constitutional?" 97 *Colum. L. Rev.* 2334 (1997); Calvin H. Johnson, "Fixing the Constitutional Absurdity of the Apportionment of Direct Tax," 21 *Const. Comment.* 295 (2004).

⁴²Dodge, *supra* note 3, at 841-843.

piquant noncolloquy: "Mr. King asked what was the precise meaning of *direct* taxation? No one answered."⁴³

Willis and Chung's thesis would be correct if section 5000A(b) imposed a simple capitation tax — a flat dollar tax on every American citizen — to fund healthcare. That tax would apply universally and would not look to the incomes or other attributes of taxpayers. Such a capitation tax also would be administrable as a direct tax, because by definition it would be imposed in proportion to each state's population. A capitation tax like this in fact is the only tax on persons (as opposed to property or an attribute of property) that to my knowledge has ever been classified as a direct tax. But section 5000A(b) of course does not operate in this manner. It applies only to taxpayers with incomes above specified levels, and then only to those taxpayers who have made the economic decision to self-insure their healthcare costs. The tax itself is one that varies based on the taxpayer's income. If the question is asked, as for example the *Murphy* court did, whether this tax more closely resembles a capitation tax or the income tax, the answer is obvious.

Bruce Ackerman has shown that the apportionment requirement was an integral part of the notorious three-fifths compromise, under which slaves were counted as three-fifths of a person for purposes of calculating the number of members of the House of Representatives from each state.⁴⁴ He persuasively argues that with the abolition of slavery through the Reconstruction amendments, the apportionment requirement also has been rendered superfluous, and need no longer be followed.⁴⁵ In his view, then, a capitation tax would remain subject to apportionment, because Article I, section 9 so requires, but apportionment would not be required of any other direct tax.

This conclusion may seem surprising to tax professionals, who are trained to take every word in a text literally. After all, the Reconstruction amendments did not strike the apportionment rule from the Constitution's text. The answer here is that the Reconstruction amendments also did not strike the three-fifths compromise from the original text: To this day the Constitution lays out the three-fifths compromise for counting slaves in Article I, section 2; the 13th and 14th amendments effectively override the original text but do not directly restate it. The Constitution is not a code. (By contrast, new tax legislation generally modifies the Internal Revenue Code, so that the code is a composite amended and restated legislative text.)

Putting Ackerman's argument to one side, most modern debate on the direct tax apportionment requirement has related to the taxation of property.⁴⁶ These debates have no relevance to section 5000A(b), which is a tax on

⁴³2 *The Records of the Federal Convention of 1787*, at 524 (Max Farrand ed., 1966), at 350 (Aug. 20, 1787).

⁴⁴Bruce Ackerman, "Taxation and the Constitution," 99 *Colum. L. Rev.* 1 (1999). The article also offers a convincing explanation for the existence of the original Constitution's two separate references to direct taxes. *Id.* at 11-13.

⁴⁵*Id.*

⁴⁶Dodge, *supra* note 3, at 842.

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the activities (self-insurance) of individuals, not their ownership, use, or economic returns from property.

From the other direction, a capitation tax is the only form of tax on persons that the Supreme Court has ever indicated is a direct tax. But a capitation tax is universally understood as a tax imposed on an individual “without regard to property, profession or any other circumstances.”⁴⁷ That also does not describe taxpayers subject to section 5000A(b). The section applies only to applicable individuals with incomes above specified thresholds who choose to self-insure their healthcare costs; in turn, the amount of the tax varies with incomes. These are special circumstances that take section 5000A(b) out of any common understanding of a capitation tax.

To summarize, for Willis and Chung’s argument to prevail, they must clear three hurdles. They must show that section 5000A(b) is not a valid exercise of commerce clause authority, that the apportionment of direct taxes has survived the Reconstruction amendments, and that section 5000A is a direct tax other than an income tax. Arguing that section 5000A(b) doesn’t sound much like the sort of indirect tax that Alexander Hamilton had in mind when he wrote about customs and excise duties isn’t enough to win this case. One must instead demonstrate the positive — that section 5000A(b) is some sort of noncapitation direct tax imposed on persons. But what can one cite for this proposition?

Not *Pollock*.⁴⁸ That case famously held that a tax on the income derived from property functioned as a tax on the property itself, and therefore a direct tax, in the view of the majority in that case. But *Pollock* did not hold that taxes on individuals other than true capitation taxes were direct taxes: To the contrary, it concluded that taxing labor income was not a direct tax on the person.⁴⁹ The *Pollock* Court of course could not have contemplated section 5000A(b).⁵⁰ However, given that section 5000A(b) applies to individuals and not their property, is not a capitation tax, is measured by incomes, and is imposed on a particular economic activity (self-insurance), to what authority can Willis and Chung point in support of the argument that this is a direct nonincome tax?

Willis and Chung might argue in response that I have phrased things backwards, and that it is incumbent on defenders of section 5000A(b) to demonstrate that the provision is not a direct tax. Such an argument, however, would misapprehend standard canons of statutory construction (by presuming legislation to be unconstitutional

unless proven to be constitutional). It also would ignore the many Supreme Court cases that have urged a narrow construction for direct taxes, and that have reaffirmed the very broad taxing powers of Congress.⁵¹

E. The Kreplach Connection

Kreplach are a boiled or fried meat- or potato-filled sort of ravioli or won ton, whose principal claim to individuality is that they are triangular in shape.⁵² They are a staple of Jewish cooking (hence their appearance in chicken soup). My late father once told me a story about kreplach, the moral of which was lost on me until I read the Willis and Chung report.

It seems there was a young boy with an irrational hatred of kreplach. His father set out to help the boy overcome this bizarre behavior. The father laid out all the ingredients on the table. “Now,” he said, “is there anything here that upsets you?” “No,” replied the boy. “And if I mix up the flour, salt, and eggs to make this dough, is that troubling?” “Of course not,” said his son. “And if I grind the meat and add onions and parsley, can there be any harm in that?” “No, not at all,” said his son, “it’s just hamburger.”

The father continued his demonstration. “If I cut the dough into triangles, that won’t be upsetting, will it? You like fun shapes.” “I do indeed,” said the boy. “And now I put the chopped meat on the triangle, and I fold up one corner, like so.” “I see,” said the boy. And then the father folded up the second corner, and the boy quietly continued to watch. Finally, the father triumphantly folded up the last corner to make the classic triangular meat-filled dumpling. “Oy,” shouted the boy, “kreplach!”

And so it is with Willis and Chung. They acknowledge that Congress plainly has the authority to impose a mandatory healthcare system funded through taxes. And if Congress were to enact such a system, and then were to enable taxpayers to opt out, but only on condition of demonstrating that the taxpayer had adequate private insurance, with a penalty imposed if the taxpayer were to let the private insurance lapse, could there be a constitutional problem in that? Of course not. Adding extra rights can hardly be a constitutional issue. And if Congress were later to decide to withdraw the federal government from the healthcare insurance business, and leave behind simply the private insurance mandate and a penalty for noncompliance?

Oy! Kreplach!

⁴⁷*Hylton*, 3 U.S. at 175 (Chase, J.).

⁴⁸157 U.S. 429 (1895) and 158 U.S. 601 (1895).

⁴⁹158 U.S. 601. This effectively was the basis for the *Pollock* Court’s tortured distinction of an earlier case, *Springer v. United States*, 102 U.S. 586 (1880), which had held the Income Tax Act of 1864 to be a constitutional indirect tax. See Roswell Magill, *Taxable Income* 338-340 (rev. ed. 1945).

⁵⁰“And although there have been from time to time intimations that there might be some tax which was not a direct tax nor included under the words ‘duties, imposts and excises,’ such a tax for more than one hundred years of national existence has as yet remained undiscovered, notwithstanding the stress of particular circumstances has invited thorough investigation into sources of revenue.” 157 U.S. at 557.

⁵¹The list would begin with one of the Supreme Court’s early decisions, *Hylton*, 3 U.S. 171, would include many of the cases mentioned in Section D.1, and would extend at least through *South Carolina v. Baker*, 485 U.S. 505 (1988).

⁵²Interested readers can find a kreplach recipe, available at <http://www.epicurious.com/recipes/food/views/Kreplach-236219>. Why in fact readers would be interested is unclear to the author, as this is the sort of food that drove him to vegetarianism at an early age.