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A Tax or Not a Tax: That is the Question

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tial's recovery in a subsequent bankruptcy proceeding to the typed-in amount, \$92,885. According to the *Wall Street Journal*, a federal court held that Prudential was entitled to its full claim. However, Prudential had already settled for a lesser amount, about \$12 million. These facts turned into a litigation nightmare for the law firms involved. Milo Geyelin and Amy Stevens, *Typo Causes Problems for Two Law Firms*, WALL ST. J., Dec. 11, 1990, at B4.

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A TAX OR NOT A TAX, THAT IS THE QUESTION

To the Bag:

In a letter published in the Spring 2011 issue, Jack Metzler said I had argued, in *Prepositions in the Constitution*, 14 GREEN BAG 2D 163 (Winter 2011), “that a capped tax on income is unconstitutional because it is not a tax ‘on’ incomes, as permitted by the Sixteenth Amendment.” If that argument is right, Mr. Metzler added, he “take[s] it [that he] can stop paying Social Security.”

That first quoted passage doesn't get my argument quite right. Yes, a federal tax must be “on incomes,” within the meaning of the Sixteenth Amendment, to be valid – *if* it's a direct tax and hasn't been apportioned among the states on the basis of population. And I'm willing to concede that “a capped tax *on income*,” as Mr. Metzler put it, is a “tax on income” for this purpose. (In Ohio we call that a tautology.) In the unusual situation where a tax's validity depends on the Amendment,¹ however, what the tax is “on” is the question –

¹ Most federal taxes, although unapportioned, are clearly valid. (No tax has been apportioned since 1861.) Indirect taxes (duties, imposts, excises) are not subject to apportionment to begin with. Direct taxes, however – including, at a minimum, capitation and real-estate taxes – must be apportioned unless they're “taxes on incomes.” The Sixteenth Amendment, ratified in 1913, made the modern income tax possible: in 1895 the Supreme Court had held that the 1894 income tax was direct and, because it hadn't been apportioned, unconstitutional.

it's not a given – and a cap can affect that analysis. Some caps might be OK, others not so much.

When it comes to determining what a tax is “on,” the Amendment should be interpreted in light of its purpose: to make possible a system in which the well-to-do pay a fair share of taxes, which hadn't been happening when Congress relied on tariffs and excises for revenue. With a “tax on incomes,” if you earn more, you should generally pay more.

Suppose Congress were to impose a tax at a single rate (10%, 50%, 90%, whatever) on the first \$10,000 of every adult American's “income.” Congress could call that a “tax on incomes,” I suppose, but I wouldn't and you shouldn't – even if “income” were properly measured. With the low cap, almost everyone would be paying the same amount. That would be a lump-sum capitation tax, or close to it, not a “tax on incomes.”

I know, I know – that's a silly hypothetical. Let's get real and consider Mr. Metzler's reference to Social Security, an obviously important subject. I originally thought he might be suggesting that, because the old-age, survivors, and disability insurance (OASDI) “tax” has been subject to an annual income cap,² and no one seems to question its constitutionality, caps don't matter for Sixteenth Amendment purposes. But I now understand him to suggest that, if my argument about “taxes on incomes” has merit, there really might be a serious constitutional issue with the OASDI tax.

I agree. We ought to be nervous about the constitutionality of the OASDI tax – *if* the Amendment is essential to that analysis. For years, that capped, regressive tax has represented by far the largest federal tax obligation for lower-income Americans. Perhaps none of that is critical, but it's not what Sixteenth Amendment boosters had in mind.³

² The Medicare component of the scheme has, in contrast, not been subject to an income cap for some time.

³ I address issues involving Social Security levies in a forthcoming article. *See, if it ever comes out*, Erik M. Jensen, *The Individual Mandate and the Taxing Power*, 37 N. KY. L. REV. ___ (2011). A draft is on SSRN; downloads are always welcome.

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There's a potentially easy way out, however. Many assume that unapportioned Social Security "taxes" are constitutional *because* they are "taxes on incomes." But the Supreme Court has never said that,⁴ and, to my mind, Social Security levies weren't taxes at all as the system was created. If you make a payment to a government, and you get something specific in return – entry into a park, say – you're not being taxed. And payors into Social Security are (or were) acquiring a specific benefit, a retirement and disability plan.⁵ With that understanding, the Taxing Clause and the Sixteenth Amendment were irrelevant to constitutional analysis in 1935.⁶ The justification for the OASDI "tax" had to be found elsewhere, presumably in the Commerce Clause.

But let's assume *arguendo* that today we do need the Sixteenth Amendment to justify the unapportioned OASDI levy: assume, that is, that it is a tax, but it isn't an indirect tax.⁷ Even if that's the case, maybe the cap in its present form isn't fatal. The argument goes like this: The cap does come into play for high-income folks, like big firm lawyers and *Bag* editors, for whom the OASDI obligation is a flat amount, unaffected by income above the cap.⁸ That's troubling, but, as Steven Willis and Nakku Chung have noted, by far most

⁴ See Steven J. Willis & Nakku Chung, *Constitutional Decapitation and Healthcare*, 128 TAX NOTES 169, 187 (2010) (noting the pervasive assumption and dissecting it).

⁵ You also get benefits from paying taxes, I've been told, but those are the more amorphous benefits of a civilized society – i.e., before the designated hitter and gangsta rap came along.

⁶ The Supreme Court has referred to the levy as a "tax," *see, e.g., Flemming v. Nestor*, 363 U.S. 603, 609 (1960), although not in evaluating constitutionality. On the other hand, the Court referred to Social Security "as a form of social insurance." *Id.* On the other, other hand, the Court concluded that an employee has no "accrued property rights" in his Social Security interest, *id.* at 610, and the interest "cannot be soundly analogized to that of the holder of an annuity, whose right to benefits is bottomed on his contractual premium payments." *Id.* This is hard, isn't it?

⁷ Most of my academic colleagues, however, believe that an income tax is indirect, and that the Sixteenth Amendment should have been unnecessary. In their view, the Court blew it in 1895. *See supra* note 1.

⁸ *See Willis & Chung, supra* note 4, at 187.

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Americans have incomes below the cap (\$106,800 in 2010 and 2011). Most therefore wind up paying a percentage of their earnings into the system, which sounds a lot like a “tax on incomes.”⁹ Deviations from income norms occur at higher levels, to be sure, but the whole structure shouldn’t fall simply because the measure of “income” isn’t perfect.¹⁰

Despite the cap, the OASDI levy might therefore be treated as a “tax on incomes” and therefore unquestionably valid in its unapportioned form.¹¹ But I remain uncomfortable about all of this; I can imagine clearly problematic caps. In any event, I certainly wouldn’t infer, as many seem to, that, just because the OASDI levy is subject to a cap which *might* be consistent with a “tax on incomes,” *any* cap is therefore acceptable. That can’t be right. There are serious issues here, and I thank Mr. Metzler for raising the Social Security issue. (I advise him, however, to keep paying Social Security, at least for now.)

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⁹ *Id.* at 188.

¹⁰ Suppose what is otherwise unquestionably an unapportioned tax on incomes provides for a 0% rate on taxable income above \$1 billion. That cap would affect almost no one. Surely it shouldn’t affect the legitimacy of the tax.

¹¹ I reemphasize, however, that if the levy isn’t a tax or if it’s an indirect tax, the Amendment matters not a whit. *See supra* note 1; *cf.* Lawrence Zelenak, *Radical Tax Reform, the Constitution, and the Conscientious Legislator*, 99 COLUM. L. REV. 833, 843 n.58 (1999) (describing unsuccessful constitutional challenges to Social Security taxes).