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Unapportioned Direct-Consumption Taxes and the Sixteenth Amendment

by Erik M. Jensen

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The point of this essay is simple: a direct-consumption tax like the Forbes-Armev-Hall-Rabushka flat tax or the Nunn-Domenici USA tax isn't a "tax on incomes" within the meaning of the Sixteenth Amendment.¹ As a result, such a tax would be constitutional only if it were apportioned among the states on the basis of population.² And since these taxes wouldn't be apportioned — how could they be and work as they're intended to work? — they would be unconstitutional.

I've written on this subject before,³ and I intend to do so again — probably at mindnumbing length.⁴ This

¹The Congress shall have 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." U.S. Const. amend. XVI.

²The direct-tax apportionment rule is set out twice in the Constitution. In pertinent part, article I, section 9 provides that "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before direct to be taken." U.S. Const. art. I, section 9, cl. 4. And "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers. . . ." U.S. Const. art. I, section 2, cl. 3.

³See Erik M. Jensen, "The Apportionment of 'Direct Taxes': Are Consumption Taxes Constitutional?," 97 *Colum. L. Rev.* 2334, 2408-14 (1997), abridged version at *Tax Notes*, Nov. 2, 1998, p. 611 (1998). My article was recently trashed by Bruce Ackerman, "Taxes and the Constitution," 99 *Colum. L. Rev.* 1 (1999), but I immodestly think Ackerman is dead wrong. I have responded to him, in an article that I hope some thick-skinned law review will eventually publish. Erik M. Jensen, "Taxation and the Constitution: How to Read the Direct-Tax Clauses" (forthcoming, maybe).

⁴I assume, without discussion, that a shorter essay on this subject isn't necessarily mindnumbing.

article briefly presents my current thinking on Sixteenth Amendment issues. It was supposed to serve as part of a symposium on constitutional issues in taxation — in fact, it was supposed to serve as a bull's-eye that other commentators could shoot at — but, so far, no one has wanted to open fire. Here, not-so-gentle readers, is your chance.

Choose your weapons; let the battle begin.

I begin with a few assumptions that are necessary to keep the debate limited to the Sixteenth Amendment point. I then outline my reasons for treating the phrase "taxes on incomes" as having substantive content and for doubting that a direct-consumption tax is such a tax on incomes.

Lest I be misunderstood, let me emphasize that I'm not advancing arguments about the merits of direct-consumption taxes. I'm focusing on issues of constitutional interpretation, and just as not all arguably bad policies are unconstitutional, not all arguably good policies meet constitutional requirements.

Assumptions

To focus on the meaning of "taxes on incomes," I make some assumptions that will seem peculiar to most tax buffs.

Assumption number 1: I assume that an income tax is a direct tax within the meaning of the direct-tax apportionment rule of the Constitution.⁵ I assume, that is, that the 1895 *Income Tax Cases*⁶ were rightly decided, and that the only reason a "tax on incomes" needn't be apportioned among the states is the Sixteenth Amendment. This isn't an unfounded assumption — I've set out the reasoning to support it elsewhere⁷ — but for present purposes it needs to be treated as a given.

I recognize that not everyone accepts this assumption, and that others, like Calvin Johnson,⁸ who might agree that an income tax is a direct tax under the original understanding, nevertheless believe that Sixteenth Amendment questions go away because the direct-tax apportionment rule was properly aban-

⁵See *supra* note 2.

⁶*Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), 158 U.S. 601 (1895).

⁷See Jensen, *supra* note 3, at 2366-75.

⁸Of course, there isn't anyone really "like" Calvin Johnson.

done long ago. An exception to the direct-tax rules is irrelevant if the rules themselves are merely historical curiosities.⁹

Direct taxes other than 'taxes on incomes' must be apportioned. If an unapportioned direct-consumption tax is direct and isn't a 'tax on incomes,' it would be unconstitutional.

For now, I put aside that issue in order to focus on the meaning of "taxes on incomes." We can't discuss every interpretational issue simultaneously; please understand me in Assumption Number 1.

Assumption Number 2: I assume a *direct-consumption* tax, like the flat tax or the USA tax, which would operate on individuals very much like a traditional income tax but which would reach only the consumption component of income, is a direct tax. Although debatable, this also isn't an unfounded assumption. Such a tax is a direct tax for many of the same reasons that the tax at issue in the *Income Tax Cases* was direct: it's a tax imposed directly on individuals and isn't presumptively shiftable like a classic indirect tax on articles of consumption.¹⁰ The Sixteenth Amendment dealt with the practical consequences of the *Income Tax Cases*, but no judicial authority has explicitly repudiated the meaning of "direct taxes" that can be derived from those cases and from a study of the original understanding of the direct-tax clauses.¹¹

With those assumptions, the Sixteenth Amendment issue takes center stage. Direct taxes other than "taxes on incomes" must be apportioned. If an unapportioned direct-consumption tax is direct and isn't a "tax on incomes," it would be unconstitutional.

Why a Consumption Tax Isn't a Tax on Incomes Under the Sixteenth Amendment

We've all grown up assuming that the Constitution imposes no serious limitations on the congressional taxing power, and it's therefore hard to take seriously any constitutional language that seems to put limits on that power. (I venture to guess that few even know that there's limiting language in the Constitution.) But, as tax professionals, we don't ordinarily disregard statutory language that's inconvenient. And we should

show at least as much respect for constitutional text as we do for language in the Internal Revenue Code.¹²

To be sure, in form the Sixteenth Amendment isn't a limiting provision. Quite the contrary. Not long after the Supreme Court in the *Income Tax Cases* struck down an income tax on the ground that it was an unapportioned direct tax, the Sixteenth Amendment was approved by Congress and ratified by the states — ratification was certified in 1913 — to permit such a tax. The Amendment makes clear that "taxes on incomes" needn't be apportioned, and that's an expansion of the taxing power as understood after the *Income Tax Cases*.

But in form it's not an unlimited expansion. The amendment was a response to the *Income Tax Cases*, and it's only "taxes on incomes" that the Amendment removes from the apportionment requirement. A direct tax that isn't a tax on incomes must be apportioned to be valid. It has become the conventional wisdom that a "tax on incomes" is whatever Congress says it is, or whatever we want it to be. In Daniel Shaviro's words, "[I]t is generally agreed that the [Sixteenth] Amendment does not significantly constrain how taxable income can be defined by Congress and the courts."¹³ I challenge the conventional wisdom.

Here are a couple of samples of the conventional wisdom, drawn from works by important writers on taxation. Both samples contain language that is consistent with common understanding, and that elegantly make the points I want to rebut.

Victor Thuronyi argues that, "[b]ecause people have different views of tax equity, there is no 'true' concept of income."¹⁴ Instead, the concept "is by its nature highly practical, flexible and ad hoc,"¹⁵ and that has constitutional implications:

[T]he Constitution allows Congress to provide for the common defense. Can a congressional funding of a missile be challenged on the basis that, in fact, the missile . . . decreases our security? Apart from standing concerns, such a challenge surely would be summarily rejected by the courts on the basis that the common defense is an inherently malleable term the meaning of which must be left to the judgment of Congress. The

⁹See Calvin H. Johnson, "Apportionment of Direct Taxes: The Foul-Up in the Center of the Constitution," 7 *Wm. & Mary Bill of Rts. J.* 1 (1998); cf. Ackerman, *supra* note 3. Ackerman argues that the apportionment rule was originally limited to real-estate and capitation taxes. And he goes on to argue that, because of "social justice," the "American People," and the New Deal Revolution, the Sixteenth Amendment also shouldn't be interpreted as a limitation on the taxing power.

¹⁰See Jensen, *supra* note 3, at 2407-08. Calvin Johnson thinks that the original understanding of "direct taxes" was even broader than my definition. See Johnson, *supra* note 9.

¹¹I recognize that the issue isn't likely to come before the Supreme Court, given the Sixteenth Amendment, and that one therefore shouldn't read too much into the Court's silence on the meaning of "direct taxes."

¹²For that reason, I am shocked — shocked! — to see Professor Kahn question the proposition that "Congress cannot tax as income an item that does not fall within the meaning of 'income' as that term is used in the Sixteenth Amendment." Douglas A. Kahn, "The Constitutionality of Taxing Compensatory Damages for Mental Distress When There Was No Accompanying Physical Injury," 4 *Fla. Tax Rev.* 128, 130 (1999).

¹³Daniel N. Shaviro, "Psychic Income Revisited: Response to Professors Johnson and Dodge," 45 *Tax L. Rev.* 707, 711 n.17 (1990).

¹⁴Victor Thuronyi, "The Concept of Income," 46 *Tax L. Rev.* 45, 53 (1990) (footnote omitted). "Under the terms of the definition, income could mean the same thing as consumption or wealth, or something else, depending on the criteria we use for determining tax equity." *Id.* at 54 (footnote omitted).

¹⁵*Id.* at 61.

same should apply to the meaning of income in the [S]ixteenth [A]mendment.¹⁶

And Professor Marjorie Kornhauser seems to agree that "incomes" is an inherently malleable term. Congress must therefore provide meaning for an otherwise amorphous concept:

[T]he Sixteenth Amendment must give Congress a fully vested power to tax all income, however Congress defines it, without worrying about fine distinctions. Such an interpretation yields a meaning of income that is broad and evolutionary. Income's meaning is to be determined by Congress, not the Court, and that meaning changes over time as congressional conceptions of income change and become more sophisticated.¹⁷

I've no doubt that almost all tax practitioners and tax teachers, if they think about the matter at all, would accept those propositions. (Indeed, that most don't think about the matter is itself evidence that the propositions are accepted.) In the following discussion, I'll explain why the conventional wisdom isn't necessarily true, or, even if it's true, why it doesn't necessarily mean that a direct-consumption tax is a "tax on incomes."

1. The nature of the constitution and 'inherent malleability.' To begin with, the notion that the term "taxes on incomes" is "inherently malleable" and therefore means whatever Congress says it means is inconsistent with the idea of the Constitution. Yes, the Constitution was intended to increase national power, to make a real national government possible. But, as we all know, the Constitution is full of limitations on national power — it wouldn't have been ratified without limitations — and we don't usually think of Congress as having the final say on matters of constitutional interpretation.¹⁸ It would be peculiar to interpret a document that was intended, in part, to limit federal power as granting to Congress a nearly unlimited power to determine what those limits are.¹⁹

If their intention was to remove all direct taxes from the apportionment requirement, the drafters of the Sixteenth Amendment did a poor job indeed. Instead, it

¹⁶*Id.* at 101.

¹⁷Marjorie E. Kornhauser, "The Constitutional Meaning of Income and the Income Taxation of Gifts," 25 *Conn. L. Rev.* 1, 24 (1992).

¹⁸Congress has a say, and congressmen should feel obligated to consider the constitutionality of proposed legislation. But we don't usually think of Congress's having the *only* say.

¹⁹The fact that the Sixteenth Amendment was added later doesn't change the nature of the Constitution. The Amendment had a limited purpose, to overturn the narrow holding of the *Income Tax Cases*; it shouldn't be interpreted as having repealed other constitutional values. As Judge Kozinski and Professor Volokh state,

The notion that every constitutional amendment is a partial repeal of every previously-enacted constitutional provision has hair-raising implications. Does the Sixteenth Amendment . . . authorize a tax levied only on income derived from sale of antigovernment literature, or a tax only on blacks? Does it allow collection techniques that violate the Fourth Amendment?

Alex Kozinski & Eugene Volokh, "A Penumbra Too Far," 106 *Harv. L. Rev.* 1638, 1650 (1993) (footnotes omitted).

was only "taxes on incomes" that were exempted. That term may not have a precisely defined set of boundaries — what constitutional terms do? — but that doesn't mean that the term becomes an empty vessel into which Congress can pour whatever definition it wishes.

It may well be the case that, as Joseph Isenbergh has put it, the "Framers [of the Sixteenth Amendment] . . . rarely worked on the entire canvas at one time," and, as a result, they "may not themselves always have understood the full import of the provisions they introduced, and even less of the system overall."²⁰ I don't necessarily agree that the confusion was so great, but suppose for the sake of argument it was. What interpretational principles would follow from that assumption? One could find similar confusion in the origin of many legal documents, including the Internal Revenue Code. Do constitutional and statutory provisions become open-ended simply because they present difficult interpretational tasks?²¹

It would be peculiar to interpret a document that was intended, in part, to limit federal power as granting to Congress a nearly unlimited power to determine what those limits are.

In a passage I quoted earlier, Victor Thuronyi is right, in some sense, when he argues that "[b]ecause people have different views of tax equity, there is no 'true' concept of income."²² But that proposition doesn't transfer well into constitutional law, where concepts aren't ordinarily defined by agreement. There may be no clearly "true" concept of "unreasonable searches and seizures," but we can't therefore ignore that constitutional phrase.

And Thuronyi's missile example doesn't hit the target.²³ He's right that a constitutional challenge to deployment of a particular missile system would (and should) go nowhere in court. But that's a trivially easy case. Let's get closer to reality (or as close as we can after putting standing issues aside). Does Thuronyi mean to suggest that any expenditure would be constitutionally acceptable simply because Congress declared it to be for national defense?²⁴ The defense umbrella covers a lot, but does it really cover everything — as long as Congress mumbles the word "defense" in its deliberations? If constitutional lan-

²⁰Joseph Isenbergh, "The End of Income Taxation," 45 *Tax L. Rev.* 283, 287 (1990).

²¹Hint: the right answer to that question is No.

²²Thuronyi, *supra* note 14, at 53.

²³See *supra* text accompanying note 16.

²⁴The practical answer may be Yes, but I want to examine the *impractical* interpretational issue: Should an expenditure that has no other authority to justify it be valid merely because Congress says the expenditure is being made for national defense?

guage is that malleable, then there are effectively no constitutional limitations on congressional power.

In any event, that's not the sort of challenge that would be made to a direct-consumption tax. In questioning whether such a tax is really a tax on incomes, we wouldn't be doing the equivalent of second guessing Congress's judgment about the military capabilities of something that is unquestionably a military weapon. We would be asking whether a purported weapon is really a weapon at all, whether a purported income tax is really a tax on incomes. In neither case should the answer be Yes just because Congress says it is.

2. The income tax was a reaction to the perceived inadequacies of consumption taxes. Historically, consumption taxes and income taxes weren't considered to be functional equivalents; that's one reason we should be skeptical that the Sixteenth Amendment term "taxes on incomes" would encompass a tax, like the flat tax or the USA tax, that picks up only the consumption component of income.

Before the enactment of the 1894 income tax, which was struck down by the Supreme Court in the *Income Tax Cases*, there was a sense that the taxes that had funded the United States for most of the nation's history were unfair: the burdens were falling disproportionately on lower-income persons. That's why a new form of taxation was necessary,²⁵ and, once the Supreme Court had repudiated the 1894 tax, the move to amend the Constitution began. Income taxes were different because they would reach a different tax base, and, as a result, fall more heavily on higher-income, wealthier Americans. In Michael Graetz's words, "More than eighty years ago when this nation adopted the Sixteenth Amendment, achieving fairness in the distribution of the tax burden was the essential reason for taxing income and for taxing it at progressive rates."²⁶

I haven't done as much research as I need to on the income tax debates in the 1890-1913 period, but this much I'm sure about: commentators then and now generally see the late nineteenth-, early twentieth-century proponents of an income tax as trying to reorient the tax system.²⁷ As historian Gerald Eggert put it,

Congressional debates made it clear . . . that the [1894 income] tax was, in part, a response to the widespread demand to equalize the tax burdens borne by the various classes. The tariff, which was the federal government's chief source of revenue, lay most heavily on the poorer classes

²⁵The income tax wasn't an entirely new idea; one had been used during the Civil War. But it wasn't until enactment of the 1894 income tax that many people contemplated an income tax as a permanent part of the revenue system.

²⁶Michael J. Graetz, *The Decline [and Fall?] of the Income Tax* 222 (1997).

²⁷One significant exception is Robert Stanley, *Dimensions of Law in the Service of Order: Origins of the Federal Income Tax, 1861-1913* (1993) (characterizing enactment of income tax as means of cutting off far-reaching reform).

— ran the argument — while the proposed income tax would be paid by the wealthier classes.²⁸

Edward Whitney (Assistant Attorney General at the time of the *Income Tax Cases*) explained the 1894 tax in this way: "The party controlling the House of Representatives, accepting the theory that the prevailing taxes on consumption bore especially hard on the smaller incomes, undertook to make up the deficit with a compensatory duty upon the larger ones."²⁹

The Sixteenth Amendment isn't authority for a consumption tax; indeed, it was the perceived failure of consumption taxes that made the income tax — and hence the Sixteenth Amendment — necessary.

When the 1894 income tax was struck down, a push for a constitutional amendment was inevitable. The Sixteenth Amendment was intended to constitutionally validate what income-tax proponents had attempted to do in 1894. In defending today's income tax against flat-tax supporters, Michael Graetz makes this basic point about the Amendment: "A flat-rate tax on consumption would shift substantial amounts of taxes from higher- to lower-income families. . . . [T]he American people will not accept such a tax as fair. Indeed, the Sixteenth Amendment was added to the Constitution to redress such a situation."³⁰

In short, the Sixteenth Amendment isn't authority for a consumption tax; indeed, it was the perceived failure of consumption taxes that made the income tax — and hence the Sixteenth Amendment — necessary.

3. Direct-consumption taxes aren't what is meant by 'taxes on incomes' today. The understanding that income taxes and consumption taxes are different animals continues today. The current proponents of consumption taxes aren't modest in their public pronouncements. Taxes like the flat tax or the USA tax would, it's plausibly argued, dramatically change the American tax system. The goal of the consumption tax proponents, according to House Ways and Means Committee Chair Bill Archer, is to "pull the income tax out by its roots and throw it away."³¹ That doesn't sound like income tax talk to me.

²⁸Gerald G. Eggert, "Richard Olney and the Income Tax Cases," 48 *Miss. Valley Hist. Rev.* 24, 24-25 (1961).

²⁹Edward B. Whitney, "The Income Tax and the Constitution," 20 *Harv. L. Rev.* 280, 284 (1907).

³⁰Graetz, *supra* note 26, at 262. "The fear of . . . backlashes . . . is at least part of the reason why consumption tax proponents in Congress have cloaked their proposals in income tax garb." *Id.* at 263; see also Michael J. Graetz & Michael M. O'Hear, "The 'Original Intent' of U.S. International Taxation," 46 *Duke L.J.* 1021, 1043 (1997) ("The Sixteenth Amendment permitting a federal income tax had . . . been sold to the American people on fairness grounds. . . .").

³¹Quoted in John Godfrey, "Archer Keen on Killing Code, Full Speed Ahead on Tax Reform," *Tax Notes*, Mar. 11, 1996, p. 1431.

Nevertheless, critics have suggested to me that the difference between a direct-consumption tax and an income tax is just a matter of accounting (that is, whether taxpayers should be entitled to deductions or exclusions to reflect savings), and accounting issues don't rise to constitutional levels. Moreover, it's possible to pick passages out of Supreme Court opinions to support that position. For example, the Court wrote in 1934, "Unquestionably Congress has the power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax."³²

If we were talking about an isolated deduction or exclusion, I'd agree that the Constitution is likely to be irrelevant: determining one's entitlement to most deductions or exclusions doesn't require constitutional analysis.³³ But this is different: exempting the savings component of income from taxation would fundamen-

³²*Helvering v. Independent Life Ins. Co.*, 292 U.S. 371, 381 (1934).

³³But I don't mean to say that the current code is the standard by which constitutionality of tax legislation should be measured, and I reject the idea that anything hidden in the code under the heading "Income Taxes" is necessarily constitutional. An unapportioned tax on real estate wouldn't become constitutional merely because Congress put it into subtitle A of the code. See *Helvering v. Independent Life Ins. Co.*, 292 U.S. 371, 378 (1934) ("If the statute lays taxes on the part of the building occupied by the owner or upon the rental value of that space, it cannot be sustained, for that would be to lay a direct tax requiring apportionment.").

Some cases that could be interpreted as taking a cavalier position on the meaning of income or as standing for the proposition that accounting is all-powerful, like *Burnet v. Sanford & Brooks Co.*, 282 U.S. 359 (1931), do nothing of the sort. Yes, the Court deferred to the system of annual accounting in a case where, over time, the taxpayer had little or no net income; the result, therefore, was that an "income" tax was imposed on a person without economic income. But the case merely held that allowances must be made for accounting practicality, as that practicality was understood in 1913, when the Sixteenth Amendment was ratified:

It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals. Only by such a system is it practicable to produce a regular flow of income and apply methods of accounting, assessment, and collection capable of practical operation. It is not suggested that there has ever been any general scheme for taxing income on any other basis. The computation of income annually as the net result of all transactions within the year was a familiar practice, and taxes upon income so arrived at were not unknown, before the Sixteenth Amendment. . . . It is not to be supposed that the amendment did not contemplate that Congress might make income so ascertained the basis of a scheme of taxation such as had been in actual operation within the United States before its adoption. While, conceivably, a different system might be devised . . . , Congress is not required by the amendment to adopt such a system in preference to the more familiar method, even if it were practicable.

Id. at 365.

tally change our conception of what income is.³⁴ The Sixteenth Amendment didn't constitutionalize the Haig-Simons definition of income, of course, and a tax needn't reach all increases in wealth to constitute a valid income tax.³⁵ But exempting savings is different from the selective exclusion of certain income items in today's code. The exclusion of broad categories of income items — of what everyone concedes can be included in "incomes" constitutionally — may leave a tax base that isn't income in any generally accepted sense.³⁶

The economic literature can't be controlling in interpreting a constitutional provision, but it's instructive to see how economists have promoted the flat tax and the USA tax: by emphasizing how different those taxes would be from the existing scheme.³⁷ As the terms are ordinarily used in the literature, an income tax is the opposite of a consumption tax.³⁸ At least since the time of Irving Fisher, consumption tax advocates have complained about an income tax's being imposed both on the receipt of capital and on the income generated by the capital.³⁹ In contrast, a pure consumption tax avoids double taxation, either by exempting the capital, or by exempting income from the capital, from tax.⁴⁰

³⁴And, as I've already suggested, it would be inconsistent with the conception in 1913 — and that's significant. See *Merchants' Loan & Trust Co. v. Smietanka*, 255 U.S. 509, 519 (1921) (focusing on "the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution").

³⁵If *Eisner v. Macomber*, 252 U.S. 189 (1920), is still good law, as about three people in the world (including me) think, an income tax couldn't reach all appreciation in wealth.

³⁶It's been said to me that a gross receipts tax — a tax that permits no deductions, even for legitimate business expenses — may be a "tax on incomes," and there is lower court authority for that proposition. See *Penn Mut. Indem. Co. v. Commissioner*, 277 F.2d 16, 20 (3d Cir. 1960). But taxing someone who has no net income (say receipts of \$100,000 but also expenses of \$100,000) under an "income" tax is absurd. (Note the reference to "net" in the text accompanying *supra* note 32.) The goal of the Sixteenth Amendment was to reach higher-income, not no-income, persons.

The difference between a gross receipts tax and an income tax isn't merely a matter of accounting. Permitting this deduction or that may be an accounting issue; deciding whether to permit any deductions at all is decidedly not a simple accounting question. Cf. *Doyle v. Mitchell Brothers*, 247 U.S. 179, 185 (1913) (concluding that basis or cost-of-goods-sold concept was implicit in statutory definition of "income": "In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.").

³⁷See Jensen, *supra* note 3, at 2411-13.

³⁸I hate to admit it, but I'm indebted to Calvin Johnson for these points. He's really not a bad guy.

³⁹Irving Fisher & Herbert W. Fisher, *Constructive Income Taxation: A Proposal for Reform* 56-57 (1942).

⁴⁰Professor Fisher and, more recently, Professor Jeff Strnad have argued that a true income tax wouldn't impose a double tax on capital. See *id.*; Jeff Strnad, "Taxation of Income From Capital: A Theoretical Appraisal," 37 *Stan. L. Rev.* 1023 (1985).

(Footnote 40 continued on next page.)

Despite its hybrid status, our current "income" tax satisfies the double-tax criterion for an income tax. Indeed, if the income tax didn't reach most sources of capital, it wouldn't have come into being. In contrast, the flat tax and the USA tax don't satisfy the double-tax criterion; that's part of their attraction.

4. The Supreme Court for years didn't think the definition of 'incomes' was 'inherently malleable.' The idea that the term "taxes on incomes" is "inherently malleable" is a modern one. The Supreme Court clearly didn't accept that notion for a long time (and, for that matter, there's not much evidence that the Court has a position one way or the other on that issue today⁴¹).

We all know *Eisner v. Macomber*,⁴² which held that shareholders couldn't be taxed on the receipt of totally proportionate stock dividends. In *Macomber*, in 1920, the Court stated that a

proper regard for its genesis, as well as its very clear language, requires also that [the Sixteenth] Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and it is not to be overridden by Congress or disregarded by the courts.⁴³

And

it becomes essential to distinguish between what is and what is not 'income,' as the term is used [in the Sixteenth Amendment]; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution. . . .⁴⁴

Clear enough? *Macomber* is rejected by most commentators today, as if it were aberrational,⁴⁵ but it isn't the only case in which the Court assumed that "incomes" had content. Consider, for example, the well-known 1929 case of *Taft v. Bowers*,⁴⁶ regarding the basis of property transferred by gift: "Under former decisions here the settled doctrine is that the Sixteenth Amendment confers no power upon Congress to define and tax as income without apportionment something

But those arguments haven't been generally accepted within the profession. See, e.g., Henry C. Simons, *Personal Income Taxation* 226 (1938) ("To an unsympathetic critic, Fisher's main point still seems to be that anything which is called an income tax ought to be a tax on what Fisher calls income."); Louis Kaplow & Alvin C. Warren, Jr., "Professor Strnad's Rejoinder: Simply Semantics," 39 *Stan. L. Rev.* 419, 419-25 (1987).

⁴¹I doubt that the issue grabs Supreme Court justices in the way it grabs me.

⁴²252 U.S. 189 (1920).

⁴³*Id.* at 206.

⁴⁴*Id.*

⁴⁵See, e.g., Ackerman, *supra* note 3, at 42-46.

⁴⁶278 U.S. 470 (1929).

which theretofore could not have been properly regarded as income."⁴⁷

In *Taft v. Bowers*, the donee-taxpayer's position (that the income tax couldn't reach appreciation in property that had occurred while the property was held by the donor) didn't prevail, so that the language about the restrictive nature of the Sixteenth Amendment could be viewed as *dictum*. But in the 1925 decision in *Edwards v. Cuba Railroad Co.*,⁴⁸ the taxpayer, a railroad company, was successful in urging that it couldn't be taxed on subsidy payments made by the Cuban government: "The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment."⁴⁹ In short, they weren't the sort of benefit — if benefit they were — that people think of when they think of income, and "[t]he Sixteenth Amendment, like other laws authorizing or imposing taxes, is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used."⁵⁰

One doesn't necessarily have to have an all-encompassing theory of 'income' to decide whether a particular item is or isn't income.

In 1921, in *Merchants' Loan & Trust Co. v. Smietanka*,⁵¹ the Court had written that "in determining the definition of the word 'income' . . . , this Court has consistently refused to enter into the refinements of lexicographers or economists, and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution."⁵²

That kind of language lends itself to ridicule by modern commentators. For example, the Third Circuit, in 1940, stated that the test relied on "some illusory theory that the state legislatures who ratified the 16th Amendment had some idea of an 'ordinary meaning' for such an economic abstraction."⁵³ The Tax Court has been particularly unsympathetic to Sixteenth Amendment claims. In 1978, for example, in rejecting a con-

⁴⁷*Id.* at 481.

⁴⁸268 U.S. 628 (1925).

⁴⁹*Id.* at 633.

⁵⁰*Id.* at 631-32.

⁵¹255 U.S. 509 (1921) (upholding tax on capital gains).

⁵²*Id.* at 519; see also *Helvering v. Independent Life Ins. Co.*, 292 U.S. 371, 378 (1934) ("The rental value of the building used by the owner does not constitute income within the meaning of the Sixteenth Amendment."); *Bowers v. Kerbaugh-Empire Co.*, 271 U.S. 170, 173 (1926) ("It was not the purpose or effect of that Amendment to bring any new subject within the taxing power.").

⁵³*Union Trust Co. v. Commissioner*, 115 F.2d 86, 87 (3d Cir. 1940) (characterizing *Merchants' Loan & Trust Co. v. Smietanka*).

stitutional challenge to section 83,⁵⁴ the court referred to a "long-abandoned" Supreme Court effort to "fashion a concept of income."⁵⁵

The Court may not have considered the meaning of "incomes" for a long time, but I'm not sure that the effort has actually been abandoned,⁵⁶ or if it was abandoned, what that means. One doesn't necessarily have to have an all-encompassing theory of "income" to decide whether a particular item is or isn't income. That is, one doesn't need to be able to feel certain how all conceivable cases would be treated to rule on a particular case; that's the genius of the common law.

My point in mentioning these old cases isn't to argue that the reasoning or results were necessarily right one-by-one. I'm citing the cases for the proposition that the early understanding was that the Sixteenth Amendment didn't grant unlimited power to Congress. The Court consistently rejected the idea that the meaning of the term "incomes" — in the words of Professors Gabinet and Coffey — ought "to float freely on the shifting tides of tax theologies."⁵⁷ Despite all the difficulties that can arise in categorizing cases at the margin, I would be very surprised to have the Court today subscribe to the notion that Congress can define a constitutional term however Congress wishes.

5. It's not impossible to distinguish consumption and income taxes. It's true that the Supreme Court hasn't heard a lot of Sixteenth Amendment cases recently, but that doesn't mean defining "incomes" is a hopeless project. This has unfortunately become a common method of legal argument: drawing lines is difficult, and, if a line is drawn, some cases at the margin may be wrongly decided. Moreover, we can always come up with difficult, marginal cases. Therefore (the argument goes) meaningful distinctions can't be made at all. Because some people have trouble distinguishing *Playboy* and *Penthouse* for First Amendment purposes, many wind up deciding that no legally meaningful lines can be drawn between *The New York Times* and *Hustler*.

I'm not saying we should necessarily draft a rule that treats the *Times* and *Hustler* differently. I'm suggesting only that the difficulty of making distinctions at the margin shouldn't blind us to our ability to distinguish quite different phenomena.

That we might fight about whether a particular taxed item is really part of a "tax on incomes" doesn't mean that there are no important distinctions to be drawn between income taxes and consumption taxes.

⁵⁴The challenge was to the part of section 83 that defines the lapse of a restriction as a taxable event in some circumstances.

⁵⁵*Sokol v. Commissioner*, 67 T.C. 986, 991, *aff'd* 574 F.2d 694, 699, *cert. denied* 439 U.S. 859 (1978).

⁵⁶The Court still cites *Macomber* as if the case means something. See, e.g., *Cottage Sav. Ass'n v. Commissioner*, 499 U.S. 554, 563 (1991).

⁵⁷Leon Gabinet & Ronald J. Coffey, "The Implications of the Economic Concept of Income for Corporation-Shareholder Income Tax Systems," 27 *Case W. Res. L. Rev.* 895, 919 (1977).

Those two types of taxes have been treated as fundamentally different in the United States for a long time, and the distinctions aren't ones that can be abolished by congressional fiat.

6. The assumption that Congress has unlimited power to define 'incomes' has been based on the assumption that Congress would broaden the income tax base. To this point, I've been questioning the proposition that the term "incomes" is so inherently malleable that Congress can define the term however it wants. I'll now briefly shift gears.

I would be very surprised to have the Court today subscribe to the notion that Congress can define a constitutional term however Congress wishes.

Deference to Congress in characterizing a tax as an income tax isn't a principle I'm happy with, but you know what? It really doesn't matter with the direct-consumption taxes we're talking about *because Congress wouldn't purport to be defining the tax base as "incomes."* Put another way: we don't need to defer to a congressional definition of "incomes" if Congress doesn't say it's defining "incomes," or if Congress does say it's defining incomes but is engaging in a subterfuge.

It's my impression that most commentators who have stressed how broad the congressional taxing power is have assumed that Congress would make a good-faith effort to define "incomes." That's true of Thuronyi and Kornhauser, the commentators I quoted on the "inherently malleable" point.⁵⁸ Take away that assumption, and the case for deference disappears.

Congress knows the flat tax and the USA tax aren't income taxes, or it will before a vote is taken. We'll make sure of that in our debates on these proposals. As a result, Congress shouldn't be able to rely on the Sixteenth Amendment as authority to enact a direct-consumption tax.

In addition, those who have argued that the term "taxes on incomes" is inherently malleable — or something similar — have assumed that Congress would act to broaden the definition of income. When Professor Kornhauser refers to a "broad and evolutionary" notion of income — as "congressional conceptions of income change and become more sophisticated" — she doesn't have in mind shrinking the tax base.⁵⁹ She

⁵⁸See *supra* notes 14-17 and accompanying text.

⁵⁹See *supra* note 17 and accompanying text. If nothing else, this discussion illustrates some of the peculiarities that arise from treating constitutional and legislative definitions of "income" as if they necessarily coincide. What does it mean to say that Congress defines "incomes" under the Sixteenth Amendment? It can't be that Congress defines the constitutional terms in a way that has effect on other governmental bodies or even on Congress itself. If Congress were to cut

(Footnote 59 continued on next page.)

doesn't have in mind, that is, a tax like any of the proposed direct-consumption taxes.

For example, in a number of articles, Professor Kornhauser sees "ability to pay" (particularly as reflected in a progressive rate structure) as a defining feature of the income tax: "[T]he graduated rate has been integrally connected under U.S. tax laws to the ability-to-pay theory that underlies the income tax."⁶⁰

[A] progressive rate structure has been a constant feature of the income tax since 1913, when the first income tax was enacted under the Sixteenth Amendment. At that time, most of the general public, politicians and economists accepted the idea of progressivity (though they disagreed as to the appropriate rates) because it conformed to their conception of 'ability to pay,' which was the basis of the income tax.⁶¹

And Victor Thuronyi has commented:

An issue that has been important in the past, and may become important in the future if Congress becomes more creative with the income tax, is the definition of 'income' as used in the Sixteenth Amendment. . . . [I]t may be appropriate to base the definition of income for purposes of the Constitution on tax equity. A constitutional definition of income in terms of tax equity would recognize that *as long as Congress is striving to impose a tax based on the relative annual financial positions of taxpayers, according to its concept of fairness, the Court should not overturn its determinations.*⁶²

If Congress isn't trying to do that, it seems to me the inference from Kornhauser's and Thuronyi's discussions is clear.⁶³

back on the meaning of income, I can't believe that anyone would say that the narrow definition had constitutional status. Congress can't tie its own hands in the future by defining "incomes" narrowly today, or can it?

⁶⁰Marjorie E. Kornhauser, "The Rise of Rhetoric in Tax Reform Debate: An Example," 70 *Tul. L. Rev.* 2345, 2347 (1996).

⁶¹Marjorie E. Kornhauser, "What Do Women Want: Feminism and the Progressive Income Tax," 47 *Am. U. L. Rev.* 151, 152 (1997) (footnotes omitted).

⁶²Thuronyi, *supra* note 14, at 99-100 (emphasis added) (footnotes omitted).

⁶³Of course, one might argue that the term "taxes on incomes" has no content at all, and that the state of the law is such that, whatever the language of the Sixteenth Amendment, Congress can do whatever it wants. Professor Ackerman has recently done just that: "Under the constitutional regime inaugurated by the New Deal, there are no significant limits on the national government's taxing, spending, and regulatory power where the economy is concerned. . . ." Ackerman, *supra* note 3, at 3. And, with respect to the Sixteenth Amendment, he brushes aside the idea that we should try to figure out what "taxes on incomes" means: "When the People mobilize to overrule the Court, it seems particularly inappropriate for the Justices to respond in a niggling fashion." *Id.* at 55. In particular, Ackerman picks up on Holmes's dissent in *Eisner v. Macomber*, to the effect that "[t]he known purpose of the [Sixteenth] Amendment was to get rid of nice questions as to what might be direct taxes." *Macomber*, 252

(Footnote 63 continued in next column.)

Conclusion

*"Income tax, if I may be pardoned for saying so, is a tax on income."*⁶⁴

Those words of Lord Macnaghten, in *London County Council v. Attorney-General*, written in 1900, obviously can't be direct authority in interpreting the meaning of the Sixteenth Amendment of the United States Constitution. It's an English case, interpreting a passage from a century-old English revenue act.⁶⁵ But to my mind those words suggest the appropriate method of analysis in determining whether a tax is a "tax on incomes," and they suggest that not every levy is a tax on incomes.

Policymakers who proceed as if there were no constitutional issues associated with direct-consumption taxes do so at their — and ultimately our — peril.

I've presented some evidence that both historically and currently commentators have tended to think of income taxes and consumption taxes as fundamentally different. It is for that reason I question the generally held assumption that a consumption tax could be enacted, without apportionment, under the authority of the Sixteenth Amendment.

Of course, this conclusion is only as good as the assumptions that I made for purposes of this discussion. If a direct-consumption tax isn't a direct tax, within the meaning of the Constitution, or if the direct-tax apportionment rule is a dead letter, then any debate about the meaning of the Sixteenth Amendment is irrelevant to the consideration of direct-consumption taxes.

U.S. at 219-20 (Holmes, J., dissenting); see Ackerman, *supra* note 3, at 45; see also Kahn, *supra* note 12, at 139 (also approvingly citing Holmes's dissent). Suffice it to say for present purposes that Ackerman's sweeping statements aren't based on constitutional text or structure; his interpretation of the Sixteenth Amendment makes sense only if we ignore the Amendment's language. Moreover, Justice Holmes cited no authority or evidence in support of his *Macomber* dissent. That fact reduces Professor Ackerman to making the bizarre argument that we should defer to Holmes because "we can never recapture the directness of his lived experience of the [Sixteenth Amendment's] ratification campaign." Ackerman, *supra* note 3, at 45; see also *id.* at 45-46 ("[W]e are left with Holmes's *ipse dixit* concerning original understanding — certainly an important resource, but one that may be too easily dismissed by readers who have not themselves lived through the process of amendment ratification."). Why Holmes's "lived experience" during Sixteenth Amendment ratification was superior to the experiences of the *Macomber* Court's majority is never explained.

⁶⁴*London Co. Council v. Attorney-General*, [1901] A.C. 26, 35 (H.L.) (Lord Macnaghten).

⁶⁵The language was "upon payment of any interest of money or annuities charged with income tax under Sched. D and not payable or not wholly payable out of profits or gains brought into charge to such tax."

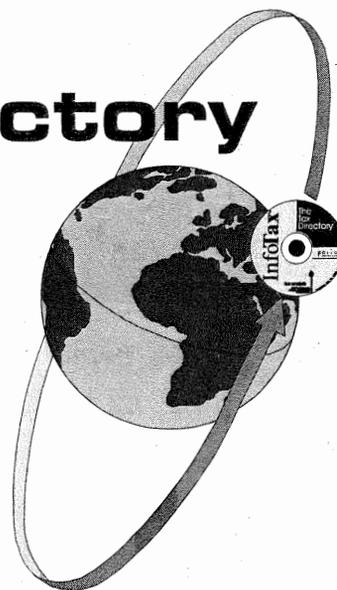
But if direct-consumption taxes are direct taxes — as I think they are — and if the apportionment rule still has effect — as I think it does — then the constitutionality of direct-consumption taxes hinges on the meaning of “taxes on incomes” in the Sixteenth Amendment. If nothing else, I hope I’ve shown why

it’s not self-evident that a direct-consumption tax is exempt from the apportionment requirement. Policymakers who proceed as if there were no constitutional issues associated with direct-consumption taxes do so at their — and ultimately our — peril.

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