# THE INDIRECT TAX CANON, APPORTIONMENT, AND DRAFTING A CONSTITUTIONAL WEALTH TAX

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*Abstract*

The Constitution requires that "direct taxes" be "apportioned"—that is, that the revenues collected from each State be in proportion to population. Based on this obscure provision, prior scholarship has debated whether *unapportioned* wealth taxes or related accrual-income tax reforms should generally be held constitutional, unconstitutional, or whether specific proposals should be held constitutional and others unconstitutional.

This Article takes a different approach. Recognizing the real uncertainty about how the Supreme Court might ultimately decide, this Article explains how Congress can draft a reform to navigate through that uncertainty. Specifically, this Article explains how Congress can draft a wealth tax or accrual-income tax reform that should survive constitutional scrutiny regardless of how the Supreme Court might ultimately rule on the disputed constitutional questions.

To that end, this Article argues that the long line of cases on direct and indirect taxes, combined with the 16th Amendment, synthesize into what we label as the "Indirect Tax Canon." This Article further argues that courts following that Canon should uphold properly constructed wealth tax or accrual-income tax reforms structured as *indirect* taxes—without requiring apportionment.

Yet this Article then additionally explains how Congress can bolster such reform proposals by drafting fallback provisions to easily transform these reforms into apportioned taxes, fairly and practically, in the event of the Court ruling that apportionment is required. Any interstate inequities from this can be remedied through a fiscal equalization program that would rebate excess revenues to poorer states. As a result, with careful drafting, the constitutional risks for a wealth tax or related accrual-income tax reform should be minimal.

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INTRODUCTION

Some of the most obscure and ambiguous clauses of the Constitution are suddenly relevant again, after being largely ignored for over 100 years.[1] Due to rising inequality and to structural budget deficits, calls for a wealth tax—or for similar reforms to the income tax—have exploded in recent years.[2] Polls suggest that these reforms have strong support among American voters.[3] Yet these calls for reform have run into resistance based on concerns that the Supreme Court might rule them to be unconstitutional.[4] However, as this Article will explain, both wealth tax reforms and related income tax reforms are absolutely constitutional—if they are properly drafted.

Several prior articles have argued as to why the Supreme Court should hold specific wealth tax reforms or related income tax reforms to be constitutional,[5] or unconstitutional,[6] or have argued that some of these reforms

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[1] *See, e.g.,* Ari Glogower, *A Constitutional Wealth Tax*, 118 MICH. L. REV. 717, 719–20 (2020) (explaining that "[p]olicymakers and scholars are giving serious consideration to a federal wealth tax" but that there is disagreement about whether an unapportioned federal wealth tax would be constitutional); Eric M. Jensen, *Did The Sixteenth Amendment Ever Matter? Does It Matter Today?*, 108 NW. U. L. REV. 799, 823 (2014) ("If an appropriate case could be found to reconsider the meaning of 'direct taxes,' it looks like there might be the requisite four votes on the current Court to grant certiorari."); Bruce Ackerman, *Taxation and the Constitution,* 99 COLUM. L. REV. 1, 2 (1999).

[2] Jonathan Curry, *UC Berkeley Economists Chosen as Tax Notes Federal's Persons of the Year*, TAX NOTES FEDERAL, Dec. 16, 2019, at 1707-1711 (describing the recent rise of wealth tax and accrual-income tax reform proposals).

[3] *E.g.,* Gabriela Schulte, *Poll: Two-Thirds of Voters Say Billionaires Should Pay a Wealth Tax*, THE HILL, Feb. 26, 2020; Matthew Yglesisas, *Taxing The Rich Is Extremely Popular*, VOX, Feb. 4, 2019.

[4] *E.g.,* Daniel Hemel & Rebecca Kysar, *The Big Problem With Wealth Taxes: Proposals By Senators Warren And Sanders May Not Pass Constitutional Muster. Then What?*, N.Y. TIMES, Nov. 7, 2019 ("The problem, alas, is the Constitution. The Warren and Sanders plans run headlong into more than two centuries of precedent that cast doubt on the constitutionality of wealth taxation."); Erik M. Jensen, *The Constitutionality of a Mark-to-Market Taxing System*, TAX NOTES, June 16, 2014, at 1301 ("If *Macomber* remains the law, and it is the law until the Supreme Court says otherwise, an unapportioned mark-to-market regime of taxation is constitutionally suspect.").

[5] *See, e.g.,* Ackerman, *supra* note 1; Dawn Johnsen & Walter Dellinger, *The Constitutionality of a National Wealth Tax*, 93 IND. L.J. 111 (2018).

[6] *See, e.g.,* Hank Adler, *The Mandatory Repatriation Tax Is Unconstitutional*, 171 TAX NOTES FEDERAL 63, 64-69, April 5, 2021 (arguing that *Macomber* has only been partially overturned and that "the mandatory repatriation tax" provisions of the 2017 Tax Cuts and Jobs Act are unconstitutional under the portions of *Macomber* that remain law); Sean P. McElroy, *The*

should be held constitutional and others unconstitutional.[7] This Article takes a somewhat different approach. Recognizing the real uncertainty about how the Supreme Court might ultimately decide, this Article explains how Congress can draft a reform to navigate through that uncertainty. Specifically, this Article will explain how Congress can draft a wealth tax (or related income tax reform) that should survive constitutional scrutiny regardless of how the Supreme Court might ultimately rule on the disputed constitutional questions.

As background to appreciate the motivation for these reforms, it is important to understand that the existing income tax is severely hobbled in its ability to tax the very wealthy.[8] And just raising tax rates is not enough to solve this, because the root of the problem is not primarily in the *rate* of taxation, but rather in the *method* of taxation. Specifically, the existing income tax fails at effectively taxing investment income, which makes up an ever-larger share of the income and wealth accumulation of the ultra-wealthy.[9] In a companion article to this one, we lay out in detail why the realization doctrine governing the existing income tax—the rule that investment gains are not included in taxable income until there has been a sale or other *realization event*—creates a host of problems. These problems include diminished government revenues, exploding inequality and unfairness, barriers to achieving progress for historically disadvantaged groups, harm to the overall economy, and massive tax-law complexity.[10] On that last point, it is only a slight exaggeration to say that most

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*Mandatory Repatriation Tax Is Unconstitutional*, 36 YALE J. ON REG. BULL. 69, 76–83 (same); Gene Magidenko, *Is a Broadly Based Mark-to-Market Tax Unconstitutional?*, 143 TAX NOTES 952, 952 (2014) ("A broadly based federal mark-to-market tax on unrealized capital gains would almost certainly be unconstitutional unless apportioned among the states….").

[7] *E.g.,* Daniel Hemel, *Taxing Wealth in an Uncertain World*, 72 NAT'L TAX J. 755 (2019); Joseph M. Dodge, *What Federal Taxes Are Subject to the Rule of Apportionment Under the Constitution?*, 11 J. CONST. L. 839 (2009).

[8] David Gamage & John R. Brooks, *Tax Now or Tax Never: Political Optionality and the Case for Current-Assessment Tax Reform*, 100 N.C. L. REV. ___ (forthcoming 2022)

[9] EMMANUEL SAEZ & GABRIEL ZUCMAN, THE TRIUMPH OF INJUSTICE: HOW THE RICH DODGE TAXES AND HOW TO MAKE THEM PAY (2020).

[10] Gamage & Brooks, *supra* note 8.

of the complexity of income tax law is a result of trying to accommodate the fact that wage and salary income is taxed when earned, but investment income is taxed only when "realized."

Solving these problems requires moving away from the realization doctrine, at least for the ultra-wealthy, and instead either taxing investment income as it is earned or taxing wealth as it is accumulated (or both).[11] This is at the root of recent proposed *wealth tax* reforms, such as those proposed by Senators Elizabeth Warren and Bernie Sanders during the 2020 presidential campaign and after.[12] It also underlies proposals for *accrual-income tax* reforms, such as the "mark-to-market" reforms currently being proposed by the chairman of the Senate Finance Committee, Senator Ron Wyden, which would tax investment income as it is accrued, not just when it is realized.[13]

Both sets of proposals are the subjects of active policy debate on questions such as whether they might generate adverse behavioral responses (such as increased evasion) and whether they are generally the right policy response to deal with economic inequality.[14] But perhaps the most important—and most direct—challenge to these proposals is whether they are *constitutional*.[15]

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[11] *Id.*

[12] Greg Iacurci, *Elizabeth Warren, Bernie Sanders propose 3% wealth tax on billionaires*, CNBC, March 2, 2021, https://www.cnbc.com/2021/03/01/elizabeth-warren-bernie-sanders-propose-3percent-wealth-tax-on-billionaires.html. For disclosure, one of us (Gamage) has advised on Senator Warren's proposed wealth tax reforms and both of us have advised on Senator Sanders's proposed reforms.

[13] Ernst & Young Tax New Update, *Senator Wyden Details Finance Committee Tax Priorities*, Jan. 13, 2021, https://taxnews.ey.com/news/2021-0085-senator-wyden-details-finance-committee-tax-priorities; Senate Finance Committee Ranking Member Ron Wyden, *Treat Wealth Like Wages: A Plan To Fix Our Broken Tax Code, Ensure The Wealthy Pay Their Fair Share, And Protect Social Security*, Sept. 12, 2019, https://www.finance.senate.gov/ranking-members-news/wyden-unveils-proposal-to-fix-broken-tax-code-equalize-treatment-of-wages-and-wealth-protect-social-security-

[14] *E.g.,* Huaqun Li & Karl Smith, *Analysis of Sen. Warren and Sen. Sanders' Wealth Tax Plans*; Tax Foundation Fiscal Fact No. 691, Jan. 2020, *available at*: https://taxfoundation.org/wealth-tax; Natasha Sarin & Lawrence H. Summers, *Fair, comprehensive tax reform is the right path forward*, BOSTON GLOBE, March 28, 2019, https://www.bostonglobe.com/opinion/2019/03/28/fair-comprehensive-tax-reform-right-path-forward/DwzX8IbqbRY5zxaCy2DoBI/story.html.

[15] *See, e.g., supra* notes 4–7.

The answer to this last question, we argue, is a resounding *yes*—if the taxes are drafted correctly.

The Constitution offers two paths for designing a federal tax. The first path requires that duties, imposts, and excises—often lumped together as "indirect taxes"—must be *uniform*, that is, taxed at in the same manner regardless of the taxpayer's state.[16] We refer to this as the *uniformity path*. The second path requires that "direct taxes" be *apportioned*, that is, collected from each state in proportion to that state's share of the national population.[17] We refer to this as the *apportionment path*.

Congress has plenary taxing power—as the Supreme Court has explained, "[t]hat the authority conferred upon Congress . . . 'to lay and collect taxes, duties, imposts and excises' is exhaustive and embraces every conceivable power of taxation has never been questioned…."[18] But any tax enacted by Congress must follow one of these two paths, primarily depending on whether it is a "direct tax" or not.[19]

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[16] "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States." U.S. Const. art. I, § 8, cl. 1. On the meaning of uniformity as "geographic uniformity" rather than, e.g., flat tax rates, *see* Knowlton v. Moore, 178 U.S. 41, 83–107 (1900).

[17] "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons." U.S. Const. art I, § 2, cl. 3. "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken." U.S. Const. art I, § 9, cl. 4.

[18] Brushaber v. Union Pacific Rail Co., 240 U.S. 1, 12 (1916); *see also* Congressional Resource Service, *The Federal Taxing Power: A Primer*, September 28, 2020.

[19] *Brushaber*, *id.* ("[T]he requirements of apportionment as to one of the great classes and of uniformity as to the other class were not so much a limitation upon the complete and all-embracing authority to tax, but in their essence were simply regulations concerning the mode in which the plenary power was to be exerted.") Note that the Court in *Brushaber*, *id.* at 18–19, further held that taxes on income that are exempted from the apportionment requirement by the 16th Amendment are indirect taxes and that any contentions to the contrary that would "destroy[] the two great classifications" are "wholly without foundation."

The challenge for both wealth taxes and for accrual-income tax reforms is that Supreme Court caselaw is unclear as to whether these taxes are *direct taxes* or *indirect taxes*.[20] This uncertainty then creates a dilemma. To the extent that the Supreme Court would deem a provision of a wealth tax or accrual-income tax reform to be a "direct tax," then that provision must be apportioned. Conversely, to the extent that the Supreme Court would deem a provision to be an indirect tax, then that provision must be uniform. It is generally not possible for a tax provision to simultaneously be both uniform and apportioned.[21]

Our solution to this dilemma involves multiple levels of analysis. The first level is based on unpacking the long line of Supreme Court cases on indirect taxes. We argue that these cases form what we label as the "Indirect Tax Canon," i.e., a canon of constitutional interpretation that courts should (a) be deferential to the form of taxation chosen by Congress for characterizing a tax as either direct or indirect, and (b) not inquire into the underlying "substance" of that form so long as the characterization chosen by Congress is reasonable. We further argue that the Supreme Court should uphold a wealth tax or accrual-income tax reform designed to follow the uniformity path in accordance with the Indirect Tax Canon—that is, without requiring apportionment. For example, a uniform federal wealth tax reform could be constructed either as an excise tax on the activities of accumulating and maintaining extreme wealth holdings or as taxing the *imputed income* earned by specified wealth holdings. A court properly following the Indirect Tax Canon and prior precedents should defer to Congress's choice of form and allow these taxes to follow the uniformity path.

We believe that our exposition of the Indirect Tax Canon should be persuasive as a descriptive account of how Congress can design a wealth tax or accrual-income tax reform to follow the uniformity path in accordance with

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[20] *See infra* Part II.

[21] The sole exception is "capitations"—that is, lump-sum taxes on persons. Dodge, *supra* note 7, at 844.

existing Supreme Court precedents. Nevertheless, we fully acknowledge that the current Supreme Court might well reject our views on these precedents and the Indirect Tax Canon. Indeed, we explain how the uncertain status of two prior Supreme Court cases—the 1895 case of *Pollock v. Farmers' Loan & Trust*[22] and the 1920 case of *Eisner v. Macomber*[23]—poses some challenges for our account of the Indirect Tax Canon.

Recognizing that uncertainty, and the likely ideological hostility from the more conservative Justices toward an expansive view of the Congressional taxing power,[24] the second level of our solution thus looks to the prior history of apportionment to learn how it can be done effectively. Congress enacted five Direct Tax Acts[25] during the 18th and 19th century that were never challenged in court and that provide us with presumptively constitutional elements to use in constructing an apportioned direct tax.[26] We explain how Congress can design an apportioned wealth tax or accrual-income tax reform in accordance with these historical precedents. We further explain how any possible interstate inequities that might result from such apportionment can be remedied through targeted federal spending. For instance, one way to accomplish this is through a fiscal equalization regime—a system of transfer payments designed to remedy fiscal disparities among states or provinces that is commonly used by other federal nations like Canada and Australia.[27]

This last component of our analysis is especially important, because most of the prior scholarship and commentary has wrongly assumed that the

[22] 157 U.S. 429 (1895), *affirmed on rehearing*, 158 U.S. 601 (1895).

[23] 252 U.S. 189 (1920).

[24] *See* Cass R. Sunstein et al., ARE JUDGES POLITICAL? AN EMPIRICAL ANALYSIS OF THE FEDERAL JUDICIARY vii (Brookings 2006) ("Republican appointees and Democratic appointees differ in their voting patterns, often very significantly.").

[25] For clarity we will capitalize the statutory Direct Taxes passed by Congress, in contrast to general discussion about whether a tax is a "direct tax" under the Constitution.

[26] *See infra* Section I.C.

[27] *See infra* Section III.C.2.

inequities that would result from a simple apportionment regime would present fatal obstacles to drafting an apportioned wealth tax or accrual-income tax reform.[28] That assumption was likely valid in the 18th and 19th centuries, as the limited administrative technologies of those eras would have made it difficult (if not impossible) to implement a sufficiently robust fiscal equalization regime or alternative mechanism for overcoming interstate inequities.[29] But, as we will explain, this is no longer true today. The successful implementation of fiscal equalization systems in other federal nations—and, to a more limited extent, in the U.S. itself—shows how today's Congress could design an apportioned wealth tax or accrual-income tax reform and then resolve any potential interstate inequities. If future taxes are to follow the apportionment path—which has not happened in over 150 years—then apportionment requires real and sustained scholarly study, and we show how to fairly and practically apply apportionment in the modern era.

The final level of our solution puts this all together using carefully drafted fallback clauses. We explain how the Direct Tax Act of 1798 provides a good model for drafting such a fallback clause, because the apportionment methodology of that Act relied on the combination of a *uniform* tax on dwelling-houses and enslaved people, and a *residual* tax on land as needed to satisfy each state's apportioned quotas.

This Article makes the following contributions. First, this is the first article to explain the Indirect Tax Canon as a synthesis of the early constitutional jurisprudence on taxation, and to show how that Canon was further reaffirmed by the 16th Amendment and how it continues to operate today. We argue for the Indirect Tax Canon both as a descriptive synthesis of existing precedents and as

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[28] *E.g.,* Johnsen & Dellinger, *supra* note 5, at 125; Dodge, *supra* note 7, 841; Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 CONST. COMMENT. 295, 309–14 (2004); Magidenko, *supra* note 6, at 955.

[29] Notably, it was also widely thought in the 18th Century that an income tax would be "impractical because of accounting and collection problems." Dodge, *supra* note 7, at 874.

a prescriptive approach for how we argue that courts should interpret the relevant clauses of the Constitution. Second, we explain why courts following the Indirect Tax Canon should uphold the recent proposals for uniform federal wealth taxes (such as those proposed by Senators Warren and Sanders). We also explain how Congress could construct a wealth tax as being measured by imputed income and why this form of wealth tax should similarly be upheld by courts following the Indirect Tax Canon. Third, we put the meaning of apportionment into clear historical context to show how it was intended to operate, and did operate in historical practice. We then offer a constitutionally robust proposal for apportioning either a wealth tax or an accrual-income tax reform that is both fair and administrable.

This article proceeds as follows. Part I reviews the early history of direct tax jurisprudence up to and including the seminal case of *Pollock v. Farmers' Loan & Trust* and the development of the Indirect Tax Canon. Part I also reviews the history and construction of the five previous apportioned federal Direct Taxes. Part II picks up the story after *Pollock* to show how the 16th Amendment overruled *Pollock*'s source-based inquiry and reinstated the Indirect Tax Canon. Part II also covers the cases that followed the 16th Amendment, especially *Eisner v. Macomber*, the only example besides *Pollock* of the Court flirting dangerously with ignoring the Indirect Tax Canon. Part III presents our proposed solutions for drafting a wealth tax or accrual-income tax reform to follow either the uniformity path or the apportionment path. Part III also further develops the theory behind the Indirect Tax Canon, and why it is not only a historical fact, but also a necessary feature of a tax jurisprudence capable of supporting an administratively sound income tax system as was intended by the 16th Amendment. Part III further explains how a modern fiscal equalization system can be combined with the precedents established by the early federal Direct Tax Acts to create a fair and practical apportionment regime for the modern era.

## I. THE ORIGINS OF THE INDIRECT TAX CANON AND THE DIRECT TAX ACTS

Discussions of federal tax law history often begin with the Supreme Court's decision overturning an income tax in *Pollock*[30] and the 16th Amendment to the Constitution that was ratified in response. But this neglects the 100 years of federal taxation and Supreme Court precedents prior to *Pollock*. In that period, the federal government enacted several taxes—including an early income tax and taxes that we would describe today as partial wealth taxes—*without* apportionment, and the Supreme Court universally upheld them, and in the process developed an approach to tax jurisprudence that we call the Indirect Tax Canon. Moreover, Congress enacted apportioned direct taxes several times, but only for one-off lump-sum levies against the value of real property (and enslaved persons) in a manner more akin to the requisition taxes used under the Articles of Confederation than to the forms of taxation we are accustomed to today.

Much of the debate in the literature about *Pollock*, and the Apportionment Clauses more generally, is over the "correct" meaning of the term "direct tax," at least to the Framers, and whether *Pollock* wrongly held that all taxes on property were direct taxes.[31] We understand the lure and importance of today's quasi-originalist jurisprudence, but this approach misses what we argue is the more important error of *Pollock* and the subsequent overruling of that error by the 16th Amendment and by subsequent Supreme Court cases.

*Pollock*—contrary to popular belief—did *not* hold that an income tax was a direct tax. Instead, it held: 1) that any tax on property solely because of its

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[30] *Supra* note 22..

[31] *See, e.g.,* Ackerman, *supra* note 1*;* Erik M. Jensen, *Taxation and Constitution: How to Read the Direct Tax Clauses*, 15 J.L. & POL. 687 (1999)*;* Calvin H Johnson, *Purging Out* Pollock*: The Constitutionality of Federal Wealth or Sales Taxes*, 97 TAX NOTES 1723 (2002)*;* Johnsen & Dellinger, *supra* note 5.

ownership was a direct tax,[32] and 2) that an income tax was in substance equivalent to a tax on the source of the income, and when that source was property, that tax must also be apportioned.[33]

While we believe the first holding was flawed, we think it likely that the current Supreme Court would sustain that holding—especially in light of Chief Justice Roberts's recent citation to *Macomber*, in *dicta*, to that effect.[34] As a recent report by the Congressional Resource Service concludes, "it does not appear that the Supreme Court has overruled *Pollock'*s central holding that a tax on real or personal property solely because of its ownership is a direct tax."[35] By contrast, as we will elaborate below, the second holding—that a court should look through the form of a tax to determine whether it is substantively equivalent to a direct tax—has already been overruled both by the 16th Amendment and by Supreme Court cases following *Pollock*.[36]

Accordingly, our purpose in this Part is not to argue for any particular meaning of the term "direct tax" to the Framers at the time of the Constitution. (Interested readers should instead review the impressive work of Calvin Johnson,[37] Bruce Ackerman,[38] Dawn Johnson and Walter Dellinger,[39] and Erik

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[32] *See Pollock II*, 158 U.S. at 637.

[33] *See Pollock I*, 157 U.S. at 581, 583; *Pollock II*, 158 U.S. at 637; *Macomber*, 252 U.S. at 205 ("[In *Pollock*] it was held that taxes upon rents and profits of real estate and upon returns from investments of personal property were in effect direct taxes upon the property from which such income arose, imposed by reason of ownership").

[34] Nat'l Fed'n of Indep. Bus. v. Sebelius, 567 U.S. 519, 571 (2012) ("we continued to consider taxes on personal property to be direct taxes").

[35] Congressional Resource Service, *supra* note 18, at 9.

[36] *Id.* ("[W]hile the Court in *Pollock* held that a tax on income derived from property was indistinguishable from a tax on the property itself, the Court later rejected that reasoning in *Stanton v. Baltic Mining Company*, upholding an unapportioned tax on a mine's income as being [an excise].").

[37] *See* Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 CONST. COMMENT. 295 (2004); Johnson, *supra* note 31; Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution*, 7 WM. & MARY BILL RTS. J. 1 (1998).

[38] Ackerman, *supra* note 1.

[39] Johnsen & Dellinger, *supra* note 5.

Jensen,[40] all of whom come to somewhat different conclusions.) Indeed, we believe that the literature and the history points instead to the overwhelming conclusion that the term is ambiguous and was so at the time.[41] Plausible evidence exists, for example, suggesting that the Framers and other contemporaneous individuals thought that "direct tax" meant: a head tax;[42] a head tax and a land tax;[43] only taxes the incidence of which could not be shifted to others;[44] only requisition-style lump-sum taxes;[45] the *opposite* of requisition-style taxes;[46] taxes on real property;[47] taxes on all property, including financial assets;[48] any tax on a person (as opposed to a transaction);[49] and any internal tax.[50] Ackerman has also written compellingly that the meaning of the term direct tax is inextricably bound up with slavery and the three-fifths clause in way that makes the term effectively meaningless today,[51] a view that was also shared

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40 Erik M. Jensen, *Interpreting the Sixteenth Amendment (By Way of the Direct-Tax Clauses)*, 21 CONST. COMMENT. 355 (2004); Erik M. Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of Incomes*, 33 ARIZ. ST. L.J. 1057 (2001); Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334 (1997).

41 *See* Edward B. Whitney, *The Income Tax and the Constitution*, 20 HARV. L. REV. 280, 280–83 (1907) (discussing the paltry debate around the issue, both at the Constitutional convention and in state ratifying conventions); Dodge, *supra* note 7, at 860-64

42 Ackerman, *supra* note 1, at 12–13.

43 *See, e.g.*, THE FEDERALIST NO. 21, 130 (Alexander Hamilton), United States v. Hylton, 3 U.S. (3 Dall.) 171, 175 (Chase, J.).

44 *E.g.*, Oliver Wolcott Jr., *Direct Taxes*, H.R. Doc. No. 100 (1796), *in* 1 AMERICAN STATE PAPERS: FINANCES 414 (1832); EDWIN R.A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY, AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD 537–38 (1911).

45 Johnson, *Foul-Up, supra* note 37, at 12–14.

46 *See* THE FEDERALIST NO. 30 (Alexander Hamilton) (arguing that a purpose of the Constitution was to overcome the failures of the requisition system), No. 36, at 220 (Alexander Hamilton) (distinguishing between taxes and requisitions).

47 Dodge, *supra* note 7, at 917–32.

48 *See* Wolcott, *supra* note 44 (generally describing all such taxes as "direct taxes").

49 *E.g., Hylton*, 3 U.S. (3 Dall.) at 180 (Chase, J.) (noting that distinction from Adam Smith); Jensen, *Consumption Taxes*, *supra* note 40, at 2394–96.

50 Johnson, *Foul-Up*, *supra* note 37, at 46–51.

51 Ackerman, *supra* note 1.

by earlier scholars[52] and that goes back even to the very first direct tax case in 1796.[53]

Given that ambiguity, a quasi-originalist approach to answering this question is unlikely to resolve the uncertainties. Instead, we should look to the practical wisdom of Congress and common-law courts in trying to make the complicated and confusing language of the Constitution work given the realities of public finance. To aid in that project, we review below some of the key pre-*Pollock* jurisprudence on direct taxation, as worked out by the Supreme Court and Congress. As we will argue, these cases synthesize into the doctrine that we label as the Indirect Tax Canon. This Part also examines the federal Direct Tax Acts of the 18th and 19th centuries and concludes with the upending of prior doctrinal understandings in *Pollock*.

## A. Hylton v. United States

The term "direct tax" is not just ambiguous from our standpoint nearly 250 years later, but was also ambiguous at the time of the Constitution's adoption, as clearly illustrated by *Hylton v. United States*,[54] a case brought just a few years after the ratification of the Constitution concerning a federal tax on carriages. The Justices in *Hylton* gave their opinions *seriatim*, and only three are fully reasoned decisions, which presents a challenge for drawing out a clear holding. But the general sense of the Justices was clear—the carriage tax was not a direct tax subject to apportionment, and likely few taxes were. Justice Chase wrote that "[t]he Constitution evidently contemplated no taxes as direct

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[52] *See* SELIGMAN, *supra* note 44, at 594 ("We have learned that the only reason of its [references to direct taxes] original insertion was to effect a compromise on the slavery questions. Now that slavery had long been abolished, there was no further reason for retaining the clause in the constitution.").

[53] *See* Hylton v. United States, 3 U.S. (3 Dall.) 171, 178 (1796) (Paterson, J.).

[54] 3 U.S. (3 Dall.) 171 (1796).

taxes, but only such as Congress *could* lay in proportion to the census" (emphasis added).[55] He went on to say, in *dicta*, that "I am inclined to think, but of this I do not give a judicial opinion, that the direct taxes *contemplated by the Constitution* are only two, to wit, a capitation, or poll tax, simply, without regard to property, profession, or any other circumstance; and a tax on LAND" (first emphasis added, second in original).[56] Justice Paterson wrote, "[w]hether direct taxes, *in the sense of the Constitution* comprehend any other tax than a capitation tax, and a tax on land, is a questionable point" (emphasis added).[57] And Justice Iredell wrote that "it is evident that the Constitution contemplated [no tax] as direct but such as could be apportioned. If this cannot be apportioned, it is, therefore, not a direct tax *in the sense of the Constitution*" (emphasis added).[58]

The three Justices all make clear that they are interpreting the phrase "direct tax" *only as used in the Constitution*, and not in any broader senses of the term. In the first *Pollock* case, as we will see, much is made about other uses of the term, such as by Adam Smith in *Wealth of Nations*, to describe any tax on people or property, while indirect taxes are taxes on "expense," or consumption.[59] But these definitions were hardly unknown to the Justices in *Hylton*. Indeed, Justice Paterson quotes extensively from Smith's *Wealth of Nations*,[60] and the Justices heard arguments for how the term was used in political economy.[61] The Court understood well that the term "direct tax" could easily mean something different within the four corners of the constitutional text.

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[55] 3 U.S. (3 Dall.) at 174.

[56] *Id.* at 175. Paterson also noted that slavery was the root of the Apportionment Clauses, and thus they should not be "extended by construction." *Id.* at 178. For more on the connection between the Apportionment Clauses and slavery, *see* especially Ackerman, *supra* note 1.

[57] 3 U.S. (3 Dall.) at 177.

[58] *Id.* at 181.

[59] *See Pollock I*, 157 U.S. at 685 (quoting Albert Gallatin).

[60] *See, e.g., Hylton*, 3 U.S. (3 Dall.) at 180–81.

[61] *See* AJAY K. MEHROTRA, MAKING THE MODERN AMERICAN FISCAL STATE: LAW, POLITICS, AND THE RISE OF PROGRESSIVE TAXATION, 1877–1929 135 (2013) (quoting Clarence Seward, appellant counsel).

Presented with ambiguous text that, if interpreted too broadly, had the risk of undermining a clear intent by the Constitutional Convention to give the new U.S. Congress stronger and more effective taxing powers than it held under the Articles of Confederation, the Justices began the process of making workable law. And that process proceeded apace for the next hundred years.

### *B. The Pre-*Pollock *Cases and the Development of the Indirect Tax Canon*

In its jurisprudence following *Hylton* the Court gradually solidified its interpretation of "direct tax" to include just capitations and taxes on land. But more importantly—and, we believe, not previously explained in the literature—the Court also developed what is essentially a canon of constitutional tax jurisprudence, that if a tax could plausibly be described as an indirect tax—and if Congress describes it that way—courts should defer to that interpretation *even if* the tax could alternatively be described as a "direct tax." We call this the "Indirect Tax Canon." As we will see, this Canon derives from the Constitution's grant of a strong taxing power to Congress (in contrast to the Articles of Confederation) and from the impracticalities of trying to enforce arbitrary limits to that power.

In *Hylton*, the Court understood that some taxes can be plausibly described as either direct or indirect, but if so, that it should defer to the indirect interpretation. For example, Justice Chase asked, rhetorically, "I believe some taxes may be both direct and indirect at the same time. If so, would Congress be prohibited from laying such a tax, because it is partly a direct tax?"[62] The Court then applied a similar approach in *Pacific Insurance Co. v. Soule*[63] and again

[62] 3 U.S. (3 Dall.) at 174.
[63] 74 U.S. (7 Wall.) 433 (1869).

in *Veazie Bank v. Fenno*,[64] in both cases adopting a broad construction of "indirect" and a narrow construction of "direct" to defer to Congress.

Specifically, in *Pacific Ins. Co.*, the Court upheld a tax on the income of insurance companies, saying that the injustice of trying to apportion such a tax required a narrow reading of the term "direct tax."[65] In *Veazie*, the Court upheld a 10% tax on the value of bank notes as a tax on an object and therefore "under the head of duties."[66] Noting the "difficulty of defining with accuracy"[67] the term "direct tax," the Court relied heavily on the fact that Congress had only ever levied direct taxes on real property and enslaved persons.[68] "It may be rightly affirmed, therefore, that in the practical construction of the Constitution, direct taxes have been limited to taxes on land and appurtenances, and taxes on polls, or capitation taxes. And this construction is entitled to great consideration, especially in the absence of anything adverse to it in the discussions of the Convention which framed, and of the conventions which ratified, the Constitution."[69]

This deferential approach was perhaps most clear in *Scholey v. Rew*,[70] a case regarding a "succession tax"—an early form of inheritance or estate tax—imposed on the value of real estate transferred to another because of death.[71] The Court held that the succession tax is "an excise tax or duty," because it was levied on the "devolution" of the property, not the property itself, and the fact that it was computed based on the value of land and became a lien on the land did not contradict that conclusion.[72] But recall that even the narrowest

[64] 75 U.S. (8 Wall.) 533 (1869).
[65] 74 U.S. (7 Wall.) at 446.
[66] 75 U.S. (8 Wall.) at 546–47.
[67] *Id.* at 540.
[68] *Id.* at 542–43.
[69] *Id.* at 544.
[70] 90 U.S. (23 Wall.) 331 (1875).
[71] *Id.* at 346.
[72] *Id.* at 346–47. We note that the earlier cases relied more on a sort of rule of exclusion, that the taxes were indirect because they were not clearly direct. In *Scholey* the Court instead

constructions of "direct tax" up to this point would include a tax on land. The succession tax in *Scholey* fell on the "devolution" of title to real property—and *only real property*. Of any of the taxes in question before *Pollock*, this would seem to be at the most risk of being declared a direct tax in the sense of the Constitution. Nonetheless, the Court held that the tax was affirmatively an indirect tax, a tax on the *act* of devolution, rather than on the land itself. Here we see the Indirect Tax Canon taking further shape: Even though it would have been straightforward to hold that a succession tax based on the value of real property was equivalent to a tax on land, and therefore a direct tax, the Court nonetheless deferred to the formal construction of the tax as an indirect tax on the act of devolution, to uphold Congress's statutory scheme.

Finally, in *Springer v. United States*,[73] the Court confronted precisely the question that it would face again in *Pollock*—is an income tax a direct tax that must be apportioned?[74] The case concerned a Civil War–era tax on "income, gain, and profits."[75] As in past cases, the Court noted the ambiguity of the terms as used in the Constitution[76] and looked to Congress's practice in enacting explicit Direct Taxes to guide its interpretations.[77] As in *Veazie*, the Court found that the only direct taxes passed by Congress covered just real estate and enslaved people and that those determinations made "by the legislative and executive departments of the government, though not conclusive, is a consideration of great weight."[78]

The Court also finally ruled on the question that earlier cases had somewhat side-stepped—what, exactly, are direct taxes?

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describes the succession tax as affirmatively an excise tax.

[73] 102 U.S. 586 (1881).

[74] The Court has also previously upheld a tax on the income of insurance companies. *See* Pacific Ins. Co. v. Soule, 74 U.S. (7 Wall.) 433 (1869).

[75] *Id.* at 592.

[76] *See id.* at 596–98.

[77] *See id.* at 598–99.

[78] *Id.* at 596.

> Our conclusions are, that direct taxes, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate; and that the tax of which the plaintiff in error complains is within the category of an excise or duty.[79]

One can easily see, then, why *Pollock* was such a shock.

### *C. The Direct Tax Acts*

Despite the challenges of apportionment, Congress passed five apportioned taxes on real property (and enslaved persons) over the course of the 18th and 19th centuries, with the first enacted less than ten years after the Constitution's passage. These taxes were never challenged as unconstitutional, and the Court frequently looked to them as examples, illustrating part of the Indirect Tax Canon—that Congressional description of a tax as either "indirect" or "direct" is entitled to great weight. Because these are the only examples of apportioned federal direct taxes to guide our construction of a constitutional apportionment path for any new direct tax, they merit a close look.

Before enacting that first Direct Tax in 1798, the Ways and Means Committee directed the Secretary of the Treasury, Oliver Wolcott Jr., to prepare "a plan for raising the sum of two millions of dollars, by apportionment among the several states, agreeably to the rule prescribed by the constitution; adapting the same to such objects of direct taxation, and such modes of collection, as may appear, the laws and practices of the States, respectively, to be most eligible in each."[80] Wolcott presented his report to Congress in December of that year.[81]

Wolcott's report illustrates a couple of important points. First, there was already developing a clear distinction between a political-economy

[79] *Id.* at 602.
[80] *Increase of Revenue*, H.R. Doc. No. 95 (1796), *in* 1 AMERICAN STATE PAPERS: FINANCE 409.
[81] Wolcott, *supra* note 44.

understanding of the term "direct tax" and the more limited meaning of the term for purposes of constitutional law. For example, Wolcott describes a number of *state* direct taxes, including taxes on personal property,[82] financial assets,[83] and even labor income.[84] Nonetheless, Wolcott distinguishes these direct taxes from the "direct taxes" requiring apportionment under the Constitution. For instance, regarding state direct taxes on the income of professions and merchants, Wolcott says that "[i]t is presumed, that taxes of this nature cannot be considered as of that description with the constitution requires to be apportioned among the States."[85] Furthermore, he says that "[a] direct tax, *in the sense of the constitution*, must necessarily include a tax on lands" (emphasis added), again distinguishing between the state direct taxes he reports on and the type of tax required to be apportioned.[86]

Second, the modes of valuation and assessment of the state direct taxes do not line up well with our modern financial tools of valuation. In many of the states, Wolcott describes a form of *presumptive taxation*, whereby land and other property is simply declared by statute to have a particular value, without any attempt to derive the property's actual value. For example, Vermont only taxed improved lands used for farming or grazing, at a fixed rate of 10 shillings per acre,[87] and New Hampshire valued orchard land at 1 shilling, six pence, per acre; arable land and mowing land at 1 shilling per acre; and pasture land and at five

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[82] *See, e.g., id.* at 413 (Vermont), 419 (N.H.).

[83] *See, e.g.,* id at 413 (Vermont).

[84] *See, e.g., id.* (Vermont: "profits of lawyers, traders, and owners of mills"). Seligman took issue with equating these sorts of "faculty" taxes to income taxes, since they were intended more as a way to measure what we might today call "human capital," or alternatively to a tax on business profits. Edwin R.A. Seligman, *The Income Tax in the American Colonies and States*, 10 POL. SCI. Q. 221, 222–23, 244 (1895). These taxes only tried to measure the value of a thing, rather than all of the income of a person. *Id.* at 244; *see also* MEHROTRA, *supra* note 61, at 133–35. The distinction is relevant, but like in other analyses, Seligman may be trying to give too much substance to formalistic distinctions. *See* John R. Brooks, *The Definitions of Income*, 71 TAX L. REV. 253, 114–18 (2017).

[85] Wolcott, *supra* note 81, at 439.

[86] *Id.*

[87] *Id.* at 418.

pence per acre.[88] And even in some of the states that purported to tax land *ad valorem*, the valuation might have been without regard to improvements or without regard to rental income.[89] This underscores the fluidity of tax base concepts like "income" and "wealth," even from the very beginnings of the union.

Because of the range of methodologies, when Wolcott recommends a tax on land, that is only the first step, since just as important was the "mode of assessment, of which the principles shall be, as nearly as possible, certain, uniform, and equal."[90] In other words, though land taxation must be apportioned, what land is taxed and how it is valued can help to move it more toward uniformity. Foreshadowing *Pollock* somewhat, he concludes that "[t]axes proportioned to the value of improved lands, and taxes proportioned to their…annual income" are roughly the same, and that either would be the fairest criterion, on the assumption that the value of improved land would be proportional to population.[91] While this is not true today—and may not have been true at the time—it does underscore that in the early Republic the idea of an apportioned land tax was not obviously unjust in the way that the pre-*Pollock* Court assumed would be true for other kinds of wealth or income taxes.[92] Land, particularly "improved land" (by which is mostly meant land cleared for farming or grazing), was thought to largely correlate with population, so apportioning by population was considered reasonable.[93]

Wolcott's report ultimately recommended that Congress impose a direct tax on land, *ad valorem*; on house value above an exemption amount (perhaps

[88] *Id.* at 418.
[89] *Id.* at 431 (Virginia).
[90] *Id.* at 439.
[91] *Id.*
[92] *See supra* notes 55–58 and accompanying text.
[93] *See, e.g.,* Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 702 (Harlan, J., dissenting).

with three classes of presumptive value, though the report is not clear on this); and on enslaved persons, at a single uniform rate.[94]

The first Direct Tax enacted by Congress in 1798 largely followed the model proposed by Wolcott, and it in turn provided the model for the four subsequent Direct Taxes: of 1813, 1815, 1816, and 1861. The Acts are all structured similarly, so we review a few of their key elements. These are essentially our only examples of how the "apportionment path" could work, and since these Direct Taxes were never challenged in court, we take them to be presumptively constitutional. We also note that the Court has implied that these Direct Taxes are indeed presumptively constitutional.[95]

The 1798 Direct Tax called for a tax of $2 million, apportioned among the states based on population,[96] and then further into geographic divisions.[97] The commissioners for each division were then to assess their tax quotas against land, dwelling houses, and slaves.[98] But even though the overall quotas were apportioned among the states based on population, the assessment methods were not—the whole tax was actually a combination of a *uniform* tax on dwelling houses and enslaved persons, and a *residual* tax on land assessed at whatever rates were necessary to fill out each state's quota. The Act instructed district tax commissioners to assess the value of all dwelling houses exceeding $100 in a uniform way across all districts,[99] and to then assess tax against those houses at uniform, graduated rates of between 0.2% and 1%.[100] Similarly, the owners of enslaved persons between the ages of 12 and 50 were taxed at a uniform rate of 50 cents per person.[101] Land was then taxed as follows:

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[94] Wolcott, *supra* note 44, at 440.
[95] *E.g.,* notes 89 & 99 *supra*.
[96] Act of July 14, 1798 § 1, 1 Stat. 597, 597-98.
[97] Act of July 9, 1798 § 1, 1 Stat. 580, 581-584.
[98] Act of July 14, 1798 § 2, 1 Stat. at 598.
[99] Act of July 7, 1798 § 8, 1 Stat. at 585.
[100] Act of July 14, 1798 § 2, 1 Stat. at 598.
[101] Act of July 7, 1798 § 8, 1 Stat. at 585 (on age range); Act of July 14, 1798 § 2, 1 Stat. at

> And the whole amount of the sums so to be assessed upon dwelling-houses and slaves within each state respectively, shall be deducted from the sum hereby apportioned to such state, and the remainder of the said sum shall be assessed upon the lands within such state according to the valuations to be made pursuant to the act [of July 7], and at such rate per centum as will be sufficient to produce the said remainder.[102]

Thus, seen as three separate taxes—a tax on dwelling-houses, a tax on enslaved persons, and a tax on land—*none* was apportioned based on population. For example, a flat 50-cent tax on enslaved persons would of course collect no revenue at all in the free states. And a uniform set of tax rates on dwelling-houses would collect tax in proportion to those values, not in proportion to population. And the residual tax on land was neither uniform nor apportioned.[103] It was only the combination of the three—*the total revenue collected*—which was proportional to population. This is an immensely important point that informs our construction of apportionment in Part III.C.

The 1813 Direct Tax was also assessed against land, dwelling-houses, and enslaved persons, but in a somewhat more straightforwardly *ad valorem* way.[104] However, the Act also allowed a deduction of up to 15% if a state paid its quota directly to the U.S. Treasury before certain dates (thereby relieving federal tax collectors of their work).[105] Only seven states took advantage of the discount, meaning that the final revenues actually collected were *not* exactly proportional to population (another noteworthy consideration in designing a practical apportioned tax).[106] The 1815 and 1816 Direct Taxes were substantially the same as the 1813 Direct Tax, though only four states pre-paid their taxes in

598 (on tax rate).

[102] Act of July 14 § 2, 1 Stat. at 598.

[103] Furthermore, the Act of July 14 even contemplated that there would be no tax on land in some states, if the tax on dwelling-houses and slaves fulfilled or exceeded the state's quota, in which case the commissioners could proportionally lower the tax rates on dwelling-houses. *Id.* § 3, 1 Stat. at 599.

[104] Charles F. Dunbar, *The Direct Tax of 1861*, 3 Q.J. ECON. 436, 443 (1889).

[105] Act of Aug. 2, 1813 § 7, 3 Stat. 53, 71.

[106] Dunbar, *supra* note 104, at 443.

those years.[107] We draw two key points from this: a precedent of cooperation with the states in collection, and the allowance of a rebate to a state without undermining the original apportionment calculation.

The Act of 1861 was intended to be roughly the same as the 1813–16 Acts, though without the tax on enslaved persons—retaining only the taxes on land and on dwelling-houses. But the circumstances of the Civil War made assessment and collection a challenge. Moreover, the growing disparities in wealth concentration due to the growth of manufacturing and commerce in the northern states made what had once been viewed as only somewhat unreasonable now seem to at least some observers as prohibitively inequitable. As Dunbar says, "[o]nly the smallness of the sum to be raised made special assessment upon one species of property tolerable, in a country where personal property had multiplied so greatly."[108]

### D. Pollock v. Farmers' Loan & Trust Co.

We turn now to the pivotal case of *Pollock vs. Farmers' Loan & Trust Co.*[109] *Pollock* was understood as a shocking result and an extraordinarily bad opinion even at the time it was decided.[110] It is correctly seen today as one of the first of the *Lochner*-era cases, wherein the Court purported to derive previously-nonexistent *laissez-faire* natural law from vague passages in the Constitution.[111] The key legal move in *Pollock* was to treat a tax on rent from land as a burden on the land itself—so that a tax on the income from property has the same effect

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[107] *Id.* at 444.

[108] *Id.* at 445.

[109] *Supra* note 22.

[110] Even Jensen, who says the result in *Pollock* was right, describes the opinion as "embarrassing." Jensen, *Interpreting*, *supra* note 40, at 391.

[111] *See* RICHARD WHITE, THE REPUBLIC FOR WHICH IT STANDS: THE UNITED STATES DURING RECONSTRUCTION AND THE GILDED AGE, 1865–1896 820 (2017); Marjorie E. Kornhauser, *The Story of Macomber: The Continuing Legacy of Realization*, in TAX STORIES: AN IN-DEPTH LOOK AT TEN LEADING FEDERAL INCOME TAX CASES 112 (2009).

as taxing the property.[112] The Court also held—for the first time—that taxes on personal property (not just real property) were direct taxes, and therefore a tax on income from *any* property must also be apportioned.[113]

A typical criticism of *Pollock* today is to challenge one of these steps, especially the first two, equating income from property with a tax on the property itself.[114] We take a somewhat different view. We largely do not take issue with the *economic* equivalence of a tax on income and a tax on the *source* of income. Indeed, as noted above, this was even well-understood to be the case throughout the 18th and 19th centuries, when the state direct taxes often valued property by reference to its rent.[115] In our view, the deeper error of the Court was ignoring the Indirect Tax Canon by looking through the formalities in the first place, to try to divine the "substance" of an income tax by reference to the source of income.

The case actually consisted of three consolidated cases argued twice, and with two separate opinions.[116] But for our purposes we can focus on the core elements. The taxpayer made several arguments for the unconstitutionality of the income tax. *Pollock I* held for the taxpayer on the claims that a tax on rent from land was the same as a tax on land and that a tax on the interest from municipal bonds was unconstitutional in its own right.[117] After rehearing, the Court in *Pollock II* held additionally that taxes on personal property were direct taxes, and thus so were taxes on the income from that property.[118] The Court

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[112] *See Pollock I*, 157 U.S. at 580–83.

[113] *Pollock II*, 158 U.S. at 628.

[114] *See., e.g.,* Ackerman, *supra* note 1, at 29; Johnson & Dellinger, *supra* note 5, at 126–27.

[115] To be clear, there is not always a direct one-to-one relationship between the value of property and its income, particularly its net income, due to complicated deduction rules, especially for depreciation. Property of equal value might produce very different net income. That said, at its core, the economic value of property is derived from its ability to generate an economic return of some sort.

[116] *See* MEHROTRA, *supra* note 61, at 132.

[117] *Pollock I*, 157 U.S. at 583 (real estate), 586 (municipal bonds).

[118] *Pollock II*, 58 U.S. at 628.

further held that the entire act was unconstitutional because the unconstitutional taxes on rent, other income from property, and municipal bond interest were inseparable from the act as a whole.[119]

Most of our criticism of *Pollock* here is regarding its failure to follow the Indirect Tax Canon and instead attempt to look through the form of a tax to discover its "true" substance. But we first briefly touch on two other problems with the opinions. First, the Court bases its holding in part on a novel interpretation of the Apportionment Clauses as embodying how the states and the federal government shared their "concurrent power" over direct taxation. Under this view, the states were wary of sharing this power, particularly when they were also giving up the power to "levy taxes on imports and to regulate commerce,"[120] and thus they deliberately tied the hands of Congress.[121] The Court also implies that the Constitution was intentionally protecting property owners from the "unfair and discriminat[ory]" will of a "mere majority vote."[122] This is an interpretation of the Constitution that is wholly absent from any of the prior indirect tax cases, not to mention from the Constitutional Convention itself—though it was of course ascendent in the *Lochner* era.[123] Indeed, it is in conflict with the Court's reasoning in *Hylton*, *Pacific Ins. Co.*, and elsewhere, that a narrow construction of "direct tax" was necessary precisely because apportionment was so difficult.

Second, the Court selectively cites historical evidence purporting to show what the framers intended by "direct tax," while dismissing or ignoring

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[119] *Id.* at 636–37.

[120] *Pollock I*, 157 U.S. at 556–57.

[121] It is worth noting that Joseph Story refers to this argument as "wholly without any solid foundation." 1 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 939 (2d. ed 1851). As he notes, the mere fact of concurrent power is sufficient protection, since states are not in any way prohibited from direct taxation. *Id.* §§ 940–43.

[122] *Pollock II*, 158 U.S. at 621.

[123] *See, e.g.*, MORTON J, HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1870–1960: THE CRISIS OF LEGAL ORTHODOXY 19–31 (on the linkage between *Pollock*, *Lochner*, and the push to invalidate any redistributive government action); WHITE, *supra* note 111, at 810–22.

any contrary evidence. But, as discussed above and as the Court itself held on numerous occasions prior to *Pollock*, there is good evidence to support many different interpretations—which is precisely why the Court had been called on so often to answer this precise question.[124] Indeed, the *Pollock* Court likely misinterpreted some of the historical evidence when it said that the income tax in England had always been treated as a "direct tax,"[125] since those taxes were in effect land taxes, and to the degree there were taxes on incomes, they were called "duties."[126] The general income tax in England did not even appear until 1799, well after the passage of the U.S. Constitution.[127]

In addition to these points, the dissenters also give voice to our Indirect Tax Canon—indeed, Justice Brown refers to the collected holdings of the major pre-*Pollock* cases as a "canon of interpretation."[128] Justice White notes that the source-based argument in *Pollock*—that a tax on income is the same as a tax on the income's source—was even stronger in some of the earlier cases, such as *Scholey*, in which the tax was "laid directly on the right to take real estate by inheritance."[129] Nonetheless the *Scholey* Court deferred to Congress's characterization of it as a tax on the act of devolution.[130] Justice Brown writes that "if [a tax] can be done directly in one manner, i.e. by the rule of apportionment, *it does not follow that it may not be done indirectly in another manner*" (emphasis added).[131]

To underscore the dissenters, we again emphasize the near-unanimous view of courts, constitutional scholars, and tax scholars prior to *Pollock* that

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[124] *See supra* notes 41–51 and accompanying text.

[125] *See Pollock II*, 158 U.S. at 630–31.

[126] *See* Whitney, *supra* note 41, at 293–95.

[127] *See, e.g.,* S.J. Thompson, *The First Income Tax, Political Arithmetic, and the Measurement of Economic Growth*, 66 ECON. HIST. REV. 873, 876 (2012); Whitney, *supra* note 41, at 295.

[128] *Pollock II*, 158 U.S. at 689 (Brown, J., dissenting).

[129] *Id.* at 648.

[130] *Id.*

[131] *Pollock II*, 158 U.S. at 692–93 (Brown, J., dissenting).

direct taxes were only capitations and taxes on land, and that an income tax was not a direct tax.[132] Importantly, these jurists and commentators all fully understood—just as the *Hylton* Court and Wolcott did—that the *economic* meaning of "direct tax" can be different from the *constitutional* meaning, that these are just the same pair of words used to describe different concepts. Moreover, as Edwin Seligman noted, even "among economists there is no absolute agreement as to the exact distinction between direct and indirect taxes."[133] Even so, he wrote, "the Supreme Court is undoubtedly correct in assuming that the only direct taxes contemplated by the constitution were the poll tax and the general property tax, chiefly the land tax," and that there is "no reason to suppose that [*Soule*] will be reversed."[134] Writing after *Pollock*, Seligman described the pre-*Pollock* state of affairs:

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[132] *See, e.g.,* THOMAS COOLEY, A TREATISE ON THE CONSTITUTION LIMITATIONS WHICH REST UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION 589 (6th ed. 1890) ("The term 'direct taxes,' as employed in the Constitution, has a technical meaning, and embraces capitations and land taxes only."); 1 JAMES KENT, COMMENTARIES ON AMERICAN LAW *256 ("[T]he better opinion seemed to be, that the direct taxes contemplated by the Constitution were only two, viz. a capitation, or poll tax, and a tax on land.")); 1 STORY, *supra* note 121, § 955 ("It has been seriously doubted, if, in the sense of the constitution, any taxes are direct taxes, except those on polls or on lands."); SAMUEL FREEMAN MILLER, LECTURES ON THE CONSTITUTION OF THE UNITED STATES 237 (1893) ("Direct taxes, with the meaning of the Constitution, are only capitation taxes as expressed in that instrument, and taxes on real estate."); JOHN NORTON POMEROY, AN INTRODUCTION TO THE CONSTITUTIONAL LAW § 277 (5th ed. 1880) ("Direct taxes include those assessed upon land, and those which pass under the denomination of capitation or poll, and probably no others. Indirect taxes would then embrace all the remaining species, and would be co-extensive with duties, imposts and excises."); 1 J.I. CLARK HARE, AMERICAN CONSTITUTIONAL LAW 149–50 (1889); W.H. BURROUGHS, A TREATISE ON THE LAW OF TAXATION 502 ("The construction given to the expression 'direct taxes' is that it includes only a tax on land and a poll tax, and this is accord with the views of writers upon political economy.") (1877); JOHN ORDRONAUX, CONSTITUTIONAL LEGISLATION IN THE UNITED STATES 225–26 (1891) ("The two rules prescribed for the government of Congress in laying taxes, are those of apportionment for direct taxes and uniformity for indirect. In the first class are to be found capitation or poll taxes, and taxes on land; in the second, duties, imposts, and excises…. Direct taxes are now well settled in their meaning…."); *see generally* MEHROTRA, *supra* note 61, at 130–38.

[133] Edwin R.A. Seligman, *The Income Tax*, 9 POL. SCI. Q. 610, 634 (1894).

[134] *Id.* at 625.

> It was accepted as part of American constitutional law, and was taught without exception by all writers on the subject, that the words "direct tax" as used in the constitution, signified only land and poll taxes.[135]

The economist Richard Ely, after describing the income tax as within an economist's definition of "direct tax," notes (with exasperation) that "[t]he American federal classification is indeed a strange one. … It has been held that by direct taxes meant only taxes on real estate and on slaves; consequently an income tax was imposed during the late Civil War and was regarded as an indirect tax!"[136]

And the pre-eminent tax law scholar of the time, Thomas Cooley—again, after first clearly putting an income tax under the general *economic* heading of "direct tax"[137]—goes on to say that, for purposes of apportionment, it is a different question "as to the meaning of the term direct taxes as … employed [by the Constitution]." He notes that *Hylton* "strongly intimated … that only capitation taxes and taxes on land should be deemed to be within the provision," and that "the intimation of [*Hylton*] is very distinctly affirmed in one recently decided where a tax on land was in question."[138]

### *E. The Aftermath of* Pollock

The negative response to *Pollock* was swift and intense. Faced with massive pushback, the Court pivoted in later cases, falling back to its pre-*Pollock* practice of finding taxes to be indirect whenever possible—in other words, applying the Indirect Tax Canon.

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135 SELIGMAN, *supra* note 44, at 534.

136 RICHARD T. ELY, TAXATION IN AMERICAN STATES AND CITIES 77 (1888).

137 THOMAS M. COOLEY, A TREATISE ON THE LAW OF TAXATION, INCLUDING THE LAW OF LOCAL ASSESSMENTS 6 (2d ed. 1886). This was despite the fact that Cooley was a supporter of "constitutional barriers against the use of taxation for redistributive ends." HORWITZ, *supra* note 123, at 22.

138 COOLEY, *supra* note 137, at 8 (citing Springer v. United States, 102 U.S. 586 (1881)).

For example, in *Nicol v. Ames*,[139] decided in 1899, taxpayers raised a challenge to a stamp tax on certain commodity sales through the Chicago Board of Trade, arguing that it was a direct tax because it was assessed based on the value of property being sold.[140] Even though *Pollock* had held that taxes on personal property were direct taxes, the Court nonetheless held unanimously that the tax here was "a duty or excise laid upon the privilege, opportunity, or facility offered at boards of trade or exchanges."[141] In its opinion—written by Justice Peckham, who joined the Court after *Pollock*, but was later the author of the *Lochner* decision[142]—the Court used language that would seem to reject the approach taken in *Pollock*. For example, the Court wrote, in language that mirrors our Indirect Tax Canon:

> It is no part of the duty of this court to lessen, impede, or obstruct the exercise of the taxing power by merely abstruse and subtle distinctions as to the particular nature of a specified tax… In deciding upon the validity of a tax … no micro-scopic [sic] examination as to the purely economic or theoretical nature of the tax should be indulged in, for the purpose of placing it in a category which would invalidate the tax. *As a mere abstract, scientific, or economical problem, a particular tax might possibly be regarded as a direct tax, when as a practical matter pertaining to the actual operation of the tax it might quite plainly appear to be indirect* (emphasis added).[143]

In *Knowlton v. Moore*,[144] also from 1899, the Court unanimously upheld a "death duty"—an estate tax, essentially—as an indirect "duty or excise."[145] In the course of its discussion, the Court seemed to challenge and narrow some of the claims made in *Pollock*. The Court noted, for example, that *Pollock* had stated that "if a tax was direct within the constitutional sense, the mere erroneous qualification of it as an excise or duty would not take it out of the

[139] 173 U.S. 509 (1899).
[140] *Id.* at 514.
[141] *Id.* at 519.
[142] *See* Lochner v. New York, 198 U.S. 45, 52 (1905).
[143] *Nicol*, 173 U.S. at 515–16.
[144] 178 U.S. 41 (1900).
[145] *Id.* at 83.

constitutional requirement as to apportionment," but said this statement was specified to "the subject-matter under consideration" in *Pollock*, and was inapplicable to the question of whether a tax that had always been held to be a duty or excise could nonetheless be held to be a direct tax (even though that was precisely what *Pollock* did).[146] The Court also rejected the incidence-based analysis of what is direct or indirect as a "fallacy,"[147] despite it playing a role in *Pollock*.[148] The Court went on to incorporate the Indirect Tax Canon language from *Nicol* (as in our quote above).[149] To be clear, "a succession tax is direct in a much more positive sense than is a general income tax," as Edward Whitney (the former assistant attorney general who argued and lost in *Pollock*[150]) pointed out in the *Harvard Law Review* in 1907,[151] yet the Court nonetheless departed from the source-based analytical approach of *Pollock*.

In *Patton v. Brady*,[152] the Court was asked to rule whether a tax levied on the value of tobacco was a direct tax. Again, in the course of the opinion, the Court endorsed a more deferential attitude to Congress's determination of national necessities.[153] The Court also noted the clear similarity between an excise and a tax on property: "But what is the difference in the nature of an excise and an ordinary property tax which forbids a repetition or increase in the one case and permits it in the other? They are each methods by which the individual is made to contribute out of his property to the support of the government, and if an ordinary property tax may be repeated or increased when

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[146] *Id.* at 81. Recall that the income tax had already been clearly held to be an indirect tax in *Springer*.

[147] *Id.* at 82.

[148] *See* Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 558 (1895).

[149] *Knowlton*, 178 U.S. at 83 (quoting *Nicol,* 173 U.S. at 515–16).

[150] Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 607 (1895); *see* MEHROTRA, *supra* note 61, at 263.

[151] Whitney, *supra* note 41, at 287.

[152] 184 U.S. 608 (1902).

[153] *Id.* at 621 (quoting THOMAS COOLEY, A TREATISE ON THE LAW OF TAXATION, INCLUDING THE LAW OF LOCAL ASSESSMENTS 34–35 (1st ed. 1876) (internal quotations omitted)).

the exigencies of the government may demand, no reason is perceived why an excise should not also be repeated or increased under like exigencies."[154]

Finally, in the most famous example of this deferential approach, the Court upheld a corporate income tax in *Flint vs. Stone Tracy Co.*[155] The Court again reverted to the pre-*Pollock* approach of holding a tax to be indirect as long as there was a plausible reading as such—even if there were also a plausible reading of it as a direct tax. The Court underscored that *Pollock*'s definition of a direct tax was a tax on a person "solely because of their general ownership of property,"[156] and that *Pollock* endorsed looking through an income tax to the source of the income to determine if that was so. However, the *Flint* Court held, even looking through a corporate income tax to the same extent as in *Pollock*, a corporate income tax was not a tax on property solely because of its ownership, but was instead "a tax upon business done in a corporate capacity,"[157] and therefore could be called indirect.[158] Interestingly, the Court declined to provide an external rule or definition of what is an "excise" tax. That is, it did not have to affirmatively fit the corporate tax into a pre-determined definition of "excise" in order for it to pass constitutional muster—it was enough that the tax "*may be described* as an excise upon the particular privilege of doing business in a corporate capacity."[159]

In each of these cases, the Court relied on a combination of earlier precedent as to what fell in the category of indirect excise taxes and an avoidance of calling something a direct tax if an indirect label was plausible. But, to be

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[154] *Id.* at 622.
[155] 220 U.S. 107 (1911).
[156] *Id.* at 149 (quoting *Knowlton*, 178 U.S. at 82).
[157] *Id.* at 150.
[158] To be clear, by this point corporations were deemed to be legal "persons," Cty. of Santa Clara v. S. Pac. R.R., 118 U.S. 394 (1886), so it's not immediately obvious why a choice to do business in a corporate capacity is different from a choice to do business (i.e., generate income) at all. *See* MEHROTRA, *supra* note 61, at 257–61.
[159] *Flint*, 220 U.S. at 151.

clear, that same approach would certainly have applied in *Pollock* as well, since the Court had already clearly held in *Springer* that an income tax was indirect, even if it taxed a person in part based on their ownership of land, and furthermore a tax on income could be framed without much difficulty as a tax on the choice to generate income from property, rather than just to hold it passively.[160] In this view, *Pollock* is the anomaly, the only time in an otherwise unbroken line of jurisprudence when the Court stepped outside of our Indirect Tax Canon and attempted to make a source-based inquiry into the "true" nature of a tax, rather than relying on formalities of the particular assessment method chosen by Congress.

## II. THE REINSTATEMENT OF THE INDIRECT TAX CANON—AND THE CHALLENGE OF *EISNER V. MACOMBER*

The prior Part explained that the cases following *Pollock* backed away from its source-based inquiry into the "substance" of an indirect tax to see if it had the same effect as a direct tax, and instead deferred to a combination of Congressional prerogative and historical experience—that is, they followed the Indirect Tax Canon. But even if *Pollock* could be read as a repeal of the Indirect Tax Canon, the 16th Amendment along with subsequent Supreme Court cases clearly reinstated it. The Amendment reads:

> The 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.[161]

In this Part, we look more closely at the 16th Amendment and argue for why it should be read as overruling *Pollock*'s source-based inquiry and explain how subsequent Supreme Court cases have held that it did indeed overrule

[160] *See* Ackerman, *supra* note 1, at 32–33.
[161] U.S. Const. amend. XVI.

*Pollock*'s source-based inquiry. We then analyze the line of cases following the 16th Amendment, up to the modern era. In particular, we take a close look at *Eisner v. Macomber*, the second of the two cases (along with *Pollock*) that create the biggest challenge for drafting a constitutional wealth tax or accrual-income tax reform. As with *Pollock*, we show that *Macomber* has been effectively overruled in key respects.

### *A. "From Whatever Source Derived"*

Scholars have long debated whether to read the 16th Amendment as a full repudiation of *Pollock*—including its extension of the legal definition of "direct tax" to cover any tax on property solely because of its ownership—or only as a narrow allowance for an income tax while keeping intact the apportionment requirement for any other taxes on property. As with the drafting of the Constitution itself, there is evidence for both views. For example, Bruce Ackerman has argued that, because of post-*Pollock* cases such as *Knowlton*, there was no need to draft a full repeal for the Apportionment Clauses, since it appeared that the only problem was the income tax—every other potentially direct tax had already been upheld as a valid exercise of Congress's taxing power.[162] And some income tax supporters argued that a Constitutional amendment of any kind wasn't even necessary, since *Pollock* was clearly an erroneous aberration that the Court was not likely to uphold.[163] On the other hand, there is the clear language of the Amendment itself, which only addresses income, when Congress well understood that a broader repeal of apportionment was available.[164]

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[162] Ackerman, *supra* note 1, at 33-34.

[163] *See* ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 27–36, 60–64 (1940); MEHROTRA, *supra* note 61, at 263–69.

[164] Hemel & Kysar, *supra* note 4.

For our purposes, we want to focus in particular on the importance of the language "from whatever source derived." This is sometimes understood today to mean an endorsement of a broad definition of income. In *Commissioner v. Glenshaw Glass*,[165] for example, the Court used that language to reject earlier language from *Eisner v. Macomber*[166] that implied that income was derived only from labor or capital sources, holding instead that it could come from any source.[167] But read in light of *Pollock*, the phrase takes on a different and more important meaning—namely a repudiation of *Pollock*'s source-based reasoning and a full reinstatement of the Indirect Tax Canon.

First, we should briefly review some of the Congressional debate and the process by which this language was included, since it adds important context. A first draft of the Amendment was proposed by Senator Norris Brown in April 1909 that read: "The Congress shall have the power to lay and collect taxes on income and inheritances."[168] But as Senator Rayner immediately pointed out, Congress *already had* the power to tax income and inheritances—but the Constitution demanded the apportionment path if those taxes were considered "direct taxes."[169] Ackerman describes this, not unreasonably, as an attempt to gut the Amendment, since it said nothing about relieving the apportionment requirement.[170] The second attempt by Brown, in June, read:

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165 348 U.S. 426 (1955).

166 252 U.S. 189 (1920).

167 *Id.* at 207.

168 S.J. Res 25, 61st Cong., 44 Cong. Rec. 1568 (1909).

169 44 Cong. Rec. 1568–69.

170 *See id.* at 36–37. Jensen takes issue with Ackerman characterizing Brown as a "conservative" opponent of income taxation not acting in "good faith." Jensen, *supra* note 40, at 1111–12 n.271. Jensen implies instead that Brown was acting in good faith, even as other income tax supporters were more transparently supporting the amendment as a way to punt the issue from Congress. *Id.* at 1113. The truth is probably somewhere in the middle. *See infra* notes 177–184 and accompanying text.

> The Congress shall have the power to lay and collect *direct* taxes on incomes without apportionment among the several States accordingly to population. (emphasis added)[171]

The danger with this language was that it could have reified a disputed reading of the holding of *Pollock*—that income taxes were themselves direct taxes, and by implication that there were other kinds of direct taxes as well.[172] Recall that *Pollock* was more subtle, holding that an income tax that taxed income from property *had the same effect* as a tax on property. *Pollock* never questioned, for example, that an income tax on labor or business income would be indirect.[173] Senator Anselm McLaurin, an income tax supporter, objected and instead called for an amendment to remove the phrase "direct tax" from the relevant portions of the Constitution entirely—a change that would in effect have removed the apportionment requirement for *any* tax, direct or otherwise.[174] Brown objected to the removal of that phrase, saying candidly that his "purpose was to confine it to income taxes alone."[175] Thus, some argue, we should understand the 16th Amendment as only allowing unapportioned income taxes, while keeping the apportionment requirement for any other kind of "direct tax."[176]

That argument is flawed for two main reasons, however. First, it is not clear why we should give Senator Brown's intent any particular weight. Even though he formally proposed the amendment, his role in the strategy and

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[171] S.J. Res. 39, 61st Cong., 44 Cong. Rec. 3377 (1909); *see* Ackerman, *supra* note 1, at 37.

[172] *See* JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA 126 (1985) ("The belief that income is taxable regardless of its source…would not have been supported by Brown's wording."); SIDNEY RATNER, AMERICAN TAXATION: ITS HISTORY AS A SOCIAL FORCE IN DEMOCRACY 299 (1942) ("The justification for the income tax given in 1895, that income is taxable irrespective of the source from which it is derived, would not have been written into the Constitution by Brown's amendment."); Ackerman, *supra* note 1, at 36–37.

[173] *See, e.g.*, Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 578–79 (distinguishing *Springer* on this basis).

[174] The change would have meant that only capitations were required to be apportioned—but they are apportioned by definition anyway.

[175] 44 Cong. Rec. 3377 (1909); *see* Ackerman, *supra* note 1, at 37.

[176] *See Hemel & Kysar, supra* note 4.

negotiations around the amendment was minimal.[177] Ackerman suggests that he may even have been an opponent of the income tax not acting in good faith[178]—which was true for most of the amendment proponents, since the strongest income tax supporters wanted instead to pass a new income tax bill, suspecting that the Supreme Court would be forced to overrule *Pollock*.[179]

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[177] For example, in their "classic study of the legislative history of the income tax," MEHROTRA, *supra* note 61, at 28 n.59, Roy and Gladys Blakey describe Brown as striving to be recognized during the Senate debates and being quickly usurped by Senate Finance. ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 61 (1940). They describe him as "zealous[ly]" trying to maintain a connection to the amendment by formally proposing the Senate Finance version in July, likely not when it was originally planned to be brought up. *Id.* Historian Sidney Ratner says the Senate Finance "buried [his] suggestion." RATNER, *supra* note 172, at 298. Historian John Buenker describes Brown largely as a tool of President Taft. *See* BUENKER, *supra* note 172, at [1743]. In Ajay Mehrotra's masterful history of the intellectual and legal movement behind the income tax, Brown isn't even mentioned. *See* MEHROTRA, *supra* note 61.

[178] Ackerman, *supra* note 1, at 36–37. *But see* discussion at note 170, *supra*. In the Congressional debates in July, McLaurin called out Brown:

> "Mr. McLaurin: …If I understood the vote yesterday, the proponent of this proposed constitutional amendment voted against the income tax.
>
> Mr. Brown: I voted for an income tax.
>
> Mr. McLaurin: I did not catch the vote of the Senator aright if he voted for an income tax. The Senator from Nebraska [Brown], as I heard it, voted to substitute the corporation tax against the income tax.
>
> Mr. Brown: I did. A corporation tax is a tax on incomes, which the court has sustained. I voted for that which the court sustained and rejected that which the court has rejected."

44 Cong. Rec. 4067 (1909). In its practical effect, this is not easily distinguished from the strategy of Aldrich, who famously declared, "I shall vote for the corporation tax as a means to defeat the income tax." 44 Cong. Rec. 3929 (1909).

[179] *See* BLAKEY & BLAKEY, *supra* note 177, at 27–36 (on the Bailey-Cummins income tax proposal), 60–64 (on the 16th Amendment as a compromise position); BUENKER, *supra* note 172, at [1730–1885]; MEHROTRA, *supra* note 61, at 263–69; RATNER, *supra* note 172, at 298. The issue is more complex than can be treated fully here, but it appears that President Taft and some "Insurgent" Republicans were attempting a middle ground between completely abandoning an income tax, as Senator Aldrich and the more conservative Northeastern Republicans wanted, and passing an income tax in Congress in order to force the Supreme Court to overturn *Pollock*, as Democrats and some more progressive Republicans wanted. *See id*; MEHROTRA, *supra* note 61, at 268–69; SELIGMAN, *supra* note 44, at 592–93. It seems that Taft, though hardly an income tax supporter, had come around to the view that *Pollock* was wrongly decided, but feared the optics of Congress forcing the Supreme Court to backtrack. *See* BUENKER, *supra* note 172, at [1296, 1374]; MEHROTRA, *supra* note 61, at 268. His compromise solution was to instead pass a corporation excise tax in Congress and a constitutional amendment. The amendment would either die in the states or would allow the Supreme Court to save face. According to Buenker, Taft "won over" Brown to this view, splitting him from the more progressive Insurgent Republications like Senators Borah, Bristow, Cummins, and La Follette. BUENKER, *supra* note 172, at [1743]. Buenker describes Brown as a "marginal Insurgent," *id.*, and Sidney Ratner

Contemporaneous and historical accounts understood Senator Aldrich as the real force behind the Amendment,[180] with Senator Nelson authoring the key language.[181] This leads to the second flaw in this argument—that the language in the final Amendment was significantly different than Brown's version. The Senate Finance Committee's version—the final version—as written by Nelson, removed the phrase "direct tax" and added the phrase "from whatever source derived."[182] Ackerman describes this as a "major retreat from Brown's conservative ambitions."[183] Whether or not Brown's ambitions were conservative, the final draft is clearly more broad than the Brown version and could more easily be read as rejecting *Pollock*—and at any rate Brown's understanding of the language becomes far less relevant when Aldrich and Nelson were the key drafters.[184]

The comparison between the two drafts reveals something else, though, which is that the "from whatever source derived" language was not strictly necessary to make an unapportioned income tax possible. Brown's second version—the one containing the "direct tax" language and the apportionment language—would have done the job. So, we have to ask, what does the phrase "from whatever source derived" add in addition to allowing an income tax?[185]

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describes him as a "halfway insurgent," RATNER, *supra* note 172, at 298, The other Insurgent Republicans continued to support passing an income tax bill instead, though they ultimately voted for the constitutional amendment as better than nothing. *See* BLAKEY & BLAKEY, *supra* note 177, at 60; BUENKER, *supra* note 172, at [1834–1847], RATNER, *supra* note 172, at 301.

[180] *See, e.g.,* RATNER, *supra* note 172, at 300 ("Aldrich's Proposal for a Constitutional Amendment"); SELIGMAN, *supra* note 44, at 595 (on Aldrich controlling the Senate debate); Harry Hubbard, *"From Whatever Source Derived,"* 6 A.B.A. J. 202, 203 (1920) (on Aldrich controlling the Committee process).

[181] *See id.*

[182] S.J. Res. 40, 61st Cong., 44 Cong. Rec. 3900 (1909); *see* Ackerman, *supra* note 1, at 38.

[183] *Id.; see* Johnson, *Purging*, *supra* note 31, at 1733.

[184] Because he proposed the original resolution, "[a]s a formal matter of parliamentary procedure, Brown's amendment served as the basis for the entire debate on the Senate floor," but his particular language was quickly put aside, with the Finance Committee's amendment being the subject of full debate. Ackerman, *supra* note 1, at 37–38.

[185] There was a vigorous debate before and after the 16th Amendment's ratification on whether these words were specifically intended to allow the taxation of income derived from

The Supreme Court addressed this question early on, in *Brushaber*,[186] in which the taxpayer challenged application of the new income tax as unconstitutional, even given the new 16th Amendment. The *Brushaber* Court explained that *Pollock* "did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property, but on the contrary recognized the fact that taxation on income was in its nature an excise" unless it had the effect of being a direct tax on property, "in which case the duty would arise to *disregard form and consider substance alone* and hence subject the tax to the regulation as to apportionment which otherwise as an excise would not apply to it" (emphasis added).[187] The Court is here articulating what we argue is the key error of *Pollock*, of disregarding the form of taxation chosen by Congress and also disregarding the fact that an income tax could be—and, indeed, had been on several occasions—described as indirect, and instead purporting to look through that form to its substance. That is, of disregarding the Indirect Tax Canon.

As the Court subsequently elaborated in *Stanton v. Baltic Mining Co.*, "[By *Brushaber*,] it was settled that the provisions of the Sixteenth Amendment conferred no new power of taxation, but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning from being taken out of the category of indirect taxation to which it inherently belonged and being placed in the category of direct taxation subject to apportionment by a consideration of the sources from which the income was

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state governments, such as municipal bond interest (at issue in *Pollock*) or judicial salaries, *see* Evans v. Gore, 253 U.S. 245 (1920). *See, e.g.,* BLAKEY & BLAKEY, *supra* note 177, at 454–67; MEHROTRA, *supra* note 61, at 270–76; SELIGMAN, *supra* note 44, at 596–604; Hubbard, *supra* note 181, at 202. The particulars of that debate are not important here, since the drafters who supported that view, especially Nelson, intended by it to make "the power to tax incomes as broad as 'incomes' themselves could possibly be," *id.* at 203, which is consistent with our interpretation of the phrase and with later Supreme Court interpretations, as discussed *infra*. *See* South Carolina v. Baker, 485 U.S. 505 (1988); Brushaber, 240 U.S. 103 (1916).

[186] Brushaber, *id.*

[187] *Id.* at 16–17.

derived, that is, by testing the tax not by what it was—a tax on income, but by a mistaken theory deduced from the origin or source of the income taxed."[188] In light of this reading of *Pollock*, the purpose of the 16th Amendment, the *Brushaber* Court said, "was to relieve all income taxes when imposed from apportionment from a consideration of the source whence the income was derived"[189]— that is, to no longer attempt to determine if the income tax is in "substance" a tax on the source of the income solely because of its ownership:

> [T]here is no escape from the conclusion that the Amendment was drawn for the purpose of doing away for the future with the principle upon which the Pollock Case was decided, that is, of determining whether a tax on income was direct not by a consideration of the burden placed on the taxed income upon which it directly operated, but by taking into view the burden which resulted on the property from which the income was derived…[190]

To be clear, the *Brushaber* Court understood the 16th Amendment as enshrining *Pollock*'s view that direct taxes include not just taxes on *real* property solely because of its ownership, but taxes on *all* property solely of its ownership.[191] More importantly, however, the *Brushaber* Court held that the purpose of the 16th Amendment was to "prevent[]…resort to the sources from which a taxed income was derived in order to cause a direct tax on the income to be a direct tax on the source itself."[192]

Thus, in both *Brushaber* and *Stanton*,[193] the Court reaffirmed the Indirect Tax Canon, overruling the second critical error of *Pollock* by holding that courts should not inquire into the underlying "substance" of a form of taxation chosen by Congress for purposes of characterizing a tax as either direct or indirect.

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188 240 U.S. 103, 112–113 (1916).
189 *Brushaber*, 240 U.S. at 18.
190 *Id. See also* BORIS BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS at ¶ 1.2.4.
191 *Brushaber*, 240 U.S. at 19; *see* Ackerman, *supra* note 1, at 41.
192 *Brushaber*, 240 U.S. at 19.
193 *Supra* note 188 and accompanying text.

However, this raises the question of whether the 16th Amendment and the holdings of *Brushaber* and *Stanton* apply generally or only to taxes that comply with some constitutional definition of "income."

But before moving to that question, we should note that the third main holding of *Pollock*—that an income tax could not constitutionally tax municipal bond interest—followed a similar logic as for rent. That is, the Court asked whether a tax on municipal bond interest was in effect a tax on the bond itself.[194] The result of that source-based logic was not to make a tax on municipal bond interest an unapportioned direct tax, however, but rather to view it as violating intergovernmental immunity, because the federal government would in essence be taxing a state, by placing a burden on its contracts.[195] That intergovernmental immunity point is not relevant to us here,[196] but in that line of cases following the 16th Amendment, the repudiation of the source-based inquiry is even more strongly held, up to an explicit overruling of *Pollock* on that account in *South Carolina v. Baker*.[197] As early as 1939 the Court—citing a long string of cases—wrote in *Graves v. New York ex rel. O'Keefe* that "[t]he theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable."[198]

Therefore, in our view—and in the Supreme Court's view—the phrase "from whatever source derived" is a command to accept the form of an income tax as declared by Congress and not to inquire into the source of the income to determine whether it is in substance a tax on property because of its ownership.[199]

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194 *See* Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 583–86 (1895).

195 *Id.*

196 *See supra* note 185.

197 485 U.S. 505, 524 (1988).

198 306 U.S. 466, 480–81 (1939) (citations omitted).

199 *See* Ackerman, *supra* note 1, at 40–41 (noting that *Brushaber* overruled this "second prong" of *Pollock*).

### *B.* Eisner v. Macomber *and the Problem of Realization*

Although the 16th Amendment overruled the key error of *Pollock* and reinstated the Indirect Tax Canon, it also introduced a new issue—whether in order to take advantage of the 16th Amendment an income tax had to comply with some constitutional definition of "income." To be clear, this framing of the question is problematic because Article I, Section 8, of the Constitution still clearly allows *any* indirect tax to follow the uniformity path and avoid apportionment—thus, whether something is or is not "income" should not be dispositive.[200] Nevertheless, the Court in *Eisner v. Macomber*[201] evaluated the constitutionality of a uniform income tax provision as turning solely on the question of whether the thing taxed was "income" in a constitutional sense.

The case arose in 1917—just four years after the 16th Amendment, and still solidly in the *Lochner* era.[202] It involved the inclusion of the value of stock dividends in a taxpayer's income for tax purposes. For tax purposes, a dividend is a distribution of "earnings and profits" by a corporation to its shareholders.[203] Dividends are typically cash, but they can be any property, such as business assets of the corporation or stock of another corporation. Indeed, they can even by stock of the corporation itself. In that case, the shareholder receives additional shares of the corporation. But because every shareholder receives those shares *pro rata*, their relative ownership of the corporation is unchanged. Furthermore, there is no change in the assets held by the corporation itself. For this reason, the plaintiff in *Macomber* argued that a stock dividend could not be

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[200] *See supra* note 16.
[201] 252 U.S. 189 (1920).
[202] *See* Kornhauser, *supra* note 111, at 112 ("*Macomber* is best understood as part of the struggle during the *Lochner* era to define the nature and scope of government.").
[203] *See, e.g.,* I.R.C. § 316.

considered "income" for purposes of the 16th Amendment.[204] All that had happened was a change to some entries on the corporate balance sheet—nothing had "come in" to the taxpayer. The Court agreed and declared that it was unconstitutional for the income tax to include stock dividends.[205]

The history of *Macomber* and its continuing relevance to modern tax law has been well-covered elsewhere, particularly by Marjorie Kornhauser.[206] We focus in particular here on two issues the case raises that are relevant to our analysis of direct tax jurisprudence. First, the Court appeared again to deviate from the Indirect Tax Canon. Importantly, it should not have been dispositive to hold that stock dividends are not "income." All that does is move stock dividends out from under the particular protections of the 16th Amendment. In order for the tax to be unconstitutional, however, it must be an unapportioned direct tax. The Court does an extensive analysis of the question of whether a stock dividend can be considered "income,"[207] but after holding that it cannot be, it simply asserts without analysis that the tax is therefore a direct tax, i.e., a tax on property "imposed by reason of ownership."[208] With so little reasoning we cannot say for sure what the Court's rationale is for this necessary second step in the argument, but it seems that the Court equates the taxation of a stock dividend with the taxation of a corporation's accumulated earnings, which would be, in the Court's view, the same as taxing part of the overall value of the corporate stock solely because of its ownership.[209]

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[204] *See Macomber*, 252 U.S. at 201; Kornhauser, *supra* note 111, at 101.

[205] *Macomber*, 252 U.S. at 219.

[206] Kornhauser, *supra* note 111.

[207] *See Macomber*, 252 U.S. at 205–17.

[208] *Id.* at 217; *see* BITTKER & LOKKEN, *supra* note 190 at ¶ 1.3.4. ("[The Court] failed, despite the length of the opinion, to explain why a tax on the receipt of a stock dividend is a 'direct' tax requiring apportionment rather than an excise tax or indirect tax that is not subject to apportionment.").

[209] *Macomber*, 252 U.S. at 217.

But, of course, that's not what the tax actually was—it was a tax only upon a particular type of corporate act. Although the government argued in the alternative that it had the power to tax undistributed corporate earnings whenever it liked,[210] that was not at issue in the case. The Court could quite easily have found that the tax was an excise, i.e., a tax on the *act* of declaring a stock dividend—in the same way that the succession tax in *Scholey* was an excise tax on the *act* of devolving real property,[211] and the corporate tax itself in *Flint* was an excise tax on the *act* of operating a business in corporate form.[212] Although the Court does not say this explicitly in *Macomber*, the decision only makes jurisprudential sense if the Court is looking through the "form" of a tax on a stock dividend to treat it as in effect a tax on personal property—corporate stock—solely because of its ownership. In other words, of ignoring the Indirect Tax Canon. This worry is partially captured by Justice Holmes in dissent, who writes, "[t]he known purpose of this Amendment was to get rid of nice questions as to what might be direct taxes, and I cannot doubt that most people not lawyers would suppose when they voted for it that they put a question like the present to rest."[213] In our view, the opinion's limited and flawed discussion of the issue means that *Macomber* should not be read as overturning the Indirect Tax Canon, but Holmes's dissent underscores the uncertainties and potential risks.

The second challenge raised by *Macomber* for our purposes is whether realization is constitutionally required for unapportioned taxes. The *Macomber* Court concluded that a stock dividend cannot be considered income because it has not been "severed" or separated from the underlying capital itself.[214] If that is so—if realization is constitutionally required for any tax purporting to be an

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[210] *Id.*
[211] Scholey v. Rew, 90 U.S. (23 Wall.) 331, 346–47 (1875).
[212] Flint v. Stone Tracy Co., 220 U.S. 107, 152 (1911).
[213] *Id.* at 220 (Holmes, J., dissenting).
[214] *Id.* at 207.

"income tax"—that poses a problem for both wealth taxes and for accrual-income tax reforms designed to follow the uniformity path (although this problem is not necessarily insurmountable). For wealth taxes, the problem is clear—the tax would be levied on the value of property, without reference to whatever had been "severed" from it. But accrual-income tax reforms work in a similar way, by taxing the growth in value of property, again without any severance. The Court in *Macomber* held that, "[e]nrichment through increase in value of capital investment is not income in any proper meaning of the term."[215]

The upshot is that a broad reading of *Macomber*'s continuing force has very real potential to tie the hands of Congress, not just on its ability to pass a wealth tax, but also on its ability to implement alternative income tax reforms. Thankfully, there can be no doubt that *Macomber* has been at least partially overturned. In the next Section, we discuss the uncertainty about whether *Macomber* has been fully overturned or only partially overturned, and some of the implications for drafting a wealth tax or accrual-income tax reform.

### *C. To What Extent has* Eisner v. Macomber *Been Overturned?*

As we explained above, *Macomber* held that the 16th Amendment only authorizes a *realization-based* income tax without apportionment, such that both accrual-income tax and wealth tax reforms could be found to be direct taxes that must be apportioned. The uncertainty then arises because it is unclear today to what extent *Macomber* remains good law. The decision has been at least partially overturned by subsequent cases like *Bruun*[216] and *Glenshaw Glass*,[217] but perhaps not completely overturned.

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[215] *Id.* at 214–15.
[216] Helvering v. Bruun, 309 U.S. 461 (1940).
[217] Comm'r v. Glenshaw Glass Co., 348 U.S. 426 (1955).

The *Bruun* Court held that, "[h]ere, as a result of a business transaction, the respondent received back his land with a new building on it, which added an ascertainable amount to its value. It is not necessary to the recognition of gain that he should be able to sever the improvement begetting the gain from his original capital."[218] This holding thus at least partially overturned *Macomber*'s rule that "income" requires severance from the underlying capital.[219] But the *Bruun* holding might still be interpreted as just narrowing the realization rule to requiring only that there be some "business transaction"; for instance, Jensen has argued that the *Bruun* Court did not repudiate *Macomber*'s realization requirement but rather just "interpreted its scope narrowly."[220]

The *Glenshaw Glass* Court then subsequently overruled *Macomber*'s holding that "income" must derive "from capital, from labor, or from both combined."[221] But, in doing so, the *Glenshaw Glass* Court held that there was income in that case because there was "undeniable accessions to wealth, *clearly realized*, and over which the taxpayers have complete dominion" (emphasis added).[222] This could be read as maintaining the realization requirement from *Macomber*.

When Congress last seriously considered substantial accrual-income tax reforms—such as taxing shareholders on certain undistributed profits in 1962, or taxing unrealized gains at death in 1963—there was controversy over whether the Supreme Court would uphold these reforms without apportionment, and that controversy played a role in these reforms being defeated.[223] Notably, this was during the era of the "progressive" Warren Court. There is every reason to

[218] *Bruun*, 309 U.S. at 469.
[219] *Macomber*, 252 U.S. at 207.
[220] Jensen, *The Taxing Power*, *supra* note 40, at 1143.
[221] *Glenshaw Glass*, 348 U.S. at 430.
[222] *Id.* at 431.
[223] Kornhauser, *supra* note 111, at 129–30.

suspect that today's Roberts Court would be even more inclined to limit Congress's taxing powers.[224]

Congress has since successfully enacted more limited departures from the realization doctrine, which might be thought of as partial accrual-income tax reforms, including Internal Revenue Code Sections 467,[225] 475,[226] 817A,[227] 877A, 965(a)-(c),[228] 1256,[229] 1296,[230] and the original issue discount rules.[231] Of these, Section 1256 was challenged and then upheld by the 9th Circuit's decision in *Murphy*.[232] But *Murphy* upheld Section 1256 based on a constructive receipt theory, because the taxpayer in that case "receive[d] profits as a matter of right daily."[233] The decision explicitly cautioned that "[w]e need not, and do not, decide the broader issue of whether Congress *could* tax the gains inherent in capital assets prior to realization or constructive receipt."[234] Similar theories could potentially be used to uphold the other existing legislated departures from the realization doctrine.[235]

The best recent discussion of these issues is in the district court opinion in *Moore*, dismissing a challenge to the "mandatory repatriation tax" enacted by

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224 *See* note 24 *supra*.

225 Requiring recognition of accrued but unpaid rent for certain types of property, even for a cash-method taxpayer.

226 Requiring securities dealers to mark securities in their inventory to market, with corresponding recognition of gain or loss.

227 Requiring life insurance companies to mark to market certain "modified guaranteed contracts."

228 The so-called "mandatory repatriation tax"; *see* Adler, *supra* note 6, at 63.

229 Requiring certain types of financial derivatives to be marked to market and recognizing any resulting gain or loss.

230 Allowing a mark-to-market election for certain stock held by a passive foreign investment company.

231 Requiring recognition of accrued but unpaid interest income for holders of bonds issued at a discount to their stated redemption price at maturity, even for a cash-method taxpayer. I.R.C. §§ 1272–1275.

232 Murphy v. United States, 992 F.2d 929 (9th Cir. 1993).

233 *Id.* at 931.

234 *Id.* at 931–32.

235 For arguments to that effect, *see* Magidenko, *supra* note 6, 955–56.

the 2017 Tax Cuts and Jobs Act.[236] The *Moore* decision reviewed a series of cases following *Macomber* along with some of the existing legislated departures from the realization doctrine to hold that, "[g]iven the cabining of *Macomber* by the Supreme Court and the clear departure from it by other courts, there is no reason for this Court to conclude that *Macomber* currently controls whether the [mandatory repatriation tax] is an income tax. Accordingly, the [mandatory repatriation tax] does not violate the Apportionment Clause, as it is a tax on income rather than a direct tax."[237]

If sustained upon appeal, the *Moore* decision might thus mark the final death of *Macomber*. Regardless, the reasoning in *Moore* corresponds with the near scholarly consensus that *Macomber*'s holding is no longer valid.[238] It is also noteworthy that the Supreme Court has suggested in *dicta* in the 1991 case of *Cottage Savings* that "the concept of realization is 'founded on administrative convenience.'"[239] This is often read as implying that *Macomber*'s holding that the realization rule is a constitutional requirement has been overturned.

Nevertheless, the Supreme Court has never explicitly overturned *Macomber* on this question, and it is not clear whether today's "more conservative" Supreme Court would follow the direction suggested by scholars and by some lower courts and by *dicta* written by Justices who have since retired. Specifically, some commentators predict that a majority of the Justices on the current Supreme Court might be inclined to revive *Macomber* so as to strike down expansions of Congress's taxing powers.[240] Moreover, our recent experience

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236 Moore v. United States, No. 2:19-cv-01539 (W.D. Wash. 2020).

237 *Id.* at 8–9.

238 For support that there is a near scholarly consensus on this question, *see* BITTKER & LOKKEN, *supra* note 190, at ¶5.1. We say "near scholarly consensus" because there are some dissidents, *see, e.g.,* Eric Jensen, *Mark-to-Market*, *supra* note 4, Adler, *supra* note 6, 64-69; McElroy, *supra* note 6, 76-83; Magidenko, *supra* note 6.

239 Cottage Savings Assn. v. Comm'r, 499 U.S. 554, 559 (1991) (quoting Helvering v. Horst, 311 U.S. 112, 116 (1940))).

240 *See, e.g.*, Jensen, *supra* note 1, at 818 ("So Pollock and Macomber both live as statements of constitutional law? It is hard to read the Chief Justice's opinion in any other way.");

working on broad-based accrual-income tax reforms for both New York[241] and Illinois[242] suggests to us that opponents of such reforms are eager to argue that courts should revitalize *Macomber*'s realization requirement so as to strike down such reforms.[243]

This leaves us with very substantial uncertainty about the constitutional status of an unapportioned wealth tax reform. This also leaves us with significant (though probably somewhat less) uncertainty about the constitutional status of an unapportioned accrual-income tax reform. It is that uncertainty, plus the history of both direct and indirect federal taxation, that motivates our proposal in the next Part for how to draft a constitutionally safe wealth tax or accrual-income tax reform.

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Magidenko, *supra* note 6, at 956 ("the Supreme Court's consideration of direct taxation in NFIB suggests that it does not view the question as a dead letter. One cannot justly evaluate the merits and deficiencies of a mark-to-market tax without acknowledging the formidable, and quite possibly impassable, attendant constitutional barriers."); Joe Bishop-Henchman & Grant Gourley*, Justice Thomas, a Medical Marijuana Dispensary, and the Limits of the Sixteenth Amendment*, NATIONAL TAXPAYERS UNION FOUNDATION BLOG, July 6, 2021.

241 New York Senate Bill S8277B, 2019-2020 Legislative Session, *available at* *https://www.nysenate.gov/legislation/bills/2019/S8277*. Note that one of us (Gamage) co-drafted this bill along with Emanuel Saez and Darien Shanske and other co-collaborators, and the other of us (Brooks) signed a letter in support of this bill; *see* David Gamage, Emmanuel Saez, & Darien Shanske, *The NY Billionaire Mark-to-Market Tax Act: Revenue, Economic, and Constitutional Analysis*, January 15, 2021, *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3766547*.

242 Illinois House Bill 3475, 102nd General Assembly, *available at* *https://ilga.gov/legislation/BillStatus.asp?DocNum=3475&GAID=16&DocTypeID=HB&LegId=132472&SessionID=110&GA=102*. Note that this bill—the Illinois "Extremely High Wealth Mark-to-Market Tax Act" was modeled after the NY Act, *id.*, and was co-drafted by one of us (Gamage) along with Darien Shanske.

243 *See, e.g.,* Jared Walczak, *Taxes And New York's Fiscal Crisis: Evaluating Revenue Proposals To Close The State's Budget Gap*, TAX FOUNDATION REPORT at 24, December 8, 2020 ("Proponents contend that accumulated but unrealized gains, which would be subject to taxation under the Billionaire Mark to Market Tax Act, are income, not wealth, and can be taxed as such without violating the state constitution. But while we might conceptualize them as economic income, this is a concept, not a taxable flow."); Bill Mahoney, *Would a New Billionaires' Tax Be Constitutional?*, POLITICO, July 30, 2020 (quoting an opponent of the NY Billionaire Mark-to-Market Tax Act as saying "'The arguments for it being federally unconstitutional are overwhelming,' he said. 'The arguments for it being unconstitutional in New York are absolutely slam dunk.'").

## III. Drafting A Constitutional Wealth Tax or Accrual-Income Tax Reform

Having presented the forgoing discussion as background for understanding both the jurisprudence around direct taxation, and the history of imposing direct taxation, we now in this Part explain how Congress can draft a wealth tax or accrual-income tax reform so as to navigate through the constitutional uncertainties. In Section A below, we first elaborate on the Indirect Tax Canon, and why it is essential to the effective operation of our tax system. We then turn to specifying the two possible paths for a wealth tax or accrual-income tax reform—the uniformity path and the apportionment path.

The first path (the uniformity path) is relatively easy for drafting an accrual-income tax reform, but potentially more complicated for drafting a wealth tax. In Section B, we thus explain how Congress might draft what is effectively a *uniform* wealth tax that—if a court properly applies the Indirect Tax Canon—should be upheld. We also argue why a Court following the Indirect Tax Canon should uphold the recently proposed federal taxes on extreme wealth holdings.

However, as the *Macomber* Court showed, it is possible for a court to disregard the command of the 16th Amendment and still attempt to describe a tax as direct "in substance" and thus require apportionment. Therefore, in Section C we present fallback provisions that would *apportion* a wealth tax or accrual-income tax reform proposal. To counteract the unfairness that might otherwise result from this apportionment, we also propose that such fallback provisions include a fiscal equalization regime for resolving interstate inequities.

In considering our two proposals—the uniformity path and the apportionment path—we again remind readers that one of these two paths must be possible under the clear language and longstanding interpretations of the Constitution.[244] This is because the Constitution does not exclude wealth taxation or accrual-income tax reforms from Congress's "very extensive" taxing powers—the Constitution only provides that these reforms must follow one of the two paths.[245] Thus, if the Court decides that the uniformity path is foreclosed because a wealth tax or an accrual-income reform is a direct tax, then the Constitution demands that the apportionment path must be possible[246]—and we provide such a possibility here.

### *A. The Indirect Tax Canon*

We have argued that the proper way to read the jurisprudence before and after *Pollock*, and after the 16th Amendment in particular, is for courts (a) to be deferential to the form of taxation chosen by Congress for characterizing a tax as either direct or indirect, and (b) to not inquire into the underlying "substance" of that form so long as the characterization chosen by Congress is reasonable. This is our Indirect Tax Canon. We have further argued that the key errors of both *Pollock* and *Macomber* were in ignoring this interpretive Canon. As we explained in Part II, the 16th Amendment and subsequent Supreme Court cases overruled *Pollock* on that issue and fully reinstated the Indirect Tax Canon.

We now turn to explaining why the Indirect Tax Canon is not just a convenient way of reading the Court's direct taxation jurisprudence, but rather is necessary to support the full functioning of the tax system. The early Court

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[244] *See supra* notes 16–19 and accompanying text.

[245] Congressional Resource Service, *supra* note 18, at 2 (quoting *License Tax Cases*, 72 U.S. at 471.)

[246] *Id.* ("Supreme Court Chief Justice Salmon P. Chase famously described the taxing power in the *License Tax Cases*: It 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.").

developed the Canon over time precisely because the *Pollock* Court was not wrong in its substantive analysis—an income tax is indeed in substance equivalent to a tax on the source of that income. For this reason, any attempt to create a theoretically robust distinction between an income tax and taxes on other forms of individual economic capacity is doomed to fail. For an "income tax" to succeed in practice therefore requires deference to Congress's choice of what is "income," without resort to some imagined purely exogenous concept. Otherwise, if the 16th Amendment allows only an "income tax" to be uniform and unapportioned, then we necessarily have to answer the question of what is and is not an "income tax." When does a particular tax stop being an income tax and start being something else, like a tax on wealth? As *Macomber* and its aftermath showed, this is a trickier question than it may first appear, both because income is in fact a highly amorphous concept[247] and because of the close relationship between income and other measures of economic capacity, particularly wealth and consumption.

For example, it is often stated that the key difference between income and wealth is that income is a "flow" while wealth is a "stock" from which that income flows.[248] But that surface distinction ends up being not that helpful or precise for characterizing real world taxes. Consider again the problem of stock dividends in *Macomber*. A cash dividend would clearly be a "flow" in the simplistic sense, so why would a distribution of stock be any different? A dividend by definition is out of "earnings and profits" of a corporation, and moreover it can clearly be a distribution of non-cash property (such as the assets of the corporation, or stock in a subsidiary corporation).[249] The stock dividend may at first appear to be different than a distribution of other property because

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[247] *See* Brooks, *supra* note 84.

[248] *See, e.g.,* Ari Glogower, *Taxing Inequality*, 93 N.Y.U. L. REV. 1421, 1429–30 (2018); Edwin R.A. Seligman, *Are Stock Dividends Income?*, 9 AM. ECON. REV. 517, 517–18 (1919).

[249] *See* I.R.C. § 316.

little changes on the shareholder's balance sheet—no change in the relative value of cash vs. equity holdings. But the "flow" of a cash dividend is also something of a fiction, because that value was already reflected in the value of the corporate stock—the cash dividend is just a shift from the value of one asset (corporate stock) to another (cash), rather than something that has "come in" to the shareholder's wealth.[250] In that sense, cash dividends and stock dividends have similar economic effects. One would have to look—as the *Macomber* Court did—to other notions, like "separation" of income and capital to justify a distinction.

Yet, as we've already noted, today's income tax often levies against mere increases in value of property regardless of whether the income is realized or "separated" from that property.[251] To list just a few examples, today's income tax includes in income unrealized "marked to market" gain for certain futures, options, and other financial derivatives;[252] unrealized gain on stocks and some debt when there has been a "constructive sale" through use of offsetting swaps, futures, or short sales;[253] deemed interest from original issue discount bonds;[254] and a partner's share of undistributed profits of a partnership.[255] Following the logic of *Macomber* further would also put into question the taxation of exchanges

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[250] Indeed, that was the (losing) argument the taxpayer made in *Phellis* for why dividends should not be treated as "income" where the taxpayer bought the shares shortly before the ex-dividend date. United States v. Phellis, 257 U.S. 156, 168 (1921). In that case, the Court relied heavily on a combination of the change in legal status of the funds due to their "severance" from the "common fund" of the corporation, *id.* at 170–171, and on the idea that a stockholder bought the shares with knowledge that any dividends paid were "subject to the burden" of future taxation, *id.* at 171–72. Notably, however, the Court did not disagree with the claim that the taxpayer was not actually made more wealthy due to the dividend payment. *See id.* at 170.

[251] *See* notes 225-236 and accompanying text *supra*. Note that while some dissidents do argue that *Macomber* retains enough life to block a broad-based uniform accrual income tax reform (notes 240 & 243 *supra*), to our knowledge no one argues that *Macomber*'s original holding should be fully revitalized to strike down the many partial accrual-based provisions of the existing income tax or the expanded doctrine of constructive receipt; *see* notes 252-260 and accompanying text *infra*.

[252] *See* I.R.C. § 1256.

[253] *Id.* § 1259.

[254] *Id.* § 1272.

[255] *Id.* §§ 61(a)(12); 702.

of business property when no cash is involved,[256] the taxable form of certain corporate transactions like spin-offs,[257] or even, as Justice Brandeis pointed out in his dissent, the distribution of preferred stock or corporate bonds to shareholders in lieu of cash dividends.[258] Indeed, despite *Macomber*, today's income tax does in fact tax some stock dividends, even if they do not involve any "separation" of corporate earnings.[259] More generally, the concept of constructive receipt has been greatly expanded over time to prevent numerous forms of tax gaming and is now understood as a fundamental income tax concept "that can have a broad and frightening impact."[260]

Recognizing these as examples of "income" means setting aside any fundamental distinction between a "flow" and a "stock," or at least redefining a "flow" to be any change in value of the "stock," as captured by the Haig-Simons income concept, which has been the touchstone for tax law and public finance economics for nearly 100 years.[261] But because Haig-Simons income can encompass concepts like imputed income, psychic income, income from the

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[256] According to Kornhauser, Congress passed the original section 1031, providing for nonrecognition of certain like-kind exchanges, in part because of a real concern that *Macomber* might treat exchanges of like-kind business property as non-taxable, since they represented merely a reallocation of business assets, not a withdrawal or separation of cash from the business. Kornhauser, *supra* note 111, at 120–22. Since that time, section 1031 has been progressively limited, particularly after the 2017 tax reform bill, which limited section 1031 only to exchanges of real property, meaning that other exchanges of like-kind business property of equal value would realize taxable gain. Pub. L. No. 115–97, § 13303, 131 Stat. 2054, 2123–24 (2017).

[257] If the concern in *Macomber* was that a stock dividend did not cause any meaningful change in the shareholders underlying rights, then the same could be said for, e.g., a corporate division into two parts, where the shares of the spun-off corporate is distributed to all the shareholders *pro rata*. Section 355 provides for nonrecognition for many such divisions, but only if its quite technical rules are followed; if not, then the distribution of the new corporation's shares to the existing shareholders is, essentially, a taxable dividend of stock representing ownership of *some* of the original corporation.

[258] Eisner v. Macomber, 252 U.S. 189, 227 (1920) (Brandeis, J., dissenting).

[259] *See* § 305(b).

[260] Robert W. Wood, *What Lawyers Should Know about Taxes, Constructive Receipt, and Structured Fees*, A.B.A.: BUSINESS LAW TODAY, Feb. 16, 2017, *available at* *https://www.americanbar.org/groups/business_law/publications/blt/2017/02/01_wood/*.

[261] JOSEPH BANKMAN, DANIEL N. SHAVIRO, KIRK J. STARK & EDWARD D. KLEINBARD, FEDERAL INCOME TAXATION 52 (18th ed. 2019)]

consumption of leisure, and more, this hardly provides courts with a more rigorous definition.[262] A person could literally sit alone in a cave their entire life and still have "income" in a Haig-Simons sense.[263] As one of us has documented previously, this lack of firm foundation for the concept of "income" has been an issue since modern income taxation appeared in Germany in the 19th century, and it has not gone away.[264]

Ari Glogower makes a similar point in a recent article on wealth taxation.[265] He argues that one way that wealth can be taxed without raising constitutional objections is for the income tax to take account of wealth without taxing it directly. For example, a taxpayer's wealth could determine a different set of graduated rates to apply to income,[266] or deny the taxpayer certain deductions from gross income.[267] He argues convincingly that these "Wealth Integration" methods must pass constitutional muster, because otherwise courts would be forced also to invalidate a host of precedents that determine how our income tax actually functions, including ways that it already burdens wealth.[268]

But Glogower's view of the role of substance-over-form in direct tax cases differs somewhat from ours. He argues that if a court must approve of "Wealth Integration" income tax methods, then it should also approve of wealth taxation itself, since trying to draw a line between the two is not jurisprudentially feasible.[269] While we agree with that logic, we would then add that the only way

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262 Simons acknowledges this, though he is skeptical that including imputed and psychic income would affect the tax base much. *See* HENRY SIMONS, PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY 52–53 (1938); Brooks, *supra* note 84, at 111–13.

263 For example, from the net imputed rent from the cave, from the consumption of leisure, for the imputed rent from any self-provided services, such as dressing, shaving, washing, and cooking, and so on.

264 *See* Brooks, *supra* note 84, at 107–10.

265 Ari Glogower, *A Constitutional Wealth Tax*, 118 MICH. L. REV. 717 (2020).

266 *Id.* at 754.

267 *Id.* at 753.

268 *Id.* at 765–75.

269 *Id.* at 780–83.

to give the constitutional text some content is to recognize the formal distinctions between direct and indirect taxation, while also allowing Congress the discretion to choose the form it wants. By contrast, Glogower would apply the same look-through analysis as *Pollock*,[270] but to achieve the opposite result—upholding a wealth tax because it is substantively the same as an income tax with Wealth Integration. But of course, we've already seen how the Supreme Court can wield that logic in a more destructive way. Thus, if Congress were to pass a tax that is clearly, explicitly, and only a tax "on property…solely because of its ownership,"[271] then we would expect a Court following the first holding of *Pollock* to rule this as a direct tax that must be apportioned. Nevertheless, as we will explain, the Indirect Tax Canon means that Congress has other options.

As another example of how misguided the project of trying to inquire into the "substance" of an income tax is, consider Erik Jensen's argument that a cash-flow consumption tax is constitutionally forbidden (absent apportionment) because it is a direct tax that is not an income tax.[272] Jensen allows that a consumption tax levied on a transaction—like a sales tax or Value-Added Tax—would be allowed without apportionment as an indirect tax.[273] The original duties, excises, and imposts that had always been allowed without apportionment were essentially consumption taxes of that sort. While a cash-flow consumption tax is, like a sales tax, a tax on the value of everything consumed by a person, it is levied on the *person*, rather than the transaction, by in essence taking a person's income and subtracting any net savings.[274] By construction, what is left is just consumption. Jensen says that, because a cash-flow consumption tax is directly on the person, not on the transaction, such a

[270] *Id.* at 732–34.
[271] Knowlton v. Moore, 178 U.S. 41, 82 (1900).
[272] Jensen, *supra* note 40.
[273] *See id.* at 2405–07.
[274] *See, e.g.,* William D Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113 (1973).

tax would be a direct tax.[275] And because the tax would subtract net savings, leaving only consumption, it would not be taxing income.[276] Therefore, Jensen concludes that the cash-flow consumption tax would be a direct tax, but not an income tax, and apportionment should thus be required since it would fall outside the protections of the 16th Amendment.

But how would a court make this inquiry? For example, our current income tax already includes substantial deductions for net savings—for example, for contributions to qualified retirement plans.[277] We also know under the Cary Brown Theorem that the exclusion of some income from capital is equivalent to a deduction for the amount invested in that capital.[278] Our current income tax excludes most gains on personal residences,[279] and easily allows the avoidance of most capital gain income on tradable securities.[280] As a result, many commentators refer to our income tax as a hybrid income/consumption tax.[281] When would this hybrid tax shift too far toward being a consumption tax for it to pass constitutional muster? If we raised the 401(k) contribution limits too high, or expanded the section 121 exclusion—even though the vast majority of taxpayers will probably never hit the current limits? Our current income tax shows that there is a smooth spectrum between taxing "income" and taxing "consumption," and trying to hinge Constitutional legitimacy on an erroneously sharp substantive distinction between the two must fail.

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[275] Jensen, *supra* note 40, at 2337–28, 2402, 2407. Jensen would say that any tax on a person is a "direct tax," which is a clear expansion from *Pollock*'s definition as a tax on property solely because of its ownership, but we leave that aside.

[276] *Id.* at 2408–14.

[277] *See* IRC §§ 219, 404.

[278] E. Cary Brown, *Business-Income Taxation and Investment Incentives*, *in* INCOME, EMPLOYMENT AND PUBLIC POLICY: ESSAYS IN HONOR OF ALVIN H. HANSEN 300 (1948).

[279] *See* IRC § 121.

[280] Because of the realization requirement, tax loss harvesting, and other strategies. *See* Gamage & Brooks, *supra* note 8, at __.

[281] *See, e.g.,* BANKMAN, ET AL., *supra* note 261, at 58.

For these reasons, a properly deferential Court should not attempt to determine if Congress's definition of "income" matches some (nonexistent) external definition. It is quite clear that Congress is not required to tax *all* income—as the massive number of exclusions and deductions make clear—and it is equally clear that Congress can also use non-income factors—e.g., charitable deductions or number of children—to adjust a person's taxable income. For a court to require Congress to include or not include some item in the tax base would be an outrageous assertion of judicial supremacy, not to mention being unworkable in practice.

Ironically, if we went the other direction and made capital income *more* likely to be taxed—i.e., if we moved away from our hybrid income/consumption tax to a more "normal" income tax without preferences for capital income[282]—we might also face problems under a "constitutional" definition of income. For example, if instead of allowing indefinite deferral of capital gain income we instituted a full mark-to-market system, as we've discussed it could be argued that what is being taxed isn't "income," because there is no realization or separation, just an increase in the value of capital.[283] It would not be too difficult for an antagonistic court to again ignore the Indirect Tax Canon and strike down an unapportioned mark-to-market income tax as a tax on property solely because of its ownership. In a sense, it's damned if you do, damned if you don't—meaning that somehow our current equilibrium hybrid system is, implausibly, "just right."

All of this is just to scratch the surface of the chaos that would be created if courts attempted a substance-over-form analysis in the area of constitutional direct tax jurisprudence, and why the Court gradually developed

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[282] Using "normal" in the sense that tax expenditure analysis does. See, e.g., Joint Comm. on Tax'n, *Estimates of Federal Tax Expenditures for Fiscal Years 2020–2024 (JCX-23-20*), November 5, 2020, at 2, available at: https://www.jct.gov/publications/2020/jcx-23-20.

[283] *See supra* Part II.B.-C.

the Indirect Tax Canon over the centuries, and why Congress and the states had to act to shore it up through the 16th Amendment after the Court erroneously departed from it in *Pollock*.

We should note here that some tax lawyers and scholars may react negatively to a full-throated call to reject substance-over-form analysis, which is a pillar of tax law jurisprudence.[284] But our questions here are ultimately of *constitutional* law, not legislated tax law. The constitutional law scholar Thomas Reed Powell, writing about the role of the constitution in tax law shortly after the 16th Amendment, noted the relative unimportance of the Constitution to most questions of tax law following the post–*Pollock* cases like *Stone v. Flint Tracy Co*. These cases revealed, he wrote, that "assessments which might be defeated when laid formally on income may be victorious if levied in special acts of occupations or on doing business in general. The presence of this independent power shows the weakness of reliance on the Constitution *when to a large extent the Constitution forbids, not the thing done, but only the particular way of doing it*" (emphasis added).[285] Constitutional law has of course evolved since 1921, but it still retains elements of formal line-drawing that may seem confusing to tax lawyers.[286]

Furthermore, our framing of the Indirect Tax Canon is consistent with the "tax" vs. "penalty" analysis of *NFIB v. Sebelius*.[287] In that case, the Court upheld the Affordable Care Act's shared responsibility penalty as a valid exercise of Congress's taxing power.[288] The dissenters argued—not unreasonably—that

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[284] *See, e.g.,* BITTKER & LOKKEN, *supra* note 190, at ¶ 4.3.3; BANKMAN ET AL., *supra* note 261, at 484.

[285] Thomas Reed Powell, *Constitutional Aspects of Federal Income Taxation*, *in* THE FEDERAL INCOME TAX 55 (Robert Murray Haig, ed., 1921).

[286] Consider, for example, the fact that charitable contributions to churches are tax deductible, I.R.C. § 170(c)(2)(B), but direct payment by the government to a church to fund religious activities violate the Establishment Clause, *see, e.g.,* Lemon v. Kurtzman, 403 U.S. 602, 612 (1971).

[287] 132 S. Ct. 2566 (2012).

[288] *Id.* at 2598.

there was a clear formalist distinction in case law between a "tax" and a "penalty" even if they could be *substantively* the same, and the Court should follow Congress's choice of form.[289] In rejecting that argument, the majority said, in essence, that the result should not turn on whether "Congress used the wrong labels."[290] Some have read that to be in line with tax law's substance-over-form doctrine—that even if something is formally labeled a "penalty" it can still be in substance a constitutional "tax."[291] However, *NFIB* was concerned with the source of Congress's power to pass the penalty—whether it was under the Commerce Clause or the taxing power. As Justice Roberts wrote, that question should not turn on whether Congress had correctly "recit[ed]… the power which it undertakes to exercise."[292] Our issue is distinct. There is no question that we are discussing the taxing power, and furthermore there is no question that Congress has the power to pass a wealth tax. The issue is instead one of determining which path applies to the particular form of tax chosen by Congress. The majority also applies an interpretive approach that would support Congress's taxing power, just as ours would here.

As we hope we have made clear, any attempt to constitutionalize a substantive distinction between "income" and "wealth" must rely on some artificial notion that would likely force courts to micromanage Congress's tax law designs, against the purposes of the 16th Amendment. This is because any income tax must unavoidably burden the wealth from which that income is derived, and so in economic substance, an income tax is also a tax on wealth. Therefore, rather than making up some artificial limiting principle based on an imagined substantive distinction between wealth taxes and income taxes, we argue that the much better approach is to follow the long line of prior Supreme

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[289] *Id.* at 2650–55 (Scalia, Kennedy, Thomas & Alito, JJ, dissenting).
[290] *Id.* at 2597.
[291] *See, e.g.,* Glogower, *supra* note 265, at 781–82.

Court decisions and other precedents that we have synthesized into our Indirect Tax Canon. That is, courts should (a) be deferential to the form of taxation chosen by Congress for characterizing a tax as either direct or indirect, and (b) not inquire into the underlying "substance" of that form so long as the characterization chosen by Congress is reasonable.

### *B. The Uniformity Path: Constructing a Wealth Tax as an Excise or as a Tax on Imputed Income*

For purposes of this Article, we take as given that *Pollock*'s first holding—that a direct tax is a tax on property solely because of its ownership—remains good law.[293] While we would welcome overruling *Pollock* on that issue, recall that our argument is that *Pollock*'s key error was rather in its second holding—the analytical step of inquiring whether an income tax was in substance the same as a tax on the income's source.[294] Given that, we now embark on the task of constructing the equivalent of a wealth tax that should avoid the direct tax label and therefore be upheld following the uniformity path. (This exercise is not as necessary for an accrual-income tax reform, which already benefits from being more clearly a tax on "income" and therefore under the protections of the 16th Amendment.[295])

The term "wealth tax" can potentially be applied to many different forms of taxation. For instance, the real property taxes levied by local governments in the United States are sometimes called a form of wealth tax.[296]

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[293] *See supra* notes 32–36 and accompanying text.

[294] *Id.*

[295] To elaborate, our exercise here is to construct a wealth tax that, in form, operates as an income tax, and more specifically as a version of an accrual income tax. An accrual income tax, such as a mark-to-market system, does not require that step. There is still constitutional risk, of course, though perhaps somewhat less as we noted in Part II.C., *supra*, and as we elaborate *infra* in Part III.C.3.

[296] Kyle Pomerleau, *A Property Tax is a Wealth Tax, but…*, TAX FOUNDATION, April 30,

But these local government real property taxes are formally levied on the real property itself, with tax liability then attaching to persons solely because of ownership, similar in form to the early Direct Tax Acts. Thus, were Congress to enact a new federal tax on real property fashioned with the same form as existing local government real property taxes, we would view this as a direct tax that must be apportioned under *Pollock*'s first holding. Expanding the base of such a tax to include all property (including intangibles) would not change this analysis, because the form of the tax would still be on the property itself with liability attaching to persons solely because of ownership of that property.

By contrast, recent federal wealth tax reform proposals have been fashioned quite differently. For instance, both Senator Warren's and Senator Sander's wealth tax reform proposals have been fashioned as only reaching extreme wealth holdings above some high exemption threshold (above $30 million of wealth accumulations for Senator Sanders' proposals, and above $50 million for Senator Warren's proposals) and with graduated rates then applying to wealth holdings above even higher threshold levels.[297] These proposals are thus quite different in both form and substance as compared to either existing local government real property taxes or the early Direct Tax Acts, in particular because these recent proposals do not take the form of being taxes on "property solely because of its ownership."

To see why, consider that a person with wealth of, say, $51 million, would be subject to these recently proposed taxes, but these taxes would very clearly *not* be levied on all of the property owned by that person. In other words, ownership is not the *sole* criteria for property to be taxed by these taxes. Indeed, any property subject to these taxes could easily be made exempt simply by transferring the property to another person with less total wealth. Again, that is

2019 ("residential property taxes are a type of wealth tax.").

[297] *See supra* notes 12–13 and accompanying text.

because these taxes would not be on "property solely because of its ownership." Ultimately, only a small portion of the property owned by the nation's taxpayers would be taxed under these reform proposals, and the trigger for making property taxed would be based on the overall economic activities engaged in by the owners, rather than being based on any characteristics of the property itself.

For these reasons, for purposes of determining whether these reform proposals should follow the uniformity path or the apportionment path, we argue that these reform proposals should be viewed as excises on the activities of accumulating and maintaining extreme wealth holdings under the protections and benefits of the U.S. legal and economic systems.[298] The United States legal and economic systems both protect and facilitate the activities of accumulating and maintaining such extreme wealth holdings, and if a taxpayer takes advantage of that, then Congress is entitled to excise the property accumulated through such activity.[299]

That these reform proposals are called wealth taxes should not be dispositive, just as it was not dispositive in *Flint* that Congress did not explicitly label the corporate income tax as an excise.[300] As in *Flint*, that these reform

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[298] Indeed, one of us has argued this in testimony before the U.S. Senate; *see* David Gamage, *Creating Opportunity Through a Fairer Tax System: The Case for Taxing Extreme Wealth Holdings and "Real" (Book) Corporate Profits and for Improving IRS Funding*, INDIANA LEGAL STUDIES RESEARCH PAPER NO. 446 (2021), *available at* https://ssrn.com/abstract=3834454.

[299] It might theoretically be argued that some wealth may not benefit from the protections and benefits of the U.S. legal and economic systems—for example, if it were literally held under the taxpayer's mattress or otherwise completely outside of the economy. We think this argument would be wrong, however. First, such wealth would still be under the protection of U.S. laws. Second, the U.S. military and foreign policy establishments regularly act for the protection of citizens abroad and of their wealth located abroad, in addition to protecting domestically held wealth from acts of theft or destruction, even if that wealth is held under a mattress. Third, a person could always opt to renounce their U.S. citizenship, which would then exempt that person from future U.S. wealth taxation, at least for wealth held outside of the U.S. (although that person might be subject to an exit tax for wealth or unrealized income accumulated while that person was a U.S. citizen). Thus, by choosing to accumulate extreme wealth holdings while maintaining U.S. citizenship, a person is opting to benefit from the protections and benefits that the U.S. provides to such extreme wealth holdings.

[300] *See supra* notes 155–159 and accompanying text.

proposals "may be described as an excise" should suffice to permit the uniformity path,[301] with the excise in this case being on the activities of accumulating and maintaining extreme wealth.[302] As in *Flint* and the other indirect tax cases, the inquiry should be based on form, not mere labels. In other words, following the language of *Patton v. Brady*, these reform proposals are not "a tax upon property as such but upon certain kinds of property, having reference to their origin and their intended use."[303]

All of that said, we acknowledge that the activities of accumulating and maintaining extreme wealth holdings are somewhat different from the activity of holding wealth in the corporate form or from the other activities and uses of property ruled to be excises in the prior indirect tax cases. One could argue that merely holding extreme wealth under the protection of the U.S. legal and economic system is different from putting that wealth to work in a particular way (though we would point out that wealth can never be wholly passive, unless perhaps shoved under a mattress). To further shore up the constitutionality of a wealth tax reform, Congress should consider repackaging any wealth tax that it wishes to follow the uniformity path as being a tax on the *imputed income* earned by the wealth or property that Congress wishes to include in the tax base.[304] For example, if Congress wishes to collect 2% of a person's wealth above a $50 million exemption threshold, that would be equivalent to, say, a 40% tax on a

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[301] *Id.*

[302] *See* Fernandez v. Wiener, 326 U.S. 340, 362 (1945) ("A tax imposed upon the exercise of some of the numerous rights of property is clearly distinguishable from a direct tax, which falls upon the owner merely because he is owner, regardless of his use or disposition of the property.")

[303] Patton v. Brady, 184 U.S. 608, 619 (1902).

[304] We are far from the first to suggest a wealth tax of this form. *See, e.g.,* Deborah H. Schenk, *Saving the Income Tax With a Wealth Tax*, 53 TAX L. REV. 423, 446 (1999); Noël B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A Revolutionary Approach to Ownership*, 47 TAX L. REV. 725, 735–36 (1991). Ari Glogower proposes something similar, inclusion of the annuity value of a taxpayer's wealth in their income. Glogower, *supra* note 248, at 1468. The version we present here is only one of many possibilities.

presumed income of 5% on the wealth above that $50 million threshold. Thus, the tax could be designed in the form of a 40% tax on that imputed income.

We propose this approach for repackaging wealth taxes both as a practical way to invoke the "income" language of the 16th Amendment and (perhaps more importantly) to further illustrate that no robust substantive distinction can be drawn between income taxes and wealth taxes.[305] To be clear, measuring based on imputed income involves specifying *ex ante* how much income is earned by property without reference to the actual measured returns. Our proposal would thus be a form of *presumptive tax*,[306] determined by using some set of proxies—in this case, observed wealth—as a way to estimate income. An antagonistic court could perhaps see that as the sort of legislation that falls within the exception of *Patton v. Brady*, i.e., that even if a court should not look through the legislature's description of an indirect tax, nor can a legislature totally ignore the Constitution.[307] And we of course are not being shy here about the substantive equivalence between a tax on imputed investment income and a tax on wealth. Nevertheless, we will argue that for a Court to rule that an income tax cannot be based on a measure of imputed income would be improper.

We have already explained why it is not feasible for a court to measure this tax against some externally valid concept of income. Alternatively, perhaps a court could try to explain why at a minimum this *particular* measure of economic well-being cannot be "income," regardless of whatever the full definition of income might be. Thus, even if *Macomber* was fully abrogated such that unrealized gain is clearly "income" under the 16th Amendment, it could still be argued that including imputed, but unmeasured, gains to wealth is a step too

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[305] *See supra* Part III.A.

[306] *See, e.g.,* Kenan Bulutoglu, *Presumptive Taxation, in* TAX POLICY HANDBOOK 258 (Parthasarathi Shome, ed., IMF 1995); Valeria Bucci, *Presumptive Taxation Methods: A Review of the Empirical Literature*, 34 J. ECON. SURVS. 372 (2019).

[307] *See supra* note 153 and accompanying text.

far. However, for the reasons we explain below, we believe that a Court should properly hold that Congress can declare imputed investment income to be "income."

### 1. Historical Use of Presumptive Taxes

We first underscore that using a presumptive measure of income is not fancy academic theorizing, but rather has deep historical roots in tax practice, to the extent that using easier-to-measure proxies for income or wealth was likely within policymakers' understanding of how an income tax might be constructed at the time of the 16th Amendment. Indeed, writing contemporaneously to the 16th Amendment, Seligman noted that presumptive income taxes generally preceded taxes on realized income, because initially tax collectors lacked the administrative capacity to observe and measure actual incomes.[308] We have also already seen in the review of Wolcott's report that colonial and early state "direct taxes" often used presumptions of value or income based on more easily observed characteristics, like acreages of land.[309]

Furthermore, many aspects of our current income tax incorporate elements that could be seen as "presumptive," that is, estimates of items of income, deduction, or loss based on exogenous factors, rather than direct measurement of the actual income, deduction, or loss. For example, the leading public finance economists Joel Slemrod and Schlomo Yitzhaki have treated the standard deduction—a flat deduction to taxpayers that is meant to approximate certain basic costs of living—as a presumptive tax.[310] Other modern examples could include schedular approximations of depreciation,[311] the alternative

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[308] *See* SELIGMAN, *supra* note 44, at 34–35.

[309] *See* Part I.C. *supra*.

[310] Joel Slemrod & Shlomo Yitzhaki, *Analyzing the Standard Deduction as a Presumptive Tax*, 1 INT'L & PUB. FIN. 25 (1994).

[311] *See* Shlomo Yitzhaki, *Cost-Benefit Analysis of Presumptive Taxation*, 63 FINANZARCHIV 311, 315 (2007). For example, rather than calculate actual economic depreciation, the U.S. tax code simply assigns useful lives and depreciation methods based solely on the type of asset. *See* I.R.C.

minimum tax,[312] the Israeli *tachshiv*,[313] and small business taxation in Italy.[314] Presumptive tools are especially common in developing countries with weaker administrative capacity.[315] Returning briefly to academic theorizing, optimal tax theory in economics tends to approach income taxation itself as a proxy for—that is, a presumptive measure of—actual economic capacity.[316]

### 2. Imputed and Psychic Income

Second, income from wealth can encompass more than just financial returns. Among scholars, there is little dispute that the income concept—as elastic as it is—can accommodate notions of imputed and psychic income.[317] As a trivial example, the imputed rental income from owner-occupied housing is almost certainly an item of economic income that could be included in a person's taxable income, even without any actual flow of cash or other property—indeed, many income taxes, including those in the United States, have included imputed rent,[318] and the U.S. Treasury treats the exclusion of net

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[312] *See* Yitzhaki, *supra* note 311, at 315. In the U.S., the AMT deliberately deviates from the otherwise-applicable method of calculating taxable income in order to generate what policymakers consider a more accurate measure of some taxpayers' ability to pay. *See* I.R.C. § 55. The AMT applies when certain triggers, such as high deductions from gross income, in effect become proxies for applying a different rule.

[313] *See* Yitzhaki, *supra* note 311, at 315–17. The *tachshiv* was in effect from 1954 to 1975, and essentially taxed small business based on observable non-income criteria in order to relieve businesses from bookkeeping. For example, flower shop profit was assumed based on number of workers, using a presumptive measure of revenue per worker, and presumptive profit percentage, both based on the type of flower shop. *See id.* at 317.

[314] *See* Christine Marciasini, 7190 T.M., *Business Operations in Italy*, at VIII.B; Alessandro Balestrino & Umberto Galmarini, *On the Redistributive Properties of Presumptive Taxation*, CESifo Working Paper No. 1381 (2005), at 1, *available at*: https://ssrn.com/abstract=648601 (reporting that up to 13% of reported income for tax purposes is presumptive income of this sort).

[315] *See, e.g.,* Bulutoglu, *supra* note 306, at 258–60.

[316] *See, e.g.,* LOUIS KAPLOW, THE THEORY OF TAXATION AND PUBLIC ECONOMICS 96–98 (2008).

[317] *See, e.g., id* at 233–34; Brooks, *supra* note 84, at 107–10.

[318] *See, e.g.,* Dan Andrews, Aida Caldera Sánchez & Åsa Johansson, *Housing Markets and Structural Policiesin OECD Countries*, OECD Working Paper No. 836 (Jan. 2011) (reporting, as of 2011 that Iceland, Luxembourg, the Netherlands, Slovenia, and Switzerland at least partially taxed imputed rent from owner-occupied housing). One of the first modern income taxes in the U.S., in Wisconsin in 1911, included imputed rent from owner-occupied house. *See* Kossuth

imputed rent as a "tax expenditure," i.e., a deviation from a "normal" income tax for non-tax policy reasons.[319]

We call this a "trivial example," because it is still fairly straightforward to think of imputed rent as a measurable economic flow, based on the rental value of the property. But the imputed rent concept doesn't stop there—it can also include the "rental" value of any property, such as a car, furniture, appliances, dishware, and so on. And this then bleeds into ideas of psychic income. A Ferrari and a Corolla may perform the same function, but one would generate a much greater rental value than the other—and that higher rent corresponds in part to the psychic value an owner would get from driving it herself. The imputed income generated by the Ferrari is not just, say, the cost avoided by not paying for public transportation—it would also include that higher level of psychic enjoyment. And we could say the same for eating off more expensive dishware, wearing finer clothes, living in a fancier house—or simply accumulating vast wealth. The mere ownership of wealth could without much trouble be determined to generate a degree of psychic value—in economic terms, of *utility*—independent of the actual financial return. This should fall squarely within Congress's power and discretion to determine what is "income."

### 3. The Normal Return

Third, basic financial theory holds that all assets earn what is typically termed a "normal" return, i.e., a risk-free, time-value-based rate of return.[320] The normal return is a component of the overall return (or loss) from property.

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Kennan, *The Wisconsin Income Tax*, 26 Q.J. ECON. 169, 173 (1911). The Civil War income tax provided an explicit exclusion for the rental value of owner-occupied housing, Act of June 30, 1864, ch. 173, § 117, 13 Stat. 223, 281, implying that it might otherwise be included (as, indeed, the Commissioner of Internal Revenue had recommended in 1863), *see* SELIGMAN, *supra* note 44, at 439.

[319] U.S. Dep't of the Treas., Off. of Tax Analysis, *Tax Expenditures* tbl. 1(Feb. 26, 2020).

[320] *See, e.g.,* Edward D. Kleinbard, *The Right Tax at the Right Time*, 21 FLA. TAX REV. 208, 267–76 (2017).

Other components of income include inflationary gains, risk premia, and, most importantly, the "risky" gain or loss from the stochastic movements in value of the asset itself.[321] Thus, even an asset that records a decline in market value is considered to have still earned a positive risk-free normal return—but just coupled with an even greater risky loss.[322]

Congress's power to tax income does not require it to tax *all* income. It clearly has the discretion to tax some types of income but not others (as the long list of exclusions in the tax code makes plain). Congress should thus be able use its discretion to tax only the normal return from property, but not the risky returns. (Indeed, some scholars have argued that the normal return is in fact all the income tax can actually reach successfully anyway.[323])

Although there is little dispute that the normal return exists, there is less certainly of its value, on what the actual normal rate of return is. Scholars have argued for a range of values, and its value likely changes over time as well.[324] If Congress made a reasoned finding of what it believed that rate to be for tax purposes, a court would not be equipped to challenge that finding, given the lack of expert consensus. To shore up this approach, Congress could alternatively charge Treasury with making an annual determination of that year's normal return, based on economic and other conditions, and then use that rate to determine the imputed income from wealth to be taxed. The IRS already does something similar in determining the Applicable Federal Rates for purposes of the original issue discount bond rules[325] (indeed, the AFR estimate may be a

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[321] *See, e.g.,* Noël B. Cunningham, *The Taxation of Capital Income and the Choice of Tax Base*, 52 TAX L. REV. 17, 23 (1996).

[322] *See, e.g.*, David A. Weisbach, *The (Non) Taxation of Risk*, 58 TAX L. REV. 1, 13–14 (2004).

[323] *See, e.g., id.* at 2; Cunningham, *supra* note 321, at 21; Joseph Bankman & Barbara H. Fried, *Winners and Losers in the Shift to a Consumption Tax*, 86 GEO. L.J. 539, 541–42 (1998). *But see* John R. Brooks II, *Taxation, Risk, and Portfolio Choice: The Treatment of Returns to Risk Under a Normative Income Tax*, 66 TAX L. REV. 255, 256 (2013) (arguing that more than the normal return is taxed by an income tax, even under strong assumption).

[324] *See* Kleinbard, *supra* note 320, at 267-282 (discussing "what is a normal return").

[325] *See, e.g.,* Rev. Rul. 2021-9, 2021-23 I.R.B. (applicable federal rate tables).

decent estimate of a normal return). This may result in more year-to-year variance in collections as a percentage of wealth, but would still accomplish the broader goal of increasing contributions from the wealthy.

#### 4. A Tax on Imputed Income Can be Unapportioned Even if it is Not a Tax on "Income"

Finally, even a holding that imputed investment income may not be "income" would not fully resolve the constitutional question. For example, consider the D.C. Circuit's decision in *Murphy v. I.R.S*. In that case the court first held that compensatory damages for emotional distress were not "income," and therefore taxing them was unconstitutional.[326] The rationale was that the damages were not a gain, but rather just a restoration of capital, the taxpayer's "human capital." In the opinion, the court made much of the necessity to define the outer bounds of "income" based on some general understanding of the term, writing that "[t]he Sixteenth Amendment simply does not authorize the Congress to tax as 'incomes' every sort of revenue a taxpayer may receive. As the Supreme Court noted long ago, the '"Congress cannot make a thing income which is not so in fact."'"[327]

However, the near-universal condemnation of the *Murphy I* case from the tax bar, scholars, and many others prompted the court to *sua sponte* vacate that holding and rehear the case.[328] The court in *Murphy II* then held the opposite—that Congress *did* have the power under the Constitution to tax compensatory damages from emotional distress.[329] Along the way, the court made several conclusions relevant to direct tax jurisprudence. First, it stated that an item need not strictly be an "accession to wealth" in order for Congress to include it under the definition of "income" for tax purposes: Congress can "*label*

[326] 460 F.3d 79, 88 (D.C. Cir. 2006).
[327] *Id.* at 87 (citing Burk-Waggoner Oil Ass'n v. Hopkins, 269 U.S. 110, 114 (1925)).
[328] Order for vacation and rehearing at 2006 WL 4005276.
[329] Murphy v. I.R.S., 493 F.3d 170 (2007).

a thing income and tax it, so long as it acts within its constitutional authority, which includes not only the Sixteenth Amendment but also Article I, Sections 8 and 9."[330] After concluding that Congress did, in fact, intend such damages to be treated as gross income under Section 61(a), the court turned again to the constitutional question. Ultimately, the court decided that it did not need to resolve the question of whether compensatory damages were "income," because that was ultimately irrelevant to the question of whether Congress had the power to tax compensatory damages without apportionment. Instead, the court said, the issue turned on whether such a tax was a "direct tax" or more akin to a duty, impost, or excise.[331] Looking at the cases on this issue (many of which we discussed in Parts I and II), the court held that taxing compensatory damages was an excise—an indirect tax for which apportionment was not required.

This case illustrates, first, an application of the broad reading of "excise" in U.S. constitutional jurisprudence, and second, that Congress's power to tax does not hinge on some definition of the word "income"—even if that is the label Congress statutorily puts on the item being taxed. In other words, even if taxing "imputed investment income" would extend the meaning of the word "income" beyond its accepted meaning, that does not foreclose the issue.

This then brings us back to the argument we started with in this Section. That is: if Congress enacts a tax that can reasonably be characterized as an excise (regardless of whether the tax is labeled as an income tax, and even if other alternative characterizations might also be reasonable), and if Congress also expresses its intention for the tax to be characterized as indirect by making the tax uniform, then courts should defer to that characterization chosen by Congress. To be clear, we offer this formulation of an excise tax on wealth partly

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[330] *Id.* at 179.

[331] Here, we note, the court is doing what the Supreme Court failed to do in *Macomber*, in which it just assumed that the tax was a direct tax.

as a possible legislative path, but also to illustrate again that any lines between "income" and "wealth" are theoretically and doctrinally blurry, particularly when considering the income from wealth. It is precisely because nearly any wealth tax could be repackaged as an income tax or excise tax (and vice versa) that the Court developed the deferential approached embodied in our Indirect Tax Canon.

### *C. The Apportionment Path: Drafting Fallback Provisions*

As *Pollock* and *Macomber* demonstrate, a Court seeking to impose substantive constitutional limits on what counts as income or excises could well strike down a uniform federal wealth tax or accrual-income tax reform, the Indirect Tax Canon and the 16th Amendment notwithstanding. Thus, we also propose that such reforms be drafted to include fallback provisions that would take effect in the event of the Court requiring apportionment.

As Michael Dorf explains, "[t]o address the risk that a court will declare all or part of a law unconstitutional, legislatures sometimes include 'fallback' provisions that take effect on condition of such total or partial invalidation."[332] Dorf cautions that substitutive fallback provisions (like those we propose here) should be drafted with "great care"[333] and that courts should not enforce fallback provisions "aimed at coercing judicial acceptance of an unconstitutional original provision, unless the fallback is clearly germane to the law as a whole."[334] Nevertheless, it is clear that Congress has the power to legislate fallback provisions and that the courts must enforce such provisions so long as they are drafted carefully to avoid constitutional defects.[335]

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[332] Michael C. Dorf, *Fallback Law*, 107 COLUM. L. REV. 303, 304 (2007).
[333] *Id.* at 373.
[334] *Id.*
[335] *See id.* at 372–73.

There are numerous ways in which fallback provisions might be designed, and the best design will depend in part on the specifics of the original reform proposal, the goals of the reform coalition, and the political circumstances at the time in which the reform is proposed. Thus, our goal here is not to attempt to develop the best possible fallback provisions, but rather to explain some parameters for how reasonable fallback provisions might be designed.

To that end, we propose that fallback provisions include both a residual tax modeled after the 1798 Direct Tax Act and a fiscal equalization system for resolving interstate inequities. Recall that the 1798 Direct Tax Act was a combination of a *uniform* tax on dwelling houses and enslaved people plus a *residual* tax on land at whatever rates were necessary to satisfy each state's apportioned quota. Recall further that fiscal equalization systems are now common in federal nations and that what might be thought of as partial fiscal equalization systems have also been used in the United States.

To be more concrete, for any tax for which apportionment is required, the revenues to be raised from within each state must be in proportion to the state's population. For a wealth tax or accrual-income tax reform, this then means that states whose residents have less wealth or income per capita would need to pay a higher percentage of their wealth or income as taxes by comparison to states whose residents have relatively more wealth or income. This then raises two key questions that we will address below: First, how can a wealth tax or accrual-income tax reform be apportioned practically? Second, what can be done to resolve the resulting interstate inequities?

### 1. Apportioning a Wealth Tax or Accrual-Income Tax Reform

The revenues raised by any form of taxation depend on both the tax rates and the tax base. Thus, because both wealth and accrued income are unequally distributed among the states, apportioning a wealth tax or accrual-income tax reform requires varying by state the tax rates, the tax base, or both. This is why taxes on anything other than capitations cannot simultaneously be both apportioned and uniform.[336]

As we have discussed, the Wolcott Report and the early Direct Tax Acts provide two different ways for accomplishing apportionment. The first approach, which we will call the *residual tax* method, was used by the 1798 Direct Tax Act. This approach involves combining uniform taxes on some components of the overall tax base with a residual tax on another component or components, with the rates of the residual tax then varying by state to satisfy each state's apportionment quota. The 1798 Direct Tax Act accomplished this by combining uniform taxes on dwelling houses and enslaved persons with a residual tax on land. The second approach, which we will call the *comprehensive rate adjustment* method, was used by the 1813 and later Direct Tax Acts. This approach involves varying the rates of all components of the tax base by state to satisfy each state's apportionment quota. In essence, then, this second approach treats the entire tax base as the residual tax.

At least since *Hylton*, commentators have complained about the difficulties of apportionment and with many then citing such difficulties as arguments in favor of narrowly interpreting the scope of what counts as "direct taxes" that must be apportioned. For instance, Justice Paterson's opinion in *Hylton* reasons, "A tax on carriages, if apportioned, would be oppressive and

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[336] *See supra* note 21 and accompanying text.

pernicious. How would it work? In some states there are many carriages, and in others but few. Shall the whole sum fall on one or two individuals in a state, who may happen to own and possess carriages? The thing would be absurd, and inequitable."[337]

This critique is valid insofar as it contemplates a tax on just carriages and nothing else. When contemplating taxes on a narrow class of property, that may not exist or only scarcely exist in some states, it might well be impossible to vary the tax rates enough by state to raise the same revenues per capita. But this critique would not hold for an apportioned tax levied on carriages (or another narrow class of property) as only one component of a broader tax base. It would not have been especially difficult, for instance, to add a tax on carriages to the 1798 Direct Tax Act along with the uniform taxes on dwelling units and enslaved people, while continuing to satisfy each state's apportionment quota with the residual tax on land (the *residual tax* method). Nor would it have been especially difficult to add a tax on carriages to the 1813 Direct Tax Act and then vary the tax rates on all components of the overall base by state so as compensate for the different distributions of the overall tax base amongst the states and thereby satisfy each state's apportionment quota (the *comprehensive rate adjustment* method).

Indeed, the apportionment requirement for direct taxes was added to the Constitution in part for this exact reason—to prevent Congress from levying direct taxes solely on narrow classes of property that were nonexistent or scarcely existent in some states, and prevalent in other states, without those taxes being accompanied by taxes on other property in a manner designed to raise equal per capita revenues from every state.[338] Specifically, the representatives of southern states wanted to prevent Congress from levying direct taxes just on enslaved people.[339] But the Constitution clearly authorized taxes on enslaved

[337] Hylton v. United States, 3 U.S. (3 Dall.) 171, 179 (1796).
[338] Dodge, *supra* note 7, at 853–54.
[339] *Id.*

people as a component of a broader tax base, and indeed each of the first four Direct Tax Acts included taxes on enslaved people as a component of the overall tax base.[340] Thus, at least one purpose of the apportionment requirement for direct taxes was to prevent Congress from imposing direct taxes just on enslaved people (or another similarly narrow class of property), but to authorize Congress to tax enslaved people (or other narrow classes) as part of a broader tax base.

Some commentators have suggested that a tax on extreme wealth holdings with a high enough exemption threshold is akin to a tax on just a narrow form of property, like carriages or enslaved people. For instance, imagine a hypothetical tax on only billionaire's extreme wealth holdings, with a billion-dollar exemption threshold. Because not every state has resident billionaires,[341] it would currently be impossible to apportion this tax without adjusting the base.

However, in designing fallback provisions that would go into effect only in the event of the Court holding that the original uniform tax must be apportioned, recall that Congress can vary the base of the substitutive apportioned version of the tax. For instance, if Congress were to pass a uniform wealth tax with a billion-dollar exemption threshold, the substitutive apportioned version of that tax in the fallback clause could be designed with a lower threshold to make apportionment possible. That lower threshold could then apply either to only a component of the overall base (the residual tax method) or to the entire base (the comprehensive rate adjustment method).

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[340] *Id.* at 854–55; *see supra* text at notes 96–107.

[341] Lisette Voytko, *Here's the Richest Billionaire in Every U.S. State 2021*, FORBES, April 7, 2021 ("Only seven states—Alabama, Alaska, Delaware, New Hampshire, North Dakota, Vermont and West Virginia—have no known billionaire residents.").

Both the residual tax method and the comprehensive rate adjustment method are viable approaches for apportioning a wealth tax or accrual-income tax reform, and which is preferable will depend in part on the specific details and circumstances surrounding the proposed reform. That said, we think that the residual tax method has some advantages that will often make it the better approach, and so we will focus on that method here.

To begin with, when designing fallback provisions, it may be unclear in advance which portions of the reform (if any) the Supreme Court might require to be apportioned. This is an especially difficult question for accrual-income tax reforms that would be incorporated into the existing income tax. What would it mean to apportion just the accrual-income tax provisions of such a reform? This is a hard question to answer in advance of an actual Court ruling.

The residual tax method circumvents these conceptual difficulties. We recommend that the residual tax be set on either all land value or all real estate value within a state. We further recommend that a substantial "circuit-breaker" be added to the residual tax to exempt all persons with reported incomes below a specified threshold—circuit breakers of this sort are a common mechanism in existing real property taxes.[342] For example, such a circuit breaker could exempt all tax households with adjusted gross income of below $400,000 from the residual tax, with liability for the residual tax phasing in above that exemption threshold. The Treasury Department could then be charged with setting state-specific rates for the residual tax to meet each state's apportionment quota, in the event of the Court ruling that the original tax reform proposal must be apportioned, and with the apportionment quotas set based on whatever portions of the original tax reform proposal that the Court holds must be apportioned. In other words, the original uniform tax would remain in place and with the uniform rates as specified by the original legislation, and the residual

[342] Aidan Davis, *Property Tax Circuit Breakers in 2018*, ITEP POLICY BRIEF (2018).

tax would then be added on top of that to raise any additional revenues required to meet each state's apportionment quota. This circumvents the need to predict in advance which specific provisions the Court might rule need to be apportioned.

There are multiple reasons why we propose that the residual tax be set on either all land value or on all real estate value within a state. A tax on land is the only tax that nearly everyone agrees would come within the original Constitutional meaning of "direct tax" and a residual tax on land value would also correspond exactly to the precedent of the residual tax in the 1798 Direct Tax Act. As we noted previously, Wolcott concluded that "[a] direct tax, in the sense of the constitution, must necessarily include a tax on lands."[343] These factors might favor constructing the residual tax as just on land value. However, broadening the base of the residual tax to include all real estate within a state would result in lower rates for the residual tax and would also better facilitate obtaining valuations from existing local-government real property tax systems. Most local government real property tax systems value land separately from structures, and so valuations for the residual tax could potentially be obtained from existing local government real property tax systems for either a residual tax just on land value or a tax on all real estate value.[344] Yet, for some existing local government real property tax systems, the overall assessed value of the entire real estate is more easily obtainable than just the assessed land value, and so this arguably favors constructing the residual tax on all real property within a state.[345]

We view the potential for designing the residual tax to piggyback on existing real property tax systems as a major advantage of the residual tax

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[343] *Supra* note 86.

[344] Michael E. Bell & John H. Bowman, *Methods of Valuing Land for Real Property Taxation: An Examination of Practices in States that Require Separate Valuation of Land and Improvements*, LINCOLN INSTITUTE OF LAND POLICY WORKING PAPER 1 (2006).

[345] *Id.*

method. Every U.S. state has a real property tax system whereby the state government authorizes local governments to levy taxes subject to restrictions set by the state government.[346] Because apportioned taxes involve calculating state-specific quotas and then setting tax rates to meet those quotas, there is a logic to piggybacking on a tax base controlled by the state governments for valuation purposes. In effect, doing so enhances the requisition-like nature of the apportioned taxes, because the state government would retain control of the valuations used by the residual tax. Moreover, administration and compliance should be relatively simple because taxpayers could just be required to report the valuations that are already being conducted by property tax assessors.

The primary challenges facing the early Direct Tax Acts were in assessing the tax base and in actually collecting the taxes owed.[347] By contrast, adjusting the tax rates to apportion the tax burdens was a relatively minor issue, under either the residual tax method used by the 1798 Direct Tax Act or the comprehensive rate adjustment method used by the subsequent Direct Tax Acts.[348] By piggybacking on the valuation assessments already being conducted by state and local government property tax assessors, and with the administration and collection systems of the federal income tax already in place, it should not be especially difficult to apportion a new federal wealth tax or accrual-income tax reform through adjusting the rates of a residual tax that would be levied on either land value or real property value within each state.

### 2. Resolving Interstate Inequities

The Justices in *Hylton* famously questioned whether any taxes other than capitations and taxes on land "could be apportioned."[349] Citing to that language,

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[346] Janelle Cammenga, *How High Are Property Taxes in Your State?*, TAX FOUNDATION, July 7, 2021.
[347] Dodge, *supra* note 7, at 925.
[348] *Id.*
[349] *See supra* Part I.A.

numerous commentators have suggested that it might be impossible or impractical to apportion a wealth tax or income tax. However, despite their somewhat exaggerated language, the Justices in *Hylton* clarified that they were not actually questioning whether it was *literally* possible to apportion broad-based taxes on property or persons, but rather whether such apportionment could be done without "great inequality and injustice."[350] Similarly, as Joseph Dodge has explained, no one has seriously argued that it would be literally impossible to apportion a broad-based wealth tax or income tax, or any other broad-based tax "on the economic attributes of a person."[351] The real question is whether such taxes can be apportioned *equitably*.

Viewed in isolation, an apportioned wealth tax or income tax must take as taxes a greater percentage of the wealth or income from the residents of states with less wealth or income, and a lesser percentage from the residents of states with relatively more wealth or income. That is, a given taxpayer in a poorer state would end up paying a greater proportion of their wealth or income in tax as compared a taxpayer with the same wealth or income in a richer state. This has generally been viewed as so inequitable as to be a fatal obstacle to apportioning a wealth tax or income tax.[352]

However, consider that, for the existing U.S. income tax, combined federal- and state-level tax rates *already* differ dramatically among the states. For instance, the highest combined capital gains tax rate is currently 13.3 percentage points higher in California than in Florida.[353] Because all existing federal taxes are uniform, federal-level tax rates are currently set the same in every state; but

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[350] *Hylton*, 3 U.S. (3 Dall.) at 174 (Chase, J.).
[351] Dodge, *supra* note 7, at 917.
[352] *See supra* note 28.
[353] Garrett Watson & Erica York, *Top Combined Capital Gains Tax Rates Would Average 48 Percent Under Biden's Tax Plan*, TAX FOUNDATION, April 23, 2021.

combining federal taxes with state-level "piggyback" taxes then makes the combined tax rates unequal.

Tax rates varying by state is a natural result of a federal system wherein both state governments and the federal government have discretion over their own tax rates. But this is not generally considered to be inequitable because each state government then receives the revenues raised by its own tax rates to fund its own spending. An apportioned federal-level tax differs from this because the federal government would receive the revenues raised by the tax rates that vary by state instead of the state governments receiving those revenues. For an apportioned federal-level wealth tax or income tax, this then means that the federal government would take a greater percentage of the wealth or income of poorer states as compared to richer states. This, rather than the mere fact of tax rates varying by state, is the heart of the inequity.

Understanding that this is the heart of the inequity shows how the inequity can be resolved. All that is needed is for the federal government to spend the extra revenues raised from the tax rates varying by state for the benefit of the poorer states. This could be accomplished in a number of ways, including by just funding a federal spending program that would primarily benefit poorer states. But we think that the most straightforward solution is to establish a fiscal equalization system.

As Kirk Stark has explained, "Australia, Canada, Germany, India, South Africa, and numerous other federations through the world have in place a complex system of 'equalization grants' whereby the central government makes fiscal transfers to ensure that resources available to state or provincial governments do not exhibit significant variation."[354] Such fiscal equalization systems typically involve the federal government measuring the fiscal capacities

[354] Kirk J. Stark, *Rich States, Poor States: Assessing the Design and Effect of a U.S. Fiscal Equalization Regime*, 63 TAX L. REV. 957, 957 (2010).

of state governments and then providing block grants to the state governments with lower fiscal capacities.

Although the United States has never implemented a comprehensive fiscal equalization system like those in other federal nations, the U.S. federal government has implemented many programs that are in essence partial fiscal equalization systems. For instance, existing federal grants to state governments, such as through Medicaid and Title I of the Elementary and Secondary Education Act, already operate as a form of partial fiscal equalization, and "General Revenue Sharing" under the State and Local Fiscal Assistance Act of 1972 made unrestricted grants directly to states and municipalities based in part on income and need, prior to its repeal under President Reagan.[355] Moreover, between the early 1960s and 1995 (when it was terminated by Congress), the Advisory Commission on Intergovernmental Relations periodically published a fiscal capacity study of the U.S. states.[356] Since then, private researchers have continued to publish similar studies using the same methodology.[357]

We propose that the fallback provisions of a federal wealth tax or accrual income tax reform revive the Advisory Commission on Intergovernmental Relations and charge it with renewing its studies of state fiscal capacities. We further propose that all revenues raised by the residual tax be channeled into block grants given to states with lesser fiscal capacities, as so measured. Reviving the Advisory Commission on Intergovernmental Relations and its studies of state fiscal capacities is well worth doing even absent the need to apportion a federal tax reform.[358] And doing so should make it relatively straightforward to implement a new fiscal equalization system to resolve the inequities that might

[355] *See* Staff of the Joint Comm. on Tax'n, *General Explanation of the State and Local Fiscal Assistance Act and the Federal-State Tax Collection Act of 1972 (JCS-1-73)* 1–4 (Feb. 12, 1973).

[356] Stark, *supra* note 354, at 985.

[357] *Id.*

[358] David Gamage & Darien Shanske, *Tax Cannibalization and Fiscal Federalism in the United States,* 111 NW. U. L. REV. 295, 370–71 (2017).

otherwise result from apportioning a federal wealth tax or accrual-income tax reform.

State legislatures should then have the discretion for how to use the block grant funds provided by the fiscal equalization program. For instance, state governments might opt to use these funds to rebate some or all of the apportioned taxes that state residents pay to the federal government. This would be similar to how state governments piggyback on existing federal taxes by levying supplemental state taxes on the what is essentially the same base,[359] but in reverse, as the state legislatures would be rebating some or all of the federal-level apportioned tax liabilities of state residents rather than levying additional state-level taxes. For example, under the residual tax method, the federal government could rebate to each state its share of the residual tax on land or real estate value, and the state could further rebate that payment to the individual taxpayers who paid the residual tax. Alternatively, state legislatures might opt to reduce other state-level taxes or fund state-level spending programs.

The goal of the fiscal equalization program should not necessarily be to put taxpayers back to the position that they would have been in absent the combined residual tax and fiscal equalization block grants however.[360] Rather, the goal should be to remedy the inequity of the federal government taking a greater percentage of the wealth or income of poorer states as compared to richer states. This goal can be met by providing the legislatures of such poorer states with fiscal equalization block grants, and then leaving it up to the state

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[359] *Id.* at 337–38.

[360] In this sense, our proposals here differ from both the proposals we made in an earlier (unpublished) draft of this paper that we posted to SSRN and also from a prior proposal for combining an apportioned wealth tax with state-level pick-up taxes in an earlier article by John T. Plecnik, *The New Flat Tax: A Modest Proposal for a Constitutionally Apportioned Wealth Tax*, 41 HASTINGS CONST. L.Q. 483 (2014). We discuss Plecnik's proposal and some issues with it in our earlier draft, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3489997.

legislatures to decide the best way to spend those funds for the benefit of their states.

### 3. Evaluating Possible Constitutional Vulnerabilities

Might our proposed fallback provisions be constitutionally vulnerable? The answer to that question depends at least in part on what it means for a legislative proposal to be considered constitutionally vulnerable. To elaborate, we think it is helpful to think in terms of multiple tiers of escalating constitutional risks.

We would then reserve the lowest tier for legislative proposals of the sort that have regularly been done in the recent past and without the Court having offered any indications that such proposals might be vulnerable. For instance, consider if Congress were to raise the top rate of the federal income tax. Congress has raised and lowered the top income tax rate repeatedly over past decades, and the Court has reviewed many income tax cases without ever suggesting any constitutional issues with raising the top rate. Nevertheless, it is theoretically possible that legislation raising the top rate might be challenged and that a majority of the Justices might then join a decision striking it down. Notably, some academics have argued that the progressive rate structure of the income tax could be struck down as a violation of the Fifth Amendment's Takings Clause and that the Court has never ruled otherwise.[361]

We explain that even this lowest tier involves some conceivable constitutional risks, not because we think that Congress should actually worry about such risks, but rather to illustrate the point that *any* legislative proposal

[361] *E.g.,* Calvin R. Massey, *Takings and Progressive Rate Taxation,* 20 HARV. J.L. & PUB. POL'Y 85, 124 (1996) ("The United States Supreme Court has never decided the question of whether progressive taxation is an uncompensated taking. Taxation is not, or at least should not be regarded as, immune from the strictures of the Takings Clause."); RICHARD EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 295-303 (1985).

might conceivably be challenged and then struck down by a majority of the Justices. Thus, to describe a proposal as constitutionally vulnerable merely because some academics might come up with arguments for how such a proposal might theoretically be struck down is to take an unhelpfully oversimplistic view of the nature of constitutional risks.

Therefore, we suggest thinking instead in terms of escalating tiers of constitutional vulnerability. For the lowest tier, which we reserve for proposals that have regularly been done in the recent past and without the Court having offered any indications that such proposals might be vulnerable, we think the constitutional risks are sufficiently low as to not be worth Congress spending time worrying about them.

In the next tier, we would put proposals of the sort that have been done in the past and without the Court having offered any indications that such proposals might be vulnerable, but that have not been regularly done in the recent past and/or that were not done in precisely the same manner in the past as is currently being considered. We would put our proposed fallback provisions in this second tier.

To our knowledge, there are no serious arguments that Congress lacks the constitutional power to enact a wealth tax or accrual-income tax reform; the debates have exclusively been about whether such reforms must be uniform or apportioned.[362] Also, to our knowledge, the Court has never given any indications of any constitutional issues with either the residual tax method of apportionment used by the 1798 Direct Tax Act or of any of the prior or existing partial fiscal equalization programs. Of course, it is still conceivable that our proposed fallback provisions might be challenged, and the risks are somewhat higher than for proposals in the first tier (such as just raising the top

[362] *See supra* notes 339–341 and accompanying text.

rate of the existing income tax). But we ultimately think that the risks are minimal.

One line for a possible challenge might be to claim that the combination of all of (i) our proposed uniform tax provisions, (ii) our proposed residual tax apportionment mechanism, and (iii) our proposed fiscal equalization program, could amount to what would in effect be an unapportioned tax (recall that it only the combination of (i) and (ii) that is apportioned). For instance, if a state government were to use all of its fiscal equalization block grant funds to rebate the residual tax paid by state residents, this might (more or less) effectively cancel out the apportionment mechanism.

But such a challenge would ignore that the apportionment requirement applies only to direct *taxes*. There is no requirement that the combination of a direct tax and any federal government spending or transfers be apportioned—indeed, that would be absurd and unworkable. Even though scholars often note the economic equivalent of taxes and transfers, legal doctrine by necessity treats them as distinct. If courts required netting transfers against taxes for determining constitutionality, this would be a challenge not only for apportioned taxes, but also for uniform indirect taxes, since the net of taxes and transfers would be unlikely to be uniform across the states.

Moreover, our proposed fiscal equalization program would direct the block grant funds to state *governments*, rather than to *taxpayers*. The total federal tax bill would still be at the apportioned levels—it would only be after possible state government–issued rebates that a person's total tax bill might be reduced. The apportionment clause of the Constitution clearly applies only to federal direct taxes, not to the combination of state and federal taxes. This must be so, because with varying tax rates by state, our current combined tax levels would otherwise fail both the uniformity requirement and the apportionment requirement (just as with netting taxes and transfers). On top of that, our proposal leaves completely to the discretion of the states whether to rebate any portion of the residual taxes paid by state residents. We think it likely that some state governments might choose to rebate some portions of the residual taxes, but we think it quite unlikely that all state governments would choose to fully rebate all residual tax payments. Regardless, the mere fact that state governments could choose to counteract a federal apportionment mechanism does not change the fact that the federal-level taxes would have been apportioned.

Finally, if Congress thinks this possible line of challenge is worth taking seriously, the enacting legislation could be drafted to include severance instructions that would drop out the fiscal equalization system, while retaining the other tax provisions, were the Supreme Court to so rule. To address the inequities that such a ruling could cause (in the exceedingly unlikely event of the Court ruling in this manner), Congress could then subsequently implement an independent fiscal equalization system (of the sort we have proposed) in new, completely independent, legislation following such a Supreme Court decision.

Another line for a possible challenge might involve arguing that the residual tax method is not a valid method for apportionment, despite the historical precedent of the 1798 Direct Tax Act. We believe such an argument should be a non-starter because apportionment *must* be tested at the level of the total tax paid, not at a per-asset level. Remember that any tax on enslaved people could not have been apportioned on its own, or at the per-asset level, because many states had zero enslaved persons.[363] Yet there is no doubt that the apportionment clause was written to allow taxes on enslaved people to be included as a component of a broader tax base.[364] Thus, the residual tax method should be just as valid as a method for apportionment as any other method that would apportion the total tax paid by state. But again, if Congress thinks this

[363] *See supra* notes 338–340 and accompanying text.
[364] *Id.*

possible line of challenge is worth taking seriously, the enacting legislation could be drafted to include additional fallback instructions that would swap in the comprehensive rate adjustment method or whatever other apportionment method that the Court might rule to be required.

Although we cannot here anticipate and respond to every imaginable objection that might possibly be raised, we hope that the overall theme should be clear. For proposals like our fallback provisions—of the sort that have been done in the past and without the Court having offered any indications that such proposals might be vulnerable, but that have not been regularly done in the recent past and/or that were not done in precisely the same manner in the past as is currently being considered—we think that the risks are slightly higher than for the first tier but still minimal. We recommend that Congress draft such proposals carefully, but that Congress otherwise not operate based on fear of constitutional vulnerabilities that are merely conceivable.

## CONCLUSION

How can we distinguish constitutional vulnerabilities that are merely conceivable from those that represent real risks that should be taken more seriously? Evaluating constitutional risks is more of an art than a science, and reasonable minds can disagree. Yet our sense is that most tax legal scholars currently think that—absent apportionment—the risks would be: (i) relatively high for a federal wealth tax reform (including for the taxes on extreme wealth holdings recently proposed by Senators Warren and Sanders[365]); (ii) either medium or low for a broad-based accrual-income tax reform (such as Senator Wyden's proposals[366]); and (iii) even lower for partial accrual-income tax reforms

[365] *Supra* note 12.
[366] *Supra* note 13.

(such as those recently proposed by President Biden[367] or that were included in the 2017 Tax Cuts and Jobs Act[368]).

Nevertheless, we note again that even the unapportioned partial accrual-income tax provisions of the 2017 Tax Cuts and Jobs Act are currently being challenged.[369] The risks that an appellate court might side with those challengers seem at least slightly more than just minimal or merely conceivable.[370] In our view, the lingering questions about whether *Macomber* has been completely overturned or only partially overturned imply that there are some real risks.[371] Even if those risks may be small for some reform proposals, we still think it prudent for Congress to consider drafting carefully to further minimize those risks.

We have argued that the precedents on direct taxes synthesize into our Indirect Tax Canon, and that the Indirect Tax Canon is also essential to the operation of our tax system. We then further argued why a Court following the Indirect Tax Canon should uphold both accrual-income tax reforms and properly constructed wealth tax reforms—all without requiring apportionment.

However, we also argued that Congress should bolster such reforms by carefully drafting fallback clauses. We thus explained how Congress could draft fallback provisions to apportion a tax reform fairly and practically in the event of the Court ruling that apportionment is required.

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[367] Most notably, President Biden recently proposed reforms that would treat both death and gifts of appreciated property as realization events; David S. Miller et al., *Treasury's Green Book Provides Details on the Biden Administration's Tax Plan*, THE PROSKAUER TAX BLOG, June 15, 2021, *available at* *https://www.proskauertaxtalks.com/2021/06/treasurys-green-book-provides-details-on-the-biden-administrations-tax-plan/*.

[368] *See supra* notes 236–239 and accompanying text.

[369] *Id.*

[370] *See* Adler, *supra* note 6 (arguing that these provisions are unconstitutional); McElroy, *supra* note 6 (same).

[371] *See supra* Part II.C.

Income and wealth inequality are among the central problems of our time.[372] As we have argued previously, the existing U.S. income tax is broken, and something like a wealth tax or a broad-based accrual-income tax reform is required to fix it.[373] The Constitution should not stand in the way of such reforms. Although current doctrine is uncertain as to whether such reforms can be uniform or must be apportioned, we have explained in this Article how Congress can navigate through those uncertainties. With careful drafting, the constitutional risks should be minimal.

[372] Emmanuel Saez, *Income and Wealth Inequality: Evidence and Policy Implications*, 35 CONTEMPORARY ECON. POL. 7 (2017).
[373] Gamage & Brooks, *supra* note 8.