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Congress, Public Values, and the Taxing Power

By Mary L. Heen★

In an article published several years ago, I examined the financing dimension of private choice and proposed a framework for analyzing Congress's taxing and spending decision-making processes. Although issues other than health care reform provided the impetus for the article, the framework developed there provides a broader perspective from which to consider the taxing power portion of Chief Justice Roberts' opinion in *National Federation of Independent Business v. Sebelius*, 567 U.S. — (2012).

The article's abstract stated in part as follows:

> Congress coordinates its taxing and spending decisions through the budget process, collectively determining what will be financed and performed through government and what will be left to private choice. The courts generally defer to the taxing and spending decisions made by Congress. Nevertheless, in the process of developing this highly deferential approach, the U.S. Supreme Court historically has drawn distinctions between taxes and other means of paying for or regulating the production of goods and services. Although it can be quite difficult to distinguish "taxes" or "revenue raising" from "user fees," "prices," or "penalties," they are not constitutionally interchangeable. When the Court has interpreted express limitations on Congress's taxing power, it has drawn distinctions similar to those drawn in the privatization literature between "individual" and "collective" financing. These doctrinal distinctions reflect the democratic values inherent in Congress's taxing and spending powers.

As explained in greater detail in the article, private choice can be financed individually, that is, paid for by an individual's own resources, facilitated by general tax reduction and by deregulation. Alternatively, private choice can be financed collectively by using tax revenues (or government-borrowed funds) to pay for privately provided goods and services. The tendency in political debate to conflate those two forms of financing, as well as the failure to distinguish between financing and performance, obscures important decisions about private choice and the government's role in managing or monitoring collectively financed activities.

Defining Public Values: Congress's Taxing and Spending Powers

In interpreting express constitutional limits on the taxing power, the Supreme Court historically has analyzed the government's taxing power in relation to its financing function. Differences between collective and individual financing thus underlie certain distinctions important in constitutional analysis. The cases suggest, for example, that express constitutional limitations on the taxing power are enforced when Congress is engaged in general "revenue raising" as opposed to collecting fees in exchange for goods or services. That is, an imposition may be a "tax" when funds are collected from private parties for a "public" purpose.

In addition, the Court has drawn historically significant distinctions between "taxes" and "penalties" for regulatory violations. In the early part of the last century, taxes were upheld as valid revenue measures rather than prohibited regulatory "penalties" if they were unconditional taxes, achieving their regulatory effects through their rate structure; or if their regulatory provisions bore a "reasonable relation" to their enforcement as a revenue measure.

When this doctrinal distinction became less salient after the Court's view of the commerce power expanded during the New Deal period, the Court generally tended to treat tax provisions producing revenue as constituting valid "revenue" measures. After adopting a more expansive view of national legislative powers, the Court never again held a federal tax to be an impermissible effort by Congress to impose regulatory standards outside the scope of its other enumerated powers. Because taxes imposed as regulatory penalties in the past had been upheld as sufficiently necessary and proper under the Commerce Clause, the relationship between the taxing power and other legislative powers received no serious discussion or reconsideration until the Court's decision last June in *Sebelius*.

A Functional Approach to the Taxing Power

The portion of Chief Justice Roberts' opinion applying a "functional" approach to the taxing power is fully consistent with those earlier cases. The Chief Justice wrote for the Court that regardless of the label applied by Congress, the "shared responsibility" exaction imposed on the uninsured is a valid "tax" for constitutional purposes as opposed to an impermissible regulatory "penalty." In reaching that conclusion, Chief Justice Roberts applied three "practical" factors considered by the Court in 1922 when it invalidated the "Child Labor Tax" in *Drexel Furniture*. Decided when the Commerce Clause

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was thought not to permit federal regulation of child labor, *Drexel Furniture* held that an excise tax imposed on employers for noncompliance with child labor restrictions was an improper regulatory device rather than a valid revenue measure.

In distinguishing the statute at issue in *Drexel Furniture* from the individual mandate, Chief Justice Roberts pointed out that unlike the "penalty" of ten percent of the company's net income for employing children, the shared responsibility exaction imposes a relatively low level of burden on those without insurance (usually less than the cost of insurance and, by statute, never more than that cost). *Sebelius*, slip op. at 35. In addition, although the Child Labor Tax was imposed on only those who knowingly broke the law, the individual mandate of the health care legislation contains no *scienter* or *mens rea* requirement, a feature typical of punitive statutes. *Id*. Finally, he observed that although the Child Labor Tax was enforced in part by the Department of Labor, the shared responsibility "payment is collected solely by the IRS through the normal means of taxation—except that the Service is *not* allowed to use those means most suggestive of a punitive sanction, such as criminal prosecution." *Id.* at 36 (emphasis in original).

After concluding that the shared responsibility exaction is a "tax," Chief Justice Roberts then went on to analyze whether the "tax" complied with other express constitutional limitations on the taxing power. Although the Supreme Court has generally accorded Congress a presumption of validity in the exercise of its taxing power, express constitutional limitations on the taxing power include the uniformity requirement imposed on indirect taxes, the prohibition against the taxation of exports, and the apportionment requirement imposed on direct taxes. In addition, under the Origination Clause, all bills for "raising revenue" must originate in the House of Representatives. The taxing power is also limited by the crosscutting limitations of the Bill of Rights, which can apply to any exercise of congressional power.

Chief Justice Roberts rejected the argument asserted by the plaintiffs that the shared responsibility payment was a "direct" tax subject to the apportionment requirement. He first observed that a tax on going without health insurance was not within any recognized category of "direct" tax. It is not a "capitation" and "also plainly not a tax on the ownership of land or personal property." *Id.* at 41.

He then went on to explain why it was not troubling to permit Congress to impose a tax for not doing something when it had held that the Commerce Clause "did not permit Congress to regulate those who abstain from commerce." *Id*. at 41. According to the Chief Justice, three considerations allayed any potential concern. First, "and most importantly, it is abundantly clear the Constitution does not guarantee that individuals may avoid taxation through inactivity," with the express contemplation of a capitation tax by the Constitution. He then pointed out that Congress's use of the Taxing Clause "to encourage buying something is, by contrast, not new," citing provisions related to the home mortgage interest deduction and certain higher education tax incentives. *Id.* at 42. Second, although Congress's ability to use its taxing power to influence conduct is not without its limits, the shared responsibility payment "passed muster" within the "strictest limits" applied by the Court. "More often, and more recently," he observed, the Court had "declined to closely examine the regulatory motive or effect of revenue raising measures." *Id.* He noted, "we need not here decide the precise point at which an exaction becomes so punitive that the taxing power does not authorize it." *Id.* at 43. Third, imposition of a tax "nonetheless leaves an individual with a lawful choice to do or not to do a certain act, so long as he is willing to pay a tax levied on that choice." The only thing they may not lawfully do "is not buy health insurance and not pay the resulting tax." *Id*. at 44 & n.11.

In the past, courts have offered limited additional guidance with regard to the meaning of the term "revenue" in other constitutional contexts, distinguishing between revenue measures and special assessments or user fees. In interpreting the Origination Clause, for example, the Supreme Court has included revenues intended for the general support of government but not special assessments designed to fund specific programs through fines or fees. For purposes of interpreting the Export Clause, which prohibits the taxation of exports from the states, the Supreme Court has similarly distinguished between prohibited taxes on exports and permissible user fees tied to specific benefits, services, or facilities. Thus, in defining revenue provisions, both Origination Clause and Export Clause cases draw distinctions between individually financed "user fees" and collectively financed "general revenues."

Federalism and the Spending Power

On the spending side, Congress also has had a great deal of latitude historically in determining whether a particular expenditure serves "public" purposes, that is, whether the spending is in pursuit of the "general welfare." Under the spending power cases such as *South Dakota v. Dole*, 483 U.S. 203 (1987), objectives not thought to be within the enumerated legislative powers "may nevertheless be attained through the use of the spending power and the conditional grant of federal funds." *Id*. at 207. In *Dole* the Court adopted a multi-part test to determine whether federal spending conditions are constitutional. Although the Court also noted that Congress cannot enact spending conditions to induce the states to engage in unconstitutional acts or to *coerce* states into actions rather than offering them a choice, no clear limiting principle on the spending power had emerged under the Court's subsequent federalism decisions until its decision on the Medicaid portions of the health care reform legislation. In *Sebelius*, Chief Justice Roberts observed that the threatened loss of *all of the state's existing* federal Medicaid funding if a state declined to comply with the legislation's expanded Medicaid coverage provisions was coercive,

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contrary to federalism, and thus, an impermissible spending condition. Slip op. at 45-58. Finding the Medicaid provision to be severable from the rest of the legislation, the Court remedied the constitutional violation by precluding the Secretary from withdrawing existing Medicaid funds for failure to comply with the requirements set out in the expansion. *Id.* at 55-58.

Taxing and Spending: The Financing and Performance of Private Choice

The combined impact of the Chief Justice Roberts' analysis in *Sebelius* of the taxing and spending powers suggest that the Court will continue to defer to Congress's broad authority to enact tax provisions with either revenue-raising or revenue-losing effects. Constitutionally required enactment procedures, including bicameralism and presentment, provide democratic legitimacy for Congress's taxing and spending decisions. Of course, such decision making procedures apply to all legislation, whether Congress is raising or lowering taxes, enacting targeted tax incentives, or appropriating funds. The fostering of other democratic values, including transparency and accountability, depends upon the availability of information about and public understanding of those decisions.

As I argued in my earlier article, general tax reduction and targeted tax incentives, both ways of advancing privatization goals, differ in approaches to financing. General tax reduction results in more individual financing of goods and services. Targeted tax incentives, on the other hand, like the home mortgage interest deduction and higher education tax credits, subsidize certain legislatively favored activities, and therefore comport with the pattern of privatization typically followed in the United States of retaining collective financing but delegating performance to the private sector. Across-the-board tax reduction and targeted tax incentives advance different privatization goals, with very different political consequences.

The argument that targeted tax incentives are more like spending programs than across-the-board tax cuts is somewhat counterintuitive and has been controversial in both academic and political quarters. Regardless of whether that argument is accepted as a matter of theory, however, the characterization of tax provisions as revenue raisers or revenue losers provides useful information to legislators because taxing and spending decisions tend to be made incrementally, and by reference to a current budgetary or revenue baseline. Since enactment of the Congressional Budget Act of 1974, for example, Congress has required that a list of "tax expenditures" be included in the budget showing revenue losses from certain existing federal income tax incentives.

Tax incentives generally do not involve negotiated relationships between government and private contractors, but typically involve tax reporting to the Internal Revenue Service and oversight jurisdiction by the tax-writing committees. The delivery of subsidies through the tax system can mask governmental funding levels and allocations and obscure accountability for outcomes being funded. The use of tax incentives as an alternative to discretionary spending by government serves privatization goals through their use of market incentives and private choice.

Targeted tax incentives encourage private businesses or individuals to engage in certain socially or economically favored activities. This type of "privatization" also involves a redrawing of lines between the public and private sectors, however, making public goals private interests by modifying market incentives. Privatization proponents tend to favor tax incentives as an alternative to government performance. Incentives use the tax system to stimulate private activity, a mechanism that permits the market to respond to individual preferences. Proponents tend to view the market as representing an aggregation of individual preferences and thus an effective and cost-efficient way of achieving goals. Under this view, public purposes would be well served by programs that permit the market to operate with as little government control as possible.

Critics of privatization tend to view public values as representing something other than the aggregation of individual preferences. They point out that the exercise of individual choice in the marketplace is quite different from collective choice exercised through political participation in the democratic process. The marketplace records individual preferences through purchasing power. Its increased use for performance of collectively financed activities, critics argue, may result in a loss of political participation and deliberation as well as the loss of those choices made possible through government action.

Conclusion

In sum, although the Constitution links the taxing power with the power to spend for the "general welfare," the courts have largely deferred to the political process for determination of the public purposes appropriate for congressional action. The political dynamics involve raw budgetary conflicts, contested ideas about the value of collective versus private choice, and deep differences in views about governmental competencies and functions. Although the Court in the future may opt to enforce limits on Congress's use of tax penalties or tax incentives for regulatory purposes, the Supreme Court's decision in *Sebelius* demonstrates its current willingness to accord Congress a presumption of validity in the exercise of its taxing power.

Achieving greater political accountability for both the financing and performance of tax incentives remains a central challenge. Administrative lawyers and scholars are engaged in studying new ways in which regulation, contracts, and contract monitoring may respond to the accountability problems created by increased "contracting out" or privatization of government services. A parallel effort to study ways in which effective monitoring of tax incentives can be accomplished needs to be undertaken.