

Not the Power to Destroy:
A Theory of the Tax Power for a Court that Limits the Commerce Power

Robert D. Cooter & Neil S. Siegel

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ABSTRACT

Effective limits on the power of Congress to regulate interstate commerce require the Court's tax power jurisprudence to reinforce restrictions on the Commerce Clause. Otherwise Congress can circumvent limits on its commerce power by calling regulations backed by penalties "taxes" and justifying them under the tax power. When the Court restricted federal commerce power in the 1920s and 1930s, it distinguished between taxes, which raise revenues, and penalties, which regulate behavior. This distinction is useless because so many federal exactions do both, like the 18th century "imposts" that raised revenues from imports and suppressed foreign competition with American industry. The post-1937 Court essentially abandoned judicially enforceable limits on the Commerce Clause, so it had no need to rethink or overrule previous distinctions between regulations of interstate commerce and taxes. Since its "new federalism" decisions, the Court has yet to reconsider the constitutional scope of the tax power. As a result, judges and litigants contradict one other in current litigation over the minimum coverage provision in the Patient Protection and Affordable Care Act (ACA).

Legal theory helps to answer constitutional questions when existing doctrine does not. A person who must pay a *pure penalty* is condemned for wrongdoing. Moreover, she must pay more than the usual gain from the forbidden conduct, and she must pay at an increasing rate with intentional or repeated violations. Condemnation coerces expressively and relatively high rates with enhancements coerce materially. A pure penalty prevents behavior, thereby raising little revenue.

Alternatively, a person who must pay a pure tax is permitted to engage in the taxed conduct. Moreover, she must pay less than the usual gain from the taxed conduct, and intentional or repeated conduct does not enhance the rate. Permission does not coerce expressively and relative low rates without enhancements do not coerce materially. A pure tax dampens conduct but does not prevent it, thereby raising revenues.

Situated between pure taxes and pure penalties are mixed exactions whose expression sounds like a penalty and whose material characteristics look like a tax. Thus the ACA's exaction for non-insurance has a penalty's expression and a tax's materiality. Should courts interpret a mixed exaction as a tax or a penalty? Our answer depends on the exaction's effect. If an exaction dampens behavior and raises revenue, then it should be interpreted as a tax, regardless of what the statute calls it. If an exaction prevents behavior, then it should be interpreted as a penalty. The Congressional Budget Office predicts that ACA's exaction for non-insurance will dampen uninsured behavior but not prevent it, thereby raising several billion dollars in revenue each year. Accordingly, the exaction is a tax for purposes of the tax power.

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The difficulty of saying when the power to lay uniform taxes is curtailed, because its use brings a result beyond the direct legislative power of Congress, has given rise to diverse decisions. In that area of abstract ideas, a final definition of the line between state and federal power has baffled judges and legislators.¹

INTRODUCTION

Effective limits on the power of Congress to regulate interstate commerce require the Court’s tax power jurisprudence to reinforce restrictions on the Commerce Clause. Otherwise Congress can circumvent limits on its commerce power by calling regulations backed by penalties “taxes” and justifying them under the tax power. When the Court restricted federal

* Herman Selvin Professor of Law, University of California at Berkeley.

** Professor of Law and Political Science, Duke University School of Law. For instructive conversations, we thank Jack Balkin, Curtis Bradley, Josh Chafetz, Michael Dorf, Mary Dudziak, R. Craig Green, Daniel Hemel, Prasad Krishnamurthy, Justin McCrary, Bernadette Meyler, Gillian Metzger, Barak Richman, Stephen Sachs, Richard Schmalbeck, Lawrence Solum, Lawrence Zelenak, and workshop participants at Cornell Law School, Duke Law School, Michigan State Law School, and Berkeley Law School.

¹ United States v. Kahriger, 345 U.S. 22, 29 (1953).

commerce power in the 1920s and 1930s,² it distinguished taxes, which raise revenues, from penalties, which regulate behavior.³ This distinction is useless because so many federal exactions do both, like the 18th century “imposts” that raised revenues from imports and suppressed foreign competition with American industry.⁴ After 1937, the Court effectively abandoned judicially enforceable limits on the Commerce Clause, so it had no need to distinguish between regulations of interstate commerce and taxes. In 1995, however, the Supreme Court began to restrict the power of Congress to regulate under the Commerce Clause.⁵ Since its “new federalism” decisions, the Court has yet to reconsider the constitutional scope of the tax power.

Reconsideration is overdue. Courts, commentators, and litigants today are as perplexed as in 1953, when the Court wrote that “diverse decisions” in this “area of abstract ideas” show that the difference between a tax and a penalty “has baffled judges and legislators.”⁶ As a result, they currently disagree over whether the minimum coverage provision in the Patient Protection and Affordable Care Act (ACA) constitutes a tax or a regulation backed by a penalty.⁷ Judges and litigants have drawn selectively from the different eras of the Court’s tax power

² See, e.g., *Carter v. Carter Coal Co.*, 298 U.S. 238, 303–04 (1936) (invalidating the Bituminous Coal Conservation Act of 1935 because federal regulation of wages and hours concerned production, not commerce); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 546 (1935) (invalidating the Live Poultry Code for New York City, which regulated the sale of sick chickens and which included wages, hours, and child-labor provisions, based on an “indirect” relationship to interstate commerce); *United States v. E.C. Knight Co.*, 156 U.S. 1, 12–13 (1895) (holding that the Sherman Antitrust Act could not be used to thwart a monopoly in the sugar refining industry because the commerce power did not authorize Congress to regulate manufacturing, which was antecedent to commerce).

³ See *Bailey v. Drexel Furniture Co.*, 259 U.S. 20, 38 (1922) (Child Labor Tax Case).

⁴ For numerous examples in addition to the impost, see *infra* Part I.

⁵ See *United States v. Lopez*, 514 U.S. 549 (1995); *U.S. v. Morrison*, 529 U.S. 598 (2000).

⁶ *United States v. Kahriger*, 345 U.S. 22, 29 (1953).

⁷ Public L. No. 111-148, 124 Stat. 119 (2010); see Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029 (2010).

jurisprudence, and they have mostly disputed the relevance of the fact that Congress labeled the exaction on the uninsured a “penalty” and not a “tax.”⁸

Legal theory helps to answer constitutional questions when existing doctrine does not. For purposes of analysis, we distinguish between two pure types of exactions. A person who must pay a *pure penalty* is condemned for wrongdoing; she must pay more than the usual gain from the forbidden conduct; and she must pay at an increasing rate with intentional or repeated violations. Condemnation coerces expressively and relatively high rates with enhancements coerce materially. A pure penalty prevents behavior, thereby raising little revenue.

Alternatively, a person who must pay a pure tax is permitted to engage in the taxed conduct; she must pay less than the usual gain from the taxed conduct; and intentional or repeated conduct does not enhance the rate. Permission does not coerce expressively and relative low rates without enhancements do not coerce materially. A pure tax dampens conduct but does not prevent it, thereby raising revenues.

Situated between pure taxes and pure penalties are exactions whose expression sounds like a penalty and whose material characteristics look like a tax. Thus the ACA provides that individuals who do not maintain minimum health insurance must pay a “penalty.”⁹ The rate of the “penalty” is low enough that a significant number of people will pay it, and the rate does not increase with intentionality or recidivism. The ACA’s exaction for non-insurance has a penalty’s expression and a tax’s materiality.

Should courts interpret a mixed exaction as a tax or a regulation backed by a penalty? Our answer depends on the exaction’s effect. When interpreting an exaction under Article I, Section 8, whether under the commerce power or the tax power, an exaction with the effect of a

⁸ For a discussion, see *infra* Part IV.

⁹ 26 U.S.C. § 5000A(b).

tax should be considered a tax, regardless of what it is called. If Congress rationally concluded that an exaction will dampen behavior, then courts should interpret it as a tax.¹⁰ If Congress rationally concluded that an exaction will prevent behavior, then courts should interpret it as a penalty. If it is rational to believe that the ACA's exaction for non-insurance will dampen uninsured behavior and not prevent it, as the Congressional Budget Office predicts, then courts should construe it as a tax for purposes of Section 8.¹¹

This article develops a theory of the tax power for a Court that restricts the commerce power.¹² Part I, on history, recounts why supporters of the Constitution advocated a robust tax power and identifies the purposes of federal taxation throughout American history. Part II, on doctrine, distinguishes three eras in the Court's struggle to differentiate a tax from a penalty. These parts conclude that the modern Court needs a distinction between taxes and regulations backed by penalties, and that this distinction cannot turn on whether an exaction raises revenues or regulates behavior.¹³

Part III, on theory, distinguishes between a tax and a penalty by analyzing their expressive and material differences, and by using economics to predict the effect of these differences. Part IV, on health care, applies this analysis to the minimum coverage provision and

¹⁰ For a discussion of judicial deference in enumerated powers cases, see *infra* Part III.B.

¹¹ See *infra* note 176 and accompanying text (noting the CBO's prediction).

¹² We limit our analysis to the distinction between a tax and a penalty under Article I, Section 8. We do not analyze the distinction between taxes and fees under the Export Clause, U.S. CONST. art. 1, § 9, cl. 5, nor do we analyze the distinction in the constitutional context of intergovernmental tax immunity. Finally, we do not analyze the distinction between a tax and a penalty in various federal statutes, including the federal tax Anti-Injunction Act, 26 U.S.C. § 7421(a) (2006), the Tax Injunction Act, 28 U.S.C. § 1341, or the Bankruptcy Act, 11 U.S.C. §§ 101-112 (2006). These constitutional and statutory settings implicate context-specific legal questions that we cannot attempt to address here.

¹³ The relevant distinction is between taxes and regulations backed by penalties, not between taxes and regulations. To regulate conduct is to lay down a rule (or standard) governing the conduct. Regulations change behavior by various means, especially by imposing obligations backed by penalties. Like regulations backed by penalties, taxes change behavior. When a lawmaker wants to change behavior, a regulation backed by a penalty sometimes does a better job than a tax, and sometimes the opposite is true. In these circumstances, the difference between a regulation backed by a penalty and a tax is not the lawmaker's ends but the choice of means. Penalties and taxes have different characteristics, which change behavior by different means. This Article explains how taxes and penalties differ in characteristics and effects.

shared responsibility payment in the ACA.¹⁴ The Conclusion summarizes the argument and connects it to the theory of collective action federalism.¹⁵

I. HISTORY

Article I, Section 8 grants Congress the power to “lay and collect Taxes . . . to pay the Debts and provide for the common Defense and general Welfare of the United States.”¹⁶ Its original justifications and historical uses show that the constitutional difference between taxes and penalties cannot turn on the difference between raising revenues and regulating behavior.

A. *Pre-Ratification*

The Articles of Confederation created a form of government that often impeded the states from acting collectively to accomplish common objectives.¹⁷ The structure of governance established by the Articles posed two obstacles to collective action. First, the Articles authorized little federal power and imposed a unanimity requirement in order to amend them.¹⁸ Significant federal action thus required unanimous agreement among the states. A single “holdout” state legislature could defeat measures that were deemed critically important by most other states.

¹⁴ Although the unsettled constitutional distinction between a tax and a penalty under the tax power is implicated in the constitutional litigation over the minimum coverage provision and shared responsibility payment, the Court’s decision may not settle the matter. The Court will not reach the merits of the question if it decides that the federal tax Anti-Injunction Act, 26 U.S.C. § 7421(a) (2006), bars the present challenges to the minimum coverage provision. If the Court does reach the merits, it may uphold the constitutionality of the minimum coverage provision by relying on either the Commerce Clause or the Necessary and Proper Clause (or both), in which case it could decline to say anything about the constitutional scope of the tax power.

¹⁵ See Robert D. Cooter & Neil S. Siegel, *Collective Action Federalism: A General Theory of Article I, Section 8*, 63 STAN. L. REV. 115 (2010).

¹⁶ U.S. CONST. art. I, § 8, cl. 1.

¹⁷ See, e.g., JACK N. RAKOVE, ORIGINAL MEANINGS: POLITICS AND IDEAS IN THE MAKING OF THE CONSTITUTION 24–28, 47–48, 102–08, 167–68, 188–89 (1996) (discussing various failures of the Articles of Confederation). Almost all of the first thirty-six essays in *The Federalist* detail the inadequacies of the Articles.

¹⁸ See ARTICLES OF CONFEDERATION OF 1781, art. XIII.

A key instance of collective inaction was the repayment of the debts of the United States.¹⁹ During the 1780s, the United States needed to restore its credit by repaying its debts incurred during the Revolutionary War.²⁰ Without credit, the nation would be vulnerable militarily because it could not borrow from other nations to finance another war.²¹ To repay existing debts, a federal impost (a tax on imports) was proposed three times in Congress. These proposals were modest in their ambitions. “[T]he 1781 and 1783 proposals to give the national government the 5 percent impost would have limited use of the revenues collected to the payment of the debts of the Revolutionary War,”²² rather than creating a general federal power to tax. These modest proposals did not survive the unanimity requirement of the Articles. Each time a different state vetoed the measure.²³

Second, the Articles required Congress to ask the states to control individuals, rather than Congress’s doing so directly through federal law. Thus Congress could apportion taxes among the states, but levying and collection from individuals were left to state governments.²⁴ The Articles forced the federal government to finance itself by requisitioning the states. The amount per state was set “in proportion to the value of all land within each State.”²⁵ State governments,

¹⁹ See generally CALVIN H. JOHNSON, *RIGHTEOUS ANGER AT THE WICKED STATES: THE MEANING OF THE FOUNDERS’ CONSTITUTION* (2005) (arguing that the most pressing need at the time the Constitution was created was to allow the federal government to tax in order to pay off the Revolutionary War debts).

²⁰ See generally JOHNSON, *supra* note 19; W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA* 16 (2d ed. 2004) (“Among the most pressing [practical problems] were how to finance the Revolutionary War debts, and how to establish the credit of the nation in a way that would win respect in international financial markets.”).

²¹ AKHIL REED AMAR, *AMERICA’S CONSTITUTION: A BIOGRAPHY* 107 (2005) (“Without the ability first to borrow money from abroad when war threatened and then to pay back the loans on time . . . America would become a tempting target for European empires lusting after dominion.”); BROWNLEE, *supra* note 20, at 16–17 (“A central goal was to fund the foreign debts that the Confederation had inherited from the Revolutionary War, and to do so in a way that would win the confidence of the international financial markets to which the new nation would have to turn for capital.”).

²² JOHNSON, *supra* note 19, at 89.

²³ The 1781 impost proposals were vetoed first by Rhode Island and then by Virginia. The 1783 impost proposal was vetoed by New York. See *id.*

²⁴ ARTICLES OF CONFEDERATION OF 1781, art. VIII.

²⁵ *Id.*

however, defaulted on congressional requisitions, free riding on the contributions of other states to the United States treasury.²⁶ The predictable consequence was very little federal revenue.²⁷

For example, the “Requisition of 1786, the last before the Constitution, ‘mandated’ payments by the states . . . of \$3.8 million, but collected only \$663.”²⁸ The requisition scheme plagued Congress’s efforts to pay and equip troops for the national military.²⁹ The need to rely on the states denied Congress the resources it required to protect against external attack and internal violence, just as it had earlier caused the nation almost to lose the Revolutionary War.³⁰

In his *Vices of the Political System of the United States*,³¹ a memorandum he wrote while preparing for the Constitutional Convention,³² James Madison recorded various problems with the Articles of Confederation. These problems included the failure of states to comply with congressional requisitions, lack of concert despite common interests, lack of federal protection of the states against internal violence, and lack of coercive power.³³ Madison further decried the inability to pass various necessary measures, “wch. may at present be defeated by the perverseness of particular States whose concurrence is necessary.”³⁴ The states acted individually when they needed to act collectively. These collective action failures made the

²⁶ See generally ROGER H. BROWN, *REDEEMING THE REPUBLIC: FEDERALISTS, TAXATION, AND THE ORIGINS OF THE CONSTITUTION* (1993) (describing the failure of the requisition scheme).

²⁷ See, e.g., BROWNLEE, *supra* note 20, at 15 (“The Continental Congress depended on funds requisitioned from the states, which usually ignored calls for funds or responded very slowly. There was little improvement under the Articles of Confederation. States resisted requisitions and vetoed efforts to establish national tariffs.”).

²⁸ See JOHNSON, *supra* note 19, at 1.

²⁹ AMAR, *supra* note 21, at 45 (“Experience had proved that the individual states could not be trusted to provide their fair share of American soldiers and the money to pay for them . . .”). Under the Articles, Congress could only “requisition” the states for their “quota[s]” of men, which was based on their white populations. To pay for the men and their equipment, Congress had to rely on a quota system based on wealth. *Id.* at 114.

³⁰ *Id.* at 114–15 (“The requisition system failed miserably and came perilously close to handing victory to the British in the Revolutionary War. With inadequate mechanisms to enforce states’ obligations, many states held back, hoarding resources for local defense despite more urgent need for them elsewhere on the continent.”).

³¹ James Madison, *Vices of the Political System of the United States*, in JAMES MADISON: WRITINGS 69, 78–79 (Jack N. Rakove ed., 1999) [hereinafter *Vices Memo*].

³² See RAKOVE, *supra* note 17, at 46.

³³ Madison, *supra* note 31, at 69–73.

³⁴ *Id.*

Critical Period critical. Solving them was the principal reason for calling the Constitutional Convention.³⁵

The problems of collective action among the states during the 1780s “necessitated a government with many more powers than were possessed by Congress under the Articles—including the great powers to tax, to raise and support armies, and to regulate commerce.”³⁶ Ameliorating these problems also “necessitated conferring authority to exercise these powers by acting directly on individual citizens.”³⁷

The Philadelphia Convention produced, and the country ratified, what amounts to a Constitution of collective action in the text of Article I, Section 8.³⁸ Clause 2 gives Congress the power to “borrow Money on the credit of the United States,” which would be as essential in the next war as it had been in the previous one.³⁹ Clauses 3 through 6 give Congress the power to combat various impediments to the successful operation of interstate markets.⁴⁰ Clauses 10 through 16 give Congress the power to internalize the externalities associated with providing for the common defense, establishing a postal network, and securing intellectual property rights.⁴¹ And to solve what was probably the single most significant collective action failure during the

³⁵ See, e.g., BROWNLEE, *supra* note 20 (“The Constitution reflected the desire of James Madison, Alexander Hamilton, and its other leading supporters to provide the new central government with far greater capacity to tax than the old national government had enjoyed under the Articles of Confederation. The protracted political crisis of the 1780s convinced Madison and Hamilton that the new representative government must have the fiscal power required to create a strong and meaningful nation.”); Akhil Amar, *The Lawfulness of Health-Care Reform*, 121 YALE L.J. ONLINE (forthcoming 2012) (“A primary goal (indeed, perhaps the single most important and frequently expressed goal) of the Federalist Founders was to empower the federal government to impose taxes upon individuals to finance basic federal functions . . .”).

³⁶ Larry D. Kramer, *Madison’s Audience*, 112 HARV. L. REV. 611, 619 (1999). State discrimination against interstate commerce was yet another major collective action problem facing the states during the 1780s that Congress was impotent to address. Madison thus decried “want of concert in matters where common interest requires it,” a “defect . . . strongly illustrated in the state of our commercial affairs. How much has the national dignity, interest, and revenue suffered from this cause?” Madison, *supra* note 31, at 71.

³⁷ Kramer, *supra* note 36, at 619–20.

³⁸ See Cooter & Siegel, *supra* note 15, at 144–50 (analyzing the eighteen clauses of Article I, Section 8).

³⁹ See *supra* note 21 (quoting Akhil Amar).

⁴⁰ Cooter & Siegel, *supra* note 15, at 149–50.

⁴¹ *Id.* at 147–49.

Critical Period—the problem of financing the national government⁴²—Clause 1 empowers Congress to assess, levy, and collect taxes by bypassing the states and acting directly on individuals.⁴³

The Constitution does not limit the tax power of Congress to the repayment of debts, even though repaying the Revolutionary War debts was the immediate problem solved by the General Welfare Clause.⁴⁴ Instead, the Constitution also gives Congress the power to tax in order to “provide for the common Defense and general Welfare.”⁴⁵ Promoting the general welfare by taxes may involve regulatory ends such as dampening imports and stimulating domestic production.

B. *Post-Ratification*

Congress immediately enacted tariffs that raised revenues and changed behavior.⁴⁶ In the first two decades under the new Constitution, customs generated more than ten times the amount

⁴² See BROWNLEE, *supra* note 20, at 16 (“The fundamental structure of the federal tax system, as well as that of modern tax regimes, emerged from the formative emergency for the American federal government—the revolutionary crisis that extended through the formation of the U.S. Constitution.”).

⁴³ “The Framers adopted a complete national government able to collect taxes from individuals so as to avoid military action that would amount to civil war.” JOHNSON, *supra* note 19, at 88. The Supreme Court has recalled this history. See, e.g., *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533 (1869):

The general government, administered by the Congress of the Confederation, had been reduced to the verge of impotency by the necessity of relying for revenue upon requisitions on the states, and it was a leading object in the adoption of the Constitution to relieve the government to be organized under it from this necessity and confer upon it ample power to provide revenue by the taxation of persons and property. And nothing is clearer from the discussions in the Convention and the discussions which preceded final ratification by the necessary number of states than the purpose to give this power to Congress as to the taxation of everything except exports in its fullest extent.

Id. at 540.

⁴⁴ Rakove, *supra* note 17, at 180 (“But [the Framers] balked at limiting its revenue to that source alone. The only restriction placed on the discretion of the legislature was to prohibit it from laying duties on exports.”); JOHNSON, *supra* note 19, at 89 (“[T]he Constitution gives Congress the absolute power to tax.”).

⁴⁵ U.S. CONST. art. I, § 8, cl. 1.

⁴⁶ AMAR, *supra* note 21, at 94 (“The big money would likely flow—and after 1789 did in fact flow—from federal levies on imports”); Rakove, *supra* note 17, at 180 (“[T]he framers believed that its revenue needs

of federal revenue than did internal revenue.⁴⁷ In 1792, for instance, internal revenue was \$209,000 and customs produced \$3,443,000.⁴⁸ “And between 1789 and 1815, the tariff revenues accounted for about 90 percent of total federal tax revenues.”⁴⁹ The Founders understood that import duties would not only raise revenues, but would also change the behavior of those subject to them. Like raising revenues, stimulating domestic production of manufactured goods by reducing their importation was an important legislative purpose.

Thus Alexander Hamilton, in his December 1791 “Report on Manufactures” to Congress, proposed “tariffs to protect new industries and exemptions from tariffs for raw materials needed for industrial development.”⁵⁰ Hamilton’s defended such policies not only on revenue-raising grounds, but also on the regulatory ground that they would “encourage Americans to spend their money and energy to advance industrial technology.”⁵¹ As it turned out, Congress rejected most of Hamilton’s program for industrialization. But in March 1792, Congress enacted most of the tariff program he had recommended: higher tariffs on manufactured goods and lower tariffs on raw materials.⁵²

In the subsequent course of American history, taxes were used for the dual purposes of raising revenues and dampening behavior, as Joseph Story observed in his *Commentaries*.⁵³ For

would be met through a program of indirect taxation centering on import duties”); BROWNLEE, *supra* note 20, at 21 (“Tariffs, in fact, turned out to provide the core of federal finance.”).

⁴⁷ www2.census.gov/prod2/statcomp/documents/CT1970p2-12.pdf. Table Y 352-357 covers 1789-1939 and distinguishes between customs and internal revenue. *See* BROWNLEE, *supra* note 20, at 13–14 (“[T]he tax regime that followed the creation of the new constitutional order was based on customs duties; it lasted until the Civil War, making it the longest in American history.”). The Federalists made only limited use of excise taxes after the Whiskey Rebellion of 1794, limiting them almost entirely to goods and services used by affluent Americans, such as levies on carriages and snuff manufacturing, and stamp duties on legal transactions. *See* BROWNLEE, *supra* note 20, at 23–24.

⁴⁸ *Id.*

⁴⁹ BROWNLEE, *supra* note 20, at 23.

⁵⁰ *See, e.g., id.* at 22.

⁵¹ *Id.*

⁵² *Id.*

⁵³ “[T]he taxing power is often, very often, applied for other purposes than revenue.” JOSEPH STORY, 1 COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES § 965 (5th ed. 1905) (originally published in 1833).

example, Congress made a rare and temporary deviation from low tariffs in the antebellum period when it experimented with protectionism during the 1820s and 1830s. The rationale for high tariffs was not to raise additional revenues. The rationale, rather, “was industrialization—protecting America’s high-wage workers and high-cost industries as they learned how to meet their British competition.”⁵⁴ Likewise, the Civil War tax regime instituted by the Republican Party consisted principally of high tariffs, which sought to encourage “a national market in which wages and profits were high.”⁵⁵ The federal government had committed itself not merely to raising revenues, but to protecting capitalists and workers from foreign competition.

After the Civil War, in the late 1860s and 1870s, the Republican-controlled Congress maintained high excise taxes on alcohol, tobacco, and luxury items such as perfumes and cosmetics. The public supported this system of consumption taxes partly “because of its regulatory dimensions.”⁵⁶ It amounted to “a stunning victory for economic protectionism and, more generally, for government regulation through taxation. [T]he system established tax incentives, disincentives, and subsidies as important, popular, and permanent elements of the federal revenue structure.”⁵⁷

The leaders of American business “lauded the regulatory effects of the tariff system,” including protection from foreign competition and capital formation at home.⁵⁸ The financial community was attracted to “the way in which substantial taxes on consumption forced national savings and facilitated repayment of the wartime debt.”⁵⁹ Labor also supported high tariffs to stimulate the industries in which they worked and to protect them from low-wage labor in other

⁵⁴ *Id.* at 29.

⁵⁵ *Id.* at 245; *see id.* at 5, 31. This regime also imposed excise taxes on almost all consumer goods. *Id.* at 32.

⁵⁶ *Id.* at 40.

⁵⁷ *Id.*

⁵⁸ *Id.* at 41.

⁵⁹ *Id.*

parts of the world. “Labor support for the high-tariff position of the Republican Party had much to do with its smashing victory in the ‘critical election’ of 1896 and its strong electoral displays, which continued until the Great Depression.”⁶⁰

Progressives, mindful of the effects of past taxes on alcohol and tobacco, sought taxes to regulate individual and corporate conduct. After 1900, they used the federal tax power “to regulate grain and cotton futures, the production of white phosphorous matches, the consumption of narcotics, and even the employment of child labor.”⁶¹

The tax historian W. Elliot Brownlee argues that America shifted to new tax regimes in response to national crises.⁶² The eighteenth century saw the constitutional crisis of the critical period, which produced the plenary federal tax power. The nineteenth century saw the Civil War, which produced high tariffs that survived the war. The twentieth century saw three crises—World War I, the Great Depression, and World War II. In each case, the federal government responded by using the tax power to raise revenues and regulate behavior. By using the tax power for these two purposes, Congress solved collective action problems that would have impeded the states from acting on their own to fight wars and combat depressions.⁶³ Congress thereby vindicated Chief Justice Marshall’s declaration that “[t]his provision is made in a constitution, intended to endure for ages to come, and consequently, to be adapted to the various *crises* of human affairs.”⁶⁴

⁶⁰ *Id.* at 41–42.

⁶¹ *Id.* at 45 n. 26 (citing R. ALTON LEE, A HISTORY OF REGULATORY TAXATION (1973)).

⁶² *Id.* at 2.

⁶³ See generally Cooter & Siegel, *supra* note 15 (arguing that the principal purpose of the clauses of Article I, Section 8 is to authorize Congress to solve collective action problems involving multiple states).

⁶⁴ *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316, 415 (1819).

Threats to existence make people think about their reason for being.⁶⁵ What is the nation's purpose? Who are we as a people? American fiscal crises generated divisive debates over fundamental national values. The winners enforced their values partly by using the tax power to regulate behavior, not simply to raise revenues. In response to World War I, the government attempted to reduce social tensions over unequal wealth by imposing progressive taxes to finance the war. During this period, federal tax policy discouraged vast accumulations of wealth by taxing excess profits and incomes, and by taxing large estates.⁶⁶ The federal government responded to the Great Depression by assuming "greater responsibility to promote economic recovery through such fiscal mechanisms as cutting taxes, increasing expenditures, and expanding deficits."⁶⁷ The World War II regime defended "mass-based income taxation in terms of not only sacrifice for national survival but also progressive social justice."⁶⁸

After World War II, the combination of inflation and progressive taxation automatically increased tax revenues unless offset by lower tax rates. Rates were reduced piecemeal, for selected sources of income. Tax breaks benefited favored constituents and created less public resistance than government subsidies because they were hidden in the tax code instead of being exposed in the budget. Tax breaks allowed politicians to accomplish regulatory objectives—such as promoting homeownership through the mortgage-interest deduction—without subjecting themselves to the greater transparency of federal expenditures.⁶⁹

⁶⁵ National leaders "faced issues that went far beyond the financial problem of meeting demands to increase government spending." BROWNLEE, *supra* note 20, at 2. These crises involved either the survival of the nation or the meaning of the American ethos, "our fundamental nature as a people." Hanna Fenichel Pitkin, *The Idea of a Constitution*, 37 J. LEGAL. EDUC. 167, 167 (1987).

⁶⁶ BROWNLEE, *supra* note 20, at 58-71.

⁶⁷ *Id.* at 102.

⁶⁸ *Id.* at 245; *see id.* at 107-28.

⁶⁹ *Id.* at 129.

More recently, Presidents Ronald Reagan and George W. Bush justified significant tax cuts, including on the wealthiest Americans, as enhancing economic productivity.⁷⁰ These Presidents echoed the rhetoric and actions of Republicans during the 1920s, when they used control of the federal government to cut taxes and open loopholes for corporations and wealthy individuals.⁷¹ Republicans justified these reductions, exemptions, and deductions as “necessary to stimulate economic expansion and restore prosperity.”⁷² Likewise, Democrats have created tax loopholes for their favored constituents.

While the two major political parties often disagree about the regulatory objectives that federal tax policy should pursue, they agree that federal tax policy aims to accomplish regulatory objectives in addition to raising revenues. Brownlee concludes a history of federal taxation in the United States by observing that “[h]istorically, the introduction of new tax regimes that enhance confidence in American government has required,” among other things, “regulation of behavior in ways that were widely regarded as improving the national well-being.”⁷³

The constitutional text and political history suggest that Congress possesses ample power to alter individual behavior by using taxes much like it uses various kinds of regulations. Accordingly, a viable distinction between taxes and regulations backed by penalties cannot turn on whether an exaction has a regulatory purpose or effect. Text and history, however, offer only limited guidance; they do not identify limits on the regulatory ends that Congress may pursue by the means of taxes. Article I, Section 8 uses the language of both taxation and regulation, and it does not use them interchangeably, which suggests that they are not entirely synonymous. The next Part reviews the Supreme Court’s attempts to distinguish them.

⁷⁰ *Id.* at 147–243.

⁷¹ *Id.* at 71–81.

⁷² *Id.* at 74.

⁷³ *Id.* at 245.

II. DOCTRINE

At various times throughout American history, the Supreme Court has addressed the constitutional definition of “Taxes” in the first clause of Article I, Section 8. Roughly speaking, the Court’s decisions divide into three eras. Although a number of these rulings are flawed and inconsistent with one another, collectively they point towards a promising theory of the constitutional differences between taxes and regulations backed by penalties.

A. *Three Eras*

The Introduction distinguished between exactions that prevent behavior and exactions that both dampen it and raise revenue. Before the 1920s, the Court deferred to Congress and did not make such distinctions. Thus in *Veazie Bank v. Fenno*, the Court upheld a federal law that increased a tax on state bank notes from one percent to ten percent, even though the tax seemed likely to eliminate the state notes, thereby raising little or no revenue.⁷⁴ In response to the charge that the tax was “so excessive as to indicate a purpose on the part of Congress to destroy the franchise of the bank,” the Court responded in part that courts “cannot prescribe to the legislative departments of the government limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected.”⁷⁵

Similarly, in *McCrary v. United States*,⁷⁶ the Court upheld a federal law that increased the excise tax from two cents to ten cents on oleomargarine that was colored yellow to make it look like butter. (The tax on uncolored oleomargarine, which is white, remained one-quarter of a cent per pound.) The Court rejected the argument that the exaction was a penalty that would

⁷⁴ 75 U.S. (8 Wall.) 533 (1869).

⁷⁵ *Id.* at 548.

⁷⁶ 195 U.S. 27 (1904).

achieve the regulatory objective of preventing the production of yellow oleomargarine. Because “the taxing power conferred by the Constitution knows no limits except those expressly stated in that instrument, it must follow, if a tax be within the lawful power, the exertion of that power may not be judicially restrained because of the results to arise from its exercise.”⁷⁷ The Court was unconcerned that the exaction would raise negligible revenue.

Likewise, in *United States v. Doremus*,⁷⁸ the Court upheld the Narcotic Drug Act of 1914, which both assessed individuals who dealt in narcotics and regulated their sale. The exaction was only \$1 per year, and Congress attached a detailed enforcement regime to it. Even though the exaction could not significantly change behavior or raise revenue, the Court wrote that “[i]f the legislation enacted has some reasonable relation” to the “raising of revenue, it cannot be invalidated because of the supposed [regulatory] motives which induced it.”⁷⁹

The doctrine changed in the 1920s and 1930s, when the Court was imposing significant limits on the scope of Congress’s power to regulate interstate commerce. In *Hammer v. Dagenhart*, the Court held that Congress may not use its commerce power to prohibit the shipment in interstate commerce of goods produced by child labor.⁸⁰ Congress responded with the Child Labor Tax Law, which provided that individuals employing child labor “shall pay for each taxable year, in addition to all other taxes imposed by law, an excise tax equivalent to 10 per centum of the entire net profits received or accrued for such year from the sale or disposition of the product of such mine, quarry, mill, cannery, workshop, factory, or manufacturing establishment.”⁸¹ The law further authorized a federal inspection regime, interference with

⁷⁷ *Id.* at 59. *See id.* at 56 (rejecting “the proposition that where there is a lawful power to impose a tax its imposition may be treated as without the power because of the destructive effect of the exertion of the authority”).

⁷⁸ 249 U.S. 86 (1919).

⁷⁹ *Id.* at 93–94.

⁸⁰ 247 U.S. 251 (1918).

⁸¹ *Bailey v. Drexel Furniture Co.*, 259 U.S. 20, 35 (1922).

which was made subject to fine or imprisonment.⁸² The law exempted employers from liability for the exaction in cases of “a child employed or permitted to work under a mistake of fact as to the age of such child and without intention to evade the tax.”⁸³

In the *Child Labor Tax Case*,⁸⁴ the Justices invalidated the law.⁸⁵ Writing for the Court, Chief Justice Taft distinguished exactions that the Constitution authorizes under the tax power from penalties, which the tax power does not authorize. He stated that taxes have “only that incidental restraint and regulation which a tax must inevitably involve.”⁸⁶ “Taxes,” he elaborated, “are occasionally imposed in the discretion of the Legislature on proper subjects with the primary motive of obtaining revenue from them and with the incidental motive of discouraging them by making their continuance onerous.”⁸⁷ On this view, “[t]hey do not lose their character as taxes because of the incidental motive.”⁸⁸ He insisted, however, that “there comes a time” when an exaction amounts to a penalty.⁸⁹ That time comes when, “in the extension of the penalizing features of the so-called tax . . . it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.”⁹⁰

Turning to the child labor statute, Chief Justice Taft concluded that it “regulate[s] by use of the so-called tax as a penalty” because it “provides for a heavy exaction for a departure from a

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Bailey v. Drexel Furniture Co.*, 259 U.S. 20 (1922).

⁸⁵ *Id.* at 37 (“[A] court must be blind not to see that the so-called tax is imposed to stop the employment of children within the age limits prescribed. Its prohibitory and regulatory effect and purpose are palpable. All others can see and understand this. How can we properly shut our minds to it?”); *id.* at 39 (“The case before us cannot be distinguished from that of *Hammer v. Dagenhart*.” (citation omitted)).

⁸⁶ *Id.* at 36.

⁸⁷ *Id.* at 38.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.* *Accord* *United States v. Butler*, 297 U.S. 1, 61 (1936) (“A tax, in the general understanding of the term, and as used in the Constitution, signifies an exaction for the support of the government. The word has never been thought to connote the expropriation of money from one group for the benefit of another.”); *id.* (The exaction cannot be wrested out of its setting, denominated an excise for raising revenue and legalized by ignoring its purpose as a mere instrumentality for bringing about a desired end. To do so would be to shut our eyes to what all others than we can see and understand.” (citing *Child Labor Tax Case*, 259 U.S. at 37)).

detailed and specified course of conduct in business,” and because “[s]cienters are associated with penalties, not with taxes.”⁹¹ The Chief Justice noted that the statute does not explicitly prohibit child labor, but “it does exhibit its intent practically to achieve [this] result by adopting the criteria of wrongdoing and imposing its principal consequence on those who transgress its standard.”⁹² The Chief Justice feared that recognizing such a penalty as a tax for constitutional purposes would end judicially enforceable limits on Congress’s enumerated powers.⁹³ The exaction had the expressive characteristics of a tax and the material characteristics of a penalty. Moreover, the exaction likely would have the effect of a penalty. The Court struck it down because materiality dominated expression in its interpretation of the Constitution.⁹⁴

Other decisions from this era similarly distinguished regulatory exactions, which the Court deemed to be penalties, from revenue-raising exactions, which the Court regarded as taxes. In *Hill v. Wallace*, decided immediately after the *Child Labor Tax Case*, the Court invalidated a federal exaction on sales of grain for future delivery (grain future contracts).⁹⁵ The “tax” was 20 cents a bushel, which would be imposed unless the contracts were made by or through a member

⁹¹ *Id.* at 37.

⁹² *Id.* at 38.

⁹³ The Court wrote that if the exaction at issue was a tax, then Congress could regulate all private behavior:

Grant the validity of this law, and all that Congress would need to do, hereafter, in seeking to take over to its control any one of the great number of subjects of public interest, jurisdiction of which the states have never parted with, and which are reserved to them by the Tenth Amendment, would be to enact a detailed measure of complete regulation of the subject and enforce it by a so-called tax upon departures from it. To give such magic to the word “tax” would be to break down all constitutional limitation of the powers of Congress and completely wipe out the sovereignty of the states.

Id. at 38.

⁹⁴ *Id.* at 39 (“Congress in the name of a tax which on the face of the act is a penalty seeks to do the same thing, and the effort must be equally futile.”); (“[T]he so-called tax is a penalty to coerce people of a state to act as Congress wishes them to act in respect of a matter completely the business of the state government under the federal Constitution.”).

⁹⁵ 259 U.S. 44 (1922).

of a board of trade recognized by the U.S. Department of Agriculture.⁹⁶ This exaction supplemented the existing federal tax of 2 cents on every hundred dollars in value of such sales.⁹⁷ The Court viewed this “most burdensome” exaction as a penalty and not a tax because its “manifest purpose” was “to compel boards of trade to comply with regulations, many of which have no relevancy to the collection of the tax at all.”⁹⁸ According to the Court, “[t]he act is in essence and on its face a complete regulation of boards of trade, with a penalty of 20 cents a bushel on all ‘futures’ to coerce boards of trade and their members into compliance.”⁹⁹

In *United States v. Constantine*, the Court invalidated a federal exaction on liquor dealers who had violated state liquor laws.¹⁰⁰ In addition to the \$25 excise tax that federal law already imposed on retail liquor dealers, the challenged provision imposed a “special excise tax” of \$1,000 on liquor dealers in business contrary to local law.¹⁰¹ “If in reality a penalty,” the Court wrote, “it cannot be converted into a tax by so naming it, and we must ascribe to it the character disclosed by its purpose and operation, regardless of name.”¹⁰² The Court ignored “the designation of the exaction,” instead “viewing its substance and application.”¹⁰³ Because the exaction was “highly exorbitant” relative to other federal taxes on liquor dealers, and because its imposition was conditioned on “the commission of a crime,” the Court held that it “exhibits . . .

⁹⁶ *Id.* at 63. The other exception to imposition of the tax was “where the seller holds and owns the grain at the time of sale, or is the owner or renter of land on which the grain is to be grown, or is an association made of such owners or renters.” *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.* at 66.

⁹⁹ *Id.* at 66. “When this purpose is declared in the title to the bill, and is so clear from the effect of the provisions of the bill itself, it leaves no ground upon which the provisions we have been considering can be sustained as a valid exercise of the taxing power.” *Id.* at 66–67.

¹⁰⁰ 296 U.S. 287 (1935).

¹⁰¹ *Id.* at 288–89.

¹⁰² *Id.* at 294. *Accord* *United States v. La Franca*, 282 U.S. 568, 572 (1931) (“A tax is an enforced contribution to provide for the support of government; a penalty . . . is an exaction imposed by statute as punishment for an unlawful act. The two words are not interchangeable, one for the other.”).

¹⁰³ *Id.*

an intent to prohibit and to punish violations of state law [and thus to] remove all semblance of a revenue act, and stamp the sum it exacts as a penalty.”¹⁰⁴

After the constitutional crisis of 1937,¹⁰⁵ the Court did not formally overrule the *Child Labor Tax Case* and related decisions. The same is true of other pre-1937 precedents that have long since been abandoned, including *Lochner v. New York*.¹⁰⁶ Courts, commentators, and litigants presently disagree about whether the Court’s tax power decisions from the 1920s and 1930s remain good law.¹⁰⁷ They agree, however, that the Court sustained federal laws when interpreting the scope of the tax power in the decades after 1937. Thus in *Sonzinsky v. United States*, the Court upheld as within the scope of the tax power a \$200 annual license tax on firearms dealers.¹⁰⁸ The Court appeared to rest on the ground that exactions with regulatory effects are still taxes if they appear, both expressively and materially, to have been imposed pursuant to the tax power. As to expression, the Court wrote:

¹⁰⁴ *Id.* at 295. Justice Cardozo, joined by Justices Brandeis and Stone, dissented. “Not repression,” Justice Cardozo stressed, “but payment commensurate with the gains is . . . the animating motive.” *Id.* at 297 (Cardozo, J., dissenting).

¹⁰⁵ See, e.g., ALEXANDER M. BICKEL, *THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS* 45 (1962) (“Serving this value [of *laissez faire*] in the most uncompromising fashion, at a time when it was well past its heyday, five Justices, in a series of spectacular cases in the 1920’s and 1930’s, went to unprecedented lengths to thwart the majority will. The consequence was very nearly the end of the story.”). For a recent account of the political fight over President Franklin Delano Roosevelt’s “court-packing” plan, see generally JEFF SHESOL, *SUPREME POWER: FRANKLIN ROOSEVELT VS. THE SUPREME COURT* (2010); see also BARRY FRIEDMAN, *THE WILL OF THE PEOPLE: HOW PUBLIC OPINION HAS INFLUENCED THE SUPREME COURT AND SHAPED THE MEANING OF THE CONSTITUTION* 3–8, 202, 214, 217–36 (2009).

¹⁰⁶ Compare, e.g., *Lochner v. New York*, 198 U.S. 45 (1905), with *West Coast Hotel Co. v. Parish*, 300 U.S. 379, 391 (1937) (“What is this freedom of contract? The Constitution does not speak of freedom of contract.”). See Richard A. Primus, *Canon, Anti-Canon, and Judicial Dissent*, 48 *DUKE L.J.* 243, 244 (1998) (“*Lochner* is never cited for its legal authority. Although it has never been formally overruled, it is well understood among constitutional lawyers that relying on *Lochner* would be a pointless, if not a self-destructive, endeavor.”).

¹⁰⁷ Compare, e.g., *Thomas More Law Ctr. v. Obama*, --- F.3d ---, 2011 WL 2556039, at *33 (6th Cir.) (Sutton, J., concurring in part and delivering the opinion of the court in part) (“The taxing-power cases, it is true, are old. Yet cases of a certain age are just as likely to rest on venerable principles as stale ones, particularly when there is a good explanation for their vintage.”), with, e.g., Brian Galle, *Conditional Taxation and the Constitutionality of Health Care Reform*, 120 *YALE L.J. ONLINE* 27, 28 (2010), <http://yalelawjournal.org/2010/5/31/galle.html> (“[T]he best reading [of existing doctrine] is that courts will not impose any substantive limits on the uses to which Congress may put its taxing authority. Any confusion results from the Court’s failure to formally overrule outdated precedents that once suggested otherwise.”).

¹⁰⁸ 300 U.S. 506 (1937).

Every tax is in some measure regulatory. To some extent it interposes an economic impediment to the activity taxed as compared with others not taxed. But a tax is not any the less a tax because it has a regulatory effect, and it has long been established that an Act of Congress which on its face purports to be an exercise of the taxing power is not any the less so because the tax is burdensome or tends to restrict or suppress the thing taxed.¹⁰⁹

The Court declared that “[i]nquiry into the hidden motives which may move Congress to exercise a power constitutionally conferred upon it is beyond the competency of courts.”¹¹⁰ As to materiality, it was enough for the Court that the tax “is productive of some revenue” and “operates as a tax.”¹¹¹

The Court deferred further in *United States v. Sanchez*.¹¹² The case involved a constitutional challenge to the Marihuana Tax Act, which imposed a tax of \$100 per ounce on transferors of marijuana who make transfers to unregistered transferees without the order form required by federal law and without payment by the transferees of the tax.¹¹³ Although it was “obvious” that the law “impos[ed] a severe burden on transfers to unregistered persons,”¹¹⁴ the Court declared that an exaction is a tax even if it prevents the conduct and raises little or no revenue. “It is beyond serious question,” wrote the Court, “that a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed.”¹¹⁵ Moreover, “the principle applies even though the revenue obtained is obviously negligible, or the revenue purpose of the tax may be secondary.”¹¹⁶ The Court also deemed it significant that the

¹⁰⁹ *Id.* at 513.

¹¹⁰ *Id.* at 513–14,

¹¹¹ *Id.* at 514.

¹¹² 340 U.S. 42 (1950).

¹¹³ *Id.* at 43–44.

¹¹⁴ *Id.* at 43–44.

¹¹⁵ *Id.* at 44.

¹¹⁶ *Id.*; *see id.* (“Nor does a tax statute necessarily fall because it touches on activities which Congress might not otherwise regulate.”). It was settled long ago that the power of Congress to regulate conduct through taxation (or conditional expenditures) under the General Welfare Clause is not limited to regulation that is otherwise permissible under another enumerated power. *See License Tax Cases*, 72 U.S. (5 Wall.) 462, 470–71 (1867) (upholding under the tax power a federal law requiring the purchase of a license before engaging in certain businesses, including intrastate businesses, even though “Congress has no power of regulation nor any direct

tax was “not conditioned upon the commission of a crime.”¹¹⁷ The Court thus rejected the claim that Congress had “levied a penalty, not a tax.”¹¹⁸

Since *Sanchez*, the Court has repeatedly refused to invalidate exactions on the ground that Congress was using the taxing power to regulate conduct. In *United States v. Kahriger*, the Court upheld a federal law imposing a wagering tax of \$50 per year on bookmakers, requiring them to register with the Collector of Internal Revenue, and penalizing the failure to pay the tax and register.¹¹⁹ The Court stated that “[u]nless there are provisions extraneous to any tax need, courts are without authority to limit the exercise of the taxing power.”¹²⁰ At the same time, the Court stressed that the exaction being challenged “produces revenue.”¹²¹

More recently, in *Montana Department of Revenue v. Kurth Ranch*,¹²² the Court distinguished a permissible tax from an impermissible punishment in the context of the Double Jeopardy Clause.¹²³ The Court has long held that the Constitution bans successive punishments for the same offense.¹²⁴ The state of Montana sought to impose a “tax” on top of an already imposed criminal penalty for illegal possession of a drug. Was this “tax” really a second penalty? In *Kurth Ranch*, the Court invalidated the exaction partly because of its “high rate” and “obvious deterrent purpose,” which “lend support to the characterization of the drug tax as

control” over “the internal commerce or domestic trade of the States”); *United States v. Butler*, 297 U.S. 1 (1936); *United States v. Sanchez*, 340 U.S. 42, 44 (1950) (“Nor does a tax statute necessarily fail because it touches on activities which Congress might not otherwise regulate.”). This principle is not being challenged in the constitutional litigation over the Affordable Care Act. *See infra* Part IV.

¹¹⁷ *Id.* at 45.

¹¹⁸ *Id.* at 43.

¹¹⁹ 345 U.S. 22 (1953) (*overruled on other grounds by Marchetti v. United States*, 390 U.S. 39, 41–42 (1968)).

¹²⁰ 345 U.S. at 31. *See id.* at 28 (“It is conceded that a federal excise tax does not cease to be valid merely because it discourages or deters the activities taxed. Nor is the tax invalid because the revenue obtained is negligible.”).

¹²¹ *Id.* at 28. In *Bob Jones University v. Simon*, the Court acknowledged its abandonment of the pre-1937 jurisprudence, which sought to distinguish between “regulatory and revenue-raising taxes.” 416 U.S. 725, 741 n.12 (1974).

¹²² 511 U.S. 767 (1994).

¹²³ *See* U.S. CONST. amend. V.

¹²⁴ *See, e.g., Kurth Ranch*, 511 U.S. at 769.

punishment,” but which, “in and of themselves, do not necessarily render the tax punitive.”¹²⁵ In addition, the Court stressed that “this so-called tax is conditioned on the commission of a crime,” a condition that is ““significant of penal and prohibitory intent, rather than the gathering of revenue.””¹²⁶

In reaching its conclusion, the Court invoked the *Child Labor Tax Case* and stated that “there comes a time in the extension of the penalizing features of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.”¹²⁷ At the same time, the Court seemed to distance itself from the pre-1937 Court’s distinction between regulatory and revenue-raising taxes. The Court distinguished exactions imposed on illegal activities both from “taxes with a pure revenue-raising purpose that are imposed *despite* their adverse effect on the taxed activity,” and from “mixed-motive taxes that governments impose both to deter a disfavored activity and to raise money.”¹²⁸ The Court thus

¹²⁵ *Id.* at 780, 781.

¹²⁶ *Id.* at 781 (quoting *United States v. Constantine*, 296 U.S. 287, 295 (1935)). The Court also deemed it significant that the exaction “is exacted only after the taxpayer has been arrested for the precise conduct that gives rise to the tax obligation in the first place,” *id.*, and that the exaction “is levied on goods that the taxpayer neither owns nor possesses when the tax is imposed,” *id.* at 783.

¹²⁷ *Id.* at 779 (citing the Court’s invocation of the *Child Labor Tax Case* in *A. Magnano Co. v. Hamilton*, 292 U.S. 40, 44 (1934)).

¹²⁸ *Id.* at 782. The Court discussed a cigarette tax to make its point:

By imposing cigarette taxes, for example, a government wants to discourage smoking. But because the product’s benefits—such as creating employment, satisfying consumer demand, and providing tax revenues—are regarded as outweighing the harm, that government will allow the manufacture, sale, and use of cigarettes as long as the manufacturers, sellers, and smokers pay high taxes that reduce consumption and increase government revenue. These justifications vanish when the taxed activity is completely forbidden, for the legitimate revenue-raising purpose that might support such a tax could be equally well served by increasing the fine imposed upon conviction.

Id. This example makes clear that the Court used the term “deter” referenced in the text as a synonym for “discourage,” not as a synonym for “prevent.”

acknowledged that taxes can raise revenues and also regulate behavior by dampening the conduct subject to the tax.¹²⁹

B. *Three Insights*

The Court insisted during the 1920s and 1930s that some exactions enacted by Congress may not qualify as “Taxes” under the General Welfare Clause. The dramatic expansion in the scope of the commerce power after 1937, however, reduced the importance of the constitutional distinction between a tax and a penalty under the General Welfare Clause.¹³⁰ Limits on the Commerce Clause imposed by the Court in 1995 and again in 2000 renewed the significance of this constitutional distinction.¹³¹ Federalism doctrine now requires a distinction between taxing and penalizing that it lacks.

In *United States v. Lopez*,¹³² the Court held that the Commerce Clause does not authorize Congress to criminalize possession of firearms in a school zone. Imagine that Congress subsequently imposed a “tax” of \$25,000, enforced by the Internal Revenue Service through Title 26 of the United States Code, on individuals who knowingly possess firearms in school zones, with the exaction increasing by \$25,000 for each repetition of the act. It is very unlikely that the Court would uphold such an exaction as a permissible use of the tax power and allow Congress to undermine *Lopez* so easily.

¹²⁹ Elsewhere in the majority opinion, however, the Court may have overlooked the fact that taxes often have the regulatory purpose and effect of dampening behavior in addition to the non-regulatory purpose and effect of raising revenues. *See id.* at 779–80 (“Whereas fines, penalties, and forfeitures are readily characterized as sanctions, taxes are typically different because they are usually motivated by revenue-raising, rather than punitive, purposes.”).

¹³⁰ *See* LAURENCE H. TRIBE, 1 AMERICAN CONSTITUTIONAL LAW 846 (3rd ed. 2000).

¹³¹ *See* *United States v. Lopez*, 514 U.S. 549 (1995); *U.S. v. Morrison*, 529 U.S. 598 (2000).

¹³² 514 U.S. 549 (1995) (holding that a federal ban on firearm possession in a school zone was beyond the scope of the Commerce Clause).

How should the Court distinguish taxes from regulations backed by penalties? The first clause of Article I, Section 8 explicitly gives Congress the power to tax in order to raise revenues and pay debts. The first clause also gives Congress the power to tax to promote the general welfare. Taxes can promote the general welfare by dampening excessive activities. As documented in Part I, many federal exactions throughout U.S. history have raised revenues and dampened activities perceived as excessive, without one being primary and the other secondary. Because commonplace taxes serve both purposes, the Court has had to draw back from its past attempt to distinguish a tax from a regulation based on whether an exaction raises revenue or regulates behavior, or primarily does one and secondarily does the other.

The Court's cases provide three insights into distinguishing taxes and regulations backed by penalties. First, some past decisions suggest that the difference between taxing and penalizing relates to coercion and revenue raising. The Court has, at times, appreciated that taxes are characteristically less coercive than penalties. So, for example, the Court during the 1920s and 1930s stressed the sheer magnitude of certain exactions and the scienter requirements attached to them.¹³³ The post-1937 Court, in cases like *Sonzinsky* and *Kahriger*, often observed that the federal exactions it was upholding would produce revenue.¹³⁴

Second, post-1937 decisions understand that the difference between taxing and penalizing does not depend on whether an exaction raises revenue or regulates behavior. Third, other past decisions (though not all) follow the basic principle of interpretation in tax law that

¹³³ See, e.g., *Bailey*, 259 U.S. at 36 (“If an employer departs from this prescribed course of business, he is to pay to the government one-tenth of his entire net income in the business for a full year. The amount is not to be proportioned in any degree to the extent or frequency of the departures, but is to be paid by the employer in full measure whether he employs 500 children for a year, or employs only one for a day.”); cf. *Kurth Ranch*, 511 U.S. at 780 (“A significant part of the assessment was more than eight times the drug’s market value—a remarkably high tax.”).

¹³⁴ See *supra* notes 108-111 & 119-121 and accompanying text (discussing these cases).

substance dominates form.¹³⁵ On this view, an exaction’s material characteristics matter more than its expressive characteristics in constitutional review of federal statutes¹³⁶ and state laws,¹³⁷ and in federal statutory interpretation.¹³⁸ These three insights emerge from the cases even though many of them contradict each another, and none is entirely correct in its rationale.

The next Part draws from these judicial decisions and improves the Court’s tax power doctrine. Because the Court now imposes some restrictions on the Commerce Clause, it is unlikely to defer completely to Congress concerning the difference between taxes and regulations backed by penalties, as it did in the decades following the crisis of 1937. The Court requires a viable theory of the tax power, one that is consistent with its limits on the commerce power. Such a theory cannot result from a doctrinal synthesis, as the inconsistencies in the cases

¹³⁵ See, e.g., *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978).

¹³⁶ In addition to decisions like the one in the *Child Labor Tax Case*, the Court in the *License Tax Cases*, 72 U.S. (5 Wall.) 462 (1866), upheld under the tax power a federal law providing “that no persons should be engaged in certain trades or businesses, including those of selling lottery tickets and retail dealing in liquors, until they should have obtained a ‘license’ from the United States,” which “license” was later relabeled a “special tax” by Congress, on the ground that “[t]he granting of a license . . . must be regarded as nothing more than a mere form of imposing a tax” (footnote omitted). *Id.* at 471. The Court praised Congress for substituting the term “special tax” for “license.” Such “judicious legislation,” the Court wrote, “removed all future possibility of error” and “guarded against any misconstruction of the legislative intention.” *Id.* at 473. But the Court did not rest its holding on the substitution or intimate that the exaction would not have qualified as a tax if Congress has stuck with the word “license.” See *Seven-Sky v. Holder*, --- F.3d ---, 2011 WL 5378319, at *54 n.36 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits) (“[T]he fact that an exaction is not labeled a tax does not vitiate Congress’s power under the Taxing Clause.” (citing *License Tax Cases*, 72 U.S. at 471)).

Similarly, some federal laws refer to exactions on illegal acts as “taxes,” which is misleading because the conduct is illegal. But the Court judges the material characteristics of these exactions without concern for whether they are called legal or illegal. See, e.g., *Montana Dept. of Revenue v. Kurth Ranch*, 511 U.S. 767, 778 (1994) (“As a general matter, the unlawfulness of an activity does not prevent its taxation.” (citing *Marchetti v. United States*, 390 U.S. 39, 44 (1968), *United States v. Constantine*, 296 U.S. 287, 293 (1935), and *James v. United States*, 366 U.S. 213 (1961)).

¹³⁷ See, e.g., *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 363 (1941) (“In passing on the constitutionality of a tax law ‘we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it.’” (quoting *Lawrence v. State Tax Comm’n*, 286 U.S. 276, 280 (1932), and citing *Southern Pacific Co. v. Gallagher*, 306 U.S. 167, 177 (1939), and *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435 (1940))). *Lawrence*, in turn, cited a series of earlier decisions for the same proposition. See *Lawrence*, 286 U.S. at 280 (citing *Educational Films Corp. v. Ward*, 282 U.S. 379, 387 (1931), *Pacific Co. v. Johnson*, 285 U.S. 480 (1932), and *Shaffer v. Carter*, 252 U.S. 37, 54–55 (1920)). These cases involved a variety of constitutional challenges, most notably dormant commerce and due process objections to state exactions. In all of them, the Court stressed the substance of the exaction over its form.

¹³⁸ See, e.g., *United States v. Reorganized CF & I Fabricators*, 518 U.S. 213, 220 (1996) (holding in the bankruptcy context that the determination of whether an exaction is a tax requires courts to “look[] behind the label placed on the exaction and rest its answer directly on the operation of the provision”).

across historical eras preclude this possibility. Nor, however, can a theory of the tax power ignore the cases. The task, rather, is to distinguish between a tax and a penalty for purposes of Section 8 by drawing on the Court’s past decisions while avoiding analytical errors.

III. THEORY

A. *Taxes and Penalties: Pure and Mixed*

Regulations backed by penalties and taxes often have distinct characteristics.¹³⁹ The language of an exaction expresses a value judgment about the underlying conduct. The language of penalties usually condemns by using words such as “wrong,” “penalty,” “punishment,” or “ought not to.” Examples include most criminal fines, some regulatory fines, and punitive damages in civil cases.

Besides expression, an exaction’s material characteristics include its magnitude and conditions. A penalty is usually high relative to the gain from forbidden conduct for almost everyone, so self-interest deters wrongdoing. The penalty that deters rational people may not be enough to deter irrational or unusual people. To deter them, a penalty’s magnitude often increases for intentional or repeated wrongdoing. Intentionality or recidivism triggers an enhancement. Thus an unintentional tort may trigger liability for actual harm, whereas doing the same act intentionally may trigger punitive damages. Similarly, a second criminal offense often triggers a more severe punishment than the first.

Compared to a penalty, a tax usually has the opposite characteristics. The language describing the taxed conduct does not forbid or condemn it. Rather, the tax is described in the language of choice, such as “permitted,” “allowed,” or “neither required nor forbidden.” The

¹³⁹ Theories in social science often invoke “ideal types,” “stylized facts,” or simplified models. *See, e.g.*, Max Weber, *On the Theory of Ideal Types*, in *THE METHODOLOGY OF THE SOCIAL SCIENCES* 91–112 (Henry A. Finch ed. 1949).

language explicitly permits the taxed conduct as long as one pays the tax, or people infer permission from the absence of a prohibition. The income tax does not condemn earning income, and a tax on industrial pollution does not condemn industrial activity. Other examples of taxes on permitted activities include tariffs, excises, head taxes, and property taxes.¹⁴⁰

Unlike a penalty, a tax is usually low relative to the gain from the taxed conduct for many people. Furthermore, the tax rate does not increase for intentional or repeated conduct. Earning income intentionally does not affect the income tax rate, and the income tax rate does not change just because someone earns income year after year.¹⁴¹

Table 1 summarizes the usual characteristics of penalties and taxes.

Table 1: Characteristics of Exactions

	Expression	Material Characteristics	
		Rate	Intentionality, Repetition
Penalty	Condemns	relatively high	Enhancements
Tax	Permits	relatively low	no enhancements

Whether from conscience or self-interest, these characteristics affect behavior predictably. A penalty prevents almost everyone from engaging in the forbidden conduct. Almost everyone obeys most criminal and regulatory laws most of the time. A tax causes many people (but not everyone) to engage in the taxed conduct at a reduced rate. A tax dampens conduct without preventing it. The income tax does not prevent many people from earning income, although it

¹⁴⁰ Sometimes exactions that are expressively and materially equivalent to taxes are not called taxes. For example, “user fees” are taxes because they signal permission and they do not prevent the conduct in question.

¹⁴¹ It is theoretically possible for a tax to increase the assessed conduct, as when individuals work more as a result of the tax’s imposition because they need the money. This scenario is analogous to very unusual goods whose demand increases when the price rises (“Giffin good”). For our purposes, such an exaction is a tax, not a penalty, because it does not prevent the assessed conduct.

may cause some to earn less, and a tariff does not prevent many people from importing goods, although it may cause them to import less.

Pure penalty is our phrase for an exaction with all of the usual characteristics and effects of a penalty. A pure penalty condemns the assessed conduct, exacts a high cost relative to the gain from the forbidden conduct for almost everyone, and enhances the rate for intentional or repeated violations. These characteristics prevent the conduct. *Pure tax* is our phrase for an exaction with all of the usual characteristics and effects of a tax. A pure tax permits the assessed conduct, exacts a low cost relative to the gain from the assessed conduct for many people, and does not enhance the rate for intentional or repeated conduct. These characteristics dampen the conduct and generate revenue.

The distinction in pure types illuminates two criteria sometimes used to distinguish between penalties and taxes. The first criterion is coercion. A pure penalty coerces expressively and materially, and its effect is to prevent the assessed conduct. Alternatively, a pure tax does not coerce expressively or materially, and its effect is to dampen the assessed conduct.

The second criterion is revenue-raising. A pure penalty prevents the assessed conduct and thereby raises little revenue. By contrast, a pure tax dampens the assessed conduct but does not prevent it, thereby raising revenues.

Some jurists, following the lead of the Court during the 1920s and 1930s, suggest that the key difference between taxes and regulations backed by penalties concerns raising revenues for the government on the one hand, and changing the behavior of citizens on the other.¹⁴²

¹⁴² See, e.g., *Thomas More Law Ctr. v. Obama*, --- F.3d ---, 2011 WL 2556039, at *30 (6th Cir.) (Sutton, J., concurring in part and delivering the opinion of the court in part) (concluding that the exaction in the Affordable Care Act for remaining uninsured was a penalty because its “central function . . . was not to raise revenue,” but “to change individual behavior by requiring all qualified Americans to obtain medical insurance”).

According to this suggestion, taxes primarily raise revenues, although they may also change behavior, whereas penalties primarily change behavior, although they may also raise revenues.

The difference between changing behavior and raising revenues, however, cannot decide whether an exaction is one or the other. Because many taxes do both, this criterion is unworkable, which may be why the Supreme Court apparently abandoned it.¹⁴³ This distinction also contradicts contemporary economists and other policy experts, who argue that taxes can channel some behavior more efficiently than ordinary regulations. Thus environmental economists recommend using pollution taxes, not commands, to abate air and water pollution.¹⁴⁴

Sometimes a pure tax is levied on a beneficial activity in order to collect revenues. Dampening is perceived as an *undesirable* byproduct of raising revenues by taxing activities perceived as *beneficial*. Thus income taxes raise revenues and dampen earning income, and property taxes raise revenues and dampen improvements on property. Because people engage in the activity and pay the tax, the state collects tax revenues. Economists try to devise taxes that minimize the dampening of behavior perceived as desirable.

Conversely, dampening is regarded as a *desirable* product of taxing activities perceived as *excessive*, like pollution in the 20th century or imports in the 19th century. Economists favor externality taxes that dampen excessive behavior optimally. When a pure tax is levied on an excessive activity, society benefits from dampening the activity and raising revenues for the

¹⁴³ See *supra* part II (discussing the doctrinal shift from *Bailey v. Drexel Furniture Co.*, 259 U.S. 20 (1922) (Child Labor Tax Case), to *Sonzinsky v. United States*, 300 U.S. 506, 513 (1937), and *United States v. Kahriger*, 345 U.S. 22, 31 (1953)); see also *id.* (discussing *Montana Dep't of Revenue v. Kurth Ranch*, 511 U.S. 767 (1994)).

¹⁴⁴ The primary reason that economists advocate pollution taxes is to change behavior, and the secondary reason is to raise revenues. Taxes on excessive behavior, however, are the ideal means to finance the government because they raise revenues by correcting a distortion in market prices, not by creating one. Cf. *United States v. Kahriger*, 345 U.S. 22, 35 (1953) (Jackson, J., concurring) (“Congress may and should place the burden of taxes where it will least handicap desirable activities and bear most heavily on useless or harmful ones.”).

government.¹⁴⁵ As noted in Part II, the Court stated in *Sonzinsky v. United States*¹⁴⁶ that an exaction qualifies as a tax if it “is productive of some revenue” and it “operates as a tax.”¹⁴⁷ An exaction produces revenues and operates as a tax if it dampens permitted conduct, whereas an exaction raises little or no revenue and operates as a penalty if it prevents forbidden conduct.¹⁴⁸

Situated between pure taxes and pure penalties are exactions with mixed characteristics—the expressive characteristics of a penalty and the material characteristics of a tax, or vice versa. The exaction either sounds like a tax and looks like a penalty, or else it sounds like a penalty and looks like a tax. Mixed characteristics confuse people about what the law requires of them. Some people think that overstaying in a metered parking place is wrong because the exaction is called a “fine,” while others think that overstaying is permitted provided that one pays the fine, because the fine per violation does not increase for overstaying intentionally or repeatedly.

What is the correct constitutional interpretation of mixed exactions? Should expressive characteristics trump material characteristics or should materiality trump expression? Our answer depends on the exaction’s effect. If it has the effect of a penalty by preventing conduct, then it should be interpreted as a penalty. If it has the effect of a tax by dampening conduct and raising revenue, then it should be interpreted as a tax.

The effect of an exaction is a fact, but facts are often uncertain when it is enacted. Although people respond to materiality and expression, they usually respond more to the materiality of exactions assessed and collected by the Internal Revenue Service (notwithstanding

¹⁴⁵ The economist’s ideal pollution tax internalizes the social cost of pollution. Such a tax is a “price” to increase the cost of a permitted activity, not a “sanction” to prevent wrongdoing. See Robert Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523 (1984).

¹⁴⁶ 300 U.S. 506 (1937).

¹⁴⁷ *Id.* at 514. *Accord Doremus*, 249 U.S. at 93–94 (stating that laws are supported by the tax power only if they bear “some reasonable relation” to the “raising of revenue”); *Kahriger*, 345 U.S. at 28 (noting that the exaction under review “produces revenue”).

¹⁴⁸ *Cf.* *United States v. Kahriger*, 345 U.S. 22, 35 (1953) (Jackson, J., concurring) (“Of course, all taxation has a tendency, proportioned to its burdensomeness, to discourage the activity taxed. One cannot formulate a revenue-raising plan that would not have economic and social consequences.”).

occasional assertions to the contrary).¹⁴⁹ Absent reliable information about actual effects, we generally side with the prediction of price theory in economics that people mostly respond to the material characteristics of a federal exaction more than to its expression. The material interpretation of exactions ties the meaning of a statute to deep human motivations and predictable responses to it.

When expression and materiality conflict in a federal statute, preserving the constitutional division of powers between the federal government and the states ordinarily requires materiality to outweigh expression. Materially identical exactions should have the same constitutional consequences regardless of what a statute calls them, unless the facts indicate that people will respond more to an exaction's expression than to its material characteristics. A categorical distinction between materially equivalent statutes would make sense only if legal expression motivates people more than materiality.¹⁵⁰

If the constitutional division of powers means anything, then Congress cannot acquire a power that it lacks by calling it a power that it has. Otherwise Congress could avoid any constitutional limitation on its powers by the way it refers to them. Congress cannot acquire the power to regulate for the general welfare by calling a regulation backed by a penalty a "tax."¹⁵¹ Conversely, Congress does not lose a power that it has by calling it a power that it lacks.

¹⁴⁹ See *Seven-Sky v. Holder*, --- F.3d ---, 2011 WL 5378319, at *17–18 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits) ("Congress often chooses the label 'penalty' instead of 'tax' because the 'penalty' label suggests violation of a legal rule and thus has a more powerful effect in altering underlying behavior that Congress wants to encourage or discourage." (citations omitted)); *id.* at 18 n. 11 (quoting statements in a 1999 Treasury Department Report that "penalties clearly signal that noncompliance is not acceptable behavior," and that "[i]n establishing social norms and expectations, subjecting the noncompliant behavior to any penalty may be as important as the exact level of the penalty").

¹⁵⁰ For an examination of the importance of the expressive form of legal regulation in a different area of constitutional law, see generally Robert C. Post & Neil S. Siegel, *Theorizing the Law/Politics Distinction: Neutral Principles, Affirmative Action, and the Enduring Legacy of Paul Mishkin*, 95 CAL. L. REV. 1473 (2007); Neil S. Siegel, *Race-Conscious Student Assignment Plans: Balkanization, Integration, and Individualized Consideration*, 56 DUKE L.J. 781, 830–33, 841–43 (2006).

¹⁵¹ See, e.g., *United States v. La Franca*, 282 U.S. 568, 572 (1931) ("No mere exercise of the art of lexicography can alter the essential nature of an act or a thing; and if an exaction be clearly a penalty it cannot be converted into a tax by the simple expedient of calling it such.").

Otherwise the constitutional reach of a statute is controlled by how Congress refers to constitutional powers, not by the Constitution's concepts. With Holmes, we believe that a reviewing court should "think things, not words."¹⁵²

According to longstanding legal doctrine, the Constitution authorizes Congress to impose pure taxes to promote the general welfare, and the Constitution authorizes Congress to impose pure penalties to regulate interstate commerce.¹⁵³ Does the Constitution authorize Congress to promote the general welfare by imposing mixed exactions? Because the General Welfare Clause authorizes Congress to tax, it should also be interpreted as authorizing Congress to impose materially equivalent regulations.¹⁵⁴ Congress does not lose its power to tax for the general welfare by referring to a tax as a "regulation" or a "penalty." Nor does Congress lose its power to tax for the general welfare by declining to invoke the General Welfare Clause when it imposes an exaction.¹⁵⁵ Whatever Congress says, the effect of the exaction—how it works—matters most.

Table 2 summarizes our conclusion that (1) mixed exactions should be interpreted according to their effect, and (2) the usual effect depends on the material characteristics. For purposes of the tax power, "tax equivalents" are exactions that condemn and exact at a low rate,

¹⁵² Oliver Wendell Holmes, Jr., *Law in Science and Science in Law*, 12 HARV. L. REV. 443, 460 (1899) ("We must think things not words, or at least we must constantly translate our words into the facts for which they stand, if we are to keep to the real and the true.").

¹⁵³ See *United States v. Butler*, 297 U.S. 1, 64 (1936) ("The true construction [of the first clause] undoubtedly is that the only thing granted is the power to tax for the purpose of providing funds for payment of the nation's debts and making provision for the general welfare.").

¹⁵⁴ See *Cooter & Siegel*, *supra* note 15, at 171–72 ("The tenuous economic distinction between many taxes and regulations . . . suggests that allowing one and not the other under Clause 1 makes little sense.").

¹⁵⁵ See *Woods v. Cloyd W. Miller Co.*, 333 U.S. 138, 144 (1948) ("The question of the constitutionality of action taken by Congress does not depend on recitals of the power which it undertakes to exercise."). The constitutional question remains whether the exaction is a tax. Note, however, that a different situation is presented when Congress explicitly disclaims use of a particular enumerated power. As a matter of institutional deference, it is appropriate for courts to defer to a clearly articulated congressional judgment that an enumerated power is not available or not desirable to justify an Act of Congress. But calling an exaction something other than a "tax" does not by itself amount to explicit disavowal of the tax power, particularly in light of the case law suggesting that substance controls over form.

which dampens behavior. Conversely, “penalty equivalents” are exactions that permit and exact at a high rate, which prevents behavior.

Table 2: Exactions With Mixed Characteristics

	Condemns	Permits
High Rate	pure penalty	penalty equivalent
Low Rate	tax equivalent	pure tax

B. A Constitutional Test

One aim of the Constitution is to limit federal power to coerce the states and citizens. To pursue this aim, the Constitution gives the federal government limited, enumerated powers, and denies it a general police power.¹⁵⁶ Concern about federal coercion partly justifies restricting congressional regulations backed by penalties more than taxes. As noted above, pure penalties coerce more than pure taxes, both materially and expressively. An exaction that prevents almost everyone from engaging in the conduct is a penalty for constitutional purposes, even though the statute calls it a tax. An exaction that exceeds almost everyone’s gain from engaging in the assessed conduct is too coercive to qualify as a tax under the tax power, even if a few people with unusual preferences or resources still engage in it. As with other enumerated powers, the constitutional question is whether the exaction prevents the general class of conduct subject to the exaction.¹⁵⁷

A constitutional test for a tax under the tax power and a penalty under the Commerce Clause should focus on the *effect* of the exaction on the conduct of the people subject to it. The

¹⁵⁶ See, e.g., U.S. v. Morrison, 529 U.S. 598 (2000); United States v. Lopez, 514 U.S. 549 (1995).

¹⁵⁷ Cf., e.g., Gonzales v. Raich, 545 U.S. 1, 17 (2005) (“We have never required Congress to legislate with scientific exactitude. When Congress decides that the total incidence of a practice poses a threat to a national market, it may regulate the entire class.” (citations and internal quotation marks omitted)).

test should distinguish exactions that raise revenues and dampen behavior (thereby working like a tax) from exactions that prevent behavior (thereby working like a penalty). Although expression is relevant to whether an exaction is a tax or a penalty, the test should ordinarily presume that materiality trumps expression when the two conflict, absent evidence that rebuts this presumption. We favor a test that asks three questions about the material characteristics of the exaction:

- (1) Is the amount of the exaction so high that it exceeds the expected benefit from engaging in the assessed conduct for almost everyone?
- (2) Does the exaction's amount depend on whether the assessed individual has a certain mental state, especially the intention to perform the assessed conduct?
- (3) Does the amount of the exaction increase with repetition of the assessed conduct?¹⁵⁸

If none of the answers to the three questions is “yes,” then the exaction is a tax for purposes of the tax power because it has the material characteristics of a tax and most likely will dampen behavior and raise revenues. If all of the answers to the questions are “yes,” then the exaction is a penalty for purposes of the tax power because it has the material characteristics of a penalty and most likely will prevent the assessed conduct and raise little or no revenue.¹⁵⁹ The

¹⁵⁸ The social costs imposed by the conduct subject to an exaction are not relevant to whether the exaction is a tax or a penalty. Purely self-interested people care only about their private costs, not about social costs. Most people care more about their private costs than social costs. An exaction by the state imposes a private cost on a person's conduct. Most people respond by comparing the exaction to their private benefit from the conduct. Grounding a theory of the difference between a tax and penalty on its behavioral consequences requires a focus on private costs and benefits.

Notably, the social costs imposed by certain conduct are relevant to whether the conduct should be regulated by a tax or a penalty. A tax that internalizes social costs causes a self-interested person to do what is best for society, and the inability to design and implement such a tax is an important reason for imposing a penalty.

¹⁵⁹ Whether the exaction is imposed only after detection by the police is not a criterion. Although some penalties are imposed only after police detection, others are not. For an instance in which the Court erred by confusing the effects of an exaction with who enforces it, see *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 36 (1958) (holding that the Commissioner properly disallowed the tax deductibility of payments of several hundred fines imposed on a trucking business for violations of state maximum weight laws because “the truckers were fined by the State as a penal measure when and if they were apprehended by the police”). For an effective

alignment of these material characteristics can decide many cases, as we illustrate later by analyzing the ACA’s minimum insurance requirement.¹⁶⁰

The constitutional meaning of an exaction, which turns on its effect, is distinct from the question of whether and how courts should exercise the power of judicial review.¹⁶¹ Judicial review in tax power cases defers to Congress in two ways. First, the presumption of constitutionality in enumerated powers litigation requires courts to uphold a contested exaction in close cases.¹⁶² Second, in Commerce Clause cases, the Court asks whether Congress had a rational basis to believe that the regulated subject matter would substantially affect interstate commerce in the aggregate—not whether those effects in fact materialized.¹⁶³ So too, here, the question for judicial resolution is whether Congress could have rationally concluded that the exaction would have the effect of a tax—not whether the exaction in fact had that effect (or is certain to have that effect).

critique of the decision as promoting inefficient behavior through the tax code where efficient behavior would accord with the state’s goal of obtaining compensation for damage done to its roads, see RICHARD SCHMALBECK & LAWRENCE ZELENAK, *FEDERAL INCOME TAXATION* 536–38 (3d ed. 2011).

¹⁶⁰ If some of the answers to the first three questions are “yes” and some are “no,” then it is a hard case that turns on the exaction’s effect. Will the exaction raise revenues and dampen the conduct, or will it prevent the conduct? The question is especially difficult when the exaction applies to conduct that most people engage in once or not at all, but not twice. Thus a tax on home ownership dampens it by preventing marginal homeowners from buying houses. The question is also difficult for exactions with enhancements for intentional or repeated conduct that most people engage in, such as driving faster than the speed limit.

¹⁶¹ See, e.g., Jack M. Balkin, *Fidelity to Text and Principle*, in *THE CONSTITUTION IN 2020*, at 20 (Jack M. Balkin & Reva B. Siegel eds., 2009) (“Many theories of constitutional interpretation conflate two different questions. The first is the question of what the Constitution means and how to be faithful to it. The second asks how a person in a particular institutional setting—like an unelected judge with life tenure—should interpret the Constitution and implement it through doctrinal constructions and applications.”).

¹⁶² See, e.g., *United States v. Morrison*, 529 U.S. 598, 607 (2000) (“Due respect for the decisions of a coordinate branch of Government demands that we invalidate a congressional enactment only upon a plain showing that Congress has exceeded its constitutional bounds. With this presumption of constitutionality in mind, we turn to the question whether [the statute] falls within Congress’ power under Article I, §8, of the Constitution.” (citations omitted)).

¹⁶³ See, e.g., *Gonzales v. Raich*, 545 U.S. 1, 22 (2005) (“In assessing the scope of Congress’ authority under the Commerce Clause, we stress that the task before us is a modest one. We need not determine whether respondents’ activities, taken in the aggregate, substantially affect interstate commerce in fact, but only whether a ‘rational basis’ exists for so concluding.”)

Under our test, whether Congress calls an exaction a “tax” is neither necessary nor sufficient for the exaction to fall within the scope of the tax power. Some of the Court’s past decisions, however, suggest that calling an exaction a “tax” is necessary and sufficient for it to be one constitutionally,¹⁶⁴ and some suggest the opposite, as we noted in Part II. Making the tax power turn on a jurisprudence of labels is inconsistent with the Court’s Commerce Clause jurisprudence. If using the “T” word were sufficient to justify an exaction under the tax power, then a court would have to approve a \$25,000 federal “tax” on carrying a gun in a school zone after *Lopez*. And because the effects of an exaction turn primarily on its material characteristics, not its expressive characteristics, Congress need not use the “tax” label in order to rely on the tax power.¹⁶⁵

In sum, we agree with Holmes that materiality matters more than expression “on the very question whether a given statutory liability is a penalty or a tax.”¹⁶⁶ “A bad man,” Holmes wrote, does not care “whether conduct is legally right or wrong, and also whether a man is under compulsion or free.”¹⁶⁷ “It does not matter, so far as the given consequence, the compulsory payment, is concerned, whether the act to which it is attached is described in terms of praise or in

¹⁶⁴ We agree that *Veazie Bank*, *McCrary*, and *Sanchez* can be read that way. *See supra* Part II.A (discussing these cases).

¹⁶⁵ Some exactions are neither taxes nor penalties. For example, there are federal regulations backed by exactions that are called “penalties” by Congress. They are low and lack enhancement, however, so they lack the three material characteristics of pure penalties. *See, e.g.*, 7 U.S.C. § 610(c) (“The Secretary of Agriculture is authorized, with the approval of the President, to make such regulations with the force and effect of law as may be necessary to carry out the powers vested in him by this chapter. Any violation of any regulation shall be subject to such penalty, not in excess of \$100, as may be provided therein.”). At the same time, they are not well described as taxes because they are so low that they do not raise much revenue. At most, they have one characteristic of pure taxes (dampening behavior). What should exactions be called when “penalties” or “taxes” do not fit? “Exactions” may be the best term. Regardless of the label, they need not originate in the House of Representatives. *See* U.S. CONST. art. I, § 7 (“All Bills for raising Revenue shall originate in the House of Representatives . . .”).

¹⁶⁶ Oliver Wendell Holmes, *The Path of the Law*, in COLLECTED LEGAL PAPERS 173 (1920). *See id.* (“But from his point of view, what is the difference between being fined and being taxed a certain sum for doing a certain thing?”).

¹⁶⁷ *Id.*

terms of blame, or whether the law purports to prohibit it or to allow it.”¹⁶⁸ Unlike Holmes, however, we think expression counts for something because most people are not bad. We also think that a tax and a penalty differ materially. The bad man would prefer to be taxed than penalized because taxes are less coercive than penalties. Our approach grants the federal government robust power to raise revenues and regulate behavior through taxation, as it has enjoyed throughout American history. Our approach denies that the federal “power to tax involves the power to destroy,”¹⁶⁹ at least “while th[e] Court sits.”¹⁷⁰

IV. APPLICATION

Constitutional litigation over the Patient Protection and Affordable Care Act (ACA) focuses primarily on the “Requirement to Maintain Minimum Essential Coverage,” which opponents call the “individual mandate.” It provides that every “applicable individual”—that is, most individuals lawfully living in the United States—“shall” obtain “minimum essential coverage” for each month.¹⁷¹ Applicable individuals who do not obtain minimum essential coverage must include in their federal taxes for the year a “[s]hared responsibility payment”

¹⁶⁸ *Id.* at 174.

¹⁶⁹ *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316, 431 (1819) (stressing that it is a “proposition[] not to be denied” that the “power to tax involves the power to destroy”). Chief Justice Marshall was referring specifically to taxes imposed on the federal government by the states, which are not governments of limited, enumerated powers. *See id.* at 327 (“An unlimited power to tax involves, necessarily, a power to destroy; because there is a limit beyond which no institution and no property can bear taxation. . . . If the states may tax, they have no limit but their discretion; and the bank, therefore, must depend on the discretion of the state governments for its existence.”); *id.* at 391–92 (“A right to tax, without limit or control, is essentially a power to destroy. If one national institution may be destroyed in this manner, all may be destroyed in the same manner. If this power to tax the national property and institutions exists in the state of Maryland, it is unbounded in extent. There can be no check upon it, either by congress, or the people of the other states. Is there then any intelligible, fixed, defined boundary of this taxing power?”). We offer a precise formulation of the meaning of “destroy” as “preventing the behavior completely.”

¹⁷⁰ *Panhandle Oil Co. v. Mississippi ex rel. Knox*, 277 U.S. 218, 223 (1928) (Holmes, J., dissenting) (“The power to tax is not the power to destroy while this Court sits. The power to fix rates is the power to destroy if unlimited, but this Court while it endeavors to prevent confiscation does not prevent the fixing of rates. A tax is not an unconstitutional regulation in every case where an absolute prohibition of sales would be one.” (citing *Hatch v. Reardon*, 204 U.S. 152, 162 (1907))).

¹⁷¹ 26 U.S.C. § 5000A(b)(1). The minimum coverage provision goes into effect on January 1, 2014. It applies to U.S. citizens and legal residents. It does not apply to undocumented aliens, people in prison, and people with certain religious objections. *Id.*

based on household income, which the statute labels a “penalty.”¹⁷² (Individuals who need not pay the exaction form a heterogeneous group of mostly disadvantaged people.¹⁷³) In 2014, the annual exaction for remaining uninsured will be the greater of \$95 or one percent of income. By 2016, the annual exaction will be the greater of \$695 or 2.5 percent of income.¹⁷⁴ The Congressional Budget Office estimates that four million people each year will pay the exaction for going without health insurance coverage,¹⁷⁵ and that the exaction will produce roughly \$4 billion in federal revenue annually.¹⁷⁶

The minimum coverage provision and shared responsibility payment address two free rider problems. Anyone can be grievously injured or fall ill at any moment, and such injury or illness can be ruinous financially.¹⁷⁷ Almost all who are grievously injured or ill will end up at emergency rooms, where they will receive treatment regardless of whether they are insured.¹⁷⁸ This fact encourages financially able individuals to decline to purchase health insurance and to

¹⁷² 26 U.S.C. § 5000A(b), (c).

¹⁷³ Individuals who need not pay the exaction include those who need not file a federal income tax return because their household incomes are too low, people whose premium payments would be greater than eight percent of their household income, individuals who are uninsured for short periods of time, members of Native American tribes, and people who show that compliance with the requirement would impose a hardship. 26 U.S.C. § 5000A(e).

¹⁷⁴ 26 U.S.C. § 5000A(c).

¹⁷⁵ Congressional Budget Office, Payments of Penalties for Being Uninsured Under the Patient Protection and Affordable Care Act (April 22, 2010), at 1, available at <http://www.cbo.gov/publication/21351> (reporting that “[i]n total, about 4 million people are projected to pay a penalty because they will be uninsured in 2016 (a figure that includes uninsured dependents who have the penalty paid on their behalf)”).

¹⁷⁶ *Id.* (estimating that “total collections from those penalties will be about \$4 billion per year over the 2017–2019 period”).

¹⁷⁷ See 42 U.S.C. § 18091(a)(2)(G) (“62 percent of all personal bankruptcies are caused in part by medical expenses.”).

¹⁷⁸ Federal law requires hospitals that participate in Medicare and offer emergency services (almost all hospitals in the United States) to provide stabilizing care to patients who enter their emergency rooms while experiencing medical emergencies regardless of their ability to pay. Emergency Medical Treatment and Active Labor Act of 1986, 42 U.S.C. § 1395dd (“EMTALA”). This law reinforces the longstanding mission of many hospitals to provide care to individuals who are unable to pay fully or at all. See, e.g., CHARLES ROSENBERG, THE CARE OF STRANGERS: THE RISE OF AMERICA’S HOSPITAL SYSTEM 347 (1995) (observing that “the hospital never assumed the guise of rational and rationalized economic actor during the first three-quarters of the twentieth century”; that it “continued into the twentieth century, as it had begun in the eighteenth, to be clothed with public interest in a way that challenged categorical distinctions between public and private”; and that “[p]rivate hospitals had always been assumed to serve the community at large—treating the needy.”); *id.* at 352 (seeing “little prospect of hospitals in general becoming monolithic cost minimizers and profit maximizers,” and predicting that American society “will feel uncomfortable with a medical system that does not provide a plausible (if not exactly equal) level of care to the poor and socially isolated”).

free ride on the benevolence of others.¹⁷⁹ The minimum coverage provision and shared responsibility payment are designed in part to overcome risk taking in reliance on benevolence.¹⁸⁰

These two provisions also ameliorate a second kind of free rider problem: adverse selection in insurance markets.¹⁸¹ Individuals in bad health have an immediate reason to purchase insurance that individuals in good health lack. As more people in bad health purchase insurance, the premiums must rise, which causes fewer people in good health to buy insurance, which causes a further increase in premiums, which causes fewer people in good health to buy insurance, and so on. This price spiral exists in unregulated health insurance markets without the ACA. However, some features of the ACA aggravate it. Specifically, the ACA prohibits insurance companies from denying coverage based on preexisting conditions, canceling insurance absent fraud, charging higher premiums based on medical history, and imposing lifetime limits on benefits.¹⁸² These regulations encourage healthy individuals without insurance to wait to buy it until they require expensive medical care, which increases the price spiral.¹⁸³ To decrease the price spiral, the ACA requires both the healthy and the unhealthy to buy insurance or pay a yearly fee. The exaction for non-insurance thus ameliorates a problem that the ACA worsens but did not create.

¹⁷⁹ See, e.g., Brief for Appellant, *Virginia v. Sebelius*, Nos. 11-1057 & 11-1058 (4th Cir.), at 42 (discussing state tort law creating liability for failure to provide emergency care).

¹⁸⁰ For a development of this argument, see generally Neil S. Siegel, *Free Riding on Benevolence: Collective Action Federalism and the Minimum Coverage Provision*, 75 LAW & CONTEMP. PROBS., no. 3 (forthcoming 2012).

¹⁸¹ See generally KENNETH J. ARROW, *ESSAYS IN THE THEORY OF RISK BEARING* (1971).

¹⁸² 42 U.S.C.A. § 300gg, 300gg-1(a), 300gg-3(a), 300gg-11, 300gg-12.

¹⁸³ See Brief for America's Health Insurance Plans as *Amicus Curiae* in Support of Neither Party, *Virginia v. Sebelius*, Nos. 11-1057 & 11-1058 (4th Cir.), at 3 (“Without an individual mandate requirement, more individuals will make the rational economic decision to wait to purchase coverage until they expect to need health care services. If imposed without an individual mandate provision, the market reform provisions would reinforce this ‘wait-and-see’ approach by allowing individuals to move in and out of the market as they expect to need coverage, undermining the very purpose of insurance to pool and spread risk.”).

The federal courts presently disagree whether the minimum coverage provision is within the scope of the Commerce Clause,¹⁸⁴ either alone or in combination with the Necessary and Proper Clause.¹⁸⁵ So far, three federal district courts and two federal courts of appeals have upheld the provisions based partly on cost shifting and adverse selection.¹⁸⁶ Three other federal district courts and one federal court of appeals have struck down the provisions on the ground that they regulate “inactivity,” which (according to those courts) Congress may not reach using its commerce power.¹⁸⁷

Whatever the pertinence of the activity-inactivity distinction to the commerce power, it is irrelevant to the scope of the tax power. Some taxes are assessed on status, not activity. For example, head taxes assess people for being alive. Moreover, tax rates increase for inactivity. Thus non-married individuals in long-term relationships can often reduce their tax liability by marrying. The Internal Revenue Code raises their tax rate for the “inactivity” of not marrying.

Nonetheless, no federal court has upheld the minimum coverage provision and shared responsibility payment as justified by the tax power.¹⁸⁸ For example, in his influential and

¹⁸⁴ U.S. CONST. Art. I, § 8, cl. 3.

¹⁸⁵ U.S. CONST. Art. I, § 8, cl. 18.

¹⁸⁶ See *Mead v. Holder*, -- F. Supp. 2d -- (D.D.C. 2011), 2011 WL 611139; *Liberty Univ., Inc. v. Geithner*, -- F. Supp. 2d -- (W.D. Va. 2010); 2010 WL 4860299; *Thomas More Law Center v. Obama*, 720 F. Supp. 2d 882 (E.D. Mich. 2010); *Thomas More Law Ctr. v. Obama*, --- F.3d ---, 2011 WL 2556039, at *16 (6th Cir. 2011); *Seven-Sky v. Holder*, --- F.3d ---, 2011 WL 5378319 (D.C. Cir. 2011).

¹⁸⁷ *Virginia ex rel. Cuccinelli v. Sebelius*, 728 F.Supp.2d 768 (E.D. Va. 2010); *Florida ex rel. Bondi v. U.S. Dept. Health & Human Serv.*, --- F.Supp.2d ---, 2011 U.S. Dist. LEXIS 8822 (N.D. Fla. Jan. 31, 2011); *Goudy-Bachman v. U.S. Dep’t of Health & Human Servs.*, No. 1:10-CV-763, --- F. Supp. 2d ---, 2011 WL 4072875, at *-- (M.D. Pa. Sept. 13, 2011). These district courts reasoned that Congress may regulate only economic activity using its commerce power, and that the minimum coverage provision regulates inactivity—specifically, the failure to purchase health insurance. The United States Court of Appeals for the Eleventh Circuit reasoned similarly in invalidating the minimum coverage provision. *Florida ex rel. Att’y Gen. v. U.S. Dep’t Health & Human Servs.*, --- F.3d ---, 2011 WL 3519178, at *66–67 (11th Cir. Aug. 12, 2011).

¹⁸⁸ *But cf. Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915, at *50 (4th Cir. Sept. 8, 2011) (Wynn, J., concurring) (“[W]here I to reach the merits, I would uphold the constitutionality of the Affordable Care Act on the basis that Congress had the authority to enact the individual and employer mandates under its plenary taxing power.”). In two decisions, the United States Court of Appeals for the Fourth Circuit ruled for the federal government on jurisdictional grounds. See *Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915 (4th Cir. Sept. 8, 2011) (holding that the federal tax Anti-Injunction Act bars the action); *Virginia ex rel. Cuccinelli v. Sebelius*, Nos. 11-1057, 11-1058, --- F.3d ---, 2011 WL 3925617 (4th Cir. Sept. 8,

dispositive opinion, the widely respected conservative jurist Jeffrey Sutton of the United States Court of Appeals for the Sixth Circuit rejected a facial Commerce Clause challenge to the provisions, but concluded that “[t]he individual mandate is a regulatory penalty, not a revenue-raising tax.”¹⁸⁹ He so concluded because “that is what Congress said”¹⁹⁰; because “the legislative findings in the Act show that Congress invoked its commerce power, not its taxing authority”¹⁹¹; because “Congress showed throughout the Act that it understood the difference between these terms and concepts, using ‘tax’ in some places and ‘penalty’ in others”¹⁹²; because “the central function of the mandate was not to raise revenue,” but “to change individual behavior by requiring all qualified Americans to obtain medical insurance”¹⁹³; and because “case law supports this conclusion.”¹⁹⁴ In the view of Judge Sutton (and many other federal judges), this part of the ACA plainly imposes a penalty and not a tax.¹⁹⁵

Our analysis of four types of exactions—pure taxes, pure penalties, tax equivalents, and penalty equivalents—identifies why courts have been reluctant to view the ACA’s exaction for non-insurance as a tax for constitutional purposes. Congress used the label “penalty” many times in the statute creating the provisions.¹⁹⁶ Moreover, Congress did so after labeling the

2011) (holding that Virginia lacks Article III standing to bring the action). Unlike Judge Wynn, Judge Motz, who wrote both opinions, did not express her view of the merits. Judge Davis would have upheld the individual and employer mandates under the Commerce Clause. *See Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915, at *67 (4th Cir. Sept. 8, 2011) (Davis, J., dissenting).

¹⁸⁹ *See, e.g., Thomas More Law Ctr. v. Obama*, --- F.3d ---, 2011 WL 2556039, at *29 (6th Cir. June 29, 2011) (Sutton, J., concurring in part and delivering the opinion of the court in part).

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.* at *30.

¹⁹³ *Id.*

¹⁹⁴ *Id.* at *31 (discussing, *inter alia*, *Child Labor Tax Case*, 259 U.S. 20, 38 (1922), and *Dep’t of Revenue v. Kurth Ranch*, 511 U.S. 767, 778, 779 (1994)).

¹⁹⁵ *See Florida ex rel. Att’y Gen. v. U.S. Dep’t Health & Human Servs.*, --- F.3d ---, 2011 WL 3519178, at *68 (11th Cir. Aug. 12, 2011) (“Beginning with the district court in this case, all have found, without exception, that the individual mandate operates as a regulatory penalty, not a tax.”) (citing cases).

¹⁹⁶ 26 U.S.C. § 5000A(b), (c). *See Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915, at *59 (4th Cir. Sept. 8, 2011) (Davis, J., dissenting) (“And Congress did not simply use the term ‘penalty’ in passing: Congress refers to the exaction no fewer than seventeen times in the relevant provision, and each time Congress calls it a ‘penalty.’”).

exaction a “tax” in earlier versions of the bill.¹⁹⁷ This choice of words is not arbitrary, thoughtless, or expressively interchangeable with the language of taxation. On the contrary, such normative language appears to reflect a congressional judgment that failing to insure is wrong—the wrong of shifting medical costs to others. The minimum coverage provision *expresses* a penalty.

The contrary argument can be made that the ACA exaction for non-insurance expresses a tax. Congress placed the exaction in the Internal Revenue Code; identified the individuals subject to the exaction as “taxpayers”; calculated the exaction in part as a “percentage of . . . the taxpayer’s household income for the taxable year”; and included the amount owed in the taxpayer’s tax return liability.¹⁹⁸ Congress, in short, also used the language of taxation. These observations, however, cannot overcome the fact that Congress repeatedly labeled the exaction a “penalty,” it never labeled the exaction a “tax,” and it did so after having previously called it a “tax” in earlier versions of the bill that became law.

Even so, courts are wrong to conclude that the ACA exaction for non-insurance *is* a penalty for purposes of the tax power. To distinguish between what an exaction is called and how it will work, the law must supply details on how it applies. The ACA describes the material characteristics of the exaction in sufficient detail to determine its likely effects. Each of our three criteria for distinguishing a tax from a penalty indicates that the ACA exaction is a tax.

¹⁹⁷ *Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915, at *59-60 (4th Cir. Sept. 8, 2011) (Davis, J., dissenting) (“Congress considered earlier versions of the individual mandate that clearly characterized the exaction as a ‘tax’ and referred to it as such more than a dozen times. Congress deliberately deleted all of these references to a ‘tax’ in the final version of the Act and instead designated the exaction a ‘penalty.’” (citations omitted)).

¹⁹⁸ *Cf., e.g.,* Brian Galle, *The Taxing Power, the Affordable Care Act, and the Limits of Constitutional Compromise*, 120 *YALE L.J. ONLINE* 407, 409 (2011), <http://yalelawjournal.org/2011/4/5/galle.html> (stressing these facts in arguing that the exaction is a tax); *Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915, at *58 (4th Cir. Sept. 8, 2011) (Wynn, J., concurring) (“Notably, while the individual mandate in some places used the term ‘penalty,’ some form of the word ‘tax’ appears in the statute over forty times.”).

First, when an exaction's rate gets very high, it prevents people from engaging in the assessed conduct, which coerces them much like a penalty. For many people, the shared responsibility payment is too low to have this effect.¹⁹⁹ This exaction increases with income until it hits a cap at “the national average premium for qualified health plans which have a bronze level of coverage,” the lowest level of health insurance coverage identified by the ACA as sufficient to comply with the minimum coverage provision.²⁰⁰ The exaction costs less than this minimum level of insurance for many people,²⁰¹ so many who are determined to remain uninsured will do so.²⁰² The exaction's level apparently reflects a political compromise that aims to discourage people from gaming the system without coercing them.²⁰³

Second, the exaction has no mens rea requirement. It does not matter whether an individual declines to obtain health insurance intentionally or innocently. Third, there is no

¹⁹⁹ Congressional Budget Office, Effects of Eliminating the Individual Mandate to Obtain Health Insurance (June 16, 2010), at 2, available at <http://www.cbo.gov/publication/21351> (predicting that elimination of the individual mandate to obtain coverage “would increase the number of uninsured by about 16 million people”).

²⁰⁰ 26 U.S.C. §§ 5000A(c)(1)(B) and (b)(1).

²⁰¹ See, e.g., Alec MacGillis, *The Individual Mandate: How It Will Work*, in THE STAFF OF THE WASHINGTON POST, LANDMARK: THE INSIDE STORY OF AMERICA'S NEW HEALTH-CARE LAW AND WHAT IT MEANS FOR US ALL 89 (2010) (“[T]he law expressly states that failure to pay the penalties will not result in criminal prosecution or even in property liens. Also, the government probably will enforce the mandate loosely because of the political sensitivity of the health-care law.”).

²⁰² A condition attached to an exaction becomes coercive when the individual has no self-interested choice but to comply with the condition. A penalty coerces almost everyone. In a subsequent paper, we will examine the idea of unconstitutional coerciveness in the potentially distinct context of conditional expenditures. See *South Dakota v. Dole*, 483 U.S. 203, 211 (1987) (“Our decisions have recognized that in some circumstances the financial inducement offered by Congress might be so coercive as to pass the point at which ‘pressure turns into compulsion.’” (quoting *Steward Machine Co. v. Davis*, 301 U.S. 548, 590 (1937))). Another part of the ACA—the Medicaid expansion—implicates this distinct constitutional question.

²⁰³ Experts fear that the existing exaction may be too low to prevent a significant percentage of individuals from delaying the purchase of insurance, which could threaten the viability of the insurance business. See, e.g., MacGillis, *supra* note 201, at 89 (“[T]hose who wrote the legislation set the penalty for not carrying health coverage lower than what many health-care experts believe is necessary for the mandate to work, precisely because they were worried about the political fallout from making the requirement seem too onerous.”); Editorial, *Curing a Sick System: The “Individual Mandate” is Healthcare Reform’s Most Divisive—and One of Its Most Crucial—Components*, L.A. TIMES, Oct. 24, 2010, available at <http://articles.latimes.com/2010/oct/24/opinion/la-ed-health-20101024> (“By requiring all adult Americans and legal residents to obtain a basic level of coverage or else pay an annual tax penalty of up to \$2,085, the law seeks to deter people from signing up for insurance only after they need expensive care. It’s not the only approach Congress could have taken, and it isn’t perfect—the penalty seems too low to stop healthy people from going without coverage or employers from ceasing to offer health benefits to their employees.”).

surcharge for recidivism. The amount of the exaction does not increase with each month or year that an individual declines to obtain health insurance coverage. Instead, the law imposes a flat fee regardless of an individual's insurance status in previous years.

Because the shared responsibility payment has all the material characteristics of a tax, it should work like a tax by dampening (but not preventing) behavior and thereby raising revenues from the uninsured.²⁰⁴ The Congressional Budget Office estimated that the shared responsibility payment will add around \$4 billion to the U.S. treasury each year, which will be less than the government's costs of treating the uninsured.²⁰⁵ Medical costs will shift partly from the public to the uninsured.

The unfolding politics of the Affordable Care Act cannot change this conclusion. Congress changed the label of the exaction from "tax" to "penalty" apparently to blunt the opposition of people committed to no new taxes.²⁰⁶ Labeling an exaction a "penalty" instead of a "tax" may "carr[y] political benefits" at a particular time.²⁰⁷

Some judges and scholars fear that the federal government will escape political accountability if it can call an exaction one thing in the legislature and something else in court.²⁰⁸

²⁰⁴ The distinction between dampening and prevention is meaningful as applied to the general class of individuals subject to the ACA exaction for non-insurance, not as applied to each individual who must decide whether to comply with the minimum coverage provision. This is because the individual either complies with the provision or does not. "Dampening" here means that a significant number of people remain uninsured despite the provision. "Prevention" means that almost no one remains uninsured.

²⁰⁵ See *supra* note 176 and accompanying text (citing Congressional Budget Office estimate).

²⁰⁶ Congress likely did not consider the potential constitutional consequences of changing the label of the exaction in light of Supreme Court decisions that have declared the constitutional irrelevance of the label affixed to an exaction. See *supra* notes 136–138 and accompanying text (citing past Court decisions).

²⁰⁷ *Liberty Univ., Inc. v. Geithner*, No. 10-2347, --- F.3d ---, 2011 WL 3962915, at 39 n.12 (4th Cir. Sept. 8, 2011) (citing *Florida v. HHS*, 716 F. Supp. 2d 1120, 1142–43 (N.D. Fla. 2010)). Ironically, Congress tried to *diminish* political objections by using the name that signals *more* coercion ("penalty"), instead of the one that signals less coercion ("tax").

²⁰⁸ See, e.g., *Florida ex rel. McCollum v. U.S. Dept. Health & Human Servs.*, 716 F. Supp. 2d 1120, 1144 (N.D. Fla. 2010) ("[N]ow that it has passed into law . . . , government attorneys have come into this court and argued that it was a tax after all. This rather significant shift in position, if permitted, could have the consequence of allowing Congress to avoid the very same accountability that was identified by the government's counsel in the Virginia case as a check on Congress's broad taxing power in the first place." (citations omitted)); Randy E. Barnett, *Commandeering the People: Why the Individual Health Insurance Mandate is Unconstitutional*, 5 N.Y.U. J.L. &

It is a novel proposition, however, that political accountability by accurate labeling applies to Congress's tax power.²⁰⁹ We are unaware of constitutional authority for the proposition that an exaction with the material characteristics and effects of a tax must be a penalty to achieve political accountability. Thus Judge Kavanaugh of the U.S. Court of Appeals for the D.C. Circuit, in an important opinion in a recent ACA case, deemed it constitutionally irrelevant that the ACA labeled the exaction for non-insurance a "penalty" instead of a tax. Indeed, he reduced to a footnote his dismissal of the objection that Congress chose the wrong label for the exaction.²¹⁰

In any event, political accountability regarding federal exactions usually turns on who must pay and how much they must pay, not on the name for what they must pay. In spite of naming the exaction a "penalty" instead of a "tax," neither the Congress that passed the ACA nor the President who signed it into law escaped political accountability for supporting the minimum coverage provision, which remains controversial.²¹¹

LIBERTY 581, 632–33 (2010) ("The public is acutely aware of tax increases. Rather than incur the political cost of imposing a general tax on the public using its tax powers, economic mandates allow Congress and the President to escape accountability for tax increases by compelling citizens to make payments directly to private companies.").

²⁰⁹ Federal commandeering of states raises distinct constitutional concerns. *See* *Printz v. United States*, 521 U.S. 898 (1997); *New York v. United States*, 505 U.S. 144 (1992).

²¹⁰ *Seven-Sky v. Holder*, --- F.3d ---, 2011 WL 5378319, at *54 n.36 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits) (quoted *supra* note 136). As did the Fourth Circuit, see *supra* note 188, Judge Kavanaugh would have held that the action was barred by the federal tax Anti-Injunction Act (TAIA), 26 U.S.C. § 7421(a). For a novel explanation of why the TAIA imposes no jurisdictional impediment, see generally Michael C. Dorf & Neil S. Siegel, "Early-Bird Special" *Indeed!: Why the Tax Anti-Injunction Act Permits the Present Challenges to the Minimum Coverage Provision*, 121 YALE L.J. ONLINE 389 (2012), <http://yalelawjournal.org/2012/01/19/dorf&siegel.html>.

²¹¹ According to a recent Associated Press-National Constitution Center poll, 82 percent of respondents answered "no" to the question of whether "the Federal Government should have the power to require all Americans to buy health insurance, and to pay a fine if they don't." *AP-Constitution Center Poll* (August 2011), available at http://surveys.ap.org/data/GfK/AP-GfK%20Poll%20Aug%202011%20FINAL%20Topline_NCC_1st%20story.pdf (last visited Oct. 5, 2011). This datum is striking, although the phrasing of the question leaves much to be desired. The ACA does not require all Americans to buy health insurance, and calling the exaction for going without insurance a "fine" is provocative and controversial. As we have shown, it is materially equivalent to a tax. Moreover, the poll question says nothing about the benefits, such as guaranteed access to insurance, that the minimum coverage requirement helps to make possible.

Many federal statutes have titles and preambles that misstate their content, whether by calling civilian expenditures “military” or by declaring high-minded purposes for self-serving logrolls.²¹² For decades Congress has hidden tax breaks in the tax code instead of exposing them in the budget, as noted in Part I.²¹³ The Court has never suggested that any of these practices raises concerns about the constitutionality of federal taxes or expenditures.²¹⁴ If the Court were to impose a “clear statement” requirement that the tax power justifies an exaction only if Congress labels it a “tax,” many other kinds of mislabeling logically should fall under such a requirement.²¹⁵ Policing these practices would require a massive judicial undertaking. A Court that wishes to do so might start with easy cases that are blatantly misleading, not subtle cases like the ACA.²¹⁶

²¹² For a discussion, see generally Susan Rose-Ackerman, *Judicial Review and the Power of the Purse*, 12 INT’L REV. L. & ECON. 191 (1992).

²¹³ See *supra* note 69 and accompanying text.

²¹⁴ Some sections of the Internal Revenue Code mislabel penalties as taxes, notably the rules regarding private foundations. Among other things, a foundation must distribute at least five percent of its assets for charitable purposes each year; it must not engage in acts of self-dealing with foundation insiders; it must not hold more than insubstantial interests in corporate or noncorporate businesses; and (with few exceptions) it must not lobby. These rules, however, are not phrased as mandates or prohibitions. Rather, a foundation can do what it wants, but must pay “excise taxes” if it chooses wrong. For example, section 4941(a) imposes a first-tier tax of ten percent on any self-dealing transaction. I.R.C. § 4941(a) (West 2006). Section 4941(b) imposes a 200 percent tax on any act of self-dealing subject to the tier-one tax, if the act that triggered the tax is not “corrected” in a timely fashion. I.R.C. § 4941(b) (West 2006). The first-tier tax grabs attention and the second-tier tax prevents wrongdoing if the foundation does not fix the problem. Unsurprisingly, these “taxes” raise negligible revenue.

²¹⁵ The tax context is distinct from others in which the Court has imposed clear statement requirements. For example, unlike how some jurists and commentators view conditional spending cases, see, e.g., *Arlington Central School Dist. Bd. of Ed. v. Murphy*, 548 U.S. 291 (2006), imposing a clear statement requirement here is not the only judicially manageable way to enforce federalism values, as this Article shows. In addition, unlike the context of a potential habeas suspension by Congress, see, e.g., *Boumediene v. Bush*, 553 U.S. 723 (2008), the tax setting does not raise profound and perplexing questions about whether such controversies are justiciable and, if so, how to resolve them on the merits, as this Article also shows.

²¹⁶ It may be easier to identify instances in which Congress calls a penalty a “tax” than it is to find situations in which Congress labels a tax a “penalty.” The shared responsibility payment is unusual in this regard. *But cf.* *United States v. Sotelo*, 436 U.S. 268, 275 (1978) (“We . . . cannot agree . . . that the ‘penalty’ language of Internal Revenue Code § 6672 is dispositive of the status of respondent’s debt under Bankruptcy Act § 17a(1)(e). . . . That the funds due are referred to as a ‘penalty’ when the Government later seeks to recover them does not alter their essential character as taxes for purposes of the Bankruptcy Act . . .”). The paucity of instances in which Congress mislabels taxes as penalties suggests that judicial review of congressional labeling is unnecessary to ensure political accountability for tax increases.

Judge Kavanaugh, however, voiced a distinct expressive concern: “Section 5000A arguably does not just incentivize certain kinds of lawful behavior but also mandates such behavior,” with the consequence that “a citizen who does not maintain health insurance might be acting *illegally*.”²¹⁷ In his view, the “Taxing Clause has not traditionally authorized a legal prohibition or mandate, as opposed to just a financial disincentive or incentive.”²¹⁸ Although recognizing “that a legal mandate with a civil tax penalty for non-compliance is economically indistinguishable from a traditional regulatory tax if the amounts of the exactions are the same,” Judge Kavanaugh responded that “[s]uch an argument assumes that citizens care only about economic incentives and not also about complying with The Law.”²¹⁹ He noted the plaintiffs’ argument that “the United States does not necessarily consist of 310 million people who have over-absorbed their Posner,” for “common sense tells us that many citizens want to be law-abiding (and known as law-abiding), and that their desire to be law-abiding affects their behavior.”²²⁰ Judge Kavanaugh’s concern that the exaction may have the effect of a penalty, contrary to the CBO’s prediction, seems unwarranted in fact. Materiality outweighs expression if the exaction will have the effect of a tax, even though expression has some effects.

The minimum coverage provision (§ 5000A(a)) and the shared responsibility payment (§ 5000A(b)) are best read together, as parts of a whole (§ 5000A). Congress placed them together in the same section of the ACA, and the only legal consequence of not behaving in accordance with § 5000A(a) is contained in § 5000A(b). In other words, subsection (b) describes the tax consequences, and subsection (a) describes the circumstances triggering those consequences. The best reading of the statutory text and structure is that an applicable individual who goes

²¹⁷ *Seven-Sky*, 2011 WL 5378319, at 54–55.

²¹⁸ *Id.* at 55.

²¹⁹ *Id.* at 56.

²²⁰ *Id.* at 56–57.

without insurance is acting lawfully so long as she pays the exaction for non-insurance, which is the Government's position.²²¹ Moreover, the Court has previously upheld tax laws framed in mandatory language,²²² in accordance with the judicial obligation to construe federal laws so as to avoid constitutional problems.²²³

In sum, the ACA exaction for non-insurance is mixed because it has a penalty's expression and a tax's materiality. An exaction that has the expressive characteristics of a penalty, the material characteristics of a tax, and the predicted effect of a tax is most appropriately classified as a tax. Because the predicted effect of the ACA's exaction for non-insurance is to dampen uninsured behavior, not to prevent it, it is a *tax equivalent* for purposes of Congress's tax power.

CONCLUSION

If the Commerce Clause has limits, then "Taxes," which Congress may impose under the General Welfare Clause, must differ from regulations backed by penalties, which Congress may not impose under this clause. In this Article, we have identified analytical differences between taxes and penalties by interpreting constitutional text, structure, history, and precedent with help from economics. Taxes raise revenues and change behavior without preventing it. *Pure taxes* express permission to engage in the taxed conduct as long as one pays the tax. By contrast, penalties prevent conduct by imposing a high exaction relative to the gain of almost all actors

²²¹ *Id.* at 55 n.38. See Brief for Petitioners (Minimum Coverage Provision), Dep't of Health & Human Servs. v. Florida, No. 11-398, at 61 (January 2012) ("[N]either the Treasury Department nor the Department of Health and Human Services interprets Section 5000a as imposing a legal obligation on applicable individuals independent of its tax-penalty consequences; each instead views it as only a predicate provision for the imposition of tax consequences.").

²²² See, e.g., License Tax Cases, 72 U.S. (5 Wall.) 462, 471–72 (1867) (discussed *supra* note 136).

²²³ See, e.g., Northwest Austin Municipal Utility District Number One v. Holder, 557 U.S. __ (2009). Citing *Northwest Austin*, Judge Kavanaugh wrote that "perhaps the canon of constitutional avoidance would allow" the interpretation that non-compliance with the minimum coverage provision is lawful, thereby "squeeze[ing] it within the Taxing Clause." *Seven-Sky*, 2011 WL 5378319, at 55 n.38.

from engaging in the conduct, and by increasing the exaction for intentional or repeated wrongdoing. *Pure penalties* express a prohibition against the penalized conduct. This analysis implies that the exaction for non-insurance in the Affordable Care Act is a tax equivalent because it has the expressive characteristics of a penalty, the material characteristics of a tax, and almost certainly will have the effect of a tax. In these circumstances, the exaction’s name should make no difference to its constitutionality under the General Welfare Clause.²²⁴

²²⁴ In *Collective Action Federalism*, we suggested the possibility that the General Welfare Clause confers at least some regulatory authority. See Cooter & Siegel, *supra* note 15, at 170–75. We left unresolved, however, the permissible scope of Congress’s regulatory power under this clause. Nor can we fully resolve this difficult question here. We have shown, however, that (1) the General Welfare Clause authorizes Congress to tax; (2) some taxes are materially equivalent to regulations that dampen conduct without penalizing it; and (3) the material characteristics of an exaction generally affect conduct more than its expressive form when the two conflict. Because the General Welfare Clause permits federal taxation, it should also be interpreted as authorizing Congress to impose materially equivalent regulations, which we call “tax equivalents.”