ESSAY

RADICAL TAX REFORM, THE CONSTITUTION, AND THE CONSCIENTIOUS LEGISLATOR

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In an earlier article in these pages, Professor Erik M. Jensen examined the history of the Direct-Tax Clauses of the Constitution and concluded that two proposals for fundamental tax reform—the flat tax and the Unlimited Savings Allowance (USA) tax—would be unconstitutional as unapportioned direct taxes. In this essay, Professor Zelenak disagrees with that conclusion. Zelenak accepts, for the sake of argument, Jensen’s reading of the historical record, but differs with Jensen on how to apply the Direct-Tax Clauses to forms of taxation not imagined in the eighteenth century. He suggests that a conscientious legislator could decide that neither proposal would violate the Direct-Tax Clauses. Zelenak also argues that even if the proposals were viewed as unapportioned direct taxes, they would nevertheless be income taxes within the meaning of the Sixteenth Amendment, and thus would be relieved of the apportionment requirement.

In a recent article, Erik M. Jensen dusts off the Direct-Tax Clauses of the Constitution, long ignored by both courts and scholars, and considers what limitations they might impose on current proposals to replace the income tax with some form of consumption tax.¹ The clauses require that “direct Taxes” be apportioned among the states according to their populations.² The Sixteenth Amendment waives the apportionment requirement, but only for “taxes on incomes.”³ None of the proposed replacements for the income tax is apportioned. Thus, if a replacement is a direct tax, and if it is not an income tax, it is unconstitutional.

Jensen challenges the conventional wisdom that there is no way of knowing what—if anything—the founders believed a direct tax to be.⁴ He carefully examines the founding-era debates surrounding the Direct-Tax Clauses and demonstrates that the original understanding of the nature of direct taxes was considerably better developed than is usually sup-

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1. See Erik M. Jensen, *The Apportionment of “Direct Taxes”: Are Consumption Taxes Constitutional?*, 97 Colum. L. Rev. 2334 (1997).

2. See U.S. Const. art. I, § 2, cl. 3, & art. I, § 9, cl. 4.

3. U.S. Const. amend. XVI.

4. The standard quotation in support of the conventional wisdom is from James Madison’s notes of the Constitutional Convention: “Mr. King asked what was the precise meaning of *direct* taxation? No one ansd.” 2 *The Records of the Federal Convention of 1787*, at 350 (Max Farrand ed., rev. ed. 1966) (Aug. 20, 1787).

posed. He concludes that *indirect* taxes, not subject to the apportionment requirement, are taxes imposed on articles of consumption—"duties, imposts, and excises," in the language of the Constitution.⁵ The consumer may bear the burden of those taxes through a higher price, but that burden is indirect. And the consumer can avoid the burden altogether by deciding not to buy the taxed goods. A direct tax, by contrast, imposes taxes on individuals rather than on goods and provides "little if any option to avoid paying."⁶

From his research Jensen concludes that the four leading proposals for fundamental tax reform would have different constitutional fates.⁷ A value-added tax (VAT) and a retail sales tax (RST) are in the mold of the classic indirect taxes and need not be apportioned.⁸ But the flat tax and the Unlimited Savings Allowance (USA) tax are imposed directly on individuals. If enacted, they would be unapportioned direct taxes.⁹ They would be constitutional nevertheless, if they qualified as income taxes within the meaning of the Sixteenth Amendment. Jensen concludes, however, that the Amendment would not save either tax, because the base of each is consumption, not income.¹⁰

Jensen harbors no illusions that the Supreme Court would invalidate either tax. He notes that the modern Supreme Court has virtually abdicated its power to declare federal tax laws unconstitutional.¹¹ Given the havoc that would follow from a judicial declaration that the federal government's major revenue source was invalid, abdication might be prudent. Jensen suggests, however, that conscientious legislators should not enact an unconstitutional tax law merely because they could probably get away with it: "[L]egitimate reservations about the constitutionality of proposed revenue measures ought to affect congressional and popular debate. . . . It is not only the judiciary, after all, that should serve as guardian of constitutional values."¹²

Jensen's research on the original understanding of the Direct-Tax Clauses is a major accomplishment, presented with clarity and style.

5. See Jensen, *supra* note 1, at 2394. The U.S. Constitution provides: "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises . . ." U.S. Const. art. I, § 8, cl. 1.

6. Jensen, *supra* note 1, at 2337.

7. The proposals are briefly described *infra* Part I.

8. See Jensen, *supra* note 1, at 2405-07. Jensen refers to a "national sales tax" rather than a retail sales tax, but the meaning is the same.

9. See *id.* at 2407-08.

10. See *id.* at 2408-14.

11. See *id.* at 2416, 2419. I agree with Jensen that "it is hard to imagine a federal court's invalidating a taxing scheme of far-reaching import." *Id.* at 2414. See also Lawrence Zelenak, *Are Rifle Shot Transition Rules and Other Ad Hoc Tax Legislation Constitutional?*, 44 *Tax L. Rev.* 563, 610 (1989) (suggesting that if a court found the rifle shot transition rules in the Tax Reform Act of 1986 to be unconstitutional, there would be "very little chance that a court would actually adopt such an extreme remedy" as nullification of the entire Act).

12. Jensen, *supra* note 1, at 2419.

There is also a satisfying irony to his conclusions. In 1895 a conservative Supreme Court used an expansive interpretation of the Direct-Tax Clauses to invalidate a populist-inspired income tax.¹³ More than one hundred years later, Jensen has advanced his own interpretation of the clauses to challenge the constitutionality of conservative proposals to eliminate the income tax as we know it. Tax conservatives may have been hoisted on their own constitutional petard, albeit with some delay.

I admire Jensen's research, I appreciate the irony, and I agree that legislators should consider themselves bound by the Constitution even when the courts would fail to act. Nevertheless, I disagree with his advice to the conscientious legislator. I question his application of the original understanding of the Direct-Tax Clauses to the current reform proposals, and I disagree with his conclusion that the flat tax and the USA tax are not "taxes on income" under the Sixteenth Amendment.

In this essay I will explain why a conscientious legislator need not reject the flat tax and the USA tax on constitutional grounds. Part I briefly describes the four proposals for fundamental tax reform considered by Jensen. Parts II and III consider the constitutionality of the flat tax and the USA tax. An unapportioned tax is constitutional if it is not a direct tax, or (even if it is a direct tax) if it qualifies as a tax on income under the Sixteenth Amendment. Part II shows how a conscientious legislator could conclude that the flat tax and the USA tax are not direct, and thus not subject to the apportionment requirement. Part III argues that even if the flat tax and the USA tax are direct, they are within the scope of the Sixteenth Amendment's removal of the apportionment requirement for "taxes on income." Consumption taxes and income taxes may be mutually exclusive categories in the minds of many tax experts today, but under the Sixteenth Amendment some forms of consumption taxation—including the flat tax and the USA tax—qualify as income taxes.

I. CURRENT TAX REFORM PROPOSALS

Despite the differing appearances of the four proposals considered by Jensen, the base of each tax is consumption. The USA Tax, proposed by Senators Nunn, Kerrey, and Domenici, would retain much of the structure of the current income tax.¹⁴ As a "cash flow" version of a consumption tax, it has the same base as an income tax, except it allows a deduction for saved income (and it taxes spending out of savings).¹⁵ When savings are deducted from income, what remains as the tax base is consumption. The USA Tax is unique among the proposals considered by

13. See *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, *aff'd on reh'g*, 158 U.S. 601 (1895) (invalidating the Income Tax Act of 1894 as being in crucial respects an unapportioned direct tax).

14. See USA Tax Act of 1995, S. 722, 104th Cong. (1995) (sponsored by Sens. Nunn, Kerrey, and Domenici).

15. See *id.* § 50.

Jensen because it is not flat. It features marginal rates ranging from nineteen to forty percent.¹⁶

Although individuals (or married couples) would file USA tax returns in the same way they file income tax returns today, a consumption tax need not involve the filing of tax returns by individuals. A sufficiently broad-based retail sales tax (RST) would have the same aggregate tax base as the USA tax. Some commentators and politicians have called for replacing the income tax with a national RST, and Ways and Means Chairman Bill Archer has been supportive.¹⁷ A value-added tax (VAT) resembles an RST, but a portion of the tax is collected at each stage of the production process, rather than all at once upon sale to the consumer. In a subtraction-method VAT, a business pays tax on its total sales, reduced by deductions for purchases of inputs from other firms, and for purchases of plant and equipment.¹⁸ The logic behind this tax base is straightforward. Each firm in the production process is taxed on the value added by that firm. A deduction is allowed for purchased inputs because their cost represents value added by firms at earlier stages in the production process, which value has already been taxed to those firms. By the time the product reaches the consumer, all value added has been taxed once and only once, and the taxed value is the same amount that would be taxed at the cash register under an RST. Chairman Archer has also mentioned a VAT as a possible replacement for the income tax.¹⁹

The flat tax is a variation on a VAT. Designed by economists Robert E. Hall and Alvin Rabushka,²⁰ it has found political champions in Steve Forbes²¹ and Dick Armey.²² The flat tax splits a VAT into a two-part tax base. The business tax portion is the same as the base of a VAT, except there is a deduction for wages and salaries paid.²³ The wages deducted from the business tax are the base of the wage tax portion of the flat tax.²⁴ Simply subtracting wages from one part of the bifurcated base, and then adding them to the other part of the base, would result in a flat tax base identical to the base of a VAT. If both parts of the base are subject to the same flat rate—as they are in the flat tax proposal—bifurcation

16. See *id.* §§ 1, 15.

17. See Stephen Moore, *The Economic and Civil Liberties Case for a National Sales Tax*, 71 *Tax Notes* 101 (1996); Dan Balz, *Lugar Calls for a National Sales Tax to Replace Federal Levy on Income*, *Wash. Post*, Apr. 6, 1995, at A26; Clay Chandler, *Archer Calls for End to Income-Based Tax*, *Wash. Post*, June 6, 1995, at D1 (Archer undecided between national sales tax and some combination of sales tax and VAT).

18. See Charles E. McLure, Jr., *The Value-Added Tax: Key to Deficit Reduction?* 16 (1987).

19. See Chandler, *supra* note 17, at D1.

20. See Robert E. Hall & Alvin Rabushka, *The Flat Tax* (2d ed. 1995).

21. See Ernest Tollerson, *Bowing Out: Forbes Quits and Offers His Support to Dole*, *N.Y. Times*, Mar. 15, 1996, at A26 (summarizing the Forbes presidential campaign).

22. See *Freedom and Fairness Restoration Act of 1995*, H.R. 2060 and S. 1050, 104th Cong. (sponsored by Rep. Armey and Sens. Shelby, Craig, and Helms).

23. See Hall & Rabushka, *supra* note 20, at 55–57.

24. See *id.*

would seem to be a pointless exercise. The bifurcated tax would be nothing more than a needlessly complex version of a VAT. In fact, however, there is a point to the two-part base. Bifurcation makes it possible to exempt subsistence-level wages from tax. In the Hall-Rabushka proposal, the tax-free allowance for wages is \$16,500 for a married couple, \$9,500 for a single person, and \$14,000 for a single head of household, with an additional \$4,500 for each dependent.²⁵ In addition to eliminating the tax on subsistence wages, these exemptions also create average-rate progressivity in the system²⁶ and adjust tax liabilities to reflect differences in family size.

II. THE DIRECT TAX CLAUSE

Neither Jensen nor I claims that the application of the Direct-Tax Clauses to current tax reform proposals is free from doubt. Jensen generously concedes that some will disagree with his reading of the clauses, "including [some of] those who carefully study the historical record."²⁷ As the following discussion will demonstrate, my conclusions about the inapplicability of the Direct-Tax Clauses to the flat tax and the USA tax are also tentative.

Perhaps more important than our differences of constitutional interpretation are our differing views of how a conscientious legislator should proceed in the face of constitutional uncertainty when there will be no judicial review. Jensen suggests that the legislator should not vote for tax laws that raise any constitutional questions, even if it is clear that the Supreme Court would not intervene.²⁸ I disagree. If a legislator believes the USA tax or the flat tax is good policy, and is *probably* constitutional, then she should vote for it—even if the issue is not free from doubt, and even if Congress will be the only defender of the Constitution. I agree that the absence of judicial review is not a good reason for Congress to ignore the Constitution,²⁹ but neither is it a good reason for Congress to put itself in a constitutional straitjacket. If conscientious legislators may

25. See *id.* at 59 fig.3.1, 114 (all allowances would be indexed for inflation).

26. See *id.* at 55. The effect of a flat rate above an exemption is to make average tax rates rise with income, even though there is only one positive tax rate.

27. See Jensen, *supra* note 1, at 2415.

28. See *id.* at 2419.

29. See Laurence H. Tribe, *American Constitutional Law* 16 (2d ed. 1988) (constitutional questions should be taken seriously by legislators "*whether or not judges threaten to offer binding answers of their own*"); Paul Brest, *The Conscientious Legislator's Guide to Constitutional Interpretation*, 27 *Stan. L. Rev.* 585, 587 (1975) ("Legislators are obligated to determine, as best they can, the constitutionality of proposed legislation."); Hans A. Linde, *Judges, Critics and the Realist Tradition*, 82 *Yale L.J.* 227, 252 (1972) ("there is a constitutional law directly binding on government even without judicial review").

Similarly, I have argued that the executive branch should not promulgate a regulation inconsistent with a governing statute, merely because no one would have standing to challenge the regulation. See Lawrence Zelenak, *Does Treasury Have Authority to Index Basis for Inflation?*, 55 *Tax Notes* 841, 841 (1992).

vote for probably constitutional laws when there will be judicial review, they may also do so when there will not.

Or perhaps *probability* of constitutionality is not the right way to think about this situation. When Congress is the final arbiter of constitutionality, if enough legislators believe the provision is *probably* constitutional, and vote for it, then it is constitutional—in the same way that a judicially reviewable provision is constitutional if five justices believe it probably is, and decide accordingly.

A. *The USA Tax, the VAT, and Avoidability*

Jensen has no difficulty concluding that a VAT or an RST is constitutionally permissible: “[A] VAT [or an RST] is a classic indirect tax—like duties, imposts, and excises—and the founders thought that taxes on articles of consumption presented no constitutional problems.”³⁰ His analysis of the USA tax and the flat tax is more complicated, because they do not closely resemble any form of taxation known in the eighteenth century. Applying the Direct-Tax Clauses to forms of taxation unimagined by the founders is a difficult and uncertain task, and it is in the performance of that task that I part company with Jensen. Even accepting his reading of the historical record,³¹ I question his application of that record to novel forms of taxation.

Jensen remarks that mere novelty should not immunize a tax from challenge under the Direct-Tax Clauses, because “forms of taxation that were unknown or little known in 1787 might implicate the dangers at which the apportionment rules were directed.”³² What were those dangers? Jensen reports that the policy behind the constitutional distinction is that indirect taxes are less susceptible to abuse than direct taxes, and so are less in need of special constitutional restraints against “the danger of governmental overreaching.”³³ Individuals can choose not to buy a prod-

30. Jensen, *supra* note 1, at 2405.

31. His reading of the historical record is not beyond dispute, however, and has recently been contested in separate articles by Bruce Ackerman and Calvin H. Johnson. See Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 301 (1999); Calvin H. Johnson, *The Constitutional Meaning of “Apportionment of Direct Taxes,”* 80 Tax Notes 591 (1998). Johnson argues, on the one hand, that the founders understood direct taxes very broadly, as including all taxes except custom duties. See Johnson, *supra*, at 592. On the other hand, he argues that the founders did not intend the apportionment requirement to hobble the federal government’s ability to raise revenue; thus they would not have required apportionment of any tax incapable of apportionment as a practical matter. See *id.* Ackerman concludes that, at most, the Direct-Tax Clauses should be read to cover only capitation taxes and real estate taxes. See Ackerman, *supra*, at 55–58. Moreover, he argues that because the Clauses were a part of the slavery compromise in the original Constitution, and because that compromise lost its point following the Reconstruction Amendments, an even narrower interpretation is appropriate today. He would apply the Clauses only to capitation taxes. See *id.* at 58.

32. Jensen, *supra* note 1, at 2356.

33. *Id.* at 2337.

uct subject to an indirect tax, and so avoid the tax.³⁴ As an eighteenth-century statement of this position, he cites the antifederalist Brutus: “[I]f [imposts] are laid higher than trade will bear, the merchants will cease importing, or smuggle their goods. We have therefore sufficient security, arising from the nature of the thing, against burdensome and intolerable impositions from this kind of tax.”³⁵

Jensen understandably does not dwell on the reference to smuggling. It is hard to believe that ease of illegal evasion is a constitutional virtue in a tax. In any event, he makes no attempt to prove that a VAT or an RST is easier to cheat on than the USA tax or the flat tax.

The more serious constitutional policy relates to *legal* avoidability. Jensen concludes that the USA tax and the flat tax are not sufficiently avoidable to qualify as indirect: “The tax liability falls directly on individuals, with nothing hidden, . . . and no purchasing decision to serve as a protection against governmental overreaching.”³⁶ The problem with this analysis is that it does not distinguish the permissible VAT and RST from the impermissible taxes. If practical avoidability is the key, the VAT and RST should be constitutionally dubious, despite their classic indirect forms. With a narrow-based eighteenth-century indirect tax, such as a tax on certain imports, avoidance was a real option. The consumer could buy a domestic product, or perhaps substitute a non-taxed import. By contrast, only a miser can avoid a modern broad-based VAT or RST. Avoidance would require ceasing *all* purchases for consumption, not just of imports or of particular products.

Is a tax indirect if it can be avoided by not spending at all, or is it indirect only if it can be avoided by not spending on particular products? The founders never imagined a consumption tax with a base as broad as a modern VAT, so we cannot be sure whether avoidability by a miser would have sufficed to make a tax indirect in their view. A possible conclusion is that Jensen is right about the USA tax and the flat tax, but wrong about the VAT and the RST. Despite their formal indirectness, the latter taxes may be too broadly based—and thus too hard to avoid—to qualify as indirect.

A conscientious legislator could, however, reasonably reach a different conclusion. She could accept Jensen’s view that even a broad-based VAT (or RST) is an indirect tax, because of its form. Having accepted that conclusion, the legislator might consider whether there is any avoidability difference of constitutional dimensions between a VAT and the USA tax or the flat tax. Jensen notes that one can theoretically avoid the USA tax by saving all one’s income, but he thinks this is not enough to qualify the tax as indirect: “The ‘should-I-save-or-should-I-consume?’

34. See *id.* at 2337, 2405.

35. Essays of Brutus, N.Y.J., Dec. 13, 1787, reprinted in 2 *The Complete Anti-Federalist* 388, 392–93 (Herbert J. Storing ed., 1981) (cited in Jensen, *supra* note 1, at 2396).

36. Jensen, *supra* note 1, at 2407.

decision is far more abstract than the choice inherent in the archetypical indirect tax: Do I buy *this particular product* and pay the associated tax?"³⁷ That serves to distinguish the USA tax from an eighteenth-century impost, but not from a modern VAT. There is only one technique for avoiding a modern VAT, and it is identical to the technique for avoiding the USA tax: Be a miser. If that means of avoidance is sufficient to make a VAT indirect, it should also be sufficient to make the USA tax indirect. In contrast to both a VAT and the USA tax, the flat tax cannot be avoided even by a miser, if he earns an above-subsistence wage.³⁸ Thus the legislator might accept the constitutionality of the USA tax, but continue to harbor doubts about the flat tax.

In short, the policy Jensen identifies as the foundation of the Direct-Tax Clauses—avoidability—does not support the constitutional distinction he draws between a VAT (or an RST) and the USA tax. A conscientious legislator could accept Jensen's conclusion about the VAT, decide that the VAT and the USA taxes are indistinguishable in terms of avoidability, and vote for an unapportioned USA tax.

B. *The Flat Tax*

Although the flat tax is distinguishable from a VAT or an RST with respect to avoidability, there are other serious problems with Jensen's conclusion that an unapportioned flat tax violates the Direct-Tax Clauses. Those problems are discussed below.

1. *The Flat Tax and a VAT-Rebate System.* — As explained earlier, the flat tax is a bifurcated version of a subtraction-method VAT.³⁹ The only substantive difference is the flat tax's exemption for subsistence wages.

This close kinship between the flat tax and a VAT has implications for Jensen's analysis. If Jensen is right—if a VAT is indirect but the flat tax is direct—then bifurcating a VAT to provide an exemption for subsistence wages is unconstitutional. That is a surprising result, not supported by any obvious policy arguments.

Things get stranger still. In an earlier article I explained how results virtually identical to the flat tax—i.e., a VAT modified to provide an exemption for the cost of subsistence consumption—can be achieved without the bifurcation approach of the flat tax.⁴⁰ The alternative uses a simple subtraction-method VAT, but relieves the tax on subsistence by

37. *Id.* (emphasis added).

38. Alice G. Abreu suggests that tax systems are empowering to the extent they allow taxpayers to choose how much tax they will pay by altering their behavior. See Alice G. Abreu, *Taxes, Power and Personal Autonomy*, 33 *San Diego L. Rev.* 1 (1996). Although she only hints at how empowerment analysis should be applied to fundamental tax reform proposals, see *id.* at 77 n.174, the ability to avoid tax by saving seems to offer more choice than the ability to avoid tax by not working.

39. See *supra* text accompanying notes 20–26.

40. See Lawrence Zelenak, *Flat Tax vs. VAT: Progressivity and Family Allowances*, 69 *Tax Notes* 1129 (1995).

sending each family a rebate check equal to the VAT burden on subsistence consumption for a family of that family's size and composition.⁴¹

The universal rebate accomplishes the same goals the flat tax accomplishes through bifurcation. Subsistence consumption is exempt from tax, average tax rates are progressive, and tax burdens are adjusted for family size, all without the need for wage tax returns.⁴² For the vast majority of families, tax burdens would be the same under either system. The only two substantive differences are minor. First, the VAT-rebate system provides a subsistence exemption for a family that finances current consumption out of wages saved from a previous year, whereas the flat tax does not⁴³ (except in the case of qualified retirement savings).⁴⁴ Second, the VAT-rebate system results in net transfers to families that consume below the subsistence level, whereas the flat tax does not.⁴⁵

Jensen does not discuss the constitutional status of a VAT-rebate system, but nothing in his analysis suggests that coupling a VAT with a universal rebate of the tax on subsistence consumption would affect the indirect status of a VAT. If anything, the rebate increases the avoidability of a VAT, thus making it more clearly indirect. If the VAT-rebate system is constitutional but the flat tax is not, the implication is that the two minor substantive differences are constitutionally decisive. I cannot imagine any policy underlying the Direct-Tax Clauses to which those differences could be relevant.

Without a clearer mandate, in text or history, for Jensen's reading of the clauses, a conscientious legislator could reject it simply because it implies an irrational distinction between a VAT (especially a VAT with a universal rebate) and the flat tax. The legislator could conclude that if Jensen is right about the VAT, he must be wrong about the flat tax.

2. *Two Taxes or One: A Constitutional Question?* — Jensen's application of the Direct-Tax Clauses to the flat tax occupies just one short paragraph of his article.⁴⁶ It is so conclusory that it requires some unpacking, but I think the expanded version would go as follows: (1) Viewing the two parts of the flat tax together, it is a consumption tax.⁴⁷ (2) A con-

41. See *id.* at 1130.

42. See *id.*

43. See *id.* at 1132.

44. The flat tax provides that qualified retirement savings are subject to the wage tax when received in retirement, not when earned. See Hall & Rabushka, *supra* note 20, at 58–59.

45. See Zelenak, *supra* note 40, at 1132–33. Since the rebate equals the VAT that would be paid on subsistence consumption, a family that consumes below the subsistence level would receive a rebate greater than the VAT actually paid, resulting in a net transfer from the government to the family. By contrast, the same family would pay no tax and receive no refund under the flat tax, resulting in no net transfer in either direction. See *id.*

46. See Jensen, *supra* note 1, at 2407.

47. Jensen makes this point explicitly earlier in the article. See *id.* at 2403–04.

sumption tax is direct if "[t]he tax liability falls directly on individuals."⁴⁸ (3) One part of the flat tax—the wage tax—falls directly on individuals, and that is enough to make it a direct tax.

Consider what happens, though, if the two parts of the flat tax are considered independently. Viewed apart from the wage tax, the business tax meets Jensen's standards for a "classic indirect tax."⁴⁹ The tax is embedded in the price of products, not imposed directly on individuals, and it can be avoided by not buying the products.

The constitutional status of the wage tax is more complicated. It would seem to be direct under Jensen's description of a direct tax as "fall[ing] directly on individuals, with nothing hidden, no state intermediaries to buffer the effects, and no purchasing decision to serve as a protection against governmental overreaching."⁵⁰ But this does not take into account the Supreme Court's understanding, expressed in the *Pollock* opinion of 1895, that a tax imposed solely on earned income is *not* a direct tax.⁵¹ The Court assumed that a tax on earned income alone would be constitutional without apportionment; the tax on earned income was invalidated only because the Court viewed it as not severable from the unapportioned direct tax on income from property.⁵²

Viewing the two portions of the tax separately, each appears constitutional: the business tax under Jensen's own historical analysis, and the wage tax under *Pollock* (the most expansive Supreme Court interpretation ever given to the Direct-Tax Clauses). Jensen reaches his conclusion of unconstitutionality too easily. The key issues requiring more careful consideration are the current status of the *Pollock* view of wage taxes, and whether the flat tax should be viewed as two separate indirect taxes or as a single direct tax.⁵³

48. Id. at 2407.

49. Id. at 2405.

50. Id. at 2407.

51. "We have considered the act only in respect of the tax on income derived from . . . property, and have not commented on so much of it as bears on gains or profits from business, privileges, or employments, in view of the instances in which taxation on business, privileges, or employments has assumed the guise of an excise tax and been sustained as such." *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 635 (1895).

52. If the tax on income from property were stricken from the act, "this would leave the burden of the tax to be borne by professions, trades, employments, or vocations; and in that way what was intended as a tax on capital would remain in substance a tax on occupations and labor." Id. at 637.

53. Although this question has some similarities to severability analysis, it is not the same. Severability is an issue when a portion of an act is unconstitutional, and a court must consider whether Congress would rather have the constitutional portion without the unconstitutional portion, or no act at all. Here, by contrast, if the two taxes are analyzed independently, there is no constitutional violation, and the severability question never arises.

a. *Pollock and Wage Taxes*. — Although Jensen never directly challenges the *Pollock* view of wage taxes, he hints at disagreement.⁵⁴ His historical analysis suggests that direct imposition of a tax on individuals should make the tax constitutionally direct, regardless of its base.

It is true that the *Pollock* opinion offers virtually no explanation of why a wage tax is not direct, and it is also true that the opinion's blessing of a wage tax is dictum, since the Court ultimately invalidated the wage tax, finding it not severable from the tax on income from capital. Nevertheless, the *Pollock* support for the constitutionality of an unapportioned wage tax is considerably more than "a possibility suggested by *Pollock*,"⁵⁵ or a "hint,"⁵⁶ as Jensen describes it. Rather, it is central to the structure of the Court's analysis, and it is the entire motivation for the Court's discussion of severability.⁵⁷ If a tax on earned income were itself direct, there would have been no need for the Court to consider severability.

Pollock is the broadest Supreme Court interpretation of the Direct-Tax Clauses in history, and even the *Pollock* opinion takes it for granted that a wage tax is not direct. Given the complete absence of judicial support for the proposition that a wage tax is direct, it is very late in the day to challenge the *Pollock* view. It is especially late considering that Social Security taxes are unapportioned wage taxes; if *Pollock* is wrong about wage taxes, then billions of dollars of Social Security taxes may have been unconstitutionally collected over the past six decades. The constitutionality of the Social Security wage tax has not been seriously questioned, however, for many years.⁵⁸ Either it is not a direct tax (following *Pollock*), or it

54. On the *Pollock* Court's distinction between property income and earned income, Jensen comments: "It is not clear why earned income might be treated differently, except that it is easier to fit a tax on income from property into the conceptual boxes created by *Hylton*." Jensen, *supra* note 1, at 2370 n.190. The reference is to *Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796), the first Supreme Court decision interpreting the Direct-Tax Clauses.

55. Jensen, *supra* note 1, at 2411, n.403.

56. *Id.* at 2343 n.43.

57. See *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 635–37 (1895).

58. Although there have been vigorous challenges to the constitutionality of Social Security taxes, no court has ever given serious consideration to the claim that they are invalid as unapportioned direct taxes. In the course of rejecting various constitutional challenges to a Social Security unemployment insurance wage tax imposed on *employers*, the Supreme Court remarked, "A capitation or other 'direct' tax it certainly is not." *Steward Mach. Co. v. Davis*, 301 U.S. 548, 582 (1937). A companion case involved an employer's (more precisely, a shareholder's) constitutional challenge to both the employer and employee portions of the old age benefits tax. See *Helvering v. Davis*, 301 U.S. 619 (1937). The Court affirmed the district court's ruling that the employer had no standing to challenge the employee portion of the wage tax. See *id.* 638, 646. Interestingly, the reported arguments of the employer's attorney did *not* include a claim that the employee tax was an unapportioned direct tax. See *id.* at 625–34.

The Fifth Circuit dealt rather summarily with a later constitutional challenge to the Social Security self-employment tax. See *Cain v. United States*, 211 F.2d 375 (5th Cir. 1954). The taxpayer's challenge was based on the Tenth Amendment, not the Direct-Tax Clauses, but the court used sweeping language:

qualifies as an income tax under the Sixteenth Amendment,⁵⁹ or both. In any event, one cannot argue that the wage tax portion of the flat tax violates the Constitution unless one is prepared to claim the same for the Social Security tax.

b. *How Many Taxes?* — Given that an attack on the *Pollock* view of wage taxes appears so unpromising, the second question becomes the real key. For purposes of constitutional analysis, are the two parts of the flat tax a single unapportioned direct tax, or two indirect taxes not requiring apportionment? Jensen's assumption (unstated) that the two parts must be considered together is certainly defensible, especially considering the insistence by the leading academic proponents of the flat tax that it is a package deal.⁶⁰ Still, the conscientious legislator might reasonably question an argument against the flat tax which works only if the wage and business taxes are analyzed together. Or the conscientious legislator might decide that any constitutional scruples would be adequately addressed simply by embodying the wage and business taxes in separate (albeit companion) pieces of legislation.

3. *The More Dangerous Tax?* — Jensen's interpretation of the Direct-Tax Clauses is based on the idea that indirect taxes are those that consumers can avoid. Because of avoidability, indirect taxes "contain their own protection against abuse," and require no special constitutional constraints.⁶¹ Direct taxes, by contrast, are dangerous precisely because they are not readily avoidable: "Without rules, even arbitrary rules, to constrain their imposition, the danger of governmental overreaching is too great."⁶² Jensen concludes that the flat tax is a dangerous direct tax subject to the apportionment requirement, but a VAT is a docile, self-policing indirect tax. Ironically, the leading proponents of the flat tax have the opposite view of the dangers of the two taxes. Hall and Rabushka

Congress can constitutionally, in imposing income taxes, distinguish between earned and unearned income and between income from various kinds of property and occupations, and has often done so. The imposition and collection of an additional income tax on the income of persons not self employed has been going on without contest or question for many years. We think it clear that persons receiving income from self employment can be subjected to additional income taxes . . . to the same extent

Id. at 377. If the court was correct in its assumption that a wage tax is an income tax, then whether a wage tax is a direct tax is a moot question.

In the only case I have found in which a taxpayer specifically raised an objection to Social Security taxes under the Direct-Tax Clauses, the court summarily dismissed the argument as "frivolous and groundless." *Diffley v. Commissioner*, 54 T.C.M. (CCH) 1585, 1587 (1985).

59. The scope of the Sixteenth Amendment's reference to "taxes on incomes" is discussed *infra* Part III.

60. See Hall & Rabushka, *supra* note 20, at 60. ("Again, we stress that the wage tax is not a complete income tax on individuals; it taxes only wages, salaries, and pensions. The companion business tax picks up all other components of income. Together they form an airtight tax system.").

61. See Jensen, *supra* note 1, at 2337.

62. *Id.*

claim that the wage tax portion of the flat tax—precisely the part Jensen finds dangerously direct—is an important *protection* against excessive taxation. According to them, it serves to restrain Congress from increasing tax rates, by making increases more visible than they would be under a simple VAT:

If individuals did not file returns [as they would not under a simple VAT], advocates of more government spending could promise voters new benefits without higher costs. They would promise to place new taxes solely on rich, anonymous corporations, as if those taxes will not affect the employees or the owners of those corporations.⁶³

The two sides have differing views about which tax is more dangerous because each relies on a different method of tax resistance. Hall and Rabushka want effective political resistance to increased tax rates, and they think such resistance is more likely to succeed with a visible flat tax than with a hidden VAT.⁶⁴ Jensen's concern is for taxpayers' ability to engage in do-it-yourself avoidance of an enacted tax. From that perspective, he reasonably views a tax on consumption purchases as more avoidable (and so less dangerous) than a tax on wage income.

Which concern is more relevant today? There is room for debate, but it is interesting that Hall and Rabushka, who have done considerable thinking on the subject, are convinced that it is the VAT that carries the greater threat of excessive taxation. This, too, could give the conscientious legislator pause before accepting Jensen's conclusions.

4. *The Bottom Line.* — Nothing I have said definitively refutes Jensen's analysis. He makes a plausible case that the flat tax, viewed in the least favorable light, is a direct tax. But to accept that case, one must ignore the close kinship between the flat tax and a concededly indirect VAT, ignore the fact that each component of the flat tax considered independently is indirect, and ignore the fact that the flat tax probably provides better protection against governmental overreaching than the indirect VAT. A conscientious legislator could decide not to ignore those points, and thus reject Jensen's conclusions.

III. THE SIXTEENTH AMENDMENT

Even if the flat tax and the USA tax are direct, they are still constitutional if they are "taxes on incomes." The Sixteenth Amendment would

63. Hall & Rabushka, *supra* note 20, at 121. Jensen twice notes in passing the low visibility of a VAT—the fact that it is a somewhat hidden tax—but he does not consider the implications of that low visibility for his constitutional analysis. See Jensen, *supra* note 1, at 2337, 2405.

64. To the extent there is a political difference between the two taxes, they are probably correct. I have previously suggested, however, that they may underestimate the political difficulty of raising rates even under a VAT. If the VAT were the major federal revenue source, proposed rate increases would be major news, and resulting price increases would be noticed. See Zelenak, *supra* note 40, at 1133.

then relieve them of the apportionment requirement. Jensen concludes that neither qualifies as an income tax.⁶⁵ Although he concedes that Congress need not tax all income in order to have an income tax,⁶⁶ he argues that the exclusion of broad categories of income from the tax base "could leave a tax base that is not income in any generally accepted sense."⁶⁷ Thus a cash flow tax (such as the USA tax), which exempts all saved income from tax, may no longer be an income tax. The same logic applies to a flat tax, which achieves similar results through different means.⁶⁸ Jensen also argues that, however much leeway the Sixteenth Amendment gives Congress in designing an income tax, the Amendment does not apply when Congress does "not purport to be engaged in defining 'incomes.'"⁶⁹ Proponents of fundamental tax reform cannot claim they are (in the words of Ways and Means Chairman Bill Archer) "pull[ing] the income tax out by its roots and throw[ing] it away," and then use the Income Tax Amendment to defend the constitutionality of the replacement.⁷⁰ Jensen acknowledges that politicians sometimes claim that their radical tax reform proposals are income taxes, but he thinks they are dissembling.⁷¹ The experts behind the proposals know better; they clearly state that the base of their proposals is consumption.⁷² Instructed by the experts, politicians also know better. If they claim otherwise, it is a subterfuge.⁷³

Jensen's arguments are far from frivolous,⁷⁴ but in the end I am not persuaded. The argument that excluding saved income from the tax base is inconsistent with an income tax proves too much. It suggests that the actual income tax has long been on shaky constitutional ground—that it may have been unconstitutional at times in the past, and that it could become unconstitutional again at any time, even without radical tax reform. The second argument—that the politicians and the experts know their proposals are not income taxes—is based on a misunderstanding of the "smoking gun" quotation from Bill Archer, on an inadequate survey of the experts' terminology, and on a category mistake.

65. See Jensen, *supra* note 1, at 2408–14.

66. See *id.* at 2408.

67. *Id.* at 2410.

68. Perhaps the simplest way to see the similar result under the flat tax is to start with the fact that the flat tax is a bifurcated VAT. See *supra* notes 23–24 and accompanying text. A VAT obviously taxes only consumption, not saving.

69. Jensen, *supra* note 1, at 2411.

70. See *id.* at 2411. Jensen takes the Archer quotation from John Godfrey, Archer Keen on Killing Code; Full Speed Ahead on Tax Reform, 70 *Tax Notes* 1431, 1431 (1996) (quoting Archer's comments at a press conference on Mar. 4, 1996).

71. See Jensen, *supra* note 1, at 2411–13.

72. See *id.* at 2412.

73. See *id.* at 2413.

74. They are fundamentally different, however, from his analysis of the Direct-Tax Clauses, in that they are not based on historical research on the original understanding of the provision in question.

A. *Falling Off a Constitutional Tightrope?*

Jensen takes the classic Haig-Simons definition of income as the starting point for his analysis. Haig-Simons defines a person's income for a given accounting period as the value of consumption during the period plus the change in the value of property rights between the beginning and the end of that period.⁷⁵ The actual income tax has never closely approached this ideal; its base has always been an income-consumption hybrid.⁷⁶ The Supreme Court has even held that too close an approach to a Haig-Simons income tax is *itself* unconstitutional. In the famous early case of *Eisner v. Macomber*,⁷⁷ the Court indicated that a tax on unrealized appreciation is unconstitutional, because unrealized appreciation is *not* income within the meaning of the Sixteenth Amendment. The health of *Macomber* is doubtful today, but the modern Court continues to cite it as good law.⁷⁸

If a tax that too closely approaches Haig-Simons is not an income tax (according to *Macomber*), and if a tax that strays too far from Haig-Simons is not an income tax (according to Jensen), then the Sixteenth Amendment requires Congress to walk a tightrope. Or if there is no longer a constitutional danger of falling off on the *Macomber* side, then the metaphor changes, with Jensen's analysis putting Congress on a constitutional ledge, always at risk of falling off by legislating too narrow a tax base. A more reasonable conclusion is that just as "[t]he Fourteenth Amendment does not enact Mr. Herbert Spencer's Social Statics,"⁷⁹ the Sixteenth Amendment does not enact Dr. Haig's and Dr. Simon's definition of income, and the fact that a tax base is less inclusive—even far less inclusive—than Haig-Simons does not render it constitutionally suspect.

If the Sixteenth Amendment really does put Congress on a tightrope or a ledge, then Congress could fall off by making the base too narrow, *even without* enacting radical tax reform. Perhaps it has already done so. Especially significant departures from Haig-Simons are the failure to tax unrealized appreciation⁸⁰ and the deferral of tax on qualified retirement

75. See Jensen, *supra* note 1, at 2404 & n.373 (citing Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* 50 (1938)).

76. See Edward J. McCaffery, *Tax Policy Under a Hybrid Income-Consumption Tax*, 70 *Tex. L. Rev.* 1145, 1146 (1992) (describing the actual income tax as a hybrid system, and considering possible justifications for such a system).

77. 252 U.S. 189, 219 (1920).

78. See Jensen, *supra* note 1, at 2408 n.393 (citing *Cottage Sav. Ass'n. v. Commissioner*, 499 U.S. 554, 563 (1991)). On the other hand, in the same case the Court describes the realization requirement as resting on "administrative convenience," suggesting a downgrading of *Macomber* to sub-constitutional status. See 499 U.S. at 559 (quoting *Helvering v. Horst*, 311 U.S. 112, 116 (1940)).

79. *Lochner v. New York*, 198 U.S. 45, 75 (1905) (Holmes, J., dissenting).

80. Generally, an increase in the value of an asset is taxed only upon the "sale or other disposition" of the asset. See I.R.C. § 1001(a) (West 1998). According to Louis Kaplow, the most important category of unrealized appreciation not subject to tax is human capital (i.e., the present value of one's future earning potential). See Louis Kaplow, *Human*

savings (including individual retirement accounts).⁸¹ Other important departures include permanent exemption from tax of certain kinds of income from property (such as interest on municipal bonds⁸² and the investment return on Roth IRAs⁸³), various non-recognition provisions for deferring gain,⁸⁴ and accelerated cost recovery system (ACRS) allowances.⁸⁵

Jensen suggests that "[a]t some point" the so-called income tax could acquire so many consumption tax features that it would no longer be within the scope of the Sixteenth Amendment.⁸⁶ This raises the possibility that Congress might slip off the tightrope by enacting incremental tax reform, rather than jumping off with radical reform. As Ernest S. Christian has recently observed, both the flat tax and the USA tax can be understood as "part of a long process of evolutionary change in the tax code [toward a consumption base] that has been going on for many decades," rather than as "radical futuristic tax designs."⁸⁷ Continued incremental movement in that direction—more generous ACRS deductions, lower capital gains rates, and increased ceilings on IRA contributions, for example—might one day result in an unconstitutional tax system, under Jensen's analysis.

Perhaps that happened in 1981, without anyone having noticed. The Reagan-inspired Economic Recovery Tax Act of 1981 (ERTA) permitted cost recovery deductions so rapid that, when combined with the investment tax credit,⁸⁸ they were the economic equivalent of expensing

Capital Under an Ideal Income Tax, 80 Va. L. Rev. 1477, 1478, 1498–1500 (1994). I have questioned this view of human capital as unrealized appreciation. See Lawrence Zelenak, *The Reification of Metaphor: Income Taxes, Consumption Taxes and Human Capital*, 51 Tax L. Rev. 1 (1995).

81. See I.R.C. §§ 219, 408 (individual retirement accounts), 401–420 (providing rules for employer-provided pensions and individual retirement accounts) (West 1998).

82. See *id.* § 103.

83. See *id.* § 408A.

84. Examples include I.R.C. sections 351 (transfers to a controlled corporation in exchange for stock), 368 (various corporation reorganizations), 1031 (like kind exchanges), and 1033 (involuntary conversions). See *id.* §§ 351, 368, 1031, 1033.

85. See *id.* § 168. The proper cost recovery allowance under an income tax is based on economic depreciation. A consumption tax, by contrast, allows immediate expensing of the cost of business assets. The ACRS allowances are somewhere between the income tax and consumption tax poles, although the current version is closer to the income tax approach. But see *id.* § 179 (permitting expensing of a limited dollar amount of assets which would otherwise be subject to ACRS).

86. Jensen, *supra* note 1, at 2410.

87. Ernest S. Christian, *De-Radicalizing Tax Reform*, 79 Tax Notes 243, 244 (1998).

88. See Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 209, 95 Stat. 172, 226–27 (codified at I.R.C. § 168 (West 1994)). The investment tax credit (ITC) was available for most depreciable property other than buildings, and in most cases equalled 10% of the taxpayer's investment. See I.R.C. §§ 38, 46 (1982). The ITC was repealed by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 211, 100 Stat. 2085, 2166.

for many business assets.⁸⁹ Expensing of investments is a major consumption tax feature. Considering ERTA's expensing-equivalent together with other consumption tax features—such as the treatment of retirement savings, unrealized appreciation, and capital gains—the “income tax” of the early 1980s was as much consumption tax as income tax.⁹⁰ According to one expert writing in 1985, “*Flow of Funds* data on the combined size of . . . tax-favored investments suggest that we are at least halfway to the consumption tax already.”⁹¹ Although the Tax Reform Act of 1986 brought the income tax back from the consumption tax brink,⁹² from 1981 to 1986 the “income tax” may have been unconstitutional as an unapportioned direct tax, if Jensen is right. While such a “gotcha” reading of the Sixteenth Amendment is possible, it is unappealing, and Jensen offers no evidence that it is required by text or by history.

Just as incremental changes in the “income tax” might make it unconstitutional under Jensen's analysis, incremental changes in the flat tax might make it constitutional. Although the combined base of the bifurcated wage/business flat tax is consumption, the base would become income if expensing of investments under the business tax were replaced by depreciation.⁹³ Hall and Rabushka suggest, as an acceptable variation on their flat tax proposal, *partial* expensing of investments, presumably with depreciation of the remaining cost.⁹⁴ Partial expensing results in an income/consumption tax hybrid. Under Jensen's tipping point analysis, the constitutionality of the tax would depend on the extent of permitted expensing. Presumably eighty percent expensing and twenty percent depreciation would still be an unconstitutional consumption tax, but at some point (sixty percent expensing? fifty percent? forty percent?), the income tax element would be sufficient to validate the tax. Again, such a reading of the Sixteenth Amendment is possible, but it is neither attractive nor required by text or history.

89. See Marvin A. Chirelstein, Back From the Dead: How President Reagan Saved the Income Tax, 14 Fla. St. U. L. Rev. 207, 219–20 (1986).

90. “ERTA reflected . . . hostility toward . . . the income tax as a whole, and a preference for the old but newly risen idea of a tax on consumption.” *Id.* at 220. ERTA was part of a movement “towards a consumed income tax by gradually eliminating or reducing the taxes on capital income, for example, the capital gains tax cuts, the IRAs, the 401(k)s, and things of that type.” Charles Walker, Comments of Panel Commentators to Prof. Graetz's Address, 5 Va. Tax Rev. 589, 590 (1986) (commenting on Michael Graetz, Introduction to the Edwin S. Cohen Tax Symposium: An Overview of Business Taxation, 5 Va. Tax. Rev. 577 (1986)).

91. Don Fullerton, The Consumption Tax: An Idea Whose Time Has Come?, 27 Tax Notes 435, 438 (1985).

92. See Chirelstein, *supra* note 89, at 224–25.

93. See David F. Bradford, Tax Reform: Waiting for a New Consensus of the Experts, 79 Tax Notes 899, 901 (1998).

94. See Hall & Rabushka, *supra* note 20, at 81–82.

B. *What's in a Name?*

1. *The Politicians.* — Jensen himself may not be much attracted to the idea of a constitutional tightrope; he presents his argument for the tightrope quite tentatively.⁹⁵ He states his second argument with much more conviction: A Congress which claims to be pulling the income tax out by the roots and throwing it away cannot look to the Sixteenth Amendment to validate the replacement.⁹⁶ The problem with this argument is that the members of Congress using the anti-income tax rhetoric are not those calling for adoption of the flat tax or the USA tax. Jensen furnishes only one quotation in support of his claim—from Bill Archer—and it is singularly inapposite. Archer wants to replace the income tax with a VAT or a retail sales tax (indirect taxes, under Jensen's analysis), *not* with the flat tax or the USA tax, so he cannot be cited as a proponent of the taxes challenged by Jensen.⁹⁷ In fact, Archer regularly characterizes the flat tax as an *income* tax, and rejects the flat tax precisely because it is an income tax: "In my common sense, if your wages are going to be taxed before you get them, that's an income tax."⁹⁸ Archer is a flat-tax opponent who thinks it is an income tax, not a proponent who thinks it is not. And far from looking to the Sixteenth Amendment to validate his preferred tax system, Archer advocates repeal of the Amendment.⁹⁹

Jensen cites no evidence that actual proponents of either the flat tax or the USA tax claim to be rejecting income taxation. In fact, proponents of both describe their proposals as income taxes. Senator Domenici describes the philosophy of the USA tax as "tax[ing] *income* that is not saved or invested,"¹⁰⁰ and Representative Armey describes the flat tax as embodying the policy that "[a]ll income should be taxed only once."¹⁰¹

2. *The Experts.* — That leaves only the argument that the politicians really know better. The experts have told them that their proposals are not income taxes, and the politicians are trying to deceive the public by claiming the income tax label.¹⁰² The problem with this argument is that

95. See Jensen, *supra* note 1, at 2410–11.

96. See *id.* at 2411.

97. See Chandler, *supra* note 17.

98. Jacqueline Rieschick, March Madness Spurs Trash Talk on Tax Reform, 78 Tax Notes 1209, 1210 (1998) (quoting Archer's remarks following a tax reform debate sponsored by the American Enterprise Institute).

99. See Chandler, *supra* note 17.

100. Hearings on S. 722 before the House Comm. on Ways and Means, Federal News Service, June 7, 1995 (available in Lexis ARCNWS file) (prepared testimony of Sen. Pete V. Domenici) (emphasis added).

101. Dick Armey & Billy Tauzin, Should We Scrap the System? Flat Tax or Sales Tax, A New System Should Have a Single Rate and Shouldn't Favor Any One Type of Income, L.A. Times, Oct. 5, 1997, at M5.

102. Someone must be wrong about the public's response to the income tax label. The conventional wisdom (to which I have subscribed myself) is that fundamental tax reform is more marketable if described as a different version of the income tax. See Michael J. Graetz, The Decline (and Fall?) of the Income Tax 216–220 (1997); Jensen, *supra* note 1, at 2411; Zelenak, *supra* note 40, at 1134. Bill Archer, by contrast, must

even expert use of tax base terminology is not consistent. It is true that the majority academic usage would describe the USA and flat taxes as consumption taxes, but calling them income taxes has a long history and important adherents today.

Many decades ago, the prominent economist Irving Fisher argued that income should be defined as consumption.¹⁰³ Under the Fisher usage, either the flat tax or the USA tax would be an income tax. Henry Simons strongly objected to Fisher's terminology,¹⁰⁴ but some later experts have followed Fisher's lead in calling a cash flow tax a kind of income tax. Consider, for example, the title of William D. Andrews's path-breaking article on the administrability advantages of a cash flow tax: "A Consumption-Type or Cash Flow Personal *Income* Tax."¹⁰⁵ Jensen describes Andrews's terminology as "assum[ing] away any constitutional objections,"¹⁰⁶ but every indication is that Andrews made an honest choice of a descriptive label. Certainly Andrews was not trying to deceive the public as to the nature of the tax,¹⁰⁷ and there is no indication that he believed there was a constitutional problem in need of finessing.¹⁰⁸ Other scholars have referred to a cash flow tax as a "consumed income tax," again with no apparent purpose beyond neutral description.¹⁰⁹ Actually, this usage can be traced back at least as far as John Stuart Mill, who claimed that "[n]o income tax is really just from which savings are not exempted."¹¹⁰ The implication, of course, is that a tax from which savings are exempted can still qualify as an income tax. We can be sure that Mill did not adopt his terminology with an eye toward the Sixteenth Amendment.

The simple justification for the income tax label is that a cash flow tax *does* tax income, albeit only when it is consumed.¹¹¹ One might prefer a sharper terminological distinction between income and consump-

believe that to describe the flat tax as an income tax is to score a point against it. See Rieschick, *supra* note 98, at 1210.

103. See Irving Fisher, *The Nature of Capital and Income* 101–18 (1906). What is usually called income, Fisher referred to as earnings. See *id.* at 332–33.

104. See Simons, *supra* note 76, at 98.

105. 87 Harv. L. Rev. 1113 (1974) (emphasis added).

106. Jensen, *supra* note 1, at 2413 n.414.

107. The public was not the audience for the article, and the article is not misleading in any event.

108. Andrews mentions constitutional issues only once, in a footnote briefly reviewing the history of *Pollock* and the Sixteenth Amendment. See Andrews, *supra* note 105, at 1170 n.125. That footnote gives no indication that Andrews was concerned about the constitutionality of a cash flow tax.

109. See, e.g., J. Clifton Fleming, Jr., *Scoping Out the Uncertain Simplification (Complication?) Effects of VATs, BATs and Consumed Income Taxes*, 2 Fla. Tax Rev. 390, 390 (1995); George K. Yin, *Accommodating the "Low Income" In a Cash-Flow or Consumed Income Tax World*, 2 Fla. Tax Rev. 445, 445 (1995).

110. John Stuart Mill, *Principles of Political Economy* 814 (Sir William Ashley ed., Augustus M. Kelley Publishers 1969) (1848).

111. See Andrews, *supra* note 105, at 1120. ("The difference between an accretion-type and a consumption-type personal income tax involves only accumulation, and it is in

tion taxes, but the fact is that many experts refer to cash flow taxes such as the USA tax as income taxes, without trying either to fool the public or finesse the Constitution.

There is also a more complicated justification for the income tax label. Jeff Strnad has offered an elaborate analysis purporting to prove that a "cash flow income tax and not the traditional income tax implements the Haig-Simons ideal," when that ideal is properly understood.¹¹² Strnad's claim has been sharply criticized by Louis Kaplow and Alvin C. Warren as replacing the Haig-Simons accretion-based definition of income with an idiosyncratic concept they call "Strnad income."¹¹³ Even if one concludes that Kaplow and Warren have the better of the debate, the point for Jensen's analysis is that Strnad is a tax expert (a lawyer and economist) with a highly sophisticated argument that the USA tax is an income tax.

Barbara Fried has described an argument for a consumption tax as a "perfected income tax," which has some affinity with the Strnad position.¹¹⁴ In simplest terms, the argument is that the return on savings is matched by an offsetting psychic cost of deferring consumption. By taxing the return on savings without allowing an offsetting deduction for the psychic cost of deferral, a standard income tax overtaxes savers. A consumption tax would allow the equivalent of a deduction for the psychic cost of deferral, thus eliminating the overtaxation of savers and "perfect[ing]" the income tax.¹¹⁵ Although Fried disagrees (at length) with the perfected income tax argument for a consumption tax,¹¹⁶ again, the point for present purposes is that she has identified a sophisticated argument that a consumption tax is a kind of income tax.

What about the flat tax? Flat tax developers Hall and Rabushka agree with Dick Armey's claim that the flat tax is an income tax. They

an important sense only a difference of timing. If an item of accumulation is not reflected in taxable income, the tax is not waived but only deferred.").

112. Jeff Strnad, *Taxation of Income from Capital: A Theoretical Reappraisal*, 37 *Stan. L. Rev.* 1023, 1024 (1985).

113. Louis Kaplow & Alvin C. Warren, Jr., *An Income Tax by Any Other Name—A Reply to Professor Strnad*, 38 *Stan. L. Rev.* 399, 406 (1986). They explain, "Strnad income definitionally comprises cash flow and satisfies Professor Strnad's two conditions: (1) After-tax net present values equal those in the no-tax world, reduced by the rate of tax. (2) After-tax changes in present value equal those in a no-tax world, reduced by the rate of tax." *Id.* at 406-07 (footnotes omitted). There is a Round Two to the debate. See Jeff Strnad, *The Bankruptcy of Conventional Tax Timing Wisdom is Deeper than Semantics: A Rejoinder to Professors Kaplow and Warren*, 39 *Stan. L. Rev.* 389 (1987); Louis Kaplow & Alvin C. Warren, Jr., *Professor Strnad's Rejoinder: Simply Semantics*, 39 *Stan. L. Rev.* 419 (1987).

114. See Barbara H. Fried, *Fairness and the Consumption Tax*, 44 *Stan. L. Rev.* 961, 967-97 (1992).

115. See *id.* at 968. The perfected income tax argument points toward a wage tax rather than a tax measured by consumption, but Fried notes that "[u]nder a plausible set of assumptions" a wage tax produces results equivalent to those of a consumption tax. See *id.* at 961.

116. See *id.* at 967-70.

describe the base of the tax as a "comprehensive definition of income."¹¹⁷ They also describe the base of the tax as consumption,¹¹⁸ but that is not merely an effort to have it both ways. Their view is that, properly understood, an income base and a consumption base are the same thing.¹¹⁹ Thus they claim that the flat tax "moves toward the goal of taxing all income once . . . and achieving a broad consumption tax."¹²⁰

Their claim of income tax status for the flat tax is coherent. Returns to labor are taxed under the wage tax, and returns to capital are taxed under the business tax. The combination of the two tax bases can be plausibly described as a comprehensive definition of income. There is an objection to their view, however. Under certain conditions, allowing an immediate deduction for the cost of business investments and then taxing the investment return (the approach of the flat tax) is the economic equivalent of allowing no up-front deduction and not taxing the return.¹²¹ Under this view, the flat tax only nominally taxes income from capital, and the practical exemption for such income makes the flat tax more a wage tax than an income tax.¹²²

Hall and Rabushka have a response to this objection. They characterize an income tax (in the Haig-Simons sense) as imposing "double taxation of saving"—once when income is saved, and again when the saved income produces an investment return.¹²³ The merits of the double-tax label are debatable, but Hall and Rabushka are clearly right that a Haig-Simons income tax burdens saving for future consumption more heavily

117. Robert E. Hall & Alvin Rabushka, *The Flat Tax: A Simple, Progressive Consumption Tax*, in *Frontiers of Tax Reform* 27 (Michael J. Boskin ed., 1996). They make the same claim in their book: "Again, we stress that the wage tax is not a complete income tax on individuals; it taxes only wages, salaries, and pensions. The companion business tax picks up *all other components of income*." Hall & Rabushka, *supra* note 20, at 60 (emphasis added).

118. See Hall & Rabushka, *supra* note 20, at 40–41.

119. See *id.* at 40. ("[I]t is a comprehensive income tax (the base is GDP) with a 100 percent immediate write-off of all business investment at the level of the business enterprise. It is a consumption tax because it removes all investment spending from the tax base.").

120. *Id.* at 63.

121. The most significant condition is that the tax rate must remain constant over time. See Michael J. Graetz, *Expenditure Tax Design*, in *What Should be Taxed: Income or Expenditure?* 161, 172–73 (Joseph A. Pechman ed., 1980). There is another qualification. Expensing of investment would approximate an exemption for income from capital only for investments made after the adoption of the flat tax. The flat tax would impose a real burden on the return to old capital. See *id.* at 172.

122. See Alvin C. Warren, Jr., *How Much Capital Income Taxed Under an Income Tax is Exempt Under a Cash Flow Tax?*, 52 *Tax L. Rev.* 1, 15 (1996) (the argument that capital income is not exempt under a cash flow tax "is valid only if the tax savings from expensing are ignored, a condition that renders the [argument] meaningless in a comparison of income and cash flow taxation").

123. See Hall & Rabushka, *supra* note 20, at 71.

than current consumption.¹²⁴ In their view, expensing does not amount to exemption of capital income from tax; it merely eliminates double taxation.¹²⁵

Jensen to the contrary, the experts behind the flat tax *do* claim that it is a kind of income tax. They may see political advantage in their use of the income tax label, and they sow confusion in claiming that the flat tax is both a consumption tax and an income tax.¹²⁶ But they offer plausible defenses of their use of the income tax label, and there is no indication that they have claimed the label in order to finesse a perceived constitutional problem.

3. *The Public.* — As Justice Holmes wrote in his dissent in *Eisner v. Macomber*, “it was for public adoption that [the Sixteenth Amendment] was proposed,” and the public understanding of what constitutes an income tax should determine the constitutionality of the flat tax and the USA tax.¹²⁷ Ernest S. Christian has rightly observed that “almost everyone [other than tax policy experts] thinks of the flat tax as an amended version of the current income tax.”¹²⁸ If anything, the public understanding is even stronger that the USA tax is a kind of income tax. No one seems to think that IRAs or tax deferrals on employer-provided pensions threaten the income tax status of the current system, or that expansion of those provisions would do so.

124. See Marvin A. Chirelstein, *Federal Income Taxation* 386 (8th ed. 1997) (using simple arithmetic to illustrate this point).

125. See Hall & Rabushka, *supra* note 20, at 71. (“With expensing, the first tax is abolished.”) Presumably they would argue that the sometimes-equivalent of expensing—allowing no deduction for investment and not taxing investment return—also effectively taxes income from capital. The tax imposed at the time of the investment would be viewed as a tax prepayment, in lieu of a later tax on the investment return. See David F. Bradford, *Untangling the Income Tax* 67–69 (1986).

126. See Warren, *supra* note 122, at 15. (“[C]haracterizing cash flow taxes as fully taxing capital income, on the grounds that labor income is only taxed once, even if saved and invested, is quite confusing, because the desired single tax is accomplished precisely by eliminating the taxation of capital income.”).

127. 252 U.S. 189, 220 (1920) (Holmes, J., dissenting) (citation omitted). Holmes’s appeal was to the public understanding at the time of the adoption of the Amendment, but there is no obvious reason to think the public understanding on this question has changed between 1913 and today. Holmes’s dissent went on to note that “[t]he known purpose of this Amendment was to get rid of nice questions as to what might be direct taxes, and I cannot doubt that most people not lawyers would suppose when they voted for it that they put a question like the present to rest.” *Id.*

128. Christian, *supra* note 87, at 246. Moreover, it is inconceivable that the public would understand an expensing-based flat tax as not an income tax, but a depreciation-based flat tax as an income tax. See *supra* note 93 and accompanying text. The difference between the two taxes could not be of constitutional dimensions in the public understanding.

On a related point, David Bradford has noted that “in principle, the difference between income and consumption taxes is the treatment of the risk-free reward to waiting, certainly below 2 percent (real, inflation adjusted) per year.” Bradford, *supra* note 93, at 901. This difference is also not intuitively of constitutional dimensions.

In the end, Jensen's Sixteenth Amendment analysis rests on a category mistake. He is right that most experts today see income and consumption as labels for two different tax bases. For those experts, if a tax is a consumption tax it cannot also be an income tax. But to everyone else—politicians, the general public, and even a significant number of experts—Jensen's dichotomy makes little sense. To his argument that the flat tax and the USA tax are consumption taxes, and therefore are not covered by the Sixteenth Amendment, they would respond with the classic demurrer, "I get it all except the therefore." If experts tell the general public that those taxes have consumption bases, the public may accept the fact, but it will not see consumption tax and income tax as mutually exclusive categories. Although the flat tax and the USA tax may be consumption taxes, they are also income taxes. As income taxes, they are constitutional without apportionment.

CONCLUSION

I have nothing but praise for Jensen's superb research on the original understanding of the Direct-Tax Clauses. I disagree, however, with his analysis of the significance of that research for modern fundamental tax reform proposals.

Whether the flat tax and the USA tax are direct taxes under the original understanding is a question to which no definitive answer is possible. As Jensen remarks, nothing resembling either the flat tax or the USA tax was known in late-eighteenth-century America.¹²⁹ While his conclusion that both are direct is certainly defensible, it implies distinctions that make no sense (or are even perverse) in terms of the policy behind the Direct-Tax Clauses, and that put taxes nearly identical in substance on opposite sides of the constitutional line. Jensen and I agree that there is room for doubt about the correct application of the Direct-Tax Clauses to modern reform proposals, but I believe a conscientious—even scrupulous—legislator could resolve those doubts in favor of the proposals.

In any event, the conscientious legislator does not have to resolve those doubts, because the case is so strong that both the flat tax and the USA tax are "taxes on income" within the meaning of the Sixteenth Amendment. The dichotomy Jensen draws between consumption taxes and income taxes is not to be found in the Amendment. To politicians, to many experts, and—most significantly—to the public, both taxes are income taxes. That should be enough.

Fundamental tax reform may be bad policy, but—like many bad policies—it is not unconstitutional.

129. See Jensen, *supra* note 1, at 2417.