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Constitutional Questions Surrounding the Health Care Law's Individual Mandate: Beyond Congress's Power to Tax

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Mr. Chairman, Mr. Ranking Member, and members of the Committee:

Thank you for the opportunity to speak with you today about the Tax Foundation's perspective on whether the health care law's individual mandate is within Congress's power to lay and collect Taxes, granted by Article I, Section 8 of the Constitution. Since our founding in 1937, the Tax Foundation has advanced the ideas of simpler, more sensible tax policy with reliable research and principled analysis of tax issues at all levels of government.

As you know, the federal government is a government of limited and defined powers, so for the health care law's individual mandate to be valid, some grant of power in the Constitution must be found to sustain it. While the government and most of the other briefs in the case focus on Congress's power to regulate interstate commerce as the most relevant provision, the government has secondarily relied on Congress's power to tax. We authored our brief in the case to refute the government's mischaracterization of the individual mandate as a tax, to explain why the definition they propose is unworkable, and to warn that an adverse ruling on this point jeopardizes important taxpayer protections and well-defined case law in nearly every state.

A Tax is an Exaction Imposed for the Primary Purpose of Raising Revenue for Government Spending

I want to take a brief moment to explain why this is so important. While some may equate a tax as any government action that results in costs, monetary or non-monetary, the general public and

the courts have been careful to distinguish between different forms of government-collected exactions. Long-standing American suspicion of taxes, which dates from colonial times, has led to numerous federal and state restrictions specific only to taxes, such as the federal Anti-Injunction Act, tax supermajority requirements in 16 states, tax uniformity requirements in nearly every state, and voter approval thresholds. For these taxpayer protections to mean anything, a workable definition of “tax” is required.

Federal and state courts have risen to meet that need, articulating a definition that is widely accepted today. First, what matters is how the tax operates and not necessarily what it was labeled by policymakers who passed it. Otherwise, creative labeling (for which there is great political incentive) would nullify any restrictions. Second, look at what entity imposes the assessment, upon whom it is imposed, and how the revenue is used. Taking all that together, the definition that has emerged is that a tax is an exaction imposed for the primary purpose of raising revenue for general spending. This is in contrast to a fee, which is an exaction imposed for the primary purpose of recovering from the payor the cost of providing a particular service to the payor, and in contrast to a penalty, which is an exaction imposed for the primary purpose of punishment for an unlawful act.

We at the Tax Foundation work extensively on this issue, and our brief spends 5 pages listing case after case from federal and state courts that use this definition. (*See Appendix.*) Taxes are enacted primarily to raise revenue for general spending, penalties are enacted primarily to punish.

The Individual Mandate’s Charge is a Penalty and Not a Tax Because Its Primary Purpose is Not to Raise Revenue but to Penalize

Applying that definition here, the individual mandate is not a tax because its primary purpose is to punish, not to raise revenue. The most common reason cited for its purpose is to regulate so-called “free riders” who use health care services but do not bear the cost. President Obama said to ABC News in 2009 that he “absolutely reject[s] the notion” that the individual mandate is a tax. The bill itself refers to the mandate as a “requirement to maintain minimum essential coverage,” a “shared responsibility payment,” and a “penalty.” 26 U.S.C. § 5000A *et seq.* In fact, the law refers to it as a “penalty” twelve times and as a “tax” zero times. *See id.* The mandate also does not share the same enforcement provisions as taxes, with the IRS denied the use of liens or levies to enforce the provision. *See* 26 U.S.C. § 5000A(g)(2).

The Joint Committee on Taxation, which produced the technical explanation of the bill, refers to it as a tax in its subheading, but all of its other references evidence JCT’s judgment that the mandate is not a tax. *See* Joint Committee on Taxation, *Technical Explanation of the Revenue Provisions of the “Reconciliation Act of 2010,” As Amended, in Combination with the “Patient Protection and Affordable Care Act”* at 31 (Mar. 21, 2010), <http://www.jct.gov/publications.html?func=startdown&id=3673>. Aside from the reference in the subheading, the JCT never again refers to the mandate as a “tax” and instead invariably refers to it as a “penalty,” doing so 24 times in its technical explanation of how the provision operates. *See id.* at 31-34. The explanation also falls under the policy and regulatory provisions of the Act, not under the “Revenue Provisions” heading. *See id.* at i-ii. JCT also left the mandate out of its revenue projections, where it estimated the financial impact of all provisions of the bill related to

raising revenue. See Joint Committee on Taxation, *Estimated Revenue Effects of the Amendment in the Nature of a Substitute to H.R. 4872, The “Reconciliation Act of 2010,” As Amended, In Combination With the Revenue Effects of H.R. 3590, The “Patient Protection And Affordable Care Act (‘PPACA’),” As Passed by the Senate, And Scheduled For Consideration By The House Committee On Rules On March 20, 2010*, at 1-3 (Mar. 20, 2010), <http://www.jct.gov/publications.html?func=startdown&id=3672>.

Our brief also lists Supreme Court cases that emphasize a firm distinction between taxes and penalties. See, e.g., *United States v. Reorganized CF & I Fabricators of Utah, Inc.*, 518 U.S. 213, 224 (1996), quoting *La Franca*, 282 U.S. at 572 (“[A] ‘penalty,’ as the word is here used, is an exaction imposed by statute as punishment for an unlawful act.”); *Dep’t of Rev. of Montana v. Kurth Ranch*, 511 U.S. 767, 779-80 (1994) (“[W]hereas 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.”); *Bailey v. Drexel Furniture Co.*, 259 U.S. 20, 38 (1922) (“Taxes 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. They do not lose their character as taxes because of the incidental motive. But 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.”).

While incidental revenue may be generated, the undeniable purpose of the individual mandate is to punish, discourage, and reduce illegal behavior, as a penalty and not a tax.

If the Mandate is a Tax, It Would Be an Unconstitutional Capitation Tax Unapportioned by State Population

In asserting that the individual mandate is permissible under the Taxing Power, the Government does not address the fact that if this were true, this tax would be a capitation tax unapportioned by state population, in direct violation of the constitutional requirement that “No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.” U.S. CONST. art. I, § 9, cl. 4. A direct tax is only permissible if it is apportioned among the states in proportion to population, or levied on incomes. See U.S. CONST. amend. XVI; *Eisner v. Macomber*, 252 U.S. 189, 206 (1920) (“A proper regard for its genesis, as well as its very clear language, requires also that this amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal. This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts.”).

The prohibition of unapportioned direct taxes exists for a strong purpose. Alexander Hamilton, conceding that a federal government with unlimited taxing power invited tyranny, explained that “[t]he proportion of these taxes is not to be left to the discretion of the national Legislature but is to be determined by the numbers of each State as described in the second section of the first article.” THE FEDERALIST NO. 36, 226, 229-30 (1788). Hamilton characterized the provision as a compromise that ensured that the federal government could have recourse to direct taxation if

needed, but not in a way that could invite abuse or partiality. *See id.* George Mason, who felt that the provision was not sufficiently restrictive on government direct taxation, nevertheless described it correctly as meaning “that the quantity to be raised of each state, should be in proportion to their numbers in the manner therein directed.” GEORGE MASON, VIRGINIA RATIFYING CONVENTION PAPERS 3:1087 (June 17, 1788).

Assuming *arguendo* that the Government’s characterization of the mandate as a tax is correct, it would operate as a levy on individuals and not their incomes. The mandate penalty in 2016, for example, is imposed either in the amount of \$695 per uninsured adult, or at the rate of 2.5 percent of the uninsured taxpayer’s income in excess of the filing threshold (in 2010, \$9,350), whichever is greater. *See* 26 U.S.C. § 5000A(c). Although the latter calculation could conceivably be considered a tax on income, the former direct amount cannot be. If it is a tax, it is a capitation tax, levied directly on the individual. Because its collection is not apportioned according to state population, its operation would violate U.S. CONST. art. I, § 9, cl. 4.

Conclusion

A meaningful distinction between “tax” and “penalty” is vital to give operation to numerous federal and state provisions relating to tax policy. If the U.S. Supreme Court held that a tax is any government collection of revenue, then government revenue collection efforts across the country would be imperiled, as many revenue sources are not subjected to the heightened restrictions that “taxes” are. To collect fees or impose criminal fines, states for the first time would see these charges subjected to supermajority, multiple reading, and other requirements. While some states may choose to extend such procedural requirements to non-tax revenue sources, this should be done explicitly through the legislative process, not by announcing a new definition of “tax” not comprehended at the time these provisions were adopted.

It is for these reasons that we requested that the Court find that the individual mandate exceeds Congress’s Taxing Power under the U.S. Constitution.

Appendix: Federal and State Case Law Imperiled by a Ruling That the Individual Mandate is a Tax

- ◆ *United States v. State of New York*, 315 U.S. 510, 515-16 (1942) (“But a tax for purposes of [the Bankruptcy Code] includes any pecuniary burden laid upon individuals or property for the purpose of supporting the government, by whatever name it may be called.”) (internal citations omitted);
- ◆ *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,’ as the word is here used, is an exaction imposed by statute as punishment for an unlawful act.”).
- ◆ *San Juan Cellular Tel. Co. v. Pub. Serv. Comm’n of Puerto Rico*, 967 F.2d 683, 685 (1st Cir. 1992) (finding that a tax is thus an exaction imposed by the government, on the public, for the purpose of raising revenue which is then spent on general (not particular) public purposes; a charge not imposed by government, or a charge collected from those receiving particularized benefits, or a charge collected for primary purpose other than raising revenue, is not a tax.)
- ◆ *Valero Terrestrial Corp. v. Caffrey*, 205 F.3d 130, 134 (4th Cir. 2000) (applying *San Juan Cellular* to determine if a charge “qualifies” as a tax);
- ◆ *Neinast v. Texas*, 217 F.3d 275, 278 (5th Cir. 2000) (applying *San Juan Cellular*);
- ◆ *Hedgepeth v. Tennessee*, 215 F.3d 608, 612 (6th Cir. 2000) (describing *San Juan Cellular* as the “leading decision” used for “the definition of the term ‘tax’”);
- ◆ *RTC Commercial Assets Trust 1995-NP3-1 v. Phoenix Bond & Indem. Co.*, 169 F.3d 448, 457 (7th Cir. 1999) (“Penalties stand on a different footing. States do not assess penalties for the purpose of raising revenue. . . .”);
- ◆ *Chicago & Nw. Transp. Co. v. Webster County Bd. of Supervisors*, 71 F.3d 265, 267 (8th Cir. 1995) (“A government levy is a tax if it raises revenue to spend for the general public welfare.”);
- ◆ *Bidart Bros. v. California Apple Comm’n*, 73 F.3d 925, 931 (9th Cir. 1996) (applying *San Juan Cellular* test to “determin[e] whether an assessment is a tax”);
- ◆ *Hill v. Kemp*, 478 F.3d 1236, 1244 (10th Cir. 2007) (finding that a tax’s “primary purpose . . . is revenue rather than regulation”);
- ◆ *Seven-Sky v. Holder*, 661 F.3d 1, 8 (D.C. Cir. 2011) (“It is well established that Congress used the term ‘tax’ in the Tax Injunction Act to mean assessments made for the purpose of raising revenues, not regulatory ‘penalties’ intended to encourage compliance with a law.”);
- ◆ *Rural Tel. Coal. v. F.C.C.*, 838 F.2d 1307, 1314 (D.C. Cir. 1988) (“[A] regulation is a tax only when its primary purpose judged in legal context is raising revenue.”);
- ◆ *Lightwave Tech., LLC v. Escambia County*, 804 So.2d 176, 178 (Ala. 2001) (finding that a charge “designed to generate revenue” for general spending is a tax);
- ◆ *May v. McNally*, 55 P.3d 768, 773-74 (Ariz. 2002) (adopting *San Juan Cellular*);
- ◆ *City of North Little Rock v. Graham*, 647 S.W.2d 452, 453 (Ark. 1983) (finding that a tax “is a means of raising revenue to pay additional money for services already in effect”);
- ◆ *Sinclair Paint Co. v. State Bd. of Equalization*, 937 P.2d 1350, 1354 (Cal. 1997) (“In general, taxes are imposed for revenue purposes, rather than in return for a special benefit conferred or privilege granted.”);

- ◆ *Zelinger v. City & County of Denver*, 724 P.2d 1356, 1358 (Colo. 1986) (“A hallmark of such taxes is that they are intended to raise revenue to defray the general expenses of the taxing entity.”);
- ◆ *Stuart v. Am. Sec. Bank*, 494 A.2d 1333, 1337 (D.C. 1985) (describing taxes as “for the purpose of raising revenue”);
- ◆ *Gunby v. Yates*, 102 S.E.2d 548, 550 (Ga. 1958) (“A tax is an enforced contribution exacted pursuant to legislative authority for the purpose of raising revenue to be used for public or governmental purposes”);
- ◆ *State v. Medeiros*, 973 P.2d 736, 742 (Haw. 1999) (holding that a tax does not apply to direct beneficiaries of a service, does not directly defray the costs of a particular service, or is not necessarily proportionate to the benefit received);
- ◆ *BHA Inv., Inc. v. State*, 63 P.3d 474, 479 (Idaho 2003) (“[T]axes are solely for the purpose of raising revenue.”);
- ◆ *Crocker v. Finley*, 459 N.E.2d 1346, 1350 (Ill. 1984) (“[A] charge having no relation to the services rendered, assessed to provide general revenue rather than compensation, is a tax.”);
- ◆ *Ennis v. State Highway Comm’n*, 108 N.E.2d 687, 693 (Ind. 1952) (“Taxes are levied for the support of government”);
- ◆ *City of Hawarden v. US W. Commc’ns, Inc.*, 590 N.W.2d 504, 507 (Iowa 1999) (holding that an exaction intended to raise revenue is a tax);
- ◆ *Citizens’ Util. Ratepayer Bd. v. State Corp. Comm’n*, 956 P.2d 685, 708 (Kan. 1998) (“The primary purpose of a tax is to raise money, not regulation.”);
- ◆ *Krumpelman v. Louisville & Jefferson County Metro. Sewer Dist.*, 314 S.W.2d 557, 561 (Ky. 1958) (“[T]axes are generally held to be a rate or duty levied each year for purposes of general revenue”);
- ◆ *Audubon Ins. Co. v. Bernard*, 434 So.2d 1072, 1074 (La. 1983) (holding that “revenue is the primary purpose” of a tax);
- ◆ *Bd. of Overseers of the Bar v. Lee*, 422 A.2d 998, 1004 (Me. 1990) (“[T]axes are primarily intended to raise revenue”);
- ◆ *Workmen’s Comp. Comm’n v. Prop. & Cas. Ins. Guar. Corp.*, 570 A.2d 323, 325 (Md. 1990) (finding that taxes “are intended to raise revenue for public purposes”);
- ◆ *Emerson Coll. v. City of Boston*, 462 N.E.2d 1098, 1105 (Mass. 1984) (finding that a charge “collected not to raise revenues” but for another purpose is not a tax);
- ◆ *Bolt v. City of Lansing*, 587 N.W.2d 264, 269 (Mich. 1998) (holding that a charge with “a revenue-raising purpose” is a tax);
- ◆ *County Joe, Inc. v. City of Eagan*, 560 N.W.2d 681, 686 (Minn. 1997) (holding that a charge “expressly intended to raise revenue” is a tax);
- ◆ *Leggett v. Missouri State Life Ins. Co.*, 342 S.W.2d 833, 875 (Mo. 1961) (finding that a charge is not a tax unless “the object of [it] is to raise revenue to be paid into the general fund of the government to defray customary governmental expenditures”);
- ◆ *Monarch Mining Co. v. State Highway Comm’n*, 270 P.2d 738, 740 (Mont. 1954) (“Taxes are levied for the support of government, and their amount is regulated by its necessities.”);
- ◆ *Douglas County Contractors Ass’n v. Douglas County*, 929 P.2d 253, 257 (Nev. 1996) (holding that a charge with the “true purpose . . . to raise revenue” is a tax);

- ◆ *Horner v. Governor*, 951 A.2d 180, 183 (N.H. 2008) (finding that a tax must be “intended to raise additional revenue” not “solely to support a governmental regulatory activity made necessary by the actions of those who are required to pay the charge”);
- ◆ *Resolution Trust Corp. v. Lanzaro*, 658 A.2d 282, 290 (N.J. 1995) (finding that a tax “is intended primarily to raise revenue”); *Scott v. Donnelly*, 133 N.W.2d 418, 423 (N.D. 1965) (“If the primary purpose is revenue, it is a tax; on the other hand, if the primary purpose is regulation, it is not a tax.”);
- ◆ *Olustee Co-op Ass’n v. Oklahoma Wheat Utilization Research and Market Dev. Comm’n*, 391 P.2d 216, 218 (Okla. 1964) (citing definition of tax in part including purpose “to provide public revenue”);
- ◆ *Woodward v. City of Philadelphia*, 3 A.2d 167, 170 (Pa. 1938) (“[T]axes are defined to be burdens or charges imposed by the legislative power upon persons or property to raise money for public purposes, and to defray the necessary expenses of government.”);
- ◆ *State v. Foster*, 46 A. 833, 835-36 (R.I. 1900) (“If the imposition of such a condition has for its primary object the regulation of the business, trade, or calling to which it applies, its exercise is properly referable to the police power; but if the main object is the obtaining of revenue, it is properly referable to the taxing power.”);
- ◆ *Brown v. County of Horry*, 417 S.E.2d 565, 568 (S.C. 1992) (citing with approval the standard that “a tax is an enforced contribution to provide for the support of government”);
- ◆ *Valandra v. Viedt*, 259 N.W.2d 510, 512 (S.D. 1977) (“[T]axes are imposed for the purpose of general revenue”);
- ◆ *Memphis Retail Liquor Dealers’ Ass’n v. City of Memphis*, 547 S.W.2d 244, 245-46 (Tenn. 1977) (“If the imposition is primarily for the purpose of raising revenue, it is a tax”);
- ◆ *Hurt v. Cooper*, 110 S.W.2d 896, 899 (Tex. 1937) (finding that a tax is a charge with the “primary purpose” of “raising of revenue”);
- ◆ *V-1 Oil Co. v. Utah State Tax Comm’n*, 942 P.2d 906, 911 (Utah 1996), *vacated on other grounds*, 942 P.2d 915 (Utah 1997) (“Generally speaking, a tax raises revenue for general governmental purposes”);
- ◆ *Marshall v. Northern Virginia Transp. Authority*, 657 S.E.2d 71, 77-78 (Va. 2008) (“We consistently have held that when the primary purpose of an enactment is to raise revenue, the enactment will be considered a tax, regardless of the name attached to the act.”);
- ◆ *City of Spokane v. Spokane Police Guild*, 553 P.2d 1316, 1319 (Wash. 1976) (“[I]f the primary purpose of legislation is regulation rather than raising revenue, the legislation cannot be classified as a tax even if a burden or charge is imposed.”);
- ◆ *City of Huntington v. Bacon*, 473 S.E.2d 743, 752 (W.Va. 1996) (“The primary purpose of a tax is to obtain revenue for the government”);
- ◆ *State v. Jackman*, 211 N.W.2d 480, 485 (Wis. 1973) (“A tax is one whose primary purpose is to obtain revenue”)

Other Support:

- ◆ 4 Cooley, *The Law of Taxation*, ch. 29 § 1784 (4th ed. 1924) (“If revenue is the primary purpose and regulation is merely incidental the imposition is a tax; while if regulation is the primary purpose the mere fact that incidentally a revenue is also obtained does not make the imposition a tax”);

- ◆ BLACK’S LAW DICTIONARY 1214 (9th ed. 2009) (defining tax as “[a] charge, usu. monetary, imposed by the government on persons, entities, transactions, or property to yield public revenue.”).

Contrary Case Law:

- ◆ *Apocada v. Wilson*, 525 P.2d 876, 884-85 (N.M. 1974) (holding that a charge that raises revenue beyond costs is not a tax);
- ◆ *Heatherly v. State*, 678 S.E.2d 656, 657 (N.C. 2009) (dividing equally on the question of definition of tax);
- ◆ *State ex. rel. Petroleum Underground Storage Tank Release Comp. Bd. v. Withrow*, 579 N.E.2d 705, 710 (Ohio 1991) (“It is not possible to come up with a single test that will correctly distinguish a tax from a fee in all situations where the words ‘tax’ and ‘fee’ arise.”);
- ◆ *Auto. Club of Oregon v. State*, 840 P.2d 674, 678 (Or. 1992) (describing “tax” as any revenue collected by government, separate from “assessment”).

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