Determining Which Taxes Are Prohibited Direct Taxes After *NFIB*

By Mark E. Berg


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In this article, Berg summarizes the law regarding the constitutional prohibition against unapportioned direct taxes as it existed before the Supreme Court's June 2012 decision in *National Federation of Independent Business v. Sebelius (NFIB)*. He analyzes the portion of *NFIB* that discusses the direct tax issue and applies that analysis to other types of federal taxes, including the sort of wealth tax proposals that have been the subject of recent proposals. Berg argues that nothing in *NFIB* should be seen as changing the conclusion that those other types of federal taxes are unconstitutional direct taxes unless they are apportioned among the states or income taxes permitted by the 16th Amendment.

The Supreme Court's decision in *National Federation of Independent Business v. Sebelius (NFIB)*[1] regarding the constitutionality of the Patient Protection and Affordable Care Act of 2010 (PPACA) was eagerly awaited by politicians, partisans, and constitutional scholars alike. Among the constitutional issues they were expecting the Court to address were whether Congress had the authority to enact the PPACA's individual health insurance mandate under the commerce clause[2] or the necessary and proper clause,[3] whether that mandate is properly construed as a tax levied under Congress's power under the taxing clause to "lay and collect Taxes, Duties, Imposts and Excises,"[4] and whether the Medicaid expansion prescribed by the PPACA exceeds Congress's power under the spending clause to "pay the Debts and provide for the common Defense and general Welfare of the United States."[5] Few anticipated that the Court would address the direct tax clauses,[6] which prohibit the imposition of any direct tax (other than a tax on "incomes" within the meaning of the 16th Amendment) absent apportionment of that tax among the states. This article discusses the portion of the Court's opinions in *NFIB* regarding the direct tax clauses, leaving for others the task of analyzing the Court's more widely publicized holdings regarding the scope of the commerce clause, the necessary and proper clause, the taxing clause, and the spending clause.[7]

A. Background

Among the constitutional limitations on Congress's power to tax, Article I, section 9 of the Constitution provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."[8] Similarly, Article I, section 2 of the Constitution, which requires that a census be taken every 10 years, provides that "Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers."[9] For this purpose,

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[1]132 S. Ct. 2566 (June 28, 2012), *Doc 2012-13784, 2012 TNT 126-12*.

[2]U.S. Const. Art. I, section 8, cl. 3.

[3]U.S. Const. Art. I, section 8, cl. 18.

[4]U.S. Const. Art. I, section 8, cl. 1.

[5]*Id.*

[6]U.S. Const. Art. I, section 9, cl. 4; U.S. Const. Art. I, section 2, cl. 3.

[7]For a more detailed discussion of the direct tax clauses and their pre-*NFIB* interpretation by the Supreme Court, which focuses on the constitutionality of the exit tax imposed on expatriates and certain others under section 877A, see Mark E. Berg, "Bar the Exit (Tax)! Section 877A, the Constitutional Prohibition Against Unapportioned Direct Taxes and the Realization Requirement," 65 *Tax Law.* 181 (2012).

[8]U.S. Const. Art. I, section 9, cl. 4, *amended by* U.S. Const. Amend. XVI (excluding taxes on incomes from the apportionment requirement). Other limitations include the uniformity requirement for duties and excise taxes (U.S. Const. Art. I, section 8, cl. 1) and the requirement that all revenue bills originate in the House (U.S. Const. Art. I, section 7, cl. 1).

[9]U.S. Const. Art. I, section 2, cl. 3, *amended by* U.S. Const. Amend. XIV (changing the manner in which persons other than "free Persons" are counted for this purpose) and U.S. Const. Amend. XVI (excluding taxes on incomes from the apportionment requirement).

apportionment means that the tax must be imposed at rates that ensure that each state's residents collectively bear the tax in proportion to the states' respective populations so that, for example, if the population of New Jersey makes up 3 percent of the total population of the United States, an apportioned tax will yield 3 percent of its revenues from collections in New Jersey.

The 16th Amendment, ratified in 1913, modified the direct tax clauses as they had previously been interpreted by the Supreme Court by permitting Congress to "lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."[10] The 16th Amendment came into being as a response to the Supreme Court's two 1895 decisions in *Pollock v. Farmers' Loan & Trust Co.*,[11] in which the Court had held that income taxes imposed on income from real and personal property are direct taxes subject to the apportionment requirement.[12] The Court, soon after the 16th Amendment was ratified, cast serious doubt on the conclusion in the *Pollock* cases that taxes on income from property (real or personal) are direct taxes,[13] thus in retrospect rendering the 16th Amendment largely unnecessary. However, the Supreme Court has never repudiated the constitutional prohibition against unapportioned direct taxes, and indeed the Court recently reaffirmed it in *NFIB*.

Presumably because of their provenance as part of the three-fifths compromise at the Constitutional Convention of 1787, whereby only 60 percent of each slave was counted for purposes of determining how many representatives each state would have in the House and how some taxes would be borne by individuals in the various states, the direct tax clauses have received much scholarly criticism in recent years. For example, professor Bruce Ackerman of Yale University would limit the scope of the direct tax clauses to capitations on the basis of an "intergenerational synthesis" of the 14th Amendment's repeal of the three-fifths compromise in 1868 with the direct tax clauses, and treatment of the 16th Amendment as a "'transformative amendment,' requiring a reshaping of vast areas of our constitutional law in light of grand new principles."[14] Somewhat similarly, professor Calvin H. Johnson of the University of Texas, citing the absurdity and unworkability of the apportionment requirement, would apply an "obliterating construction" to the direct tax clauses that would construe the constitutional apportionment requirement "so tightly as to amount almost to repeal."[15] While a full refutation of those countertextual positions is beyond the scope of this discussion,[16] suffice it to say that the Constitution explicitly provides that apportionment, however absurd it may be, is required for any direct tax, and a construction of the Constitution that limits the direct tax restriction to capitations would require reading out of the direct tax clauses the words "or other direct, Tax."[17]

Thus, the text of the Constitution requires the following analysis of a tax under the direct tax clauses:

1. if the tax is not a direct tax, no apportionment is necessary[18];
2. if the tax is a direct tax, apportionment is necessary unless it is a tax on incomes; and
3. if the tax is a tax on incomes, no apportionment is necessary regardless of whether the tax is a direct tax.

Surprisingly, the definition of direct taxes, which of course lies at the center of the analysis, has proved somewhat elusive.[19] Very early on, in *Hylton v. United States*,[20] the Supreme Court interpreted the term extremely narrowly, finding a federal tax on carriages, whether hired out or used by the owner, to be an indirect tax not subject to apportionment. That conclusion was apparently reached on the basis of the justices' hostility to the apportionment

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[10]U.S. Const. Amend. XVI.

[11]157 U.S. 429 (1895) (*Pollock I*); and 158 U.S. 601 (1895) (*Pollock II*).

[12]*Pollock I*, 157 U.S. at 558-583 (real property); *Pollock II*, 158 U.S. at 618-637 (personal property).

[13]*See Brushaber v. Union Pac. R.R.*, 240 U.S. 1 (1916); *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916).

[14]Bruce Ackerman, "Taxation and the Constitution," 99 *Colum. L. Rev.* 1, at 31-32, 39, 51-56 (1999). *But see* U.S. Const. Art. I, section 9, cl. 4 ("Capitation, or other direct, Tax").

[15]*See, e.g.*, Johnson, "Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution," 7 *Wm. & Mary Bill Rts. J.* 1, at 81-82 (1998).

[16]For a discussion, see Berg, *supra* note 7, at 186, n.26, 190-192, and notes 51-63.

[17]U.S. Const. Art. I, section 9, cl. 4 ("No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken").

[18]As noted, however, indirect taxes are subject to other constitutional limitations, such as the requirement that they be imposed uniformly throughout the United States. U.S. Const. Art. I, section 8, cl. 1.

[19]*See NFIB*, 132 S. Ct. at 2598 ("Even when the Direct Tax Clause was written it was unclear what else, other than a capitation (also known as a 'head tax' or a 'poll tax'), might be a direct tax"); Berg, *supra* note 7, at 184-185.

[20]3 U.S. 171 (1796).

requirement and its perceived absurdity in their eyes.[21] In this connection, Justice Salmon P. Chase, in one of the seriatim opinions in *Hylton*, expressed the view in dicta that the only two direct taxes are simple capitations, which are explicitly mentioned in the Constitution, and taxes on land.[22] The other two justices writing opinions in *Hylton* questioned that view.[23]

As noted, however, the Supreme Court in 1895 took a much more expansive view of the direct tax clauses in the *Pollock* cases. In *Pollock I*, the Court in a 6-2 opinion held that an unapportioned income tax enacted in 1894 was a direct tax insofar as it applied to income from real property, but it split 4-4 on whether the 1894 income tax was a direct tax insofar as it applied to income from personal property.[24] The Court defined a direct tax as "a tax upon property holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided."[25] By contrast, the Court defined indirect taxes as "all taxes paid primarily by persons who can shift the burden upon some one else, or who are under no legal compulsion to pay them."[26] In *Pollock II*, the Court, in a 5-4 decision with vigorous dissenting opinions, struck down the rest of the 1894 income tax as an unapportioned direct tax, stating, "We are unable to conclude that the enforced subtraction from the yield of all the owner's real or personal property . . . is so different from a tax upon the property itself, that it is not a direct, but an indirect tax, in the meaning of the Constitution."[27]

As noted, the 16th Amendment overruled the *Pollock* cases to the extent they held that an income tax is required to be apportioned,[28] and the Supreme Court shortly thereafter repudiated the notion that an income tax is a direct tax.[29] However, neither the 16th Amendment nor the Court eliminated the apportionment requirement for any direct taxes that are not income taxes.[30]

After *Pollock*, the Supreme Court significantly clarified the meaning of the term "direct tax" for purposes of the direct tax clauses. For example, in *Knowlton v. Moore*,[31] the Court held that an unapportioned federal inheritance tax was not a direct tax because it was a tax on transfers of property at death rather than a tax on the property itself, and the Court defined a direct tax as a tax "imposed upon property solely by reason of its ownership."[32] Likewise, in *Bromley v. McCaughn*,[33] the Court held that an unapportioned federal gift tax was not a direct tax because it was a tax on the *inter vivos* transfer of property rather than a tax on the property itself. In *Bromley*, the Court defined a direct tax as a tax "levied upon or collected from persons because of their general ownership of property," "a tax which falls upon the owner [of property] merely because he is the owner, regardless of the use or disposition made of his property," and a tax "on property itself."[34] By contrast, the Court in *Bromley* defined an indirect tax as "a tax imposed upon a particular use of property or the exercise of a single power over property incidental to ownership" and a tax that applies "only to a limited exercise of property rights."[35] On that basis, the federal taxes on transfers of property, either at death or *inter vivos*, were considered indirect taxes not subject to the apportionment requirement. Significantly, the Court in neither case suggested that direct taxes are limited to capitations and taxes on land, but rather it explicitly upheld the federal estate and gift taxes as indirect taxes on the basis that those taxes are imposed on transfers or other particular uses of property rather than merely by reason of the ownership of the property. At the very least, this strongly implies that if the federal taxes in question in those cases had been imposed in the absence of a transfer or other use of the property, they would have been held to be direct taxes and thus unconstitutional absent apportionment.

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[21]*See* Berg, *supra* note 7, at 185-187.

[22]*Hylton*, 3 U.S. at 175 (opinion of Chase, J.). Justice Chase made it explicit that these words were dicta by stating that he was not giving a judicial opinion on this point. *Id.*

[23]*Id.* at 183 (opinion of Iredell, J.) ("there may possibly be considerable doubt" on this point); *id.* at 177 (opinion of Paterson, J.) (declining to hold that those are the only two categories of direct taxes).

[24]*Pollock I*, 157 U.S. at 583-586.

[25]*Id.* at 558.

[26]*Id.*

[27]*Pollock II*, 158 U.S. at 618. Although the term "indirect tax" is not found in the Constitution, this article adopts the usage employed by the majority in *Pollock II*, describing taxes that are not direct taxes as indirect taxes.

[28]U.S. Const. Amend. XVI.

[29]*See* cases cited, *supra* note 13.

[30]*See, e.g.*, *NFIB*, 132 S. Ct. at 2598 ("any 'direct Tax' must be apportioned so that each State pays in proportion to its population"); *Eisner v. Macomber*, 252 U.S. 189, 206 (1920) (confirming that the 16th Amendment did not repeal the direct tax clauses except as to income taxes); *see generally* Berg, *supra* note 7, at 190-191.

[31]178 U.S. 41 (1900).

[32]*Id.* at 81-83.

[33]280 U.S. 124 (1929).

[34]*Id.* at 136-138.

[35]*Id.*; *see also Fernandez v. Wiener*, 326 U.S. 340, 352 (1945) (indirect taxes are imposed "upon a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property").

B. The *NFIB* Decision

In *NFIB*, a 5-4 majority of the Court, in an opinion written by Chief Justice John Roberts, held that the PPACA's individual health insurance mandate exceeds Congress's power under the commerce clause and the necessary and proper clause, while a different 5-4 majority of the Court, also in an opinion written by Chief Justice Roberts, held that the penalty imposed by the PPACA on individuals who fail to obtain health insurance is a tax for purposes of Congress's power under the taxing clause (but not, interestingly, for purposes of the Anti-Injunction Act (AIA)[36]) and is a valid exercise of Congress's power under the taxing clause.[37] The portion of the *NFIB* opinions dealing with the direct tax clauses, which is the focus of this article, was necessitated by the Court's holding that the exaction imposed by the PPACA for failing to obtain health insurance is a tax for purposes of the taxing clause.[38]

After holding that the exaction imposed by the PPACA on those who fail to obtain health insurance is considered a tax for purposes of the taxing clause, the Court, apparently unanimously,[39] explicitly acknowledged that the direct tax clauses limit Congress's power to tax by requiring that "any 'direct Tax' must be apportioned so that each State pays in proportion to its population,"[40] thus reaffirming for the first time in many years the continuing relevance of the direct tax clauses. The balance of the Court's discussion of the direct tax clauses, however, is extremely brief and less than illuminating.

The Court began by pointing out that the meaning of direct tax was unclear even to the Framers, and by discussing the narrow view of direct taxes taken by the Supreme Court in 1796 in *Hylton*. Remarkably, the Court asserted in this connection that "those Justices who wrote opinions [in *Hylton*] either directly asserted or strongly suggested that only two forms of taxation were direct: capitations and land taxes."[41] As noted above, however, of the three justices who wrote opinions in *Hylton*, only one expressed that view, and then only in dicta,[42] whereas the other two justices questioned that view.[43]

After this inauspicious start, the Court noted that in 1881 the Court in *Springer v. United States*[44] held that the only direct taxes were capitations and taxes on real estate, and that in 1895 the Court in *Pollock II*[45] expanded its interpretation to include taxes on personal property and income from personal property.[46] The result in *Pollock II* "was overturned by the Sixteenth Amendment, although we continued to consider taxes on personal property to be direct taxes," the Court said.[47] However, as noted above, although the 16th Amendment overturned the holding in the *Pollock* cases that income taxes are required to be apportioned, it did so without regard to whether income taxes are properly considered direct taxes, and indeed it had nothing at all to say about what is or is not a direct tax. The Court in *NFIB* did not discuss or even mention its cases such as *Knowlton* and *Bromley* that clarified the meaning of direct tax by illuminating the category of direct taxes imposed on real or personal property.

The balance of the Court's discussion of the direct tax issue is composed of a single paragraph (in which the Court refers to the exaction as the "shared responsibility payment"):

> A tax on going without health insurance does not fall within any recognized category of direct tax. It is not a capitation. Capitations are taxes paid by every person, "without regard to property, profession, or *any other circumstance*." *Hylton*, *supra*, at 175 (opinion of Chase, J.) (emphasis altered). The whole point of the

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[36]Section 7421(a); *see NFIB*, 132 S. Ct. at 2582-2584. If the penalty were considered a tax for purposes of the AIA, no lawsuit would have been permitted to proceed until actual collection of the amount in question, which could not occur until 2014 at the earliest.

[37]*NFIB*, 132 S. Ct. at 2584-2600. To avoid clouding this discussion of the direct tax clauses with the question whether the amount exacted under the PPACA for failing to obtain health insurance should be characterized as a tax or a penalty for purposes of the taxing clause, the balance of this discussion will refer to that amount as an exaction rather than as a tax or a penalty.

[38]*Id.* at 2598-2599. Although the discussion of the direct tax clauses is included in the portion of Chief Justice Roberts's opinion that is labeled the "Opinion of the Court," the separate opinion of Justice Ruth Bader Ginsburg that is joined by the other four justices making up the majority on this point does not mention the direct tax clauses issue. *See NFIB*, 132 S. Ct. at 2609-2642 (Ginsburg, J., concurring in part, concurring in the judgment in part, and dissenting in part).

[39]*See NFIB*, 132 S. Ct. at 2598; *id.* at 2609-2642 (Ginsburg, J.) (joining this part of the Court's opinion); *id.* at 2655 (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting) (stating that the majority's holding that the PPACA's health insurance mandate is a tax for purposes of the taxing clause forces the Court to decide "whether this is a direct tax that must be apportioned among the States according to their population"). *But cf. supra* note 38.

[40]*Id.* at 2598.

[41]*Id.*

[42]*Hylton*, 3 U.S. at 175 (opinion of Chase, J.).

[43]*Id.* at 183 (opinion of Iredell, J.); *id.* at 177 (opinion of Paterson, J.). *See supra* text accompanying notes 22-23.

[44]102 U.S. 586, 602 (1881).

[45]158 U.S. at 618.

[46]*NFIB*, 132 S. Ct. at 2598. It is unclear why the Court did not mention in this context *Pollock I*, which held that taxes on income from real property are also direct taxes.

[47]*Id.* (citing *Eisner v. Macomber*, 252 U.S. 189, 218-219 (1920)).

> shared responsibility payment is that it is triggered by specific circumstances — earning a certain amount of income but not obtaining health insurance. The payment is also plainly not a tax on the ownership of land or personal property. The shared responsibility payment is thus not a direct tax that must be apportioned among the several States.[48]

Justices Antonin Scalia, Anthony Kennedy, Clarence Thomas, and Samuel Alito, who jointly dissented from the portion of the Court's opinion that discussed the taxing clause, objected that the Court's holding that the PPACA's health insurance mandate is a tax for purposes of the taxing clause forced the Court "to confront [the] difficult constitutional question" of "whether this is a direct tax that must be apportioned among the States according to their population," which the dissenters characterized as "a question of first impression that deserves more thoughtful consideration than the lick-and-a-promise accorded by the Government and its supporters."[49] The dissenters noted that the meaning of the direct tax clauses is "famously unclear,"[50] and pointed out that the government's opening brief did not even address this issue, that its reply brief devoted a mere 21 lines to the question, and that the most prolonged statement at oral argument on the question was just over 50 words.[51] According to the dissenters, "one would expect this Court to demand more than fly-by-night briefing and argument before deciding a difficult constitutional question of first impression."[52]

C. Analysis of *NFIB*

The direct tax clauses are among the few constitutional limitations on Congress's power to impose taxes, and *NFIB* is the first Supreme Court decision regarding the direct tax clauses in many years.[53] As a result, it is surprising that the Court delved into this important issue without the benefit of more than cursory briefing or other discussion by the parties. In any event, while it can be debated whether the Court was correct that the unusual exaction at issue in *NFIB* is not a direct tax,[54] of more general interest is the impact of *NFIB* on other types of taxes.

As an initial matter, it bears repeating that the Court (apparently unanimously) confirmed the continuing relevance of the direct tax clauses,[55] thus confirming that they were not somehow implicitly repealed by a combination of the 14th Amendment's repeal of the three-fifths compromise and the 16th Amendment's repeal of the apportionment requirement for income taxes.[56] The Court's interpretation of the direct tax clauses, however, cuts off with the *Pollock* cases in 1895, failing to discuss or even mention the important clarifications by the Court in later cases such as *Knowlton* and *Bromley*. The Court's approach to taxes that are not capitations in those cases was to draw a distinction between taxes imposed on property solely by reason of its ownership, which are characterized as direct taxes, and taxes imposed on a particular use of the property such as its sale or other transfer, which are characterized as indirect taxes. Instead, the Court in *NFIB*, after declaring the exaction not to be a capitation,[57] decided the issue of whether the exaction is a tax imposed on property in a single conclusory sentence: "The payment is also plainly not a tax on the ownership of land or personal property."[58]

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[48]*Id.* at 2599.

[49]*NFIB*, 132 S. Ct. at 2655 (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting).

[50]*Id.*

[51]*Id.*

[52]*Id.*

[53]For a rare instance of a recent court of appeals decision regarding the direct tax clauses, which the Supreme Court declined to review, see *Murphy v. IRS*, 493 F.3d 170 (D.C. Cir. 2007), *Doc 2007-15777*, *2007 TNT 129-4*, *cert. denied*, 553 U.S. 1004 (2008).

[54]For a pre-*NFIB* discussion, see Steven J. Willis and Nakku Chung, "Constitutional Decapitation and Healthcare," *Tax Notes*, July 12, 2010, p. 169, *Doc 2010-11669*, or *2010 TNT 133-6*.

[55]*See supra* text accompanying note 39.

[56]This conclusion was clear, to this author at least, from the text of the Constitution before *NFIB* (see Berg, *supra* note 7, at 190-192 and 206), but apparently was less clear to commentators who, in the context of their advocacy for a federal wealth tax, have argued that the direct tax clauses are either a dead letter or should be construed so narrowly as to effectively repeal them. *See, e.g.*, Ackerman, *supra* note 14; Johnson, *supra* note 15; *see also* S. Douglas Hopkins, "Factual Distortions Derail Productive Debate on Tax Reform," *Tax Notes*, June 18, 2012, p. 1517, *Doc 2012-11567*, or *2012 TNT 119-7* (proposing a federal wealth tax); Hopkins, "Does a Constitutionality Challenge Preempt a Wealth Tax?" *Tax Notes*, July 16, 2012, p. 335, *Doc 2012-14585*, or *2012 TNT 136-14* (responding to this author's observation that an unapportioned federal wealth tax would be unconstitutional by reason of the direct tax clauses (see Berg, "Wealth Tax Proposal Unconstitutional, Practitioner Says," *Tax Notes*, July 2, 2012, p. 125, *Doc 2012-13376*, or *2012 TNT 127-15*)).

[57]According to the Court, the exaction "is not a capitation. Capitations are taxes paid by every person, 'without regard to property, profession, or *any other circumstance*.' *Hylton*, *supra*, at 175 (opinion of Chase, J.) [emphasis altered]. The whole point of the [exaction] is that it is triggered by specific circumstances — earning a certain amount of income but not obtaining health insurance." *NFIB*, 132 S. Ct. at 2599.

[58]*Id.*

The conceptual problems with the Court's approach become evident in the next portion of the Court's opinion, in which it addresses the perceived objection that the taxing clause does not "permit Congress to impose a tax for not doing something."[59] The Court's primary response to this objection is as follows:

> First, and most importantly, it is abundantly clear the Constitution does not guarantee that individuals may avoid taxation through inactivity. A capitation, after all, is a tax that everyone must pay simply for existing, and capitations are expressly contemplated by the Constitution.[60]

It is, of course, true that capitations are generally imposed on individuals merely because they exist, whether or not they engage in activity, and that the Constitution explicitly permits Congress to impose capitations. But the above-quoted statement misses the important point that the Constitution explicitly characterizes a capitation as a direct tax, and just as explicitly creates a serious obstacle to the imposition of such a tax in the form of the apportionment requirement. Indeed, it is arguably the very nature of taxes that are imposed merely by reason of a person's existence (that is, many capitations) and taxes that are imposed on property without regard to what one does with it that prompted the Framers to impose sharp limits on Congress's power to impose such a tax by subjecting all those taxes to the apportionment requirement.

Given their experience with taxes imposed by England before the Revolutionary War, and the role of those taxes in inspiring the Revolution, the Framers were understandably wary of giving the new federal government the power to levy taxes and so circumscribed that power in various ways. For indirect taxes, the incidence of which was expected to be passed on as part of the price of the item whose transfer gave rise to the tax, the Framers deemed it unnecessary to apply the onerous apportionment requirement because it was expected that the market would provide adequate protection against intolerable levels of indirect taxation.[61] By contrast, for direct taxes, which by their nature could not be passed on to a transferee or other person, the market-based check was unavailable and the apportionment requirement was deemed necessary to provide a check on intolerable levels of direct taxation.[62] Thus, direct taxes, which are imposed merely because an individual exists or owns property, were made subject to the apportionment requirement; while indirect taxes, which are imposed on a particular use to which an individual's property is put, such as a sale or other transfer of the property, were not. Presumably, the distinction between direct and indirect taxes that the Court set out in cases such as *Knowlton* and *Bromley* — taxes imposed on an individual's property itself are direct taxes whereas taxes imposed on the individual's sale, transfer, or other use of the property are indirect taxes — was drawn on the basis of this fundamental difference between the incidence of direct and indirect taxes.

Viewed in this light, the Court's conclusion that the exaction imposed by the PPACA is not a direct tax is questionable. To be sure, the Court is on fairly solid ground when it concludes that the exaction is not a capitation, because the exaction is imposed regarding the specific circumstances of the individual on whom it is imposed rather than merely for the privilege of existing.[63] Less clear, however, is whether the Court's conclusion that the exaction is "plainly not a tax on the ownership of . . . personal property" is correct. The exaction would appear to be imposed not on a particular transaction entered into with, or other use of, one's property, but rather on an individual's decision *not* to enter into a particular transaction — that is, purchasing health insurance. Under the framework established by cases such as *Knowlton* and *Bromley*, this feature of the exaction would at least arguably place it in the category of direct taxes.

Because the Court did not provide any reasoning for its conclusion that the exaction nonetheless is not a tax on the ownership of property, one is left to speculate whether the Court intended for its rationale for concluding that the exaction is not a capitation — that it is triggered by an individual's specific circumstances — also to be applied to its conclusion that the exaction is not a tax on property. That position, however, would be unpersuasive and should be rejected for two reasons: First, the Court explicitly applied the specific circumstances test only to capitations and not to taxes on the ownership of property. Perhaps more importantly, it seems clear that the Court could not have meant to apply the specific circumstances limitation to taxes on the ownership of property: Because *all* property

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[59]*Id.*

[60]*Id.*

[61]*See* Berg, *supra* note 7, at 184-185, and the authorities cited therein.

[62]*Id.*

[63]*But see* Erik M. Jensen, "Post-*NFIB*: Does the Taxing Clause Give Congress Unlimited Power?" *Tax Notes*, Sept. 10, 2012, p. 1309, *Doc 2012-16869*, or *2012 TNT 176-8*, at 1315 and n.49; Jensen, "The Apportionment of 'Direct Taxes': Are Consumption Taxes Constitutional?" 97 *Colum. L. Rev.* 2334, 2392-2393 (1997) (arguing that the Framers understood capitations to include taxes other than flat rate per capita taxes).

taxes are imposed only in the specific circumstances of an individual who owns property that has value at the measuring date, applying the specific circumstances test to property taxes would eliminate the property tax category of direct taxes, which would directly contradict the Court's holding in *NFIB* (and the well-established principle) that taxes on the ownership of property are a category of direct taxes.

Accordingly, the specific circumstances test applied by the Court in *NFIB* in the context of capitations is properly limited to that context and should not be applied to non-capitation taxes on real or personal property, regarding which the Court's opinion does not appear to change what seemed clear under the law before *NFIB*[64] — that taxes that are imposed merely because an individual owns property, without regard to any disposition or other use of the property, are direct taxes that must be apportioned in order to be constitutional. Under that approach, the exaction imposed under the PPACA, which is triggered not by one's use of property but rather by a circumstance not involving a use of property, is arguably a direct tax (assuming it is properly considered a tax at all).

D. *NFIB* and Other Federal Taxes

The unusual and somewhat ambiguous nature of the exaction at issue in *NFIB* renders the implications of the case for other types of federal taxes unclear. Indeed, the Court highlighted the exaction's ambiguous nature by characterizing it as a tax for some purposes (for example, the taxing clause) and as not a tax for others (for example, the AIA). The balance of this discussion is an attempt to determine whether several taxes that Congress has imposed or might attempt to impose are properly characterized as direct taxes, taking *NFIB* into account.

1. Capitations. In the simplest case of an unapportioned federal per capita tax imposed at a flat rate on every individual, that tax would, even after *NFIB*, presumably be considered a direct tax (although the apportionment requirement would be superfluous since that sort of tax would by definition be apportioned). It seems clear that a capitation imposed on any other basis, such as a sliding-scale head tax that is imposed in a different fixed sum amount depending on the individual's income, would not be considered a direct tax under *NFIB*.[65] This is so even though there is evidence that the Framers intended the term "capitations" to include taxes other than flat, per capita taxes, not least of which is that an apportionment requirement for flat, per capita taxes (which are by definition apportioned in accordance with population) would have been superfluous.[66]

2. *Ad valorem* real and personal property taxes. The Court's opinion in *NFIB* reaffirms that a federal real property tax imposed on the assessed value of one's residential or commercial real property, such as those commonly imposed by municipalities, as well as a federal tax on the value of one's automobile or other personal property, would be considered a direct tax.[67]

3. Wealth taxes. Next on the spectrum is a generally applicable federal wealth tax imposed on the aggregate value of an individual's property at the end of each year, proposals for which as a means of solving our nation's fiscal and other ills are becoming increasingly common.[68] While there has been much discussion in recent years regarding whether such a tax would be constitutional,[69] *NFIB* makes it clear that the argument that direct taxes need not be apportioned in order to be constitutional is without merit; and it seems clear from *NFIB* that a generally applicable wealth tax, which would be imposed solely by reason of one's ownership of property that has value, with no activity or transaction required on the part of the owner of the property and without regard to any specific circumstances of the taxpayer,[70] would be considered a direct tax. To be sure, it could be argued that ownership of property having value is itself a specific circumstance of the taxpayer and that a wealth tax applicable to those who own property having value is therefore an indirect tax under *NFIB*. However, that argument should be rejected as inconsistent with the Court's opinion in *NFIB* and long-standing precedent for the reasons discussed above. For non-capitation taxes on real or personal property, the Court's opinion in *NFIB* does not appear to change what seemed clear under the existing law — that a generally applicable wealth tax is a tax on the

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[64]*See* Berg, *supra* note 7, at 215-216.

[65]*NFIB*, 132 S. Ct. at 2599 (a tax that is triggered by the specific circumstances of earning a certain amount of income but not obtaining health insurance is not a capitation).

[66]*See* Jensen, "Are Consumption Taxes Constitutional?" *supra* note 63, at 2392-2393.

[67]*NFIB*, 132 S. Ct. at 2598 (noting that taxes on land and on personal property are among the recognized categories of direct taxes).

[68]*See, e.g.*, Daniel Altman, "To Reduce Inequality, Tax Wealth, Not Income," *The New York Times*, Nov. 19, 2012, at A21; Hopkins, *supra* note 56; Ronald McKinnon, "The Conservative Case for a Wealth Tax," *The Wall Street Journal*, Jan. 9, 2012, at A13.

[69]For examples, see the articles cited *supra* in notes 14, 15, and 56.

[70]*See NFIB*, 132 S. Ct. at 2599.

ownership of real and personal property and therefore is a direct tax that must be apportioned in order to be constitutional.[71]

4. Mark-to-market, deemed-sale taxes. Rather than a simple wealth tax imposed on the *value* of an individual's assets, consider a tax imposed on the *appreciation* in value of some or all of an individual's assets from one measuring date to another, that is, on a mark-to-market or deemed-sale basis. Congress has in fact enacted taxes of this type in some limited circumstances — including the mark-to-market regime for futures contracts under section 1256,[72] the mark-to-market regime for some securities dealers under section 475, and the exit tax imposed by section 877A on a deemed sale by expatriates and some other individuals of all their assets at fair market value — but to date has not enacted a generally applicable mark-to-market tax. Taxes such as these raise the question whether the tax is a direct tax and, if so, the further question whether a mark-to-market tax is imposed on "incomes" within the meaning of the 16th Amendment and is therefore constitutional. This discussion will focus only on the former issue.[73]

Previously, on the basis of the Court's conclusions and language in cases such as *Knowlton* and *Bromley*, it seemed clear, to this author at least, that mark-to-market taxes such as the exit tax under section 877A should properly be characterized as direct taxes because they are imposed on a taxpayer's property without regard to any transaction entered into with that property, on a deemed sale of property that does not actually occur.[74] However, the Court in *NFIB* held that the exaction there in issue is not a direct tax even though it is imposed only in circumstances in which the individual on whom it is imposed chooses not to use property in a particular transaction (that is, purchasing health insurance). The question is whether mark-to-market taxes, which are generally imposed in the absence of a transaction involving the property, must now be considered indirect taxes by reason of *NFIB*.

As noted, the Court in *NFIB* provided the following rationale for its determination that the exaction is not a direct tax: (1) the only recognized categories of direct taxes are capitations and taxes on land or personal property; (2) the exaction is not a capitation because it is not imposed without regard to the payer's property, profession, or any other circumstance, but rather is triggered by the specific circumstances of the payer's "earning a certain amount of income but not obtaining health insurance"; and (3) the exaction is "plainly not a tax on the ownership of land or personal property."[75] Under that analysis, a mark-to-market tax presumably would not be considered a capitation, because it is triggered by the specific circumstances of owning property that has appreciated since the last measuring date. However, even before *NFIB* one would have been hard-pressed to characterize a mark-to-market tax as a capitation. The more interesting question is whether a mark-to-market tax would be considered "a tax on the ownership of land or personal property," a question on which the majority opinion in *NFIB* provides no guidance other than to say that the exaction in that case is "plainly" not such a tax.

While the answer to this question is by no means clear from the majority opinion in *NFIB*, on balance it would appear that a mark-to-market tax, particularly one that is imposed across the board on every individual who owns property that has appreciated above its value at some earlier measuring date, is sufficiently different from the penalty-like exaction imposed under the PPACA that the prior analysis in cases such as *Knowlton* and *Bromley*, which were not repudiated (or even mentioned) by the Court in *NFIB*, should continue to apply. Under that analysis, because an across-the-board mark-to-market tax would be imposed without regard to whether the taxpayer did anything with the property, such as selling or otherwise transferring it, the tax should be considered a tax on the ownership of property and thus a direct tax. To be sure, were the Court's capitation analysis in *NFIB* to apply to this type of tax, one might conclude that ownership of appreciated property is the type of specific circumstance that takes the tax out of the category of direct taxes. However, for the reasons set forth above, application of the Court's capitation analysis to whether a tax is a tax on the ownership of real or personal property should be rejected.

Nor should the result be different for mark-to-market, deemed-sale taxes that are imposed only in limited circumstances, such as the exit tax imposed on expatriates and some others under section 877A. This result is somewhat less clear than the result for an across-the-board mark-to-market tax, because

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[71]*See* Berg, *supra* note 7, at 215-216; Jensen, "Post-*NFIB*," *supra* note 63, at 1315.

[72]Found to be constitutional in *Murphy v. United States*, 992 F.2d 929 (9th Cir. 1993), *Doc 93-5499*, *93 TNT 103-17*, but without deciding "the broader issue of whether Congress *could* tax the gains inherent in capital assets prior to realization or constructive receipt." 992 F.2d at 931-932 (emphasis in original).

[73]For an argument that a mark-to-market tax such as the exit tax is not a tax on incomes within the meaning of the 16th Amendment, see Berg, *supra* note 7, at 192-205 and 208-215.

[74]*See* Berg, *supra* note 7.

[75]*NFIB*, 132 S. Ct. at 2599.

NFIB could be read as having changed the focus of the inquiry and narrowed the definition of direct tax to taxes imposed in the absence of *any action* by the taxpayer, in which case the act of expatriating could be seen as a sufficient action to cause the exit tax to be considered an indirect tax under *NFIB*. *NFIB* should not be so read. First, that reading would improperly apply the Court's special circumstances analysis of capitations in *NFIB* to taxes on the ownership of property, thus reading the latter class of taxes out of the definition of direct taxes in a manner that would be inconsistent with the Court's opinion in *NFIB* and its long-standing precedent. Moreover, under the Court's prior analysis in cases such as *Knowlton* and *Bromley*, the determination of whether a tax is imposed on the ownership of property and is thus a direct tax is made not on the basis of whether the taxpayer had engaged in any activity at all, but rather on the basis of whether he had done something with the property being taxed, such as used it, sold it, or transferred it as a gift or bequest.

Accordingly, deemed-sale taxes such as the exit tax, which are imposed on a deemed sale of a taxpayer's property irrespective of whether the taxpayer has done anything with that property, are properly considered taxes on the ownership of property and thus direct taxes, even when they are triggered by specific circumstances such as expatriation. Indeed, that the exit tax is imposed even on real property situated outside the United States — regarding which the act of expatriation cannot be said to have effected a transfer of, or done anything else with, that property — makes it reasonably clear that the exit tax is imposed on the taxpayer's property without regard to any transfer or other use of the property. It is therefore a direct tax that, because it is not apportioned, is constitutional only if it is properly considered a tax on incomes within the meaning of the 16th Amendment.

Because the Supreme Court's discussion of the direct tax clauses in *NFIB* is so brief and the exaction there at issue was so unusual, it remains to be seen how the decision will be applied in future cases testing the limits of Congress's taxing power, and indeed whether it will be followed or treated as largely irrelevant in those cases.