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## A Constitutional Wealth Tax

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# A CONSTITUTIONAL WEALTH TAX

Ari Glogower\*

*Policymakers and scholars are giving serious consideration to a federal wealth tax. Wealth taxation could address the harms from rising economic inequality, promote equality of social and economic opportunity, and raise the revenue needed to fund critical government programs. These reasons for taxing wealth may not matter, however, if a federal wealth tax is unconstitutional.*

*Scholars debate whether a tax on a wealth base (a “traditional wealth tax”) would be a “direct tax” subject to apportionment among the states by population. This Article argues, in contrast, that this possible constitutional restriction on a traditional wealth tax may not matter. If the Court struck down a traditional wealth tax, Congress could instead tax wealth by adjusting a taxpayer’s income tax liability on account of her wealth. This Article describes three general methods for making this adjustment (collectively, “Wealth Integration” methods). A taxpayer’s wealth could affect her taxable income base (the “Base Method”), the applicable rate schedule (the “Rate Method”), or the availability of credits against tax (the “Credit Method”).*

*Wealth Integration methods could replicate the economic effects of a traditional wealth tax but with an intrinsically different constitutional analysis. The Court could strike down Wealth Integration methods only by overruling settled prior precedent, invalidating many current features of the income tax, and fundamentally restricting Congress’s power to tax income under the Sixteenth Amendment.*

*Finally, the possibility that Congress could instead tax wealth through Wealth Integration methods provides a new argument why the Court should uphold a traditional wealth tax. Otherwise, the Court would have to choose between fundamentally restricting the Sixteenth Amendment—and jeopardizing the income tax as we know it—or distinguishing between economically similar taxes on the basis of their formal label while still allowing Congress to*

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*tax wealth and diminishing the effect of the apportionment requirement as a restraint on Congress's taxing power.*

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INTRODUCTION

Policymakers and scholars are giving serious consideration to a federal wealth tax.<sup>1</sup> Wealth taxation could address the harmful effects of economic inequality on our politics and our society,<sup>2</sup> promote equality of social and economic opportunity,<sup>3</sup> and raise the revenue needed to service the national debt and fund critical government programs.<sup>4</sup> In some accounts, the fate of our democracy hangs in the balance.<sup>5</sup>

1. See, e.g., Press Release, Elizabeth Warren, Senator, Senator Warren Unveils Proposal to Tax Wealth of Ultra-Rich Americans (Jan. 24, 2019), <https://www.warren.senate.gov/newsroom/press-releases/senator-warren-unveils-proposal-to-tax-wealth-of-ultra-rich-americans> [http://perma.cc/2MA2-N87C] (describing a proposal by Senator Elizabeth Warren (D-MA) for a tax of 2% on net wealth above \$50 million and 3% on net wealth above \$1 billion); Dawn Johnsen & Walter Dellinger, *The Constitutionality of a National Wealth Tax*, 93 IND. L.J. 111, 111–14 (2018); Letter from Emmanuel Saez & Gabriel Zucman, Professors of Econ., Univ. of Cal., Berkeley, to Elizabeth Warren, Senator (Jan. 18, 2019), <https://www.warren.senate.gov/imo/media/doc/saez-zucman-wealthtax.pdf> [http://perma.cc/A8C8-ZCKK] (evaluating the revenue and distributional effects of Senator Warren’s proposal). For prior scholarship advocating for a wealth tax, see, for example, BRUCE ACKERMAN & ANNE ALSTOTT, THE STAKEHOLDER SOCIETY 94–112 (1999); JEREMY BEARER-FRIEND, RESTORING DEMOCRACY THROUGH TAX POLICY 10–12 (2018), <https://greatdemocracyinitiative.org/wp-content/uploads/2018/12/Tax-and-Democracy-121118.pdf> [http://perma.cc/YZS5-GHMC]; THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 515–18, 524–30 (Arthur Goldhammer trans., 2014); Ari Glogower, *Taxing Inequality*, 93 N.Y.U. L. REV. 1421 (2018); Beverly Moran, *Wealth Redistribution and the Income Tax*, 53 HOW. L.J. 319, 329–35 (2010); David Shakow & Reed Shuldiner, *A Comprehensive Wealth Tax*, 53 TAX L. REV. 499 (2000).

2. See, e.g., BEARER-FRIEND, *supra* note 1 (advocating for a federal wealth tax and other reforms in order to raise revenue and address the “concentrated political power of economic elites”); Glogower, *supra* note 1, at 1441–43, 1445–52; Johnsen & Dellinger, *supra* note 1, at 111.

3. See, e.g., ACKERMAN & ALSTOTT, *supra* note 1, at 94–112 (proposing a wealth tax to fund a “stakeholder grant” to every citizen to promote equality of opportunity); Moran, *supra* note 1, at 329–35.

4. See, e.g., Johnsen & Dellinger, *supra* note 1, at 111 (advocating for a national wealth tax “to support vital infrastructure, social service, and other governmental functions”); Greg Leiserson, *Wealth Taxation: An Introduction to Net Worth Taxes and How One Might Work in the United States*, WASH. CTR. FOR EQUITABLE GROWTH (Jan. 23, 2019), <https://equitablegrowth.org/wealth-taxation-an-introduction-to-net-worth-taxes-and-how-one-might-work-in-the-u-s/> [https://perma.cc/6DW5-55YH] (describing the revenue-raising potential of a wealth tax).

5. E.g., Johnsen & Dellinger, *supra* note 1, at 111; Walter Dellinger & Dawn Johnsen, *We Need a National Debate on a Federal Tax on Wealth*, TAKE CARE (Apr. 14, 2017), <https://takecareblog.com/blog/we-need-a-national-debate-on-a-federal-tax-on-wealth> [https://perma.cc/95FP-GX6S]; see also GANESH SITARAMAN, THE CRISIS OF THE MIDDLE-CLASS

The reasons for taxing wealth may not matter, however, if a federal wealth tax is unconstitutional. The Constitution requires that any “direct tax” must be apportioned among the states by population,<sup>6</sup> which would be impossible for any modern progressive tax.<sup>7</sup> Not surprisingly, the prior literature on the constitutionality of a wealth tax generally focuses on one central question: Is a traditional wealth tax<sup>8</sup> a “direct tax” subject to the rule of apportionment?<sup>9</sup> Some argue that the Court should interpret the term “direct tax” and the apportionment requirement narrowly to allow a traditional wealth tax,<sup>10</sup> others disagree,<sup>11</sup> and still others consider the constitutional provisions innately indeterminate.<sup>12</sup>

This Article argues, in contrast, that the possible constitutional restrictions on a traditional wealth tax may not matter. If the Supreme Court were to strike down a traditional wealth tax, Congress could instead tax wealth indirectly by adjusting a taxpayer’s income tax liability on account of her wealth, through different methods that this Article collectively terms “Wealth Integration” methods. Scholars have just begun to appreciate the potential for using wealth as a factor in the income tax<sup>13</sup> and the possible constitutional implications of this approach.<sup>14</sup>

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CONSTITUTION: WHY ECONOMIC INEQUALITY THREATENS OUR REPUBLIC 223–73 (2017) (describing generally how economic inequality threatens democratic governance).

6. U.S. CONST. art. I, § 2, cl. 3; *id.* art. I, § 9, cl. 4.

7. See *infra* notes 43–44 and accompanying text.

8. By “traditional wealth tax,” this Article refers to all methods whereby a measure of a taxpayer’s wealth serves as a separate tax base. See *infra* Section II.B.1.

9. See *infra* Section II.B.2.

10. See, e.g., Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1, 56–58 (1999); Johnsen & Dellinger, *supra* note 1, at 135–37; Calvin H. Johnson, *Purging Out Pollock: The Constitutionality of Federal Wealth or Sales Taxes*, 97 TAX NOTES 1723, 1728–29, 1734 (2002); *infra* notes 219–244 and accompanying text.

11. See, e.g., Miranda Perry Fleischer, *Not So Fast: The Hidden Difficulties of Taxing Wealth*, in WEALTH 261, 284–85 (Jack Knight & Melissa Schwartzberg eds., 2017); Erik M. Jensen, *The Constitution Matters in Taxation*, 100 TAX NOTES 821, 829 (2003); *infra* notes 245–251 and accompanying text.

12. See, e.g., Eric Rakowski, *Can Wealth Taxes Be Justified?*, 53 TAX L. REV. 263, 270 (2000) (“A court might reasonably decide the issue either way, depending upon the theory of constitutional interpretation it embraced and its conception of the weight and point of relevant precedents.”).

13. For example, Professor Lee Anne Fennell suggests that policymakers could account for a taxpayer’s wealth to determine eligibility for a system of preferential income tax rates. Lee Anne Fennell, *Willpower Taxes*, 99 GEO. L.J. 1371, 1427–29 (2011). Professor James Puckett similarly suggests that specific benefits in the current income tax rules could be “phased out” for wealthy taxpayers. James M. Puckett, *Improving Tax Rules by Means-Testing: Bridging Wealth Inequality and “Ability to Pay,”* 70 OKLA. L. REV. 405, 444–47 (2018). OECD economists also suggested that capital income taxes could be “designed to increase with both income and wealth.” OECD, TAX POLICY STUDIES NO. 26, THE ROLE AND DESIGN OF NET WEALTH TAXES IN THE OECD 53 (2018). Professor Chris Sanchirico describes in theoretical terms the advantages of cross-dependent tax instruments—which would account for multiple attributes of a taxpayer in determining tax liabilities—in an optimal taxation framework. See Chris William Sanchirico, *Deconstructing the New Efficiency Rationale*, 86 CORNELL L. REV. 1003, 1027–

Before turning to a constitutional analysis of possible Wealth Integration methods, this Article provides the first general account of these methods in the literature. Under each method, a taxpayer's wealth affects one of the factors determining her income tax liability. Under the "Base Method," a taxpayer's wealth affects the amount of her base of taxable income.<sup>15</sup> Under the "Rate Method," a taxpayer's wealth adjusts the rates on her taxable income.<sup>16</sup> Finally, under the "Credit Method," a taxpayer's wealth affects the availability of credits against her income tax liability.<sup>17</sup>

The Wealth Integration methods are flexible general approaches that could be adjusted to tax wealth at different levels and to varying degrees. This Article describes how Wealth Integration methods are also more versatile policy tools than previously appreciated in the literature,<sup>18</sup> particularly when combined with other possible reforms of the tax system.<sup>19</sup>

Wealth Integration methods have the same general effect of a traditional wealth tax in adjusting tax liabilities on account of a taxpayer's wealth. At the same time, these methods also have basic limitations and would operate differently from a traditional wealth tax. Under Wealth Integration, wealth is not taxed as an additive element in the taxable base. As a result, Wealth Integration methods will generally affect tax liabilities only when the taxpayer has a sufficient base of taxable income for the year.<sup>20</sup> For the same reason, a taxpayer's liability will never increase continuously and linearly with her wealth, unlike under a traditional wealth tax. Rather, these methods would

28 (2001) ("With a multidimensional tax table it is possible to make the individual's tax on each attribute . . . a function of the levels of the individual's other attributes. Taxes can thus be *cross-dependent*. Income tax rates, for instance, can be based on wealth . . .").

14. Prior consideration of this question in the literature focuses on a hypothetical considered by Chief Justice Roberts in *National Federation of Independent Business v. Sebelius* (*NFIB*), 567 U.S. 519 (2012), of a tax on windows implemented through the income tax, where a taxpayer's income could affect the amount of the window tax due. *Id.* at 569–70; see Puckett, *supra* note 13, at 454 ("The underlying rationale is a mystery, but the facts of the case and the hypothetical suggest that the Court would be reluctant to strike down income taxes that distinguish between taxpayers because of their personal characteristics or property."). Chief Justice Roberts only raised this hypothetical in the portion of the opinion distinguishing between a "tax" and a "penalty," however, and did not suggest that the tax on windows would not be a direct tax subject to apportionment. See Erik M. Jensen, *Did the Sixteenth Amendment Ever Matter? Does It Matter Today?*, 108 NW. U. L. REV. 799, 821 (2014) ("The Chief Justice may have been right that his hypothetical 'penalty' would actually be a tax, but what he did not mention is that, if so, it almost certainly would be a direct tax, a tax on property."). Chief Justice Roberts's hypothetical also does not describe a Wealth Integration method in the first instance. The hypothetical describes a tax on property that adjusts with a taxpayer's income, rather than a tax on income that adjusts with a taxpayer's wealth.

15. See *infra* Section III.A.1.

16. See *infra* Section III.A.2.

17. See *infra* Section III.A.3.

18. See, e.g., Puckett, *supra* note 13, at 445–46 ("There is a relatively limited value, however, in the tax benefits that could sensibly be put on the table for phase-outs . . .").

19. See *infra* Section III.C.

20. For a discussion of the exception to this rule, see *infra* note 288.

operate as progressive taxes on wealth up to a ceiling, with the location of the ceiling set by Congress based on how the method is applied.<sup>21</sup> At the same time, this general limitation can also mitigate the efficiency costs from taxing wealth<sup>22</sup> and would not inhibit Wealth Integration methods from raising significant revenue and advancing distributional goals.<sup>23</sup>

Despite their economic similarities, the constitutional analyses of Wealth Integration methods and a traditional wealth tax would be intrinsically different. This Article traces an argument for why the Court should uphold Wealth Integration methods that begins with doctrinal analysis and then considers the conceptual challenges with invalidating these methods. Wealth Integrations methods are consistent with the Court's own precedent interpreting the constitutional provisions—including with the *Pollock* cases that invalidated the 1894 Income Tax<sup>24</sup> and represent the Court's most restrictive view of Congress's taxing power.<sup>25</sup> The Court has consistently upheld Congress's ability to use various factors in determining tax liabilities, even if those same factors cannot be used as independent subjects of tax. That is, for purposes of the constitutional analysis, the Court has always distinguished between the subject or "occasion" of tax and the "basis" of tax, which refers more broadly to the factors Congress may consider when determining the final tax due.<sup>26</sup> Under Wealth Integration, wealth operates as a basis of tax, or one of the factors used to determine the tax due on the base of taxable income, which remains the "subject" of tax.<sup>27</sup>

Even if the Court overruled or narrowed these prior precedents, this Article explains why the Court could only invalidate Wealth Integration methods by also invalidating integral features of the current income tax rules and fundamentally restricting Congress's power to tax income under the Sixteenth Amendment.<sup>28</sup> In fact, the current income tax already uses Wealth Integration methods, although these rules are not explicitly labeled as such, and a ruling striking down Wealth Integration could also jeopardize these features of the current tax system.<sup>29</sup> More conceptually, this Article explains why Wealth Integration methods should not be understood as taxes on wealth at all for purposes of the constitutional analysis, and are indistinguishable from rules that simply advantage taxpayers with less wealth.<sup>30</sup>

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21. See *infra* Section III.B.1.

22. See *infra* Section III.B.2.

23. See *infra* Section III.B.2.

24. *Pollock v. Farmers' Loan & Tr. Co. (Pollock I)*, 157 U.S. 429, *aff'd on reh'g*, 158 U.S. 601 (*Pollock II*) (1895); see *infra* notes 65–71, 89–90 and accompanying text.

25. See *infra* notes 349–350 and accompanying text.

26. See *infra* Section I.B.2.

27. See *infra* Section IV.A.1.

28. See *infra* Section IV.A.

29. See *infra* Section IV.A.3.

30. See *infra* Section IV.A.2.

The Article then revisits the different fates of the apportionment requirement for direct taxes and the “uniformity requirement” for other taxes—which has been virtually written out of the Constitution<sup>31</sup>—and argues that the same reasons for the desuetude of the uniformity argument explain why the Court should interpret a narrow scope for the apportionment requirement as well.<sup>32</sup>

Finally, this Article considers the broader implications of Wealth Integration methods for the scope of Congress’s taxing power. While Wealth Integration methods may be desirable “first best” reforms, the possibility that Congress could tax wealth through Wealth Integration methods also provides a new argument why the Court should uphold a traditional wealth tax. The tax law generally prioritizes substance over form in designing tax rules, since formal distinctions tend to be less effective to the extent taxpayers can respond by shifting from less favorable to more favorable rules.<sup>33</sup> Similarly, if the Court found that the Constitution foreclosed a traditional wealth tax, Congress could respond by reproducing the economic effects of a traditional wealth tax through Wealth Integration methods, but with a more favorable constitutional analysis. In this case, the Court could only invalidate Wealth Integration methods by fundamentally restricting Congress’s power to tax income under the Sixteenth Amendment. On the other hand, if the Court upheld Wealth Integration methods but invalidated a traditional wealth tax, this approach would distinguish between economically similar taxes on the basis of their formal label while still allowing Congress to tax wealth and thereby diminishing the effect of the apportionment requirement as a restraint on Congress’s taxing power. In this case, the Court should instead interpret the constitutional tax provisions as allowing Congress broad power to tax wealth, regardless of the form.

## I. THE CONSTITUTIONAL TAXING POWER

### A. *The Constitutional Provisions*

The Constitution gives Congress broad taxing power to raise revenue for public purposes. Article I, Section 8 provides: “The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States . . . .”<sup>34</sup>

This broad federal taxing power replaced the previous (and ineffective) system of requisitions from the states under the prior Articles of Confederation, which allowed Congress to request money from the states but did not

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31. See *infra* note 37 and accompanying text; *infra* Section I.B.4.

32. See *infra* Section IV.A.4.

33. See *infra* notes 114–116 and accompanying text.

34. U.S. CONST. art. I, § 8, cl. 1.



empower Congress to enforce these requisitions.<sup>35</sup> The constitutional taxing power remedied this failure and ensured Congress's ability to raise revenue to fund the new federal government.<sup>36</sup>

The Constitution specifies how Congress must implement different forms of taxes. First, Congress must impose taxes subject to the "uniformity requirement" consistently across the country. Article I, Section 8 provides: "[A]ll Duties, Imposts and Excises shall be uniform throughout the United States . . ." <sup>37</sup> Congress must also apportion "direct taxes" subject to the "apportionment requirement" among the states relative to population. Article I, Section 2 and Article I, Section 9 provide, respectively: "Representatives and direct Taxes shall be apportioned among the several States . . . according to their respective Numbers"<sup>38</sup> and "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein . . ."<sup>39</sup>

These operational rules do not explicitly limit Congress's taxing power.<sup>40</sup> Congress can impose a direct tax as long as it is apportioned and other taxes as long as they are uniform.<sup>41</sup> In reality, however, the apportionment requirement likely prevents Congress from imposing a modern direct tax.<sup>42</sup> Apportionment would require Congress to allocate the amount of revenue raised from direct taxes among the states in proportion to their populations. This method—without other offsetting tax adjustments—would result in a regressive distribution of the tax burden<sup>43</sup> whenever a tax is imposed on a base and the share of the total population exceeds the share of the base in one or more states.<sup>44</sup> As a result, the definition of a "direct tax" could have significant consequences for the scope of Congress's taxing power.

35. See ARTICLES OF CONFEDERATION OF 1781, art. VIII, paras. 1–2; *id.* art. IX, para. 5.

36. See Joseph M. Dodge, *What Federal Taxes Are Subject to the Rule of Apportionment Under the Constitution?*, 11 U. PA. J. CONST. L. 839, 848, 855 (2009).

37. U.S. CONST. art. I, § 8, cl. 1.

38. *Id.* art. I, § 2, cl. 3.

39. *Id.* art. I, § 9, cl. 4. For an explanation of the two redundant clauses requiring apportionment, see Dodge, *supra* note 36, at 904–07.

40. The Constitution only explicitly precludes Congress from taxing state exports. U.S. CONST. art. I, § 9, cl. 5.

41. The two requirements are commonly understood in the literature as mutually exclusive, since it would be impossible to simultaneously satisfy both unless the distribution of the population among the states equals the distribution of the taxable base. See, e.g., Dodge, *supra* note 36, at 856 ("The uniformity requirement is incompatible with apportionment, because apportionment . . . must necessarily impose different tax rates with respect to different states.").

42. Congress did periodically enact apportioned real estate taxes, beginning in 1798. See Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334, 2354–56 (1997). Jensen concedes, however, that doing so "may not be politically possible today." *Id.* at 2355.

43. That is, taxpayers with greater shares of the taxed base pay tax at lower rates than taxpayers with lower shares of the same base.

44. For example, consider the effect of the apportionment requirement on a national wealth tax (if the Court were to hold that a wealth tax is a direct tax). Assume State A and State

## B. Interpretative Questions

The tax provisions in the Constitution raise a series of interpretive questions that have consequences for the constitutionality of Wealth Integration methods or a traditional wealth tax.<sup>45</sup>

### 1. Direct Taxes and the Scope of Apportionment

Because of the impracticality of apportionment, the definition of a direct tax could have significant consequences for the scope of Congress's taxing power.<sup>46</sup> For more than a century after the Constitution's ratification, the Court construed the definition of a direct tax narrowly and never required apportionment when it would invalidate a federal tax. In the formative early case *Hylton v. United States*,<sup>47</sup> the Court found that a 1794 tax on carriages was not a direct tax, and therefore not subject to apportionment. In seriatim opinions, the justices interpreted the term "direct tax" narrowly as meaning only a capitation tax, a tax on land, and possibly a tax on personal property.<sup>48</sup> Justice Chase did not specify any basis for this determination, while Justice Paterson based this interpretation on "theory and practice" and the Framers' intent, without further elaboration or corroborating evidence.<sup>49</sup>

The *Hylton* Court was more concerned with the purpose and function of the apportionment requirement than the precise definition of the constitutional terms. For example, Justice Chase stated that the constitutional provisions gave Congress a "general power . . . without any restraint,"<sup>50</sup> and that the apportionment rule was intended only for taxes where it could "reasona-

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B have equal populations but State B has less taxable wealth. If Congress apportioned a wealth tax, each state would be responsible for the same amount of total tax revenue. As a result, taxpayers in State B would pay tax at a higher rate on their wealth, precisely because State B is less wealthy. As the Court noted in the early case of *Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796), apportionment could consequently result in "very great inequality and injustice." *Id.* at 174 (opinion of Chase, J.).

45. This discussion does not address other possible questions affecting Congress's taxing power and reserves interpretative questions pertaining to the Sixteenth Amendment and Congress's power to tax income for *infra* Section II.A.2.

46. But see Professor Johnson's argument, *infra* notes 229–239 and accompanying text, that apportionment should not constrain Congress's taxing power at all.

47. 3 U.S. (3 Dall.) 171.

48. *Hylton*, 3 U.S. (3 Dall.) at 175 (opinion of Chase, J.); *id.* at 177 (opinion of Paterson, J.) ("Whether direct taxes . . . comprehend any other tax than a capitation tax, and tax on land, is a questionable point. . . . [B]ut as it is not before the court, it would be improper to give any decisive opinion upon it.")

49. *Id.* at 176–77 (opinion of Paterson, J.); see also Charlotte Crane, *Reclaiming the Meaning of "Direct Tax,"* SSRN (Feb. 16, 2010), <https://www.ssrn.com/abstract=1553230> [<http://perma.cc/MZP5-9RNP>] ("[A]side from conceding that land and poll taxes probably were direct taxes, the several decisions of the Justices in *Hylton* offered no insight into the concepts that might have been behind this conclusion.")

50. *Hylton*, 3 U.S. (3 Dall.) at 174 (opinion of Chase, J.).

bly apply.”<sup>51</sup> Justice Paterson reasoned that the Framers only added the apportionment requirement in a compromise with delegates from the Southern states, to ensure that their slaves and large tracts of land would not be disproportionately burdened.<sup>52</sup> Paterson similarly adopted a functionalist approach premised on a broad federal taxing power and suggested that this consideration was more probative than any precise definitions of the constitutional terms.<sup>53</sup>

For nearly a century after *Hylton*, Congress primarily depended upon tariffs to fund the country’s limited revenue needs, rather than internal taxes.<sup>54</sup> Challenges to the limits of the federal taxing power returned during the Civil War era, when Congress sought new sources of revenue to fund the war.<sup>55</sup> The Court generally followed *Hylton*’s analysis to uphold taxes on gross receipts of insurance companies in *Pacific Insurance Co. v. Soule*;<sup>56</sup> on bank notes in *Veazie Bank v. Fenno*;<sup>57</sup> on distilled spirits and tobacco in *United States v. Singer*;<sup>58</sup> on the succession of real estate and personal property in *Scholey v. Rew*;<sup>59</sup> and on “gains, profits, and incomes” of individuals in *Springer v. United States*.<sup>60</sup>

In these cases, the Court followed *Hylton*’s interpretation of direct taxes without much further scrutiny.<sup>61</sup> If anything, these opinions expressed even greater skepticism than did the *Hylton* Court that the constitutional terms

51. *Id.*

52. *Id.* at 177 (opinion of Paterson, J.).

53. *Id.* at 176 (“What is the natural and common, or technical and appropriate, meaning of the words, duty and excise, is not easy to ascertain. . . . It was, however, obviously the intention of the framers of the Constitution, that Congress should possess full power over every species of taxable property, except exports.”). The other two justices who issued opinions, Iredell and Wilson, generally concurred with Chase and Paterson’s rationale. *Id.* at 181–83 (opinion of Iredell, J.); *id.* at 183–84 (opinion of Wilson, J.).

54. See MICHAEL J. GRAETZ, *THE U.S. INCOME TAX: WHAT IT IS, HOW IT GOT THAT WAY, AND WHERE WE GO FROM HERE* 14–15 (1997).

55. *Id.*; see also W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA: A HISTORY* 40–63 (3d ed. 2016) (describing the federal government’s evolving sources of revenue, from a reliance on excise taxes in the early republic, then tariffs, and then to the first income tax in the Civil War era).

56. 74 U.S. (7 Wall.) 433 (1868).

57. 75 U.S. (8 Wall.) 533 (1869).

58. 82 U.S. (15 Wall.) 111 (1873).

59. 90 U.S. (23 Wall.) 331 (1874).

60. 102 U.S. 586 (1881).

61. See *Springer*, 102 U.S. at 600–02 (citing *Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796)); *Scholey*, 90 U.S. (23 Wall.) at 347 (citing *Hylton*, 3 U.S. (3 Dall.) 171); *Veazie*, 75 U.S. (8 Wall.) at 546 (“[I]t may further be taken as established upon the testimony of Paterson, that the words direct taxes, as used in the Constitution, comprehended only capitation taxes, and taxes on land, and perhaps taxes on personal property by general valuation . . . .”); *Soule*, 74 U.S. (7 Wall.) at 444–46.

had ascertainable meanings relevant to the constitutional analysis.<sup>62</sup> The Court continued to interpret the constitutional provisions as granting Congress broad taxing power<sup>63</sup> and the apportionment requirement as simply a “mode” of taxation available to Congress when implementing certain taxes,<sup>64</sup> rather than a substantive limit on this power. In the two 1895 *Pollock v. Farmers’ Loan & Trust Co.* decisions, the Court departed from its prior interpretative methodology and its assumption of a broad congressional taxing power. The case considered the constitutionality of the 1894 income tax,<sup>65</sup> which included in the taxable base rents and income from real estate. In *Pollock I*, the Court held that the portion of the law taxing income from real estate was unconstitutional as an unapportioned direct tax on the underlying real estate.<sup>66</sup> Upon rehearing, *Pollock II* held more broadly that taxes on personal property or the income from personal property were also direct taxes,<sup>67</sup> and that the entire 1894 income tax was therefore invalid on account of these direct tax elements.<sup>68</sup>

The *Pollock* Court departed from *Hylton*’s interpretative template in critical respects. The Court viewed the apportionment requirement as a substantive restraint on the federal taxing power rather than simply a mode of taxation available for Congress. In this account, although the states ceded taxing power to the federal government, the apportionment requirement ensured that direct taxes would be imposed in proportion to the population of voters approving the taxes<sup>69</sup> and that states would maintain control over revenue collection from their residents.<sup>70</sup> To support this different understand-

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62. See, e.g., *Veazie*, 75 U.S. (8 Wall.) at 544 (recounting the oft-repeated story that constitutional delegate Rufus King asked what was the precise meaning of the term “direct taxation” and no one answered, as evidence of the “uncertainty as to the true meaning of the term direct tax” among the Framers).

63. See, e.g., *id.* at 540 (finding that the general intent of the constitutional provisions is “to give this power to Congress . . . in its fullest extent”); *Soule*, 74 U.S. (7 Wall.) at 446 (“The taxing power is given in the most comprehensive terms. . . . It cannot be supposed that the framers of the Constitution intended that any tax should be apportioned, the collection of which on that principle would be attended with such [adverse] results.”).

64. See, e.g., *Veazie*, 75 U.S. (8 Wall.) at 541 (“These are not strictly limitations of power. They are rules prescribing the mode in which it shall be exercised.”).

65. Act of Aug. 27, 1894, ch. 349, 28 Stat. 509.

66. *Pollock v. Farmers’ Loan & Tr. Co. (Pollock I)*, 157 U.S. 429, 583 (1895). The case also held that the taxation of interest from municipal bonds was unconstitutional as a tax on the instrumentalities or property of a state. *Id.* at 586. This portion of the holding was explicitly overturned in *South Carolina v. Baker*, 485 U.S. 505, 515–27 (1988), which described the erosion in the principle of immunity from taxation of income from government contracts since the time of *Pollock*. The rationale equating a tax on income from property with a tax on the underlying property was subsequently rejected in *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 314–16 (1937).

67. *Pollock v. Farmers’ Loan & Tr. Co. (Pollock II)*, 158 U.S. 601, 637 (1895).

68. *Id.* at 635–37.

69. *Pollock I*, 157 U.S. at 556–57.

70. *Pollock II*, 158 U.S. at 620–21; *Pollock I*, 157 U.S. at 566–68.

ing of apportionment's purpose, the Court placed greater emphasis on the original meaning of "direct tax" and cited evidence suggesting that the Framers understood the term as covering a broader range of taxes.<sup>71</sup> In the cases immediately following *Pollock*, the Court found other ways to uphold federal taxes without reaching the question of the direct tax definition.<sup>72</sup>

The Sixteenth Amendment overruled *Pollock* and provided that Congress has the power to tax income "from whatever source derived" without apportionment.<sup>73</sup> This change shifted the focus of constitutional questions on the federal taxing power to the limits of Congress's power to tax income under the Sixteenth Amendment.<sup>74</sup> The Court continued to consider the direct tax definition and the scope of apportionment, however, when evaluating other non-income taxes.<sup>75</sup>

For a modern example, in the 2012 case *National Federation of Independent Business v. Sebelius (NFIB)*,<sup>76</sup> the Court considered the constitutionality of the Affordable Care Act's "individual mandate,"<sup>77</sup> which penalized individuals who did not obtain medical insurance. The Court upheld the individual mandate as an exercise of the federal taxing power, even though Congress framed the rule as a penalty rather than as a tax.<sup>78</sup> The Court then considered whether the mandate, if a tax, was a direct tax subject to apportionment.<sup>79</sup> The Court, citing *Springer*, reaffirmed the view that a direct tax was limited to a tax on capitations, real estate, and personal property.<sup>80</sup> The individual mandate, in contrast, fell outside this definition since it was "not a tax on the ownership of land or personal property."<sup>81</sup>

## 2. The Subject of Tax

Although the direct tax definition is central to most analyses of Congress's taxing power, interpreting the constitutional provisions also requires answering a predicate question: What does it mean for something to be a subject of tax such that the constitutional requirements apply? For example, the income tax rate schedule taxes married taxpayers at certain levels of in-

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71. *E.g.*, *Pollock II*, 158 U.S. at 624 (citing evidence that Hamilton considered direct taxes to cover all internal taxes other than "duties and excises on articles of consumption").

72. *See infra* Section I.B.2.

73. U.S. CONST. amend. XVI; *see infra* Section II.A.2.

74. *See infra* Section II.A.2.

75. As described *infra* Section I.B.2, in many non-income tax cases immediately following the Sixteenth Amendment, the Court continued to find other means to uphold the taxes without reaching the question of the direct tax definition. *See*, for example, the discussion of *Bromley v. McCaughn*, 280 U.S. 124 (1929), *infra* notes 107–110 and accompanying text.

76. 567 U.S. 519 (2012).

77. Patient Protection and Affordable Care Act, I.R.C. § 5000A(b) (2012).

78. *NFIB*, 567 U.S. at 561–70.

79. *Id.* at 570.

80. *Id.* at 570–71.

81. *Id.* at 571.

come more heavily than unmarried taxpayers.<sup>82</sup> Does this feature of the income tax constitute a “tax on marriage,” or is marriage simply a factor used to determine the amount of tax on income? More broadly, is any factor that could affect a tax liability necessarily a subject of tax?

Since *Hylton*, the Court has distinguished in this manner between the immediate subject (or “occasion”) of tax and the factors used in determining the final tax liability due, such as a taxpayer’s marital status in the example above. These factors may be termed the “basis”—in contrast to the subject—of tax. The Court has continuously relied on this basic distinction to limit the potential reach of the apportionment requirement for direct taxes.<sup>83</sup>

As described above, the *Hylton* Court did not conclusively define what would be a “direct tax” other than a tax on real estate and possibly on personal property.<sup>84</sup> The Court found another way, however, to distinguish the carriage tax at issue in the case without resolving the question of the direct tax definition. It introduced a distinction between the immediate subject of tax for constitutional purposes and the attributes or assets of the taxpayer that Congress may use to determine the final tax liability. Justice Chase characterized the carriage tax as a tax on the carriage’s use as a “consumeable commodity” (and therefore an indirect “duty”) rather than a tax on the ownership of the carriage.<sup>85</sup> Of course the tax burdened the ownership of carriages, just like the income tax rate schedule can burden marriage. The *Hylton* Court did not consider this fact material, however, for purposes of the constitutional analysis, as long as the immediate subject of tax (the use of the carriage) did not fall within the direct tax definition.

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82. I.R.C. § 1(a)–(d), (j). Under current law, the marriage penalty in the ordinary rate schedule only affects households with two high-income earners and total household taxable income over approximately \$600,000. For further explanation of the “marriage penalty,” see MICHAEL J. GRAETZ ET AL., *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 500–02 (8th ed. 2018).

83. Formally, the Court has made this distinction by characterizing a tax on a permissible subject or occasion as an “excise” or a “duty” that is not subject to apportionment. See Johnson, *supra* note 10, at 1733 (“[E]xcise’ should be understood as a malleable concept that a Court can use to avoid apportionment.”). The Court has not consistently applied the distinction in other contexts. For example, in *Trinova Corp. v. Michigan Department of Treasury*, 498 U.S. 358 (1991), the Court considered whether Michigan’s single business tax violated the Due Process Clause or the Commerce Clause because it used a formula to approximate the amount of “business activity” attributable to the state. *Id.* at 366–68. The Court upheld the formula but conceded that in this context the subject of tax should be defined as any object or attribute that is burdened by the tax. *Id.* at 374 (“A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes.” (quoting Francis Shackelford et al., *State Taxation of Interstate Commerce*, 27 TENN. L. REV. 239, 242 (1960))). As described below, the Court could not import this same logic into the direct-tax-definition context without also invalidating integral features of the current income tax and restricting Congress’s power to tax income under the Sixteenth Amendment. See *infra* Section IV.A.5.

84. *Supra* note 48 and accompanying text.

85. *Hylton v. United States*, 3 U.S. (3 Dall.) 171, 175 (1796) (opinion of Chase, J.) (emphasis omitted); *accord id.* at 180 (opinion of Paterson, J.) (“All taxes on expences or consumption are indirect taxes.”).

The early cases after *Hylton* adopted this formal distinction between the subject and basis of tax to limit the range of taxes falling within the direct tax definition. In *Veazie* (the bank notes case), the Court found that the tax at issue was a duty on “bank circulation” and therefore did not fall within the scope of direct taxes.<sup>86</sup> In *Scholey* (the succession tax case), the taxpayer objected that the tax on succession of real property in effect burdened the ownership of the land transferred in the succession.<sup>87</sup> The Court held, however, that the immediate subject of tax was the devolution of the real estate, or “the right to become the successor of real estate upon the death of the predecessor.”<sup>88</sup>

*Pollock* upended the precedent by finding that a tax on income was a direct tax but maintained the distinction between the subject and basis of tax. The *Pollock* Court faced a challenge in striking down the 1894 income tax: the Court had previously upheld a tax on insurance company income in *Soule*.<sup>89</sup> The Court distinguished *Soule* by reasoning that, while Congress cannot tax income directly, it can still tax the privilege of operating as an insurance company and can then determine the amount of tax due by reference to the company’s income.<sup>90</sup> That is, the Court held that income can serve as a basis for determining the amount of tax due, even if it cannot be taxed independently as the subject of tax.

Soon after *Pollock*, Congress introduced new taxes to fund the Spanish-American War.<sup>91</sup> To uphold these taxes, the Court used *Hylton*’s distinction between the subject and basis of tax to narrow the scope of *Pollock* and the range of taxes subject to apportionment. In *Nicol v. Ames*,<sup>92</sup> the Court upheld a wartime stamp tax on transactions conducted at exchanges or boards of trade as a “duty or excise laid upon the privilege, opportunity or facility offered at boards of trade or exchanges” rather than as a tax on the underlying property or business.<sup>93</sup>

In *Knowlton v. Moore*, the Court used the same logic to uphold another provision of the 1898 Act taxing legacies and estates as an indirect duty or

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86. *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533, 546–47 (1869). In *Veazie*, the Court followed the reasoning in *Hylton* that the direct tax definition only covered “capitation taxes, and taxes on land, and perhaps taxes on personal property.” *Id.* at 546.

87. *Scholey v. Rew*, 90 U.S. (23 Wall.) 331, 339 (1874).

88. *Id.* at 347.

89. *Pac. Ins. Co. v. Soule*, 74 U.S. (7 Wall.) 433 (1868); *supra* note 56 and accompanying text.

90. *Pollock v. Farmers’ Loan & Tr. Co. (Pollock I)*, 157 U.S. 429, 576 (1895); *see infra* notes 123–124 and accompanying text. The *Pollock* Court also distinguished the income tax upheld in *Springer v. United States*, 102 U.S. 586 (1881), described *supra* note 60 and accompanying text, on the grounds that the plaintiff in that case derived his earnings from professional income and bonds, rather than from real estate.

91. War Revenue Act of 1898, ch. 448, 30 Stat. 448.

92. 173 U.S. 509 (1899).

93. *Nicol*, 173 U.S. at 519.

excise.<sup>94</sup> Citing *Scholey*, the Court characterized this rule as a tax on the passage of property rather than on property ownership alone.<sup>95</sup> In *Spreckels Sugar Refining Co. v. McClain*, the Court also considered a provision of the Act taxing gross receipts from sugar refiners.<sup>96</sup> The plaintiff analogized to *Pollock* and argued that gross receipts could include income attributable to income from investments and real property, such as wharfage fees.<sup>97</sup> The Court, with little formal reasoning, upheld the tax by relying on the logic in the prior cases.<sup>98</sup>

In 1909 Congress enacted a corporate income tax,<sup>99</sup> at a time when *Pollock* precluded an income tax on individuals. As a result, the 1909 corporate tax presented a significant test of *Pollock*'s reach and Congress's power to tax income in other forms. In *Flint v. Stone Tracy Co.*,<sup>100</sup> the plaintiffs offered a litany of objections to the new tax, including that it taxed income in violation of *Pollock*.<sup>101</sup> Following the analysis in the prior cases and in *Pollock* itself,<sup>102</sup> the Court held that the tax was imposed "not upon the franchises of the corporation irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate . . . business."<sup>103</sup> The Court formally articulated the rule implicit in these prior cases, distinguishing between the subject of tax and what the Court termed the "measure" determining the amount of tax due.<sup>104</sup> In this case, the Court reasoned that the subject (or occasion) of the tax was the act of doing business and that the base (or measure) of tax was the amount of corporate income earned.<sup>105</sup> Since the direct tax definition pertained only to the immediate subject of the tax, Con-

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94. 178 U.S. 41, 83 (1900).

95. *Knowlton*, 178 U.S. at 44–52; *id.* at 47 (citing French law for the proposition that inheritance taxes are indirect "for the reason that all inheritance and legacy taxes are considered as levied on the 'occasion of a particular isolated act'").

96. 192 U.S. 397 (1904).

97. *Spreckels*, 192 U.S. at 400–02.

98. *Id.* at 413 ("This conclusion is inevitable from the judgments in prior cases, in which the court has dealt with the distinctions, often very difficult to be expressed in words, between taxes that are direct and those which are to be regarded simply as excises.").

99. The law taxed domestic corporations and certain other businesses at a rate of 1% on net income (from all sources) over \$5000. Payne-Aldrich Tariff Act of 1909, Pub. L. No. 61-5, § 38, 36 Stat. 11, 112–17.

100. 220 U.S. 107 (1911).

101. *Stone Tracy*, 220 U.S. at 124.

102. See *supra* notes 89–90 and accompanying text.

103. *Stone Tracy*, 220 U.S. at 146.

104. *Id.* ("[T]he tax is imposed upon the doing of business of the character described, and the measure of the tax is to be the income . . .").

105. *Id.*



gress could then determine the amount of tax due by reference to the corporation's income.<sup>106</sup>

The Court also followed this same logic in evaluating non-income taxes after the Sixteenth Amendment. For example, in *Bromley v. McCaughn*,<sup>107</sup> the Court considered whether a tax on gifts was a direct tax on the property transferred.<sup>108</sup> The Court upheld the tax, reasoning that a “tax imposed upon a particular use of property or the exercise of a single power of property incidental to ownership is an excise” rather than a direct tax on property itself.<sup>109</sup> Relying on prior cases, the Court distinguished this scenario from a tax imposed on a taxpayer merely by virtue of their ownership of property.<sup>110</sup> Finally, the Court in *NFIB* echoed this same logic in upholding the individual mandate penalty in the Affordable Care Act, by finding that the penalty could not be a direct capitation tax since it was only triggered in “specific circumstances—earning a certain amount of income but not obtaining health insurance.”<sup>111</sup>

### 3. Substance and Form

The distinction between the subject and basis of tax may also be understood as one aspect of the recurring tension in the tax law between substance and form.<sup>112</sup> Two activities may have similar economic consequences but different tax treatment because of the different legal forms of the activities. For example, Professor Alvin Warren demonstrated how the economic substance of investing in a share of non-dividend-paying stock could be replicated by investing in a riskless zero-coupon bond, a call option to buy the stock in the future, and a put option to sell the stock in the future, which would be taxed differently.<sup>113</sup> Treating economic substitutes differently for tax purposes is inefficient (as taxpayers may incur costs to access preferential

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106. *Id.* at 150 (“In the present case the tax is not payable unless there be a carrying on or doing of business in the designated capacity, and this is made the occasion for the tax, measured by the standard prescribed.”).

107. 280 U.S. 124 (1929).

108. The Sixteenth Amendment was not relevant in this case, because the gift tax was imposed upon the donor rather than upon the recipient. *Id.* at 125 (petitioner’s brief).

109. *Id.* at 136.

110. *Id.* at 137.

111. Nat’l Fed’n of Indep. Bus. v. Sebelius (*NFIB*), 567 U.S. 519, 571 (2012).

112. See, e.g., Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 863 (1982) (book review) (“[T]here is almost universal assent among tax lawyers and theorists that the revenues should not be defeated by certain entirely artificial maneuvers. . . . [T]he ‘substance’ of events should determine their tax consequences . . .”).

113. Alvin C. Warren, Jr., Commentary, *Financial Contract Innovation and Income Tax Policy*, 107 HARV. L. REV. 460, 465–67 (1993). In this case, the actual stock would benefit from deferral of gains until a realization event, while the zero-coupon bond would be taxed on an accrual basis each year. *Id.* at 467.

treatment<sup>114</sup>) and inequitable (as some taxpayers are treated more favorably than others due to the form of their activities<sup>115</sup>). If taxpayers can substitute the form of their activity to access preferential tax treatment without incurring any costs at all, then a tax on the disfavored activity would simply not raise any revenue.<sup>116</sup> As a result, policymakers would have less public funds available or would have to introduce or raise taxes on other activities.<sup>117</sup>

The cases described above often framed the constitutional categorization of tax instruments—and the distinction between the subject of tax and other factors affecting the tax liability—as a question of substance and form.<sup>118</sup> In some cases, the Court endorsed formal distinctions among taxes, irrespective of their economic similarities. For example, in *Nicol* (the stamp tax case) the Court suggested that taxes should be categorized by the form in which they are implemented rather than through an analysis of their economic effects.<sup>119</sup>

The *Pollock* Court instead reasoned that taxes should be characterized by their economic substance rather than their form. In striking down the 1894 income tax, the Court rejected the formal distinction between a tax on income and a tax on the underlying property<sup>120</sup> on the grounds that a tax on income had the economic effect of burdening the property.<sup>121</sup>

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114. See Joel Slemrod & Shlomo Yitzhaki, *Tax Avoidance, Evasion, and Administration*, in 3 HANDBOOK OF PUBLIC ECONOMICS 1423, 1428–29 (Alan J. Auerbach & Martin Feldstein eds., 2002) (describing the various costs taxpayers incur by substituting to more lightly taxed behaviors).

115. For discussion of how these problems manifest in the particular case of the “put-call” parity described above, see Michael S. Knoll, *Put-Call Parity and the Law*, 24 CARDOZO L. REV. 61, 63 (2002) (describing how, when “economically equivalent positions receive different legal treatments,” then “form takes precedence over substance” and as a result “such arbitrage creates both inefficiency and unfairness”). See also *id.* at 87–88 (describing how section 1259 of the Code limits certain abuses of these economic identities in order to obtain more favorable tax treatment).

116. See Joel Slemrod & Shlomo Yitzhaki, *The Costs of Taxation and the Marginal Efficiency Cost of Funds*, 43 INT’L MONETARY FUND STAFF PAPERS 172, 186 (1996) (describing how “a rational taxpayer will be ready to sacrifice . . . one dollar in order to save a dollar of taxes”). Conversely, a rational taxpayer only motivated by a desire to minimize taxes would not incur any tax at all of if they can entirely avoid it at zero cost.

117. For a more detailed discussion of the efficiency costs and revenue losses resulting from taxpayer substitution into preferentially taxed activities, see Ari Glogower & David Kamin, *The Progressivity Ratchet*, 104 MINN. L. REV. 1499 (2020).

118. For a review of the Court’s shifting approach to the choice between substance and form in the context of the direct tax definition, see JASPER L. CUMMINGS, JR., *THE SUPREME COURT, FEDERAL TAXATION, AND THE CONSTITUTION* 67–68 (2013).

119. *Nicol v. Ames*, 173 U.S. 509, 516 (1899) (“As a mere abstract, scientific or economical problem, a particular tax might possibly be regarded as a direct tax, when as a practical matter pertaining to the actual operation of the tax it might quite plainly appear to be indirect.”).

120. See *Pollock v. Farmers’ Loan & Tr. Co. (Pollock II)*, 158 U.S. 601, 628 (1895) (“We find it impossible to hold that a fundamental requisition . . . can be refined away by forced distinctions between that which gives value to property, and the property itself.”).

121. *Id.* at 636–37.

The *Pollock* Court failed to follow through the full implications of a substance over form analysis, however, and adopted its own formal distinctions elsewhere in the holding: between a tax imposed purely by virtue of ownership and a tax imposed as a result of a particular activity or use of the property.<sup>122</sup> As described above, the *Pollock* Court distinguished the tax in *Soule* as a tax on the “privilege, or on the transaction of business, without any necessary reference to the amount of property belonging to those on whom the charge might fall.”<sup>123</sup> The Court acknowledged, however, that Congress could adjust the amount of the tax on the basis of the “extent to which the privilege was exercised or the business done.”<sup>124</sup> In making this distinction, the Court implied that Congress has broad latitude to consider other factors in determining the tax liability due, as long as the formal “subject” of tax can be taxed without apportionment.

#### 4. The Uniformity Requirement

The Constitution requires that all “Duties, Imposts, and Excises” must be “uniform throughout the United States.”<sup>125</sup> The Court has considered two possible ways of interpreting the uniformity requirement.<sup>126</sup> A rule of “geographic uniformity” would simply require that the tax laws cannot treat taxpayers differently on the basis of where they live. A rule of “intrinsic uniformity,” in contrast, would require that Congress treat taxpayers equally in other respects beyond their geographic location.

In contrast to the conflicting and varying views of the direct tax definition and the apportionment requirement, the Court has consistently held that the uniformity requirement requires only geographic consistency but does not prevent Congress from tailoring tax liabilities to taxpayers’ other individual circumstances.<sup>127</sup>

The narrow reading of the uniformity requirement began with the *Hylton* Court. In *Hylton*, Justice Paterson described uniformity as the absence of a requirement to apportion a tax among the states.<sup>128</sup> In Paterson’s

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122. The Court assumed that this distinction was not relevant in distinguishing between an income tax and a property tax because deriving rents from property was a natural product of holding that property, not the result of a particular activity or use. *Id.* (“[C]an it be properly held that the Constitution, taken in its plain and obvious sense . . . authorizes a general unapportioned tax on the products of the farm and the rents of real estate, although imposed merely because of ownership and with no possible means of escape from payment, as belonging to a totally different class from that which includes the property from whence the income proceeds?”).

123. *Pollock v. Farmers’ Loan & Tr. Co. (Pollock I)*, 157 U.S. 429, 576 (1895).

124. *Id.*

125. U.S. CONST. art. I, § 8, cl. 1.

126. *See Knowlton v. Moore*, 178 U.S. 41, 84–85 (1900).

127. The Court has similarly held that tailoring tax liabilities to individual circumstances does not violate due process. *See infra* notes 194–195 and accompanying text (discussing *Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1 (1916)).

128. *Hylton v. United States*, 3 U.S. (3 Dall.) 171, 176 (1796) (opinion of Paterson, J.).

view, uniformity simply required that a tax liability could be determined by the tax rules, without any need to then adjust the liability based on where the subject of tax is located.<sup>129</sup>

Subsequent cases followed *Hylton's* narrow reading of the uniformity requirement. In *Singer* (the distillery tax case), the taxpayer argued that the tax violated uniformity by differentiating among distillers with different levels of production.<sup>130</sup> The Court rejected this argument and held that uniformity merely requires that the law be “assessed equally upon all manufacturers of spirits wherever they are” and may not “establish one rule for one distiller and a different rule for another, but the same rule for all alike.”<sup>131</sup> In *Nicol* (the stamp tax case), the Court considered an objection that the tax at issue (if not found to be direct) violated the uniformity requirement because it singled out sales at exchanges for taxation.<sup>132</sup> The Court did not strictly limit uniformity to a requirement of geographic consistency but rather held that uniformity required a tax rule to have “reasonable ground” for distinguishing among taxpayers.<sup>133</sup> The Court found that the tax in *Nicol* met this standard by distinguishing among taxpayers based on their particular privileges of selling property at exchanges.<sup>134</sup>

In *Knowlton* (the legacy and estate tax case) the Court again considered a similar uniformity objection, this time on the grounds that the tax at issue discriminated among taxpayers through an exemption amount and progressive rate schedule and by taking account the relationship of each heir to the decedent.<sup>135</sup> The Court formally distinguished between a rule of “intrinsic uniformity,” which would require that a tax “operate precisely in the same manner upon all individuals,” and a rule requiring that the tax simply operate in the same manner throughout the country.<sup>136</sup> The Court adopted the latter rule and noted the long history of taxes in the United States and abroad tailored to particular activities and circumstances of taxpayers,<sup>137</sup> including on the basis of the relative “ability of the owner to pay the tax.”<sup>138</sup> The Court adopted a similar logic in *Stone Tracy* (the corporate income tax case).<sup>139</sup>

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129. *Id.* at 180 (“In such case [of uniformity] the object and the sum coincide, the rule and the thing unite . . .”).

130. *United States v. Singer*, 82 U.S. (15 Wall.) 111, 118 (1873).

131. *Id.* at 121.

132. *Nicol v. Ames*, 173 U.S. 509, 520 (1899).

133. *Id.* at 521.

134. *Id.* at 521–22.

135. *Knowlton v. Moore*, 178 U.S. 41, 46, 83 (1900).

136. *Id.* at 84.

137. *Id.* at 87–91.

138. *Id.* at 91.

139. *Flint v. Stone Tracy Co.*, 220 U.S. 107, 158 (1911).

More recently, the Court has narrowed the uniformity requirement further. In the 1983 case *United States v. Ptasynski*,<sup>140</sup> the Court held that an exemption from the Crude Oil Windfall Profit Tax of 1980 for oil fields in northern Alaska and other U.S. territorial waters did not violate the uniformity requirement, even though this rule explicitly discriminated on the basis of geographic location.<sup>141</sup> The Court reasoned that Congress can adjust the tax rules to address “geographically isolated problems” if it “defines the subject of tax in nongeographic terms.”<sup>142</sup>

*Ptasynski* reduced the role of the uniformity requirement to virtual irrelevance, but this process of marginalizing uniformity began centuries earlier with *Hylton*. As described below in Section IV.A.4, the Court may have been compelled to interpret the uniformity requirement narrowly in order to preserve Congress’s taxing power. The fate of the uniformity requirement bears lessons for interpreting the apportionment requirement as well.

## II. THE INCOME TAX OR A TRADITIONAL WEALTH TAX

Different tax bases could face different possible constitutional limitations. Section II.A briefly reviews the structure of the current federal income tax and the scope of Congress’s power to tax income under the Sixteenth Amendment. This discussion may be familiar to many readers but is important to the analysis of Wealth Integration methods that follows. Section II.B then describes proposals for a wealth tax and outlines the arguments in the literature why a wealth tax would—or would not—be constitutional.

### A. *The Income Tax*

#### 1. Described

Calculating a taxpayer’s federal income tax liability begins with determining her “gross income.”<sup>143</sup> Three subsequent operations translate this gross income base into the final tax liability. First, deductions from income translate gross income into “taxable income.”<sup>144</sup> The applicable rate schedule then translates taxable income into the tax imposed.<sup>145</sup> Finally, credits against tax—if available—translate the tax imposed into the final tax liability due.<sup>146</sup>

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140. 462 U.S. 74 (1983).

141. *Ptasynski*, 462 U.S. at 77–78, 85–86.

142. *Id.* at 84.

143. Gross income is defined in I.R.C. § 61 (2012 & Supp. V 2018) (general gross income definition), §§ 71–91 (explicit inclusions), and §§ 101–40 (exclusions).

144. *Id.* §§ 63, 151–223, 261–80H.

145. *Id.* § 1(a)–(d), (g)–(h).

146. *Id.* §§ 21–53. A nonrefundable credit can offset only a positive tax liability, whereas a refundable credit can generate a tax payment from the government to the taxpayer if the net

Four basic variables thereby affect the final tax liability: amount of gross income, deductions from income, rate schedule, and credits. Congress can adjust the final income tax liability by adjusting any of these variables. For example, assume a taxpayer has \$1,000 of gross income. A final tax liability of \$100 may be achieved by taxing this gross amount at a 10% rate with no deductions, exclusions, or credits; by taxing the \$1,000 at a 50% rate but with an \$800 deduction or exclusion; or by taxing the \$1,000 at a 100% rate but with a \$900 credit.<sup>147</sup> Similarly, a standard deduction or general exemption results in a 0% rate on the exempted income and a commensurate shift of all additional income into lower brackets.<sup>148</sup> Of course there is one limit to the interchangeability of these variables: a taxpayer without a taxable base of positive gross income will not incur a positive tax liability.

Setting each of these variables depends on normative value judgments and other policy goals. Consider first the determination of gross income and taxable income. Section 61 defines gross income broadly as “income from whatever source derived.”<sup>149</sup> Scholars have noted, however, that there is no objective definition of the term “income.”<sup>150</sup> Income may be defined narrowly to include just net receipts from market transactions or more broadly to include imputed income—that is, the benefits “earned” outside market transactions, such as from self-provided services and from the use of personal property.<sup>151</sup> The current tax base, for example, does not include imputed income or “unrealized income” from appreciated assets that have not been sold.<sup>152</sup> This “realization rule” may reflect administrative considerations<sup>153</sup> or

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liability after application of the credit is negative. *See id.* § 26 (operation of nonrefundable credits).

147. *Cf.* Daniel N. Shaviro, *Welfare, Cash Grants, and Marginal Rates*, 59 SMU L. REV. 835, 840–41 (2006) (describing the interchangeability of the rate schedule, base definition, and cash grants or credits). Whereas the value of a deduction or exemption to the taxpayer (in terms of taxes saved) equals the amount of the deduction or exemption times the applicable tax rate, the value of a credit to the taxpayer (if they can fully utilize it) equals the dollar amount of the credit.

148. *Id.* at 840.

149. I.R.C. § 61.

150. *See* John R. Brooks, *The Definitions of Income*, 71 TAX L. REV. 253, 259–74 (2018) (describing different possible definitions of income and the impossibility of a single objective definition); *id.* at 253 (“Ultimately, ‘income’ is whatever society wants it to be in order to achieve a result that the democracy believes to be appropriate and just.”); Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 45–46 (1990); *see also* Glogower, *supra* note 1, at 1434–36.

151. *See* Brooks, *supra* note 150, at 259–66 (describing generally the problem of imputed income).

152. I.R.C. § 1001.

153. *See* *Helvering v. Horst*, 311 U.S. 112, 116 (1940); *see also* JOINT COMM. ON TAXATION, JCX-34-18, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2017–2021, at 5–6 (2018).

a view that taxing these nonmonetized forms of income would be unfair or burdensome.<sup>154</sup>

The term “income” may also refer to either gross or net proceeds. Withdrawing cash from a bank account may not fit most common understandings of “income.” The tax code mirrors this common understanding by generally excluding or deducting proceeds attributable to cost recovery from the calculation of net taxable income.<sup>155</sup> In other cases, however, the income tax base measures gross rather than net proceeds. For example, the income tax base includes a taxpayer’s labor income, which represents a withdrawal of a taxpayer’s “stock” of human capital,<sup>156</sup> and disallows deductions for certain costs of producing income on policy grounds.<sup>157</sup> In yet other cases, the income tax base undermeasures, rather than overmeasures, a taxpayer’s income, by allowing additional or larger deductions than are necessary to calculate net income, in order to promote other policy objectives or fairness norms.<sup>158</sup>

The third variable, the applicable rate schedule, will similarly reflect policy judgments and will vary with different attributes of the taxpayer and her income. One factor considered in setting the applicable rate schedule is the amount of the taxable income base. Under the progressive rate schedule, the rate increases with the amount of the taxable base—up to 37% for ordinary taxable income under current law.<sup>159</sup> That is, income can be understood as an attribute that in turn determines the applicable rate at which the base of income is taxed. In this respect, the base of taxable income serves two dis-

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154. See, e.g., Edward A. Zelinsky, *For Realization: Income Taxation, Sectoral Accretionism, and the Virtue of Attainable Virtues*, 19 CARDOZO L. REV. 861, 879–93 (1997).

155. See, e.g., I.R.C. § 162 (trade or business expenses); *id.* § 167 (depreciation); *id.* § 197 (amortization); *id.* § 1001 (cost basis). These rules generally conform to the “Haig-Simons” definition of income as consumption plus (net) accretions to wealth. HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY* 50 (1938).

156. See Louis Kaplow, *Human Capital Under an Ideal Income Tax*, 80 VA. L. REV. 1477, 1482–84 (1994) (equating the return to human capital each year as labor income with the withdrawing of preexisting capital as a current flow); *id.* at 1490 (“One might say, therefore, that the conventional income tax ignores the ‘capital’ in ‘human capital.’”). Of course, a taxpayer is treated more favorably than under an “ideal” income tax where the present value of human capital received were taxed as income upon birth. *Id.* at 1482–84.

157. See, for example, the disallowance of deductions in I.R.C. § 162(c) (illegal payments), § 162(e) (lobbying costs), and § 162(f) (fines and penalties).

158. See, e.g., William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972) (arguing that the desirability of deductions for medical expenses and charitable contributions may depend on whether these are considered elements of personal consumption under an ideal Haig-Simons income tax defined as consumption plus accretions to wealth); Thomas D. Griffith, *Theories of Personal Deductions in the Income Tax*, 40 HASTINGS L.J. 343, 385–94 (1989) (evaluating the desirability of the personal deduction for medical expenses under different principles of distributive justice).

159. I.R.C. § 1. Additional taxes—such as the payroll taxes under § 3101(b), the self-employment tax under § 1401(b), or the net investment income tax under § 1411—can increase the effective top rate to above 40%.

tinct functions in a tax with a progressive rate schedule, which may be described as the “calculating” and the “comparing” functions of the income tax base.<sup>160</sup> First, the base of taxable income serves a “comparing” function as a measure of a taxpayer’s relative “ability to pay”<sup>161</sup> and therefore determines the rate of tax applicable to their income. This same base of taxable income then serves a “calculating” function as a variable determining the final tax due, when this base is taxed at the applicable rates.<sup>162</sup> As a result, the income tax base determines two different variables: the base of taxable income and the applicable rate schedule.

Other attributes of the taxpayer also affect the applicable rate schedule. For example, taxpayers with different marital statuses or household compositions are taxed at different rates.<sup>163</sup> The rate schedule will also depend on the character of the income earned. Income from dividends, long-term capital gains, collectibles, and other sources are also taxed at lower rates than the rates on ordinary income.<sup>164</sup> The rate schedule will also depend on the identity of the entity earning the income. For example, corporate income is taxed at different rates than income earned by individuals or pass-throughs.<sup>165</sup>

Finally, the determination of the fourth variable, credits against tax, will also depend on policy judgments and the relevant attributes or activities of the taxpayer. The child tax credit, for example, allows taxpayers with qualifying children and adjusted gross income below a threshold amount a partially refundable credit.<sup>166</sup>

## 2. Constitutional Limits

Proponents of the income tax chose to explicitly overrule *Pollock* by constitutional amendment rather than challenge the Court’s ruling through new legislation.<sup>167</sup> The Sixteenth Amendment, adopted in 1913, explicitly granted Congress the power to tax income without apportionment, providing that “[t]he Congress shall have power to lay and collect taxes on incomes,

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160. Glogower, *supra* note 1, at 1461–62.

161. For purposes of this Article, this term is used generally to refer to the basis determined by policymakers for comparing taxpayers in a progressive tax system. *See id.*

162. *Id.* Of course, a taxpayer’s base of taxable income, or a preliminary determination of adjusted gross income, can also affect the calculation of the other variables described above, such as the availability of deductions. *See, e.g.,* I.R.C. § 199A(b)(3) (limiting the availability of the section 199A pass-through deduction for some taxpayers on the basis of their taxable income).

163. *Id.* § 1(a)–(d).

164. *Id.* § 1(h).

165. *Id.* § 1 (individual rate schedule); *id.* § 11 (corporate rate).

166. *Id.* § 24. Other credits do not fully phase out at higher income levels. For example, the credit for household and dependent care services in section 21 allows a minimum benefit for qualifying taxpayers regardless of their income. *Id.* § 21(a).

167. *See* Ackerman, *supra* note 10, at 33–38; Johnson, *supra* note 10, at 1731–32.



from whatever source derived, without apportionment among the several States, and without regard to any census of enumeration.”<sup>168</sup>

This language gave Congress unambiguous power to tax income without apportionment but left other interpretative questions for the Court to answer. The Amendment avoided the question whether an income tax was a direct tax (and therefore whether *Pollock* was correctly decided) and did not specify whether any other taxes would or would not be subject to apportionment. The Amendment also did not specify the exact scope of Congress’s new power to tax income without apportionment nor the definition of income in the first instance.

Congress reinstated the income tax in 1913.<sup>169</sup> In a series of cases, the Court considered different challenges to portions of the new law that implicated basic questions left unanswered by the Sixteenth Amendment.<sup>170</sup> The remainder of this Section describes some of these interpretative questions and the answers offered by the Court and scholars. This Section also describes how these questions implicate the operations described in Section II.A.1 that translate the base of gross income into a final income tax liability.

*The Definition of Gross Income.* As described above, the calculation of an income tax liability begins with a determination of a taxpayer’s gross income. The Sixteenth Amendment allows Congress to tax income without apportionment but does not define what income actually is.<sup>171</sup>

This question first arose in challenges to the 1913 Revenue Act. In *Towne v. Eisner*,<sup>172</sup> the Court considered Congress’s power to define the scope of gross income, particularly whether Congress could include the value of a stock dividend in this definition. The Court agreed with the taxpayer’s objection that this rule amounted to a tax on mere ownership because the substance of the stockholder’s interest has not changed upon receipt of the dividend.<sup>173</sup> *Eisner v. Macomber*<sup>174</sup> subsequently broadened this holding

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168. U.S. CONST. amend. XVI.

169. Revenue Act of 1913, Pub. L. No. 63-16, § 2, 38 Stat. 114, 166.

170. In the modern era, the Court has also considered other aspects of the federal taxing power that are not the focus of this Article. For example, a separate line of cases considered the question of the limits of Congress’s ability to implement nonfiscal policies through the tax system. See, e.g., Nat’l Fed’n of Indep. Bus. v. Sebelius (*NFIB*), 567 U.S. 519, 567–68 (2012) (upholding the “individual mandate” penalty under the Patient Protection and Affordable Care Act as a tax that influenced—but did not foreclose or make unlawful—taxpayer conduct); *Sonzinsky v. United States*, 300 U.S. 506, 513 (1937) (upholding a tax on firearm dealers, on the grounds that the tax did not foreclose the taxed activity); *Bailey v. Drexel Furniture Co.* (Child Labor Tax Case), 259 U.S. 20, 38 (1922) (holding that a tax on employers utilizing child labor was in fact a penalty and therefore an unconstitutional exercise of the taxing power).

171. See Charlotte Crane, *Pollock, Macomber, and the Role of the Federal Courts in the Development of the Income Tax in the United States*, 73 LAW & CONTEMP. PROBS. 1, 6 (2010) (“The meanings of ‘income’ and ‘income tax’ at the time the Sixteenth Amendment was passed were surprisingly uncertain.”).

172. 245 U.S. 418 (1918).

173. *Towne*, 245 U.S. at 419, 426.

174. 252 U.S. 189 (1920).

to include stock dividends with respect to post-1913 earnings, reasoning that an “income”<sup>175</sup> event requires that the value is “severed” or “derived” from the capital and does not include unrealized asset appreciation.<sup>176</sup>

Although *Towne* and *Macomber* suggest a limit on Congress’s ability to define gross income, subsequent cases narrowed these holdings and upheld similar rules that broadened the gross income base.<sup>177</sup> For example, in *Helvering v. Bruun*,<sup>178</sup> the Court required a lessor to include in his gross income the value of buildings repossessed from a lessee,<sup>179</sup> even though this scenario is comparable to the stock dividends received in *Macomber*.<sup>180</sup> Scholars continue to debate the limits of Congress’s power to define when accretions to wealth may be included in the calculation of gross income—and therefore taxed—through different interpretations of these precedents and the constitutional provisions.<sup>181</sup>

*Deductions from Gross Income.* The Sixteenth Amendment simply allows Congress to tax “income” without apportionment. The Amendment does not specify whether Congress could tax gross income or whether it must allow taxpayers deductions necessary to calculate net income. This question first arose in *Stanton v. Baltic Mining Co.*,<sup>182</sup> a challenge to the method of depletion for mining companies in the 1913 Act, which limited depletion

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175. In construing both the Sixteenth Amendment and the 1913 Revenue Act, the Court assumed the meaning of “income” in both was coextensive. *Macomber*, 252 U.S. at 203, 206.

176. *Id.* at 207.

177. For a more detailed analysis of how the holding in *Macomber* was scaled back in subsequent cases, see Marjorie E. Kornhauser, *The Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 14–21 (1992).

178. 309 U.S. 461 (1940); see also *Helvering v. Horst*, 311 U.S. 112, 116 (1940) (describing the realization principle as a rule of “administrative convenience” that does not preclude from taxation a case where a taxpayer enjoys the benefits of economic gain prior to a realization event).

179. *Bruun*, 309 U.S. at 464, 469 (“While it is true that economic gain is not always taxable as income, it is settled that the realization of gain need not be in cash derived from the sale of an asset.”).

180. That is, *Macomber* could be understood as a case where a taxpayer enjoyed an unrealized accretion to wealth, in the form of undistributed corporate earnings, followed by a subsequent event (a stock dividend) that the Court found was not a realization event, because there was no sale or disposition of the property. *Macomber*, 252 U.S. at 211. In *Bruun*, however, the Court subsequently found that an unrealized accretion to wealth, in the form of lessee improvements, could be taxed upon a subsequent event (repossession) that was still prior to a sale or disposition of the property by the taxpayer. *Bruun*, 309 U.S. at 464, 469.

181. Compare, e.g., Erik M. Jensen, *The Taxing Power, the Sixteenth Amendment, and the Meaning of “Incomes.”* 33 ARIZ. ST. L.J. 1057, 1134 (2001) (arguing that “one of the principles that *Macomber* stands for is that the concept of ‘income’ isn’t boundless”), with Kornhauser, *supra* note 177, at 21 (describing the Court’s jurisprudence as generally deferring to Congress and Treasury definitions of income “[w]ithout officially overruling *Macomber*”), and *id.* at 24 (interpreting the constitutional provisions as giving “Congress a fully vested power to tax all income, however Congress defines it”).

182. 240 U.S. 103 (1916).

deductions for ore deposits to 5% of gross value of the mine's output.<sup>183</sup> The taxpayer argued that denying a full deduction amounted to a tax on wealth rather than net income<sup>184</sup> (in the same manner as a tax on withdrawal of funds from a bank). The Court held that the Sixteenth Amendment does not limit Congress to taxing net income and does not require Congress to allow cost recovery deductions from the gross income base.<sup>185</sup>

The outcome in *Stanton* contrasts with the holdings in *Towne* and *Macomber* described above. While *Towne* and *Macomber* suggested some limits on Congress's ability to define gross income—that is, the initial variable used to determine an income tax liability—*Stanton* did not similarly limit Congress's ability to disallow deductions from gross income and therefore to determine the method of translating gross income into net taxable income.<sup>186</sup> Subsequent cases affirmed this distinction. In *Burnet v. Thompson Oil & Gas Co.*, the taxpayer challenged the method of depletion for oil drilling in the Income Tax of 1918, which disallowed deductions for pre-1913 depletion.<sup>187</sup> In this case, the parties agreed that deductions from gross income are a matter of statutory grace and not required by the Constitution, and the only question considered by the Court was one of statutory construction.<sup>188</sup> In *Commissioner v. Sullivan*, the Court similarly affirmed Congress's ability to deny deductions from gross income for illegal gambling expenses on the basis of policy considerations unrelated to the measurement of net income.<sup>189</sup>

183. Revenue Act of 1913, Pub. L. No. 63-16, § II(B), 38 Stat. 114, 167.

184. *Stanton*, 240 U.S. at 104–05, 111–12.

185. *Id.* at 113–14.

186. Congress can either exclude proceeds attributable to cost recovery from the definition of gross income or deduct them when translating gross income into net taxable income, with the same economic effect. In *Sullenger v. Comm'r*, 11 T.C. 1076 (1948), the Tax Court held that the Constitution requires Congress to exclude certain forms of cost recovery from the definition of gross income. *Id.* at 1077. Indeed, in some cases, the tax law does exclude certain forms of cost recovery from the definition of gross income. See, e.g., I.R.C. § 61(a)(3) (2012 & Supp. V 2018) (including only gains from dealings in property in the definition of gross income, rather than total proceeds); Treas. Reg. § 1.61-3(a) (as amended in 1992) (excluding costs of goods sold from gross income derived from a business). For a detailed argument why it would be inconsistent, however, to hold that the Sixteenth Amendment requires Congress to exclude some forms of cost recovery from the definition of gross income but allows Congress to deny other forms of cost recovery in the form of deductions when translating gross income into net taxable income, see Joseph M. Dodge, Murphy and the Sixteenth Amendment in Relation to the Taxation of Non-Excludable Personal Injury Awards, 8 FLA. TAX REV. 369, 391–407 (2007). See also *id.* at 392 (“[C]osts are costs . . . . The constitutional text offers no basis for distinguishing some costs of producing income from others.”).

187. 283 U.S. 301, 302 (1931).

188. *Thompson Oil & Gas Co.*, 283 U.S. at 304. In particular, the Court held that the 1918 tax rules at issue did not permit the taxpayer to recover costs for prior years. *Id.* at 306.

189. 356 U.S. 27, 28 (1958); see also *Helvering v. Winmill*, 305 U.S. 79, 84 (1938) (upholding rule disallowing deduction for certain brokerage commissions through Congress's power “to deny or limit deductions from gross income”); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) (“The power to tax income like that of the new corporation is plain and extends to the gross income. Whether and to what extent deductions shall be allowed de-

It might be argued that Congress has discretion in determining the measurement of net income but nonetheless cannot simply tax gross income instead. In this respect, these cases may be understood as evidencing the Court's reluctance to determine precisely the scope of Congress's discretion and to specify deductions that it must allow.<sup>190</sup> Professor Erik Jensen similarly argues that while the Sixteenth Amendment allowed Congress to tax income, a sufficient modification of the income tax base could overstep this grant of power.<sup>191</sup> For example, Jensen argues that certain methods of implementing a consumption tax that subtract savings from an income tax base may no longer constitute the taxation of income and may therefore fall outside the protection of the Sixteenth Amendment.<sup>192</sup> Professor Larry Zelenak argues, however, that the income tax rules already include many provisions that significantly modify the income tax base in this fashion, and restricting Congress's ability to define the income tax base would necessitate determining exactly when sufficient modifications of the income base yield something other than an income tax.<sup>193</sup>

*The Uniformity Requirement.* Another question the Sixteenth Amendment did not answer directly was when Congress could consider non-income factors to determine an income tax liability. Challenges to the 1913 income tax alleged that the differential treatment of taxpayers based on such factors violated the uniformity requirement. In *Brushaber v. Union Pacific Railroad Co.*, the appellant objected that the new income tax discriminated against income earned through corporations and against taxpayers with greater income because it taxed their income at higher rates.<sup>194</sup> In dismissing these objections, the Court again affirmed the interpretation that the uniformity requirement required only geographic uniformity and otherwise allowed Congress to treat taxpayers differently in calculating their income tax

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depends on legislative grace; and only as there is clear provision therefor can any particular deduction be allowed."); *Helvering v. Indep. Life Ins. Co.*, 292 U.S. 371, 381 (1934) ("Unquestionably Congress has power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax.").

190. As described *supra* note 156 and accompanying text, the taxation of labor income may be understood as a tax on gross income from human capital, depending on whether one considers the initial "endowment" of human capital as an accretion event that should be taxed as income.

191. See Jensen, *supra* note 42, at 2409–11.

192. See *id.* at 2410 ("At some point, the exclusion of broad categories of income items . . . could leave a tax base that is not income in any generally accepted sense."); *id.* at 2419 (arguing that Congress cannot "try to hide a nonincome tax under the 'taxes on incomes' umbrella").

193. Lawrence Zelenak, Essay, *Radical Tax Reform, the Constitution, and the Conscientious Legislator*, 99 COLUM. L. REV. 833, 847–49 (1999).

194. 240 U.S. 1, 3, 23, 24 (1916) (characterizing the appellant's objections as relying on both the Due Process Clause of the Fifth Amendment and the uniformity requirement).

liabilities.<sup>195</sup> The Court also stated a broader principle that can be understood to justify a narrow reading of the uniformity requirement: “[W]e cannot escape the conclusion that [these objections] all rest upon the mistaken theory that although there be differences between the subjects taxed, to differently tax them transcends the limit of taxation . . . .”<sup>196</sup> This reasoning links the distinction described above between the subject and the basis of tax to the interpretation of the uniformity requirement: Congress’s power to tax necessarily includes the power to account for other factors particular to the taxpayer—beyond the immediate subject of tax—when determining the amount of tax due.

### B. *A Traditional Wealth Tax*

For more than a century, the federal tax system has largely relied upon the corporate and individual income tax to raise revenue<sup>197</sup> and to pursue distributive goals.<sup>198</sup> This Section considers the possibility of a federal wealth tax as a new direction for the tax system,<sup>199</sup> describes how it might be designed, and explores the key considerations in its constitutional analysis.

#### 1. Described

The basic steps in calculating traditional wealth tax liability would mirror the steps in calculating an income tax liability. The calculation of a taxpayer’s wealth liability would begin with a determination of her taxable wealth, or gross wealth less any deductions or exclusions. The applicable rate schedule would then translate taxable wealth into the tax imposed. Finally, a wealth tax could also allow credits against tax.

As with an income tax, setting these variables will depend on normative value judgments and other policy considerations. In the case of the first variable, the initial base of gross wealth, a wealth tax may similarly allow an ex-

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195. *Brushaber*, 240 U.S. at 24. The Court similarly held that the Due Process Clause does not limit Congress’s ability to discriminate among taxpayers in calculating income tax liabilities. *Id.* at 21, 24.

196. *Id.* at 26. While the Court made this assertion in response to the Due Process objection in particular, the rationale similarly explains the necessity of a narrow reading of the uniformity requirement.

197. See GRAETZ, *supra* note 54, at 16–17 (describing the central importance of income taxation as a source of federal revenue beginning in the twentieth century).

198. See Sanchirico, *supra* note 13, at 1018 (“The income tax has been and remains the celebrity of redistributive instruments, and it may be difficult to resist confusing the fact of its prominence in actual distributive policy with the idea that this must or should be so.”).

199. Of course, subfederal tax jurisdictions already impose property taxes—which may be understood as a limited form of a wealth tax—and are not subject to the apportionment requirement for federal taxes. For a discussion of differences between a local property tax and a federal wealth tax, see Kyle Pomerleau, *A Property Tax Is a Wealth Tax, but . . .*, TAX FOUND. (Apr. 30, 2019), <https://taxfoundation.org/property-tax-wealth-tax/> [http://perma.cc/9DNR-LH7P].

clusion for specified assets or asset values. For example, Professors David Shakow and Reed Shuldiner propose a wealth tax that would generally include financial holdings, business interests, and other investment assets, but would exempt some types of assets, such as small business interests, retirement savings accounts, and both housing and consumer durables below a value threshold.<sup>200</sup>

A wealth tax can also exempt a minimal threshold of savings. For example, Senator Warren's wealth tax proposal would exempt the first \$50 million of wealth from the tax.<sup>201</sup> Switzerland's wealth tax, by contrast, has significantly lower exemption levels that vary by canton, which ranged from approximately \$27,500 to above \$200,000 (in U.S. dollars) in 2014.<sup>202</sup>

Policymakers may also adopt alternative methods for determining the amount of a taxpayer's wealth that is included in the taxable base. In prior work, I described the case for a new tax base derived from a taxpayer's income earned during the year plus a portion of that taxpayer's wealth.<sup>203</sup> Under this method, the wealth component of the taxable base would depend on both a taxpayer's wealth during the period and an estimate of the number of future years the taxpayer may expect this wealth to last.<sup>204</sup> This combined base would reconcile income and wealth as factors in a taxpayer's economic spending power each period and yield a more accurate measure for comparing taxpayers' relative economic circumstances.<sup>205</sup>

Like the income tax, a wealth tax would also allow additional deductions from gross wealth to yield the base of taxable net wealth. For example, wealth tax proposals typically allow a deduction for a taxpayer's debt, since taxing gross wealth without accounting for debt would unduly burden a taxpayer with more debt-funded assets.<sup>206</sup>

As with an income tax, the applicable rate schedule would then translate the base of net wealth into a wealth tax liability. Proposals for a traditional wealth tax vary in their choice of the applicable rate schedule. Shakow and Shuldiner propose a flat rate of tax, with progressivity implemented through an exemption of a fixed amount of wealth.<sup>207</sup> Alternatively, a wealth tax base

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200. Shakow & Shuldiner, *supra* note 1, at 532–38. In this proposal, wealth from human capital would be taxed separately under a wage tax. *Id.* at 538–44.

201. Press Release, *supra* note 1.

202. OECD, *supra* note 13, at 80; *see also, e.g.*, Shakow & Shuldiner, *supra* note 1, at 547 (proposing an exemption on the first \$40,000 of wealth).

203. *See* Glogower, *supra* note 1.

204. *See id.* at 1467–76.

205. *See id.*

206. *See, e.g.*, Shakow & Shuldiner, *supra* note 1, at 537; Press Release, *supra* note 1; *see also* Glogower, *supra* note 1, at 1454 n.148.

207. Shakow & Shuldiner, *supra* note 1, at 546.

could be taxed under a progressive rate schedule, taxing successive dollars of wealth at higher rates, as the current income tax does for income.<sup>208</sup>

Finally, as with income tax, a traditional wealth tax can allow credits against tax, either to adjust the overall progressivity of the tax or to advance other policy objectives or fairness norms. For example, Shakow and Shuldiner propose a unified tax credit against both the wealth tax and wage tax components of their combined tax. This credit adjusts the progressivity of the tax and lowers the burden on taxpayers with the fewest economic resources.<sup>209</sup>

A traditional wealth tax—regardless of how each of these variables is set—also differs from an income tax in critical respects. An income tax measures a flow of economic resources over the taxing period. A traditional wealth tax, in contrast, measures a fixed stock of a taxpayer's wealth at a moment in the taxing period.<sup>210</sup> As a result, the income base does not distinguish between resources that are saved or consumed, while the wealth tax base taxes only wealth that was not consumed in previous periods.<sup>211</sup> A wealth tax—like a tax on capital income—will therefore tax a saver more than a spender.<sup>212</sup> Unlike a tax on capital income, however, a wealth tax is imposed just by virtue of the holding of wealth, without regard to how or whether the wealth is invested.<sup>213</sup> As a result, a wealth tax can gradually diminish a taxpayer's wealth over time if her income earned from it does not exceed the total taxes paid.<sup>214</sup>

A traditional wealth tax, thus defined, may be contrasted with other methods of taxing wealth that are currently part of the tax system or that have been proposed. For example, the current income tax indirectly taxes wealth, in a fashion, by taxing capital income earned from wealth.<sup>215</sup> Scholars

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208. See, e.g., PIKETTY, *supra* note 1, at 526–30 (describing the benefits of a progressive wealth tax with rates reaching 10% on the largest fortunes); Press Release, *supra* note 1 (proposing a modestly progressive rate schedule with an additional 1% tax on net worth above \$1 billion).

209. Shakow & Shuldiner, *supra* note 1, at 546–47.

210. See, e.g., James B. Davies, *Wealth and Economic Inequality*, in THE OXFORD HANDBOOK OF ECONOMIC INEQUALITY 127, 127–28 (Wiemer Salverda et al. eds., 2009). Of course, this fixed stock value could also be determined through multiple observations, such as by taking a weighted average of the wealth stock at different points during the taxing period.

211. Glogower, *supra* note 1, at 1436.

212. That is, a saver who saves their income will necessarily pay a greater wealth tax in the next period than a spender who does not. See Rakowski, *supra* note 12, at 365–66 (“What interest does the community have in whether a person consumes post-tax earnings sooner or later, apart from any profits earned on investments?”).

213. OECD, *supra* note 13, at 49. Of course, a capital income tax can also burden holding wealth, to the extent it taxes gains attributable to inflation.

214. Saul Levmore, *Inequality in the Twenty-First Century*, 113 MICH. L. REV. 833, 851 (2015) (reviewing PIKETTY, *supra* note 1).

215. E.g., I.R.C. § 1(h) (2012 & Supp. V 2018) (capital gains and dividends); *id.* § 61(a) (2012) (interest). The tax rules also allow taxpayers to defer, and in some cases entirely avoid, the tax on unrealized capital gains. See Edward J. McCaffery, *Taxing Wealth Seriously*, 70 TAX

have also proposed taxing an imputed investment return to a taxpayer's wealth, rather than only returns that are "realized" under current law.<sup>216</sup> Wealth is also currently taxed, in a fashion, through the estate tax. For 2018, individuals' taxable estates over \$11.18 million are taxed at a 40% rate.<sup>217</sup> Scholars have also proposed taxing intergenerational wealth transfers by taxing heirs through a successions tax rather than decedents through the estate tax.<sup>218</sup>

## 2. But Is It Constitutional?

The normative reasons for a wealth tax may not matter, however, if it is a direct tax subject to apportionment. If Congress were to enact a wealth tax, the questions of constitutional interpretation that mattered less in an era of income taxation will assume central importance. The Court would have to resolve enduring ambiguities in the doctrine in order to uphold or strike down a traditional wealth tax.

The views in the literature on the constitutionality of a federal wealth tax reflect different assumptions about the scope of apportionment and Congress's taxing power. Professor Bruce Ackerman argues that the Founders intended to grant Congress broad taxing power and used the apportionment requirement as a "fig leaf" to resolve the question of the representation between the northern and southern states, rather than to impose an intentional restraint on the taxing power.<sup>219</sup> In Ackerman's account, the *Pollock* Court erred by broadening the apportionment requirement beyond its intended scope,<sup>220</sup> which should be understood narrowly as foreclosing only an unapportioned tax on real estate as suggested in *Hylton* and the early cases.<sup>221</sup>

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L. REV. 305, 316–23 (2017) (describing how taxpayers can monetize their capital income while avoiding tax through the "buy/borrow/die" strategy).

216. See Noël B. Cunningham & Deborah H. Schenk, *Taxation Without Realization: A "Revolutionary" Approach to Ownership*, 47 TAX L. REV. 725, 735–36 (1992); Deborah H. Schenk, *Saving the Income Tax with a Wealth Tax*, 53 TAX L. REV. 423, 446 (2000) (proposing an imputed wealth tax approach, though recognizing "it is not a perfect substitute for a direct wealth tax").

217. I.R.C. §§ 2001, 2010 (2012 & Supp. V 2018).

218. See, e.g., Lily L. Batchelder, *What Should Society Expect from Heirs? The Case for a Comprehensive Inheritance Tax*, 63 TAX L. REV. 1, 62–67 (2009).

219. See Ackerman, *supra* note 10, at 10–11; *id.* at 22 (endorsing the *Hylton* Court's rejection of "Republicans' effort to transform a narrow bargain with slavery into a grand principle of federalism that would cripple the taxing powers of the new nation"); see also Brian Galle, *The Taxing Power, the Affordable Care Act, and the Limits of Constitutional Compromise*, 120 YALE L.J. ONLINE 407, 415 (2011) (suggesting that the provision was "simply the result of political horse trading" and did not "embody some broader purpose").

220. Ackerman, *supra* note 10, at 51 ("[W]e should reject once and for all *Pollock's* decision to expand the scope of the bargain with slavery after it had been authoritatively repudiated.").

221. *Id.* at 24, 56. Ackerman also argues that the structure of the constitutional text corroborates the view of a broad federal taxing power. He notes that the apportionment require-



Ackerman notes that the *Hylton* Court declined to broaden the direct tax definition beyond a tax on real estate alone,<sup>222</sup> and he argues that the base of a comprehensive wealth tax, which includes real estate as well as other assets and is calculated net of debt, is qualitatively different from a tax on the gross value of real estate alone.<sup>223</sup> The key difference, in Ackerman's view, is that in the case of a broader wealth tax base there would be "no conceptual relationship between a citizen's wealth tax and the market value of his real estate holdings."<sup>224</sup>

In *NFIB*, Chief Justice Roberts similarly indicated that he considered a tax on real estate to be a direct tax.<sup>225</sup> The Court could rely on prior precedent, however, to reach a different conclusion than Ackerman on the question of whether including the value of real estate in a broader wealth tax base would "taint" this entire base.<sup>226</sup> The case law does not offer a simple answer to this question nor a clear interpretative principle the Court could rely on in making this determination. This core uncertainty results from the fact that the constitutional provisions did not specify how the uniformity and apportionment requirements should operate in the case of hybrid bases composed of elements that are subject to different constitutional requirements.

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ments were added elsewhere in the Constitution, but not within the text of Article I, Section 8 alongside the uniformity requirement. *Id.* at 7–8.

222. *Id.* at 23–24, 56–57. Of course, the question of a comprehensive wealth tax was also not before the *Hylton* Court.

223. *Id.* at 57.

224. *Id.*

225. Nat'l Fed'n of Indep. Bus. v. Sebelius (*NFIB*), 567 U.S. 519, 570–71 (2012) (distinguishing the shared responsibility payment from a tax on land or personal property that the Court would have considered a direct tax subject to apportionment, although the Court was not issuing an opinion on the constitutionality of these taxes).

226. Formally, this problem may be modeled as follows: Assume that  $X$  is a tax base, and that a tax on  $X$  would qualify as a "direct" tax subject to apportionment. Now assume that  $Y$  is a broader tax base that includes  $X$  as a factor in the base. That is,  $X \in Y$ . Alternatively, assume that  $X$  is a broader base that includes  $Y$  as a factor in the base. That is,  $Y \in X$ . In either case, the question is whether the base of  $Y$  is now subject to apportionment, by virtue of the inclusion of  $X$  (or a portion of  $X$ ) within the set of  $Y$ . That is, if  $X \in Y$  or  $Y \in X$  and  $X$  is a direct tax, then is  $Y$  also a direct tax? Congress could not avoid this question entirely by simply excluding real estate from the base of a wealth tax. Of course, a wealth tax can accommodate limited exclusions for real estate or other asset classes or amounts. It would be impracticable, however, for Congress to categorically exclude all real estate from the wealth tax base. As described above, tax rules that distinguish among economic substitutes invite inefficient tax gaming and avoidance and will be less effective in raising revenue. *See supra* notes 115–117 and accompanying text. A tax on other investment assets that excluded real estate would similarly encourage taxpayers to shift their investments into the excluded asset classes and use real estate investments as wealth tax shelters. Congress would also face the task of avoiding taxing indirect investments in real estate through entities such as corporations and partnerships, which could also run afoul of the constitutional prohibition on taxing real estate. If Congress implemented a net wealth tax that both subtracted debt and excluded real estate, taxpayers could also take advantage of this combination of rules by borrowing to finance real estate holdings and then allocating the debt to the other assets subject to the wealth tax.

For example, in *Pollock*, the Court invalidated the entire income tax because it included income from property (which the Court considered to be a direct tax element).<sup>227</sup> The current Court might analogize from the *Pollock* holding to find that a wealth tax base was similarly invalidated by the inclusion of real estate (which the Court could similarly consider a direct tax element). Implicitly, the *Pollock* Court did not consider the broader income tax base to be qualitatively different from its direct tax element, which was a tax on the income from property. Other holdings reached the opposite conclusion. In both *Springer* (the 1864 income tax case) and *Spreckels* (the sugar refiner's gross receipts tax), the Court implied that a tax base is not tainted by inclusion of elements that would result in a direct tax if they were taxed alone.<sup>228</sup>

Like Ackerman, Professor Calvin Johnson interprets the apportionment requirement as an expedient compromise rather than a purposeful constraint on Congress's taxing power, but he reaches different conclusions from this account.<sup>229</sup> He argues for an even narrower scope of the apportionment clause but a broader original meaning of the term "direct tax."<sup>230</sup> In Johnson's account, however, this original meaning of a direct tax is not relevant and rather proves the point that the Founders could not have intended such a broad application of apportionment. Rather, Johnson views the ap-

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227. *Pollock v. Farmers' Loan & Tr. Co. (Pollock II)*, 158 U.S. 601, 635–37 (1895) (finding the entire income tax void on account of its direct tax elements). This scenario mirrors the general case described *supra* note 226 where  $X \in Y$ .

228. In *Springer*, the Court conceded that a tax on income from property was economically equivalent to a tax on the underlying property but nonetheless held that a tax on income alone was qualitatively different than a tax on property: "It is not a tax on the 'whole . . . personal estate' of the individual, but only on his income, gains, and profits during a year, which may have been but a small part of his personal estate . . ." *Springer v. United States*, 102 U.S. 586, 598 (1881) (quoting Alexander Hamilton, Carriage Tax, in 8 THE WORKS OF ALEXANDER HAMILTON 378, 382 (Henry Cabot Lodge ed., 1904)). The Court held, in effect, that the "direct" nature of a tax on property did not taint a narrower tax base of only the income the property produced. This scenario mirrors the general case described *supra* note 226 where  $Y \in X$ . In *Spreckels*, the base of the gross receipts tax included income from investments and real property, such as wharfage fees. See *supra* notes 96–97 and accompanying text. The Court upheld that tax by reasoning that the income from property was integral to the taxpayer's total business income rather than separate income from investments. *Spreckels Sugar Ref. Co. v. McClain*, 192 U.S. 397, 413–15 (1904). Like in *Pollock*, this scenario mirrors the general case described *supra* note 226 where  $X \in Y$ . The reasoning in *Spreckels* implied that a direct tax base of income from real property could lose this taint if is included within a broader base of all of the taxpayer's business income.

229. See generally Calvin H. Johnson, *Apportionment of Direct Taxes: The Foul-Up in the Core of the Constitution*, 7 WM. & MARY BILL RTS. J. 1 (1998) [hereinafter Johnson, *Foul-Up*]; Johnson, *supra* note 10.

230. Johnson cites evidence that the Founders understood the term to cover all internal taxes that did not pertain to foreign trade. Johnson, *Foul-Up*, *supra* note 229, at 46–48.

portionment requirement as a relic of the requisition system<sup>231</sup> and a “glitch” or “mistake”<sup>232</sup> that was never intended to “hobble” the taxing power.<sup>233</sup>

Johnson argues that error and misunderstanding render the direct tax definition and apportionment requirement irrelevant vestiges of flawed drafting. Instead, he advocates for what he terms a “functional definition”<sup>234</sup> that would rewrite the provision to allow some sensible role for the apportionment requirement. Johnson consequently argues that apportionment should be required only where its application would be “reasonable and convenient.”<sup>235</sup> Johnson concedes that this interpretation dismisses entirely the relevance of the “direct” tax definition<sup>236</sup> and greatly diminishes the role of apportionment<sup>237</sup> but argues that it is consistent with the Founders’ original intent.<sup>238</sup> Johnson’s interpretation of the constitutional provisions would consequently allow for an unapportioned wealth tax, as long as apportionment would not be reasonable or convenient.<sup>239</sup>

Johnson’s more expansive view of the federal taxing power—and even narrower view of the scope of apportionment—could even justify an unapportioned tax on real estate alone. Of course, this approach would constitute a more significant reversal from the Court’s prior precedent. The current Court, for example, has indicated some continuing (though potentially limited) role for the apportionment requirement as a potential restraint on Congress’s taxing power.<sup>240</sup>

Professors Dawn Johnsen and Walter Dellinger bridge the arguments of both Ackerman and Johnson. Like Johnson, they endorse a “narrow con-

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231. *Id.* at 25.

232. *Id.* at 3 (“[A] glitch, or foul-up, in the core of the Constitution; it is the kind of mistake that lawyers or analytic philosophers should have fixed, but did not.”). In fact, Johnson provides evidence that some of the Founders did not even understand how apportionment worked or how it was inconsistent with uniformity. *Id.* at 66.

233. *Id.* at 14, 36.

234. *Id.* at 80.

235. *Id.* at 11 (“If Congress adopts a head tax . . . or a tax base that is equal per capita among the states, then apportionment is feasible and should be required. If apportionment is not reasonable (i.e. for every other tax base), then the tax therefore is not ‘direct.’”).

236. *Id.* at 11–12 (“The interpretation limiting ‘direct taxes’ to cases in which apportionment is reasonable . . . does, however, require one to ignore the lexicographic meaning given to ‘direct tax’ by the Founders of the Constitution, and to admit that the country’s founding document includes a technical error.”).

237. *Id.* at 25 (arguing that the apportionment requirement has been effectively written out of the Constitution by subsequent changes to the Constitution, and while “still literally in the text, it is devoid of any remaining rationale or historical purpose”).

238. *Id.* at 14–24.

239. *Id.* at 11; Johnson, *supra* note 10, at 1723–24. Johnson argues that, in fact, the apportionment requirement was specifically intended to facilitate federal wealth taxation, not to prevent it. Johnson, *Foul-Up*, *supra* note 229, at 13–14, 29–37.

240. See, for example, Chief Justice Roberts’s view that a tax on real estate would be a direct tax subject to apportionment, described *supra* note 225 and accompanying text.

struction” of the direct tax definition and apportionment,<sup>241</sup> as well as “*Hylton’s* functional test[ ]limiting apportionment to that which can be sensibly apportioned.”<sup>242</sup> Johnsen and Dellinger concede that a tax on real estate alone would pose a conflict between this functional test (on the assumption that such a tax would be impractical now) and the categorical view beginning with *Hylton* that a tax on real estate would be a direct tax.<sup>243</sup> They argue that a wealth tax avoids this conflict, however, on the basis of Ackerman’s argument that a tax on net wealth would be qualitatively different from a tax on real estate.<sup>244</sup>

Other interpretations of the constitutional provisions would preclude a wealth tax. Professor Erik Jensen argues for a more expansive definition of direct taxes and role for apportionment, based on his interpretation of the terms’ original meaning.<sup>245</sup> Jensen argues that the Founders held a relatively clear understanding of the direct tax definition and the scope of apportionment;<sup>246</sup> they understood direct taxes as, broadly speaking, “unavoidable” taxes that a taxpayer could not avoid or shift to other parties.<sup>247</sup> For example, a taxpayer could simply avoid indirect taxes, such as a consumption tax, by foregoing the taxed purchase.<sup>248</sup>

In Jensen’s account, the Founders intended for the apportionment requirement to limit the federal power to implement these unavoidable taxes. Jensen argues that the Founders included the apportionment requirement to assuage delegates’ concerns of granting Congress unbridled taxing power.<sup>249</sup> The resulting inequity or “absurdity” of complying with apportionment ensured that Congress would only enact direct taxes as a last resort.<sup>250</sup> Jensen’s more expansive interpretation of the direct tax definition and the scope of apportionment would preclude an unapportioned wealth tax. Jensen argues that a wealth tax, which is imposed by virtue of merely owning property, would be exactly the type of unavoidable tax that the Founders intended to

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241. Johnsen & Dellinger, *supra* note 1, at 119.

242. *Id.* at 124.

243. *Id.* at 126.

244. *Id.*

245. Jensen, *supra* note 42, at 2356; Jensen, *supra* note 11; Erik M. Jensen, *Interpreting the Sixteenth Amendment (By Way of the Direct-Tax Clauses)*, 21 CONST. COMMENT. 355, 367 (2004); Erik M. Jensen, *Taxation and the Constitution: How to Read the Direct Tax Clauses*, 15 J.L. & POL. 687 (1999).

246. See, e.g., Jensen, *supra* note 42, at 2377–79. *But see id.* at 2414 (conceding that the implications of his analysis “are premised on a fuzzy historical record”).

247. *Id.* at 2359–60 (arguing that Hamilton and other Founders understood an indirect tax as one that could be shifted or avoided, in contrast to a tax on the mere ownership of property that cannot be avoided).

248. *Id.* at 2337. *But see* Zelenak, *supra* note 193, at 838–40 (describing the challenges in classifying taxes on the basis of whether they are avoidable through the example of a broad-based consumption tax, which would only be “avoidable” by not consuming at all).

249. See Jensen, *supra* note 42, at 2338, 2380.

250. *Id.* at 2381–82.

subject to apportionment.<sup>251</sup> This approach also faces the essential challenge that different forms of taxes may be avoidable to varying degrees, which would frustrate the project of classifying taxes for constitutional purposes on this basis.<sup>252</sup>

Finally, other scholars have advocated for a more limited scope of the direct tax definition and apportionment requirement that would still require apportionment of a wealth tax. Professor Joseph Dodge argues that, because the meaning of the term direct tax is fundamentally indeterminate, the Court should interpret the term as covering tangible assets with an identifiable physical locale, where apportionment would at least be theoretically feasible.<sup>253</sup> Professor Charlotte Crane argues that the original meaning of the term “direct tax” referred to taxes on “previously accumulated wealth to which a relatively fixed location could be assigned.”<sup>254</sup>

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The weight of the constitutional analysis may suggest that the Court should ultimately uphold a traditional wealth tax. Nonetheless, the doctrinal ambiguities could also leave the Court opportunities to strike it down. The alternative direction of Wealth Integration methods explored in the following Parts collapses the distinction in the literature between the constitutional analysis of income and wealth taxes and highlights the basic tensions between the Sixteenth Amendment and a broad reading of the apportionment requirement.

### III. WEALTH INTEGRATION

#### A. *The Methods Described*

Wealth Integration may be implemented through three methods: the Base Method, the Rate Method, and the Credit Method. Each of these methods corresponds to one of the three operations used to translate a taxpayer’s gross income into her final income tax liability. Under these methods, however, wealth is not the starting variable for determining the amount of the

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251. Jensen, *supra* note 11, at 822, 829–30. Of course, a taxpayer could also “avoid” the wealth tax by not saving, which illustrates the challenge of classifying taxes based on whether they are avoidable, in the same manner that a taxpayer could theoretically avoid a consumption tax by not consuming.

252. See Erik M. Jensen, *Jensen’s Response to Johnson’s Response to Jensen’s Response to Johnson’s Response to Jensen (Or Is It the Other Way Around?)*, 100 TAX NOTES 841, 842 (2003) (acceding that the avoidability standard leaves ambiguity, but suggesting that “distinctions don’t become meaningless just because hard categorization cases inevitably arise at the margin”).

253. See Dodge, *supra* note 36, at 875, 942.

254. Crane, *supra* note 49, at 3.

taxable base. This critical feature distinguishes Wealth Integration methods from a traditional wealth tax, which uses wealth as the taxable base.

### 1. The Base Method

Under the Base Method, a taxpayer's wealth affects the second variable used to calculate an income tax liability: the deductions from gross income.<sup>255</sup> The Base Method could affect the availability of deductions currently in the Code or new deductions Congress introduces in connection with Wealth Integration.

For an example of how the Base Method would operate, assume that "*Wealth Holder*" has \$1 million of wealth and \$100,000 of income for the year (before accounting for the relevant deduction). Also assume that all taxable income regardless of its character<sup>256</sup> is taxed according to the following progressive rate schedule: the first \$50,000 of income is taxed at a 20% rate, and additional income is taxed at a 40% rate. If no further adjustments are made to *Wealth Holder's* taxable base or applicable rates and if no credits are allowed, she will pay a total tax of \$30,000.<sup>257</sup>

Now assume the tax rules allow taxpayers a general deduction in translating gross income into taxable income. For example, assume the rules allow a standard deduction of \$20,000.<sup>258</sup> Under this rule, *Wealth Holder* would have a taxable income base of only \$80,000 and would pay a total tax of \$22,000.<sup>259</sup> That is, for a taxpayer in the 40% bracket, the \$20,000 deduction represents an \$8,000 reduction in her tax liability.<sup>260</sup>

The Base Method could then disallow this deduction for taxpayers with sufficient wealth. For example, assume the rule provided that for each \$50 of a taxpayer's net wealth, \$1 of the \$20,000 deduction from her income would be disallowed. In this case, if *Wealth Holder* has \$1 million of wealth, she would lose the entire \$20,000 deduction.<sup>261</sup> *Wealth Holder* would pay an additional tax of \$8,000 on account of her additional wealth for an effective average rate of tax on her wealth of 0.8%.<sup>262</sup>

255. Of course, the same rules could be designed with respect to an exemption or exclusion—rather than a deduction—from gross income. The distinction would be purely semantic.

256. The examples that follow illustrate the basic principles of the Wealth Integration methods but could of course be similarly applied in the case of more complicated rate schedules, as under the current income tax.

257.  $(20\% \times \$50,000) + (40\% \times \$50,000) = \$30,000$ .

258. For 2018, joint filers are allowed a comparable \$24,000 standard deduction. I.R.C. § 63(c)(7) (2012 & Supp. V 2018).

259.  $(20\% \times \$50,000) + (40\% \times \$30,000) = \$22,000$ .

260. As compared to the \$30,000 tax liability that would have been due absent this additional deduction.

261.  $\$1,000,000 \div \$50 = \$20,000$ . Cf. Puckett, *supra* note 13, at 446–47 (suggesting that wealthy taxpayers could be disallowed certain deductions or exemptions already in the tax code, such as the standard deduction, the personal exemption, or personal expenses).

262.  $\$8,000 \div \$1,000,000 = 0.8\%$ .

Congress could also implement the Base Method by simply disallowing cost recovery deductions available to taxpayers. As previously discussed, the income tax base generally measures net income (and not gross income) through different cost recovery rules, such as the deductions for depreciation or the subtraction of an asset's cost basis from the amount realized in a taxable exchange.<sup>263</sup> By disallowing these deductions, Congress would in effect tax a taxpayer's stock of wealth. Of course, this approach may not be the most desirable application of the Base Method and would have the effect of discouraging taxable exchanges or investments.<sup>264</sup>

The Base Method is a flexible general approach, and the examples above merely illustrate some possible applications. Congress could adjust any of the following factors in implementing this method: the size of the deduction from income, the types of deductions that are disallowed, the amount of wealth taken into account to adjust the amount of the deduction, and the rate at which different levels of wealth adjust the deduction.

## 2. The Rate Method

Under the Rate Method, a taxpayer's wealth instead affects the third variable used to calculate an income tax liability: the applicable rate schedule. As with the Base Method, the Rate Method could affect the current income tax rate schedule or a revised income tax schedule that Congress introduces in connection with Wealth Integration.

For an example of how the Rate Method could operate, assume again that *Wealth Holder* has \$1 million of wealth at the start of the taxing period, earns \$100,000 of income during the period, and faces the same \$30,000 tax liability under the rate schedule described above.<sup>265</sup> Under the Rate Method, *Wealth Holder's* additional \$1 million of wealth would affect the rate schedule applicable to her taxable income. One application of this method could simply add an additional percentage of tax to each dollar of the taxpayer's income, with the amount of the increase varying with the taxpayer's wealth. For example, assume that, for each \$100,000 of a taxpayer's wealth, an additional 1% of tax would be added to each of the applicable brackets in the rate schedule applied to their taxable income. In this case, *Wealth Holder's* rate schedule would increase by 10%,<sup>266</sup> to a 30% tax rate on the first \$50,000 of income, with additional income taxed at a 50% rate. As a result, *Wealth Holder* would pay a total tax of \$40,000<sup>267</sup> instead of \$30,000. In effect, *Wealth Holder* pays an additional 10% tax on every dollar of her \$100,000 of

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263. See *supra* note 155 and accompanying text.

264. That is, a taxpayer could avoid the tax simply by not changing the form of her investments. She would face a tax liability whenever she exchanges one asset for another, even if no gain or loss is realized from the transaction.

265. See *supra* note 257 and accompanying text.

266. Since *Wealth Holder* has \$1,000,000 of wealth, and each \$100,000 of this wealth results in a 1% adjustment.

267.  $(30\% \times \$50,000) + (50\% \times \$50,000) = \$40,000$ .

income on account of her additional wealth. *Wealth Holder* is effectively taxed on her \$1 million of wealth at a 1% rate.<sup>268</sup>

The Rate Method could also adjust the rates at some brackets but not at others. For example, the Rate Method could provide that only the highest 40% bracket is subject to the increase described above. The Rate Method could also disallow the capital gains preference for wealthy taxpayers and instead tax their capital income at the top ordinary rates.<sup>269</sup> For example, ordinary income is currently taxed at a top marginal rate of 37%, while capital income is taxed at a top marginal rate of 20%.<sup>270</sup> Assume again that *Wealth Holder* has \$1 million of wealth and earns \$100,000 of capital income (qualifying for preferenced treatment as long-term capital gains or qualified dividends) during the taxing period. The Rate Method could provide that, for each \$100,000 of a taxpayer's wealth, an additional 2% of tax would be added to each of the applicable brackets for capital income until the applicable rates reflect the corresponding brackets for ordinary income. In this case, *Wealth Holder* would reach this ceiling and would pay tax on her capital income at a top marginal rate of 37%, rather than 20%.

Alternatively, under the Rate Method a taxpayer's wealth could be taken into account to "backfill" the lower rate brackets on her first dollars of income.<sup>271</sup> For example, the current income tax, with a progressive marginal rate schedule, taxes every taxpayer's first dollars of income at lower rates. In 2018, the rate schedule taxes a married couple filing jointly at 10% on taxable income up to \$19,050 and reaches the top marginal rate of 37% only for taxable income above \$600,000.<sup>272</sup> For a taxpayer in the highest bracket filing a joint return, this inframarginal subsidy will amount to \$60,621.<sup>273</sup>

The Rate Method could be structured so that a taxpayer's wealth "backfills" this amount and eliminates the inframarginal subsidy, causing more of her income to be taxed in the higher rate brackets. For example, assume that *Wealth Holder 2* has the same \$1 million of wealth but now also has \$1 million of taxable income, rather than \$100,000. In 2018, if *Wealth Holder 2* files

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268. That is, *Wealth Holder* pays an additional \$10,000 in tax as a result of her \$1,000,000 of wealth.

269. See OECD, *supra* note 13, at 53 ("In theory, capital income taxes could also be designed to increase with both income and wealth.")

270. I.R.C. § 1(a)–(b), (h), (j) (2012 & Supp. V 2018). The net investment income and payroll taxes can increase the effective top rate on both forms of income to above 40%. See *id.* §§ 3101(b), 3111(b) (Medicare payroll tax and surtax); *id.* §§ 1401(b), 164(f) (self-employment taxes); *id.* § 1411 (net investment income tax). This discussion simply uses the top marginal rates for purposes of illustration, without accounting for these possible additional taxes.

271. Cf. Puckett, *supra* note 13, at 446–47.

272. I.R.C. § 1(a)–(b), (j).

273. This is the difference between the actual tax liability of \$161,379 on the taxpayer's first \$600,000 of income (resulting from the lower rates on this income) and the \$222,000 which would have been owed if this \$600,000 of income were all taxed at the 37% rate. For the policy justification for eliminating the inframarginal subsidy from lower tax rates for wealthy taxpayers, see *infra* note 318 and accompanying text.



a joint return, she would pay a total tax of \$309,379 on her \$1 million of income.<sup>274</sup> Under this variation of the Rate Method, *Wealth Holder 2*'s wealth could backfill the lower brackets, such that her entire \$1 million would be taxed at the 37% rate, for a total tax liability of \$370,000. *Wealth Holder 2* pays an additional \$60,621 on account of her additional wealth. In effect, *Wealth Holder 2* is taxed on her \$1 million of wealth at approximately a 6% rate.<sup>275</sup>

The Rate Method could also adjust the lower income brackets further, so that the rates on the first dollars of income (whether capital or ordinary) exceed—rather than equal—the current 37% rate for income above \$600,000. For example, the Rate Method could provide that, for taxpayers with sufficient wealth, the first \$100,000 of income would be taxed at up to a 50% rate, with additional income taxed at the lower 37% rate. Applying this rate schedule to the facts immediately above would instead generate a total tax liability of \$383,000<sup>276</sup> and an effective tax rate of approximately 7.4% on the taxpayer's wealth.<sup>277</sup>

Like the Base Method, the Rate Method is also a flexible general approach, and the examples above merely illustrate some possible applications. Congress could adjust any of the following factors in implementing this method: the levels of wealth that trigger rate adjustments, the amount of the adjustments, and the location of the adjustments within the income tax rate schedule.

### 3. The Credit Method

Under the Credit Method, a taxpayer's wealth affects the fourth variable used to calculate an income tax liability: credits against tax. As with the other two methods, the Credit Method could affect the availability of credits allowed in the current income tax rate schedule or of additional credits against income tax Congress introduces in connection with Wealth Integration.

For an example of how the Credit Method could operate, Congress could disallow the child tax credit available under current law for wealthy

274.  $\$161,379 + (37\% \times \$400,000) = \$309,379$ . This simplified example, intended for purposes of illustration, assumes that *Wealth Holder's* income is all characterized as ordinary, her spouse has no additional taxable income, and no other credits or other adjustments apply to the final tax liability.

275.  $\$60,621 \div \$1,000,000 = 6.0621\%$ . Backfilling could be designed in different manners. For example, it may be designed so only wealth above a certain threshold affects the applicable income tax brackets. Similarly, backfilling may be formally structured as adding a taxpayer's wealth to her taxable income for purposes of determining the applicable rate brackets on her income, or as adjusting the applicable income tax bracket thresholds on account of the taxpayer's wealth.

276.  $(50\% \times \$100,000) + (37\% \times \$900,000) = \$383,000$ .

277.  $\$73,621 \div \$1,000,000 = 7.3621\%$ . In this case, the additional tax liability resulting from a taxpayer's wealth would exceed the amount of the inframarginal subsidy resulting from the graduated income tax schedule.

taxpayers. For 2018, the child tax credit<sup>278</sup> is worth up to \$2,000 per qualifying child and phases out for taxpayers with adjusted gross income above \$400,000 (in the case of a joint return).<sup>279</sup> Assume again that *Wealth Holder* has \$1 million of wealth at the start of the taxing period and \$100,000 of income during the period (and therefore the income phase-out does not apply). The Credit Method could provide that, for each \$500 of a taxpayer's net wealth, \$1 of the \$2,000 credit is disallowed. *Wealth Holder* would lose the entire credit,<sup>280</sup> resulting in an additional tax of \$2,000 on account of her additional wealth for an effective average rate of tax on her wealth of 0.2%.<sup>281</sup>

The Earned Income Tax Credit rules may also be understood as an indirect application of the Credit Method in the current tax law. For 2019, low-income taxpayers with more than two qualifying children can earn a maximum refundable credit of \$6,557.<sup>282</sup> This credit is disallowed, however, for taxpayers with sufficient investment income.<sup>283</sup> Congress added this disallowance in order to limit the availability of the credit to wealthy taxpayers, and it considered investment income a more administrable proxy for a taxpayer's assets.<sup>284</sup>

Congress could also implement the Credit Method in connection with a new general credit against tax. Assume that every taxpayer is allowed a new \$1,000 credit against tax, which is reduced by \$1 for each \$1,000 of a taxpayer's wealth. In this case, *Wealth Holder* would be fully disqualified for the credit on account of her \$1 million of wealth.<sup>285</sup> In effect, *Wealth Holder* is taxed at a rate of 0.1% on her wealth.<sup>286</sup>

Like the other methods, the Credit Method is also a flexible general approach, and the examples above merely illustrate some possible applications. Congress could adjust any of the following factors in implementing this method: the levels of wealth that factors into the credit adjustment, the amount of the credit subject to adjustment, and the rate at which a taxpayer's wealth adjusts the credit's availability.

278. See *supra* note 166 and accompanying text.

279. I.R.C. § 24(h)(2)–(3) (2012 & Supp. V 2018).

280.  $\$1,000,000 \div \$500 = \$2,000$ .

281.  $\$2,000 \div \$1,000,000 = 0.2\%$ .

282. 2019 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates, IRS, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-next-year> [https://perma.cc/S4VS-RVT4]; see I.R.C. § 32(a)–(b).

283. I.R.C. § 32(i).

284. See Manoj Viswanathan, *The Hidden Costs of Cliff Effects in the Internal Revenue Code*, 164 U. PA. L. REV. 931, 942 (2016) (“Congress wanted to limit receipt of the Earned Income Tax Credit to taxpayers without substantial assets. Because the Internal Revenue Service does not collect information on taxpayers’ assets, applying a strict asset test is perceived as administratively difficult. As a result, Congress used the investment income test to approximate a taxpayer’s level of assets.” (footnote omitted)).

285. That is,  $\$1,000 - (\$1,000,000 \div \$1,000) = \$0$ .

286. That is, the \$1,000 “cost” in terms of the lost tax credit, divided by her \$1 million.

## B. Evaluation and Design Choices

Wealth Integration methods are as flexible as the corresponding variables used in calculating income tax liabilities under the current income tax. Policymakers would face a series of basic considerations in choosing among these different methods and how they should be applied.<sup>287</sup>

### 1. The Ceiling

Wealth Integration methods can have the same basic effect as a traditional wealth tax, by increasing a taxpayer's tax liability on account of her wealth, and can also have a similar general effect in raising additional revenue and reducing economic inequality. Wealth Integration methods differ from a traditional wealth tax, however, in a critical respect. Under all of these methods, wealth never increases gross income—which is the starting point for calculating an income tax liability—and is therefore never additive to the taxable base. As a result, the effective tax on wealth under Wealth Integration methods is contingent upon the taxpayer's base of taxable income. For the same reason, under most applications, Wealth Integration methods will never impose a tax liability on account of a taxpayer's wealth when she does not have another source of economic resources (specifically, income) from which to pay the tax liability.<sup>288</sup> As a result, unlike under a traditional wealth tax, Wealth Integration methods would never have the effect of exhausting a taxpayer's wealth principal.<sup>289</sup>

Further, under Wealth Integration, a taxpayer's wealth will not continuously adjust her tax liability—as would a traditional wealth tax—beyond the amount of the relevant adjustment to the variable used in calculating the tax on income. In effect, Wealth Integration methods would operate as a tax on wealth up to a ceiling of a maximum amount of additional tax due but would not have any additional effect for taxpayers with additional wealth above this ceiling.<sup>290</sup>

Under the Base Method, the ceiling of the wealth tax will depend on the maximum possible adjustment to the base of taxable income. In the example above,<sup>291</sup> *Wealth Holder's* \$1 million of wealth resulted in the disallowance of

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287. An analysis of every possible configuration of Wealth Integration is beyond the scope of this Article. Rather, this discussion highlights key design considerations and generally applicable effects of the different methods.

288. One exception would be a rule that provides a tax refund for taxpayers without any income, which is then subsequently disallowed for taxpayers with wealth. *See infra* note 304.

289. *See supra* note 214 and accompanying text (on this potential effect of a traditional wealth tax).

290. *Cf.* Puckett, *supra* note 13, at 447 (suggesting a similarly limited effect for the proposed asset-based phaseouts of current benefits in the income tax). As described in this Section, the effective ceiling on the tax on wealth is more variable across the full range of possible Wealth Integration methods.

291. *See supra* notes 256–262 and accompanying text.

a \$20,000 deduction from taxable income, for an additional tax of \$8,000 and an effective rate of 0.8% on her wealth. Assume a third taxpayer, “*Wealth Holder 3*,” has \$2 million of wealth and the same \$100,000 taxable income as *Wealth Holder*. In this case, *Wealth Holder 3*’s additional wealth above \$1 million would have no effect after the deduction is fully disallowed. The tax may be recharacterized as a flat tax of 0.8% on the first \$1 million of wealth<sup>292</sup> and 0% on any additional wealth, for an overall regressive rate schedule. As a result, the effective overall rate on a taxpayer’s total wealth will decline as her wealth increases. In this case, the average effective rate on *Wealth Holder 3*’s total \$2 million of wealth will be only 0.4%.<sup>293</sup> Of course, in each of these cases, the location of the ceiling and the resulting effective rate schedule on wealth will depend on the size of the deduction or exclusion, the interaction with the rate schedule on income, and the manner in which wealth affects the adjustments to taxable income.

In the case of the Rate Method, the ceiling would operate differently and could be much higher, depending on how the method is applied. If additional amounts of wealth continuously increase a taxpayer’s applicable tax rate on her income until all income is taxed at 100%, the ceiling of the resulting tax liability on this wealth would be determined by the full amount of the taxpayer’s income for the year. Of course, policymakers would be more likely to limit the maximum rate increase under the Rate Method to well below a 100% rate.<sup>294</sup> Limiting the amount of the rate increase would consequently lower the ceiling on the effective tax on wealth. In these cases—and unlike in the case of the Base Method—the effective tax resulting from wealth would still increase as the amount of the taxpayer’s income increases. That is, the ceiling on the wealth tax under this application of the Rate Method would not be defined as a fixed dollar amount, but rather as a percentage of a taxpayer’s income for the year.<sup>295</sup>

For example, in the illustration above, *Wealth Holder*’s \$1 million of wealth resulted in an additional 10% tax on her \$100,000 of income, for an effective tax on her wealth of \$10,000, or 1%.<sup>296</sup> Now consider again *Wealth Holder 3* with \$2 million of wealth and the same \$100,000 of income. In this case, *Wealth Holder 3*’s additional \$1 million of wealth would result in an

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292. That is, in the example above, the taxpayer is disallowed a \$1 deduction for every \$50 of wealth, and the entire deduction is taken against income that would be otherwise taxed at the 40% rate. As a result, the “cost” to the taxpayer is \$0.40 for every \$50 of wealth, or \$0.008 for every dollar, until the deduction is fully disallowed.

293.  $\$8,000 \div \$2,000,000 = 0.4\%$ .

294. This desirable maximum rate, however, may be much higher than under current law. See *infra* notes 321–324 and accompanying text.

295. Of course, the effective ceiling on the tax on wealth under the Rate Method could also be a fixed dollar amount if it were structured differently. For example, if the Rate Method were structured to “backfill” the lower rate brackets, the effective tax on wealth would be limited to the value of the inframarginal subsidy from these lower brackets. See *supra* notes 271–275 and accompanying text.

296. See *supra* notes 266–268 and accompanying text.

additional 20% tax on her \$100,000 of income, for an effective tax on her wealth of \$20,000—still 1%, but of a higher wealth base.<sup>297</sup> Finally, assume that a fourth taxpayer, “*Wealth Holder 4*,” has \$1 million of wealth but \$200,000 of income. In this case, her \$1 million of wealth would result in an additional 10% tax on this income, for an effective tax on her wealth that would also be \$20,000, but at a higher 2% rate.<sup>298</sup>

In the case of the Credit Method, the ceiling would be a fixed dollar amount, in the same manner as under the Base Method, equal to the value of the disallowed credit. In the example described above, *Wealth Holder* loses the full \$1,000 credit on account of her \$1 million of wealth, for an effective rate of tax on her wealth of 0.1%.<sup>299</sup> If *Wealth Holder 3* instead has \$2 million of wealth, her additional wealth would not result in any further tax consequences. As in the case of the Base Method, the application of the Credit Method in this case may be recharacterized as a rate schedule of a 0.1% tax on the first \$1 million of wealth<sup>300</sup> and 0% on any additional wealth.

## 2. Policy Considerations

Because of the ceiling, the economic effects of Wealth Integration methods would vary from those of a traditional wealth tax. Notwithstanding the ceiling, however, Wealth Integration methods could still promote revenue and distributional objectives. The ceiling may be a “feature” as well as a “bug” and would mitigate the possible efficiency costs of a traditional wealth tax.

*Redistribution.* Because of the ceiling effect, Wealth Integration methods may have a more limited effect in burdening the taxpayers with the largest concentrations of wealth. Wealth Integration methods would still offer distributional advantages, however. These methods could still have the effect of imposing a significant additional tax on the highest wealth holders, depending on the choice of method and how it applied.<sup>301</sup> Professor Thomas Piketty also argues that even a modest tax on the wealthy could help to “regulate capitalism,” promote financial transparency, and generate valuable public information on the distribution of wealth that could in turn improve democratic governance.<sup>302</sup> A modest tax on wealth could also help to normalize the concept of using wealth as a desirable basis for taxation.<sup>303</sup>

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297.  $\$20,000 \div \$2,000,000 = 1\%$ .

298.  $\$20,000 \div \$1,000,000 = 2\%$ .

299. See *supra* notes 285–286 and accompanying text.

300. That is, in the example above, the taxpayer is disallowed a \$1 credit for every \$1,000 of wealth. As a result, the “cost” to the taxpayer is \$0.001 for every \$1 of wealth until the credit is fully disallowed.

301. See *infra* notes 306–307 and accompanying text.

302. PIKETTY, *supra* note 1, at 518–20; see also *id.* at 519 (“The benefit to democracy would be considerable: it is very difficult to have a rational debate about the great challenges facing the world today . . . because the global distribution of wealth remains so opaque.”).

303. See *supra* note 198.

Further, Wealth Integration methods could help to target tax benefits to taxpayers without significant wealth, where the resulting adjustments would have much greater relative economic impact.<sup>304</sup> Wealth Integration methods could have more significant economic effects in taxing wealth (and a higher ceiling) when implemented in connection with other income tax reforms that have been proposed.<sup>305</sup>

*Revenue.* The ceiling would also limit the revenue-raising capacity from Wealth Integration methods. In this case, many of the same considerations described immediately above explain why Wealth Integration methods may still be desirable as a revenue-raising supplement to the income tax. Even with the ceiling, Wealth Integration methods could raise significant revenue. For example, Professors Emmanuel Saez and Gabriel Zucman estimated that in 2012 the approximately 16,070,000 households in the top 10% of the U.S. wealth distribution each had at least \$660,000 of wealth.<sup>306</sup> A modest application of a Wealth Integration method that in effect taxed each of these households at a ceiling of \$10,000 would have generated more than \$160 billion in that year,<sup>307</sup> or more than \$175 billion in 2018 dollars.<sup>308</sup> As described below, the revenue effects from Wealth Integration would also increase if Congress implemented reforms to more accurately measure the base of taxable income.

Congress could also implement Wealth Integration methods in a distribution-neutral manner—to shift a greater tax burden to the wealthy without affecting revenues—or in a manner that results in a net revenue cost. For example, Congress could implement the Credit Method by allowing a new credit and then disallowing this benefit for taxpayers with sufficient wealth. In this case, the net revenue cost of the changes would be determined by the total amount of the credit that taxpayers do not lose on account of their

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304. For example, Wealth Integration methods could allow policymakers to effectively target the benefits of a “basic income” program administered through the tax system and limit the cash grants to taxpayers with less wealth. For consideration of basic income reforms, see ACKERMAN & ALSTOTT, *supra* note 1, at 4–5, 220 (proposing cash grants to citizens upon reaching adulthood); Miranda Perry Fleischer & Daniel Jacob Hemel, *The Architecture of a Basic Income*, 87 U. CHI. L. REV. (forthcoming 2020) (describing the normative case for a basic income and how it may be designed); and Ari Glogower & Clint Wallace, *Shades of Basic Income* (Ohio State Pub. Law Working Paper No. 443, 2017) (describing the different motivations underlying basic income proposals).

305. See *infra* Section III.C.

306. Emmanuel Saez & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data*, 131 Q.J. ECON. 519, 552 tbl.1 (2016). This group, while comprising only 10% of the nation’s households, held more than 75% of the total national wealth. *Id.*

307. Of course, this approximation does not account for the additional revenue raised from taxpayers with significant wealth but below this threshold. Other possible applications of Wealth Integration methods could raise significantly more than a maximum of \$10,000 per household.

308. *Inflation Calculator*, CPI INFLATION CALCULATOR, <http://www.in2013dollars.com/2012-dollars-in-2018?amount=160> [<https://perma.cc/MSA2-UT7J>].

wealth.<sup>309</sup> In this case, Congress would use Wealth Integration to limit the revenue cost of a benefit provided to the less wealthy rather than to increase net revenues.

*Efficiency.* In an optimal tax framework—which generally seeks to design tax rules to maximize a weighted measure of social welfare<sup>310</sup>—a traditional wealth tax may have the effect of discouraging a taxpayer’s welfare-increasing decision to invest and save for future periods.<sup>311</sup> Wealth Integration methods could have the same general effect, to the extent that a taxpayer’s wealth similarly generates an additional tax liability. At the same time, certain applications of Wealth Integration methods could also increase the tax on additional dollars of income.<sup>312</sup>

Scholars have argued, however, that a taxpayer with higher levels of both income and wealth should be taxed at higher rates on both in an optimal tax framework.<sup>313</sup> Wealth may be an indicator of a taxpayer’s underlying earning ability and therefore an efficient base for taxation.<sup>314</sup> Taxing both income and wealth at higher rates may be also desirable to the extent that concentrations of both result in more harmful negative externalities.<sup>315</sup>

The ceiling limiting the effective tax on wealth under Wealth Integration methods can also mitigate the adverse efficiency effects from taxing wealth. Wealth Integration methods will affect only the *first* dollars of wealth saved, and not wealth saved above the ceiling. To the extent that a taxpayer makes savings decisions at the margins, with regard to the last dollar saved, she may be less likely to change her behavior to avoid a tax on her first—rather than her final—dollar of wealth saved.<sup>316</sup> Wealth Integration methods would have

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309. The result would be similar if Congress implemented the Base Method by allowing a new deduction from gross income and then disallowing this deduction for taxpayers with sufficient wealth.

310. LOUIS KAPLOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* 31 n.31 (2002).

311. See OECD, *supra* note 13, at 58 (“The main efficiency related argument against net wealth taxes is that . . . they distort saving behaviours. . . . If the return on savings is taxed, the decision to postpone consumption . . . is distorted . . . as the tax drives a wedge between the prices of consumption at different dates.”).

312. See, for example, the effect of the Rate Method application described *supra* notes 294–297 and accompanying text.

313. See David Gamage, *The Case for Taxing (All of) Labor Income, Consumption, Capital Income, and Wealth*, 68 *TAX L. REV.* 355, 431–37 (2015); Sanchirico, *supra* note 13, at 1027–28.

314. James Banks & Peter Diamond, *The Base for Direct Taxation*, in *DIMENSIONS OF TAX DESIGN: THE MIRRLEES REVIEW* 548, 563 (James Mirrlees et al. eds., 2010).

315. See Daniel Shavito, *Economics of Tax Law*, in 3 *THE OXFORD HANDBOOK OF LAW AND ECONOMICS* 106, 108 (Francesco Parisi ed., 2017) (describing possible negative externalities from inequality that could justify redistributive taxation). See generally KAPLOW & SHAVELL, *supra* note 310, at 429 (describing the general problem of externalities).

316. That is, a taxpayer may have a strong incentive to save at least one dollar, since the marginal utility of savings will be high at early levels of savings, but may derive much less utility from saving the one millionth dollar. See BERNARD SALANIÉ, *THE ECONOMICS OF TAXATION* 142–43 (2d ed. 2011) (providing a marginal analysis of effects of taxation on savings).

the effect of avoiding taxing the marginal dollars of savings that are most elastic and therefore present the greatest efficiency costs from taxation.<sup>317</sup>

Specific applications of Wealth Integration methods may also yield additional efficiency advantages. For example, using wealth to “backfill” the lower income rate brackets under the Rate Method—or to even tax income in these brackets at *higher* rates—would mitigate the efficiency costs from increasing income tax rates on account of a taxpayer’s wealth. The current “inframarginal subsidy” allowed by the progressive rate schedule, in contrast, provides an additional subsidy to the wealthiest taxpayers that is less likely to affect their economic behavior.<sup>318</sup>

The rate schedule under an optimal tax may in fact tax the first brackets of income at higher rates, and subsequent income at lower rates, if the decision whether to earn additional income is not sensitive to tax rates on income at the lower brackets.<sup>319</sup> Applying this regressive rate schedule to all taxpayers, however, would entail taxing individuals with lower income at higher average rates than individuals with greater income.<sup>320</sup> The Rate Method, implemented through “backfilling,” could achieve the benefits of higher rates in the lower brackets while avoiding burdening those with lower income by increasing the rate of tax in these lower brackets only for the wealthiest taxpayers.

### C. *Intersection with Other Reforms*

Congress could implement Wealth Integration methods without making any additional changes to the income tax. These methods would have even greater economic effect, however, when implemented with other proposed income tax reforms.

#### 1. Increasing the Top Income Tax Rate

Scholars and policymakers have proposed raising the top marginal income tax rates on the highest earners. For example, economists Peter Diamond and Emmanuel Saez find that the optimal top rate on earned income

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317. Of course, Congress could structure a traditional wealth tax with the same ceiling effect, by specifying a maximum wealth tax liability.

318. See Jason S. Oh, *Are Progressive Tax Rates Progressive Policy?*, 92 N.Y.U. L. REV. 1909, 1920 (2017) (describing how, in the case of a taxpayer who earns significantly more than \$25,000, “[i]f the government were to raise the tax rate that applied to the first \$25,000 of income, it would have a negligible effect on your decision whether to earn additional income”); see also Robert K. Triest, *The Efficiency Cost of Increased Progressivity*, in TAX PROGRESSIVITY AND INCOME INEQUALITY 137, 139–40 (Joel Slemrod ed., 1994).

319. See Shaviro, *supra* note 147, at 850 (describing how the marginal rates on lower levels of income have fewer or no distortive effects upon taxpayers who earn higher incomes).

320. Unless this rate schedule were combined with a general refundable credit or “demogrant” to lower tax burdens on low-income taxpayers.



is 73%<sup>321</sup>—a rate significantly higher than under current law.<sup>322</sup> In recent years, policymakers have also proposed raising the top rates on both ordinary and capital income from their current levels. These proposals could again be policy priorities in future reform cycles. For example, during the 2016 presidential election, Senator Hillary Clinton proposed a 4% surcharge on adjusted gross income (AGI) above \$5 million, a phased-in minimum tax for AGI above \$1 million, and a limitation on certain deductions and exclusions that would also result in a more progressive rate schedule.<sup>323</sup> In the same cycle, Senator Bernie Sanders proposed tax rates reaching 52% on income above \$10 million.<sup>324</sup> More recently, Representative Alexandria Ocasio-Cortez advocated for a 70% top rate on the highest earners.<sup>325</sup>

Raising the top marginal rate on income could increase the economic impact of Wealth Integration methods. For example, raising the top marginal rate would increase the inframarginal subsidy for the first dollars of income earned by high-income taxpayers. If a taxpayer's wealth backfilled these lower brackets, the disallowance of this larger subsidy would result in a larger effective tax on wealth. Under Senator Sanders's proposed rate schedule, for instance, the value of the inframarginal subsidy to a high-income taxpayer on their first dollars of income could increase to more than \$550,000 for the very highest earners<sup>326</sup> from its 2018 amount of \$60,621.<sup>327</sup>

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321. Peter Diamond & Emmanuel Saez, *The Case for a Progressive Tax: From Basic Research to Policy Recommendations*, J. ECON. PERSP., Fall 2011, at 165, 167–75. Thomas Piketty has estimated that the optimal top rate is 82% in developed countries. PIKETTY, *supra* note 1, at 512 & 640 n.50.

322. See KATHERINE LOUGHEAD & EMMA WEI, TAX FOUND., FISCAL FACT NO. 643, STATE INDIVIDUAL INCOME TAX RATES AND BRACKETS FOR 2019 (2019), [https://files.taxfoundation.org/20190607141743/TaxFoundation\\_FF643.pdf](https://files.taxfoundation.org/20190607141743/TaxFoundation_FF643.pdf) [<https://perma.cc/8D55-ZF4R>]; *supra* note 270 and accompanying text (top federal income tax rates).

323. See RICHARD AUXIER ET AL., TAX POLICY CTR., AN UPDATED ANALYSIS OF HILLARY CLINTON'S TAX PROPOSALS 3 (2016), <https://www.taxpolicycenter.org/publications/updated-analysis-hillary-clintons-tax-proposals/full> [<https://perma.cc/3UG8-MB2Z>].

324. ALAN COLE & SCOTT GREENBERG, TAX FOUND., FISCAL FACT NO. 498, DETAILS AND ANALYSIS OF SENATOR BERNIE SANDERS'S TAX PLAN 2 (2016), <https://files.taxfoundation.org/legacy/docs/TaxFoundation-FF498.pdf> [<https://perma.cc/DHF4-FZ8K>] (proposing a rate schedule of 37% on income between \$250,000 and \$500,000, 43% on income between \$500,000 and \$2 million, 48% on income between \$2 million and \$10 million, and 52% on income above \$10 million).

325. See Sahil Kapur, *Ocasio-Cortez Suggests 70% Ultra-Rich Tax Could Pay for Climate Plan*, BLOOMBERG (Jan. 4, 2019, 1:56 PM), <https://www.bloomberg.com/news/articles/2019-01-04/ocasio-cortez-says-70-ultra-rich-tax-could-pay-for-climate-plan> [<https://perma.cc/Y4QU-VQ3X>].

326. Assuming the rate schedule described *supra* note 324 for joint filers and the 2018 rate schedule for income below \$250,000 yields an inframarginal subsidy for income below \$10 million of \$573,921. This is the difference between the total tax of \$4,626,079 that would be paid on income of \$10 million under this proposed rate schedule and the total tax of \$5,200,000 if all \$10 million of income were taxed at the 52% rate.

327. *Supra* note 273 and accompanying text.

This significantly larger potential subsidy would result in a higher effective tax on wealth, if the subsidy is disallowed on account of a taxpayer's wealth.

Similarly, under the Base Method, an increase in the top marginal rate would increase the cost to a wealthy taxpayer from losing a deduction or exemption on account of her wealth. In the case of a taxpayer facing a top marginal rate of 52%, for example, the value of the \$20,000 deduction or exemption described above would be \$10,400, rather than the \$8,000 under a hypothetical top rate of only 40%.<sup>328</sup>

## 2. A More Accurate Income Tax Base

Wealth Integration methods would also have greater impact if implemented in connection with reforms to more accurately measure taxable income and eliminate the possibilities for taxpayers to defer and avoid income recognition. For example, scholars have proposed taxing liquid assets on a mark-to-market basis, which would tax increases or decreases in asset values each year regardless of whether the assets are sold.<sup>329</sup> This reform would more accurately measure a taxpayer's true economic income each year and increase the taxpayer's income tax base.

In addition, this reform would increase the economic impact of Wealth Integration methods. As described above, the effective tax on wealth under Wealth Integration methods depends on the size of the taxable income base. Increasing the taxable income base would thereby increase the effect of Wealth Integration methods. The earlier example illustrating how *Wealth Holder* and *Wealth Holder 4* (with the same \$1 million of wealth and different levels of income) would be treated differently under the Rate Method<sup>330</sup> also illustrates the potential economic impact of a more accurate income tax base in connection with Wealth Integration.<sup>331</sup>

## IV. CONSTITUTIONALITY REVISITED

Despite their similar economic effects, the constitutional analysis of Wealth Integration methods would be intrinsically different from the analysis of a traditional wealth tax. The Court could only invalidate Wealth Inte-

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328. See *supra* note 260 and accompanying text.

329. See, e.g., Ari Glogower, *Taxing Capital Appreciation*, 70 TAX L. REV. 111 (2016) (proposing mark-to-market rule for traded assets and retrospective rule for illiquid assets); David S. Miller, *A Progressive System of Mark-to-Market Taxation*, 109 TAX NOTES 1047 (2005) (proposal for mark-to-market taxation for high-income or high-net-worth taxpayers); ERIC TODER & ALAN D. VIARD, TAX POLICY CTR., A PROPOSAL TO REFORM THE TAXATION OF CORPORATE INCOME (2016), <https://www.taxpolicycenter.org/publications/proposal-reform-taxation-corporate-income/full> [<https://perma.cc/T4CL-7DJ9>] (proposing mark-to-market for traded securities and pass-through treatment for other interests in businesses).

330. See *supra* notes 296–298 and accompanying text.

331. For example, assume that both taxpayers earn the same economic income of \$200,000, but *Wealth Holder 4*'s income is more accurately measured under an improved income tax.

gration methods by overturning settled precedent, jeopardizing current features of the income tax, and fundamentally restricting Congress's power to tax income under the Sixteenth Amendment.

The analysis of Wealth Integration methods also has broader implications for the scope of Congress's taxing power. The possibility that Congress could tax wealth through Wealth Integration methods offers a new argument why the Court should not restrict Congress's power to tax wealth through a traditional wealth tax.

### A. *Wealth Integration Methods*

Section IV.A.1 begins with a technical doctrinal analysis of the precedent described in Part I. The principles developed in Supreme Court precedent—including *Pollock*—support upholding Wealth Integration methods. The Court could only strike down Wealth Integration by overruling these unbroken prior precedents.

A doctrinalist view of constitutional interpretation—which places independent value on settled judicial principles and stare decisis<sup>332</sup>—might stop here and avoid overruling settled precedent.<sup>333</sup> The Court, however, could also overrule these precedents or possibly invent new ways to distinguish Wealth Integration methods from these prior holdings. More critically, invalidating Wealth Integration methods would essentially restrict Congress's power to tax income under the Sixteenth Amendment. This analysis also points toward a convergence of the apportionment and uniformity requirements as possible constraints on Congress's taxing power: the reasons for the uniformity requirement's desuetude explain why the Court should interpret the apportionment requirement narrowly and uphold the use of Wealth Integration methods.

#### 1. The Supreme Court Precedent

Wealth Integration methods conform to prior Supreme Court precedent. The Court has explicitly endorsed certain variants of Wealth Integration, and Wealth Integration methods may be justified more broadly through the doctrinal principles established in the case law. These arguments also highlight different aspects of the scope of Congress's power to tax in-

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332. That is, a view that generally prioritizes the principle of stare decisis and “will seek to extend these received decisions and understandings in incremental and piecemeal fashion to cover new cases and problems as they arise,” with an object “to preserve continuity and predictability even if effecting change.” WALTER F. MURPHY ET AL., *AMERICAN CONSTITUTIONAL INTERPRETATION* 386 (6th ed. 2019).

333. Scholars have noted that some current members of the Court have signaled a disinclination to follow prior precedent in certain cases. See, e.g., Leah Litman & Seth Davis, *Opinion, A Momentous Change May Be upon the Supreme Court*, WASH. POST (June 26, 2019), <https://www.washingtonpost.com/opinions/2019/06/27/progressive-supreme-court-justices-are-sounding-warning-we-should-heed-it/> [<https://perma.cc/RFQ8-LTP3>] (commenting on Justice Gorsuch's concurrence in *Kisor v. Wilkie*, 139 S. Ct. 2400 (2019)).

come and the broader implications of this power for understanding Congress's taxing power in general.

*Cost Recovery Disallowances.* The Sixteenth Amendment does not distinguish between net and gross income and does not specify that Congress can only tax net income without apportionment. Disallowing deductions from gross income, however, can have the effect of taxing wealth and can be understood as one application of the Base Method. Nonetheless, the Court has continuously affirmed the principle that deductions from gross income, including those necessary to calculate net income, are a matter of congressional discretion.<sup>334</sup> At the same time, the Court has explicitly acknowledged that denying cost recovery deductions to a taxpayer in this manner has the effect of taxing her previously held wealth.<sup>335</sup>

For this reason, the Base Method might be understood as the method of Wealth Integration that has been most explicitly sanctioned by the Court. Congress could implement the Base Method by simply denying or limiting cost recovery deductions more broadly, such as the deductions for depreciation.<sup>336</sup> Of course, this particular application of the Base Method may be undesirable for other reasons, as it could lead to unfair results and discourage exchanges, purchases, or productive use of new property.<sup>337</sup> The *Stanton* case illustrates, however, how the Court has already sanctioned one application of a Wealth Integration method with full awareness of its effect in taxing wealth. The case also represents one area where the Court has conceded Congress's broad latitude to adjust the income tax to replicate the effects of a wealth tax.

*A Corporate Wealth Tax.* Proposals for wealth taxes generally focus on wealth held by individual taxpayers. From a constitutional perspective, a tax on corporate wealth—and on wealth held by other tax entities—poses an easier case. The logic adopted in Supreme Court precedent suggests that a tax on corporate wealth would not be subject to apportionment. Recall again the reasoning in *Stone Tracy*, which upheld the corporate income tax of 1909.<sup>338</sup> At the time, *Pollock* had recently held that a tax on income was a direct tax subject to apportionment, and the states had not yet ratified the Sixteenth Amendment.<sup>339</sup> The Court in *Stone Tracy* still held that Congress could tax corporate income, on the grounds that the subject of tax was not the income but the act of conducting business as a corporation.<sup>340</sup> This same logic implies that Congress can tax the act of conducting business as a corporation by reference to other attributes of corporate activity that could not be

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334. See *supra* notes 182–189 and accompanying text.

335. See *Stanton v. Baltic Mining Co.*, 240 U.S. 103 (1916); *supra* note 185 and accompanying text.

336. See *supra* note 182.

337. See *supra* note 264 and accompanying text.

338. See *supra* notes 99–106 and accompanying text.

339. See *supra* text accompanying notes 99–101.

340. See *supra* note 105 and accompanying text.

taxed directly, and this logic would have also allowed Congress to also tax corporate wealth at the time, even if a tax on wealth was understood to be a direct tax.<sup>341</sup>

As in the case of the cost recovery disallowances, a tax on wealth held by corporations but not by individuals or other entities may not be the most desirable policy tool. Such a tax could discourage the corporate form and disfavor corporations relative to other business entities. The possibility that Congress could tax corporate wealth, however, suggests how Congress could introduce wealth taxation into the tax system more broadly while avoiding constitutional constraints. *Stone Tracy* also implies that Congress could tax wealth held by other tax entities, which could broaden the range of assets subject to an entity-level wealth tax.<sup>342</sup> Finally, the logic underlying *Stone Tracy* could also allow for the constitutionality of a tax on wealth held by individuals.

*The Subject of Tax.* The Court has consistently distinguished between the subject and the basis of tax—which could include other factors that determine the final tax liability—and has interpreted the direct tax restriction as only pertaining to the former.<sup>343</sup> For this reason, the Court has held that a tax on real estate solely by virtue of the taxpayer’s holding the real estate would be a direct tax subject to apportionment.<sup>344</sup> That is, in this case a tax would be imposed irrespective of whether the taxpayer did anything at all with their land.

On the other hand, the Court has continuously held since *Hylton* that Congress can tax the occasion of a particular use or application of the land or other property and that the amount of the tax may consequently depend on the value of that property, even if that property would give rise to a direct tax if taxed independently. For example, the Court has followed this basic distinction to hold that Congress can tax the devise<sup>345</sup> or gift<sup>346</sup> of the property or its use in a business.<sup>347</sup> This logic also forms the basis for the *Stone Tra-*

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341. The one possible limitation suggested in *Stone Tracy* is that the measure of the tax cannot be “so arbitrary and baseless as to fall outside of the authority of the taxing power.” *Flint v. Stone Tracy Co.*, 220 U.S. 107, 165 (1911). Of course, determining what basis of tax would constitute “arbitrary and baseless” would be a separate inquiry than whether the basis of tax would be a direct tax if it were taxed independently. The Court in *Stone Tracy* even explicitly suggests that a business’s assets could serve as an acceptable measure of a tax on the subject of doing business. *Id.* at 166.

342. For example, the Code treats a “publicly traded partnership” as a taxable corporation, even if the entity is not incorporated under state law. *See* I.R.C. § 7704 (2012). The same logic in *Stone Tracy* that allowed for a corporate income tax could also be extended to allow for a tax on the income of other noncorporate entities such as partnerships or LLCs, or to justify a tax on the wealth held by these entities as well.

343. *See supra* Section I.B.2.

344. *See supra* notes 48, 66, 80, 88 and accompanying text.

345. *See, e.g., supra* notes 87–88 and accompanying text (*Scholey*).

346. *See, e.g., supra* notes 107–110 and accompanying text (*Bromley*).

347. *See, e.g., supra* note 86 and accompanying text (*Veazie*).

cy holding that allowed for a tax on corporate income at a time when a tax on income itself was understood to be a direct tax.

The distinction between the subject and basis of tax may appear entirely formal, but this difference can also have substantive economic consequences. In particular, if a taxpayer's assets cannot serve as the subject of tax, then no tax will ever be imposed on account of the taxpayer's holding of the asset alone. That is, the role of a factor as a basis for determining the final tax liability is always contingent on the prerequisite subject of tax. This distinction mirrors the distinction between a traditional wealth tax and Wealth Integration methods. Because wealth is not additive to the taxable base, a taxpayer will never pay tax on account of holding wealth alone.<sup>348</sup>

*The Logic in Pollock.* The *Pollock* holding—which embodied the Court's most expansive conception of the apportionment requirement and the narrowest view of the federal taxing power—embraced this same logic distinguishing between the subject and basis of tax. In that case, the Court held that a tax on income was a direct tax subject to apportionment. The *Pollock* Court then distinguished *Soule* (the insurance company income tax) on the grounds that Congress can use income as a basis for determining the amount of tax due, even if it cannot make income the sole subject of tax.<sup>349</sup>

Now consider the effect of the Sixteenth Amendment combined with the logic in *Pollock*. Under the Sixteenth Amendment, income may now be taxed without apportionment, irrespective of whether *Pollock* was correct in holding that a tax on income is a direct tax. That is, Congress may now tax income as a subject of tax, and not just as a basis. Following the logic of *Pollock* in distinguishing *Soule*, Congress could similarly account for other factors to determine the amount of tax due under the income tax, even if it cannot independently tax these factors as subjects of tax.

The analysis of Wealth Integration follows this same logic. Because of the Sixteenth Amendment, Congress can now tax income as an independent subject of tax.<sup>350</sup> Even if Congress could not tax wealth as an independent subject of tax, Congress could still account for wealth as a basis of tax determining the amount of income tax liability due. In effect, the logic in *Pollock* suggests that, after the Sixteenth Amendment, Wealth Integration methods could similarly be implemented without requiring apportionment. Income—when used as a basis rather than as a subject of tax—was to the *Pollock* Court

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348. See *supra* notes 288–289 and accompanying text.

349. That is, the *Pollock* Court held that the tax in *Soule* fell on the privilege or transaction of doing business. See *supra* notes 123–124 and accompanying text.

350. Professor Johnson argues that Congress might be able to justify any tax by “[m]anipulation of the terms ‘excise,’ ‘duty,’ and ‘income’ to avoid apportionment.” Johnson, *supra* note 10, at 1733; see also *supra* note 83. In the case of Wealth Integration methods, Congress would not necessarily need to test the definitional boundaries of “excise,” “duty” or “income,” however, to justify Wealth Integration, since it has an unambiguous power to tax income under the Sixteenth Amendment. Wealth Integration would similarly not require Congress to test the definitional limits of “income,” since Wealth Integration could be applied to either a broadly or narrowly defined income base.

what wealth would be to a current Court evaluating Wealth Integration methods.

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A future Court could overrule these cases that allow cost recovery disallowances, suggest the constitutionality of a corporate wealth tax, or distinguish more generally between the subject and the basis of tax. It could reject the logic in *Pollock* described above and hold more broadly that wealth could never be a basis for tax either. The Court may also seek new ways to distinguish Wealth Integration methods from these precedents.<sup>351</sup>

These precedents justifying Wealth Integration have more significance than merely as grounds for *stare decisis*. In particular, they have followed a certain path in order to preserve the integrity of Congress's core taxing powers under the Constitution, which now include the power to tax income under the Sixteenth Amendment. A Court ruling that precluded Wealth Integration methods would fundamentally restrict Congress's taxing power under the Sixteenth Amendment and jeopardize essential features of the current income tax.

## 2. A Reversal: Preferences for the Less Wealthy

Congress could restructure Wealth Integration methods to achieve the same economic effect as benefits to taxpayers without wealth, rather than as burden to taxpayers with wealth. Each Wealth Integration method can be characterized as normal rules within the income tax (which are unambiguously within Congress's power) combined with preferences for taxpayers without sufficient wealth. This possibility points to a deeper understanding of how Wealth Integration methods are integral to the structure of the income tax. It also highlights the significance of the fact that, under Wealth Integration methods, the effective tax on wealth is wholly contingent on the prerequisite of an income tax base.

For example, the Base Method described in Section III.A.1 uses a taxpayer's wealth to reduce the availability of deductions from her taxable income. Alternatively, the Base Method may be implemented by providing for no general deduction or exclusion, but then allowing for a deduction or exclusion for taxpayers without sufficient wealth. For instance, a rule reversing the Base Method example above<sup>352</sup> could provide that taxpayers without \$1 million or more of wealth receive a standard deduction of up to \$20,000 and that taxpayers are allowed a \$1 deduction for every \$50 of wealth that they do not have below this amount. A taxpayer who is missing the full \$1 million of wealth (that is, a taxpayer with zero wealth) will receive the full \$20,000

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351. See *infra* Section IV.A.5.

352. See *supra* notes 256–262 and accompanying text.

deduction. A taxpayer who is missing only \$500,000 of wealth (that is, a taxpayer with \$500,000 of wealth) will receive a partial \$10,000 deduction.

Similarly, the Rate Method described above uses a taxpayer's wealth to increase the rate of tax on her income. Alternatively, the Rate Method could increase the applicable rates for *all* taxpayers and then allow a rate reduction for taxpayers without sufficient wealth. For instance, a rule reversing the Rate Method example above could tax all taxpayers on their income at a rate set at a maximum possible rate<sup>353</sup> and then allow taxpayers rate reductions on the basis of how far their actual wealth level falls below a threshold amount.

Finally, the Credit Method described above uses a taxpayer's wealth to affect the availability of credits against tax. In that example, the Credit Method provided a general \$1,000 credit against tax, which was reduced by \$1 for each \$1,000 of a taxpayer's wealth.<sup>354</sup> Congress could instead provide for no general credit to all taxpayers, but then allow a credit for taxpayers without at least \$1 million of wealth, with \$1 of credit allowed for each \$1,000 of wealth that they do not have below this amount. For the same reason, the Earned Income Tax Credit<sup>355</sup> can also be recharacterized as the disallowance of a general credit for taxpayers with income above a threshold, without changing the substance of the provision.

Of course, in each of these cases the economic effect from these reversed rules would be exactly the same as in the examples in Section III.A, where Congress frames Wealth Integration methods as explicit burdens to wealth. Reversing and recharacterizing Wealth Integration methods as benefits to taxpayers without wealth would be a matter of semantics: a change in the form but not the substance of the rules. The fact that Congress could restructure the Wealth Integration methods in this manner illustrates, however, that these methods do not need to be understood as burdens on wealth at all. It also highlights the structural significance of the fact that, under Wealth Integration methods, the effective burden on wealth is contingent on the income tax liability. In each case, the total amount of the additional "burden" of a taxpayer's wealth is instead derived entirely from the normal rules for taxing her income, which is unambiguously within Congress's power to tax. Under the recharacterized Wealth Integration methods, Congress simply relieves a portion of this tax on income for taxpayers without sufficient wealth.

The possibility that Congress could reverse Wealth Integration methods to preference taxpayers without wealth also highlights the broader consequences if the Court were to strike these methods down as direct taxes. In order to invalidate Wealth Integration methods, the Court would also necessarily hold that Congress could not preference taxpayers without wealth through the income tax rules. As described in the following Section, in many cases Congress in fact preferences taxpayers *with* wealth. Allowing Congress

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353. See *supra* notes 294–298 and accompanying text.

354. See *supra* note 285 and accompanying text.

355. See *supra* notes 282–284 and accompanying text.



to preference taxpayers with wealth while preventing Congress from benefiting taxpayers without wealth would be inherently inequitable and further divorce the direct tax jurisprudence from any coherent principles defining the limits of the federal taxing power.

### 3. Applications in the Current Income Tax

Policymakers should not consider Wealth Integration methods to be exotic departures from the current income tax rules. In fact, the Code already contains numerous applications of these methods, which are not formally labeled as such but that have the same effect of burdening wealth through the income tax.<sup>356</sup> These applications follow the same general Wealth Integration principles described above. This discussion also describes some of the ways that the income tax rules benefit taxpayers with wealth. Applications of Wealth Integration can be found in both the recent legislation passed in late 2017<sup>357</sup> and the longstanding rules that predated this legislation.<sup>358</sup>

*Examples in the 2017 Tax Legislation.* The 2017 tax legislation incorporated Wealth Integration principles into many of the new changes in law. For an example of the Base Method in the new legislation, Congress added a rule disallowing deduction of Federal Deposit Insurance Corporation (FDIC) deposit insurance assessments paid by large banks and savings institutions.<sup>359</sup> These payments qualified as deductible business expenses under prior law.<sup>360</sup> The new legislation phases out the deduction for these payments when the payer bank has assets between \$10 billion to \$50 billion.<sup>361</sup> This provision disallows a taxpayer a deduction from gross income on the basis of her assets, which is precisely how the Base Method operates.

For a similar example of the Rate Method, the new legislation created a new lower rate for income earned by a corporation from “foreign-derived intangible income” (FDII),<sup>362</sup> which is income derived from U.S.-sourced intangibles that are sold into foreign markets. This lower rate is implemented

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356. These examples all pertain to the taxation of business entities or activities. As described *infra* Section IV.A.5, the Court could not easily draw a line that allowed Wealth Integration methods when taxing entities but not when taxing individuals.

357. Tax Cuts and Jobs Act, Pub. L. No. 115–97, 131 Stat. 2054 (2017) (codified as amended in scattered sections of I.R.C.).

358. The current income tax uses various attributes or activities of a taxpayer to determine the values of the variables used in translating gross income into an income tax liability. See *supra* Section II.A.1. The Court has upheld such considerations as instrumental to the grant of the federal taxing power. See *supra* Section I.B.4. These examples may be distinguished from Wealth Integration methods, however, as taking account of other attributes or activities of the taxpayer, rather than holding assets.

359. Tax Cuts and Jobs Act § 13531, 131 Stat. at 2153–54 (codified at I.R.C. § 162(r) (2012 & Supp. V 2018)).

360. See Rev. Rul. 80-230, 1980-2 C.B. 169.

361. I.R.C. § 162(r)(1)–(3).

362. Tax Cuts and Jobs Act § 14202, 131 Stat. at 2213–16 (codified at I.R.C. § 250).

through a 37.5% deduction from income attributable to these assets, which results in an effective tax rate of 13.125%<sup>363</sup> on this income instead of the default corporate rate of 21%.<sup>364</sup> The new rule calculates the amount of income taxed at the lower rate as the excess of qualifying income over an imputed return to the adjusted basis of the corporation's total "qualified business asset investment,"<sup>365</sup> meant to estimate the portion of the corporation's income that is *not* attributable to intangibles. In effect, if the taxpayer has more of certain types of assets, the taxpayer will have less foreign-derived intangible income and will pay tax at a higher rate. As with other applications of the Rate Method, under the FDII rules the amount and character of a taxpayer's assets do not affect the amount of income subject to tax but only the effective rate of tax on the taxpayer's income.

In other cases, the new legislation created preferences for taxpayers with certain types and amounts of wealth. The new section 199A allowed a 20% deduction for certain forms of business income earned through pass-through entities.<sup>366</sup> Congress limited the availability of the deduction, however, to a percentage of the business's employee wages that are paid or a combination of wages and the cost basis of certain assets held by the business.<sup>367</sup> In effect, this rule provides a benefit to a business that holds a greater amount of assets of the specified types. This rule may be understood as a reverse of the Base Method—it allows a *greater* deduction for a taxpayer with certain forms of wealth held through the business.

*Entity Characterization Rules.* The income tax has used Wealth Integration methods long before the 2017 tax legislation. In many cases, a taxpayer's income tax liability will depend on the characterization of the entity through which the income is earned. An entity's character may affect the definition of the income tax base (by allowing certain deductions or exclusions to specific entities),<sup>368</sup> the applicable rate of tax on the income,<sup>369</sup> and the availability of

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363.  $21\% - (37.5\% \times 21\%) = 13.125\%$ .

364. Tax Cuts and Jobs Act § 13001, 131 Stat. at 2096 (codified at I.R.C. § 11); *id.* § 14202, 131 Stat. at 2213–16 (codified at I.R.C. § 250). Of course, this rule could be characterized as an application of either the Base Method (because it is structured as a deduction) or the Rate Method (because it has the effect of reducing the taxable rate by the same amount for all taxpayers). In its report accompanying the 2017 legislation, Congress characterized this rule as a rate reduction. H.R. REP. NO. 115-466, at 622 (2017) (Conf. Rep.).

365. I.R.C. § 250(b)(2)(B).

366. Tax Cuts and Jobs Act § 11011, 131 Stat. at 2054, 2063–71 (codified at I.R.C. § 199A). "Pass-throughs" are entities (such as LLCs, S corporations, partnerships, and sole proprietorships) that are not subject to the separate corporate-level tax. Rather, the entities' owners pay tax on their share of the income each year. *What Are Pass-Through Businesses?*, TAX POL'Y CTR.: BRIEFING BOOK, <https://www.taxpolicycenter.org/briefing-book/what-are-pass-through-businesses> [<https://perma.cc/D2PS-8R2Z>].

367. I.R.C. § 199A(b)(2)(B).

368. For example, the deduction for certain organizational expenditures of corporations under § 248.

369. For example, the difference between the taxation of income earned through a corporation—which is taxed at a 21% rate to the entity under § 11 and then again to the individual

certain credits.<sup>370</sup> In many cases, the characterization of an entity will depend in part on the amount or character of assets held. As a result, a taxpayer's income tax liability will depend on the holding of certain amounts or types of property through the entity.

For example, section 1202 allows taxpayers an exclusion of 50% of a taxpayer's gain from the sale of "qualified small business stock" held for more than five years.<sup>371</sup> For these purposes, a qualified small business is generally a corporation with gross assets of \$50 million or less.<sup>372</sup> As a result, the amount of the base of the taxable gain on the sale depends on the amount of assets that the taxpayer holds through the corporation. Of course, Congress structured this rule as a benefit for entities that hold less wealth, rather than as a penalty for entities with wealth above this threshold. As such, this rule may be considered a case of a "reversal" of the Wealth Integration methods described in the preceding Section.

In other cases, the characterization of an entity—and consequently the calculation of an income tax liability—will depend on the character, rather than the amount, of the assets held. For example, qualifying real estate investment trusts (REITs) are generally exempt from entity-level taxation if they satisfy certain qualifications.<sup>373</sup> A REIT must meet, for example, an asset diversification test, which generally provides that REITs cannot hold concentrated interests in certain securities.<sup>374</sup> If a REIT fails this test, the entity will instead be taxed as a corporation and will not avoid the "double tax" at both the entity and shareholder levels.<sup>375</sup> As a result, the income that a taxpayer earns through a REIT will be taxed differently depending on the character of the investment assets held by the entity.

The tax rules impose similar asset-based tests for many other entity types, with similar consequences for calculating a taxpayer's income tax liability. For example, a foreign corporation may be treated as a "passive foreign investment company" (PFIC) if it holds certain types of assets that generate passive income.<sup>376</sup> In such a case, a shareholder in a PFIC may be taxed on income earned through the entity at the higher ordinary rates.<sup>377</sup>

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upon a distribution or sale of the corporate interests under § 1—and the taxation of income earned through a pass-through entity, which is only taxed to the individual under § 1.

370. For example, the amount of the general business credit in § 38 may depend on whether the taxpayer is an individual, an estate, a trust, or a corporation. *E.g.*, *id.* § 38 (c)(6)(D)–(E) (listing special rules for estates, trusts, and corporations).

371. *Id.* § 1202(a). Alternatively, this exclusion may be considered a 0% rate of tax on half of the income from the sale.

372. *Id.* § 1202(d)(1).

373. *Id.* § 857(a)–(b). This exemption from tax is structured as a deduction against the REIT's taxable income for distributions paid to unitholders. *Id.* § 857(b)(2).

374. *Id.* § 856(c)(4).

375. *See id.* § 856(a)(3).

376. *Id.* § 1297(a)(2).

377. This would be the result under the default "excess distribution" regime for PFICs in § 1291.

Similarly, the Code defines “regulated investment companies” (RICs), “investment partnerships,” “real estate mortgage investment conduits” (REMICs), and “domestic international sales corporations” (DISCs) in part by their assets held,<sup>378</sup> and these definitions will affect the tax liabilities on income earned through these entities.<sup>379</sup> All these cases adopt the same general principle of Wealth Integration methods: A taxpayer is taxed differently on income earned through these entities, solely on the basis of the type or amount of assets held through these entities. That is, in each of these cases, assets themselves are not subject to tax (as would be the case under a traditional wealth tax) but instead affect the final income tax liability due.

Of course, the Court could invalidate *all* of these methods and hold that the direct tax clause also forbids *any* adjustments to a taxpayer’s income tax liability on account of the nature or amount of assets the taxpayer holds. These examples illustrate, however, how difficult it would be for Congress to eradicate all instances of Wealth Integration methods from the Code. More fundamentally, such a draconian holding could fundamentally restrict Congress’s ability to tax income under the Sixteenth Amendment. These examples also illustrate why the same logic that led the Court to narrowly interpret the uniformity requirement implies a limited role for the apportionment requirement as well.

#### 4. The Convergence of Uniformity and Apportionment

As described above, the uniformity requirement represents a “road not taken” for the Court.<sup>380</sup> Since *Hylton*, the Court has consistently interpreted this clause narrowly to require only geographic uniformity for all indirect taxes<sup>381</sup> and not more broadly to require equal treatment of taxpayers in other respects. Of course, the text of the provision,<sup>382</sup> or evidence of the provision’s original intent,<sup>383</sup> might justify this narrow reading. Professor Boris

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378. *Id.* § 851(b)(3) (asset test for defining a RIC); *id.* § 731(c)(3)(C)(i) (asset test for defining an investment partnership); *id.* § 860D(a)(4) (asset test for defining a REMIC); *id.* § 992(a)(1)(B) (asset test for defining a DISC).

379. *See, e.g., id.* § 852(b)(2) (tax consequences for qualifying RICs); *id.* § 731(c)(3)(A)(iii) (tax consequences of distributions from investment partnerships); *id.* § 860A (tax consequences for REMICs and their interest holders); *id.* § 991 (tax consequences for DISCs).

380. *See supra* Section I.B.4.

381. The Court has retreated from even this narrow interpretation of geographic uniformity. *See United States v. Ptasynski*, 462 U.S. 74 (1983) (holding that an exemption from the Crude Oil Windfall Profit Tax for crude oil produced in certain geographic areas still did not violate the uniformity requirement).

382. That is, the text specifically requires uniformity “throughout the United States,” which may be reasonably interpreted as referring to a geographic dimension of consistency alone. U.S. CONST. art. I, § 8, cl. 1.

383. In particular, scholars have argued that the original purpose of the uniformity requirement was simply to prevent Congress from imposing higher taxes in some states than others. *See, e.g., Johnson, Foul-Up, supra* note 229, at 8. In this respect, both uniformity and

Bittker argues, however, that the Court has no choice other than to interpret the uniformity requirement narrowly:

A broad reading of the uniformity clause, however, would not only have rendered exemptions and differential tax rates unconstitutional, but it might well have invalidated the distinction between capital gains and ordinary income and a host of other provisions that make up the warp and woof of the Internal Revenue Code.<sup>384</sup>

Tailoring tax liabilities to individual circumstances is integral to the concept of an income tax, because virtually *any* tax rule other than “head tax” (requiring a fixed amount per capita) could be considered a violation of uniformity if the Court interpreted this clause more broadly. Consider again the Court’s articulation of the uniformity requirement in *Singer* (the distillery tax case). In that case, the Court interpreted the rule as requiring only that Congress may not “establish one rule for one . . . and a different rule for another, but the same rule for all alike.”<sup>385</sup>

On the facts in *Singer*, the Court then reasoned that the rule satisfied uniformity since it treated similarly two taxpayers who were both distillers with the same level of production.<sup>386</sup> The Court had no trouble with the tax law treating differently two taxpayers with different levels of production.<sup>387</sup> This application might not seem at all like “the same rule for all alike,” however, because the rule treated differently taxpayers who are not distillers, or distillers with different levels of production. *Singer* illustrates more generally that *any* tax other than a per capita head tax will necessarily distinguish among taxpayers, and these distinctions cannot be precluded if Congress has the power to tax anything other than heads.

For the reasons described in the preceding Sections, Wealth Integration methods are also part of the “warp and woof” of the income tax. On many occasions the tax law already accounts for a taxpayer’s asset holdings in determining her income tax liabilities, and Congress could not eliminate these methods from the Code without significantly restricting the range of factors that may be considered under the income tax. At the same time, invalidating Wealth Integration methods would require the Court to constantly police the boundaries of the income tax rules.

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apportionment may be understood as alternative methods to protect states from shouldering a disproportionate share of federal taxes.

384. Boris I. Bittker, *Constitutional Limits on the Taxing Power of the Federal Government*, 41 TAX LAW. 3, 10 (1987); see also Galle, *supra* note 219, at 418 (arguing that interpreting the Sixteenth Amendment to preclude “deviations from the constitutional definition of ‘income’” would require courts to determine whether “nearly every provision of the Tax Code” is a deviation from the definition of income).

385. *United States v. Singer*, 82 U.S. 111, 121 (1873); see also *supra* note 131 and accompanying text.

386. *Singer*, 82 U.S. at 121.

387. See *id.* at 118.

In this respect, the reasons for the limits of the uniformity and the apportionment requirements converge. Although the literature generally considers these two rules as independent constraints on the taxing power,<sup>388</sup> the case of Wealth Integration methods illustrates how the two requirements ultimately face similar limitations. Since the period of the earliest tax cases, the Court was constrained to read the uniformity requirement narrowly—virtually to the point of reading the requirement out of the Constitution. The Court considered this narrow reading necessary to preserve Congress’s ability to tailor tax liabilities to taxpayers’ individual circumstances. A broader reading of the uniformity requirement, in contrast, could have jeopardized many features of the tax system and essentially restricted Congress to an undifferentiated head tax. A broad reading of the apportionment requirement and the direct tax definition would have the same effect of fundamentally restricting Congress’s power to tax income under the Sixteenth Amendment and could similarly jeopardize many integral features of the current income tax.

### 5. A Line-Drawing Challenge

The Court could attempt to draw different lines to disallow broader application of Wealth Integration methods while preserving Congress’s power to tax income under the Sixteenth Amendment. In doing so, however, the Court would face the essential challenge of disentangling Wealth Integration methods from the rest of the income tax rules, which would necessitate exactly the same policing of the income tax rules that led the Court to a narrower reading of the uniformity requirement.

*Intent to Burden Wealth.* The Court might distinguish among different features of the income tax on the basis of congressional intent.<sup>389</sup> One possible rule could provide that Congress could not intentionally burden a factor (such as wealth) through the income tax that would result in a direct tax if the factor were taxed independently. On the other hand, Congress could unintentionally burden a factor as a consequence of designing the income tax rules. For example, when Congress enacted the new section 162(r) it did not intend to burden wealth, but merely to disallow a federal subsidy for deposit insurance payments.<sup>390</sup> The Court might reason that this case is intrinsically

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388. See *supra* note 41 and accompanying text.

389. Of course, congressional intent should not matter if one takes the view that the apportionment requirement represents a purely formal constraint, which Congress could simply avoid by structuring the legislation in an acceptable form. See, e.g., Galle, *supra* note 219, at 416 (implying that the apportionment requirement, like other expedient compromises in the Constitution, could be understood as a “somewhat inexplicable, thin, and formal requirement, easily satisfied”). I thank Brian Galle for this point.

390. See H.R. REP. NO. 115–409, at 266–69 (2017) (explaining the reasons for this change that did not pertain to the measurement of net income). Similarly, in *Druker v. Commissioner*, 697 F.2d 46 (2d Cir. 1982), the court held that the “marriage penalty,” described *supra* note 82 and accompanying text, did not discriminate against married couples in violation of the Four-

different than other applications of Wealth Integration methods where Congress explicitly intends to burden wealth through the income tax.

This approach would require the Court to determine the congressional intent of each provision and to decide when Congress is purposefully singling out a factor for taxation through the income tax. As such, the approach would necessitate exactly the sort of constant policing of Congress's taxing power that the Court has avoided by interpreting the uniformity requirement narrowly. More critically, and as previously described,<sup>391</sup> Congress could recharacterize Wealth Integration methods as benefits for taxpayers without wealth, rather than as burdens on taxpayers with wealth. In this case, a rule prohibiting Congress from deliberately burdening wealth through the income tax would still not prevent the reversed forms of Wealth Integration methods that merely intend to preference taxpayers without wealth.

*Relative Burdens on Income and Wealth.* The Court might also distinguish among different approaches to income taxation based on the relative burdens of the tax on different factors.<sup>392</sup> An income tax with Wealth Integration may be understood as a multivariable function with two primary inputs (income and wealth) that result in a single output of the final income tax liability.<sup>393</sup> The Court could hold that such a composite tax should be characterized on the basis of the dominant input.<sup>394</sup> Alternatively, the Court could hold that the income tax with Wealth Integration methods amounted to a tax on wealth whenever the effective tax on wealth exceeded a certain proportion of the final tax liability.

This rule, however, would be similarly challenging for the Court to enforce and for Congress to anticipate when designing tax rules. Under Wealth Integration methods, each taxpayer's final tax liability will depend on her unique individual circumstances and particular mix of income and wealth in the taxing period. Congress could structure the Wealth Integration method to ensure that the wealth factor is never dominant or never exceeds a certain proportion of the final tax liability.<sup>395</sup> In this case, however, such a rule would allow—and even sanction—a modest tax on wealth as long as it did not exceed the specified threshold.

*An Entity Classification Rule.* The Court might also allow for a limited role for wealth in the income tax as a factor determining entity classifications or tax liabilities but not as a factor in determining individual income tax lia-

teenth Amendment since “[t]he adverse effect of the ‘marriage penalty’ . . . is merely ‘indirect’ ” and Congress had no “invidious intent to discourage or penalize marriage.” *Id.* at 50.

391. *Supra* Section IV.A.2.

392. I thank Chris Sanchirico for this suggestion.

393. That is,  $T = f(I, W)$ , where  $T$  is the tax liability,  $I$  is income, and  $W$  is wealth.

394. For example, this calculation may be made by first calculating a preliminary income tax liability, if a taxpayer with a certain amount of income has no wealth, and then determining the additional tax due as the same taxpayer's wealth increases.

395. For example, by providing that the amount of the adjustment due to a taxpayer's wealth can never exceed a fixed percentage of the taxpayer's income tax liability resulting from their income alone.

bilities. This rule would allow Congress to preserve many of the current income tax rules that use wealth or assets as a factor in determining entity classifications while precluding a broader role for wealth in the income tax. The Court could justify this distinction on the grounds that using factors such as wealth to define tax entities only indirectly affects the final income tax liabilities of individuals.

This approach would still jeopardize other income tax rules that account for a taxpayer's wealth.<sup>396</sup> Limiting the consideration of wealth to entity classifications or liabilities, however, could also allow Congress to introduce new wealth-based entity classification rules to tax wealth in a broader range of circumstances. For example, Congress could provide that corporations, partnerships, or even sole proprietorships with sufficient wealth are treated as separate types of entities subject to different tax rules and a different rate schedule. In sum, this line would be difficult or impossible for a court to draw, given the versatility of Wealth Integration methods and the interaction in the tax law between entity classification rules and the general rules for calculating income tax liabilities.

*A Categorical Prohibition.* Finally, the Court could abandon the project of line drawing altogether and instead adopt the "nuclear option": a categorical prohibition on any accounting for wealth in the income tax. For example, the Court could overturn the distinction between the subject and basis of tax and hold that any tax with the effect of burdening wealth treats wealth as a subject of tax for purposes of the direct tax analysis.<sup>397</sup>

As discussed, this approach would jeopardize many essential features of the current income tax, fundamentally restrict Congress's power to tax income under the Sixteenth Amendment, and leave the Court in the role of constantly policing the tax system and invalidating any rule that could have the direct or indirect effect of burdening wealth. Such a categorical prohibition would also leave the income tax subject to challenge in any case where it burdens any factors other than wealth, if independently taxing such factors might fall under the definition of a "direct tax." As a result, this approach—in addition to discarding the prior precedent—would cut into the bone of Congress's power to tax income under the Sixteenth Amendment.

Finally, other tax rules have the effect of benefitting taxpayers with wealth.<sup>398</sup> If the Court adopted a categorical prohibition on tax rules that burden wealth, the Court would also have to choose between invalidating these rules that have the effect of benefiting wealth<sup>399</sup> or enshrining an in-

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396. See, e.g., *supra* notes 359–367 and accompanying text.

397. This rationale would essentially import the logic from *Trinova Corp. v. Michigan Department of Treasury*, 498 U.S. 358 (1991), described *supra* note 83, into the direct tax definition context.

398. See, for example, the rule allowing the I.R.C. § 199A pass-through deduction for businesses holding sufficient assets, described *supra* notes 366–367 and accompanying text.

399. See, for example, the rule in I.R.C. § 199A(b)(2)(B) described *supra* note 367 and accompanying text.



come tax system that perversely allowed benefits but not penalties for the wealthy.

B. *Implications for the Constitutionality of a Traditional Wealth Tax*

The discussion so far has considered the analysis of Wealth Integration methods and why the Court should uphold these methods as integral to Congress's power to tax income under the Sixteenth Amendment. While Wealth Integration methods may be desirable reforms in all events, their availability also has broader implications for Congress's taxing power and how the Court should evaluate any federal wealth tax. The possibility that Congress could tax wealth through Wealth Integration methods provides a new argument why the Court should uphold a traditional wealth tax.

As described above, the Court could find grounds either to uphold or strike down a traditional wealth tax, based on judicial precedent and reasonable interpretation of the constitutional provisions.<sup>400</sup> At the same time, the Court would have a much harder time striking down Wealth Integration methods while preserving prior precedent and Congress's power to tax income under the Sixteenth Amendment.<sup>401</sup>

As also described above, tax laws that distinguish between economic substitutes will have limited effect, as taxpayers substitute the favored for the disfavored activities in order to access the more favorable tax treatment.<sup>402</sup> This problem explains the general principle that the tax system cannot operate through formal rules alone and requires general standards to prevent taxpayers from accessing better treatment by changing the form but not the substance of their activities.<sup>403</sup>

The Court would encounter a variation of this same problem in assessing the constitutionality of Wealth Integration methods and a traditional wealth tax. The Court would then face three basic options: (1) invalidate a traditional wealth tax but uphold Wealth Integration methods, (2) invalidate both, or (3) uphold both.

If the Court were to follow the first option and invalidate a traditional wealth tax but uphold Wealth Integration methods, this approach would in effect invite Congress to replicate the effect of a traditional wealth tax in a different form, in the same way that formal tax rules distinguishing between substitutes invite taxpayers to change the form of their activities to access preferential treatment.

Congress could redesign a tax on wealth in a manner that would make it even more difficult for the Court to formally distinguish between Wealth In-

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400. See *supra* Section II.B.2.

401. *Supra* Section IV.A.

402. See *supra* notes 114–116 and accompanying text.

403. See, e.g., David A. Weisbach, *Formalism in the Tax Law*, 66 U. CHI. L. REV. 860, 860–61 (1999) (describing the “failure” of a tax system based solely on formal rules and the necessity of anti-abuse standards that instead characterize activities in accordance with their economic substance).

tegration methods and a traditional wealth tax and to uphold the former while invalidating the latter. As described above, Congress could redesign Wealth Integration methods as a benefit to taxpayers without wealth, rather than as a burden to taxpayers with wealth, with the same economic effect.<sup>404</sup> Congress could also redesign Wealth Integration methods as a traditional wealth tax (with wealth now serving as the subject rather than the basis of tax) with a subsequent adjustment to the wealth tax liability due on account of the taxpayer's income.

For instance, Congress could redesign the Base Method example<sup>405</sup> to provide that the first \$1 million of a taxpayer's net wealth is taxed at a rate of 0.8% and wealth above this amount is not taxed. Furthermore, the rate of tax on the wealth is phased down to 0.4% for taxpayers with only \$50,000 of taxable income, and then down to 0% for taxpayers with no taxable income.<sup>406</sup> The resulting tax on wealth would be the same as in the Base Method rule, except this time the tax would be structured as a tax on a wealth base that is consequently adjusted on the basis of a taxpayer's income, rather than as a tax on her income consequently adjusted by her wealth.

In this case, the only difference between the two methods would be the formal label of the tax, as either a tax on wealth adjusted by income or as a tax on income adjusted by wealth. Chief Justice Roberts has eschewed exactly this type of formalism when determining the scope of Congress's taxing power.<sup>407</sup> In *NFIB*, the Chief Justice upheld the individual mandate in the

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404. See *supra* Section IV.A.2.

405. See *supra* notes 256–262 and accompanying text.

406. In this case, the taxpayer's income would be separately taxed according to the general rate schedule without the additional deduction. To precisely replicate the effects in the Base Method example, the rate of tax on wealth within the phase-down ranges would be determined by (1) the amount of the deduction disallowed, calculated as  $X / \$50$  where  $X$  is the taxpayer's net wealth and  $X \leq \$1$  Million and (2) the taxpayer's marginal income tax rate before accounting for the deduction. This calculation can be understood as follows: Under the general Base Method example, each dollar of the \$20,000 deduction is worth \$0.40 for a taxpayer in the 40% bracket, and \$0.20 for a taxpayer in the 20% bracket. As a result, a disallowance of each dollar of the deduction for every \$50 of wealth translates to an effective tax rate of 0.8% ( $\$0.40/\$50$ ) on the \$50 of wealth for the 40% bracket taxpayer, and an effective tax rate of 0.4% ( $\$0.20/\$50$ ) on the \$50 of wealth for the 20% bracket taxpayer. This example is intended for illustrative purposes. A similar calculation can be made to replicate the effects of any of the other applications of Wealth Integration methods, or in the case of more complex income tax rate schedules.

407. It is an interesting question beyond the immediate scope of this Article why the Court should be more inclined to avoid formalism and adopt a posture of judicial deference in the context of the limits of Congress's (federal) taxing power than in other areas of constitutional law. In *NFIB*, for example, Chief Justice Roberts suggested a distinction between Congress's power to tax under the tax provisions and to legislate under the Commerce Clause. He argued that Congress's taxing power doesn't threaten the same risk of legislative overreach, since the taxing power "is limited to requiring an individual to pay money into the Federal Treasury, no more. If a tax is properly paid, the Government has no power to compel or punish individuals subject to it." *Nat'l Fed'n of Indep. Bus. v. Sebelius (NFIB)*, 567 U.S. 519, 574 (2012). In contrast, under a valid exercise of the Commerce Clause, "the Federal Government can bring its full weight to bear. Congress may simply command individuals to do as it di-

Patient Protection and Affordable Care Act as a valid exercise of Congress's taxing power, even though the rule was characterized in the statute as a "penalty" rather than as a "tax."<sup>408</sup> In reaching this holding, Roberts held that Congress's taxing power should not be determined by purely formal distinctions or the particular labels Congress attached to rules that are in substance valid exercises of its constitutional taxing power.<sup>409</sup>

This same reasoning would suggest that Congress's taxing power should not depend on whether Congress formally labeled a tax as a tax on wealth adjusted by the taxpayer's income or as a tax on income adjusted by the taxpayer's wealth. If the Court were to allow both, the only substantive limit on Congress's power to tax wealth as the subject of tax would be a requirement that the tax be limited in some manner on the basis of the taxpayer's income, which would be an even finer distinction on which to base the limits of Congress's taxing power.<sup>410</sup>

More generally, if the Court were to follow the first option and invalidate a traditional wealth tax but uphold Wealth Integration methods, this approach would still substantially diminish the role of the apportionment requirement in the constitutional structure. Upholding Wealth Integration methods would allow Congress to still tax wealth while circumventing any restraint on its taxing power resulting from the apportionment requirement. In this case, apportionment would no longer categorically prohibit taxation of wealth but rather would only restrict the degree and manner in which wealth could be taxed.

The Court could also avoid making these formal distinctions between Wealth Integration methods and a traditional wealth tax by following the second option and invalidating both. This option would require the Court to instead distinguish between Wealth Integration methods and Congress's power to tax income under the Sixteenth Amendment. As described above, this approach would necessarily overturn established precedent and funda-

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rects." *Id.* at 573. Of course, excessively onerous taxes that do have the effect of compelling or regulating behavior may fall beyond this taxing power. *See id.* at 572–73 (citing *Bailey v. Drexel Furniture Co.* (Child Labor Tax Case), 259 U.S. 20 (1922)). For an investigation of Chief Justice Roberts's general tendency to evaluate tax provisions by their substance—rather than their form—in other contexts as well, see generally Stephanie Hoffer & Christopher J. Walker, *Is the Chief Justice a Tax Lawyer?*, 2015 PEPP. L. REV. 33.

408. *NFIB*, 567 U.S. at 561–74; *see also* I.R.C. § 5000A (2012 & Supp. V 2018).

409. *NFIB*, 567 U.S. at 563–65 (holding that the individual mandate penalty in the Affordable Care Act should be categorized on the basis of its substantive function rather than "Congress's choice of label"); *id.* at 565 ("In passing on the constitutionality of a tax law, we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it[.]") (quoting *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 363 (1941)).

410. That is, this approach would still formally allow wealth to be taxed as the subject of tax. Congress could also structure the limit on the basis of a taxpayer's income to be vanishingly small, which would further compound the challenge in distinguishing between this tax and a traditional wealth tax.

mentally redefine and restrict the scope of the Sixteenth Amendment.<sup>411</sup> In effect, a broader holding invalidating Wealth Integration methods would allow the apportionment requirement—which is an ambiguous constraint on Congress’s taxing power, if it is understood to be a constraint at all—to subsume the Sixteenth Amendment, which is an unambiguous affirmation and expansion of Congress’s taxing power. Of course, this approach would also endanger and destabilize the collection of federal revenues through the income tax. Even a Court disinclined to uphold a wealth tax may be similarly disinclined to take the income tax down with it.

Finally, the Court could choose the third option of upholding both Wealth Integration methods and a traditional wealth tax. This approach would ensure that the ambiguous direct tax definition and apportionment requirement do not undermine Congress’s unambiguous power to tax income under the Sixteenth Amendment and would align with the prior arguments in the literature why a traditional wealth tax should be constitutional in the first instance.<sup>412</sup> At the same time, this approach would allow the Court to avoid the formal line drawing in distinguishing between Wealth Integration methods and a traditional wealth tax, and thereby avoid denying with one hand what it gives with the other.

#### CONCLUSION

In the years to come, Congress may take more seriously the calls for a wealth tax in order to raise revenue and address rising economic inequality. The Wealth Integration methods described in this Article offer Congress an alternative to a traditional wealth tax that would tax wealth through the current income tax. In many cases, these methods would have the same effect as a traditional wealth tax by generating additional tax liability on account of a taxpayer’s wealth. These methods can also have a greater economic effect than previously appreciated in the literature, particularly when implemented together with other reforms of the income tax.

The constitutional analysis of Wealth Integration methods would be different from the analysis of a traditional wealth tax. A court may find grounds, based on precedent and reasonable interpretation of the constitutional provisions, to strike down a traditional wealth tax as an unapportioned direct tax. The Court could only invalidate Wealth Integration methods, in contrast, by overruling settled precedent, jeopardizing integral features of the current income tax, and fundamentally restricting Congress’s power to tax income under the Sixteenth Amendment.

The possibility that Congress could instead tax wealth through Wealth Integration methods offers a new argument why the Court should uphold a traditional wealth tax as well. The Court could not uphold Wealth Integration methods but strike down a traditional wealth tax without distinguishing

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411. See *supra* Section IV.B.

412. See *supra* notes 219–244 and accompanying text.

between economically similar taxes on the basis of their formal label, while still allowing Congress to tax wealth and thereby diminishing the scope of apportionment in any event. In this case, the Court should instead interpret the constitutional tax provisions as allowing Congress broad power to tax wealth, regardless of the form.