

NOT THE POWER TO DESTROY: AN EFFECTS THEORY OF THE TAX POWER

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

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

INTRODUCTION

THE Commerce Clause empowers Congress to use penalties to regulate interstate commerce, whereas the Taxing Clause empowers Congress to tax commercial and non-commercial conduct. These clauses do not authorize Congress to penalize non-commercial conduct. What prevents Congress from penalizing non-commercial conduct by changing the label on an exaction from “penalty” to “tax”? The only obstacle is the constitutional distinction between a tax and a penalty. Thus a Court that seeks to impose even modest limits on the regulatory power of Congress under the Commerce Clause requires a jurisprudence that distinguishes between a tax and a penalty.

The U.S. Supreme Court’s jurisprudence has been inadequate to the task. “[D]iverse decisions” in this “area of abstract ideas,” the Court once noted, show that the difference between a tax and a penalty “has baffled judges and legislators.”² When the Court restricted federal commerce power in the 1920s and 1930s,³ it distinguished between taxes, which raise revenues, and penalties, which regulate behavior.⁴ This distinction is perplexing because many federal exactions do both, like the eighteenth century “imposts” that raised revenues from imports and suppressed foreign competition with American industry.⁵ The post-1937 Court essentially abandoned judicially enforceable limits on the Commerce Clause,

² *Id.*

³ See, e.g., *Carter v. Carter Coal Co.*, 298 U.S. 238, 303–04 (1936) (invalidating the Bituminous Coal Conservation Act of 1935 because federal regulation of wages and hours concerned production, not commerce); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 545–46 (1935) (invalidating the Live Poultry Code for New York City, which regulated the sale of sick chickens and which included wages, hours, and child-labor provisions, based on an “indirect” relationship to interstate commerce); *United States v. E.C. Knight Co.*, 156 U.S. 1, 12–13 (1895) (holding that the Sherman Antitrust Act could not be used to thwart a monopoly in the sugar refining industry because the commerce power did not authorize Congress to regulate manufacturing, which was antecedent to commerce).

⁴ See *Child Labor Tax Case*, 259 U.S. 20, 38 (1922).

⁵ For numerous instances in addition to the impost, see *infra* Part I; see generally Ruth Mason, *Federalism and the Taxing Power*, 99 *Calif. L. Rev.* 975, 984 (2011) (offering many examples to substantiate the consensus among tax scholars that “the [federal] government uses the tax law not only to raise revenue, but also to influence taxpayer behavior”); *id.* at 989 (“Congress undeniably uses taxation to raise the costs of activities it deems undesirable.”).

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so it had no need to rethink distinctions between taxes and penalties. In 1995, however, the Supreme Court began to restrict the power of Congress to regulate under the Commerce Clause.⁶ After its “new federalism” decisions, the Court did not reconsider the scope of the tax power until the minimum coverage provision in the Patient Protection and Affordable Care Act⁷ required most individuals to either buy health insurance or make a payment to the Internal Revenue Service. Writing for the Court in *National Federation of Independent Business v. Sebelius* (“*NFIB*”),⁸ Chief Justice Roberts concluded that this requirement is a tax for constitutional purposes, even though Congress called it a “penalty.”⁹

The logic, citations, and rhetoric of the Chief Justice’s tax-power analysis closely resemble this Article, which we developed for two years prior in conferences and online posting of earlier drafts.¹⁰ Is the connection between this Article and the Court’s decision coincidental or causal? This question is not our concern here.¹¹ A schol-

⁶ See *United States v. Lopez*, 514 U.S. 549, 561 (1995); see also *United States v. Morrison*, 529 U.S. 598, 617 (2000).

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

⁸ 132 S. Ct. 2566 (2012).

⁹ 26 U.S.C. § 5000A(b) (Supp. 2011).

¹⁰ An earlier version of this Article was first posted on SSRN on January 23, 2012, and revised in May 2012.

¹¹ We and others have discussed this question elsewhere. Siegel discussed this Article on the blog *Balkinization* both before and after the Supreme Court decided *NFIB*. Neil Siegel, *Not the Power to Destroy: An Effects Theory of the Tax Power*, *Balkinization*, June 28, 2012, <http://balkin.blogspot.com/2012/06/not-power-to-destroy-effects-theory-of.html>; Neil Siegel, *Not the Power to Destroy: A Theory of the Tax Power that Justifies the Minimum Coverage Provision*, *Balkinization*, Mar. 19, 2012, <http://balkin.blogspot.com/2012/03/not-power-to-destroy-theory-of-tax.html>. After the Court decided the case on June 28, 2012, Jeff Rosen provided a link to this Article in writing online at *The New Republic* that “[a]rguments by liberal scholars who care about constitutional text and history, such as Neil Siegel of Duke Law School, were reflected in Chief Justice Roberts’s opinion about the taxing power.” Jeffrey Rosen, *Welcome to the Roberts Court: How the Chief Justice Used Obamacare to Reveal His True Identity*, *The New Republic*, June 29, 2012, <http://www.tnr.com/blog/plank/104493/welcome-the-roberts-court-who-the-chief-justice-was-all-along>. Randy Barnett wrote on the *Volokh Conspiracy* blog that “it looks like Neil Siegel and Bob Cooter anticipated Chief Justice Roberts[’] approach in their paper, *Not the Power to Destroy* . . . and may even have provided him with the road map for his analysis.” Randy Barnett, *The Unprecedented Uniqueness of Chief Justice Roberts’ Opinion*, *The Volokh Conspiracy*, July 5, 2012, <http://www.volokh.com/2012/07/05/the-unprecedented-uniqueness-of-chief-justice-roberts-opinion/>. We posted on *SCOTUS-*

arly paper is an opportunity to develop a general theory unconstrained by the need to decide a particular case. This Article aims to develop an *effects theory* of the tax power in order to distinguish a tax from a penalty for purposes of Article I, Section 8. The effects theory, we believe, provides the best justification of Roberts's tax-power analysis in *NFIB*.

To sharpen the difference in the meaning of the key words, the effects theory distinguishes between *pure* penalties and *pure* taxes. A *pure penalty* condemns the actor for wrongdoing. Moreover, she must pay more than the usual gain from the forbidden conduct, and she must pay at an increasing rate with intentional or repeated violations. Condemnation coerces expressively through forms of speech, and relatively high rates with enhancements coerce materially by imposing economic costs. A pure penalty prevents behavior, thereby raising little revenue.

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

Situated between pure taxes and pure penalties are mixed exactions, whose expression sounds like a penalty and whose material characteristics look like a tax. Thus the exaction for noninsurance in the minimum coverage provision has a penalty's expression and a tax's materiality. The rate of the "penalty" is low enough that a significant number of people will pay it, and the rate does not increase with intent or recidivism. Should courts interpret a mixed

blog an account of the similarities in logic, citations, and rhetoric between this Article and the Court's decision. Neil Siegel and Robert Cooter, Online ACA Symposium: A Theory of the Tax Power that Justifies—and May Have Informed—the Chief Justice's Analysis, SCOTUSblog, July 9, 2012, 12:48 PM, <http://www.scotusblog.com/2012/07/online-aca-symposium-a-theory-of-the-tax-power-that-justifies-and-may-have-informed-the-chief-justices-analysis-2/>. Brian Leiter's blog linked approvingly to our *SCOTUSblog* post. Brian Leiter, Cooter & Siegel: The Real Originators of the Tax Power Theory for Upholding the ACA, Brian Leiter's Law School Reports, July 10, 2012, <http://leiterlawschool.typepad.com/leiter/2012/07/cooter-siegel-the-real-originators-of-the-tax-power-theory-for-upholding-the-aca.html>. Note, however, that the Chief Justice's opinion does not cite our paper or any scholarly article published in a law review.

exaction as a tax or a penalty? Our answer depends on the exaction's effect. If Congress could reasonably conclude that the exaction will dampen—but not prevent—the general class of conduct subject to it and thereby raise revenue, then courts should interpret it as a tax regardless of what the statute calls it. If Congress could reasonably conclude only that the exaction will prevent the conduct of almost all people subject to it and thereby raise little or no revenue, then courts should interpret it as a penalty.

Our effects theory of the tax power defers to the reasonable expectations of Congress concerning the consequences of an exaction.¹² In the case of the minimum coverage provision, the Congressional Budget Office predicts that the exaction for noninsurance will dampen uninsured behavior but not prevent it, thereby raising several billion dollars in revenue each year.¹³ Accordingly, the exaction is a tax for purposes of the tax power. These predictions rely primarily on the material characteristics of the exaction, not its label. In general, the material characteristics of an exaction provide incentives that can guide an effects test.

This Article develops the effects theory of the tax power in stages.¹⁴ Part I, on history, recounts why supporters of the Constitution advocated a robust tax power and identifies the purposes of federal taxation throughout American history. Part II, on doctrine, distinguishes three eras in the Court's struggle to differentiate a tax from a penalty. These parts conclude that the modern Court needs a distinction between taxes and regulations backed by penalties,

¹² For a discussion of judicial deference in enumerated powers cases, see *infra* Section III.B.

¹³ See *infra* notes 212–13 and accompanying text (noting the Congressional Budget Office's predictions).

¹⁴ We limit our analysis to the distinction between a tax and a penalty under Article I, Section 8. We do not analyze the distinction between taxes and fees under the Export Clause, U.S. Const. art. 1, § 9, cl. 5, nor do we analyze the distinction in the constitutional context of intergovernmental tax immunity. Finally, we do not analyze the distinction between a tax and a penalty in various federal statutes, including the federal tax Anti-Injunction Act, 26 U.S.C. § 7421(a) (2006), the Tax Injunction Act, 28 U.S.C. § 1341 (2006), or the Bankruptcy Act, 11 U.S.C. §§ 101–112 (2006). These constitutional and statutory settings implicate context-specific legal questions that we cannot attempt to address here.

and that this distinction cannot turn on whether an exaction raises revenues or regulates behavior.¹⁵

Part III, on theory, distinguishes between a tax and a penalty by analyzing their expressive and material differences, and by using economics to predict the effect of these differences. Part IV, on health care, applies this analysis to the minimum coverage provision and shared responsibility payment in the ACA. An addendum to this part analyzes the opinion of Chief Justice Roberts for the Court in *NFIB*. The Conclusion summarizes the argument and connects it to the theory of collective action federalism.¹⁶

I. HISTORY

Article I, Section 8 grants Congress the power to “lay and collect Taxes . . . to pay the Debts and provide for the common Defence and general Welfare of the United States.”¹⁷ Its original justifications and historical uses show that the constitutional difference between taxes and penalties cannot turn on the difference between raising revenues and regulating behavior.

A. Pre-Ratification

The Articles of Confederation created a form of government that impeded the states from acting collectively for common objectives.¹⁸ The structure of governance established by the Articles posed two obstacles to collective action. First, the Articles author-

¹⁵ The relevant distinction is between taxes and regulations backed by penalties, not between taxes and regulations. To regulate conduct is to lay down a rule (or standard) governing the conduct. Regulations change behavior by various means, especially by imposing obligations backed by penalties. Like regulations backed by penalties, taxes change behavior. When a lawmaker wants to change behavior, a regulation backed by a penalty sometimes does a better job than a tax, and sometimes the opposite is true. In these circumstances, the difference between a regulation backed by a penalty and a tax is not the lawmaker’s ends but the choice of means. Taxes and penalties have different characteristics, which change behavior by different means. This Article explains how taxes and penalties differ in characteristics and effects.

¹⁶ See Robert D. Cooter & Neil S. Siegel, *Collective Action Federalism: A General Theory of Article I, Section 8*, 63 *Stan. L. Rev.* 115 (2010).

¹⁷ U.S. Const. art. I, § 8, cl. 1.

¹⁸ See, e.g., Jack N. Rakove, *Original Meanings: Politics and Ideas in the Making of the Constitution* 24–28, 47–48, 167–68, 188–89 (1996) (discussing various failures of the Articles of Confederation). Almost all of the first thirty-six essays in *The Federalist* detail the inadequacies of the Articles.

ized little federal power and imposed a unanimity requirement in order to amend them.¹⁹ Significant federal action thus required unanimous agreement among the states. A single “holdout” state legislature could defeat measures that were deemed critically important by most other states.

A key instance of collective inaction was the repayment of the debts of the United States.²⁰ During the 1780s, the United States needed to restore its credit by repaying its debts incurred during the Revolutionary War.²¹ Without credit, the nation would be vulnerable militarily because it could not borrow from other nations to finance future wars.²² To repay existing debts, a federal impost (a tax on imports) was proposed three times in Congress. “The 1781 and 1783 proposals to give the national government the 5 percent impost would have limited use of the revenues collected to the payment of the debts of the Revolutionary War,”²³ rather than creating a general federal power to tax. These modest proposals did not survive the unanimity requirement of the Articles. Each time a different state vetoed the measure.²⁴

Second, the Articles required Congress to ask the states to control individuals, rather than Congress’s doing so directly through federal law. Thus Congress could apportion taxes among the states, but levying and collection from individuals were left to state gov-

¹⁹ See Articles of Confederation of 1781, art. XIII.

²⁰ See generally Calvin H. Johnson, *Righteous Anger at the Wicked States: The Meaning of the Founders’ Constitution* 15–26 (2005) (arguing that the most pressing need at the time of the Constitution’s creation was to allow the federal government to tax in order to pay off its Revolutionary War debts).

²¹ See generally W. Elliot Brownlee, *Federal Taxation in America* 16 (2d ed. 2004) (“Among the most pressing [practical problems] were how to finance the Revolutionary War debts, and how to establish the credit of the nation in a way that would win respect in international financial markets.”); Johnson, *supra* note 20, at 18.

²² Akhil Reed Amar, *America’s Constitution: A Biography* 107 (2005) (“Without the ability first to borrow money from abroad when war threatened and then to pay back the loans on time . . . America would become a tempting target for European empires lusting after dominion.”); Brownlee, *supra* note 21, at 16–17 (“A central goal was to fund the foreign debts that the Confederation had inherited from the Revolutionary War, and to do so in a way that would win the confidence of the international financial markets to which the new nation would have to turn for capital.”).

²³ Johnson, *supra* note 20, at 89.

²⁴ The 1781 impost proposals were vetoed first by Rhode Island and then by Virginia. The 1783 impost proposal was vetoed by New York. See *id.* at 26–28.

ernments.²⁵ The Articles forced the federal government to finance itself by requisitioning funds from the states. The amount per state was set “in proportion to the value of all land within each State.”²⁶ State governments, however, defaulted on congressional requisitions, free riding on the contributions of other states to the United States treasury.²⁷ The predictable consequence was very little federal revenue.²⁸

For example, the “Requisition of 1786, the last before the Constitution, ‘mandated’ payments by the states of \$3.8 million, but collected only \$663.”²⁹ The requisition scheme plagued Congress’s efforts to pay and equip troops for the national military.³⁰ The need to rely on the states denied Congress the resources it required to protect against external attack and internal violence, as it had earlier almost caused the nation to lose the Revolutionary War.³¹

In his *Vices of the Political System of the United States*,³² a memorandum he wrote while preparing for the Constitutional Convention,³³ James Madison recorded various problems with the Articles of Confederation. These problems included the failure of states to comply with congressional requisitions, lack of concert despite common interests, lack of federal protection of the states against

²⁵ Articles of Confederation of 1781, art. VIII.

²⁶ *Id.*

²⁷ See generally Roger H. Brown, *Redeeming the Republic: Federalists, Taxation, and the Origins of the Constitution* 12 (1993) (describing the failure of the requisition scheme).

²⁸ See, e.g., Brownlee, *supra* note 21, at 15 (“The Continental Congress depended on funds requisitioned from the states, which usually ignored calls for funds or responded very slowly. There was little improvement under the Articles of Confederation. States resisted requisitions and vetoed efforts to establish national tariffs.”).

²⁹ See Johnson, *supra* note 20, at 1.

³⁰ Amar, *supra* note 22, at 45–46 (“Experience had proved that the individual states could not be trusted to provide their fair share of American soldiers and the money to pay them . . .”). Under the Articles, Congress could only “requisition” the states for their “quota[s]” of men, which was based on their white populations. To pay for the men and their equipment, Congress had to rely on a quota system based on wealth. *Id.* at 114.

³¹ *Id.* at 114 (“The requisition system failed miserably and came perilously close to handing victory to the British in the Revolutionary War. With inadequate mechanisms to enforce states’ obligations, many states held back, hoarding resources for local defense despite more urgent need for them elsewhere on the continent.”).

³² James Madison, *Vices of the Political System of the United States*, in James Madison: *Writings* 69 (Jack N. Rakove ed., 1999) [hereinafter *Madison, Vices Memo*].

³³ See Rakove, *supra* note 18, at 46.

internal violence, and lack of coercive power.³⁴ Madison further decried the inability to pass various necessary measures, “[which] may at present be defeated by the perverseness of particular States whose concurrence is necessary.”³⁵ The states acted individually when they needed to act collectively. These collective action failures made the critical period critical. Solving them was the principal reason for calling the Constitutional Convention.³⁶

The problems of collective action among the states during the 1780s “necessitated a government with many more powers than were possessed by Congress under the Articles—including the great powers to tax, to raise and support armies, and to regulate commerce.”³⁷ Ameliorating these problems also “necessitated conferring authority to exercise these powers by acting directly on individual citizens.”³⁸

The Philadelphia Convention produced, and the country ratified, a Constitution of collective action in Article I, Section 8.³⁹ Clause 2 gives Congress the power to “borrow Money on the credit of the United States,” which would be as essential in the next war as it had been in the previous one.⁴⁰ Clauses 3 through 6 give Congress

³⁴ Madison, Vices Memo, *supra* note 32, at 69–73.

³⁵ *Id.* at 71.

³⁶ See, e.g., Brownlee, *supra* note 21, at 16 (“The Constitution reflected the desire of James Madison, Alexander Hamilton, and its other leading supporters to provide the new central government with far greater capacity to tax than the old national government had enjoyed under the Articles of Confederation. The protracted political crisis of the 1780s convinced Madison and Hamilton that the new representative government must have the fiscal power required to create a strong and meaningful nation.”); Akhil Amar, *The Lawfulness of Health-Care Reform*, 122 *Yale L.J. Online* 5 (forthcoming 2012), available at <http://ssrn.com/abstract=1856506> (“A primary goal (indeed, perhaps the single most important and frequently expressed goal) of the Federalist Founders was to empower the federal government to impose taxes upon individuals to finance basic federal functions . . .”).

³⁷ Larry D. Kramer, *Madison’s Audience*, 112 *Harv. L. Rev.* 611, 619 (1999). State discrimination against interstate commerce was yet another major collective action problem facing the states during the 1780s that Congress was impotent to address. Madison thus decried “want of concert in matters where common interest requires it,” a “defect . . . strongly illustrated in the state of our commercial affairs. How much has the national dignity, interest, and revenue suffered from this cause?” Madison, Vices Memo, *supra* note 32, at 71.

³⁸ Kramer, *supra* note 37, at 619–20.

³⁹ See Cooter & Siegel, *supra* note 16, at 144–50 (analyzing the eighteen clauses of Article I, Section 8).

⁴⁰ See Amar, *supra* note 22.

the power to combat various impediments to the successful operation of interstate markets.⁴¹ Clauses 7 through 16 give Congress the power to internalize the externalities associated with providing for the common defense, establishing a postal network, and securing intellectual property rights.⁴² And to solve what was probably the single most significant collective action failure during the critical period—the problem of financing the national government⁴³—Clause 1 empowers Congress to assess, levy, and collect taxes directly from individuals, thus bypassing the states.⁴⁴

The Constitution does not limit the tax power of Congress to the repayment of debts, even though repaying the Revolutionary War debts was the immediate problem solved by the Taxing Clause (also known as the General Welfare Clause).⁴⁵ Instead, the Constitution gives Congress the power to tax in order to “provide for the common Defence and general Welfare.”⁴⁶

B. Post-Ratification

Promoting the general welfare by taxes sometimes involves regulatory ends. Congress immediately enacted tariffs that raised reve-

⁴¹ Cooter & Siegel, *supra* note 16, at 149–50.

⁴² *Id.* at 147–49.

⁴³ See Brownlee, *supra* note 21, at 16 (“The fundamental structure of the federal tax system, as well as that of modern tax regimes, emerged from the formative emergency for the American federal government—the revolutionary crisis that extended through the formation of the U.S. Constitution.”).

⁴⁴ “The Framers adopted a complete national government able to collect taxes from individuals so as to avoid military action that would amount to civil war.” Johnson, *supra* note 20, at 88. The Supreme Court has recalled this history. See, e.g., *Veazie Bank v. Fenno*, 75 U.S. (8 Wall.) 533, 540 (1869) (“The General Government, administered by the Congress of the Confederation, had been reduced to the verge of impotency by the necessity of relying for revenue upon requisitions on the States, and it was a leading object in the adoption of the Constitution to relieve the government, to be organized under it, from this necessity, and confer upon it ample power to provide revenue by the taxation of persons and property. And nothing is clearer, from the discussions in the Convention and the discussions which preceded final ratification by the necessary number of States, than the purpose to give this power to Congress, as to the taxation of everything except exports, in its fullest extent.”).

⁴⁵ Johnson, *supra* note 20, at 89 (“[T]he Constitution gives Congress the absolute power to tax.”); Rakove, *supra* note 18, at 180 (“But [the Framers] balked at limiting its revenue to that source alone. The only restriction placed on the discretion of the legislature was to prohibit it from laying duties on exports.”).

⁴⁶ U.S. Const. art. I, § 8, cl. 1.

nues and stimulated domestic production.⁴⁷ In the first two decades under the new Constitution, customs generated more than ten times the amount of federal revenue than did internal revenue.⁴⁸ In 1792, for instance, internal revenue was \$209,000 and customs produced \$3,443,000.⁴⁹ “And between 1789 and 1815, the tariff revenues accounted for about 90 percent of total federal tax revenues.”⁵⁰ The Founders understood that import duties would not only raise revenues, but would also change the behavior of those subject to them. Like raising revenues, stimulating domestic production of manufactured goods by reducing their importation was an important legislative purpose.

Thus Alexander Hamilton, in his December 1791 “Report on Manufactures” to Congress, proposed “tariffs to protect new industries and exemptions from tariffs for raw materials needed for industrial development.”⁵¹ Hamilton defended such policies not only on revenue-raising grounds, but also on the regulatory ground that they would “encourage Americans to spend their money and energy to advance industrial technology.”⁵² As it turned out, Congress rejected most of Hamilton’s program for industrialization. But in March 1792, Congress enacted most of the tariff program he had recommended: higher tariffs on manufactured goods and lower tariffs on raw materials.⁵³

⁴⁷ Amar, *supra* note 22, at 94 (“The big money would likely flow—and after 1789 did in fact flow—from federal levies on imports . . .”); Brownlee, *supra* note 21, at 21 (“Tariffs, in fact, turned out to provide the core of federal finance.”); Rakove, *supra* note 18, at 180 (“[T]he framers believed that its revenue needs would be met through a program of indirect taxation centering on import duties . . .”).

⁴⁸ U.S. Bureau of the Census, *Historical Statistics of the United States*, Colonial Times to 1970, at 1106 (1975), available at www2.census.gov/prod2/statcomp/documents/CT1970p2-12.pdf. Table Y 352-357 covers 1789–1939 and distinguishes between customs and internal revenue. See Brownlee, *supra* note 21, at 13–14 (“[T]he tax regime that followed the creation of the new constitutional order was based on customs duties; it lasted until the Civil War, making it the longest in American history.”). The Federalists made only limited use of excise taxes after the Whiskey Rebellion of 1794, limiting them almost entirely to goods and services used by affluent Americans, such as levies on carriages and snuff manufacturing, and stamp duties on legal transactions. *Id.* at 23–24.

⁴⁹ U.S. Bureau of the Census, *supra* note 48.

⁵⁰ Brownlee, *supra* note 21, at 23.

⁵¹ See, e.g., *id.* at 22.

⁵² *Id.*

⁵³ *Id.*

In the subsequent course of American history, taxes were used for the dual purposes of raising revenues and dampening behavior, as Joseph Story observed in his *Commentaries*.⁵⁴ For example, Congress made a rare and temporary deviation from low tariffs in the antebellum period when it experimented with protectionism during the 1820s and 1830s. The rationale for high tariffs was not to raise additional revenues. The rationale, rather, was “protecting America’s high-wage workers and high-cost industries as they learned how to meet their British competition.”⁵⁵ Likewise, the Civil War tax regime instituted by the Republican Party consisted principally of high tariffs, which sought to encourage “a national market in which wages and profits were high.”⁵⁶ The federal government had committed itself not merely to raising revenues, but to protecting capitalists and workers from foreign competition.

From the Civil War’s end in 1865 and continuing through the 1870s, the Republican-controlled Congress maintained high excise taxes on alcohol, tobacco, and luxury items such as perfumes and cosmetics. The public supported this system of consumption taxes partly “because of its regulatory dimensions.”⁵⁷ It amounted to “a stunning victory for economic protectionism and, more generally, for government regulation through taxation. [T]he system established tax incentives, disincentives, and subsidies as important, popular, and permanent elements of the federal revenue structure.”⁵⁸

The leaders of American business “lauded the regulatory effects of the tariff system,” including protection from foreign competition and capital formation at home.⁵⁹ The financial community was attracted to “the way in which substantial taxes on consumption forced [national savings] and facilitated the repayment of the war-time debt.”⁶⁰ Labor also supported high tariffs to increase employ-

⁵⁴ “[T]he taxing power is often, very often, applied for other purposes than revenue.” 2 Joseph Story, *Commentaries on the Constitution of the United States* § 962 (1833).

⁵⁵ Brownlee, *supra* note 21, at 29.

⁵⁶ *Id.* at 245; see *id.* at 5, 31. This regime also imposed excise taxes on almost all consumer goods. *Id.* at 32.

⁵⁷ *Id.* at 40.

⁵⁸ *Id.*

⁵⁹ *Id.* at 41.

⁶⁰ *Id.*

ment in selected industries by shielding American workers from competition with low-wage workers in other parts of the world. “Labor support for the high-tariff position of the Republican Party had much to do with its smashing electoral victory in 1896 and its subsequent political successes until the Great Depression.”⁶¹

Progressives, mindful of the effects of past taxes on alcohol and tobacco, sought taxes to regulate individual and corporate conduct. After 1900, they used the federal tax power “to regulate grain and cotton futures, the production of white phosphorous matches, the consumption of narcotics, and even the employment of child labor.”⁶²

The tax historian W. Elliot Brownlee argues that America shifted to new tax regimes in response to national crises.⁶³ In the eighteenth century, the constitutional crisis of the critical period produced the plenary federal tax power. In the nineteenth century, the Civil War produced high tariffs that survived the war. The twentieth century saw three crises—World War I, the Great Depression, and World War II. In each case, the federal government responded by using the tax power to raise revenues and regulate behavior. Congress thereby solved collective action problems that would have impeded the states from acting on their own to fight wars and combat depressions.⁶⁴ These developments vindicated Chief Justice Marshall’s declaration that “[t]his provision is made in a constitution intended to endure for ages to come, and, consequently, to be adapted to the various *crises* of human affairs.”⁶⁵

Threats to existence make people think about their reason for being.⁶⁶ What is the nation’s purpose? Who are we as a people? American fiscal crises generated divisive debates over fundamental

⁶¹ Id. at 42.

⁶² Id. at 45 n.26 (citing R. Alton Lee, *A History of Regulatory Taxation* (1973)).

⁶³ Id. at 2.

⁶⁴ See Cooter & Siegel, *supra* note 16, at 144–150 (arguing that the principal purpose of the clauses of Article I, Section 8 is to authorize Congress to solve collective action problems involving multiple states).

⁶⁵ *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 415 (1819).

⁶⁶ National leaders “faced issues that went far beyond the financial problem of meeting demands to increase government spending.” Brownlee, *supra* note 21, at 3. These crises involved either the survival of the nation or the meaning of the American ethos, our “fundamental nature as a people.” Hanna Fenichel Pitkin, *The Idea of a Constitution*, 37 *J. Legal Educ.* 167, 167 (1987).

national values. The winners enforced their values partly by using the tax power to regulate behavior, not simply to raise revenues. In response to World War I, the government attempted to reduce social tensions over unequal wealth by imposing progressive taxes to finance the war. During this period, federal tax policy discouraged vast accumulations of wealth by taxing excess profits and incomes, and by taxing large estates.⁶⁷ The federal government responded to the Great Depression by assuming “greater responsibility to promote economic recovery through such fiscal mechanisms as cutting taxes, increasing expenditures, and expanding deficits.”⁶⁸ The World War II regime defended “mass-based income taxation in terms of not only sacrifice for national survival but also progressive social justice.”⁶⁹

After World War II, the combination of inflation and progressive taxation automatically increased tax revenues unless offset by lower tax rates. Rates were reduced piecemeal, for selected sources of income, by the use of credits, exemptions, and deductions. The tax breaks benefited favored constituents and created less public resistance than government subsidies because they were hidden in the tax code instead of being exposed in the budget. Tax breaks allowed politicians to accomplish regulatory objectives—such as promoting homeownership through the mortgage-interest deduction⁷⁰—without subjecting themselves to the greater transparency of federal expenditures.⁷¹

Another prominent example of modern regulation through the tax code is the exemption for employer-provided health insurance. Beginning with the presidency of Dwight D. Eisenhower,⁷² Congress promoted employer-sponsored health insurance through its tax power. Employees generally do not include as income and pay

⁶⁷ Brownlee, *supra* note 21, at 58–71.

⁶⁸ *Id.* at 102.

⁶⁹ *Id.* at 245.

⁷⁰ 26 U.S.C. § 163(h)(3)(E) (2006). Professor Mason notes that the deduction for home mortgage interest was “[e]stimated to cost the federal government over \$100 billion in 2009.” Mason, *supra* note 5, at 985 (citing Office of Mgmt. & Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2009*, at 298 tbl.19-3).

⁷¹ Brownlee, *supra* note 21, at 129.

⁷² For an account of the history, see Dwight D. Eisenhower: Compassionate Conservative, *in* David Blumenthal & James A. Morone, *The Heart of Power: Health and Politics in the Oval Office* 99, 112–14 (2010).

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taxes on the payments of their health insurance premiums by their employers.⁷³ In addition, employers may deduct their premium payments as business expenses.⁷⁴ This tax subsidy for employment-based health insurance amounted to \$242 billion in 2009.⁷⁵ Most other kinds of employee compensation do not receive such favorable tax treatment.

Presidents Ronald Reagan and George W. Bush justified significant tax cuts, including cuts for the wealthiest Americans, as enhancing economic productivity.⁷⁶ These Presidents echoed the rhetoric and actions of Republicans during the 1920s, when they used control of the federal government to cut taxes and open loopholes for corporations and wealthy individuals.⁷⁷ Republicans justified these reductions, exemptions, and deductions as “necessary to stimulate economic expansion and restore prosperity.”⁷⁸ Likewise, Democrats have created tax loopholes for their favored constituents.⁷⁹

While the two major political parties often disagree about the regulatory objectives that federal tax policy should pursue, they agree that federal tax policy aims to accomplish regulatory objectives in addition to raising revenues. Brownlee concludes a history of federal taxation in the United States by observing that “[h]istorically, the introduction of new tax regimes that enhance confidence in American government has required,” among other things, “regulation of behavior in ways that were widely regarded as improving the national well-being.”⁸⁰

The constitutional text and political history suggest that Congress possesses ample power to alter individual behavior by using taxes much like it uses many regulations. Accordingly, a viable dis-

⁷³ 26 U.S.C. § 106(a) (2006).

⁷⁴ *Id.* § 162(a).

⁷⁵ Brief for Petitioner at 4, *Dep’t of Health and Human Servs. v. Florida*, 132 S. Ct. 2566 (2012) (No. 11-398).

⁷⁶ Brownlee, *supra* note 21, at 165, 220–21.

⁷⁷ *Id.* at 71–81.

⁷⁸ *Id.* at 74.

⁷⁹ During the New Deal, for example, the Democratic Party created the extensive system of farm subsidies that continue despite criticism and opposition. For a discussion of the current politics of farm subsidies, see Jennifer Steinhauer, *Farm Subsidies Become Target Amid Spending Cuts*, *N.Y. Times*, May 6, 2011, at A13, available at <http://www.nytimes.com/2011/05/07/us/politics/07farm.html>.

⁸⁰ Brownlee, *supra* note 21 at 245.

inction between taxes and regulations backed by penalties cannot turn on whether an exaction has a regulatory purpose or effect. But Article I, Section 8 does not use the language of taxation and regulation interchangeably, which suggests that they are not entirely synonymous. The next Part reviews the Supreme Court's attempts to distinguish them.

II. DOCTRINE

At various times throughout American history, the Supreme Court has addressed the constitutional definition of "Taxes" in the first clause of Article I, Section 8. Roughly speaking, the Court's decisions divide into three eras. A number of these rulings are flawed and inconsistent with one another. Drawing from their strengths and disregarding their weaknesses can yield a promising theory of the constitutional differences between taxes and regulations backed by penalties.

A. Three Eras

The Introduction distinguished between exactions that prevent behavior and exactions that both dampen it and raise revenue. Before the 1920s, the Court deferred to Congress and did not make such distinctions. Thus in *Veazie Bank v. Fenno*, the Court upheld a federal law that increased a tax on state bank notes from one percent to ten percent, even though the tax seemed likely to eliminate the state notes, thereby raising little or no revenue.⁸¹ In response to the charge that the tax was "so excessive as to indicate a purpose on the part of Congress to destroy the franchise of the bank," the Court responded in part that courts "cannot prescribe to the legislative departments of the government limitations upon the exercise of its acknowledged powers. The power to tax may be exercised oppressively upon persons, but the responsibility of the legislature is not to the courts, but to the people by whom its members are elected."⁸²

Similarly, in *McCrary v. United States*, the Court upheld a federal law that increased the excise tax from two cents to ten cents on

⁸¹ 75 U.S. (8 Wall.) 533 (1869).

⁸² *Id.* at 548.

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oleomargarine that was colored yellow to make it look like butter.⁸³ (The tax on uncolored oleomargarine, which is white, remained one-quarter of a cent per pound.) The Court rejected the argument that the exaction was a penalty that would achieve the regulatory objective of preventing the production of yellow oleomargarine. Because “the taxing power conferred by the Constitution knows no limits except those expressly stated in that instrument, it must follow, if a tax be within the lawful power, the exertion of that power may not be judicially restrained because of the results to arise from its exercise.”⁸⁴ The Court was unconcerned that the exaction would raise negligible revenue.

Likewise, in *United States v. Doremus*, the Court upheld the Narcotic Drug Act of 1914, which both assessed individuals who dealt in narcotics and regulated their sale.⁸⁵ The exaction was only \$1 per year, and Congress attached a detailed enforcement regime to it. Even though the exaction could not significantly change behavior or raise revenue, the Court wrote that “[i]f the legislation enacted has some reasonable relation to the [raising of revenue], it cannot be invalidated because of the supposed [regulatory] motives which induced it.”⁸⁶

The doctrine changed in the 1920s and 1930s, when the Court was imposing significant limits on the scope of Congress’s power to regulate interstate commerce. In *Hammer v. Dagenhart*, the Court held that Congress may not use its commerce power to prohibit the shipment in interstate commerce of goods produced by child labor.⁸⁷ Congress responded with the Child Labor Tax Law, which provided that individuals employing child labor

shall pay for each taxable year, in addition to all other taxes imposed by law, an excise tax equivalent to 10 per centum of the entire net profits received or accrued for such year from the sale

⁸³ 195 U.S. 27 (1904).

⁸⁴ *Id.* at 59; see *id.* at 56 (rejecting “the proposition that where there is a lawful power to impose a tax its imposition may be treated as without the power because of the destructive effect of the exertion of the authority”).

⁸⁵ 249 U.S. 86, 94–95 (1919).

⁸⁶ *Id.* at 93.

⁸⁷ 247 U.S. 251, 276–77 (1918).

or disposition of the product of such mine, quarry, mill, cannery, workshop, factory, or manufacturing establishment.⁸⁸

The law further authorized a federal inspection regime, interference with which was made subject to fine or imprisonment.⁸⁹ The law exempted employers from liability for the exaction in cases of “a child employed or permitted to work under a mistake of fact as to the age of such child, and without intention to evade the tax.”⁹⁰

In the *Child Labor Tax Case*, the Justices invalidated the law.⁹¹ Writing for the Court, Chief Justice Taft distinguished exactions that the Constitution authorizes under the tax power from penalties, which the tax power does not authorize. He stated that taxes have “only that incidental restraint and regulation which a tax must inevitably involve[.]”⁹² “Taxes,” he elaborated, “are occasionally imposed in the discretion of the legislature on proper subjects with the primary motive of obtaining revenue from them and with the incidental motive of discouraging them by making their continuance onerous.”⁹³ On this view, “[t]hey do not lose their character as taxes because of the incidental motive.”⁹⁴ He insisted, however, that “there comes a time” when an exaction amounts to a penalty.⁹⁵ That time comes when, “in the extension of the penalizing features of the so-called tax . . . it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.”⁹⁶

⁸⁸ *Child Labor Tax Case*, 259 U.S. 20, 35 (1922).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Id.* at 37 (“[A] court must be blind not to see that the so-called tax is imposed to stop the employment of children within the age limits prescribed. Its prohibitory and regulatory effect and purpose are palpable. All others can see and understand this. How can we properly shut our minds to it?”); *id.* at 39 (“The case before us can not be distinguished from that of *Hammer v. Dagenhart*.” (citation omitted)).

⁹² *Id.* at 36.

⁹³ *Id.* at 38.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*; accord *United States v. Butler*, 297 U.S. 1, 61 (1936) (“A tax, in the general understanding of the term, and as used in the Constitution, signifies an exaction for the support of the Government. The word has never been thought to connote the expropriation of money from one group for the benefit of another.”); *id.* (“The exaction cannot be wrested out of its setting, denominated an excise for raising revenue and legalized by ignoring its purpose as a mere instrumentality for bringing about a de-

Turning to the child labor statute, Chief Justice Taft concluded that it “regulate[s] by the use of the so-called tax as a penalty” because it “provides a heavy exaction for a departure from a detailed and specified course of conduct in business,” and because “[s]cienters [are] associated with penalties not with taxes.”⁹⁷ The Chief Justice noted that the statute does not explicitly prohibit child labor, but “it does exhibit its intent practically to achieve [this] result by adopting the criteria of wrongdoing and imposing its principal consequence on those who transgress its standard.”⁹⁸ The Chief Justice feared that recognizing such a penalty as a tax for constitutional purposes would end judicially enforceable limits on Congress’s enumerated powers.⁹⁹ The exaction had the expressive characteristics of a tax and the material characteristics of a penalty. Moreover, the exaction likely would have the effect of a penalty. The Court struck it down because materiality dominated expression in its interpretation of the Constitution.¹⁰⁰

Other decisions from this era similarly distinguished regulatory exactions, which the Court deemed to be penalties, from revenue-raising exactions, which the Court regarded as taxes. In *Hill v. Wallace*, decided immediately after the *Child Labor Tax Case*, the Court invalidated a federal exaction on sales of grain for future delivery (grain future contracts).¹⁰¹ The “tax” was twenty cents a

sired end. To do so would be to shut our eyes to what all others than we can see and understand.” (citing *Child Labor Tax Case*, 259 U.S. at 37)).

⁹⁷ *Child Labor Tax Case*, 259 U.S. at 36–37.

⁹⁸ *Id.* at 38.

⁹⁹ The Court wrote that if the exaction at issue was a tax, then Congress could regulate all private behavior:

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

Id.

¹⁰⁰ *Id.* at 39 (“Congress in the name of a tax which on the face of the act is a penalty seeks to do the same thing, and the effort must be equally futile.”); *id.* (“[T]he so-called tax is a penalty to coerce people of a State to act as Congress wishes them to act in respect of a matter completely the business of the state government under the Federal Constitution.”).

¹⁰¹ 259 U.S. 44, 68 (1922).

bushel, which would be imposed unless the contracts were made by or through a member of a board of trade recognized by the U.S. Department of Agriculture.¹⁰² This exaction supplemented the existing federal tax of two cents on every hundred dollars in value of such sales.¹⁰³ The Court viewed this “most burdensome” exaction as a penalty and not a tax because its “manifest purpose” was “to compel boards of trade to comply with regulations, many of which have no relevancy to the collection of the tax at all.”¹⁰⁴ According to the Court, “[t]he act is in essence and on its face a complete regulation of boards of trade, with a penalty of 20 cents a bushel on all ‘futures’ to coerce boards of trade and their members into compliance.”¹⁰⁵

In *United States v. Constantine*, the Court invalidated a federal exaction on liquor dealers who had violated state liquor laws.¹⁰⁶ In addition to the \$25 excise tax that federal law already imposed on retail liquor dealers, the challenged provision imposed a “special excise tax” of \$1000 on liquor dealers in business contrary to local law.¹⁰⁷ “If in reality a penalty,” the Court wrote, “it cannot be converted into a tax by so naming it, and we must ascribe to it the character disclosed by its purpose and operation, regardless of name.”¹⁰⁸ The Court ignored “the designation of the exaction,” instead “viewing its substance and application.”¹⁰⁹ Because the exaction was “highly exorbitant” relative to other federal taxes on liquor dealers, and because its imposition was conditioned on “the commission of a crime,” the Court held that it “exhibits . . . an in-

¹⁰² Id. at 63. The other exception to imposition of the tax was “where the seller holds and owns the grain at the time of sale, or is the owner or renter of land on which the grain is to be grown, or is an association made of such owners or renters.” Id.

¹⁰³ Id.

¹⁰⁴ Id. at 66.

¹⁰⁵ Id. “When this purpose is declared in the title to the bill, and is so clear from the effect of the provisions of the bill itself, it leaves no ground upon which the provisions we have been considering can be sustained as a valid exercise of the taxing power.” Id. at 66–67.

¹⁰⁶ 296 U.S. 287, 295–96 (1935).

¹⁰⁷ Id. at 288–89.

¹⁰⁸ Id. at 294; accord *United States v. La Franca*, 282 U.S. 568, 572 (1931) (“A tax is an enforced contribution to provide for the support of government; a penalty . . . is an exaction imposed by statute as punishment for an unlawful act. The two words are not interchangeable, one for the other.”).

¹⁰⁹ *Constantine*, 296 U.S. at 294.

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tent to prohibit and to punish violations of state law [and thus to] remove all semblance of a revenue act, and stamp the sum it exacts as a penalty.”¹¹⁰

After the constitutional crisis of 1937,¹¹¹ the Court did not formally overrule the *Child Labor Tax Case* and related decisions. The same is true of other pre-1937 precedents that have long since been abandoned, including *Lochner v. New York*.¹¹² Courts, commentators, and litigants presently disagree about whether the Court’s tax power decisions from the 1920s and 1930s remain good law.¹¹³ They agree, however, that the Court sustained federal laws when interpreting the scope of the tax power in the decades after 1937. Thus in *Sonzinsky v. United States*, the Court upheld as within the scope of the tax power a \$200 annual license tax on fire-

¹¹⁰ Id. at 295. Justice Cardozo, joined by Justices Brandeis and Stone, dissented. “Not repression,” Justice Cardozo stressed, “but payment commensurate with the gains is . . . the animating motive.” Id. at 297 (Cardozo, J., dissenting).

¹¹¹ See, e.g., Alexander M. Bickel, *The Least Dangerous Branch: The Supreme Court at the Bar of Politics* 45 (1962) (“Serving this value [of *laissez faire*] in the most uncompromising fashion, at a time when it was well past its heyday, five Justices, in a series of spectacular cases in the 1920’s and 1930’s, went to unprecedented lengths to thwart the majority will. The consequence was very nearly the end of the story.”). For a recent account of the political fight over President Franklin Delano Roosevelt’s “court-packing” plan, see, e.g., Jeff Shesol, *Supreme Power: Franklin Roosevelt vs. The Supreme Court* (2010); see also Barry Friedman, *The Will of the People: How Public Opinion Has Influenced the Supreme Court and Shaped the Meaning of the Constitution* 3–8, 202, 214, 217–29 (2009).

¹¹² Compare, e.g., *Lochner v. New York*, 198 U.S. 45, 53 (1905) (reasoning that the Fourteenth Amendment’s Due Process Clause protects freedom of contract), with *W. Coast Hotel Co. v. Parish*, 300 U.S. 379, 391 (1937) (“What is this freedom? The Constitution does not speak of freedom of contract.”). For further discussion of whether *Lochner* remains good law, see Richard A. Primus, *Canon, Anti-Canon, and Judicial Dissent*, 48 *Duke L.J.* 243, 244 (1998) (“*Lochner* is never cited for its legal authority. Although it has never been formally overruled, it is well understood among constitutional lawyers that relying on *Lochner* would be a pointless, if not a self-destructive, endeavor.”).

¹¹³ Compare, e.g., *Thomas More Law Ctr. v. Obama*, 651 F.3d 529, 553 (6th Cir. 2011) (Sutton, J., concurring in part and delivering the opinion of the court in part) (“The taxing-power cases, it is true, are old. Yet cases of a certain age are just as likely to rest on venerable principles as stale ones, particularly when there is a good explanation for their vintage.”), with Brian Galle, *Conditional Taxation and the Constitutionality of Health Care Reform*, 120 *Yale L.J. Online* 27, 28 (2010), available at <http://yalelawjournal.org/2010/5/31/galle.html> (“[T]he best reading [of existing doctrine] is that courts will not impose any substantive limits on the uses to which Congress may put its taxing authority. Any confusion results from the Court’s failure to formally overrule outdated precedents that once suggested otherwise.”).

arms dealers.¹¹⁴ The Court appeared to rest on the ground that exactions with regulatory effects are still taxes if they appear, both expressively and materially, to have been imposed pursuant to the tax power. As to expression, the Court wrote:

Every tax is in some measure regulatory. To some extent it interposes an economic impediment to the activity taxed as compared with others not taxed. But a tax is not any the less a tax because it has a regulatory effect, and it has long been established that an Act of Congress which on its face purports to be an exercise of the taxing power is not any the less so because the tax is burdensome or tends to restrict or suppress the thing taxed.¹¹⁵

The Court declared that “[i]nquiry into the hidden motives which may move Congress to exercise a power constitutionally conferred upon it is beyond the competency of courts.”¹¹⁶ As to materiality, it was enough for the Court that the tax “is productive of some revenue” and “operates as a tax.”¹¹⁷

The Court deferred further in *United States v. Sanchez*.¹¹⁸ The case involved a constitutional challenge to the Marihuana Tax Act, which imposed a tax of \$100 per ounce on transferors of marijuana who make transfers to unregistered transferees without the order form required by federal law and without payment by the transferees of the tax.¹¹⁹ Although it was “obvious” that the law “impos[ed] a severe burden on transfers to unregistered persons,”¹²⁰ the Court declared that an exaction is a tax even if it prevents the conduct and raises little or no revenue. “It is beyond serious question,” wrote the Court, “that a tax does not cease to be valid merely because it regulates, discourages, or even definitely deters the activities taxed.”¹²¹ Moreover, “the principle applies even though the revenue obtained is obviously negligible, or the revenue purpose of

¹¹⁴ 300 U.S. 506 (1937).

¹¹⁵ *Id.* at 513 (citations omitted).

¹¹⁶ *Id.* at 513–14.

¹¹⁷ *Id.* at 514.

¹¹⁸ 340 U.S. 42 (1950).

¹¹⁹ *Id.* at 44.

¹²⁰ *Id.*

¹²¹ *Id.*

the tax may be secondary.”¹²² The Court also deemed it significant that the tax was “not conditioned upon the commission of a crime.”¹²³ The Court thus rejected the claim that Congress had “levied a penalty, not a tax.”¹²⁴

Since *Sanchez*, the Court has repeatedly refused to invalidate exactions on the ground that Congress was using the taxing power to regulate conduct. In *United States v. Kahriger*, the Court upheld a federal law imposing a wagering tax of \$50 per year on bookmakers, requiring them to register with the Collector of Internal Revenue, and penalizing the failure to pay the tax and register.¹²⁵ The Court stated that “[u]nless there are provisions extraneous to any tax need, courts are without authority to limit the exercise of the taxing power.”¹²⁶ At the same time, the Court stressed that the exaction being challenged “produces revenue.”¹²⁷

More recently, in *Department of Revenue of Montana v. Kurth Ranch*, the Court distinguished a permissible tax from an impermissible punishment in the context of the Double Jeopardy Clause.¹²⁸ The Court has long held that the Constitution bans successive punishments for the same offense.¹²⁹ The state of Montana sought to impose a “tax” on top of an already imposed criminal penalty for illegal possession of a drug. Was this “tax” really a second penalty? In *Kurth Ranch*, the Court invalidated the exaction

¹²² *Id.* (citations omitted). The power of Congress to regulate conduct through taxation (or conditional expenditures) under the Taxing Clause is not limited to regulation that is otherwise permissible under another enumerated power. See *id.* (“Nor does a tax statute necessarily fall because it touches on activities which Congress might not otherwise regulate.”); *The License Tax Cases*, 72 U.S. (5 Wall.) 462, 470–71 (1866) (upholding under the tax power a federal law requiring the purchase of a license before engaging in certain businesses, including intrastate businesses, even though “Congress has no power of regulation nor any direct control” over “the internal commerce or domestic trade of the States”).

¹²³ *Sanchez*, 340 U.S. at 45.

¹²⁴ *Id.* at 43.

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

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

¹²⁷ *Id.* In *Bob Jones University v. Simon*, the Court acknowledged its abandonment of the pre-1937 jurisprudence, which sought to distinguish between “regulatory and revenue-raising taxes.” 416 U.S. 725, 741 n.12 (1974).

¹²⁸ 511 U.S. 767 (1994); see U.S. Const. amend. V.

¹²⁹ See, e.g., *Kurth Ranch*, 511 U.S. at 769 n.1.

partly because of its “high rate” and “obvious deterrent purpose,” which “lend support to the characterization of the drug tax as punishment,” but which, “in and of themselves, do not necessarily render the tax punitive.”¹³⁰ In addition, the Court stressed that “this so-called tax is conditioned on the commission of a crime,” a condition that is “significant of penal and prohibitory intent, rather than the gathering of revenue.”¹³¹

In reaching its conclusion, the Court invoked the *Child Labor Tax Case* and stated that “there comes a time in the extension of the penalizing features of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.”¹³² At the same time, the Court seemed to distance itself from the pre-1937 Court’s distinction between regulatory and revenue-raising taxes. The Court distinguished exactions imposed on illegal activities both from “taxes with a pure revenue-raising purpose that are imposed *despite* their adverse effect on the taxed activity[,]” and from “mixed-motive taxes that governments impose both to deter a disfavored activity and to raise money.”¹³³ The Court thus acknowledged that taxes can raise revenues and also regulate behavior by dampening the conduct subject to the tax.¹³⁴

¹³⁰ *Id.* at 780, 781.

¹³¹ *Id.* at 781 (quoting *United States v. Constantine*, 296 U.S. 287, 295 (1935)). The Court also deemed it significant that the exaction “is exacted only after the taxpayer has been arrested for the precise conduct that gives rise to the tax obligation in the first place,” *id.*, and that the exaction “is levied on goods that the taxpayer neither owns nor possesses when the tax is imposed,” *id.* at 783.

¹³² *Id.* at 779 (citing the Court’s invocation of the *Child Labor Tax Case* in *A. Magano Co. v. Hamilton*, 292 U.S. 40, 44 (1934)).

¹³³ *Id.* at 782. The Court discussed a cigarette tax to make its point:

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

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

¹³⁴ Elsewhere in the majority opinion, however, the Court may have overlooked the fact that taxes often have the regulatory purpose and effect of dampening behavior in

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B. Three Insights

The Court insisted during the 1920s and 1930s that some exactions enacted by Congress may not qualify as “taxes” under the Taxing Clause. The dramatic expansion in the scope of the commerce power after 1937, however, reduced the importance of the constitutional distinction between a tax and a penalty under the Taxing Clause.¹³⁵ Limits on the Commerce Clause imposed by the Court in 1995 and again in 2000 renewed the significance of this constitutional distinction.¹³⁶ Federalism doctrine now requires a distinction between taxing and penalizing that it lacks.

In *United States v. Lopez*, the Court held that the Commerce Clause does not authorize Congress to criminalize possession of firearms in a school zone.¹³⁷ Imagine that Congress subsequently imposed a “tax” of \$25,000, enforced by the Internal Revenue Service through Title 26 of the United States Code, on individuals who knowingly possess firearms in school zones, with the exaction increasing by \$25,000 for each repetition of the act. It is unlikely that the Court would uphold such an exaction as a permissible use of the tax power and allow Congress to undermine *Lopez* so easily.

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

addition to the non-regulatory purpose and effect of raising revenues. See *id.* at 779–80 (“Whereas fines, penalties, and forfeitures are readily characterized as sanctions, taxes are typically different because they are usually motivated by revenue-raising, rather than punitive, purposes.”).

¹³⁵ See 1 Laurence H. Tribe, *American Constitutional Law* 846 (3d ed. 2000).

¹³⁶ See *United States v. Lopez*, 514 U.S. 549 (1995); *United States v. Morrison*, 529 U.S. 598 (2000).

¹³⁷ *Lopez*, 514 U.S. at 549.

exaction raises revenue or regulates behavior, or primarily does one and secondarily does the other.

The Court's cases provide three insights that will help to distinguish taxes and regulations backed by penalties. First, some past decisions suggest that the difference between taxing and penalizing relates to coercion. The Court has, at times, appreciated that taxes are characteristically less coercive than penalties. So, for example, the Court during the 1920s and 1930s stressed the sheer magnitude of certain exactions and the scienter requirements attached to them.¹³⁸ The Court has recognized indirectly that taxes are less coercive by acknowledging that they raise revenues instead of deterring conduct. The post-1937 Court, in cases like *Sonzinsky* and *Kahriger*, often observed that the federal exactions it was upholding would produce revenues.¹³⁹

Second, post-1937 decisions understand that the difference between taxing and penalizing does not depend on whether an exaction raises revenue or regulates behavior. As the Court noted in *Kurth Ranch*,¹⁴⁰ an exaction may be designed to raise revenues and dampen conduct, not to raise revenues and prevent conduct.

Third, other past decisions (though not all) follow the basic principle of interpretation in tax law that substance dominates form.¹⁴¹ On this view, an exaction's material characteristics matter more than its expressive characteristics in constitutional review of federal statutes¹⁴² and state laws,¹⁴³ and in federal statutory interpreta-

¹³⁸ See, e.g., *Child Labor Tax Case*, 259 U.S. at 36 ("If an employer departs from this prescribed course of business, he is to pay to the government one-tenth of his entire net income in the business for a full year. The amount is not to be proportioned in any degree to the extent or frequency of the departures, but is to be paid by the employer in full measure whether he employs five hundred children for a year, or employs only one for a day."); cf. *Kurth Ranch*, 511 U.S. at 780 ("A significant part of the assessment was more than eight times the drug's market value—a remarkably high tax.").

¹³⁹ See supra notes 114–17 & 125–27 and accompanying text (discussing these cases).

¹⁴⁰ See supra note 134 and accompanying text.

¹⁴¹ See, e.g., *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1978).

¹⁴² In addition to decisions like the one in the *Child Labor Tax Case*, the Court in *The License Tax Cases* upheld a federal law under the tax power providing "that no persons should be engaged in certain trades or businesses, including those of selling lottery tickets and retail dealing in liquors, until they should have obtained a 'license' from the United States," which "license" was later relabeled a "special tax" by Congress, on the ground that "[t]he granting of a license . . . must be regarded as nothing more than a mere form of imposing a tax." 72 U.S. (5 Wall.) 462, 463, 471 (1866) (footnote omitted). The Court praised Congress for substituting the term "special

tion.¹⁴⁴ The cases contain these three insights, even though several cases contradict one another and none is entirely correct in its rationale.

The next Part draws from these judicial decisions and improves the Court's tax power doctrine. Because the Court now imposes some restrictions on the Commerce Clause, it is unlikely to defer completely to Congress concerning the difference between taxes and regulations backed by penalties, as it did in the decades following the crisis of 1937. The Court requires a viable theory of the tax power, one that is consistent with its limits on the commerce power. Such a theory cannot result from a doctrinal synthesis, as the inconsistencies in the cases across historical eras preclude this possibility. Nor, however, can a theory of the tax power ignore the cases. The task, rather, is to distinguish between a tax and a penalty

tax" for "license." Such "judicious legislation," the Court wrote, "removed all future possibility of error" and "guarded against any misconstruction of the legislative intention." *Id.* at 473. But the Court did not rest its holding on the substitution or intimate that the exaction would not have qualified as a tax if Congress had stuck with the word "license." See *Seven-Sky v. Holder*, 661 F.3d 1, 48 n.37 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits) ("[T]he fact that an exaction is not labeled a tax does not vitiate Congress's power under the Taxing Clause." (citing *The License Tax Cases*, 72 U.S. (5 Wall.) at 471)).

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

¹⁴³ See, e.g., *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 363 (1941) ("In passing on the constitutionality of a tax law 'we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it.'" (quoting *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 280 (1932), and citing *Wisconsin v. J. C. Penney Co.*, 311 U.S. 435 (1940) and *S. Pac. Co. v. Gallagher*, 306 U.S. 167, 177 (1939))). *Lawrence*, in turn, cited a series of earlier decisions for the same proposition. See *Lawrence*, 286 U.S. at 280 (citing *Educ. Films Corp. v. Ward*, 282 U.S. 379, 387 (1931); *Pac. Co. v. Johnson*, 285 U.S. 480 (1932); and *Shaffer v. Carter*, 252 U.S. 37, 54-55 (1920)). These cases involved a variety of constitutional challenges, most notably dormant commerce and due process objections to state exactions. In all of them, the Court stressed the substance of the exaction over its form.

¹⁴⁴ See, e.g., *United States v. Reorganized CF&I Fabricators*, 518 U.S. 213, 220 (1996) (holding in the bankruptcy context that the determination of whether an exaction is a tax requires courts to "look[] behind the label placed on the exaction and rest its answer directly on the operation of the provision . . .").

for purposes of Article I, Section 8 by drawing on the Court's past decisions while avoiding analytical errors.

III. THEORY

A. Taxes and Penalties: Pure and Mixed

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

Besides expression, an exaction's material characteristics include its magnitude and conditions. A penalty is usually high relative to the gain from forbidden conduct for almost everyone, so self-interest deters wrongdoing.¹⁴⁵ The penalty that deters rational people may not be enough to deter irrational or unusual people. To deter them, a penalty's magnitude often increases for intentional or repeated wrongdoing. Intentionality or recidivism triggers an enhancement. Thus an unintentional tort may trigger liability for actual harm, whereas doing the same act intentionally may trigger punitive damages. Similarly, a second criminal offense often triggers a more severe punishment than the first.

Compared to a penalty, a tax usually has the opposite characteristics. The language describing the taxed conduct does not forbid or condemn it. Rather, the tax is described in the language of choice, such as "permitted," "allowed," or "neither required nor forbidden." The law explicitly permits the taxed conduct as long as one pays the tax, or people infer permission from the absence of a prohibition. The income tax does not condemn earning income, and a tax on industrial pollution does not condemn industrial activity.

¹⁴⁵ Determining whether an exaction prevents almost all people from engaging in the assessed conduct requires a definition of the relevant universe of people. We define this universe as everyone who either pays the exaction or changes her behavior in response to it. This limits analysis of the effect of the exaction to the people for whom the exaction makes a difference, not the people for whom it is irrelevant.

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Other examples of taxes on permitted activities include tariffs, excises, head taxes, and property taxes.¹⁴⁶

Unlike a penalty, a tax is usually low relative to the gain from the taxed conduct for many people. Furthermore, the tax rate does not increase for intentional or repeated conduct. Earning income intentionally does not affect the income tax rate, and the income tax rate does not change just because someone earns income year after year.¹⁴⁷

Table 1 summarizes the usual characteristics of penalties and taxes.

Table 1: Characteristics of Exactions

	Expression	Material Characteristics	
		Rate	Intentionality, Repetition
Penalty	Condemns	Relatively high	Enhancements
Tax	Permits	Relatively low	No Enhancements

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

Pure penalty is our phrase for an exaction with all of the usual characteristics and effects of a penalty.¹⁴⁸ A pure penalty condemns

¹⁴⁶ Sometimes exactions that are expressively and materially equivalent to taxes are not called taxes. For example, “user fees” are taxes (with the tax base being users) because they signal permission and they do not prevent the conduct in question.

¹⁴⁷ It is theoretically possible for a tax to increase the assessed conduct, as when an income tax causes an unusual person to work more in order to replace income taken by the tax. This scenario is analogous to very unusual goods whose demand increases when the price rises (“Giffin goods”). For our purposes, such an exaction is a tax, not a penalty, because it does not prevent the assessed conduct.

¹⁴⁸ Theories in social science often invoke “ideal types,” “stylized facts,” or simplified models. See, e.g., Max Weber, “Objectivity” in *Social Science and Social Policy*,

the assessed conduct, exacts a high cost relative to the gain from the forbidden conduct for almost everyone, and enhances the rate for intentional or repeated violations. These characteristics prevent the conduct and thus raise little or no revenue. *Pure tax* is our phrase for an exaction with all of the usual characteristics and effects of a tax. A pure tax permits the assessed conduct, exacts a low cost relative to the gain from the assessed conduct for many people, and does not enhance the rate for intentional or repeated conduct. These characteristics dampen the conduct and generate revenue.

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

The second criterion is revenue raising. A pure penalty prevents the assessed conduct for almost everyone and thereby raises little or no revenue. By contrast, a pure tax dampens the assessed conduct but does not prevent it for many people, thereby raising revenues.

Some jurists, following the lead of the Court during the 1920s and 1930s, suggest that the key difference between taxes and regulations backed by penalties concerns raising revenues for the government on the one hand, and changing the behavior of citizens on the other.¹⁴⁹ According to this suggestion, taxes primarily raise revenues, although they may also change behavior, whereas penalties primarily change behavior, although they may also raise revenues.

The difference between changing behavior and raising revenues, however, cannot decide whether an exaction is one or the other. Because many taxes do both, this criterion is unworkable, which

in The Methodology of the Social Sciences 91 (Edward A. Shils & Henry A. Finch eds., 1949).

¹⁴⁹ See, e.g., *Thomas More Law Ctr. v. Obama*, 651 F.3d 529, 551 (6th Cir. 2011) (Sutton, J., concurring in part and delivering the opinion of the court in part) (concluding that the exaction in the Affordable Care Act for remaining uninsured was a penalty because, *inter alia*, its “central function . . . was not to raise revenue,” but “to change individual behavior by requiring all qualified Americans to obtain medical insurance”).

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may be why the Supreme Court apparently abandoned it.¹⁵⁰ This distinction also contradicts contemporary economists and other policy experts, who argue that taxes can channel some behavior more efficiently than ordinary regulations. Thus environmental economists recommend using pollution taxes, not commands, to abate air and water pollution.¹⁵¹

Sometimes a pure tax is levied on a beneficial activity. Dampening a beneficial activity is an *undesirable* byproduct of raising tax revenues. Thus income taxes raise revenues and dampen earning income, and property taxes raise revenues and dampen improvements on property. Economists try to devise taxes that minimize the dampening of desirable behavior.

Conversely, dampening is regarded as a *desirable* product of taxing activities perceived as *excessive*, like pollution in the twentieth century or imports in the nineteenth century. Economists favor externality taxes that dampen excessive behavior optimally. When a pure tax is levied on an excessive activity, society benefits from dampening the activity and raising revenues for the government.¹⁵² As noted in Part II, the Court stated in *Sonzinsky v. United States* that an exaction qualifies as a tax if it “is productive of some revenue” and it “operates as a tax.”¹⁵³ An exaction produces revenues and operates as a tax if it dampens permitted conduct. Conduct is dampened when many people do less of it. Alternatively, an exac-

¹⁵⁰ See supra Part II (discussing the doctrinal shift from *Child Labor Tax Case*, 259 U.S. 20 (1922), to *Sonzinsky v. United States*, 300 U.S. 506 (1937), and *United States v. Kahriger*, 345 U.S. 22 (1953)); see also *id.* (discussing *Mont. Dep’t of Revenue v. Kurth Ranch*, 511 U.S. 767 (1994)).

¹⁵¹ The primary reason that economists advocate pollution taxes is to change behavior, and the secondary reason is to raise revenues. Taxes on excessive behavior, however, are the ideal means to finance the government because they raise revenues by correcting a distortion in market prices, not by creating one. Cf. *United States v. Kahriger*, 345 U.S. 22, 35 (1953) (Jackson, J., concurring) (“Congress may and should place the burden of taxes where it will least handicap desirable activities and bear most heavily on useless or harmful ones.”).

¹⁵² The economist’s ideal pollution tax internalizes the social cost of pollution. Such a tax is a “price” to increase the cost of a permitted activity, not a “sanction” to prevent wrongdoing. See Robert Cooter, *Prices and Sanctions*, 84 *Colum. L. Rev.* 1523, 1536 (1984).

¹⁵³ 300 U.S. 506, 514 (1937); accord *Kahriger*, 345 U.S. at 28 (noting that the exaction under review “produces revenue”); *United States v. Doremus*, 249 U.S. 86, 93–94 (1919) (stating that laws are supported by the tax power only if they bear “some reasonable relation” to the “raising of revenue”).

tion raises little or no revenue and operates as a penalty if it prevents forbidden conduct. Conduct is prevented when few people do it.¹⁵⁴

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

What is the correct constitutional interpretation of mixed exactions? When interpreting an exaction, should expressive characteristics trump material characteristics or should materiality trump expression? Our answer depends on the exaction’s effect. If it has the effect of a penalty by preventing conduct, then it should be interpreted as a penalty. If it has the effect of a tax by dampening conduct and raising revenue, then it should be interpreted as a tax. Thus the fine for overstaying in metered parking dampens the conduct but does not prevent it. Behavior is dampened because many people weigh the value of their time and the expected fine, and then decide to overstay in metered parking. They respond to the exaction’s material characteristics, which are those of a tax, not to its expressive characteristics. In contrast, fines for speeding on the highway increase with recidivism, which characterizes penalties. A person who persists in speeding sufficiently to attract the police will pay higher fines until he loses his license to drive, which prevents the conduct.

For ordinary taxes, traffic violations, and many other kinds of exactions, most people respond to material consequences more than to expression (notwithstanding occasional assertions to the

¹⁵⁴ Cf. *Kahriger*, 345 U.S. at 35 (Jackson, J., concurring) (“Of course, all taxation has a tendency, proportioned to its burdensomeness, to discourage the activity taxed. One cannot formulate a revenue-raising plan that would not have economic and social consequences.”).

contrary).¹⁵⁵ This behavior confirms the prediction of price theory in economics. The material interpretation of exactions ties the meaning of a statute to a deep and reliable human motivation, namely self-interest. Absent information to the contrary, the constitutional interpretation of an exaction should respond to its material characteristics more than to its expression. Materially identical exactions should have the same constitutional consequences regardless of what a statute calls them, unless the facts indicate that people will respond more to an exaction's expression than to its material characteristics.

If the constitutional division of powers means anything, then Congress cannot acquire a power that it lacks by calling it a power that it has. Otherwise Congress could avoid any constitutional limitation on its powers by the way it refers to them. Congress cannot acquire the power to regulate for the general welfare by calling a regulation backed by a penalty a "tax."¹⁵⁶ Conversely, Congress does not lose a power that it has by calling it a power that it lacks. Courts should resist policing statutory vocabulary through judicial review, as we discuss in Part IV in connection with the controversy over health care reform.

If materiality presumptively trumps expression when interpreting a mixed exaction, the constitutional division of powers between the federal government and the states is preserved. Like Justice Holmes, we believe that a reviewing court should "think things, not words."¹⁵⁷ Conversely, if expression trumps materiality, then Con-

¹⁵⁵ See *Seven-Sky v. Holder*, 661 F.3d 1, 29–30 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits) ("Congress often chooses the label 'penalty' instead of 'tax' because the 'penalty' label suggests violation of a legal rule and thus has a more powerful effect in altering underlying behavior that Congress wants to encourage or discourage."); *id.* at 30 n.11 (quoting statements in a 1999 Treasury Department Report that "penalties clearly signal that noncompliance is not acceptable behavior," and that "[i]n establishing social norms and expectations, subjecting the noncompliant behavior to any penalty may be as important as the exact level of the penalty . . .").

¹⁵⁶ See, e.g., *United States v. La Franca*, 282 U.S. 568, 572 (1931) ("No mere exercise of the art of lexicography can alter the essential nature of an act or a thing; and if an exaction be clearly a penalty it cannot be converted into a tax by the simple expedient of calling it such.").

¹⁵⁷ Oliver Wendell Holmes, *Law in Science and Science in Law*, 12 *Harv. L. Rev.* 443, 460 (1898–1899) ("We must think things not words, or at least we must constantly translate our words into the facts for which they stand, if we are to keep to the real and the true.").

gress controls a statute's constitutional reach by how Congress refers to constitutional powers, not by the Constitution's concepts. A constitutional distinction between materially equivalent statutes would make sense only in circumstances where legal expression motivates people more than materiality.¹⁵⁸

The implications of this analysis for the scope of Congress's tax power are straightforward. According to longstanding legal doctrine, the Constitution authorizes Congress to impose pure taxes to promote the general welfare.¹⁵⁹ Congress does not lose its power to tax for the general welfare by referring to an exaction as a "regulation" or a "penalty." Nor does Congress lose its power to tax for the general welfare by declining to invoke the Taxing Clause when it imposes an exaction.¹⁶⁰ Whatever Congress says, the effect of the exaction—how it works—matters most. If the exaction has the effects of a tax, the Constitution authorizes Congress to impose it in order to promote the general welfare.

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

¹⁵⁸ For an examination of the importance of the expressive form of legal regulation in a different area of constitutional law, see generally Robert C. Post & Neil S. Siegel, *Theorizing the Law/Politics Distinction: Neutral Principles, Affirmative Action, and the Enduring Legacy of Paul Mishkin*, 95 *Calif. L. Rev.* 1473, 1494–95 (2007); Neil S. Siegel, *Race-Conscious Student Assignment Plans: Balkanization, Integration, and Individualized Consideration*, 56 *Duke L.J.* 781, 831, 843 (2006).

¹⁵⁹ See *United States v. Butler*, 297 U.S. 1, 64 (1936) ("The true construction [of the first clause] undoubtedly is that the only thing granted is the power to tax for the purpose of providing funds for payment of the nation's debts and making provision for the general welfare."); see also Cooter & Siegel, *supra* note 16, at 171–72 ("The tenuous economic distinction between many taxes and regulations . . . suggests that allowing one and not the other under Clause 1 makes little sense.").

¹⁶⁰ See *Woods v. Cloyd W. Miller Co.*, 333 U.S. 138, 144 (1948) ("The question of the constitutionality of action taken by Congress does not depend on recitals of the power which it undertakes to exercise."). The constitutional question remains whether the exaction is a tax. Note, however, that a different situation is presented when Congress explicitly disclaims use of a particular enumerated power. As a matter of institutional deference, it is appropriate for courts to defer to a clearly articulated congressional judgment that an enumerated power is not available or not desirable to justify an Act of Congress. But calling an exaction something other than a "tax" does not by itself amount to explicit disavowal of the tax power, particularly in light of the case law suggesting that substance controls over form.

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

Table 2: Exactions With Mixed Characteristics

	Condemns	Permits
High Rate	Pure penalty	Penalty equivalent
Low Rate	Tax equivalent	Pure tax

B. Three Criteria for Distinguishing Taxes and Penalties

One aim of the Constitution is to limit federal power to coerce the states and citizens. To pursue this aim, the Constitution gives the federal government limited, enumerated powers, and denies it a general police power.¹⁶¹ As noted above, pure penalties coerce more than pure taxes, both materially and expressively. Consequently, a concern with federal coercion partly justifies more restriction on congressional power to impose penalties than taxes. As with other enumerated powers, the constitutional question concerns the exaction’s effect on the general class of conduct subject to it.¹⁶² An exaction that prevents almost everyone from engaging in the conduct is a penalty for constitutional purposes, even though the statute calls it a tax. An exaction that exceeds almost everyone’s gain from engaging in the assessed conduct is too coercive to qualify as a tax under the tax power, even if a few people with unusual preferences or resources still engage in it.

A constitutional test for a tax under the tax power and a penalty under the Commerce Clause should focus on the *effect* of the exaction on the conduct of the people subject to it.¹⁶³ The test of

¹⁶¹ See, e.g., *United States v. Morrison*, 529 U.S. 598, 618 (2000); *United States v. Lopez*, 514 U.S. 549, 566 (1995).

¹⁶² Cf., e.g., *Gonzales v. Raich*, 545 U.S. 1, 17 (2005) (“We have never required Congress to legislate with scientific exactitude. When Congress decides that the total incidence of a practice poses a threat to a national market, it may regulate the entire class.” (internal quotation marks omitted)).

¹⁶³ An effects test necessarily raises the question whether the constitutionality of a federal exaction turns in part on enforcement effort. Is an exaction a penalty if it has the expressive and material characteristics of a penalty but it is rarely enforced, or is

whether an exaction is a tax or a penalty is whether it dampens or prevents conduct. An exaction that dampens conduct raises significant revenues, and an exaction that prevents conduct does not raise significant revenues.

Three characteristics usually determine whether an exaction dampens or prevents conduct. These three characteristics are not the constitutional test of an exaction, but they are the most important criteria for predicting whether it is a tax or a penalty. We formulate the criteria in three questions about the material characteristics of an exaction:

(1) Is the amount of the exaction so high that it exceeds the expected benefit from engaging in the assessed conduct for almost everyone?

(2) Does the exaction's amount depend on whether the assessed individual has a certain mental state, especially the intention to perform the assessed conduct?

(3) Does the amount of the exaction increase with repetition of the assessed conduct?¹⁶⁴

enforced in some parts of the country but not others? We cannot fully explore this question here, but we believe that appropriately deferential courts should (and would) not take into account the degree of enforcement. Making the interpretation of an exaction depend on its enforcement potentially allows the executive branch to determine the constitutionality of congressional statutes and allows their interpretation to differ from one place to another. We distinguish the exaction from the means of its implementation. The means of implementation can change without affecting the exaction's character.

¹⁶⁴ Vague words in our theory that cry out for reduction to numbers include "almost everyone," as opposed to "everyone." 100% is "everyone" and 98% is "almost everyone." 51% is a majority, but not "almost everyone." At what exact point above 51% and below 98% does one cross the line between a majority and almost everyone? The same questions could be asked in our theory about "little or no revenue" and "no revenue," and about the point at which dampening becomes prevention. Constitutional interpretation often employs notoriously imprecise language. Although imprecision is inevitable, the choice of words still matters. There is no line between the front of your face and the back of your head, but they are not the same. Thus the "preponderance of the evidence" means something different from "beyond a reasonable doubt," even though courts refuse to reduce them to exact probabilities. Experts may suggest that "preponderance of the evidence" means a probability exceeding one-half. This numerical representation has proved useful to scholars who try to understand the meaning and consequences of the legal standard. Such scholarship and testimony presumably influences courts, even though judges refuse to equate the legal rule with a precise number. Courts presumably resist reducing legal distinctions to precise numbers because legal decisions require combining several qualitative factors,

If all of the answers to these questions are “yes,” then the exaction will almost certainly prevent conduct, so it is a penalty for purposes of the tax power. If none of the answers to the three questions is “yes,” then the exaction will almost certainly dampen behavior and raise revenues, so it is a tax for purposes of the tax power. When these three material characteristics align, there is a strong presumption that materiality trumps expression. When material characteristics predict effects, an interpretation can be based primarily on the former. Expression is then irrelevant to whether an exaction is a tax or a penalty because it does not affect behavior. The alignment of these material characteristics can decide many cases, including the ACA’s minimum insurance requirement, as we show later.¹⁶⁵

and a precise formula suggests more precision than decision makers can achieve in fact.

Courts that rely on our theory would have the same reason to resist identifying our vague terms with precise numbers as with the preponderance of the evidence standard. Our theory identifies magnitude, intentionality, and recidivism as criteria to distinguish taxes from penalties. By reducing three criteria to a single magnitude, the courts would suggest more precision in combining them than decision makers can actually achieve. Courts should leave debate on line drawing to case-by-case adjudication and commentary by others, as do we.

¹⁶⁵ We focus on these three criteria because they connect the characteristics of the exaction to its incentive effects on behavior. Many considerations that are not characteristics of an exaction affect how a person responds to it, such as the person’s taste and income. Considerations unconnected to the exaction’s character should remain in the background, such as (1) the entity charged with assessing the exaction or similar decisions about the means of implementation; (2) the uses to which the government will put the revenue generated by the exaction; and (3) the location of the exaction in the U.S. Code. Another such example is whether the exaction is imposed only after detection by the police. Although some penalties are imposed only after police detection, others are not. For an instance in which the Court erred by confusing the effects of an exaction with who enforces it, see *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30, 36 (1958) (holding that the Commissioner properly disallowed the tax deductibility of payments of several hundred fines imposed on a trucking business for violations of state maximum weight laws because “the truckers were fined by the State as a penal measure when and if they were apprehended by the police.”). For an effective critique of the decision as promoting inefficient behavior through the tax code where efficient behavior would accord with the state’s goal of obtaining compensation for damage done to its roads, see Richard Schmalbeck & Lawrence Zeleznak, *Federal Income Taxation* 536–38 (3d ed. 2011).

In addition, the social costs imposed by the conduct subject to an exaction are not relevant to whether the exaction is a tax or a penalty. Purely self-interested people

By contrast, misalignment weakens the inference of effects from material characteristics. If some of the answers to the first three questions are “yes” and some are “no,” then the exaction’s effects depend on how people weight these characteristics. Will the exaction raise revenues and dampen the conduct, or will it prevent the conduct? This question demands direct evidence about behavior, not a presumption based on its characteristics. In hard cases, the question of effects is empirical, not theoretical.¹⁶⁶

The courts, the Congress, the President, civil servants, and ordinary citizens need to understand the Constitution’s meaning in order to conform to it. In certain settings, some actors have the legal obligation to defer to another’s interpretation of the Constitution. The constitutional meaning of a statutory exaction, which is this Article’s subject, is distinct from the obligation of deference in interpreting the statute. Specifically, the constitutional meaning of a tax and a penalty is distinct from the question of whether and how courts should exercise judicial review of an exaction’s constitutionality.¹⁶⁷

care *only* about their private costs, not about social costs. Most people care *more* about their private costs than social costs. An exaction by the state imposes a private cost on a person’s conduct. Most people respond by comparing the exaction to their private benefit from the conduct. Grounding a theory of the difference between a tax and penalty on its behavioral consequences requires a focus on private costs and benefits. By contrast, the social costs imposed by certain conduct are relevant to whether the conduct should be regulated by a tax or a penalty. A tax that internalizes social costs causes a self-interested person to do what is best for society, and the inability to design and implement such a tax is an important reason for imposing a penalty.

¹⁶⁶ Given three binary criteria, there are two permutations that align and six that misalign. The most that can be said in the abstract is that the relative level of the exaction ordinarily will matter most—both the initial level and the amounts of any enhancements for recidivism. For example, a huge exaction with no enhancements will prevent more conduct than a small exaction with small enhancements that never approximate the huge exaction.

The question is especially difficult when the exaction applies to conduct that most people engage in once or not at all, but not twice. Thus a tax on home ownership dampens it by preventing marginal homeowners from buying houses. The question is also difficult for exactions with enhancements for intentional or repeated conduct that most people engage in, such as driving faster than the speed limit.

¹⁶⁷ See, e.g., Jack M. Balkin, Fidelity to Text and Principle, *in* *The Constitution in 2020*, at 11, 20 (Jack M. Balkin & Reva B. Siegel eds., 2009) (“Many theories of constitutional interpretation conflate two different questions. The first is the question of what the Constitution means and how to be faithful to it. The second asks how a person in a particular institutional setting—like an unelected judge with life tenure—

Judicial review in tax power cases defers to Congress in two ways. First, the presumption of constitutionality in enumerated-powers litigation requires courts to uphold a contested exaction in close cases.¹⁶⁸ Second, in Commerce Clause cases, the Court asks whether Congress had a rational basis to believe that the regulated subject matter would substantially affect interstate commerce in the aggregate—not whether those effects in fact materialized.¹⁶⁹ So too, here, the question for judicial resolution is whether Congress could have rationally concluded that the exaction would have the effect of a tax—not whether the exaction actually had that effect or was certain to have it.

According to our theory, the constitutional difference between a tax and a penalty depends on the whether it dampens or prevents conduct. Our theory, however, does not require the courts to make this determination. Under the preceding deference logic, the courts have to decide whether Congress could have rationally concluded that an exaction would dampen conduct. If a reviewing court decides that Congress could have rationally concluded that an exaction would dampen conduct and not prevent it, the court should defer to Congress and decide that the exaction is a tax.

Deference also affects the stability of the interpretation of a statute. Consider a statute with the expression of a penalty and the material characteristics of a tax. Perhaps people initially and uncharacteristically respond to the expression, but over time idealism wanes and self-interest waxes until people eventually become indifferent to the expression and respond only to materiality. Thus the statute initially prevents conduct and finally dampens it.

should interpret the Constitution and implement it through doctrinal constructions and applications.”).

¹⁶⁸ See, e.g., *United States v. Morrison*, 529 U.S. 598, 607 (2000) (“Due respect for the decisions of a coordinate branch of Government demands that we invalidate a congressional enactment only upon a plain showing that Congress has exceeded its constitutional bounds. With this presumption of constitutionality in mind, we turn to the question whether [the statute] falls within Congress’ power under Article I, § 8, of the Constitution.” (citations omitted)).

¹⁶⁹ See, e.g., *Gonzales v. Raich*, 545 U.S. 1, 22 (2005) (“In assessing the scope of Congress’ authority under the Commerce Clause, we stress that the task before us is a modest one. We need not determine whether respondents’ activities, taken in the aggregate, substantially affect interstate commerce in fact, but only whether a ‘rational basis’ exists for so concluding.”).

Does the change in the statute's effects also change its constitutional meaning? This is a general question about interpreting statutes when their effects change, not a special question about taxes and penalties. Thus consider a federal statute regulating an activity with an insubstantial effect on interstate commerce when enacted and a substantial effect later. Could such a statute fail constitutional review under the Commerce Clause initially and pass it subsequently? The Court has never considered such a question, presumably because it seldom (if ever) arises. Several different resolutions of the problem are possible.¹⁷⁰

Under our test, whether Congress calls an exaction a "tax" is neither necessary nor sufficient for the exaction to fall within the scope of the tax power. Some of the Court's past decisions, however, suggest that calling an exaction a "tax" is necessary and sufficient for it to be one constitutionally,¹⁷¹ and some suggest the opposite, as we noted in Part II. Making the tax power turn on a jurisprudence of labels is inconsistent with the Court's Commerce Clause jurisprudence. If using the "T" word were sufficient to justify an exaction under the tax power, then a court would have to approve a \$25,000 federal "tax" on carrying a gun in a school zone after *Lopez*. And because the effects of an exaction turn primarily on its material characteristics, not its expressive characteristics, Congress need not use the "tax" label in order to rely on the tax power.¹⁷²

¹⁷⁰ Perhaps deference to Congress requires a reviewing court to examine the expected effect of the exaction at the time of enactment. The question is what the enacting Congress rationally could have concluded at the time of enactment. Or perhaps deference to Congress requires a reviewing court to examine the expected effect of the exaction at the time of litigation. Or perhaps the most appropriate deference approach is to uphold the exaction if it had the constitutionally required effects either at the time of enactment or at the time of litigation. Alternatively, the court could not defer to Congress and ask whether exaction's effect at the time of litigation is to prevent or dampen conduct. These are just some of the possibilities.

¹⁷¹ *Veazie Bank*, *McCrary*, and *Sanchez* can be read that way. See *supra* Section II.A (discussing these cases).

¹⁷² Some exactions are neither taxes nor penalties. For example, there are federal regulations backed by exactions that are called "penalties" by Congress. They are low and lack enhancement, however, so they lack the three material characteristics of pure penalties. See, e.g., 7 U.S.C. § 610(c) (2006) ("The Secretary of Agriculture is authorized, with the approval of the President, to make such regulations with the force and effect of law as may be necessary to carry out the powers vested in him by this chapter. Any violation of any regulation shall be subject to such penalty, not in

In sum, we agree with Holmes that materiality matters more than expression “on the very question [sic] whether a given statutory liability is a penalty or a tax.”¹⁷³ “A bad man,” Holmes wrote, does not care “whether conduct is legally right or wrong, and also whether a man is under compulsion or free.”¹⁷⁴ This is because “[i]t does not matter, so far as the given consequence, the compulsory payment, is concerned, whether the act to which it is attached is described in terms of praise or in terms of blame, or whether the law purports to prohibit it or to allow it.”¹⁷⁵ Unlike Holmes, however, we think expression counts for something. Whether an exaction dampens or prevents conduct depends on the responses of many different people, not just “bad people.” What counts is the total effect on conduct, not just the effect on bad people.

Like Holmes, our approach grants the federal government robust power to raise revenues and dampen behavior through taxation, as it has enjoyed throughout American history. Holmes, however, famously denied that the “power to tax involves the power to destroy,”¹⁷⁶ at least “while th[e] Court sits.”¹⁷⁷ We agree, which is

excess of \$100, as may be provided therein.”). At the same time, they are not well described as taxes because they are so low that they do not raise much revenue. At most, they have one characteristic of pure taxes (dampening behavior). What should exactions be called when neither “penalties” nor “taxes” accurately describes them? “Exactions” may be the best term. Regardless of the label, they need not originate in the House of Representatives. See U.S. Const. art. I, § 7 (“All Bills for raising Revenue shall originate in the House of Representatives . . .”).

¹⁷³ Oliver Wendell Holmes, *The Path of the Law*, in *Collected Legal Papers* 173 (1920); see *id.* (“But from his point of view, what is the difference between being fined and being taxed a certain sum for doing a certain thing?”).

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* at 174.

¹⁷⁶ *McCulloch v. Maryland*, 17 U.S. (4 Wheat) 316, 431 (1819) (stressing that it is a “proposition[] not to be denied” that the “power to tax involves the power to destroy”). Chief Justice Marshall was referring specifically to taxes imposed on the federal government by the states, which are not governments of limited, enumerated powers. We offer a precise formulation of the meaning of “destroy” as “preventing the behavior completely.”

¹⁷⁷ *Panhandle Oil Co. v. Mississippi ex rel. Knox*, 277 U.S. 218, 223 (1928) (Holmes, J., dissenting) (“The power to tax is not the power to destroy while this Court sits. The power to fix rates is the power to destroy if unlimited, but this Court while it endeavors to prevent confiscation does not prevent the fixing of rates. A tax is not an unconstitutional regulation in every case where an absolute prohibition of sales would be one.” (citing *Hatch v. Reardon*, 204 U.S. 152, 162 (1907))).

why we deny that the federal government may invoke the tax power to justify preventing conduct.

IV. APPLICATION

Constitutional litigation over the Patient Protection and Affordable Care Act (“ACA”) focused primarily on the “Requirement to Maintain Minimum Essential Coverage,” which opponents call the “individual mandate.” It provides that every “applicable individual”—that is, most individuals lawfully living in the United States—“shall” obtain “minimum essential coverage” for each month.¹⁷⁸ Applicable individuals who do not obtain minimum essential coverage must include in their federal taxes for the year a “[s]hared responsibility payment” based on household income, which the statute labels a “penalty.”¹⁷⁹ (Individuals who need not pay the exaction form a heterogeneous group of mostly disadvantaged people.¹⁸⁰) In 2014, the annual exaction for remaining uninsured will be the greater of \$95 or 1 percent of income. By 2016, the annual exaction will be the greater of \$695 or 2.5 percent of income.¹⁸¹

The minimum coverage provision and shared responsibility payment address two free rider problems. Anyone can be grievously injured or fall ill at any moment, and such injury or illness can be financially ruinous.¹⁸² Almost all who are grievously injured or ill will end up at emergency rooms, where they will receive treatment regardless of whether they are insured.¹⁸³ This fact en-

¹⁷⁸ 26 U.S.C. § 5000A(a) (Supp. 2011). The minimum coverage provision goes into effect on January 1, 2014. It applies to U.S. citizens and legal residents. It does not apply to undocumented aliens, people in prison, and people with certain religious objections. See *id.* § 5000A(d).

¹⁷⁹ *Id.* § 5000A(b)(1).

¹⁸⁰ Individuals who need not pay the exaction include those who need not file a federal income tax return because their household incomes are too low, people whose premium payments would be greater than eight percent of their household income, individuals who are uninsured for short periods of time, members of Native American tribes, and people who show that compliance with the requirement would impose a hardship. *Id.* § 5000A(e).

¹⁸¹ *Id.* § 5000A(c).

¹⁸² See 42 U.S.C. § 18091(2)(G) (Supp. 2011) (“62 percent of all personal bankruptcies are caused in part by medical expenses.”).

¹⁸³ Federal law requires hospitals that participate in Medicare and offer emergency services (almost all hospitals in the United States) to provide stabilizing care to pa-

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courages financially able individuals to decline to purchase health insurance and to free ride on the benevolence of others. The minimum coverage provision and shared responsibility payment are designed in part to overcome risk taking in reliance on benevolence.¹⁸⁴

These two provisions also ameliorate a second kind of free rider problem: adverse selection in insurance markets.¹⁸⁵ Individuals in bad health have an immediate reason to purchase insurance that individuals in good health lack. As more people in bad health purchase insurance, the premiums must rise, which causes fewer people in good health to buy insurance, which causes a further increase in premiums, which causes fewer people in good health to buy insurance, and so on. This price spiral exists in unregulated health insurance markets without the ACA. To dampen the price spiral, the ACA requires both the healthy and the unhealthy to buy insurance or pay a yearly fee. Thus the exaction for noninsurance ameliorates a problem in insurance markets.

Some provisions of the ACA, however, also aggravate this price spiral. Specifically, the ACA prohibits insurance companies from denying coverage based on preexisting conditions, canceling insurance absent fraud, charging higher premiums based on medical history, and imposing lifetime limits on benefits.¹⁸⁶ By guaranteeing

tients who enter their emergency rooms while experiencing medical emergencies regardless of their ability to pay. *Id.* § 1395dd(a). This law reinforces the longstanding mission of many hospitals to provide care to individuals who are unable to pay fully or at all. See, e.g., Charles Rosenberg, *The Care of Strangers: The Rise of America's Hospital System* 347 (1995) (observing that “the hospital never assumed the guise of rational and rationalized economic actor during the first three-quarters of the twentieth century”; that it “continued into the twentieth century, as it had begun in the eighteenth, to be clothed with public interest in a way that challenged categorical distinctions between public and private”; and that “[p]rivate hospitals had always been assumed to serve the community at large—treating the needy.”); *id.* at 352 (seeing “little prospect of hospitals in general becoming monolithic cost minimizers and profit maximizers,” and predicting that American society “will feel uncomfortable with a medical system that does not provide a plausible (if not exactly equal) level of care to the poor and socially isolated”); see also, e.g., Brief for Appellant at 42–43, *Virginia ex rel. Cuccinelli v. Sebelius*, 656 F.3d 253 (4th Cir. 2011) (Nos. 11-1057 & 11-1058) (discussing state tort law creating liability for failure to provide emergency care).

¹⁸⁴ For development of this argument, see generally Neil S. Siegel, *Free Riding on Benevolence: Collective Action Federalism and the Minimum Coverage Provision*, 75 *Law & Contemp. Probs.* 29, 33 (2012).

¹⁸⁵ See generally Kenneth J. Arrow, *Essays in the Theory of Risk Bearing* (2d ed. 1974).

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

access to health insurance regardless of medical condition, these regulations encourage healthy people to postpone buying it until they require expensive medical care. When healthy people postpone buying health insurance until they need expensive care, the average insurance claim per insured person increases, so insurance companies need to charge higher rates in order to cover the claims. When the insurance rates go up, more healthy postpone buying health insurance, which causes another increase in insurance rates, and so on. Insurance prices spiral upwards.¹⁸⁷

Before the Supreme Court's decision in *NFIB*,¹⁸⁸ which we discuss at the end of this Part, the federal courts disagreed whether the minimum coverage provision is within the scope of the Commerce Clause,¹⁸⁹ either alone or in combination with the Necessary and Proper Clause.¹⁹⁰ Three federal district courts and two federal courts of appeals upheld the provisions based partly on cost shifting and adverse selection.¹⁹¹ Three other federal district courts and one federal court of appeals struck down the provisions on the ground that they regulate "inactivity," which (according to those courts) Congress may not reach using its commerce power.¹⁹²

¹⁸⁷ See Brief for America's Health Insurance Plans as Amicus Curiae in Support of Neither Party at 3, *Virginia ex rel. Cuccinelli v. Sebelius*, 656 F.3d 253 (4th Cir. 2011) (Nos. 11-1057 & 11-1058) ("Without an individual mandate requirement, more individuals will make the rational economic decision to wait to purchase coverage until they expect to need health care services. If imposed without an individual mandate provision, the market reform provisions would reinforce this 'wait-and-see' approach by allowing individuals to move in and out of the market as they expect to need coverage, undermining the very purpose of insurance to pool and spread risk."). The mechanism causing such a price spiral was famously modeled by George Akerlof in *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. Econ. 488 (1970).

¹⁸⁸ 132 S. Ct. 2566.

¹⁸⁹ U.S. Const. Art. I, § 8, cl. 3.

¹⁹⁰ *Id.* cl. 18.

¹⁹¹ See *Mead v. Holder*, 766 F. Supp. 2d 16, 35 (D.D.C. 2011); *Liberty Univ. v. Geithner*, 753 F. Supp. 2d 611, 635 (W.D. Va. 2010); *Thomas More Law Ctr. v. Obama*, 720 F. Supp. 2d 882, 895-96 (E.D. Mich. 2010); *Thomas More Law Ctr. v. Obama*, 651 F.3d 529, 544 (6th Cir. 2011); *Seven-Sky v. Holder*, 661 F.3d 1, 20 (D.C. Cir. 2011).

¹⁹² *Florida ex rel. Bondi v. U.S. Dep't of Health & Human Servs.*, 780 F. Supp. 2d 1256, 1306 (N.D. Fla. 2011); *Goudy-Bachman v. U.S. Dep't of Health & Human Servs.*, 811 F. Supp. 2d 1086, 1111 (M.D. Pa. 2011); *Virginia ex rel. Cuccinelli v. Sebelius*, 728 F. Supp. 2d 768, 788 (E.D. Va. 2010). These district courts reasoned that Congress may regulate only economic activity using its commerce power, and that the minimum coverage provision regulates inactivity—specifically, the failure to purchase

Whatever the pertinence of the activity-inactivity distinction to the commerce power, it is irrelevant to the scope of the tax power. Instead of activity, some taxes are assessed on status, such as owning idle land, receiving dividends from passive investments, enjoying unearned income, and inheriting wealth. “Head taxes,” which the Constitution calls “Capitation” taxes, assess people for being alive.¹⁹³ Moreover, some tax rates increase for inactivity. Thus heterosexual couples in long-term relationships with only one wage earner often face higher taxes for the “inactivity” of not marrying.¹⁹⁴ If the minimum coverage provision and shared responsibility payment were justified by the tax power, the activity-inactivity distinction would be irrelevant.

Before *NFIB*, however, no federal court upheld these provisions of the ACA under the tax power.¹⁹⁵ For example, in his influential and dispositive opinion, the widely respected jurist Jeffrey Sutton of the United States Court of Appeals for the Sixth Circuit rejected a facial Commerce Clause challenge to the provisions, but concluded that “[t]he individual mandate is a regulatory penalty, not a revenue-raising tax.”¹⁹⁶ He so concluded because “that is what

health insurance. The United States Court of Appeals for the Eleventh Circuit reasoned similarly in invalidating the minimum coverage provision. *Florida ex rel. Att’y Gen. v. U.S. Dep’t of Health & Human Servs.*, 648 F.3d 1235, 1311–13 (11th Cir. 2011).

¹⁹³ See U.S. Const. art. I, § 9, cl. 4 (contemplating federal power to impose capitation taxes under certain circumstances).

¹⁹⁴ Federal law permits married heterosexuals couples to file joint tax returns. If the couple has only one wage earner, filing a joint return usually reduces their total tax liability. Conversely, if the couple has two earners, filing a joint return usually increases their total tax liability. Unmarried individuals in long-term relationships may not file jointly, nor may married gay couples. 26 C.F.R. § 1.6013-1 (2012).

¹⁹⁵ But cf. *Liberty Univ. v. Geithner*, 671 F.3d 391, 415 (4th Cir. 2011) (Wynn, J., concurring) (“[W]ere I to reach the merits, I would uphold the constitutionality of the Affordable Care Act on the basis that Congress had the authority to enact the individual and employer mandates under its plenary taxing power.”). In two decisions, the United States Court of Appeals for the Fourth Circuit ruled for the federal government on jurisdictional grounds. See *id.* at 414–15 (holding that the federal tax Anti-Injunction Act bars the action); *Virginia ex rel. Cuccinelli v. Sebelius*, 656 F.3d 253, 266, 272 (4th Cir. 2011) (holding that Virginia lacks Article III standing to bring the action). Unlike Judge Wynn, Judge Motz, who wrote both opinions, did not express her view of the merits. Judge Davis would have upheld the individual and employer mandates under the Commerce Clause. See *Geithner*, 671 F.3d at 452 (Davis, J., dissenting).

¹⁹⁶ *Thomas More Law Ctr. v. Obama*, 651 F.3d 529, 550 (6th Cir. 2011) (Sutton, J., concurring in part).

Congress said”;¹⁹⁷ because “the legislative findings in the Act show that Congress invoked its commerce power, not its taxing authority”;¹⁹⁸ because “Congress showed throughout the Act that it understood the difference between these terms and concepts, using ‘tax’ in some places and ‘penalty’ in others”;¹⁹⁹ because “the central function of the mandate was not to raise revenue” but “to change individual behavior by requiring all qualified Americans to obtain medical insurance”;²⁰⁰ and because “case law supports this conclusion.”²⁰¹ In the view of Judge Sutton (and other federal judges), this part of the ACA plainly imposes a penalty and not a tax.²⁰²

Our analysis of four types of exactions—pure taxes, pure penalties, tax equivalents, and penalty equivalents—identifies why courts were reluctant to view the ACA’s exaction for noninsurance as a tax for constitutional purposes. Not only did Congress reference a “Requirement” to maintain minimum coverage and provide that every applicable individual “shall” obtain it,²⁰³ but it also used the label “penalty” many times in the statute creating the provision.²⁰⁴ Moreover, Congress did so after labeling the exaction a “tax” in earlier versions of the bill.²⁰⁵ This choice of words is not arbitrary, thoughtless, or expressively interchangeable. On the contrary, such normative language appears to reflect a congressional judgment that failing to insure is wrong because it shifts medical

¹⁹⁷ *Id.* at 551.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.* at 552 (discussing, *inter alia*, *Child Labor Tax Case*, 259 U.S. 20, 38 (1922), and *Dep’t of Revenue of Mont. v. Kurth Ranch*, 511 U.S. 767, 779 (1994)).

²⁰² See *Florida ex rel. Att’y Gen. v. U.S. Dep’t Health & Human Servs.*, 648 F.3d 1235, 1314 (11th Cir. 2011) (“Beginning with the district court in this case, all have found, without exception, that the individual mandate operates as a regulatory penalty, not a tax.” (citing cases)).

²⁰³ 26 U.S.C. § 5000A(a) (Supp. 2011).

²⁰⁴ *Id.* at § 5000A(b), (c); see *Liberty Univ. v. Geithner*, 671 F.3d 391, 424 (4th Cir. 2011) (Davis, J., dissenting) (“And Congress did not simply use the term ‘penalty’ in passing: Congress refers to the exaction no fewer than seventeen times in the relevant provision, and each time Congress calls it a ‘penalty.’”).

²⁰⁵ *Geithner*, 671 F.3d at 424 (Davis, J., dissenting) (“Congress considered earlier versions of the individual mandate that clearly characterized the exaction as a ‘tax’ and referred to it as such more than a dozen times. Congress deliberately deleted all of these references to a ‘tax’ in the final version of the Act and instead designated the exaction a ‘penalty.’” (citations omitted)).

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costs to others. The minimum coverage provision *expresses* a penalty.

The contrary argument can be made that the ACA exaction for noninsurance expresses a tax. Congress placed the exaction in the Internal Revenue Code; identified the individuals subject to the exaction as “taxpayers”; calculated the exaction in part as a “percentage of . . . the taxpayer’s household income for the taxable year”; and included the amount owed in the taxpayer’s tax return liability.²⁰⁶ Congress, in short, also used the language of taxation. These observations, however, cannot overcome the fact that Congress repeatedly labeled the exaction a “penalty,” it never labeled the exaction a “tax,” and it did so after having previously called it a “tax” in earlier versions of the bill that became law.

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

First, when an exaction’s rate gets very high, it prevents people from engaging in the assessed conduct, coercing them much like a penalty. For many people, the shared responsibility payment is too low to have this effect.²⁰⁷ This exaction increases with income until it hits a cap at “the national average premium for qualified health plans which have a bronze level of coverage,” the lowest level of health insurance coverage identified by the ACA as sufficient to comply with the minimum coverage provision.²⁰⁸ The exaction costs less than this minimum level of insurance for many people, so

²⁰⁶ Cf., e.g., *Geithner*, 671 F.3d at 418 (Wynn, J., concurring) (“Notably, while the individual mandate in some places used the term ‘penalty,’ some form of the word ‘tax’ appears in the statute over forty times.”); Brian Galle, *The Taxing Power, the Affordable Care Act, and the Limits of Constitutional Compromise*, 120 *Yale L.J. Online* 407, 409 (2011), available at <http://yalelawjournal.org/2011/4/5/galle.html> (stressing these facts in arguing that the exaction is a tax).

²⁰⁷ Cong. Budget Office, *Effects of Eliminating the Individual Mandate to Obtain Health Insurance*, June 16, 2010, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/113xx/doc11379/eliminate_individual_mandate_06_16.pdf (predicting that elimination of the individual mandate to obtain coverage “would increase the number of uninsured by about 16 million people”).

²⁰⁸ 26 U.S.C. § 5000A(c)(1)(B), (b)(1), (c)(2)(B).

many people who want to remain uninsured will do so.²⁰⁹ The exaction's level apparently reflects a political compromise that aims to discourage people from going without insurance without coercing them.²¹⁰

Second, the exaction has no mens rea requirement. It does not matter whether an individual declines to obtain health insurance intentionally or innocently. Third, there is no surcharge for recidivism. The amount of the exaction does not increase with each month or year that an individual declines to obtain health insurance coverage. Instead, the law imposes a flat fee regardless of an individual's insurance status in previous years.

Because the shared responsibility payment has all of the material characteristics of a tax, it should work like a tax by dampening (but not preventing) behavior and thereby raising revenues from the uninsured.²¹¹ The Congressional Budget Office ("CBO") estimates that four million people each year will choose to make the shared

²⁰⁹ See, e.g., Alec MacGillis, *The Individual Mandate: How It Will Work*, in *The Staff of the Washington Post, Landmark: The Inside Story of America's New Health-Care Law and What It Means for Us All* 89 (2010) ("[T]he law expressly states that failure to pay the penalties will not result in criminal prosecution or even in property liens. Also, the government probably will enforce the mandate loosely because of the political sensitivity of the health-care law.").

²¹⁰ Experts fear that the existing exaction may be too low to prevent a significant percentage of individuals from delaying the purchase of insurance, which could threaten the viability of the insurance business. See, e.g., *id.* ("[T]hose who wrote the legislation set the penalty for not carrying health coverage lower than what many health-care experts believe is necessary for the mandate to work, precisely because they were worried about the political fallout from making the requirement seem too onerous."); Editorial, *Curing a Sick System: The 'Individual Mandate' is Divisive, But It's Also a Crucial Component of Healthcare Reform*, *L.A. Times*, Oct. 24, 2010, at A39, available at <http://articles.latimes.com/2010/oct/24/opinion/la-ed-health-20101024> ("By requiring all adult Americans and legal residents to obtain a basic level of coverage or else pay an annual tax penalty of up to \$2,085, the law seeks to deter people from signing up for insurance only after they need expensive care. It's not the only approach Congress could have taken, and it isn't perfect—the penalty seems too low to stop healthy people from going without coverage or employers from ceasing to offer health benefits to their employees.").

²¹¹ The distinction between dampening and prevention is meaningful as applied to the general class of individuals subject to the ACA exaction for noninsurance, not as applied to each individual who is so subject. A given individual either obtains insurance or does not. "Dampening" here means that a significant number of people remain uninsured despite the provision. "Prevention" means that almost no one remains uninsured.

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responsibility payment instead of obtaining coverage.²¹² The CBO further predicts that the required payment provision will produce \$54 billion in federal revenue from 2015 to 2022.²¹³

The unfolding politics of the Affordable Care Act cannot change this conclusion. Opponents of the ACA charge that Congress changed the label of the exaction from “tax” to “penalty” to blunt the opposition of people committed to no new taxes.²¹⁴ Labeling an exaction a “penalty” instead of a “tax” may “carr[y] political benefits” at a particular time.²¹⁵

Some judges and scholars fear that the federal government will escape political accountability if it can call an exaction one thing in the political arena and something else in court.²¹⁶ It is a novel proposition, however, that political accountability through accurate

²¹² Cong. Budget Office, Payments of Penalties for Being Uninsured Under the Patient Protection and Affordable Care Act, Apr. 22, 2010, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/113xx/doc11379/individual_mandate_penalties-04-22.pdf [hereinafter Cong. Budget Office, Payments of Penalties] (reporting that “[i]n total, about 4 million people are projected to pay a penalty because they will be uninsured in 2016 (a figure that includes uninsured dependents who have the penalty paid on their behalf)”).

²¹³ Cong. Budget Office, Updated Estimates for the Insurance Coverage Provisions of the Affordable Care Act, Table 2, Mar. 2012, <http://www.cbo.gov/sites/default/files/cbofiles/attachments/03-13-Coverage%20Estimates.pdf> [hereinafter Cong. Budget Office, Updated Estimates].

²¹⁴ Congress may not have considered the potential constitutional consequences of changing the label of the exaction in light of Supreme Court decisions that have declared the legal irrelevance of the label affixed to an exaction. See *supra* notes 142–44 and accompanying text (citing past Court decisions).

²¹⁵ *Liberty Univ. v. Geithner*, 671 F.3d 391, 411 n.12 (4th Cir. 2011) (citing *Florida ex rel. McCollum v. U.S. Dep’t of Health and Human Servs.*, 716 F. Supp. 2d 1120, 1142–43 (N.D. Fla. 2010)). Ironically, Congress tried to diminish political objections by using the name that signals more coercion (“penalty”), instead of the one that signals less coercion (“tax”).

²¹⁶ See, e.g., *Florida ex rel. McCollum v. U.S. Dep’t of Health & Human Servs.*, 716 F. Supp. 2d 1120, 1143 (N.D. Fla. 2010) (“[N]ow that it has passed into law . . . , government attorneys have come into this court and argued that it was a tax after all. This rather significant shift in position, if permitted, could have the consequence of allowing Congress to avoid the very same accountability that was identified by the government’s counsel in the Virginia case as a check on Congress’s broad taxing power in the first place.” (citations omitted)); Randy E. Barnett, *Commandeering the People: Why the Individual Health Insurance Mandate is Unconstitutional*, 5 N.Y.U. J.L. & Liberty 581, 632 (2010) (“The public is acutely aware of tax increases. Rather than incur the political cost of imposing a general tax on the public using its tax powers, economic mandates allow Congress and the President to escape accountability for tax increases by compelling citizens to make payments directly to private companies.”).

labeling applies to Congress's tax power.²¹⁷ We are unaware of constitutional authority for the proposition that an exaction with the material characteristics and effects of a tax must be deemed a penalty in order to achieve political accountability. Thus Judge Kavanaugh of the U.S. Court of Appeals for the D.C. Circuit, in an important opinion in an ACA case, deemed it constitutionally irrelevant that the ACA labeled the exaction for noninsurance a "penalty" instead of a tax.²¹⁸

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

Many federal statutes have titles and preambles that misstate their content, whether by calling civilian expenditures "military" or by declaring high-minded purposes for self-serving logrolls.²¹⁹ For decades Congress has hidden tax breaks in the tax code instead of exposing them in the budget, as noted in Part I.²²⁰ The Court has never suggested that any of these practices raise concerns about

²¹⁷ Federal commandeering of states raises different constitutional questions. See *Printz v. United States*, 521 U.S. 898 (1997); *New York v. United States*, 505 U.S. 144 (1992). With commandeering, the federal government is regulating individuals indirectly by requiring the states to regulate on its behalf. With a purchase mandate or incentive, the federal government is regulating individuals directly and so does not implicate any structural concern.

²¹⁸ *Seven-Sky v. Holder*, 661 F.3d 1, 48 n.36 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits) (quoted supra note 142). Like the Fourth Circuit, see supra note 195, Judge Kavanaugh would have held the action barred by the federal Tax Anti-Injunction Act ("TAIA"), 26 U.S.C. § 7421(a) (2006). For a novel explanation of why the TAIA imposed no jurisdictional impediment, see generally Michael C. Dorf & Neil S. Siegel, "Early-Bird Special" Indeed!: Why the Tax Anti-Injunction Act Permits the Present Challenges to the Minimum Coverage Provision, 121 *Yale L.J. Online* 389 (2012), available at <http://yalelawjournal.org/images/pdfs/1042.pdf>.

²¹⁹ For a discussion, see generally Susan Rose-Ackerman, *Judicial Review and the Power of the Purse*, 12 *Int'l Rev. L. & Econ.* 191 (1992). Professor Rose-Ackerman offers proposals that "aim to improve the accountability of Congress to the voters . . . by limiting Congress's ability to make low-visibility deals through the appropriations process . . . [and by deterring] Congress from passing ambitious-sounding laws that it has no intention of funding adequately." *Id.* at 192.

²²⁰ See supra note 71 and accompanying text.

the constitutionality of federal taxes or expenditures.²²¹ If the Court were to impose a “clear statement” requirement that the tax power justifies an exaction only if Congress labels it a “tax,” many other kinds of mislabeling logically should fall under such a requirement.²²² Policing these practices would require a massive judicial undertaking. A court that wishes to do so might start with easy cases that are blatantly misleading, not subtle cases like the ACA.²²³

²²¹ Some sections of the Internal Revenue Code mislabel penalties as taxes, notably the rules regarding private foundations. Among other things, a foundation must distribute at least five percent of its assets for charitable purposes each year; it must not engage in acts of self-dealing with foundation insiders; it must not hold more than insubstantial interests in corporate or noncorporate businesses; and (with few exceptions) it must not lobby. These rules, however, are not phrased as mandates or prohibitions. Rather, a foundation can do what it wants, but must pay “excise taxes” if it chooses wrong. For example, section 4941(a) imposes a first-tier tax of ten percent on any self-dealing transaction. 26 U.S.C. § 4941(a) (2006). Section 4941(b) imposes a two hundred percent tax on any act of self-dealing subject to the tier-one tax, if the act that triggered the tax is not “corrected” in a timely fashion. *Id.* § 4941(b). The first-tier tax grabs attention and the second-tier tax prevents wrongdoing if the foundation does not fix the problem. Unsurprisingly, these “taxes” raise negligible revenue.

²²² To preserve federalism values, the Court needs to distinguish between taxes and penalties. The direct approach of distinguishing between them on the merits can succeed because a substantial theory lies behind the difference, as this Article shows. In other areas of constitutional law, the Court may seek to preserve federalism values by avoiding substantial distinctions, imposing a clear statement rule, and allowing legislative politics to take its course. After *South Dakota v. Dole*, 483 U.S. 203 (1987), the Court may have believed that imposing a clear statement requirement in conditional spending cases was the most judicially manageable way to enforce federalism values. Cf. *Arlington Cent. Sch. Dist. Bd. of Educ. v. Murphy*, 548 U.S. 291 (2006). (The Medicaid holding in *NFIB* may reveal a different belief, but that is a subject for a future paper.) Similarly, imposing a clear statement requirement for a suspension of habeas corpus by Congress may enable courts to avoid profound and perplexing questions about justiciability and the merits. See, e.g., *Boumediene v. Bush*, 553 U.S. 723 (2008). Whatever one thinks about the spending power or habeas suspensions, the best approach in the tax context is for the Court to distinguish between a tax and a penalty.

²²³ It may be easier to identify instances in which Congress calls a penalty a “tax” than it is to find situations in which Congress labels a tax a “penalty.” The shared responsibility payment is unusual in this regard. But cf. *United States v. Sotelo*, 436 U.S. 268, 275 (1978) (“We . . . cannot agree . . . that the ‘penalty’ language of Internal Revenue Code § 6672 is dispositive of the status of respondent’s debt under Bankruptcy Act § 17a(1)(e). . . . That the funds due are referred to as a ‘penalty’ when the Government later seeks to recover them does not alter their essential character as taxes for purposes of the Bankruptcy Act . . .”).

Judge Kavanaugh, however, voiced a distinct expressive concern: “Section 5000A arguably does not just incentivize certain kinds of lawful behavior but also mandates such behavior,” with the consequence that “a citizen who does not maintain health insurance might be acting *illegally*.”²²⁴ In his view, the “Taxing Clause has not traditionally authorized a legal prohibition or mandate, as opposed to just a financial disincentive or incentive.”²²⁵ Although recognizing “that a legal mandate with a civil tax penalty for non-compliance is economically indistinguishable from a traditional regulatory tax if the amounts of the exactions are the same,” Judge Kavanaugh responded that “[s]uch an argument assumes that citizens care only about economic incentives and not also about complying with The Law.”²²⁶ He noted the plaintiffs’ argument that “the United States does not necessarily consist of 310 million people who have over-absorbed their Posner,” for “common sense tells us that many citizens want to be law-abiding (and known as law-abiding), and that their desire to be law-abiding affects their behavior.”²²⁷

Judge Kavanaugh’s concern that the ACA’s exaction for noninsurance may have the effect of a penalty seems unwarranted in theory and fact. As explained, theory suggests that materiality will outweigh expression for many people, who will pay the exaction instead of buying insurance. To reiterate, the CBO’s analysis concludes that (1) four million people each year will make the shared responsibility payment,²²⁸ and (2) the provision will produce \$54 billion in federal revenue over eight years.²²⁹

The minimum coverage provision (§ 5000A(a)) and the shared responsibility payment (§ 5000A(b)) are best read together, as parts of a whole (§ 5000A). Congress placed them together in the same section of the ACA, and the only legal consequence of not behaving in accordance with § 5000A(a) is contained in § 5000A(b). In other words, subsection (b) describes the exaction,

²²⁴ *Seven-Sky v. Holder*, 661 F.3d 1, 48 (D.C. Cir. 2011) (Kavanaugh, J., dissenting as to jurisdiction and not deciding the merits).

²²⁵ *Id.* at 48–49.

²²⁶ *Id.* at 49.

²²⁷ *Id.*

²²⁸ Cong. Budget Office, *Payments of Penalties*, *supra* note 212.

²²⁹ Cong. Budget Office, *Updated Estimates*, *supra* note 213.

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and subsection (a) describes the circumstances triggering it. The best reading of the statutory text and structure is that an applicable individual who goes without insurance is acting lawfully so long as she pays the exaction for noninsurance. This interpretation matches the Government's position.²³⁰ Moreover, the Court has previously upheld tax laws framed in mandatory language,²³¹ in accordance with the judicial obligation to construe federal laws so as to avoid constitutional problems.²³²

In sum, the ACA's exaction for noninsurance is mixed because it has a penalty's expression and a tax's materiality. An exaction that has the expressive characteristics of a penalty, the material characteristics of a tax, and the predicted effect of a tax is most appropriately classified as a tax. Because the predicted effect of the ACA's exaction for noninsurance is to dampen uninsured behavior, not to prevent it, it is a *tax equivalent* for purposes of Congress's tax power. One need not rely upon the deference logic discussed in Part III to arrive at this conclusion. But in light of the deference owed to Congress in enumerated powers cases, it would be particularly inappropriate for courts to hold the minimum coverage provision and shared responsibility payment beyond the scope of the tax power.

* * *

On June 28, 2012, the U.S. Supreme Court decided *NFIB*.²³³ Writing for the Court, Chief Justice Roberts upheld the ACA's minimum coverage provision and shared responsibility payment as

²³⁰ *Seven-Sky*, 661 F.3d at 48 n.38; see Brief for Petitioners (Minimum Coverage Provision) at 61, *Dep't of Health & Human Servs. v. Florida*, 132 S. Ct. 2566 (2012) (No. 11-398) (“[N]either the Treasury Department nor the Department of Health and Human Services interprets Section 5000A as imposing a legal obligation on applicable individuals independent of its tax-penalty consequences; each instead views it as only a predicate provision for the imposition of tax consequences.”).

²³¹ See, e.g., *The License Tax Cases*, 72 U.S. (5 Wall.) 462, 471–72 (1867) (discussed *supra* note 142).

²³² See, e.g., *Nw. Austin Mun. Util. Dist. No. One v. Holder*, 557 U.S. 193, 197 (2009). Citing *Northwest Austin*, Judge Kavanaugh wrote that “perhaps the canon of constitutional avoidance would allow” the interpretation that non-compliance with the minimum coverage provision is lawful, thereby “squeeze[ing] it within the Taxing Clause.” *Seven-Sky*, 661 F.3d at 48 n.38.

²³³ 132 S.Ct. 2566 (2012).

permissible exercises of Congress's tax power.²³⁴ Several commentators quickly recognized that the logic, citations, and rhetoric of Roberts' tax-power analysis closely resemble our theory.²³⁵ In contrast to commentators—especially Roberts' critics—who proffer political explanations for his vote,²³⁶ our theory offers legal justification for almost all of his analysis of the tax power and the conclusion that he reached. Whether his opinion drew from our theory, our theory justifies his opinion for the Court.

Labeling its inquiry a “functional approach,”²³⁷ the Court adopted two of our material characteristics—Roberts called them “practical characteristics”²³⁸—that distinguish a tax from a penalty for constitutional purposes: its level and whether there is a scienter requirement. In the Court's view, a tax is an exaction at a moderate level that is collected by the IRS and does not have a scienter requirement.²³⁹

The same analysis here suggests that the shared responsibility payment may for constitutional purposes be considered a tax, not a penalty: First, for most Americans the amount due will be far less than the price of insurance, and, by statute, it can never be

²³⁴ See *id.* at 2593–600. Justices Ginsburg, Breyer, Sotomayor, and Kagan joined this part of Roberts' opinion for the Court.

²³⁵ See *supra* note 11 (quoting Jeffrey Rosen, Randy Barnett, and Brian Leiter).

²³⁶ See, e.g., Randy Barnett, Roberts Decision Didn't Open Floodgates for 'Compulsion Through Taxation,' *The Wash. Examiner*, July 5, 2012, <http://washingtonexaminer.com/roberts-decision-didnt-open-floodgates-for-compulsion-through-taxation/article/2501386> (“[T]hese maneuvers made constitutional law worse, even if they did save this law in hope of avoiding political attacks on the court.”).

²³⁷ *NIFB*, 132 S. Ct. at 2595.

²³⁸ *Id.* at 2595, 2600.

²³⁹ Chief Justice Roberts wrote for the Court:

Our cases confirm this functional approach. For example, in *Drexel Furniture*, we focused on three practical characteristics of the so-called tax on employing child laborers that convinced us the “tax” was actually a penalty. First, the tax imposed an exceedingly heavy burden—10 percent of a company's net income—on those who employed children, no matter how small their infraction. Second, it imposed that exaction only on those who knowingly employed underage laborers. Such scienter requirements are typical of punitive statutes, because Congress often wishes to punish only those who intentionally break the law. Third, this “tax” was enforced in part by the Department of Labor, an agency responsible for punishing violations of labor laws, not collecting revenue.

Id. at 2595.

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more. It may often be a reasonable financial decision to make the payment rather than purchase insurance, unlike the “prohibitory” financial punishment in *Drexel Furniture*. Second, the individual mandate contains no scienter requirement. Third, the payment is collected solely by the IRS through the normal means of taxation²⁴⁰

As we do, the Court stressed that a tax can tip into being a penalty when the burden becomes excessive and thus coercive, and that the minimum coverage provision is well below this tipping point.²⁴¹ And the Court connected the scienter requirement to the condemnation of an act as illegal, as we do.²⁴²

Moreover, the Court agreed with us that differences in characteristics cause different effects on behavior. One such difference, we agree, is that a tax raises revenues, whereas a penalty does not necessarily do so.²⁴³ We also agree on another difference in effect: a

²⁴⁰ Id. at 2595–96 (internal citations omitted).

²⁴¹ See id. at 2599–600 (“We have nonetheless maintained that ‘there comes a time in the extension of the penalizing features of the so-called tax when it loses its character as such and becomes a mere penalty with the characteristics of regulation and punishment.’” (quoting *Dep’t of Revenue of Mont. v. Kurth Ranch*, 511 U.S. 767, 779 (1994)); id. at 2600 (“We have already explained that the shared responsibility payment’s practical characteristics pass muster as a tax under our narrowest interpretations of the taxing power. Because the tax at hand is within even those strict limits, we need not here decide the precise point at which an exaction becomes so punitive that the taxing power does not authorize it. It remains true, however, that the ‘power to tax is not the power to destroy while this Court sits.’” (citations omitted) (quoting *Okla. Tax Comm’n v. Tex. Co.*, 336 U.S. 342, 364 (1949))); id. (“We do not make light of the severe burden that taxation—especially taxation motivated by a regulatory purpose—can impose. But imposition of a tax nonetheless leaves an individual with a lawful choice to do or not do a certain act, so long as he is willing to pay a tax levied on that choice.”).

²⁴² See id. at 2595 (“Congress often wishes to punish only those who intentionally break the law.”). Morality and law connect scienter and wrongdoing by penalizing intentional wrongdoing and not accidental harm; cf. id. at 2596–97 (“In distinguishing penalties from taxes, this Court has explained that ‘if the concept of penalty means anything, it means punishment for an unlawful act or omission.’ While the individual mandate clearly aims to induce the purchase of health insurance, it need not be read to declare that failing to do so is unlawful. Neither the Act nor any other law attaches negative legal consequences to not buying health insurance, beyond requiring a payment to the IRS.” (citations omitted) (quoting *United States v. Reorganized CF&I Fabricators of Utah*, 518 U.S. 213, 224 (1996))).

²⁴³ See id. at 2596 (“This process yields the essential feature of any tax: it produces at least some revenue for the Government. Indeed, the payment is expected to raise about \$4 billion per year by 2017.” (citation omitted)).

tax dampens behavior without preventing it.²⁴⁴ Indeed, this Article explains that taxes raise revenues *just because* they dampen behavior without preventing it.

In addition, the Court concluded, as we do, that the characteristics and effects of an exaction trump its label for constitutional purposes. Roberts made this point at several places in his opinion.²⁴⁵ Finally, the Court, like us, focused on the anticipated effect of an exaction on individual behavior, not on whether Congress intended to raise revenue or to regulate behavior:

None of this is to say that the payment is not intended to affect individual conduct. Although the payment will raise considerable revenue, it is plainly designed to expand health insurance coverage. But taxes that seek to influence conduct are nothing new. Some of our earliest federal taxes sought to deter the purchase of imported manufactured goods in order to foster the growth of domestic industry.²⁴⁶

In sum, the Court applied two of the three characteristics that we use to distinguish taxes from penalties for constitutional purposes; it stressed, as we do, that differences in characteristics cause different effects on individual behavior; and it concluded, as we do, that characteristics and effects trump labels and congressional intent.

Like us, the Court disagreed with those who reject any judicially enforceable limits on the tax power. We doubt that Roberts would have upheld the minimum coverage provision as a tax if he believed that doing so implied no judicially enforceable limits on the

²⁴⁴ See *id.* (“But taxes that seek to influence conduct are nothing new.”); *id.* (“Today, federal and state taxes can compose more than half the retail price of cigarettes, not just to raise more money, but to encourage people to quit smoking.”); *id.* (“That § 5000A seeks to shape decisions about whether to buy health insurance does not mean that it cannot be a valid exercise of the taxing power.”).

²⁴⁵ See *id.* at 2583 (“It is true that Congress cannot change whether an exaction is a tax or a penalty for *constitutional* purposes simply by describing it as one or the other.”); *id.* at 2594 (“It is of course true that the Act describes the payment as a ‘penalty,’ not a ‘tax.’ But . . . that label . . . does not determine whether the payment may be viewed as an exercise of Congress’s taxing power.”); *id.* at 2595 (“We have similarly held that exactions not labeled taxes nonetheless were authorized by Congress’s power to tax.”); *id.* at 2597 (“[L]abels should not control here.”).

²⁴⁶ *Id.* at 2596 (citing Brownlee, *supra* note 21, at 22, and 2 Story, *supra* note 54, § 962 (“the taxing power is often, very often, applied for other purposes, than revenue”)). Compare this with *supra* notes 51–54 and accompanying text, which discuss Hamilton’s program for industrialization and quote Brownlee and Story.

tax power, so that Congress could recast a penalty backing a regulation of non-commercial conduct as a tax.

In stressing the modest size of the exaction and the absence of a scienter requirement, the Court implied that there is an anti-coercion limit on use of the tax power. The limit is crossed when Congress coerces people, which it may do by using the commerce power but not the tax power. The Court did “not here decide the precise point at which an exaction becomes so punitive that the taxing power does not authorize it,” even as it agreed with Holmes that the “power to tax is not the power to destroy.”²⁴⁷ According to our theory, to “destroy” is to prevent the conduct. Thus an exaction changes from a tax to a penalty at the point where it prevents the conduct instead of dampening it.²⁴⁸

Besides these similarities, the Court’s analysis of the tax power differed from ours in several ways. First, the Court did not mention enhancements for recidivism, such as increasing payments for continuing to engage in the assessed conduct. Even so, Roberts—and thus the Court—likely would have responded to such enhancements if they were present in the law.²⁴⁹ Second, the Court thought it pertinent that the payment will be collected by the IRS, “the agency that collects taxes,”²⁵⁰ as opposed to an agency charged with punishing violations of the law.²⁵¹ We think whether a payment is a tax or a penalty is distinct from the question of who enforces it.²⁵² Third, Roberts invoked a saving construction in a part of his opinion for himself alone.²⁵³ This seems inappropriate to us (and to the

²⁴⁷ Id. at 2600; accord id. (quoted supra note 241); see supra note 177 and accompanying text.

²⁴⁸ See supra note 176. We have thus identified the tipping point in principle, but we do not suggest that a vague principle yields precise answers in hard cases.

²⁴⁹ If the amount that one had to pay for going without insurance went up significantly each month, Roberts probably would have concluded that the exaction was coercive and a penalty.

²⁵⁰ Id. at 2596 n.9.

²⁵¹ See id. at 2595, 2596 & n.9.

²⁵² See supra note 165 (distinguishing how an exaction works from who assesses and collects it).

²⁵³ See *NFIB*, 132 S. Ct. at 2593–94, 2600–01. He wrote:

JUSTICE GINSBURG questions the necessity of rejecting the Government’s commerce power argument, given that §5000A can be upheld under the taxing power. But the statute reads more naturally as a command to buy insurance than as a tax, and I would uphold it as a command if the Constitution allowed it. It is only because the Commerce Clause does not authorize such a command

other members of the majority) in light of the modern canon of constitutional avoidance.²⁵⁴ In spite of small differences, the Court's analysis and our analysis are so similar that our theory can justify almost all of the Court's reasoning on the tax power, as well as the decisive vote that Roberts cast.²⁵⁵

CONCLUSION

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

that it is necessary to reach the taxing power question. And it is only because we have a duty to construe a statute to save it, if fairly possible, that §5000A can be interpreted as a tax.

Id. at 2600–01 (citation omitted). Roberts also wrote that "[t]he Government asks us to interpret the mandate as imposing a tax, if it would otherwise violate the Constitution." *Id.* at 2594. That is inaccurate. The Government argued that the tax power provides an independently sufficient basis for upholding the minimum coverage provision. Brief for Petitioners (Minimum Coverage Provision) at 52, *Dep't of Health & Human Servs. v. Florida*, 132 S. Ct. 2566 (2012) (No. 11-398), ("The minimum coverage provision is independently authorized by Congress's tax power.").

²⁵⁴ The modern canon of constitutional avoidance does not license, let alone require, a judge to first conclude that the minimum coverage provision is beyond the scope of the Commerce and Necessary and Proper Clauses before concluding that the provision may reasonably be characterized as a tax. For a discussion, see generally Neil S. Siegel, *More Law than Politics: The Chief, the "Mandate," Legality, and Statesmanship*, in *The Health Care Case: The Supreme Court's Decision and Its Implications* (Gillian Metzger, Trevor Morrison & Nathaniel Persily eds., forthcoming 2013).

²⁵⁵ The joint dissent co-authored by Justices Scalia, Kennedy, Thomas, and Alito concluded that the tax power did not support the minimum coverage provision. The dissent mostly echoed the arguments of jurists and commentators who earlier rejected, or expressed concerns about, the tax power as justification for the minimum coverage provision, including Judge Sutton, Judge Kavanaugh, and Professor Randy Barnett. See, e.g., *id.* at 2652 (Scalia, Kennedy, Thomas, and Alito, JJ., dissenting) ("So the question is, quite simply, whether the exaction here is imposed for violation of the law. It unquestionably is."); *id.* at 2653 ("[W]e have never—*never*—treated as a tax an exaction which faces up to the critical difference between a tax and a penalty, and explicitly denominates the exaction a 'penalty.'"). We already responded to many of those arguments earlier in this Part.

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imposing a high exaction relative to the gain of almost all actors, and by increasing the exaction for intentional or repeated wrongdoing. *Pure penalties* also express a prohibition against the penalized conduct.

The exaction for noninsurance in the Affordable Care Act has the expressive characteristics of a penalty, the material characteristics of a tax, and almost certainly will have the effect of a tax. Although not a pure tax, the effects of this exaction are equivalent to a tax. In these circumstances, the exaction's name should make no difference to its constitutionality under the Taxing Clause, as the Court properly concluded in *NFIB*.²⁵⁶

²⁵⁶ We have shown that (1) the General Welfare Clause authorizes Congress to tax; (2) some taxes are materially equivalent to regulations that dampen conduct without penalizing it; and (3) the material characteristics of an exaction generally affect conduct more than its expressive form when the two conflict. Because the General Welfare Clause permits federal taxation, it should also be interpreted as authorizing Congress to impose materially equivalent regulations, which we call "tax equivalents." Thus in *Collective Action Federalism*, we suggested the possibility that the initial clause of Article I, § 8 confers at least some regulatory authority. See Cooter & Siegel, *supra* note 16, at 170–75.

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