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A Short History of Congress's Power to Tax

The Supreme Court has long distinguished the regulatory from the taxing power

By Paul Moreno

In 1935, Secretary of Labor Frances Perkins was fretting about finding a constitutional basis for the Social Security Act. Supreme Court Justice Harlan Fiske Stone advised her, "The taxing power, my dear, the taxing power. You can do anything under the taxing power."

In late June, in his ObamaCare opinion, *NFIB v. Sebelius*, Chief Justice John Roberts gave Congress the same advice — just enact regulatory legislation and tack on a financial penalty, as in failure to comply with the individual insurance mandate. So how did the power to tax under the Constitution become unbounded?

The first enumerated power that the Constitution grants to Congress is the "power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defense and general welfare of the United States." The text indicates that the taxing power is not plenary, but can be used only for defined ends and objects — since a comma, not a semicolon, separated the clauses on means (taxes) and ends (debts, defense, welfare).

This punctuation was no small matter. In 1798, Pennsylvania Rep. Albert Gallatin said that fellow Pennsylvania Rep. Gouverneur Morris, chairman of the Committee on Style at the Constitutional Convention, had smuggled in the semicolon in order to make Congress's taxing power limitless, but that the alert Roger Sherman had the comma restored. The altered punctuation, Gallatin said, would have turned "words [that] had originally been inserted in the Constitution as a limitation to the power of levying taxes" into "a distinct power." Thirty years later, Virginia Rep. Mark Alexander accused Secretary of State John Quincy Adams of doing the same thing after Congress instructed the administration to print copies of the Constitution.

The punctuation debate simply reinforced James Madison's point in *Federalist No. 41* that Congress could tax and spend only for those objects enumerated, primarily in Article I, Section 8.

Congress enacted very few taxes up to the end of the Civil War, and none that was a pretext for regulating things that the Constitution gave it no power to regulate. True, the purpose of tariffs was to protect domestic industry from foreign competition, not raise revenue. But the Constitution grants Congress a plenary power to regulate commerce with other nations.

Congress also enacted a tax to destroy state bank notes in 1866, but this could be seen as a "necessary and proper" means to stop the states from usurping Congress's monetary or currency power. It was upheld in *Veazie Bank v. Fenno* (1869).

The first unabashed use of the taxing power for regulatory purposes came when Congress enacted a tax on "oleomargarine" in 1886. Dairy farmers tried to drive this cheaper butter substitute from the market but could only get Congress to adopt a mild tax, based on the claim that margarine was often artificially colored and fraudulently sold as butter. President Grover Cleveland reluctantly signed

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Health Contract with America

By John Goodman, Ph.D.

Opponents of the Affordable Care Act (ObamaCare) have a nifty catch phrase: repeal and replace. Unfortunately, they are much clearer on "repealing" than they are on "replacing."

Until now. The Congressional Health Care Caucus has posted on its Website a "Health Contract with America," which I crafted. I conducted a Capitol Hill briefing on the subject in June, and you can find more details at the National Center for Policy Analysis (NCPA) Website. Let's hope every candidate for office this fall endorses the Contract.

Here are the main ideas:

Tax Fairness. The federal government should give everyone the same tax relief for the purchase of private health insurance, regardless of where it is obtained — through an employer, in a health insurance exchange, or in the marketplace.

We could replace the current system of tax and spending subsidies with a lump sum, refundable tax-credit of $2,500 for every adult and $8,000 for a family of four. These credits would fund the core insurance that we want everyone to have. Additional coverage could be purchased by individuals and their employers with (unsubsidized) after-tax dollars.

The current system of granting tax relief for the purchase of health insurance is arbitrary, regressive, and unfair. In general, only employer-purchased health insurance receives favorable tax treatment. People who must purchase their own insurance get little if any help from the IRS. In addition, the amount of subsidy depends on your tax bracket. That's why people who earn $100,000 a year get a tax subsidy that is six times the subsidy available to someone earning $25,000. Some may argue that government shouldn't be involved at all. Fair enough. But there is no rational argument for giving the most encouragement to those who need it least.

Under ObamaCare, things will get even more arbitrary and unfair. Families will be required to have health insurance — either through an employer, the government, or in a newly created health-insurance exchange. Take a family earning, say, $30,000. If the family qualifies for Medicaid, the government will pay 100 percent of the cost. If the family qualifies for insurance in the exchange, the government will pay about 95 percent of the cost. But if the family is eligible for insurance at work, the government subsidy will equal only 15 percent of the cost. Families at the same

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End of FY 2012 Report

By State Representative Jeff Kaufmann (R-Wilton)
Former House Majority Leader Pro-Tem

I am proud of the job we did the last two years to get our fiscal house in order and clean up the mess from the previous two years. Continued fiscal responsibility by the government and diversification of our businesses are critical to economic long-term success for our citizens.

Fiscal year 2012 ended July 1 with state revenue growing at just over 5 (5.04) percent. Total net receipts to the state increased $289.5 million, when compared to FY 2011. The revenue figure is higher than what the Revenue Estimating Conference (REC) had estimated at the March 2012 meeting, when it increased the FY 12 number to 2.6 percent. This amounts to $136.4 million more than the REC estimate.

The Cash Reserve Fund will be fully funded at $466.8 million. This is a significant change from two years ago when spending by former Governor Culver and the Democrat majority left the Cash Reserve Fund short of its statutory target (7.5 percent of the Adjusted Revenue Estimate). The Economic Emergency Fund will also be fully funded at $155.6 million, and the Taxpayers Trust Fund will also be

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Iowa Statewide Economic Indicators

Latest Economic Indicators	Actual Number	Amount of Change	Time Period Reported
New Vehicle Registrations	65,725	7.5%	January - June 2012
New Housing Permits	4,265	19.3%	May 2011 - May 2012
Existing Home Sales - Midwest	1,030,000	14.4%	April 2011 - April 2012
Total Resident Jobs	1,573,400	-4,600	May - June 2012
Non-Farm Employment	1,491,400	-2,400	May - June 2012
Factory Jobs	218,700	1,500	May - June 2012
Initital Unemployment Claims	11,522	-16.8%	May - June 2012
Jobless Rate	85,600	5.2%	June 2012
Personal Income	$40,470	6.4%	2010 - 2011
Exports of Goods	$10.9 billion	N/A	2010
Farmland Values	$10,500	27.0%	April 2011 - April 2012

Source: Iowa Workforce Development News and Trends, July 30, 2012,
<http://www.iowaworkforce.org/trends/>
<http://www.trade.gov/mas/ian/statereports/states/tg_ian_002727.asp>
<http://www.agweb.com/blog/Your_Precious_Land_217/>

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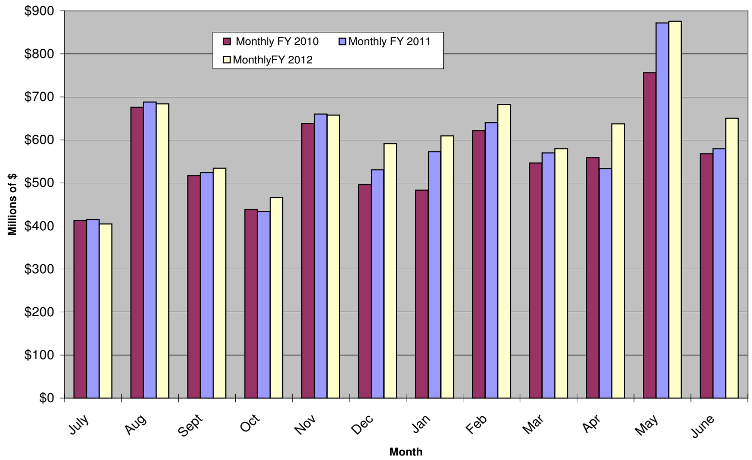
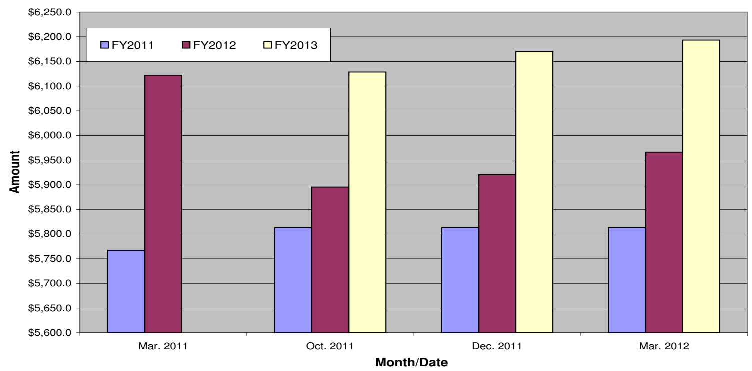
Iowa's Monthly State Revenue and Estimated Net Yearly Revenue (in millions)



Monthly State Revenue:

Monthly FY12 state revenue was $560.4 million in June, the last month of the fiscal year. This is $71 million more than in June 2011. The end of year total is $7,372 million, over $550 million more in taxes collected than in FY08. Should this money be returned to the taxpayers?

Quarterly Estimated Net Receipts

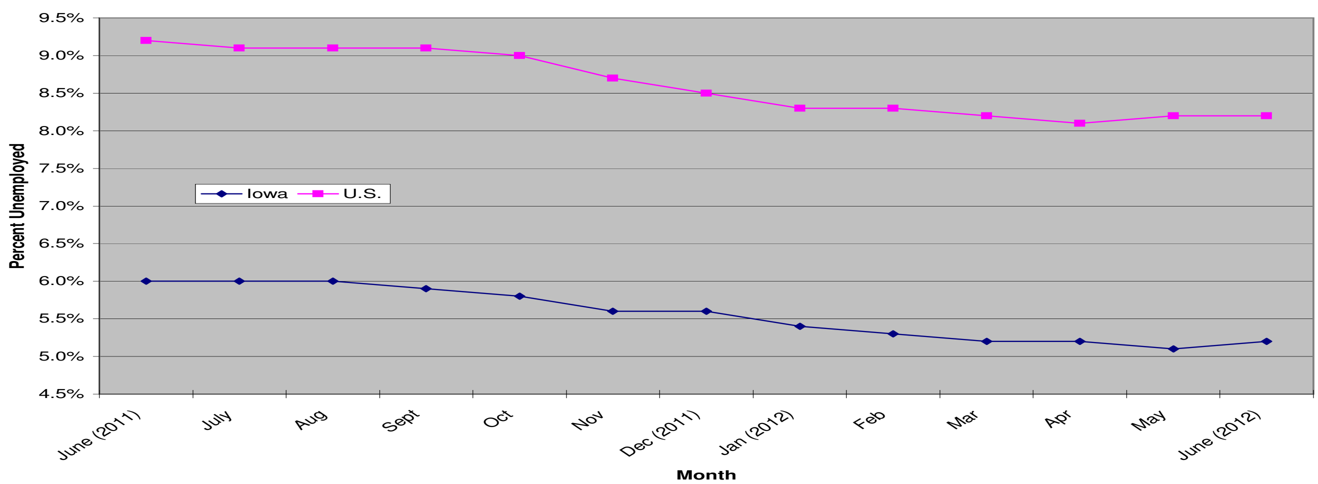


Estimated Net Yearly Revenue:

The revised Revenue Estimating Conference March prediction for FY13 is $6,193.4 million, up from the official FY13 estimate of $6,170.4 million. FY12 revenues are $1,200 million above the estimate. Do you want a tax cut?

Source: Legislative Services Agency "Monthly General Fund Revenue Memo," and Revenue Estimating Conference Report

U.S. and Iowa's Unemployment, June 2011 - Present



Nationally, unemployment remained at 8.2 percent in June. The Iowa rate increased slightly to 5.2 percent. The number of people employed in Iowa remains 41,000 below the high of 1,614,400 with jobs in March of 2007. The number unemployed also remains over 26,000 above the low of 59,500 unemployed workers in March 2007.

Source: Iowa Workforce Development, Labor Market Information Bureau, "Monthly Unemployment Rate News"

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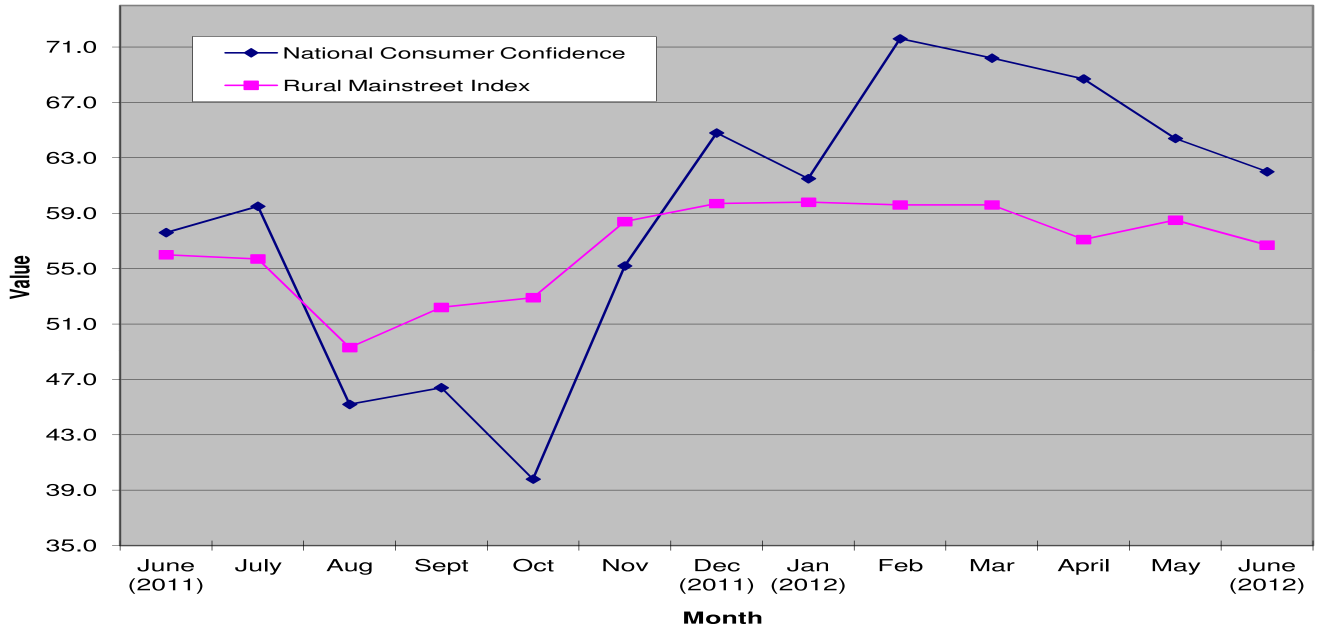
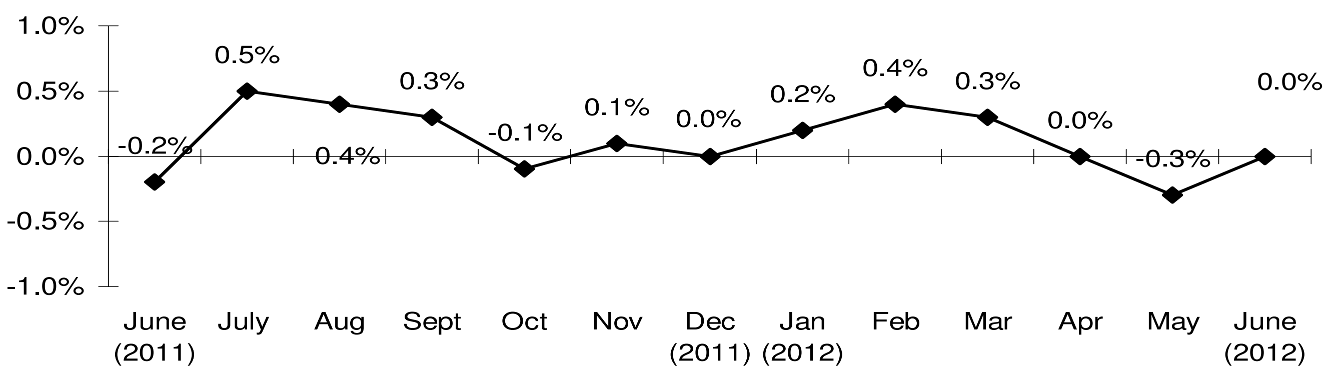
Consumer Confidence Index



The national Consumer Confidence Index (CCI) continued to decrease through June, reaching 62 down from 71.6 in February. According to the CCI board, "Income expectations, which had improved last month, declined in June." As a result, spending is expected to be "restrained in the short-term." The Rural Mainstreet Index (RMI) for the region fell to 56.7, and in Iowa to 56.1 in June. According to RMI creator Ernie Goss, "The global economic slowdown combined with a stronger U.S. dollar has pushed agriculture and energy prices lower. This is weakening overall growth for the Rural Mainstreet economy."

Source: Conference Board, "Consumer Confidence Survey," and Creighton University

Consumer Price Index, Monthly Change



The seasonally adjusted official Consumer Price Index remained flat in the second quarter of 2012. Over the last 12 months, the all-items index increased 1.7 percent. The energy index fell 1.4 percent because of lower gasoline prices, but was offset by increases in food. The food index change was driven by increases in fruits, vegetables, meats, poultry, fish, eggs, and nonalcoholic beverages. Costs for virtually every other index also rose slightly, including medical care, shelter, recreation, apparel, new cars, household furnishings, tobacco, and personal care.

Source: U.S. Department of Labor, Bureau of Labor Statistics

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the bill, saying that if he were convinced the revenue aspect was simply a pretext "to destroy . . . one industry of our people for the protection and benefit of another," he would have vetoed it.

Congress imposed another tax on margarine in 1902, which the Supreme Court upheld (*U.S. v. McCray*, 1904). Three justices dissented, but without writing an opinion.

Then, in 1914, Congress imposed taxes on druggists' sales of opiates as a way to regulate their use. Five years later, in *U.S. v. Doremus* , the Supreme Court upheld the levy under Congress's express power to impose excise taxes.

Then, in 1922, the court rejected Congress's attempt to prohibit child labor by imposing a tax on companies that employed children. An earlier attempt to accomplish this, by prohibiting the interstate shipment of goods made by child labor, was struck down as unconstitutional — since it was understood since the earliest days of the republic that Congress had the power to regulate commerce but not manufacturing. "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," Chief Justice William Howard Taft wrote in *Bailey v. Drexel Furniture Co.* "It's prohibitory and regulatory effect and purpose are palpable." Even liberal justices Oliver Wendell Holmes and Louis D. Brandeis concurred in Taft's opinion.

Things came to a head in the New Deal, when Congress imposed a tax on food and fiber processors and used those tax dollars to provide benefits to farmers. Though in *U.S. v. Butler* (1936) the court adopted a more expansive view of the taxing power — allowing Congress to tax and spend for the "general welfare" beyond the powers specifically enumerated in the Constitution — it still held the ends had to be "general" and not transfer payments from one group to another. After President Franklin D. Roosevelt threatened to "pack" the Supreme Court in 1937, it accepted such transfer payments in *Mulford v. Smith* (1939), so long as the taxes were paid into the general treasury and not earmarked for farmers.

And now, in 2012, Chief Justice Roberts has confirmed that there are no limits to regulatory taxation as long as the revenue is deposited in the U.S. Treasury.

Are there any other limits? Article I, Section 2 says that "direct taxes shall be apportioned among the states" according to population. This is repeated in Article I, Section 9, which says that "no capitation, or other direct tax, shall be laid," unless apportioned.

The Supreme Court struck down income taxes in 1895 (*Pollock v. Farmers' Loan & Trust Co.*), on the grounds that they were "direct" taxes but not apportioned by population. Apportioning an income tax would defeat the purpose of the relatively poorer Southern and Western states, who wanted the relatively richer states of the Northeast to pay the bulk of the tax. The 16th Amendment gave Congress the power to tax incomes without apportionment.

Other direct taxes should presumably have to be apportioned according to the Constitution. Justice Roberts quickly dismissed the notion that the individual mandate penalty-tax is not a direct tax "under this Court's precedents." To any sentient adult, it looks like a "capitation" or head tax, imposed upon individuals directly. Unfortunately, having plenty of other reasons to object to ObamaCare, the four dissenting justices in *NFIB v. Sebelius* did not explore this point.

Some conservatives have cheered that part of Justice Roberts's decision that limits Congress's Commerce Clause power. But an unlimited taxing power is equally dangerous to constitutional government.

Mr. Moreno is a Professor of History at Hillsdale College and the author of The American State from the Civil War to the New Deal, *forthcoming from Cambridge University Press.*

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income level can receive subsidies that differ by $10,000 or even $20,000.

Tax fairness means we are all treated the same.

Portability. Remarkable as it may seem, almost every state in the union prevents employers from helping their employees obtain the type of insurance they most want and need: portable insurance that travels with the individual from job to job and in and out of the labor market. The reason the states are doing this: misguided federal laws. ObamaCare will continue this strange and indefensible policy.

We should reverse course and encourage personal and portable insurance instead.

Patient Control. Roughly 24 million families are currently managing some of their own health care dollars in special savings accounts, and a RAND study shows that employer plans cut costs by as much as 30 percent as a result. The rules governing these accounts are too restrictive, however. What is needed is a very flexible Health Savings Account (HSA) that can wrap around any health plan. In this way, individual choice and the marketplace would determine which expenses individuals will self-insure for in an HSA and which expenses will be paid by a third-party insurer.

Real Insurance. If health insurance were portable, the problem of pre-existing conditions would rarely arise. And the remaining problems would go away if health insurance worked like life insurance or casualty insurance. Specifically, people should be able to buy change of health status insurance. If you acquire a pre-existing condition and if you are forced to switch health plans, the current plan would pay the new plan any additional premium that is needed to reflect your higher health care cost.

Universality. In any system in which individuals are offered tax relief for the purchase of health insurance, some people will inevitably turn the offer down. What happens to the unclaimed tax credits? They should be made available to safety net institutions in the area where the uninsured live, so that money is available if the uninsured cannot pay their medical bills.

This is a system under which money follows people. If everyone in Dallas County accepts the government tax-credit offer and obtains private insurance, we do not need safety net institutions. The $8,000 family tax credits all go to pay premiums and deposits to HSAs. On the other hand, if everyone in Dallas County decides to become uninsured, the unclaimed credits all go to the safety net institutions.

This is a practical, realistic, and workable form of universal coverage.

It is to be hoped that the Congress seriously considers these ideas in not only repealing, but replacing Obamacare.

John Goodman, Ph.D., is President and CEO of the National Center for Policy Analysis and author of the new book, Priceless: Curing the Healthcare Crisis*. He received his Ph.D. in economics from Columbia University. Dr. Goodman is widely known as the "Father of Health Savings Accounts." Modern Healthcare named him as one of four people who have most influenced the modern health care system.*

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full at $60 million. This how taxpayers expect us to manage their money.

When the Legislature adjourned in May, the projected ending balance in FY 2013 was $328 million. Based on the June 30 revenue number, the ending balance for FY 2013 would be $464.4 million.

It is important to remember that these numbers are not final. There will be some receipts (accruals) that will be deposited in July and August, and some expenditures will be subtracted. These include performance of duties and the decisions of the State Appeal Board. In the end, it is unlikely that there will be major changes when the books for FY 2012 officially close at the end of August.

All would be good and promising, but we need rain…badly…throughout Iowa. This could severely impact our state budget and thousands of farmers and farm-related businesses. Fortunately, Governor Branstad is attempting to pro-actively address drought issues to benefit all Iowans.

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Question of the Quarter:

Are you concerned about inflation? Why or why not?

Send your response to us at Public.Interest.Institute@LimitedGovernment.Org,
or answer on-line at http://www.LimitedGovernment.org/IESAug2012.html.
We may publish your response in the November 2012 issue of *IOWA ECONOMIC SCORECARD*.