



Ted Olson Misses the Mark on Analysis of DBCFT Constitutionality

Joseph Henchman

May 4, 2017

In *The Washington Post*, former Solicitor General Theodore Olson argues that a border adjustment would be unconstitutional as a direct tax not apportioned by population and not categorized as an income tax.

Olson is a brilliant litigator, but he's wrong on this one.

Olson correctly explains that the Constitution divides taxes into two categories: indirect and direct. Indirect taxes can be levied by Congress without much limitation, other than uniformity. (The border adjustment arguably might be vulnerable on this ground, but Olson does not raise this argument.) Direct taxes are not permitted unless (a) they are apportioned to each state on the basis of population or (b) an income tax, per the Sixteenth Amendment. *See* U.S. Const., art. I, sec. 2, cl. 3; U.S. Const., art. I, sec. 9, cl. 4.

Admittedly, the Court has never clearly defined the dividing line between direct and indirect taxes, though we at the Tax Foundation have argued that incidence is a good predictor of how the Court has ruled on various taxes. (One exception: the ruling that the ACA individual mandate is a tax, which we disagreed with and argued against.) Indirect taxes are on consumption but not generally remitted by the consumer; examples include customs duties, sales taxes, business taxes, or taxes on a particular event or exchange (like estate taxes). Direct taxes are on people or their property, where the incidence is undoubtedly and exclusively on the individual paying the tax; examples include income, property, and wealth taxes. *See Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895); *Knowlton v. Moore*, 178 U.S. 41 (1900); *Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1, 10-11 (1916).

Here's why this tax idea would be constitutional:

First, taxes on imports exist presently, and have since the Washington administration. The Constitution expressly authorizes taxes on imports ("duties, imposts"). *See* U.S. Const., art I, sec. 8. The early Supreme Court confirmed that import duties and excise taxes are indirect taxes because they are taxes on products and not on people, in a case that remains valid to this day. *See Hylton v. United States*, 3 U.S. (3 Dall.) 171, 176 (1796) (Iredell, J., seriatim op.).

Second, the Court has ruled that taxes on business receipts, income, or profits are not direct taxes, but rather indirect excise taxes on the privilege to engage in business activity. *See Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911). That's how the corporate income tax was adopted in 1909 and upheld as constitutional in 1911, prior to the ratification of the Sixteenth Amendment.

Third, the border adjustment would not be a direct tax because consumers would not bear the full legal or economic incidence. On legal incidence, the payor would be the corporation, not consumers. Economic incidence would be more debatable, with consumer purchasers likely bearing a significant but not exclusive share of the economic burden of the tax. Corporate shareholders and employees would also bear some share of it. The tax would be more accurately characterized as on a product, event, activity, or exchange, rather than on a person, their income, or their property. Consequently, it is an indirect tax not subject to the apportionment requirements of the Constitution.

Fourth, most scholars who have considered the question, including Richard Epstein, Professor Calvin H. Johnson, and Erik Jensen have concluded that a national sales tax or consumption tax would be constitutional as an excise tax. (Jensen argued that the Hall-Rabushka flat tax, a consumption tax structured as an income tax, would be a direct tax, which is probably correct.)

A national sales tax was considered in 1932 and 1942, with many objections but not on constitutional grounds. In arguing for a national sales tax, the Cato Institute assumes that it is permissible for Congress to enact one without a constitutional barrier; the Mercatus Center offers forty pages of arguments against a national sales tax but never raises a constitutional issue.

There's lots of valid arguments on both sides of the border adjustment debate. This isn't one of them.

If you want to learn more about the definition of "tax," I wrote a whole book on the subject.