Taxes and Takings - and First Principles

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Taxes and Takings – and First Principles

It has been the prevailing view for a very long time that “taxes are not subject to the takings clause” – based upon some long standing Supreme Court rulings that are cited in support of this view. But that is a misreading of these cases, which contain within their rulings both an implicit presumption that taxes are subject to the takings clause – and an explicit test for when the takings clause is violated.

The Rule and An Exception

The power of eminent domain (a/k/a the takings clause) says that “private property [shall not] be taken for public use, without just compensation.” But, in the case of taxes, there has long been an exception to the takings clause that says (in effect) that “taxes are not subject to the takings clause.” Thus, we often hear that “taxpayers are guaranteed nothing in return for their taxes.”

Now, it appears that this taxing power exception was conceived to shield general revenue taxes (whose benefits are immeasurable) from constitutional attack for failure to provide the just compensation that is required by the takings clause (because the benefits are immeasurable) – by simply declaring (with little discussion) that “taxes are not subject to the takings clause”. But when we looked more closely at this taxing power exception, to see why taxes should not be subject to the takings clause, we discovered that –

(1) Contrary to the exception, taxes are indeed subject to the takings clause, and
(2) In one case (and one case only), there is a conclusive presumption that the takings clause is satisfied, without regard to distribution of the tax benefits – when the tax is a flat rate tax, based on ability to pay, with benefits that are immeasurable, and
(3) In every other case, there is a rebuttable presumption that the takings clause is satisfied, and the benefits received for each tax must be examined for evidence of a flagrant and palpable inequality between the burden imposed and the benefit received” – that violates the takings clause – and rebuts the rebuttable presumption.

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2 U.S. Constitution, Amendment V (last twelve words).
3 “It is well settled that the takings clauses of the federal and state constitutions apply only to the state’s exercise of eminent domain and not to the state’s power of taxation.” Empress v. Giannoulis, 231 Ill.2d 62 (2008), petition for certiorari denied June 8, 2009.
4 David Morton, Manager of the Town of Casco, Maine, at a 2007 meeting at which several hundred residents were bitterly objecting to large increases in their property tax assessments.
The Principle of Ability to Pay

The centerpiece of this discussion is the principle of ability to pay — and the important role it plays in the formation of constitutional taxation. The principle of ability to pay focuses on the overall capacity of taxpayers to pay their taxes with two equitable components — horizontal equity, that taxpayers of equal wealth should pay the same amount of taxes — and vertical equity, that taxpayers of greater wealth should pay a greater share of taxes than taxpayers of lesser wealth.  

Taxes Based on Ability to Pay – and Implicit Compensation

Now, the principle of ability to pay has long been recognized as the basis for general revenue taxes whose benefits are immeasurable. The benefits are deemed immeasurable (in some cases) because they are difficult (and perhaps impossible) to measure and (in others) because the cost of the benefits (referred to as “public goods”) has been accepted as the responsibility of the community as a whole, and not of the individuals receiving the benefits. And when the benefits are immeasurable, it is logical that the taxes to pay for these benefits be spread among the taxpayers according to their ability to pay, with each taxpayer paying his fair share of the taxes. And because the benefits are immeasurable, the Supreme Court long ago decided that the constitutionality of a state tax law (i.e. satisfaction of the takings clause) will not be questioned – except in the special circumstances that are described by the Court in that case.

I. The Origin of the Taxing Power Exception

The Supreme Court speaks

In a 1921 case, the Court described the situation as follows:

[I]t may plainly be derived from the cases cited that, since the system of taxation has not yet been devised which will return precisely the same

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5 Economyprofessor.com/economictheories/ability-to-pay-principle.php

6 Edwin R.A. Seligman, Essays In Taxation (“Seligman Essays”), Professor of Political Economy and Finance, Columbia College (MacMillan & Co. 1895) 274-275, “The basis of taxation is the ability or faculty of the taxpayer; the basis of a fee is the special benefit accruing to the individual. . . . In the case of a fee, the benefit is measurable; in the case of a tax, the benefit is not susceptible of direct measurement. In the case of a fee, the particular advantage is the very reason of the payment; in the case of a tax, the particular advantage, if it exists at all, is simply an incidental result of the state action.”

7 The concept of “immeasurable benefits” includes benefits that are unevenly enjoyed by the members of a community, which may to some extent be measurable (as reflected in note 6 above), but are considered immeasurable (and not to be measured) because they are the responsibility of the community at large, and not of the individuals receiving the benefits. A notable example of these are public education benefits.

8 Seligman Essays 57, “Every civilized society professes to tax the individual according to his ability to pay . . . In the early stages of society property is indeed a rough test of ability. In modern societies, as we have seen, the basis of taxation has . . . shifted from product to income. . . . This is the reason for the failure of the property tax. . . . The property tax is unjust . . . because property is no longer a measure of ability.”
measure of benefit to each taxpayer . . . in proportion to payment made, as will be returned to every other individual . . . paying a given tax, it is not within either the disposition or power of this Court to revise the necessarily complicated taxing systems of the states for the purpose of attempting to produce what might be thought to be a more just distribution of the burdens of taxation than that arrived at by the state legislatures . . . [A] state tax law will be held to conflict with the Fourteenth Amendment only where it proposes, or clearly results in, such flagrant and palpable inequality between the burden imposed and the benefit received as to amount to the arbitrary taking of property without compensation (emphasis supplied). \(^9\)

Here, the Court focuses on the essence of the problem – the inability to know (and show) that there is equal proportionality between the burdens imposed and the benefits received by all taxpayers.

Then, a few years later, in 1934, the Court hardened its position (in a confusing way) as follows:

Except in rare and special instances, the due process of law clause contained in the Fifth Amendment is not a limitation upon the taxing power conferred upon Congress by the Constitution. . . . That clause is applicable to a taxing statute such as the one here assailed only if the act be so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power, as, for example, the confiscation of property. \(^{10}\)

This position is perplexing: how can you say the due process clause is not a limitation upon the taxing power – except when it is a limitation upon the taxing power? Does it not make more sense to say there is a presumption that the due process clause is satisfied – until it is rebutted by a showing that there has been a “confiscation of property” (i.e. a taking without just compensation)?

Now, note (in Dane) that the Court is describing a general revenue tax whose benefits are immeasurable – confirming our earlier suggestion that these are the taxes the taxing power exception was intended to protect. And note that there is an implicit presumption that the due process clause (the takings clause) is satisfied – which necessarily precedes the demanding test that follows – for what is needed to rebut the presumption – i.e., a “flagrant and palpable inequality between the burden imposed and the benefit received” for the tax.

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\(^9\) Dane v. Jackson, id., note 1, 598-599.
\(^{10}\) Magnano Co. v. Hamilton, id., note 1, 44.
As stated in the passage, the optimal *general revenue tax* is a tax:

\[ \text{. . . which will return precisely the same measure of benefit to each taxpayer . . . in proportion to payment made, as will be returned to every other individual . . . paying a given tax (emphasis supplied).} \]

And the deviation from this ideal that will violate the takings clause is said to be an “inequality between the burden imposed and the benefit received” for a tax – which we determine (by logical deduction) must mean a disproportionality between the burdens imposed and benefits received by the several taxpayers relative to each other.

This is a call for the *proportionality* between the burdens and benefits of a tax – for all taxpayers – which will satisfy the *takings clause*. When there is *comparable proportionality* with respect to all taxpayers, there are no transfers of wealth between taxpayers – and no violation of the takings clause. But, when there is *not* comparable proportionality with respect to all taxpayers, there are transfers of wealth – from taxpayers who receive less than their proportionate share of benefits – to taxpayers who receive more than their proportionate share of benefits, and (when this “inequality” is “flagrant and palpable”) there is violation of the takings clause.

At this point, the powers that be – not knowing how to determine when there is *comparable proportionality* (for all taxpayers) between the burdens and benefits of the tax – for all taxpayers – that satisfies the takings clause – simply accepted that “taxes are *not* subject to the takings clause” – and so provided the basis for the *taxing power exception*.

And, while this view has prevailed for many years, there have also been lingering doubts for many years about just what the proper relationship is – between taxes and the takings clause – and about whether this resolution of the problem (i.e. creating the *taxing power exception*) was the proper way to resolve this problem. 11

II. The Tax that Solves the Problem

So, now we ask – is there a better solution – is there a *general revenue tax* (with benefits that are *immeasurable*) about which we can say with certainty (contrary to the view in *Dane*) that there is *comparable proportionality* between the burdens and benefits of the tax – for all taxpayers – that satisfies the *takings clause*?

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11 Richard A. Epstein, *Takings (Private Property and the Power of Eminent Domain)* (Harvard University Press 1985)(“RAE Takings”) 283-285. “The proposition that all taxes are subject to scrutiny under the eminent domain clause receives not a whisper of current support. The taxing power is placed in one compartment; the takings power in another. The first power is wholly untouched by the limitations imposed upon the other. A confiscatory tax approaching 100 percent will be attacked in vain as arbitrary, but the attack is in the garb of substantive due process, not eminent domain.”
And we find there is One Tax that meets this criteria – that Automatically Produces Comparable Proportionality between the Burdens and Benefits of the Tax

It is a flat rate tax – based upon ability to pay – with benefits that are immeasurable, which automatically produces comparable proportionality between the burdens and benefits of all taxpayers, with no transfers of wealth between taxpayers, because each taxpayer pays the same proportion of his wealth into the tax collection, and receives in return a share of the implicit compensation produced by the taxes that is proportionate to his share of the total wealth of all taxpayers.

The Principle of Proration

This is the principle of proration that says that the burdens and benefits of each group enterprise are pro-rated among the members of the enterprise, whether public or private, in proportion to their investments in the enterprise. 12 A familiar application of this principle is found in a private partnership, where gains in the value of partnership property are allocated among the members of the partnership, in proportion to their investments in the partnership.

And a less familiar application is found in a public community, where gains in value from social governance (a “social surplus”) are allocated among the members of the community in proportion to their existing wealth (their “private holdings”). 13 This application is more difficult to visualize, because a social surplus is more difficult to visualize, but we can see how the principle does work to produce the proportionality between the burdens and benefits of a tax that prevents transfers of wealth between taxpayers that would violate the takings clause. 14

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13 RAE Takings 3-6 (“A Tale of Two Pies”), 163. The two (John) Lockean pies pictured on page 4 of RAE Takings show, pictorially, how the gains from social governance are allocated among the members of a community in proportion to the relative size of each member’s preexisting share of the total value of the community.
14 RAE Takings 163, “For example, if each person received an equal portion of the general gain, there would be an incentive for persons with smaller shares to force matters into the public area, where they would be relative gainers. Keeping the gains pro rata minimizes the possibilities of strategic gamesmanship.”
Now, we appreciate the need to qualify a general revenue tax (with immeasurable benefits) as a constitutional tax. But the way to do this is not by simply declaring that “taxes are not subject to the takings clause” (the outgrowth of Dane) – but rather by employing the one tax that is conclusively presumed to satisfy the takings clause (without regard to distribution of the tax benefits) – i.e. a flat rate tax, based on ability to pay, with benefits that are immeasurable.

This is the formula for the One Tax that we can

Conclusively Presume will Satisfy the Takings Clause

We call this the “self-equalizing tax”, because the proportionality between the burdens and benefits of the tax is automatically made the same – for each and every taxpayer – by the dual operation of the principle of ability to pay (that each taxpayer pays the same proportion of his wealth into the tax collection) – and the principle of proration (that each taxpayer receives in return a share of the immeasurable benefits of the tax (the “social surplus”) that is proportionate to his share of the total wealth of all taxpayers. All of this with the resulting effect – that there are no transfers of wealth between taxpayers – and we can therefore conclusively presume that the takings clause is satisfied – and that there is no need to examine the distribution of the tax benefits.

III. The Demise of the Taxing Power Exception

This is the turning point. Earlier (in Dane), we saw that – “since the system of taxation has not yet been devised” which can provide comparable proportionality between the burdens and benefits of a tax, for all taxpayers – this led to creation of the taxing power exception – that said that “taxes are not subject to the takings clause”.

But we have now discovered the tax system (that was missing in Dane), which automatically provides comparable proportionality between the burdens and benefits of the tax, for all taxpayers– and is conclusively presumed to satisfy the takings clause (i.e. the self-equalizing tax).

So now, when there are community expenses whose benefits are immeasurable, they should be financed by this self-equalizing tax that automatically produces comparable proportionality between the burdens and benefits of the tax, for all taxpayers.

And this tax will then be conclusively presumed to satisfy the takings clause – eliminating any and all need for the taxing power exception – because there is no need to shield taxes from the takings clause – when they are conclusively presumed to satisfy the takings clause.
Indeed, we now contend that there was never any logical reason for declaring that “taxes are not subject to the takings clause”. Because we now see that the creation of the taxing power exception was a product of a misreading of the plain language of Dane (that we have quoted above). And we now challenge anyone to provide any logical reason why taxes (perhaps the most obvious of all governmental “ takings”) have not always been (and should not always be) subject to the takings clauses of the state and federal constitutions.

So this is our challenge: Do we continue to accept the current view that taxes are not subject to the takings clause – or do we acknowledge that taxes are subject to the takings clause in accordance with the reasoning in this paper. A closer look at the public school property tax will show (by plausible example) why it is important that we accept and acknowledge that taxes are subject to the takings clause.

IV. The Public School Property Tax

The public school property tax is the perfect tax for showing why taxes must necessarily be subject to the takings clause – and how a wrongly structured tax will inevitably violate the takings clause.

In the beginning school property taxes were based on ability to pay, but they are no longer based on ability to pay – and for a long time they have not been based on ability to pay. The following is from a “Homeowner’s Guide to Property Tax in Maine”, published in 2004 by the Maine Municipal Association:

Property taxes have been with us since colonial times when a person’s wealth could be measured in the amount of property a person owned. Although it is our oldest form of taxation in Maine, the property tax still remains widely misunderstood. As the fundamental structure of our economic system has evolved from an agricultural economy to a manufacturing economy to a services-based economy, the patterns of ownership have changed and the property tax has become quite regressive because it is no longer necessarily based on a person’s wealth or ability to pay (emphasis supplied).

The school property tax system now rests upon two assumptions that at one time were true, but are no longer true, to wit: (1) that the tax is based upon ability to pay, and (2) that the tax benefits are apportioned among taxpayers in proportion to the taxes they pay. The undoing of these assumptions parallels the evolution of the school property tax (as noted above) from a tax that was originally based on ability to pay – into a tax that is no longer based
on ability to pay. In the process, the benefits of these taxes necessarily evolved from benefits that did not need to be examined, because the burdens and benefits were automatically proportional (when based on ability to pay) – into benefits that are no longer automatically proportional (when no longer based on ability to pay), and must now be examined for evidence of the proportionality between the burdens and benefits that is required by the takings clause.

First, we note that no one today can seriously argue that public school taxes are based on ability to pay, since this would require that the ratio between the value of each piece of property and the net worth of its owner be the same in every case – which could never be true.

Then, in Exhibits A through D (beginning on page 10) we see, in graphic display, how property is inevitably transferred from property taxpayers of lesser wealth to taxpayers of greater wealth, in violation of the takings clause.

**The Graphic Display**

In Exhibit A (page 10) we see the *disproportionate impacts* that can occur in a school tax system, and how a tax imposed *only* upon real property (a small component of total wealth (2-18%)) and not upon intangible property (the largest component of total wealth (about 82%)) falls most heavily upon those less wealthy taxpayers whose homes constitute a large part of their total wealth. 15

In Exhibit B (page 11) we see the difference in tax impacts, in tax dollars, between (1) a 2% tax on real estate, and (2) a 10% tax on income, depending on the income of the taxpayer. 16 And it is this income tax (not the real estate tax) that is based on “ability to pay”, and the diagonal line tracking the income tax that represents the equitable allocation of this tax burden. And once we accept that it is the income tax that represents the equitable allocation of these taxes, we must then agree that the taxpayers who are paying more than 10% of their income in real estate taxes – are paying the taxes being saved by the taxpayers who are paying less than 10% of their income in real estate taxes.

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16 Exhibit B also shows a 1% tax on total wealth. We assume that the income tax can be made adequately comparable to a tax on total wealth (with adjustments similar to those used in calculating “alternative minimum taxable income”), and we therefore (for ease of presentation) hereafter refer to both taxes collectively as the “income tax”. The line representing the 10% income tax and the 1% wealth tax would follow the same path (be the same line), provided the figure for taxable income can be adjusted to produce close correlation between taxable income and total wealth.
Also in Exhibit B we can see, in graphic form, how wealth is transferred from the less wealthy to the more wealthy members of a community, as the real estate taxes paid by the less wealthy members, of more than 10% of their income (lower left triangle) become the tax savings of the more wealthy members, of the amounts by which their real estate taxes are less than 10% of their income (upper right triangle).

In Exhibit C (page 12) we see the difference in tax impacts between the two taxes, in the percentages of income that are taken by each tax, and how the higher percentages of income taken by the real estate tax from less wealthy taxpayers (to the left of the crossing lines) are transferred (as tax savings) to the more wealthy taxpayers, by the lower percentages of income that are taken from them (to the right of the crossing lines).

And in Exhibit D (page 13) is a U.S. Census Bureau graph showing a range of percentages of property taxes as a percentage of income, and the percentage of U.S. households within each percentage of income bracket. These are the flesh and blood taxpayers who populate the graphs in Exhibits B and C – and are living proof of the wide disparity in the levels of income that are received (and percentages of income that are paid) by the payers of real property taxes.
Exhibit A

The School Property Tax
and
Disproportionate Impacts

<table>
<thead>
<tr>
<th></th>
<th>Taxpayer A</th>
<th>Taxpayer B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home</td>
<td>250,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Mortgage</td>
<td>0</td>
<td>(200,000)</td>
</tr>
<tr>
<td>Bank Account</td>
<td>650,000</td>
<td>250,000</td>
</tr>
<tr>
<td>Total Wealth</td>
<td>900,000</td>
<td>300,000</td>
</tr>
<tr>
<td>Income</td>
<td>90,000</td>
<td>30,000</td>
</tr>
<tr>
<td>2% Real Estate Tax</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>10% Income Tax (or 1% wealth tax)</td>
<td>9,000</td>
<td>3,000</td>
</tr>
</tbody>
</table>

Proration of tax benefits
by actual benefits received ¹
26,000
0

Proration of tax benefits
by principle of proration ²
9,000
3,000

¹ This shows allocation of the tax benefits according to the actual benefits received. Since the real estate tax is not based on ability to pay, we must examine the benefits that are received to determine whether there is proportionality between the burdens and benefits. A has two children in the school system (at an annual cost of $13,000 per student) and B has no children in the school system. Here we see the substantial transfer of wealth under the real estate tax, from B (a person of lesser wealth) to A (a person of greater wealth).

² This shows allocation of the tax benefits according to the principle of proration, in proportion to the income of A and B (provided taxable income can be adjusted to be in close correlation with total wealth), otherwise in proportion to the total wealth (“private holdings”) of A and B. Here we see the automatic proportionality between the burdens and benefits under an income tax (or a wealth tax) when the tax is based on ability to pay, and the benefits are immeasurable.
Exhibit B

School Property Tax Regression
Real Estate Tax vs. Income (Wealth) Tax
Tax Dollars

Income (Income)

Tax Dollars

10%, tax on income (1% on wealth)

2% tax on real estate
Exhibit C

School Property Tax Regression
Real Estate Tax vs. Income (Wealth) Tax
Percentage of Income (Wealth)
Exhibit D

School Property Tax Regression

Percentage of Income

FIGURE 1.2
Property Tax as a Percent of Income (2006)

Source: U.S. Census Bureau (2006a).
In the case of Taxpayers A and B portrayed in these exhibits, we see how $2,000 of
B’s wealth is transferred (each year) to A, who has three times as much wealth (and three times
as much income) as B. As time goes on, this transfer of wealth accumulates and grows, year
after year, to the ever-increasing advantage of more wealthy taxpayers and ever-increasing
disadvantage of less wealthy taxpayers. We can think of no justification for a tax that results
in an unrelenting (and uncompensated) transfer of wealth from the less wealthy to the more
wealthy members of a community.

In 1987, the Maine legislature passed a property tax “circuit breaker” program, to provide
relief for low-income taxpayers (with a current benefit limitation of $900 per annum, which is at
once both minimal and inadequate). In its foundational “statement of fact”, the legislature said,
in part:

The property tax is generally considered to be a regressive tax. Such a
tax consumes a larger proportion of the income of low-income persons
than it does of higher income persons. This bill relieves the regressivity
of the tax by providing a credit or payment which is inversely proportional
to a household’s income. 17

Now, there is nothing unique about a regressive tax – the sales tax is a regressive tax. What is
unique is a regressive tax for which the taxpayer receives nothing in return.

And now because the public school tax is no longer based on ability to pay, we must
examine the benefits that are received for these taxes, to see if there is a “flagrant and palpable
inequality” between the burdens and benefits that violates the takings clause.

The Public School Property Tax

And when we do so, we find that the public school property tax is

• a discriminatory tax
• on a small share of total wealth (real property)
• to pay a large share of the enormous cost of public education
• continually shifting to higher value properties
• without consideration of ability to pay
• returning little or nothing to many taxpayers
• who eventually lose their properties, when taxed beyond their ability to pay.

Does this tax not produce “such flagrant and palpable inequality between the burden imposed and the benefit received as to amount to the arbitrary taking of property without compensation”?

Each one of the above factors by itself is a serious defect – put them all together in a single tax system, and we have a completely dysfunctional system that should no longer exist.

Final Thoughts

In conclusion, we submit

(1) That taxes are indeed subject to the takings clause, and

(2) That there is one tax (and one tax only) that is conclusively presumed to satisfy the takings clause – without regard to distribution of the tax benefits – i.e. a flat rate tax, based on ability to pay, with benefits that are immeasurable (i.e. the self-equating tax).

(3) But this self-equating tax does not include the public school property tax – because the public school property tax is not based on ability to pay.

(4) And that makes the public school property tax only rebuttably presumed to satisfy the takings clause – and when we apply the test of Dane to this tax, we find the rebuttable presumption is rebutted by “a flagrant and palpable inequality” between the burdens and benefits of these taxes that is an undeniable violation of the takings clause of the Constitution.

And we close with the thought that this unconstitutional tax can be corrected quite easily, by shifting the responsibility for the property tax share of public school funding, from (1) a tax that is now based solely on the real estate that is owned by the taxpayers – to (2) a tax that is based upon the total wealth of the taxpayers.

And a final note, when it comes time to apply the literal Supreme Court test to the income tax, we believe we will find that a progressive rate income tax (in all likelihood) violates the takings clause, and that a flat rate income tax (almost certainly) does not.

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RAE Takings, 303. “The case for the progressive tax is not “uneasy.” It is wrong.”