are alternatives Romney should consider. But income phaseouts are bad economics and have no place in a tax reform plan that is supposed to improve the code.

A fourth alternative would be to reduce tax benefits for investment income, including dividends and capital gains. That could be part of a grand compromise with Democrats on tax reform if Romney chose to govern from the middle rather than from the far right. If Romney remains as fervently committed to distributional neutrality as he is in the quote at the beginning of this article, only tax reform that includes tax increases on investment income makes it possible to reduce the top rate by 20 percent.

Further Reading

Daniel Baneman, Joseph Rosenberg, Eric Toder, and Roberton Williams, ''Curbing Tax Expenditures,'' Urban-Brookings Tax Policy Center, Jan. 30, 2012, *Doc 2012-2120*, *2012 TNT 23-44*.

Alex Brill and Alan D. Viard, ''Effective Marginal Tax Rates, Part 1: Basic Principles,'' *Tax Notes*, Sept. 8, 2008, p. 969, *Doc 2008-18694*, *2008 TNT 175-45*.

Alex Brill and Alan D. Viard, ''Effective Marginal Tax Rates, Part 2: Reality,'' *Tax Notes*, Oct. 20, 2008, p. 327, *Doc 2008-21922*, *2008 TNT 204-35*.

Samuel Brown, William G. Gale, and Adam Looney, ''On the Distributional Effects of Base-Broadening Income Tax Reform,'' Urban-Brookings Tax Policy Center, Aug. 1, 2012, *Doc 2012-16395*, *2012 TNT 149-42*; and ''Implications of Governor Romney's Tax Proposals: FAQs and Responses,'' Aug. 16, 2012, *Doc 2012-17435*, *2012 TNT 160-28*. ■

NEWS ANALYSIS

Why Repealing the 16th Amendment Probably Wouldn't Matter

By Joseph J. Thorndike — jthorndi@tax.org

Repealing the 16th Amendment is something of a holy grail among conservatives. Even those who consider it unlikely still revere it in principle. Indeed, since adoption of the Republican Party platform in Tampa, Fla., last month, repeal has been an article of official faith:

> In any restructuring of federal taxation, to guard against hypertaxation of the American people, any value added tax or national sales tax must be tied to the simultaneous repeal of the Sixteenth Amendment, which established the federal income tax.[1]

The proposal is hardly new. For years, champions of sweeping tax reform — and especially tax replacement — have insisted that the great leap forward must begin with a big step back. In particular, champions of a national retail sales tax, including the FairTax, have argued that repealing the 16th Amendment is crucial to their plan. FairTax bills introduced in Congress actually include a self-destruct mechanism: If the 16th Amendment isn't gone within seven years of the law's enactment, the new sales tax would disappear instead.[2]

Which is all well and good, except for one thing: Repealing the 16th Amendment probably wouldn't matter.

Unnecessary in 1913

Debates over constitutional law are never fully settled, even when most people think they are. But the fact remains that most experts believe the federal government's power to levy an income tax would survive repeal.

> ***Most experts believe the federal government's power to levy an income tax would survive repeal.***

History supports that opinion. More than a decade ago, during an earlier wave of repeal proposals, historian David B. Levenstam laid out the facts.

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[1]Committee on Arrangements for the 2012 Republican National Convention, ''We Believe in America,'' *Doc 2012-18350*, *2012 TNT 170-15*.

[2]*See, for example*, H.R. 25, the Fair Tax Act of 2011, *Doc 2011-1661*, *2011 TNT 17-36*.

"They say that repealing the 16th Amendment will eliminate the income tax," he wrote. "They're wrong. Income taxes existed — and were considered constitutional — before the 16th Amendment."[3]

From the start, most advocates of a federal income tax believed the federal government had the power to impose one. The Supreme Court did not entirely agree; in 1895 it struck down an income tax law in the famous *Pollock* decision.[4] But many observers didn't believe *Pollock* was the last word on the subject.

Some income tax supporters, for instance, thought the Supreme Court would reverse itself if given the chance. In their view, the decision was simply, obviously, and embarrassingly wrong. "An overwhelming majority of the best legal opinion in this Republic believes that *Pollock* was erroneous," said Sen. Joseph Bailey.[5] Offer the Court another bite at the apple, and it might come up with a different decision. Or as legal historian and *Tax Notes* columnist Calvin H. Johnson put it: "The movement for an income tax took the position that the Supreme Court might allow an income tax, if Congress just passed it again, by distinguishing or reversing *Pollock*."

For politicians of a genuinely conservative nature, however, a direct challenge to *Pollock* was frightening. Most obviously, it smacked of disrespect. More seriously, it might undermine the Court's reputation and credibility. Many critics had already complained that *Pollock* was a political decision, not a legal one, and such charges had already harmed the Court's prestige.

But how much worse would that damage be if the Court again chose to stand in the way of income taxation? With the tax's popularity surging, further obstruction might pose a real danger to the Court's future. President Taft was among the worriers:

> I prefer an income tax, but the truth is that I am afraid of the discussion which will follow and the criticism which will ensue if there is another serious division in the Supreme Court on the subject of the income tax. Nothing has ever injured the prestige of the Supreme Court more than [*Pollock*].[6]

Ultimately, Taft and his allies convinced Congress to pursue a less confrontational course. Instead of simply passing a new law and daring the Court to invalidate it, they created a moderate tax on corporate income (framed as an excise — a technique left open by *Pollock*) and simultaneously proposed a new constitutional amendment to settle the income tax question definitively.

Arguably, the 16th Amendment was legally unnecessary but politically prudent a century ago. Today it seems almost entirely superfluous.

But it bears repeating that even at the time, most observers believed such an amendment was unnecessary. They insisted that *Pollock* was bad law (based on a historical misunderstanding of the Constitution's existing tax provisions). An amendment would clarify matters, but it wouldn't change anything. Congress already had the power to tax income.

Unnecessary Today

Arguably, the 16th Amendment was legally unnecessary but politically prudent a century ago. Today it seems almost entirely superfluous. As Johnson has said:

> At this point *Pollock*, if not strictly reversed, is such a moribund case that a puff of breath will blow it out. It would clean up the law a bit for the Supreme Court to declare that *Pollock* stands reversed in full, leaving intact the wise case law that preceded it. Clean, clear law is indeed a virtue. Still, in the meantime, *Pollock* should not matter much. One should not erect an edifice or a legal argument on a foundation as crumbling as *Pollock*.[7]

Repealing the 16th Amendment would no doubt be gratifying for opponents of the income tax. But in all likelihood, it wouldn't actually achieve its desired end. Perhaps Levenstam said it best:

> Eliminating Congress' power to tax income, as many supporters of a national sales tax propose, would require more than merely repealing the 16th Amendment. We would have to ratify an amendment prohibiting Congress from imposing any income tax as well as estate, gift, and gross receipts taxes. Otherwise, Congress could rely on the earlier Supreme Court decisions to continue collecting these and other related taxes. And as the

[3]David B. Levenstam, "Constitutional Challenge," *Reason* (Jan. 1999).

[4]*Pollock v. Farmers Loan and Trust Co.*, 157 U.S. 429 (1895).

[5]Calvin H. Johnson, "Purging Out *Pollock*: The Constitutionality of Federal Wealth or Sales Tax," *Tax Notes*, Dec. 30, 2002, p. 1723, *Doc 2003-148*, *2002 TNT 251-21*.

[6]*Id.*

[7]*Id.*

residents of Canada and Western Europe could tell us, we'd probably end up with the worst of both tax worlds: paying both a national sales tax and an income tax.[8]

Repealing the 16th Amendment could make a difference. Sure, Congress would probably retain its constitutional power to levy an income tax. (Although if the debate over Obamacare makes anything clear, it's that "settled" opinion doesn't always hold the sway it once did. Indeed, it didn't hold that sway in 1895, when the Supreme Court ignored decades of precedent to turn back a popular movement for taxing income.) But repealing the amendment might again put the Supreme Court in a sticky situation. If the justices were to conclude that the income tax remains constitutional, they would once again find themselves standing in the way of popular opinion. How would the Court's standing suffer if legislatures across the nation called for an end to income taxes and the justices stood in their way?

It wouldn't be a pretty picture. Luckily, it's not a likely one, either. ■

[8]Levenstam, *supra* note 3.

Lower Tax Reserves Hint at Possible Effects of UTP Reporting

By Jeremiah Coder — jcoder@tax.org

Fortune 500 firms recorded a collective total of $187.5 billion in tax reserves on their 2011 financial statements, a decrease from prior years even as corporations reported higher profits, the Ferraro Law Firm found in a study released September 10.

The same study in 2010 found companies claiming $200 billion as unrecognized tax benefits. The dip has practitioners wondering if the IRS's newly implemented uncertain tax position reporting regime has caused firms to establish fewer reserves. (For the 2012 study, see *Doc 2012-18887* or *2012 TNT 176-33*. For prior coverage, see *Tax Notes*, Sept. 6, 2010, p. 1027, *Doc 2010-19323*, or *2010 TNT 170-1*.)

The top five firms in terms of largest recorded tax reserves for 2011 are Pfizer Inc. ($7.309 billion); J.P. Morgan Chase & Co. ($7.189 billion); Microsoft Corp. ($6.935 billion); General Electric Co. ($6.384 billion); and AT&T Inc. ($5.853 billion). Scott A. Knott of the Ferraro Law Firm told Tax Analysts that *Fortune* 500 corporate profits were up 16 percent in 2011, while their corresponding tax reserves were down 5 percent. "With corporate profits increasing, it is natural to think that taxes and reserves would also increase, but it seems that base erosion is instead leading to lower tax numbers," he said.

> ***'It is possible that Schedule UTP is more likely to have companies not establish a reserve for an issue if they can avoid it,' Knott said.***

Knott said that in light of UTP reporting requirements, companies are likely interested in how they calculate reserves relative to their peers. "It is possible that Schedule UTP is more likely to have companies not establish a reserve for an issue if they can avoid it," he said, adding that while anecdotal evidence points to that conclusion, it is hard to quantify with solid data.

George A. Hani of Miller & Chevalier said the decrease in aggregate tax liability reserves by the *Fortune* 500 might have been a result of the UTP reporting regime. "I know that for a good number of companies, the prospect of submitting a Schedule UTP caused them to take steps to eliminate uncertainty and therefore reduce the reserve number," he said, noting that some businesses took proactive steps with the IRS to address the uncertainty while others simply took more conservative positions on the return.