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Determining when a levy is really a tax

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More from Vern Krishna

Obamacare labelled its program the Patient Protection and Affordable Care Act. The statute mandates that non-exempt individuals maintain minimal essential health insurance coverage or pay a "penalty" if they fail to do so. Alex Wong/Getty Images files

If U.S. president Barack Obama wins a second term next Tuesday, he will owe a debt of gratitude to U.S. chief justice John Roberts for his swing vote in the 5:4 Supreme Court decision that saved Obamacare. The majority characterized a "penalty" for doing nothing as a tax within the U.S. federal government's taxing power. Taxes are enforced expropriations of money from taxpayers to provide for the support of government. Penalties are exactions imposed for punishment for an unlawful act or omission.

The Canadian constitution divides the authority to impose taxes between the federal and provincial governments. The federal parliament has the power to raise money by any mode or system of taxation. In contrast, the provinces can impose income taxes only through direct taxation within the province and then only for raising revenue for provincial purposes.

In the U.S., direct taxes must be apportioned to the 50 states whereas income taxes are not. Thus, both in Canada and the U.S. it is important to determine whether a levy is a user fee, licence, penalty, or a tax and on whom the burden falls.

All taxes are painful. Hence, politicians attach attractive labels to taxing statutes to lessen the pain and convey the impression that they are doing good when they take your money. In 1996, for example, Ontario introduced the Fair Share Health Care "Levy" and in 2004, a healthcare "premium," both of which were in substance "taxes."

Obamacare followed the tradition and labelled its program the Patient Protection and Affordable Care Act. The statute mandates that non-exempt individuals maintain minimal essential health insurance coverage or pay a "penalty" if they fail to do so.

Obamacare requires individuals who do not have health coverage through their employer or government programs to purchase

insurance from a private company. From 2014, an individual who does not buy the insurance must make a “shared responsibility payment” to the Internal Revenue Service as a “penalty.” In effect, the levy is for doing nothing.

To be sure, it is well accepted that the statutory label of a levy, which may be important for political purposes, is irrelevant in determining its real nature. Courts have held exactions not to be taxes even when labelled as such and to be taxes when not so labelled. A particular licence or user fee, for example, may be an indirect tax and, if so, outside of the provincial constitutional authority to levy taxes.

There are several criteria to determine whether a levy is in fact a tax or a penalty. A tax raises revenue for public expenditures. In contrast, a penalty is a punitive sanction for doing something that is considered harmful and, in most cases, requires the actor to have knowledge of the wrongful act. The distinction can be subtle because both taxes and penalties can be used to affect taxpayer conduct. For example, governments are addicted to the revenues from cigarette taxes but they are also intended to encourage people to give up smoking.

Similarly, governments use liquor taxes primarily to raise revenues by maintaining monopolistic control over liquor stores, but they also impose severe penalties for violating the monopoly. Thus, every tax is in some measure regulatory in that it interposes an economic impediment to the activity taxed as compared with others that are not taxed.

Penalties imply punishment for an unlawful act or omission — such as, for example, failure to secure a valid motor vehicle permit when driving a car. In Obamacare, the individual mandate aims at inducing persons to purchase health insurance, but it does not overtly make the omission to purchase unlawful. The only consequence of failure to purchase is that the individual must pay an alternate levy to the IRS. There is no stigma or other penal sanction attached to the omission to purchase the mandated insurance. The levy is on doing nothing. Taxes usually follow an act — such as earning income, buying goods and services, importing products.

Obamacare allows individuals who choose to pay the penalty to buy their way out of buying the mandated health insurance. Indeed, the U.S. government estimates that six million people each year will choose to pay the IRS the penalty for doing nothing, which, in effect, is paying a tax on inertia. We’ll find out come next Tuesday, but Chief Justice Roberts’ vote for the do-nothing tax may have averted Obama’s defeat.