Proposed Tax on AIG Bonuses Raises Constitutional and Policy Concerns

By Joseph Henchman

90% Tax May Violate Bill of Attainder Clause and Sets Dangerous Precedent

I. Introduction
On March 19, 2009, the U.S. House of Representatives voted 328 to 93 to pass H.R. 1586, which imposes a 90% income tax on bonuses earned by employees who work at a company that received an aggregate of $5 billion in federal TARP bailout funds, including specifically Fannie Mae and Freddie Mac.

The tax is in lieu of the regular income tax and alternative minimum tax, and applies either to any compensation not received as part of a regular wage or benefit, or to all income exceeding $250,000, whichever is lower. If enacted, the additional tax would be retroactive to January 1, 2009, but any employee who waives or returns the bonus before the end of 2009 would have the surtax waived.

The day after the House action, Sen. Judd Gregg (R-NH) did not use the word "unconstitutional" but derided the bill as a proposal "to use the taxing authority of the government in a manner that is arbitrary, punitive, and targeted on a single group of people who they have deemed as having acted improperly."1 Two days later, while appearing on the news program 60 Minutes, President Barack Obama (D) also criticized the bill: "Well, I think that as a general proposition, you don't want to be passing laws that are just targeting a handful of individuals. You want to pass laws that have some broad applicability. And as a general proposition, I think you certainly don't want to use the tax code to punish people."2
Observers have noted that the bill is a direct result of bonuses awarded by bailout recipient American International Group (AIG), an insurance company now in something akin to bankruptcy trusteeship. Critics of the bill have raised policy concerns as well as suggestions that the bill may violate the constitutional prohibition on Bills of Attainder and other restrictions on legislation. Because the purpose of the legislation is to strip a specified group of people of their property, even though other nonpunitive options are available, and because the evidence suggests a punitive motive, the bill could be found unconstitutional as a bill of attainder.

II. That AIG Bonuses are the Target of the Tax is Common Knowledge
Media reports have labeled it the "AIG bonus tax," which is not surprising since the bill's introduction and passage occurred quickly after news broke that AIG had paid $165 million in bonuses (later revised upward to $218 million) to employees after the bailout. As Rep. Sheila Jackson-Lee (D-TX) summarized on the floor of the House of Representatives:

AIG has now received more than $180 billion in taxpayer money and is now nearly 80 percent owned by the government. As part of a restructuring plan announced by the Treasury Department earlier this month, AIG is set to receive an additional $30 billion in federal rescue aid.

The news that AIG paid $165 million in retention bonuses, including bonuses of at least $1 million each to 73 employees who worked in the financial products division that contributed to the company's troubles, has incited fervor among lawmakers and the public over the past week. Eleven of those top bonus recipients—including one who received $4.6 million—have since left AIG.3

Statements by supportive members of Congress during the one hour of floor debate indicate that the AIG bonuses were on their mind:

- Rep. Carl Levin (D-MI) said, "The head of AIG has suggested their returning the bonuses. They should. And if they don't, we're taking action. We have the authority under the Tax Code not to punish but to protect the taxpayers of the United States of America."4
- Rep. Gary Peters (R-MI) said, "I rise in support of H.R. 1586, legislation that I helped craft that will reclaim outrageous bonuses paid with our taxpayer dollars that were given out to AIG and other companies that received billions in TARP funds."5
- Rep. Bob Etheridge (D-NC) said, "If AIG will not halt these bonuses, and if its employees will not voluntarily turn them down, then this bill will ensure that the money is returned to the taxpayers."6
- Rep. Frank Kratovil (D-MD) said, "What I am interested in doing today is doing what we can do to recoup the taxpayer dollars that were used to pay AIG executives bonuses that not only did they not deserve but should be ashamed for having accepted. That is what this bill does."7
- Rep. Lynn Woolsey (D-CA) said, "I urge my colleagues to support this legislation as a way not only to express our outrage, but also as our commitment to a new system of regulation and oversight."8
- Rep. Dale Kildee (D-MI) quipped, "A bonus is supposed to be a reward for something good—for excellent performance, not for running your company into the ground and sending the economy into a tailspin. AIG's performance warrants a pink slip, not a paycheck."9
- Rep. Phil Hare (D-IL) added, "Clearly, the 'G' in AIG stands for greed."10
Rep. Sheila Jackson-Lee (D-TX) added, "I rise today with pitchfork in hand to take back from the executives at AIG, monies that rightfully belong to the taxpayers of this country." It would therefore be disingenuous to argue that reports of the AIG bonuses were anything less than the direct cause of the consideration of the tax legislation.

III. The AIG Tax Bill Has Been Criticized on Constitutional Grounds

Criticism of the bill on constitutional grounds has included reference to five separate sections of the U.S. Constitution. The Bill of Attainder Clause of Article I, Section 9 prohibits "[l]egislative acts...that apply to...easily ascertainable members of a group in a way as to inflict punishment on them without a judicial trial." The Ex Post Facto Clause of Article I, Section 9 prohibits laws that "in effect impose[] a penalty or the deprivation of a right which, when done, was lawful." The Contracts Clause of Article I, Section 10 bars states from passing any law "impairing the Obligation of Contracts." The Due Process Clause of the Fifth Amendment protects individuals from federal deprivation of "life, liberty, or property, without due process of law." The Takings Clause of the Fifth Amendment prohibits governments from taking private property except for public use and only with just compensation, and also encompasses equal protection claims against the federal government.

As the House considered the legislation, the eminent constitutional law scholar Laurence Tribe was asked to evaluate the constitutional claims. He easily disposed of the arguments relating to the Contracts Clause, which by its own terms applies only to state government actions, and the Takings Clause and Ex Post Facto Clause, where case law has not treated taxation as a taking or retroactive taxation as impermissible. Tribe also concluded that a claim under the Due Process Clause would be unlikely to prevail under prevailing judicial understanding of that clause. As for the Bill of Attainder Clause, Tribe also concluded that it would not bar the legislation, though with additional commentary.

Another renowned constitutional law scholar, Richard Epstein, penned an op-ed conducting a truncated but similar analysis, though suggesting that this would be more a result of a deferential court than constitutional command.

IV. The AIG Tax Bill Could Be an Unconstitutional Bill of Attainder

The Bill of Attainder Clause exists "not as a narrow, technical prohibition, but rather as...a general safeguard against legislative exercise of the judicial function, or more simply—trial by legislature." It serves as "a general safeguard against legislative exercise of the judicial function, or more simply—trial by legislature." As Chief Justice Earl Warren once wrote for the U.S. Supreme Court, this is because "the legislative branch is not so well suited as politically independent judges and juries to the task of ruling on the blameworthiness of, and levying appropriate punishment upon, specific persons." James Madison characterized bills of attainder as "contrary to the first principles of the social compact, and to every principle of sound legislation."

One law review note that warned against a too expansive scope for the Bill of Attainder Clause nevertheless characterized a proper claim as one where the court must provide "protection of political minorities singled out for punishment by majoritarian legislatures." Here, it is not disputed that a majoritarian legislature is singling out a very unpopular group for an action that the members of the group will find harmful.
Determining whether a law is a bill of attainder involves the application of a two-part test: (1) whether the legislature has acted with specificity, and (2) whether the legislature has imposed punishment. \(^{20}\)

**A. Specificity**

While "bills [of attainder] are generally directed against individuals by name," they "may also be directed against a whole class."\(^{21}\) The precise level of specificity at which point a class becomes unconstitutionally targeted is unsettled. In *Nixon v. Adm'r of Gen. Servs.*, which involved a congressional attempt to seize audio tapes from the former President, the Supreme Court concluded that just because a class consists only of one does not necessarily make it too specific. "[A]ny individual or group that is made the subject of adverse legislation can complain that the lawmakers could and should have defined the relevant affected class at a greater level of specificity."\(^{22}\) The attainder clause is not "a variant of the equal protection doctrine" nor does it "limit[] Congress to the choice of legislating for the universe...."\(^{23}\) In *Nixon*, while the class contained only one former president, the Court noted that future presidents could be included, and that it "constituted a legitimate class of one."\(^{24}\)

Here, Congress has defined the class subject to the tax as any employee working for a company that has received an aggregate of $5 billion in TARP funds (which includes others beyond AIG). This is the basis on which many scholars, Tribe included, have concluded that the law does not violate the constitutional prohibition against Bills of Attainder. It would be a mistake, however, to conclude that *Nixon* means that any punitive legislation affecting only a narrow class will necessarily survive a constitutional challenge. One court described the circumstances in *Nixon* as meeting the specificity test but failing the punishment test.\(^{25}\)

Specificity is satisfied "if the statute singles out a person or class by name or applies to 'easily ascertainable members of a group.'"\(^{26}\) In 2003, the D.C. Circuit of Appeals considered a bill of attainder challenge to a federal law that stripped parental visitation rights from fathers in specified situations. According the court, the "combination of factors is so exceedingly narrow and unlikely to coincide that the affected persons are indeed 'easily ascertainable.'"\(^{27}\) "Despite a feeble attempt at generality, there is no doubt that Congress targeted Dr. Foretich for application of the Act's unique child custody standard."\(^{28}\)

Thus, even where Congress applies a law to a broad group of people, if it is easily ascertainable that a particular person or class is the target of the legislation, it satisfies the specificity test. Here, as in *Nixon*, the class is defined but is likely to change over time with additions (from new companies receiving more than $5 billion in TARP funds). But the circumstances surrounding enactment, including the legislative statements referenced above, demonstrate that AIG bonuses were a specified target of the tax. Consequently, it could be concluded that Congress has acted with specificity.

**B. Punishment**

The punishment prong of the test is generally where bill of attainder claims founder. "In deciding whether a statute inflicts forbidden punishment, we have recognized three necessary inquiries: (1) whether the challenged statute falls within the historical meaning of legislative punishment; (2) whether the statute reasonably can be said to further nonpunitive legislative purposes; and (3) whether the legislative record evinces a [legislative] intent to punish."\(^{29}\) A bill of attainder need not
fit all three factors, but rather the three are together weighed in resolving the bill of attainder claim.30

"Unmistakable evidence of a punitive intent...is required before [a law] may be struck down on attainder grounds."31 If "legislative history represents the considered [legislative] decision to further nonpunitive legislative goals,"32 or "if [the] legislation has a legitimately nonpunitive function, purpose, and structure, it does not constitute punishment for the purposes of the Bill of Attainder Clause,"33 the test is not met.

Here, the questions are whether singling out a group for a very high tax would constitute punishment under any of the three factors. For the first, it would be whether such a tax falls within the historical meaning on legislative punishment. For the second, it would be whether the tax's nonpunitive purposes outweigh the asserted punishment. For the third, it would be whether there is legislative record demonstrating punishment was a motivation behind the bill.

1. Historical Factor
Bills of attainder, while at first only encompassing legislative death sentences, have been expanded over the centuries to any legislative act that "set[] a note of infamy' on persons to whom the statute applies."34 Nixon outlined historically recognized bills of attainder of varying types, with the unifying principle being that they imposed "deprivations and disabilities so disproportionately severe and so inappropriate to nonpunitive ends that they unquestionably have been held to fall within the proscription of Art. I, Section 9."35 One noted specifically is "the punitive confiscation of property by the sovereign."36

Our present federal income tax system has tax rates ranging from 10 percent to 35 percent. Imposing a new 90 percent rate is a big jump. Only once before in American history (1943-1963) has the federal income tax reached 90 percent, and then as part of a range of high rates on all taxpayers.37 Unlike the AIG tax, there was no huge jump from the next lowest rate to the 90 percent rate. In this case, therefore, there is intent inherent in the structure of the tax bill to separate out the taxed class of bonus recipients for disproportionate treatment.

To the extent that Congress is generally using the tax system in this case to single out the bonus recipients for a disproportionate deprivation of their property, or to subject them to public infamy by legislative pronouncement, it would fall under the historical meaning of a bill of attainder, as outlined in the case law.

2. Functional Factor and Motivational Factor
If Congress can show with "sufficiently clear and convincing" evidence that a legitimate legislative purpose other than punishment was the purpose of the AIG bonus tax, it can survive the functional and motivational factor tests.38 The floor statements cited above demonstrate a punitive motive.

In Nixon, for instance, the Supreme Court found that the objectives of the act were to preserve historical information, not to inflict punishment on President Nixon. In another case, where Congress limited federal financial aid to students who had registered for the draft, the Supreme Court found that the law was a rational means of furthering the selective service system.39 In Consolidated Edison, the court there found that where "the legislature piled on a burden that was obviously disproportionate to the harm caused," it would be found punitive.40 Another court
characterized the standard as "where there exists a significant imbalance between the magnitude of the burden imposed and a purported nonpunitive purpose, the statute cannot reasonably be said to further nonpunitive purposes."  

Professor Tribe characterized the nonpunitive objective of the bill as "to ensure the appropriate use of government funds," as evidenced by application of the tax to companies that receive an aggregate of $5 billion in bailout funds, and not at least $5 billion. This means that companies can reduce their federal funds outstanding to avoid employees' liability, although doing so would probably undermine the purpose of the bailout in the first place. Because of the statements expressing outrage at the use of bailout funds for AIG bonuses as opposed to other problematic uses, it is at least arguable that one challenging the AIG bill could show a punitive purpose.

If a less burdensome option was open to the legislature to achieve asserted nonpunitive objectives, that fact will weigh against Congress. "In determining whether a legislature sought to inflict punishment on an individual, it is often useful to inquire into the existence of less burdensome alternatives by which that legislature...could have achieved its legitimate nonpunitive objectives."  

Congress had nonpunitive options open to it, as described by Professor Candice Hoke. In an article written for the Cleveland Plain-Dealer, Professor Hoke suggests that the bonus contracts could have been broken under existing law, and further notes that AIG executives have corporate duties and responsibilities to shareholders (in this case, the U.S. taxpayer).

If the real purpose of the AIG tax bill is to recoup wasted money from AIG, Congress could require AIG to repay the bailout funds used for the bonuses. By specifically extracting those funds from bonus recipients, Congress is using a method that is broader than necessary for any nonpunitive purpose.

In 2002, a federal appellate court struck down a law on bill of attainder grounds because it prohibited one energy company from recovering costs from ratepayers. The action was a bill of attainder because "it defines past conduct as wrongdoing and then imposes punishment on that past conduct." More to the point, the court there noted that a determination that "it would be unfair to force ratepayers to absorb the costs of Con Ed's error," had it been reached instead by a court, would have been doubtlessly "punishment."  

Here, Congress has decided that AIG bonus recipients should be stripped of their property due to their actions and the actions of their company. This judgment of their actions has occurred without benefit of trial by jury or presentation of witnesses or evidence. The Bill of Attainder Clause exists to prevent Congress from imposing punishments on groups based on past conduct because such a role is best served by judges and juries.

V. Commentators Have Raised Additional Policy Concerns with the AIG Tax Bill
Beyond constitutional arguments, several commentators have raised interesting policy concerns with the AIG tax bill.

As James Taranto pointed out in the Wall Street Journal, the total tax take could be a hefty one for some people, particularly those in New York City.  In addition to the 90% bonus tax, income
subject to the tax earned in New York City would face a 1.45% Medicare tax, 6.85% state income tax, and 3.648% local income tax.

Commenter "D.F. Linton" on the Volokh Conspiracy blog muses whether a targeted 90% tax on other specified groups presumably for punitive reasons, such as gays or Republicans, would violate the bill of attainder clause if the AIG tax did not.49

Tax lawyer Jacoba Urist wrote about a perverse effect of applying the tax to married individuals filing separately at only $125,000:

Consider a typical professional New York couple: Tom, age 31, put himself through business school and currently works as a research associate, earning $250,000 a year-$100,000 in base salary with a $150,000 year-end bonus. If Tom were single, that would be the end of the story: no TARP penalty tax.

But Tom is married. His wife, Anne, a law firm associate, newly minted physician or McKinsey consultant (take your pick from the thousands of jobs that work here) also put herself through graduate school. She now earns an additional $140,000 for the family.

The outcome: Anne's income, added to Tom's, triggers the TARP bonus tax, even though she had absolutely nothing to do with AIG, Merrill Lynch or any of the companies that received government aid last fall. Anne's paycheck certainly doesn't "belong to the American Taxpayer." Surely Anne doesn't stand for "Arrogance, Incompetence, and Greed." Most disturbing, Anne and Tom are penalized for being married and for Anne's working outside of the home-the ultimate marriage penalty.

Unfortunately, Wall Street is still a boys club and this bill punishes a second household earner. Assuming even an extremely low estimate-let's say, only 60 percent of Wall Street executives are men-the law discriminates against married women in the paid workforce.50

Finally, and perhaps most generally, the Miami Herald eloquently stated on its editorial page why using the tax code for a purpose other than raising revenue is improper:

The national outrage over the scandalous bonuses paid to executives at AIG is fully justified, but the response in Congress doesn't make sense. Experience shows that legislation forged in haste amid the swirl of headlines and theatrical hearings tends to produce bad policy, and this case is no exception.

Using the tax code as a weapon to exact revenge on a select few, no matter how badly they've behaved, is a horrible idea. Slapping heavy taxes on the bonuses and on the company that issued them may satisfy enraged taxpayers who see incompetent executives being rewarded for failure, but it sets a bad precedent.51

VI. Conclusion
James Madison once wrote: "The sober people of America...have seen with regret and indignation that sudden changes and legislative interferences, in cases affecting personal rights, become jobs in the hands of enterprising and influential speculators, and snares to the more-industrious and less-
informed part of the community."52 The AIG tax bill upsets settled expectations and sets the precedent that our tax code can be used to inflict retroactive punishments on unpopular groups.

This has happened before. In 1969, after the revelation that 155 people with at least $200,000 in income had paid zero federal income tax, Congress reacted to the public outrage not by eliminating deductions that those high-income earners had taken advantage of, but instead by layering a second federal income tax system on top of the existing one.53

Consequently, it is not only poor tax policy but also constitutionally suspect. Congress and the American people have other avenues to express their outrage at AIG's use of bailout money in particular and the bailout policy in general. We should use the tax code only to raise revenue with the minimal distortions possible.

Joe Henchman is Tax Counsel at the Tax Foundation. He supervises the Center for Legal Reform at the Tax Foundation, filing amicus curiae briefs and writing commentaries on federal and state constitutional law.

Notes


[16] Id.

[17] Id.

[18] The Federalist No. 44 (James Madison).


[23] Id. at 471.

[24] Id. at 472.


[27] See Foretich, 351 F.3d at 1217.

[28] Id. at 1204.


[31] Selective Service System, 468 U.S. at 856 n.15.

[32] Id. at 854. See also Nixon, 433 U.S. at 484 ("[W]e may look only to its [the challenged law's] terms, to the intent expressed by Members of Congress who voted its passage, and to the existence or nonexistence of legitimate explanations for its apparent effect.").

[33] SBC Communications, 154 F.3d at 241 (summarizing Nixon).

[34] Foretich, 351 F.3d at 1220, quoting 4 William Blackstone Commentaries 380.


[36] Id. at 473, citing In Re James' Claim, 1 U.S. (1 Dall.) 47 (1780), Respublica v. Gordon, 1 U.S. (1 Dall.) 233 (1788) (involving seizure of property of Tory sympathizers).


[38] See Foretich, 351 F.3d at 1220-21, citing BellSouth Corp. v. FCC, 162 F.3d 678, 686 (D.C. 1998).

[39] See Selective Service System, 468 U.S. at 843. However, the Court recognized and permitted an effect on nonregistrants it described as "a strong tonic." Id. at 854.


[41] Foretich, 351 F.3d at 1221-22.


[43] See Nixon, 433 U.S. at 482 ("In determining whether a legislature sought to inflict punishment on an individual, it is often useful to inquire into the existence of less burdensome alternatives by which that legislature...could have achieved its legitimate nonpunitive objectives.").


[47] Id. at 352.

[49] Comment, Volokh Conspiracy (Mar. 22, 2009),


[52] The Federalist No. 44 (James Madison) (1788).

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2001 L Street NW, Suite 1050
Washington, DC 20036
Ph: (202) 464-6200
Fax: (202) 464-6201
www.taxfoundation.org