Agency Taxation

*By Christopher DeMuth Sr.**

In recent years Congress has delegated its taxing and appropriating powers to regulatory agencies under several guises. The new "agency taxation" is distinct from the economic transfers implicit in many regulatory programs and also from agency fees-for-service. Traditional electricity and telephone regulation has required cross-subsidized rate structures, with above-cost rates for urban and business customers and below-cost rates for rural and residential customers. Environmental, health, and safety regulations impose compliance costs that are paid by firms and their customers for the benefit of customers or the general public. And agencies have long charged fees for particular services and transactions, ranging from admission fees at national parks to FCC license fees and FDA and Patent Office filing fees. The subject of this paper, in contrast, is broad-based taxes unrelated to any transactions with the agencies, used to fund the agencies' budgets and grant programs.

I. Taxation by Delegation

The FCC Universal Service Program. The first recent instance of agency taxation is in the Telecommunications Act of 1996, which authorizes the FCC to set and collect taxes for promoting "universal service" and gives the Commission wide discretion to determine whom to tax and at what rate and how to spend the revenues.

Currently, the FCC collects the tax (which it calls a "contribution") on the interstate and international revenues of landline and wireless telecommunications companies, cable companies that provide voice service, and paging service companies. It is a substantial tax—much higher than the 3-percent statutory federal excise tax on telephone service—and the Commission adjusts it each quarter to keep pace with its program spending. Recently the tax rate has been 15.7 percent (3Q-2014), 16.1 percent (4Q-2014), 16.8 percent (1Q-2015), and 17.4 percent (2Q-2015).

The FCC spends the revenues, which come to about $8.8 billion per year, on grant programs for landline, wireless, broadband, and Wi-Fi equipment and services for schools, libraries, and rural health care facilities, and on rate-subsidies for low-income and rural customers. Thus the Commission's "Lifeline" program currently provides a free basic wireless phone or landline installation and free basic telephone service (250 minutes per month) to about 12 million low-income customers, at a cost of $1.6 billion annually. In May 2015, FCC Chairman Tom Wheeler announced plans to expand the Lifeline program to cover Internet broadband as well as telephone service.

The universal service program is a delegation not only of Congress's taxing power (Article I, Section 8: "The Congress shall have power to lay and collect taxes … to … provide for the … general welfare of the United States") but also of its appropriations power (Article I, Section 9: "No money shall be drawn from the treasury, but in consequence of appropriations made by law"). The FCC's annual operating budget of about $500 million is covered entirely by the Commission's licensing and other fees and a share of the net proceeds from its spectrum auction programs—but the expenditures are nonetheless subject to annual appropriations by Congress in response to FCC budget requests. The universal service program, in contrast, is administered for the FCC by a subsidiary not-for-profit corporation, the Universal Service Administrative Company, whose revenues and expenditures are independent of annual budget requests and congressional appropriations.

The Public Company Accounting Oversight Board. The Sarbanes-Oxley Act of 2002 established the PCAOB to regulate accounting firms that audit "public companies" (those that issue publicly-traded stock) and broker/dealers in public stocks. The PCAOB's annual budget of about $250 million is funded almost entirely by its own tax (which it calls an "accounting support fee") on the equity capital or net asset value of public companies and broker/dealers. The Board establishes its operating budget for the year, subtracts a small sum from annual fees it collects from the accounting firms it regulates (about $1.6 million), and allocates the remainder among public companies and broker/dealers according to their size as measured by equity capital or net asset value. (The Board exempts smaller public companies from its tax, and it typically funds part of each year's budget from carryover tax and fee revenues from prior years.)

The PCAOB, like the FCC's Universal Service Administrative Company, is a 501(c)(3) subsidiary of a regulatory agency—for the PCAOB, the parent is the SEC. Its annual budget must be approved by the SEC, but is entirely independent of congressional appropriations. The Sarbanes-Oxley Act contains several provisions emphasizing that the PCAOB is independent of Congress and that its tax revenues are not "monies of the United States." But the Board's taxes (as well of course as its accounting regulations) are federally enforced legal obligations.

The Consumer Financial Protection Bureau. The CFPB, established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, enjoys a different form of agency self-financing. The Bureau is funded, not by its own tax, but rather by a draw (up to a statutory cap) from the profits of the Federal Reserve Banks. Those profits—revenues from fees and earnings from open market operations, minus the Federal Reserve's own operating expenses—were previously remitted to the Treasury as general revenue. Guaranteeing the CFPB a portion that would otherwise support other, discretionary government programs is a new entitlement program like Social Security or Medicare—an entitlement for a regulatory agency rather than citizens. Federal Reserve profits are currently more than $100 billion, while its own operating costs are about $6 billion and the CFPB's expenses are about $500 million. The Bureau's budget, like that of the Federal Reserve, is entirely

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independent of congressional appropriations.

II. Constitutional Questions

The case law is adverse to a constitutional challenge to the delegation of taxation and appropriations in the FCC, PCAOB, and CFPB programs. The Supreme Court held in *Skinner v. Mid-American Pipeline Co.* that the nondelegation doctrine, which is extremely lenient, does not apply differently to Congress's taxing powers than to its other enumerated powers.[1] Lower courts have upheld aspects of the financing mechanisms of both the FCC universal service program and the CFPB against constitutional challenge.[2]

A well-crafted constitutional challenge to the universal service program and PCAOB could, however, have substantially greater prospects than this (rather thin) case law might suggest. The agencies' delegated powers go far beyond anything that has been considered by the Supreme Court. *Skinner* involved pipeline user fees limited to funding Transportation Department regulation of pipeline safety, and the Court noted that the fee revenues were subject to congressional appropriations (the arrangement was akin to the FCC's operating budget). *Texas Office of Public Utility Counsel v. FCC* formally considered only a poorly argued challenge to the universal service program on Origination Clause grounds (the circuit court also spurned a Taxing Clause argument in a footnote, but cursorily and as dicta because the issue had not been properly briefed). The Supreme Court's decision on the constitutionality of the PCAOB did not consider the Board's taxing and appropriating powers at all.[3]

Recently, moreover, Congress's increasingly bold delegation of regulatory discretion, and several Executive Branch actions going beyond statutory delegations, have prompted some reconsideration of whether the nondelegation doctrine is really as dead as had been supposed. During the past two Supreme Court terms, three justices have issued striking invitations to relitigate nondelegation.[4] Justice Thomas's opinion in *Department of Transportation v. Association of American Railroads* includes an impressive analysis of how "intelligible principles" might be specified to distinguish permissible from impermissible delegations. He does not touch on taxing and appropriations powers, but the features of the universal service program and PCAOB discussed here—wholesale delegation of discretion to determine whom is to be taxed and at what tax rates, and to collect and spend tax revenues without congressional appropriation—would fit well with a new effort to define constitutionally clear, judicially workable principles.

The CFPB presents issues separate from those of the universal service program and the PCAOB. The Bureau does not possess autonomous taxing power, and its independence of appropriations is part of the broader independence of the Federal Reserve System, which occupies a special place among federal institutions. It is worth noting, however, that the Fed's special status dates from a time when its primary function was to manage the money supply, which was thought to necessitate extraordinary independence from short-term political pressures. But in recent years the Fed has acquired many new regulatory powers of its own (in addition to those of the CFPB), through the Dodd-Frank Act and other statutes. The Fed's and the CFPB's regulatory policies are often highly costly and controversial, and they do not involve the considerations that motivated special independence for monetary policy. The transformation of the Fed's responsibilities and the grafting on of CFPB regulation invite a reconsideration of its freedom from congressional appropriations.

III. Policy and Political Questions—and Guiding Principles

Regardless of the constitutional status of the universal service program, PCAOB, and CFPB under prevailing or prospective Supreme Court doctrines, they raise profound questions about separation of powers and national policy that ought to be of keen interest to the president, Congress, and the general public.

The text of the Constitution indicates that the framers regarded the taxing power as particularly sensitive; they went out of their way to require that revenue measures originate in the House, the people's chamber whose members face the voters every two years. The universal service and PCAOB taxes, along with the implicit tax in the CFPB's financing mechanism, do not loom large among federal revenue raisers. They are, however, recent initiatives adopted in the context of routine deficit spending and high political controversy over taxes. They are properly viewed as ingenious means of evading accountability for taxes, which if allowed to stand could encourage a trend toward a system where Congress takes the credit for new programs but does not bear the responsibility of paying for them. It is worth notice that the annual profits of the Federal Reserve Banks could finance numerous additional "entitlement agencies" on the model of the CFPB—whose automatic budgets, siphoned from funds that would otherwise go to the Treasury as general revenues, would in effect be deficit financed. *Presidents ought to resist statutory arrangements that give executive agencies responsibility to impose taxes and spend the revenue while restricting the president's ability to supervise either.*

The appropriations power is the lynchpin of congressional control over federal spending and much else. It is also a key mechanism for countering—through "appropriations riders"—executive actions opposed by congressional majorities. But Congress's "power of the purse" has been falling into disuse, and the statutes discussed in this paper are part of a broader trend. This was dramatically illustrated in late 2014 when President Obama unilaterally revised statutory immigration policies in ways that many in Congress opposed on constitutional or policy grounds or both. Shortly after the president announced his policy changes, Republican opponents in Congress responded that they would halt them with a rider to the appropriations of the U.S. Customs and Immigration Service. Then, a few days later, came an embarrassed follow-up: staffers had discovered that USCIS is not only self-funded by its own fees, but also (unlike the FCC's operating budget) exempt from congressional appropriations. Regardless of the merits of President Obama's immigration policies, *Congress's confusion over which agencies are and are not dependent on it should be worrisome to those who believe that robust inter-branch competition is an important feature of our system of government.* Foremost among the worriers should be members of Congress themselves.

Finally, combining regulation, taxation, and appropriation

in a single executive agency is a concentration of power conducive to both abuse and bad policy. The CFPB has been notably imperious concerning its regulatory powers and independence from the rest of the federal government. The chairman of the PCAOB draws a salary of $672,676 and the other Board members $546,891—they are by far the highest paid political officials in the federal government. The FCC's Lifeline program has been infamously beset by fraud and abuse.[5] More generally, regulatory agencies already possess tremendous power to impose costs and dispense benefits by rulemaking (as in the examples mentioned at the beginning of this paper), which in the nature of the case is independent of taxation, appropriation, and budgeting.

All single-purpose, mission-driven agencies tend to pursue their missions to excess—but regulatory agencies, unlike spending agencies, lack the conventional constraints of public finance that oblige trade-offs among competing public goods. To compensate for this problem, presidents from Ronald Reagan to Barack Obama have required regulatory agencies to follow a cost-benefit standard for their new rules. Congressional reform proposals would go further with such devices as a judicially reviewable cost-benefit standard, a "regulatory budget," and "regulatory pay-go" procedures. Giving regulatory agencies additional, highly discretionary authority to tax and subsidize the firms and individuals they regulate is a large step backwards from these mainstream, bipartisan reform initiatives. *Better policy requires greater institutional discipline, but the arrangements discussed in this paper relax institutional discipline to an unprecedented degree.*

The FCC's universal service program, the PCAOB, and the CFPB are signal innovations in government. With comprehensive taxing, spending, and regulatory powers, they are, in effect, autonomous special-purpose national governments, independent of elected officials so long as their enabling statutes remain on the books. They are innovations that friends of our constitutional order, and of sound and honest public policy, should seek to counter and reverse.

Endnotes

1 490 U.S. 212 (1989).

2 *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999); *CFPB v. Morgan Drexen Inc.,* – F. Supp. 3d –, No. SACV 13-1267-JLS, 2014 WL 5785615 (C.D. Cal., Jan. 10, 2014).

3 *Free Enterprise Fund v. PCAOB*, 561 U.S. 477 (2010).

4 *City of Arlington v. FCC*, 133 S. Ct. 1863, 1879 (2013) (Roberts, C.J., dissenting); *Department of Transportation v. Association of American Railroads*, Docket No. 13-1080, March 9, 2015 (Alito, J., concurring, and Thomas, J., concurring in the judgment).

5 A 2013 review of the Lifeline subscribers of the top telephone service providers found that 41 percent of more than six million subscribers receiving free or subsidized services either could not demonstrate their eligibility or failed to respond to requests for certification. *See* Spencer E. Ante, "Millions Improperly Claimed U.S. Phone Subsidies," *Wall Street Journal*, Feb. 12, 2013. Lifeline service is widely marketed as "Free Obama Phones," and one service provider has advertised for phone distributors under the headline, "Get Paid to Pass Out Free Government Cellphones." *See* Charles C.W. Cooke, "Life, Liberty, and a Free Phone," *National Review*, March 11, 2013.