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VOLUME 134 2024-2025

FORUM

The Origins of U.S. Territorial Taxation and the *Insular Cases*

10 FEB 2025

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ABSTRACT. This Essay examines Congress's design of territorial revenue systems during 1898-1900. Eager to protect domestic industries, lawmakers imposed tariffs between Puerto Rico and the mainland. Their choices segregated the territories from the federal fiscal apparatus, prompted the *Insular Cases*, and created the territories' distinctive tax status as foreign countries.

INTRODUCTION

In April 2022, the Supreme Court decided *United States v. Vaello Madero*.[1] The respondent in that case, Jose Luis Vaello Madero, suffered from serious health problems and received federal benefits from the Supplemental Security Income (SSI) program, a means-tested economic-security program for disabled and elderly people.[2] In 2015, Vaello Madero moved from New York to Puerto Rico to care for his wife.[3] Upon his relocation, the Social Security Administration discontinued Vaello Madero's SSI benefits and sued him for restitution of an overpayment of $28,000.[4] The government cited provisions of the Social Security Act limiting SSI benefits to "resident[s] of the United States," which the statute defined as "the 50 States and the District of Columbia."[5] For the Social Security Administration, Vaello Madero was living "outside of the United States."[6] The question before the Court was thus constitutional: does the equal-protection component of the Fifth Amendment's Due Process Clause require Congress to make SSI available to residents of Puerto Rico?[7]

Writing for an 8-1 majority, Justice Kavanaugh answered with a resounding no. He found the *tax status* of Puerto Rico residents a sufficient rational basis to justify their exclusion from federal welfare programs. Congress has exempted Puerto Ricans from federal income, gift, and estate taxation.[8] Justice Sotomayor alone dissented. She explained that SSI recipients—low-income by definition—pay few if any taxes, and she pointed out Puerto Rico's vital need for aid as it has by far the highest level of poverty in the country.[9] The majority was unconvinced. It predicted dire consequences should the Court require Congress to extend SSI benefits to territorial residents: receipt of those benefits could prompt Congress to tax the territories too, imposing on them a heavy fiscal burden.[10]

The *Vaello Madero* majority rightly identified the territories' exemption from most federal taxes. Tax law treats the territories as foreign countries and defines the "United States" as consisting of the fifty states and the District of Columbia.[11] Bona fide

residents of U.S. territories thus pay one territorial income tax in satisfaction of their fiscal obligations to both the territorial and the federal treasuries.[12] Further, territorial tax systems differ from each other. As to income taxation, three territories—Guam,[13] the Northern Mariana Islands,[14] and the U.S. Virgin Islands[15]—are "mirror-Code" jurisdictions, in which the federal income tax applies as the local, territorial income tax.[16] By contrast, Congress has authorized Puerto Rico to deviate from federal income-tax rules.[17] Puerto Rico has exercised that power, taxing income at rates and brackets different from the federal government.[18]

The dispute in *Vaello Madero* highlights a pressing yet unaddressed issue: how did the U.S. territories come to acquire tax status vastly different from the mainland and from one another?[19] This Essay traces the origins of U.S. territorial taxation to a critical moment at the turn of the twentieth century. It argues that Congress exempted the territories from federal taxation not out of any consistent concern for their fiscal self-governance. Instead, Congress designed territorial tax systems to guard against erosion of the federal tax base and to test its own power to tax. Under the Constitution, "all Duties, Imposts and Excises shall be uniform throughout the United States."[20] At the turn of the twentieth century, with an income tax barred by the Supreme Court, Congress relied almost exclusively on excises and tariffs to fund the federal government.[21] Tariffs from sugar constituted one of the most important sources of federal receipts.[22] And the overseas territories under consideration for annexation by the United States—Puerto Rico, Hawai'i, and Cuba—all planted sugarcane.

Territorial acquisition posed two foundational threats to the federal fiscal regime. First, if the newly acquired territories were part of the United States subject to the Constitution's Uniformity Clause, Congress would be powerless to impose tariffs between those territories and the mainland United States. Territorial sugar would come in free of customs, and the federal government would sustain a substantial loss of revenue in the form of sugar tariffs—more than ten percent of the federal budget.[23] Second, after decades of industrial expansion, the United States was looking for foreign markets for its excess production. Congress saw China—a vast market—as the most promising option. But it recognized that open-door trading there required the acquiescence of European colonial powers and would pressure the United States to open the Philippines for free trade. If the Uniformity Clause applied to the territories, the whole tariff system would collapse, as foreign exporters could ship goods to the United States through the Philippines tax-free. That would cause even more damage to the federal tax regime.[24]

These two fiscal concerns drove Congress to segregate territorial revenue systems from federal taxation. Between 1898 and 1900, Congress engaged in extensive debate about Puerto Rico's revenue system.[25] Despite calls for direct appropriations or property taxation, Congress instituted tariffs between Puerto Rico and the mainland while exempting Puerto Rico from internal-revenue laws.[26] It did so to invite the Supreme Court to affirm its power to impose tariffs on goods imported from the territories and to deviate from the Uniformity Clause, in view of fiscal and trade-policy goals in the Philippines and China.[27] This resulted in the now-infamous *Insular Cases*.[28]

This Essay shows that Congress has, since the beginning, designed territorial revenue systems with a keen eye toward their effect on the federal fisc. Despite exempting them from aspects of the federal tax regime, Congress has included the territories as part of its broader calculus in devising what it sees as the optimal revenue system for the mainland. The territories thus bear—albeit indirectly—the costs of *federal* tax design. After all, revenue loss due to imperfect tax systems (structured to preserve the federal tax base) does not differ substantively from paying cash into the federal treasury. In the case of Puerto Rico, Congress's failure to provide appropriations, authorize borrowing,

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1 596 U.S. 159 (2022).

2 United States v. Vaello Madero, 956 F.3d 12, 15 (1st Cir. 2020), *overruled by* 596 U.S. 159 (2022);...

3 *Vaello Madero*, 956 F.3d at 15.

4 *Vaello Madero*, 596 U.S. at 164.

5 42 U.S.C. § 1382c(a)(1)(B)(i), (e) (2018). Congress made residents of Northern Mariana Islands e...

6 Joint Appendix at 39, *Vaello Madero*, 596 U.S. at 196 (2016) (No. 20-303) (documenting notice of a ...

7 *Vaello Madero*, 596 U.S. at 162.

8 *Id.* at 165 (citing Califano v. Torres, 431 U.S. 1, 3-5 (1978) (per curiam)); 48 U.S.C. § 734 (20...

9 *Vaello Madero*, 596 U.S. at 198 (Sotomayor, J., dissenting); *see* Craig Benson, *Poverty: 2018 and 20...*

10 *Vaello Madero*, 596 U.S. at 165-66.

11 I.R.C. § 7701(a)(9) (2018).

12 The main exceptions to this general rule are incomes sourced to the United States and salaries of ...

13 48 U.S.C. § 1421i(a) (2018) ("The income-tax laws in force in the United States of America and...

14 Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the U...

15 48 U.S.C. § 1397 (2018).

16 American Samoa is not strictly a mirror-Code jurisdiction but has modeled its tax system on the fe...

17 *See* 48 U.S.C. § 734 (2018); Revenue Act of 1918, ch. 18, § 261, 40 Stat. 1057, 1088 (1919) (...

impose a property tax as urged by locals and federal lawmakers, and enable free trade with the mainland all contributed to the costs the territory bore *due to*, not *despite*, its exemption from federal taxation. Today, these costs entitle the territories to the fiscal benefits that they, in part, fund. Denying welfare benefits based on formal exemption from certain taxes, as the *Vaello Madero* majority did, ignores the territories' longstanding, indirect contributions to the public fisc.

The remainder of this Essay proceeds in two Parts. Part I provides a historical account of the origins of territorial taxation. It focuses on Congress's design of Puerto Rico's revenue system in 1900 and Congress's imposition of tariffs on the movement of goods between the island and the mainland United States. This critical decision led to a longstanding tradition of exempting territories from federal taxes. Part I shows that Congress did so out of an urgent need to preserve the federal tax base. Lawmakers often invoked local autonomy in their rhetoric, but concern for the federal tax base was ultimately the overriding motivation shaping the fiscal relationship between federal and territorial governments. Part I ends with a discussion about subsequent decisions to exempt other territories (e.g., Guam and the Virgin Islands) from the federal income tax.

Part II explores the doctrinal and scholarly implications of Part I's historical account. It advances two main arguments. First, it criticizes the majority's reasoning in *Vaello Madero*. In allowing Congress to deny the SSI program to territorial residents, the majority endorsed a benefits theory of taxation that cognizes a jurisdiction's formal tax exemption solely as a cost to the federal government.[29] If Congress exempts the territories from paying general revenue into its Treasury, the argument goes, it can exclude them from expenditures that the general revenue funds. The dissent casts this theory as inapposite. SSI beneficiaries pay little in taxes because they are low-income by definition.[30] This Essay shows that even *within* the logic of the benefits theory, the majority's reasoning is fundamentally flawed. Puerto Rico's longstanding exemption from the internal-revenue system is not a *cost* to the federal government, but a tool to protect the federal tax base. The majority's reasoning is thus internally incoherent.

Second, Part II adds to the chorus of judicial and scholarly voices calling for the repeal of the *Insular Cases*.[31] All but one of the original *Insular Cases* dealt with taxation and the operation of federal tariffs in the newly acquired possessions.[32] In the most consequential case, the Supreme Court held portions of the Constitution—in particular, the Uniformity Clause as to customs—inapplicable to unincorporated territories like Puerto Rico.[33] Fiscal and tax segregation from the mainland soon seeped into other public spheres, laying the foundation for excluding the territories from the American constitutional structure.[34] This Essay clarifies the tax-centric origins of the *Insular Cases*. As Congress moved on from the *ancien regime* of tariffs, courts should too.

I. PUERTO RICO, TARIFFS, AND THE FEDERAL TAX REGIME

This Part provides an account of the origins of U.S. territorial taxation. From 1898 to 1900, Congress engaged in extensive debate as it designed the revenue systems of the newly acquired possessions. Section I.A examines lawmakers' anticipation of the fiscal costs of territorial expansion. Section I.B assesses the substantive legislative debate as Congress settled on *territorial* tariffs—and internal-revenue exemption—for Puerto Rico.[35] Lawmakers advanced several arguments for this tax design, despite calls for congressional appropriations, insular borrowing, and property taxes. The most convincing was Congress's need to confirm its power to deviate from the Uniformity Clause, in view of its trade policies and the constraints of the federal tariff regime.

18 Above a small exemption amount, Puerto Rico taxes net taxable income at marginal rates ranging fro...

19 Very little has been written on territorial taxation. One recent contribution is Diane Lourdes Dic...

20 U.S. Const. art. I, § 8, cl. 1.

21 U.S. Dep't of the Treasury, No. 2137, Annual Report of the Secretary of the Treasury on the State ...

22 *See infra* notes 51-59 and accompanying text (discussing the importance of sugar tariffs).

23 *See infra* notes 60-65 and accompanying text.

24 *See infra* Section I.B.5.

25 *See infra* Part I.

26 *See infra* Sections I.B.3-4; An Act Temporarily to Provide Revenues and a Civil Government for Port...

27 *See infra* Section I.B.5.

28 *E.g.*, Downes v. Bidwell, 182 U.S. 244, 287 (1901).

29 Congress is free to extend SSI benefits to the territories, as it did to residents of Northern Mar...

30 *See infra* Section II.A.

31 *See infra* Section II.B.

32 *See* De Lima v. Bidwell, 182 U.S. 1 (1901); Goetze v. United

A. The Fiscal Costs of Territorial Expansion

After the Spanish-American War, Spain ceded Puerto Rico, the Philippines, and Guam to the United States.[36] Even before the ratification of the Treaty of Paris in 1899, Congress had concerns about the fiscal costs of annexing overseas territories. For the preceding three decades, the federal government had obtained no new land.[37] Instead, it projected American interests abroad through intangible means like negotiating favorable treaties, securing access to seaports, and enforcing an exclusive sphere of influence in the Western Hemisphere.[38]

1. Territorial Expansion and Federal Expenditures

Acquisition of Puerto Rico and the Philippines—as well as Hawai'i—thus threatened to impose unaccustomed costs on the operation of the federal machinery. Opponents of annexation identified at least three distinct sources of fiscal distress. First, annexation might result in the federal assumption of insular debts and increased military spending when Congress was short on money.[39] In the early 1890s, solid economic growth generated budget surpluses, and federal receipts exceeded expenditures by an average of $27 million each year.[40] This string of healthy surpluses dwindled in the mid-1890s. The Panic of 1893 paused industrial expansion and reduced federal revenue.[41] Spending ballooned, roughly doubling between 1890 and 1899.[42] The Spanish-American War itself cost about $270 million.[43] In 1885, the House stripped the Appropriations Committee of its almost exclusive control over spending decisions and distributed the power of the purse to subject-matter legislative committees.[44] This decentralization of the budget process led to congressional generosity and increased outlays.[45] By 1899, the federal government ran a deficit of $89 million, almost fifteen percent of the total federal receipts in that fiscal year.[46] Anti-imperialists thus warned that territorial expansion would "tax [federal] resources severely and impose heavy burdens upon [the] people."[47]

2. Sugar and Tariffs

Annexation of Puerto Rico, the Philippines, and Hawai'i could shake the foundation of the federal tax regime. At this time, the United States was in the middle of a radical fiscal transformation. The federal government would gradually move from taxing commodities—for example, customs and excises—to taxing individual incomes and corporate profits.[48] But this transformation was far from complete in the 1890s. Congress would not enact the modern income tax until 1913, after the ratification of the Sixteenth Amendment.[49] Tariffs thus constituted a major source of federal revenue during the critical period in which Congress designed Puerto Rico's tax system. In 1899, for example, customs totaled $206 million and made up over one-third of federal receipts.[50]

A substantial portion of those customs came from sugar. Domestic production—primarily cane sugar in Louisiana and beet sugar elsewhere—satisfied only a fraction of Americans' enormous taste for sweetness. By the late 1890s, the United States imported the vast majority, over eighty percent, of the sugar it consumed.[51] The federal government has taxed imported sugar from the very beginning, with one notable exception in 1890.[52] The Tariff Act of 1789, for example, levied a duty of one cent per pound on brown sugar.[53] By the late 1880s, tariff receipts on imported sugar reached $55 million a year—the most important form of customs and a significant part of federal revenue.[54] This was despite a reciprocal treaty with Hawai'i that forwent duties

36 Treaty of Peace Between the United States of America and the Kingdom of Spain art. II, Spain-U.S.,...

37 Before 1898, the last major territorial acquisition of the United States was the purchase of Alask...

38 *See* Sam Erman, Almost Citizens: Puerto Rico, the U.S. Constitution, and Empire 13-14 (2019) (disc...

39 31 Cong. Rec. 5999 (1898) (statement of Rep. Johnson) ("[W]e do not want Hawaii or any of these ...

40 *See* U.S. Dep't of the Treasury, No. 1337 (3d ed.), Annual Report of the Secretary of the Treasury ...

41 *See* Joseph H. Davis, *An Annual Index of U. S. Industrial Production, 1790-1915*, 119 Q.J. Econ. 117...

42 *Compare* Treasury Report of 1890, *supra* note 40, at XXI (showing federal expenditures of $358 milli...

43 Hugh Rockoff, America's Economic Way of War: War and the US Economy from the Spanish-American Wa...

44 Charles Stewart III, *Does Structure Matter? The Effects of Structural Change on Spending Decisions...*

45 *Id.* at 600.

46

33 Dooley v. *Downes*, 182 U.S. 221 (1901); *Downes*, 182 U.S. at 287 ("We are therefore of opinion that the island of Porto Rico is a territo...

34 (https://twitter.com/intent/tweet?text=Yale Law Journal: The Origins of U.S. Territorial Taxation and the Insular Cases&url=https://www.yalelawjournal.org/forum/the-origins-of-us-territorial-taxation-and-the-insular-cases&via=YaleLawJ) accompanying text.

35 By "territorial" tariff regime, I refer to the imposition of tariffs on the movement of goods ...

on sugar and about $3 million of revenue each year.[55] In 1890, Congress experimented with free trade for sugar under the McKinley Tariffs. The Revenue Act of 1890 put raw sugar on the duty-free list, levied a light charge on imported refined sugar to protect the domestic sugar *refining* industry, and provided a bounty at two cents per pound to domestic *producers* of sugar.[56] Removing sugar tariffs leveled the playing field for raw foreign sugar, in effect repealing the preferential treatment for sugar imported from Hawai'i, and contributed to the overthrow of the Hawaiian Kingdom.[57] In any event, the experiment was short-lived. As federal surpluses dwindled, the need for tariff receipts returned.[58] By 1894, Congress returned to its heavy reliance on customs on imported sugar.[59]

Sugar tariffs thus propped up the fiscal state. And all four territories under consideration for annexation in 1898—Hawai'i, Puerto Rico, the Philippines, and Cuba—planted sugarcane. Before wars with Spain caused steep, but brief, drops in output, sugar production in Cuba, Puerto Rico, and the Philippines exceeded one million short tons, capable of meeting more than half of the domestic demand.[60] The Constitution granted Congress broad power to raise revenue, but provided that "all Duties, Imposts and Excises shall be uniform throughout the United States."[61] The Uniformity Clause thus appeared to bar Congress from imposing any tariff on sugar produced in any acquired territory. Accordingly, anti-imperialists in Congress declared that under "the language of the Constitution[,] no other duty, no other tariff can be imposed in the Philippines or in Porto Rico."[62] As a result, "sugar, tobacco, hemp, and other products raised by cheap tropical labor" would flood the domestic market free of customs and "injur[e]" agriculture and the labor market in the United States.[63] Duty-free importation of sugar in particular would decimate federal receipts.[64] One lawmaker made a (reasonable) estimate of sixty million dollars of revenue loss each year—a significant portion of federal revenue when the government was already in a budget crunch.[65]

Territorial acquisition thus threatened the backbone of federal taxation. Assimilating insular possessions, according to anti-imperialists in Congress, would devastate customs receipts while increasing expenditures, inevitably forcing an "enormous increase of Federal taxes."[66] It seemed unsustainable for the federal government to continue to rely on the tariff regime as a source of revenue.[67] For some, the inevitable demise of sugar tariffs necessitated structural changes in the federal tax base. Instead of taxing consumption or issuing debt for future generations to pay, the United States should turn to income taxation. One lawmaker stated, for example: "[T]he time will come when the people in the United States will cease to be willing to issue bonds . . . to pay the current expenses of the Government."[68] And "the quicker that time comes . . . the better for the American people."[69] Of course, Congress had attempted to tax income in 1894, as part of the same Revenue Act that brought back sugar tariffs after the Panic of 1893 reduced federal receipts.[70] But in a controversial decision, the Supreme Court held the 1894 income tax unconstitutional as an unapportioned direct tax.[71]

Anti-imperialists saw both fiscal danger and a glimmer of opportunity in annexation. Many Southern lawmakers opposed territorial expansion during this period, as Republicans in the North rallied behind President McKinley in pushing for territorial expansion.[72] The South disproportionately bore the customs burden on commonly consumed goods and, with the exception of Louisiana's sugarcane plantations, did not benefit much from the protective-tariff regime.[73] Income taxation would have shifted the distribution of tax burdens by extracting more revenue from the richer, manufacturing states in the North.[74] Annexation of overseas territories thus offered the

Treasury Report of 1899, *supra* note 21, at XVII.

47 31 Cong. Rec. 5999 (1898) (statement of Rep. Johnson); *see also* 31 Cong. Rec. 6643 (1898)

48 *See* Mehrotra, *supra* note 21, at 6-8.

49 Revenue Act of 1913, ch. 16, § 2(A), 38 Stat. 114, 166 (imposing an income tax); U.S. Const. amend...

50 *See* Treasury Report of 1899, *supra* note 21, at XVII.

51 Roy A. Ballinger, U.S. Dep't of Agric., No. 382, A History of Sugar Marketing Through 1974, at 16 ...

52 During the nineteenth century, customs burdens ranged from twenty percent to sixty-five percent on...

53 Act of July 4, 1789, ch. 2, § 1, 1 Stat. 24, 25 (levying a duty of 1¢ per pound on brown sugar,...

54 F.W. Taussig, The Tariff History of the United States 235 (5th ed. 2010); Douglas A. Irwin, *Higher*...

55 *See* Convention Between the United States and His Majesty the King of the Hawaiian Islands art. I, ...

56 Revenue Act of 1890, ch. 1244, §§ 1.231 (Schedule E), 1.237 (Schedule E), 2.726 (Free List), 26...

57 *See* La Croix & Grandy, *supra* note 52, at 182-85.

58 *See supra* notes 41-46 and accompanying text (discussing the rise of federal deficits in the 1890s)...

59 Revenue Act of 1894 (Wilson-Gorman Tariff Act), ch. 349, § 182½ (Schedule E), 28 Stat. 509, 521...

60 Ballinger, *supra* note 51, at 15 tbl.1.

61 U.S. Const. art. I, § 8, cl. 1.

62 32 Cong. Rec. 439 (1899) (statement of Rep. Donelson Caffery); *accord* 32 Cong. Rec. app. at 86 (18...

63 32 Cong. Rec. 1320 (1899) (statement of Rep. Johnson).

64 32 Cong. Rec. 266 (1898) (statement of Rep. McMillin) ("If the time comes that the Philippine Is...

65 32 Cong. Rec. 450 (1899) (statement of Rep. Claude A. Swanson) ("[W]ith the annexation of the Ph...

66 32 Cong. Rec. 450 (1899) (statement of Rep. Claude A. Swanson).

67 *Id.* ("Our customs duties have been decreasing each year. They will continue to do so.").

prospect of structural tax reform. Collapse of customs revenue from sugar could rekindle the conversation over a national income tax when it seemed like a constitutional dead letter.[75]

3. The Prospect and Inadequacy of Trade with East Asia

Many in Congress recognized the lucrative trade with East Asia that the Philippines could enable.[76] But they questioned whether the benefits of trade justified the cost of insular acquisition. One lawmaker pointed to Great Britain, the most successful colonial power in East Asia, with not only access to ports along the eastern Chinese coast but also possession of India and Hong Kong, a major emporium.[77] But federal acquisition of overseas territories to facilitate trade with China was a financial nonstarter: according to one congressional estimate, Britain generated a profit of less than ten million dollars in its trade with China, despite unrivaled colonial infrastructure like treaties, loans, and diplomacy.[78] The commercial gain that American industries could realize in China would thus be far less than the costs of military appropriations and declines in tariff revenue incurred by territorial expansion.[79]

Overt racism added to the fiscal costs of imperialism. Countless pages of the *Congressional Record* characterized the overseas territories as "populated with races for which we have no affinity or liking," and potential "ignorant voters" unworthy of representation in the federal government upon annexation.[80] In the view of lawmakers at the turn of the century, fitting territorial residents for democratic citizenship meant pouring immense resources into education and infrastructure that they, in large part due to their race, might not deserve.[81] Further, the status of the Philippines clearly differed from that of Hawai'i, Puerto Rico, and Cuba.[82] This was in part due to size. The Philippines had a population of 7.6 million (6.9 million of whom the 1903 Census classified as "civilized"—the criterion for civilization apparently being "Christianity").[83] By contrast, Puerto Rico had a population of fewer than one million, and Hawai'i about 150,000.[84] In fact, if admitted to the union, the Philippines would have been the largest state, surpassing the population of New York by more than 300,000.[85] Congress also directed especially harsh, race-based vitriol at Asians. For example, one senator favored annexation of Puerto Rico due to its geographic proximity, "civilized people," and willingness to be absorbed into the United States.[86] By contrast, "a very large population . . . not only uncivilized, but even barbarous and savage," inhabited the Philippines.[87] Annexing the Philippines would thus force the "precipitat[ion] into our civilization [of Malay, Chinese, and Japanese migrants] absolutely incompetent to assume the duties and responsibilities of citizenship."[88]

* * *

Congress was thus acutely aware of the fiscal costs of territorial acquisition. Lawmakers anticipated that it would drain the federal budget, deprive the government of critical revenue streams like tariffs on sugar, and fail to break even with increased trade with East Asia according to even the rosiest estimates. This pre-annexation debate foreshadowed and structured congressional design of Puerto Rico's tax system.

B. Congressional Design of Territorial Tax Systems

By 1900, led by Senator Joseph B. Foraker and after heated debate, Congress enacted an organic act establishing a civilian government in Puerto Rico.[89] The Foraker Act provided for presidential appointment of the governor, members of the Supreme

68 32 Cong. Rec. 266 (1898) (statement of Rep. Benton McMillin).

69 *Id.*

70 Revenue Act of 1894, ch. 349, § 1, 27, 28 Stat. 509, 521, 553.

71 Pollock v. Farmers' Loan & Tr. Co., 158 U.S. 601, 637 (1895). The Supreme Court had previously uph...

72 Erman, *supra* note 38, at 29; *Edwina C. Smith*, *Southerners on Empire: Southern Senators and Imperia...*

73 *See* Taussig, *supra* note 54, at 261-63; Mehrotra, *supra* note 21, at 47.

74 *See* Taussig, *supra* note 54, at 262; *see also* Robin L. Einhorn, *Look Away Dixieland: The South and ...*

75 *See* 33 Cong. Rec. 2655 (1900) (statement of Rep. Henry M. Teller) (criticizing the *Pollock* decisio...

76 32 Cong. Rec. 450 (statement of Rep. Claude A. Swanson); *see also* 32 Cong. Rec. app. at 86 (1899) ...

77 *See, e.g.*, Wolfgang Keller & Carol H. Shiue, *China's Foreign Trade and Investment, 1800-1950*, at 1...

78 32 Cong. Rec. 450 (1899) (statement of Rep. Claude A. Swanson) ("If our trade in China can rival...

79 *See id.* ("Thus, should our trade equal that of Great Britain, which is far more than the most sa...

80 *E.g.*, 31 Cong. Rec. 6532 (1898) (statement of Sen. Benjamin Tillman); 31 Cong. Rec. 5998 (1898) (...

81 *See infra* notes 109-111 and accompanying text.

82 *See* 31 Cong. Rec. app. at 651 (1899) (statement of Rep. John F. Shafroth) ("In regard to the Phi...

83 Henry Gannett, *The Philippine Census*, Bull. Am. Geographical Soc'y 257, 260 (1905); *see also* Unite...

84 Dep't of War, Report on the Census of Porto Rico, 1899, at 40 (1900); Dep't of Com., Bureau of t...

85 *See* United States Census Office, Abstract of the Twelfth Census of the United States, 1900, at 164...

Court, and the executive council (the upper house of the legislature)—what some commentators have called "a classic colonial government for the newly conquered territory, in which all power emanated from the federal government."[90] Less noticed is the Foraker Act's exemption of Puerto Rico from compliance with all federal tax laws: section 14 of the Act made "statutory laws of the United States" generally applicable to the territory but specifically provided that the "internal-revenue laws . . . shall not have force and effect in Porto Rico."[91] This statutory carveout from the U.S. tax regime laid the foundation for the next century of federal-territorial tax policy. Congress has devised, and continues to devise, territorial tax regimes that feature *formal* fiscal separation from the mainland, to varying degrees.[92]

Why would Congress segregate territorial revenue systems from federal taxation? Legislative debate in 1900 offers clues about this critical decision. The remainder of this Section analyzes five prominent developments that inform our understanding of how territories acquired their distinctive tax status: (1) the initial call for the abolition of tariffs between Puerto Rico and the mainland after territorial acquisition, in particular from President McKinley; (2) the legislative urge to create a self-sustaining territorial fiscal system, with no need for direct federal appropriations; (3) the argument that Puerto Rico could not bear a direct property tax, in particular from Senator Foraker; (4) the claim that Congress, by directing tariff revenues to territorial rather than federal government, performed an act of unprecedented generosity; and (5) the serious threat of territorial free trade to the health of the federal tax system. This analysis shows that concerns about erosion to the *national* tax base largely motivated congressional choices in the design of territorial taxation.

1. McKinley's Call for Tariff Abolition

Before the Foraker Act's tax provisions took shape, both the Executive and some lawmakers opposed any taxes on the movement of commodities between Puerto Rico and the mainland.[93] In December 1899, President McKinley delivered a written message to the Senate requesting the formation of a temporary government for the island.[94] McKinley unequivocally asked for the abolition of tariffs: "Our plain duty is to abolish all customs tariffs between the United States and Porto Rico and give her products free access to our markets."[95] He explained that Spanish cession (as well as a hurricane in 1899) had left Puerto Rico in a state of depression.[96] Freedom from the Spanish Empire led to the loss of markets on which Puerto Rico had long relied for tariff-free exports.[97] In a month, Congress followed up on the President's recommendation. Sereno Payne, the Republican chair of the House Ways and Means Committee, quickly reported a bill to extend all federal tax laws to Puerto Rico.[98] Payne's proposed bill would have made applicable in Puerto Rico all "laws of the United States relating to customs and internal revenue, including those relating to the punishment for crimes in connection with the enforcement of said laws."[99] Further, the bill would have established a customs collection district and authorized the President to establish an internal-revenue collection district on the island.[100]

Congress never enacted the bill from the Ways and Means Committee. The Foraker Act ended up *exempting* Puerto Rico from the federal tax regime, "in view of the provisions of section three" of the Act.[101] Section 3 of the Foraker Act imposed a discounted tariff on the movement of goods between Puerto Rico and the mainland—at fifteen percent of the normal rates established under the Dingley Act of 1897 (the "Dingley rates").[102] But McKinley's initial call for the abolition of tariffs reverberated in Congress as debate over the Foraker Act dragged on. Anti-imperialists praised his message as, for example, "advis[ing] justice and equal rights as the rules for our action

86 32 Cong. Rec. 1067 (1899) (statement of Sen. Stephen R. Mallory).

87 *Id.*; *see also* 32 Cong. Rec. 639 (1899) (describing residents of the Philippines as "a mongrel an...

88 31 Cong. Rec. 6642 (1898) (statement of Sen. William V. Allen); *see also* 31 Cong Rec. 6643 (1898) ...

89 An Act Temporarily to Provide Revenues and a Civil Government for Porto Rico, and for Other Purpos...

90 *Id.* § 17, 31 Stat. at 81 (regarding the presidential appointment of the governor); *id.* § 18, 31 ...

91 Foraker Act, § 14, 31 Stat. at 80.

92 *See supra* notes 13-16 and accompanying text.

93 *See* Marc-William Palen, *The Imperialism of Economic Nationalism*, 1890-1913, 39 Diplomatic Hist. 15...

94 33 Cong. Rec. 35 (1899) (statement of President McKinley) ("I recommend that legislation to the ...

95 33 Cong. Rec. 36 (1899) (statement of President McKinley).

96

in framing laws for the government of the new citizens of the United States and Puerto Rico."[103] They contended that McKinley knew the unconstitutional nature of any tariff between Puerto Rico and the mainland, pointing to both case law and the text of Article I.[104] William Stark, a representative of the Populist Party, referred to the Ways and Means Committee's immediate presentation of "a bill [abolishing] all tariffs between the United States and the territory of Puerto Rico" in an effort "to carry out the wishes of the President."[105] The new proposal to maintain tariffs (albeit at a lower rate), he claimed, caught everyone by "surprise."[106] Even supporters of the Foraker Act noted the importance of free trade to encourage business investment and erect a "wise and economical and progressive government" on the island.[107]

2. Territorial Fiscal Self-Governance

Lawmakers favored a self-sustaining territorial revenue stream. Upon the Ways and Means Committee's withdrawal of its first proposed bill, Congress recognized the territory's need for public spending and articulated several possibilities for raising the money. Relying on an account by General Davis, Representative Payne estimated an annual expenditure of $1.94 million.[108] That budget would have allocated about $350,000 to education and $390,000 to the improvement of roads—both critical to Puerto Rico's economic development.[109] Foraker later proposed a more ambitious budget, allocating $1 million each to schools and roads, and noting the deplorable state of Puerto Rico's infrastructure.[110] As one lawmaker bluntly put it: "There must be money for schools, for internal improvements, for general administration[, but w]e can get revenue only in one of three ways. By borrowing, by direct appropriations from the Federal Treasury, or by taxation."[111]

Many—but not a critical mass—in Congress supported appropriations and borrowing. One representative argued, for example, that appropriations were preferable to tariffs because the latter would burden trade and leave Puerto Rico "in a worse condition than . . . under Spanish rule."[112] Others urged Congress to authorize all territories to issue bonds like any state would and contended that it would only be fair for future beneficiaries to pay for improved infrastructure.[113] Indeed, prominent residents of Puerto Rico delivered a memorandum of protest and petition to Congress, in which they made a specific request for an authorization of borrowing.[114] They noted that the island was, at the time, free of debt, and contended that it could procure loans at four- or five-percent interest to develop industries, build infrastructure, and establish schools, before "prosperity justifie[d] an insular tax."[115]

Those voices did not prevail. Congress quickly ruled out appropriations and borrowing, in part due to the size of the budget deficit in the late 1890s, and justified its decision on the ground of territorial fiscal autonomy.[116] Lawmakers, mostly but not exclusively Republicans, variously called for Puerto Rico to stay "free from debt," to develop a "self-supporting" fiscal government, and to go "on the way of taking care of themselves" rather than relying on indefinite "almsgiving."[117] The absence of revenue streams originating from Puerto Rico, they argued, would render residents "charity patients"[118] instead of citizens with political independence, running the risk of reducing Puerto Ricans to "the status of mendicants."[119]

The rhetoric of autonomy clashed with claims that Puerto Ricans were incapable of citizenship. The legislative debate leading up to the Foraker Act's passage was replete with characterizations of Puerto Rico as undeserving of democracy. One lawmaker, for example, stated his "firm[] opinion that [residents of Puerto Rico] are not prepared for self-government" due to their "ignorance."[120] Senator Foraker justified presidential appointment of the executive council on the ground of Puerto Rico's inexperience

Id. For an assessment of the 1899 hurricane's damage, see, for example, Stuart B. Schwartz, *The Hu...*

97 33 Cong. Rec. 36 (1899) (statement of President McKinley).

98 33 Cong. Rec. 1010, 1654 (1900) (introducing a bill "to extend the laws relating to customs and ...

99 H.R. 6883, 56th Cong. § 1 (1900).

100 *Id.* §§ 2-3.

101 An Act Temporarily to Provide Revenues and a Civil Government for Porto Rico, and for Other Purpos...

102 *Id.* § 3, 31 Stat. at 77-78; An Act to Provide Revenue for the Government and to Encourage the In...

103 33 Cong. Rec. 2642 (1900) (statement of Sen. Pettus). Despite his rhetoric of justice and equal ri...

104 33 Cong. Rec. 2166-67 (1900) (statement of Rep. Ryan) (quoting Reynolds v. United States, 98 U.S. ...

105 33 Cong. Rec. 2167 (1900) (statement of Rep. Ryan).

106 *Id.*

107 33 Cong. Rec. 2140 (1900) (statement of Rep. Russell).

108 33 Cong. Rec. 1942 (1900) (statement of Rep. Payne); *see* George W. Davis, Report of Brigadier-Gen....

109 Payne stated that the budget would allocate $300,000 for the highways, but a figure of $390,000, l...

110 *See* 33 Cong. Rec. 2647-48 (1900) (statements of Sen. Foraker).

111 33 Cong. Rec. 1959 (1900) (statement of Rep. Dalzell); *accord* 33 Cong. Rec. 2051 (1900) (statement...

112 33 Cong. Rec. 2043 (1900) (statement of Rep. Bromwell).

113 *Id.* at 2044 ("[W]hat does your State . . . do when [it] wants to meet the expenses of its im...

114 33 Cong. Rec. 2231-32 (1900) (recounting "[m]emorial of protest and petition from the people of ...

115 *Id.* at 2232.

with democratic participation and modern bureaucracy.[121] Demanding "self-supporting" fiscal government from those allegedly unable to govern themselves seemed like a contradiction in terms. Indeed, one lawmaker pointed out that congressional tax legislation without Puerto Rico's consent ran contrary to a foundational principle of the United States: no taxation without representation.[122] But most members of Congress viewed Puerto Rico as a "ward."[123] That is, they were devising "a wise code of taxation" that would enable "faithful American officials" to direct expenditures to public needs.[124]

(/pdf/ZhangYLJForumEssay_id98771d.pdf)

3. The Impossibility of Territorial Internal Revenue

(mailto:?subject=Yale L. Law Journal: The Origins of U.S. Territorial Taxation and the Insular Cases&body=https://www.yalelawjournal.org/forum/the-origins-of-us-territorial-taxation-and-the-insular-cases)

After rejecting appropriations and borrowing, Congress decided that Puerto Rico could not bear any internal revenue (i.e., excise taxes on consumption or direct taxes on property). Representative Payne initially introduced a bill to extend federal internal-revenue laws to Puerto Rico.[125] That would have included excise taxes on alcohol, which in combination with tariffs on sugar accounted for close to half of federal revenues.[126] But Payne quickly changed his tune. Speaking on the House floor, he noted that Puerto Rico consumed more than one million gallons of rum each year, paying twenty-five to forty cents per gallon.[127] The extension of the federal internal-revenue system would have imposed an excise tax of $1.10 per gallon of rum.[128] It would have crippled the rum-distillation industry and deprived the locals of a key commodity.[129]

Senator Foraker spoke decisively against property taxation. On the floor, he reminded the Senate that Congress would establish a civilian government in Puerto Rico.[130] The maintenance of "governmental machinery" demanded revenue streams, which Foraker estimated at $3 million each year.[131] And "direct taxation upon the property in Puerto Rico," Foraker insisted, was "impossible" because it would impose excessive tax burdens.[132] Foraker assessed the value of all insular property at about $150 million, which would enable a 2% property-tax rate to yield the required $3 million of government revenue each year, but he argued that the "fair value for taxation" was only two-thirds of the property's economic value.[133] And because the local municipal (rather than territorial) government required an additional $1 million, Foraker concluded that a 4% property tax would be needed to meet Puerto Rico's revenue needs.[134] Further, he viewed this "burdensome" tax as beyond the ability of Puerto Ricans to administer.[135] Unlike mainland Americans, Puerto Ricans were "not familiar with the system" of property taxation.[136] It would thus run contrary to congressional intent to "authorize a system of taxation that the people of Puerto Rico can conform to and administer successfully."[137] As a result, Foraker proposed to raise territorial revenue by discounted tariffs at 25% of the Dingley rates on goods between Puerto Rico and the mainland United States, and he only reluctantly acquiesced to the House's amendment to cut the rate to 15%.[138]

Some lawmakers echoed Senator Foraker.[139] But his arguments were not compelling—at least not enough to have ruled out the partial use of a consumption or property tax to fund the territorial government. Contrary to Foraker's doubts, Puerto Rico had substantial experience in implementing tax regimes under Spanish rule. The island had extracted revenues in the forms of tariffs, excises, and taxes on select commodities (*consumo*).[140] It had also collected an income tax, which Congress had attempted to levy in 1894 before the Supreme Court held it unconstitutional.[141] T.S. Adams, a key Treasury official who would later wield significant influence over the development of the federal income tax, described pre-annexation Puerto Rico as having "in appearance at least, a successful [tax] system."[142] Adams was serving as an assistant to Puerto Rico's

116 *See supra* note 46 and accompanying text (describing federal deficits in the late 1890s), 33 Cong. ...

117 33 Cong. Rec. 2051 (1900) (statement of Rep. Long); 33 Cong. Rec. 2141 (1900) (statement of Rep. R...

118 33 Cong. Rec. 2141 (1900) (statement of Rep. Russell).

119 33 Cong. Rec. 2648 (1900) (statement of Sen. Davis).

120 33 Cong. Rec. 1355 (1900) (statement of Rep. Weeks).

121 33 Cong. Rec. 2644-45 (1900) (statement of Sen. Foraker) ("The people of Puerto Rico differ radi...

122 33 Cong. Rec. 1844 (1900) (statement of Rep. Miers) ("Has there ever been a consent by the peopl...

123 33 Cong Rec. 2097 (1900) (statement of Rep. Parker).

124 33 Cong. Rec. 1358 (1900) (statement of Rep. Weeks).

125 H.R. 6883, 56th Cong. § 1(1900); *see, e.g.*, Revenue Act of 1894, ch. 349, § 48, 28 Stat. 509, 56...

126 *See* Mehrotra, *supra* note 21, at 72 tbl.1.1; *supra* notes 52-55 and accompanying text.

127 33 Cong. Rec. 1942 (1900) (statement of Rep. Payne).

128 *See* Revenue Act of 1894, § 48, 28 Stat. at 563.

129 33 Cong. Rec. 1942 (1900) (statement of Rep. Payne).

130 *See supra* notes 89-91 and accompanying text; Organic Act of 1900 (Foraker Act), ch. 191, 31 Stat. ...

131 33 Cong. Rec. 2645 (1900) (statement of Sen. Foraker).

132 *Id.*

133 *Id.* at 2646 ("Generally in the Northern States here I think we assess property for taxation at a...

134 *Id.* ("That would mean a tax rate of 4 per cent on every dollar's worth of property belonging t...

135 *Id.*

136 *Id.*

137 *Id.* at 2648.

Treasurer at the time, and he complained about other aspects of Puerto Rico's tax policy (e.g., the use of indirect taxes, whose burden fell on the poor).[143] But even Adams conceded the "efficiency" of the pre-annexation tax system, characterizing it as an administrative process that was mercilessly effective when unimpeded by bribery."[144] Further, an *ad valorem* tax of about 2% on property was not uncommon at this time: Wisconsin taxed the full value of property at about 3% in 1900, and Utah first levied a territorial property tax at 1% in 1851.[145]

These concerns prompted many in Congress to speak in favor of an *internal* revenue system for Puerto Rico. One lawmaker, for example, conjectured that real-estate taxes would "become a profitable source of revenue" given the impending capital investment in the production of coffee, sugar, and tobacco in Puerto Rico.[146] Others attributed the tariff decision to the sugar and tobacco industries' influence on the House Ways and Means Committee, and suggested that either property taxes or excise taxes on rum could meet territorial revenue needs when combined with other methods of taxation.[147] And prominent citizens of Puerto Rico "repudiate[d] the idea that [they] cannot raise the amount necessary to carry on [territorial] affairs" through internal revenue, pointing to the island's past success in funding budgets in excess of four million dollars.[148] Indeed, Puerto Rico immediately levied a set of internal-revenue taxes upon establishing the civil government. The island's revenue act, promulgated in January 1901, provided for a tax of up to one percent on the actual market value of real and personal property, excise taxes on alcohol and tobacco, and an inheritance tax at progressive rates.[149]

4. Territorial Tariffs

Senator Foraker characterized Congress's decision to impose tariffs on the movement of goods between Puerto Rico and the mainland as an act of "unexampled generosity."[150] To be sure, the Foraker Act directed all tariff revenue to the territorial rather than the federal Treasury.[151] But many lawmakers challenged the underlying decision to impose tariffs in the first place. Two main strands of arguments emerged: policy and constitutional.[152]

With respect to policy, lawmakers contended that Puerto Rico needed not tariffs but markets. Severing colonial ties with Spain came at a cost. The island lost the largest markets for its exports like coffee, sugar, and tobacco.[153] Half of those exports, more than $8 million for the four years before 1897, went to Spain and Cuba, which soon erected tariff barriers against the entry of Puerto Rican goods.[154] Tariffs—even discounted ones—between the island and the mainland United States would thus deal an additional blow to industrial conditions.[155] Indeed, a petition from prominent residents of Puerto Rico to Congress urged free commerce and predicted "nothing but stagnation, retrogression, and disaster" should tariffs be imposed.[156] Without "free access to the [mainland] markets," Puerto Rico would have suffered a "withdrawal of Spanish interests and the nonsubstitution of American promotion of prosperity."[157]

Further, lawmakers made constitutional arguments against the imposition of tariffs. A comprehensive assessment of these voluminous objections is unwarranted here. But there was enough doubt about whether Congress had the power to impose tariffs on the movement of goods between the territories and the mainland United States that (1) opponents to the Foraker Act marshaled legal authorities against it,[158] and (2) supporters lauded the Foraker Act for enabling a possible resolution of the doubt by the Supreme Court.[159] The 1787 Constitution required "all Duties, Imposts and Excises [] be uniform throughout the United States."[160] If Puerto Rico formed part of the "United States," the Foraker Act's tariffs would violate the Uniformity Clause. And

138 *Id.* at 2647.

139 *E.g.*, *id.* at 3395 (1900) (statement of Rep. Benjamin F. Marsh) ("The extension of the internal-r...

140 *See* T.S. Adams, *The Financial Problems of Porto Rico*, 17 Annals Am. Acad. Pol. & Soc. Sci. 48, 48 ...

141 Revenue Act of 1894, ch. 349, § 27, 28 Stat. 509, 553; Pollock v. Farmers' Loan & Tr. Co., 158 U.S...

142 Adams, *supra* note 140, at 48; Lawrence Zelenak, Figuring Out the Tax: Congress, Treasury, and the ...

143 Adams, *supra* note 140, at 49.

144 *Id.*

145 Jack Stark, A History of the Property Tax and Property Tax Relief in Wisconsin 12 (2018) (presenti...

146 33 Cong. Rec. 2044 (1900) (statement of Rep. Jacob H. Bromwell).

147 *Id.* at 2045 (1900) (statement of Rep. Robert L. Henry); *id.* at 2150 (1900) (statement of Rep. Lloy...

148 *Id.* at 3609 (1900) (reading into the *Congressional Record* a letter from the Commissioners of Puert...

149 *See* J.H. Hollander, *The Finances of Porto Rico*, 16 Pol. Sci. Q. 553, 571-73 (1901); First Annual R...

150 33 Cong. Rec. 2648 (1900) (statement of Sen. Foraker).

151 An Act Temporarily to Provide Revenues and a Civil Government for Porto Rico, and for Other Purpos...

152 Lawmakers also accused the tariffs as the product of lobbying by the sugar industry. The reality i...

153 33 Cong. Rec. 1869 (1900) (report of the Sec'y of War for 1899) ("The principal difficulty now...

154 *Id.*

155

case law before 1900, if anything, gestured toward a broad reading of the Clause. One key case, the infamous *Dred Scott v. Sandford*, had held that Congress could not ban slavery in a territory on the ground of due process.[161] *Dred Scott* appeared to dismiss the federal government's power "to obtain and hold colonies and dependent territories, over which [it] might legislate without [constitutional] restriction."[162] In an earlier opinion, Chief Justice Marshall had construed Congress's taxing power—and Article I, Section 8, which contains the Uniformity Clause—as a "general" provision, "without limitation as to place," and "extend[ing] to all places over which the government extends."[163] Opponents to tariffs read these pronouncements as holding the Constitution applicable *ex proprio vigore*—of its own force and without the need for congressional action—to all territories.[164] Article I thus guaranteed "[e]quality of taxation" in all of the United States, including Puerto Rico.[165]

5. China, the Philippines, and Congressional Taxing Power

Finally, Congress needed to bring a test case to the Supreme Court to confirm its power to impose tariffs between the mainland and overseas territories. This was the most convincing reason—in the views of many contemporary lawmakers—for exempting Puerto Rico from internal-revenue laws. This question cut to the heart of the federal tax base. After astonishing industrial growth in the late nineteenth century, the United States was producing more than it could consume. The federal government searched for foreign markets to direct the excess goods.[166] China was the most promising option: it boasted an enormous base of potential consumers with five times the population of the United States and had little industrial capacity of its own (but enough wealth to pay for imports). Acquisition of the Philippines certainly facilitated trade with China, but because the federal government had just secured open-door trading at Chinese ports at the acquiescence of other colonial powers, it was under pressure to offer open-door trading in the Philippines. Tax-free entry of foreign goods into the Philippines necessitated a tariff regime between the Philippines, a territory, and the mainland. Without it, foreign merchants could have shipped goods destined for the mainland market to the Philippines first, then forwarded them—all tariff-free—to the United States. Tariffs constituted close to half of all federal receipts. The survival of the federal tax system—as constituted in 1900—thus depended on Congress's power to impose territorial tariffs.

Anti-imperialists raised this concern even before the Foraker Act. In 1899, for example, one lawmaker expressed worries about the "effect of [territorial] annexation on our revenue laws."[167] Relying on the Uniformity Clause, he noted that annexed territories would "no longer be 'foreign,'" and that acquisition would result in "absolute free trade among the States and Territories of the United States."[168] That is, Congress had "no power to put tariff duties on domestic goods going from a State into a Territory."[169] At the same time, Congress was considering an open-door trading policy in the Philippines. Throughout the country, industrialists demanded tax-free trading "to reach the hundreds of millions of people in China," and the federal government could not obtain "such a privilege of open ports" while keeping the ports in the Philippines "practically closed by a prohibitive tariff."[170] That would be a conspicuous policy failure and affront to other colonial powers given the Philippines's geographic proximity to China.[171] An open-door trading policy in the Philippines would thus result in absolute free trade throughout the United States and the abolition of the tariff system—a "portentous danger."[172]

See id. ("I wish most strongly to urge that the custom duties between Puerto Rico and the United...

156 33 Cong. Rec. 2231 (1900) (https://https://www.yalelawjournal.org/forum/the-origins-of-us-territorial-taxation-and-the-insular-cases#) (statement of Rep. Joseph Wheeler) (protest and petition from the people of Puerto...

157 *Id.*; *see also* 33 Cong. Rec. 2969 (1900) (statement of Sen. James K. Jones) ("Mr. President, our ...

158 *See* 33 Cong. Rec. 1262 (1900) (statement of Rep. Benjamin R. Tillman); 33 Cong. Rec. 1495 (1900) (...

159 *See infra* notes 160-168 and accompanying text.

160 U.S. Const. art. I, § 8, cl.1.

161 60 U.S. (19 How.) 393, 448 (1857).

162 *Id.*

163 Loughborough v. Blake, 18 U.S. (5 Wheat.) 317, 318-19 (1820).

164 *See supra* note 158. *But see* 33 Cong. Rec. 2643 (1900) (statement of Sen. Joseph B. Foraker) ("[T...

165 33 Cong. Rec. 1948 (1900) (statement of Rep. James D. Richardson) ("Equality of taxation, equali...

166 *See* 33 Cong. Rec. 2250 (1900) (statement of Sen. Joseph B. Foraker) ("We want to trade with the fa...

167 32 Cong. Rec. app. 86 (1899) (statement of Rep. William H. Fleming).

168 *Id.*

Lawmakers echoed these issues during the legislative debate on the Foraker Act. They accused the imposition of tariffs of being more or less solely motivated by the urge to test the outer bounds of congressional taxing power. Speaking on the House floor, Representative Jacob H. Bromwell dismissed other arguments marshaled in support of the tariff regime. He contended that its true intent was to "establish a precedent" and "assert a right to discriminate[] so as to avoid complications when we come to the question of tariffs for the Philippines and possibly for Cuba."[173] But Bromwell judged this attempt unnecessary. Many factors distinguished Puerto Rico from the Philippines—voluntary entry into the United States, proximity to the mainland, and ease of administering the federal tax regime—all of which could justify differential treatment of the two as to excises and tariffs.[174] To be sure, these factors might prove doctrinally irrelevant to the question of congressional taxing power if Puerto Rico and the Philippines shared the same territorial status. Even in that case, Bromwell suggested an alternative: Congress could have reduced internal-revenue rates in Puerto Rico.[175] That would have accomplished the same end of creating a variation in duty/excise/impost rates between an overseas territory and the mainland. It would have brought the same doctrinal question—albeit on slightly different facts—to the Supreme Court. And it would not have subjected Puerto Rico to a punishing tariff regime when it was looking for markets for its products. Of course, Congress did not act on this proposal—presumably because it wanted to extract enough revenues from the island to fund the territorial government, rather than rely on appropriations or borrowing. A reduction in internal-revenue tax rates would have run contrary to that goal, especially given Republican lawmakers' conviction that direct and excise taxation could not produce sustainable insular revenue streams.

Speaking on the Senate floor, Senator Foraker acknowledged these concerns. In fact, he extolled the proposed tariff regime's potential to confirm Congress's territorial taxing power as one of its virtues. Foraker noted the recent "diplomatic triumph[]" that the federal government had obtained—an open-door trading policy with China.[176] He was referring to the efforts of John M. Hay, the Secretary of State, at a time when other colonial powers were set to carve up China and acquire "exclusive spheres of influence."[177] In his capacity as the Secretary of State, Hay sent notes to Britain, Germany, France, Italy, Japan, and Russia to secure assurances that those colonial powers would not impose protective tariffs or dues on exports that reached China in their respective spheres of influence.[178] These so-called "open door notes" established at the core of American foreign policy the commitment to "safeguard . . . the principle of equal and impartial trade with all parts of the Chinese Empire."[179]

Like others, Senator Foraker recognized that this diplomatic victory came at a cost. If the United States could export its excess industrial production tax-free to China, at the concession of colonial powers, it would face immense pressure to open up the Philippines for free trade.[180] As a result, if the Philippines formed "an integral part" of the United States, and if Congress "[could] not levy an export duty" on goods coming from the Philippines due to the Uniformity Clause, any "protective or [] revenue tariff" would be impossible.[181] Foraker reached a stern conclusion: "[Y]ou may as well dismantle your custom-houses and go out of the business of collecting tariff revenues. There is no escape from it."[182]

But Senator Foraker also saw an opportunity. If Congress imposed tariffs on goods to and from Puerto Rico and exempted the island from federal internal-revenue laws, disgruntled importers would surely sue on constitutional grounds, thus bringing the question cleanly to the Supreme Court.[183] Foraker explicitly articulated this on the Senate floor. He desired to "have this question submitted to the Supreme Court and passed upon at the earliest possible time," and it "would be nothing short of criminal stupidity in the Congress of the United States not to legislate when there is necessity

169 *Id.*

170 *Id.*

171 *See id.* ("If we hope to extend our trade with other nations in the Orient, it will be the height...

172 *Id.*

173 33 Cong. Rec. 2043 (1900) (statement of Rep. Jacob H. Bromwell).

174 *Id.*

175 *Id.* at 2044.

176 33 Cong. Rec. 2650 (1900) (statement of Sen. Joseph B. Foraker).

177 *See generally* Stephen R. Halsey, Quest for Power: European Imperialism and the Making of Chinese s...

178 *E.g.*, Note No. 927 from John M. Hay, Sec'y of State, to Andrew D. White, U.S. Ambassador to Ger....

179 H.R. Doc. No. 56-1, at 299 (1902) (including a circular telegram from Secretary of State John M. H...

180 33 Cong. Rec. 2650 (1900) (statement of Sen. Joseph B. Foraker) ("But does any man imagine that ...

for it, so as to raise that question and have it settled."[184] Even Foraker himself thus acknowledged that tariffs on Puerto Rico were not solely motivated by generosity. They served the critical function of allowing Congress to protect the federal tax base in deciding on trade issues in the Philippines. Another lawmaker put it bluntly: "I understand full well that the Administration does not care a fig for Puerto Rico; that this precedent is about to be established not for the mere sake of deriving a revenue from that island, but as a precedent for our future guidance in the control of the Philippines."[185]

Congress succeeded. Within a year of the Foraker Act's passage, an importer in New York sued the customs collector to recover duties paid on oranges exported from Puerto Rico.[186] This suit reached the Supreme Court. A splintered Court held that Puerto Rico was "not a part of the United States within the revenue clauses of the Constitution," in essence giving Congress exactly what it wanted.[187] That, of course, was *Downes v. Bidwell*—one of the now-infamous *Insular Cases*.

C. Interterritorial Tax Variation

Since that critical moment in 1900, Congress has generally treated all territories in the same way by exempting their residents from the federal tax regime.[188] Most bona fide residents of the territories—including U.S. citizens—pay taxes only to their respective territorial governments. As this Part shows, territorial exemption from federal taxation originated in legislative debate about a multiplicity of fiscal concerns, most prominently the need to protect the federal tax base.

The key variation that emerged concerned each territory's power to deviate from the rules of federal income taxation. In 1913, Congress imposed our current income tax pursuant to its power under the Sixteenth Amendment. At first, Puerto Rico was required to administer federal income-tax rules but received in its insular treasury all income-tax receipts. Under the Revenue Act of 1913, "the provisions of [income taxation] extend[ed] to Porto Rico and the Philippine Islands."[189] But income-tax administration was delegated to territorial officers, and all revenues "accrue[d] intact to the general governments, thereof, respectively."[190] This changed in a few years. As part of the Revenue Act of 1918, Congress delegated to Puerto Rico (and the Philippines) the authority "to amend, alter, modify, or repeal the income tax laws."[191] Puerto Rico has exercised that power, and today it collects revenue from a territorial income tax that features rates, exemptions, and rules substantially different from the federal regime.[192] By contrast, other territories are "mirror-Code" jurisdictions. Guam, the U.S. Virgin Islands, and the Northern Mariana Islands are all exempt from federal income taxation, but they are required to institute the federal income-tax regime as the territorial income tax.[193]

The evolution of interterritorial variation in income-tax powers again reflects Congress's focus on safeguarding federal tax receipts. Guam, for example, became a U.S. territory in 1898 along with Puerto Rico.[194] Under an 1898 executive order

181 *Id.*

182 *Id.; see also* 33 Cong. Rec. 4856 (1900) (statement of Sen. Joseph B. Foraker) ("If duties, impos…

183 33 Cong. Rec. 2650 ("[E]very Senator here—Democrat and Republican alike should rejoice at the …

184 33 Cong. Rec. 2651 (1900) (statement of Sen. Joseph B. Foraker). Later in the debate, Foraker trie…

185 33 Cong. Rec. 2162 (1900) (statement of Rep. William E. Williams).

186 Downes v. Bidwell, 182 U.S. 244, 247 (1901).

187 *Id.* at 287.

188 The primary exception to this rule is payroll taxes. *See* I.R.C. §§ 3121(e), 3306(j) (2018).

189 Revenue Act of 1913, ch. 16, § 2(M), 38 Stat. 114, 180.

190 *Id.*

191 Revenue Act of 1918, ch. 18, § 261, 40 Stat. 1057, 1088 (1919); *see* Jones Act of 1917, ch. 145, §…

192 *See supra* note 18.

193 48 U.S.C. § 1421i(a)-(b) (2018); Organic Act of Guam, ch. 512, § 31, 64 Stat. 384, 392 (1950);…

issued by President McKinley, the Department of the Navy governed Guam for the next half-century, relying on congressional appropriations rather than territorial taxes.[195] In 1950, Congress finally established a civil government in Guam.[196] In doing so, Congress wanted "to set up a [territorial] tax structure sufficient to carry [Guam's] own expenses of government without asking for any contribution from the United States," and noted "sufficient sources of revenue right there on the island."[197] The rhetoric of fiscal self-governance thus persisted. Congress again decided to design a territorial tax system that would lessen Guam's fiscal reliance on federal appropriations. For precisely this reason, Congress required Guam to impose the federal income tax as its own territorial income tax. Before the Organic Act of 1950, U.S. citizens with income from Guam paid neither the federal income tax nor any income tax to the territory.[198] Closing this "loophole," Congress concluded, would make Guam fiscally self-sufficient and no longer in need of federal appropriations.[199] Aligning Guam's tax structure with that of the federal income tax would "bring in some money to the United States Treasury."[200]

The same happened with the U.S. Virgin Islands. By the early 1920s, Congress had grown tired of periodic appropriations to the Virgin Islands.[201] During the legislative debate surrounding a Navy appropriations bill in 1918, the chair of the House Committee on Insular Affairs noted the "anomalous condition" of Congress's exemption of the Virgin Islands from federal revenue laws.[202] As a result, the federal government could collect no revenue from the Virgin Islands and was forced to "furnish money to run the [territorial] government."[203] The appropriations bill then extended the federal income tax to the Virgin Islands to lessen the need for additional federal appropriations.[204]

* * *

This Part has analyzed the origins of U.S. territorial taxation. Between 1898 and 1900, Congress fiercely debated the fiscal costs and the tax status of newly acquired territories. Early on, lawmakers voiced serious concerns about the collapse of sugar tariffs—a critical source of federal receipts—that would result from tax-free importation of sugarcane from overseas possessions. After annexation, President McKinley proposed to abolish all territorial tariffs at first. But the mood quickly shifted, and the Foraker Act ended up imposing discounted tariffs and exempting Puerto Rico from the internal-revenue regime. Lawmakers attempted several justifications, including the need for the island to have self-sustaining revenue streams and the impossibility of excise or property taxation. But ultimately, the most convincing reason was that Congress needed to confirm its authority to impose territorial tariffs at the Supreme Court. That power would enable the federal government to cement an open-door trading policy with China—and secure a large foreign market for U.S. industrial production—without risking the collapse of tariff revenue. Since that time, Congress has continued to segregate the territories from the federal tax regime, but it has granted territorial governments differing powers to deviate from federal income-tax rules in imposing the territorial income tax.

II. DOCTRINAL AND SCHOLARLY IMPLICATIONS

Part I's analysis yields doctrinal and scholarly insights. Territorial fiscal segregation from the mainland arose from Congress's need to protect the *federal* tax base. As a result, the territories' tax exemption is, properly conceived, not a *cost* to Congress—a point that questions the doctrinal reasoning of *Vaello Madero*. Further, this Essay uncovers the tax-centric origins of the *Insular Cases*. It thus sheds new light on how fiscal concerns paved the way for constitutional deprivations.

194 Treaty of Peace Between the United States of America and the Kingdom of Spain art. II, Spain-U.S., Dec. 10, 1898, 30 Stat. 1754.

195 Exec. Order No. 108-A (Dec. 23, 1898) ("The island of Guam in the Ladrones is hereby placed unde...

196 Organic Act of Guam, ch. 512, § 3, 64 Stat. 384, 384 (1950).

197 96 Cong. Rec. 7577 (1950) (statement of Rep. Errett P. Scrivner).

198 *See* Act of May 28, 1939, ch. 289, 52 Stat. 532, 532 (Supp. J 1939) (exempting U.S. citizens from f...

199 96 Cong. Rec. 7577 (1950) (statement of Rep. Arthur L. Miller) ("The amendment we just adopted i...

200 *Id.* Deviations from the federal income tax regime could enable creative tax avoidance. Lower tax bu...

201 *See, e.g.*, Act of July 1, 1918, ch. 114, 40 Stat. 704, 706 (appropriating $200,000 for "expenses...

202 61 Cong. Rec. 3173 (1950) (statement of Rep. Horace M. Towner).

203 *Id.*

204 Act of July 12, 1921, ch. 44, 42 Stat. 122, 123.

A. Doctrinal Implications

This Section explores the doctrinal implications of Part I's analysis, focusing on the Supreme Court's recent decision in *United States v. Vaello Madero*. In that case, the plaintiff-respondent lost entitlement to SSI benefits upon moving to Puerto Rico, and challenged on constitutional grounds the federal government's exclusion of territorial residents from the SSI program.[205] Both the district court and the appellate court ruled in the plaintiff's favor.[206] But Justice Kavanaugh, writing for the Supreme Court majority, held that equal protection did not require Congress to extend the SSI program to territorial residents.[207] Applying a deferential rational-basis test, he concluded that "Puerto Rico's *tax* status"—and in particular its residents' exemption from federal income, gift, and estate taxes—supplied a sufficient ground for distinguishing the territory from the mainland for purposes of the SSI program.[208] The majority explained: "[I]t is reasonable for Congress to take account of the general balance of benefits to and burdens on the residents of Puerto Rico."[209] In short, because territorial residents do not pay most forms of federal income, estate, and gift taxes, the Constitution permits Congress to exclude them from public-welfare spending.

Thus, key to the majority's reasoning is a benefits theory of taxation. Broadly conceived, the benefits principle states that taxpayers should make fiscal contributions to the government to the extent they receive public services.[210] That is, taxes enable the state to provide goods that the market or private entities cannot effectively produce, and citizens should bear as much the costs of those goods as they benefit from their provision. Those goods, of course, might include welfare benefits for citizens with disabilities or the elderly with no income.[211] Such benefits accrue not only to the recipients of payments but also the public at large as an egalitarian or distributive gain.[212] As a corollary, citizens with no—or lesser—fiscal obligation to the common treasury should receive no or fewer goods provided by the government. At a minimum, the government should be free to deny them those goods as a matter of political judgment.

The critical link between federal taxation and federal spending therefore becomes the linchpin in the Court's decision. Rational basis allows Congress to conduct a cost-benefit calculus in designing welfare programs and to exclude residents of certain jurisdictions from participation if they do not bear the costs of funding the welfare programs in the first place. Thus, Justice Kavanaugh begins his analysis by listing side by side the costs borne by and the benefits accruing to residents of the U.S. territories. He notes, "[o]n the tax side," that "residents of Puerto Rico are typically exempt from most federal income, gift, estate, and excise taxes" but "generally pay Social Security, Medicare, and unemployment taxes."[213] He then observes, "[o]n the benefits side," that "residents of Puerto Rico are eligible for Social Security and Medicare[, as well as] federal unemployment benefits," but not SSI payments.[214] This comparison of "benefits to . . . burdens" leads him to conclude that Puerto Rico's tax exemption supplies a sufficient rational basis for its exclusion from SSI.[215] In other words, if Puerto Rican taxpayers do not pay for the costs, Congress can constitutionally refrain from granting them access to federal programs—the basic thrust of the benefits theory.

But framed in this way, Justice Kavanaugh's reasoning proves too much. This version of the benefits theory focuses on individuals' precise contributions to the public fisc to determine what they deserve from federal expenditures. It is unpersuasive for two reasons. First, recipients of means-tested entitlement programs inherently make little fiscal contribution to the federal government. SSI payments are not subject to federal income taxation, and it is unlikely that SSI recipients will end up owning at death property above the estate-tax exemption, currently more than $10 million.[216] If the

205 *See supra* notes 2-5 and accompanying text; 42 U.S.C. § 1382c(a)(1)(B)(i), (e) (2018).

206 United States v. Vaello Madero, 956 F.3d 12, 32 (1st Cir. 2020); United States v. Vaello Madero, 3...

207 United States v. Vaello Madero, 596 U.S. 159, 162 (2022).

208 *Id.* at 165.

209 *Id.* (citing Califano v. Torres, 435 U.S. 1, 3-5 (1978) (per curiam); Harris v. Rosario, 446 U.S. 65...

210 *See* David Elkins, *Horizontal Equity as a Principle of Tax Theory*, 24 Yale L. & Pol'y Rev. 43, 80 (...

211 *Supplemental Security Income (SSI)*, Soc. Sec. Admin., https://www.ssa.gov/ssi [https://perma.cc/9J...

212 That is, economic-security programs for lower-income and elderly populations have positive externa...

213 United States v. Vaello Madero, 596 U.S. 159, 163 (2022) (citing Jones Act of Puerto Rico, ch. 145...

214 *Id.* (citing I.R.C. §§ 3121(e), 3306(j) (2018); 42 U.S.C. §§ 410(h)-(i), 1301(a)(1) (2018)).

215 *Id.* at 165.

logic behind the *Vaello Madero* opinion concerns what benefits *individual* taxpayers deserve on the basis of their fiscal contributions to the federal government, then no SSI recipient qualifies. And Congress should be able to exclude all lower-income groups (subject to few or even negative income taxes) from spending programs—a conclusion that defies the logic and the purpose of means-tested welfare.

This is a principal critique raised by the dissent. Justice Sotomayor emphasizes that "SSI recipients pay few if any taxes at all" and "must have an income well below the standard deduction for single tax filers."[217] Variation in individual fiscal contribution to government cannot therefore distinguish SSI recipients residing in Puerto Rico from those residing on the mainland. Instead, the differentiating factor on the tax side must be inter*jurisdictional* variation.

Second, the majority's reasoning cannot rest on a precise application of the benefits theory as to taxes paid and value received. That is, there is immense variation across jurisdictions in income-tax burdens. On a per capita basis, Massachusetts contributes almost three times as much revenue to the federal government as Mississippi.[218] Surely Congress cannot exclude residents of Mississippi from the SSI program based on their lower contribution to the federal fisc, or provide residents of Massachusetts with three times the amount of the benefit because they are richer. After all, Congress designed the SSI program to support disabled and elderly populations that are *poor* and unable to earn incomes. As a result, precise variation in each jurisdiction's fiscal contribution to the federal government—that is, in how much taxes they pay into the federal Treasury—also cannot distinguish SSI recipients residing in Puerto Rico from those residing on the mainland.

To be sure, the majority appears to agree when it says, "Congress need not conduct a dollar-to-dollar comparison of how its tax and benefits programs apply in the States as compared to the Territories, either at the individual or collective level."[219] Instead, a reasonable accounting of "the general balance of benefits to and burdens on the residents of Puerto Rico" is enough.[220] In the case of Puerto Rico, its "*tax* status" justified Congress's choice to exclude welfare benefits from its residents.[221] Under the majority's logic, therefore, what distinguishes the territories from the mainland for SSI purposes is neither varying levels of individual taxpayers' fiscal contribution to the federal government (which would disqualify most SSI recipients themselves from such benefits) nor varying amounts of individual jurisdictions' fiscal contribution to the federal government (which would disqualify residents of poor mainland states from full participation in federal welfare programs).

Instead, the key here must be the formal exemption of the territories from forms of internal revenue. Under current law, bona fide residents of Puerto Rico need not pay federal income taxes on incomes derived from Puerto Rico itself, unless they are employed by the United States government.[222] According to the majority in *Vaello Madero*, such formal exemption from the federal tax regime constitutes a *cost* to the federal treasury. The loss in federal revenue resulting from the exemption then forms the rational basis for the territories' exclusion from SSI programs. This logic is threefold. It places normative weight on variations (1) across jurisdictions (2) in a formal tax-status-based exemption from the federal income tax, which (3) produces costs to the federal government and consequently detracts from the tax or fiscal-*contribution* side of the calculus. It is a formalist and jurisdiction-based version of the benefits theory of taxation that cognizes tax exemption solely as loss of potential revenue.

216 *See Frequently Asked Questions: Regular and Disability Benefits*, Internal Revenue Serv. (Jan. 24, (https://https

217 *Vaello Madero*, 596 U.S. at 196 (Sotomayor, J., dissenting).

218 Alex Zhang, *The State and Local Tax Deduction and Fiscal Federalism*, 168 Tax Notes 2429, 2436–37...

219 United States v. Vaello Madero, 596 U.S. 159, 165 (2022).

220 *Id.*

221 *Id.*

(/pdf/ZhangYLJForumEssay_id98771d.pdf)

(mailto:?subject=Yale Law Journal: The Origins of U.S. Territorial Taxation and the Insular Cases&body=https://www.yalelawjournal.org/forum/the-origins-of-us-territorial-taxation-and-the-insular-cases)

This Essay's account casts doubt on the third premise of the majority's reasoning. We might concede that federal benefits should follow tax contributions and that the formal tax status of jurisdictions, not the actual fiscal contributions of individual taxpayers, is the relevant focus of analysis. But formal exemptions from the federal tax regime must still count as *costs* to Congress for the argument to make any sense. For only in that way can the Court contend that the territories qualify for fewer benefits due to their lower fiscal contribution to the federal fisc. By contrast, if territorial tax exemption *benefits* the federal government, that status would add to, not detract from, the tax side of the calculus. In theory, it should render territorial residents eligible for *more*, not fewer, public goods.

As Part I shows, Congress exempted the territories from the federal tax regime not because it generously let go of potential revenues—*pace* Senator Foraker.[223] Much to the contrary, Congress had serious concerns about the fiscal costs of acquiring overseas territories in the first place, specifically rejected calls to fund insular treasuries with appropriations or borrowing, and designed territorial systems to *preserve* federal tax receipts. In the case of Puerto Rico, Congress exempted it from internal-revenue laws because it needed the Supreme Court to confirm its power to impose territorial tariffs despite the Uniformity Clause. That power would allow Congress to pursue an open-door trading policy in East Asia without risking the collapse of federal customs revenue.

Territorial exemption from the federal tax regime thus served to preserve federal revenue. This is a simple but important point. It means that the territories functionally bear the costs of more effective federal taxation. Their tax status—engineered by Congress for the *benefit* of the federal fisc—cannot constitute a rational basis for their exclusion from federal welfare programs.

This broader point—that Congress stands to benefit from territorial fiscal segregation—retains vitality today.[224] Territorial economies and tax systems have evolved on the basis of their exclusion from the federal fiscal community, in the process enabling Congress to use tax policy as a tool of domination.[225] By exempting the territories from most of the federal tax regime, Congress saves on expenditures that it would otherwise incur. A recent study by the Government Accountability Office estimates that treating Puerto Rico the same as states for purposes of federal welfare programs could cost Congress several billion dollars a year, *after* accounting for the extension of federal income taxes to the island (and associated behavioral shifts).[226] As in 1900, fiscal costs continue to deter lawmakers from supporting territorial aspirations to secure statehood and full citizenship.[227]

Moreover, because equal treatment costs more than federal taxes can raise in the territories, the majority in *Vaello Madero* begs the question. Exemption from federal taxes counts as a cost to the federal government only if it does not allow Congress as a constitutional matter to deny equal participation in federal spending programs to the exemptee. If it does, as the *Vaello Madero* majority holds, exemption from the federal tax regime might accrue to the benefit of the federal government. Should equal participation in federal programs result in larger spending than federal taxes can raise in the exempt jurisdiction, Congress's choice to exclude that jurisdiction from the federal fiscal regime would not be an act of generosity. That is, formal immunity from taxes can operate as a *liability* to the subnational jurisdiction and to the fiscal *advantage* of the central government, after accounting for the spending side of the calculus.

223 *See* 33 Cong. Rec. 2646 (1900) (statement of Sen. Foraker) (describing the Foraker Act as an exampl...

224 Even today, trade tensions and geopolitics threaten to return the federal government to its earlie...

225 Dick, *supra* note 19, at 83-84.

226 U.S. Gov't Accountability Off., GAO-14-31, Puerto Rico: Information on How Statehood Would Poten...

227 *See, e.g.*, José A. Hernández Mayoral, *The High Cost of Puerto Rican Statehood*, Hill (Apr. 2, 2014)...

B. Scholarly Implications

The primary scholarly contribution of this Essay is to uncover the origins of federal territorial taxation. It argues that despite the rhetoric of territorial autonomy, congressional efforts to preserve tariff revenues played a critical—perhaps decisive—role in the Foraker Act's design of Puerto Rico's tax system. This joins a burgeoning literature about the United States's imperialist past.[228] In particular, scholars have alluded to how the Philippines—and the predicament as to its constitutional status—shadowed Congress's decision-making with respect to Puerto Rico.[229] This Essay's account fleshes out this entanglement in the context of federal and territorial tax policymaking at the turn of the twentieth century.

Further, recent studies have taken a broad look at the history of federal taxation in Puerto Rico, providing surveys of more than a century of federal-territorial fiscal interactions.[230] Armed with these data, commentators have argued that the United States practiced an especially damaging form of colonialism on the island, using tax-policy tools to advance corporate interests or undermine Puerto Rico's economic self-determination.[231] They have also contended that the Court got it wrong in *Vaello Madero*, and that the majority opinion misunderstands the relationship between tax policy and spending programs while ignoring the racial backdrop of the dispute.[232] This Essay adds to both accounts. First, it provides a localized illustration of the workings of American fiscal imperialism. In exerting its control over the territories, Congress extracts indirect and invisible benefits. It has facially exempted the territories from federal taxation, asserting legislative generosity. In reality, Congress has imposed structural and developmental costs on the territories to help make the federal tax system more effective. Second, the Essay articulates an additional criticism of *Vaello Madero*. Even if we dismiss the underlying racial concerns or the Court's peculiar understanding of tax and welfare programs, the majority fundamentally errs in viewing territorial tax exemption solely as a cost to the federal government.

Finally, recent case law has provoked both calls to overrule the *Insular Cases* and caution that overruling the *Insular Cases* alone cannot sufficiently remedy the constitutional landscape.[233] This Essay clarifies the origins of *Downes v. Bidwell*, the most important of the six original *Insular Cases*.[234] *Downes* arose from an outdated need to preserve the tax base when tariffs and excises formed the overwhelming bulk of federal revenue. At the time, the federal government was small. Its receipts totaled about two to three percent of domestic output.[235] They paled in comparison to states and localities, which collected the majority of government revenues.[236] Congress jealously guarded its limited revenue streams and could not contemplate the collapse of the tariff regime as a consequence of territorial acquisition.[237] Given that fiscal reality, it imposed tariffs on the movement of goods between Puerto Rico and the mainland United States and exempted Puerto Rico from internal-revenue laws.

Both anti-imperialists and supporters of overseas expansion recognized this distinctive territorial tax design as an interbranch tool to force the Supreme Court to decide the outer bounds of congressional taxing power.[238] And decide the Supreme Court did. In *Downes*, the Court upheld Congress's power to deviate from the Uniformity Clause in territories that were "not incorporated" and enabled it to vindicate its free-trade policies in East Asia.[239] On the same day, the Court handed down five other cases about the operation of federal law in the newly acquired territories.[240] All but one of the original six *Insular Cases* focused on taxation.[241] These tax cases laid the foundation for treating the territories as lands within the control of Congress, but outside of the American constitutional structure.

228 *See, e.g.*, Daniel Immerwahr, How to Hide an Empire: A History of the Greater United States (2019);...

229 Erman, *supra* note 38, at 39.

230 *See, e.g.*, Dick, *supra* note 19; Lipman, *supra* note 19.

231 Dick, *supra* note 19, at 9.

232 Lipman, *supra* note 19, at 363-64.

233 *See* Adriel I. Cepeda Derieux & Neil C. Weare, *After* Aurelius*: What Future for the* Insular Cases*?*, ...

234 182 U.S. 244, 287 (1901); *see* Torruella, *supra* note 233, at 69 ("[*Downes v. Bidwell*] is the crucia...

235 Michael Schuyler, *A Short History of Government Taxing and Spending in the United States*, Tax Foun...

236 Schuyler, *supra* note 235.

237 *See supra* Part I.

238 *See supra* Sections I.B.4-5.

239 *Downes*, 182 U.S. at 246-47.

240 De Lima v. Bidwell, 182 U.S. 1 (1901); Goetze v. United States, 182 U.S. 221 (1901); Dooley v. Uni...

241 *See De Lima*, 182 U.S. at 1-2; *Goetze*, 182 U.S. at 221; *Dooley*, 182 U.S. at 222; *Armstrong*, 182 U.S...

242 Blackhawk, *supra* note 233, at 128; Cepeda Derieux & Weare,

This account might strike modern readers as odd. Scholarly discussions of the *Insular Cases* rarely focus on tax issues. Commentators have criticized the *Insular Cases* for denying rights to territorial residents as to citizenship, self-governance, marriage equality, or criminal procedure.[242] They have also theorized those cases as fueling a "crisis of political legitimacy," as instantiating the constitutional anticanon, or as resurrecting the specter of *Dred Scott*.[243] Few pay attention to their tax-centric origins. For most, a structural provision about excises and customs like the Uniformity Clause hardly forms a core constitutional guarantee of individual liberty. On the other side, tax scholars today rarely think about the Uniformity Clause and how it might apply to the territories. To be sure, the newly confident Supreme Court has forced scholars to move on from their previous characterization of tax as purely statutorylaw.[244] However, constitutional tax issues today deal with the possibilities of unapportioned federal taxation of net worth and unrealized gains to combat record economic inequality and concentrations of wealth.[245] The origin story of U.S. territorial taxation was lost in the shuffle.

Tax thus paved the way for deprivations of key constitutional guarantees in the territories.[246] But all the original reasons for *Downes v. Bidwell* are gone. Its key stakeholder, Congress, has abandoned the tariff-centric fiscal regime. The federal government now relies on income taxes for revenue, after the Sixteenth Amendment lifted the critical constraint on state capacity.[247] We maintain a trade deficit, not surplus, with China, and we no longer hold the Philippines.[248] Congress certainly needs no power to deviate from the Uniformity Clause to protect the federal tax base. If anything, territorial segregation amplifies existing unfairness in the federal tax system by granting wealthy taxpayers shelters for their income.[249] All these developments make the *Insular Cases* a relic of the *ancien regime* of federal tariffs. This Essay's account therefore casts further doubt on the legitimacy of that doctrinal strand.

CONCLUSION

This Essay has traced the origins of U.S. territorial taxation to the critical period of 1898–1900. Afraid of the fiscal costs of overseas expansion, Congress designed territorial tax systems to preserve its own revenue and the federal tax base. This history sheds light on the distinctive tax status of U.S. territories as foreign countries under the Internal Revenue Code. It also calls into question the Supreme Court's decision to allow Congress to exclude territorial residents from SSI programs in *United States v. Vaello Madero*. This Essay thus joins a chorus of scholars asking Congress and the Supreme Court to rethink the territories' fiscal and constitutional status within our democracy.

Assistant Professor of Law, Emory University School of Law. I thank Luis Calderon-Gomez, Conor Clarke, Jon Endean, Luis Fuentes-Rohwer, Greg Day, Assaf Harpaz, Matt Lawrence, Michelle Layser, Henry Ordower, Amanda Parsons, Diane Ring, Usha Rodrigues, Erick Sam, Ani Satz, Christine Speidel, Carla Spivak, the audiences at the Critical Tax Conference at the University of Florida School of Law, the Junior Tax Workshop, and the Emory-UGA Summer Faculty Workshop for their feedback, as well as Jared Hirschfield, Katherine Salinas, Paige Underwood, Lily Moore-Eissenberg, and the editors of the Yale Law Journal *for diligent editing.*

supra note 233, at 298-306; Christopher...

243 Ponsa-Kraus, *supra* note 233, at 2458; Sanford Levinson, *Why the* (https://https Includ...

244 *E.g.*, Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1, 1 (1999); *see generally* ...

245 *See, e.g.*, Ari Glogower, *A Constitutional Wealth Tax*, 118 Mich. L. Rev. 717, 717 (2020).

246 *E.g.*, Balzac v. Porto Rico, 258 U.S. 298, 309 (1922); Ocampo v. United States, 234 U.S. 91, 98 (19...

247 *What Are the Sources of Revenue for the Federal Government?*, Tax Pol'y Ctr. (Jan. 2024), https://w...

248 *The People's Republic of China*, Off. U.S. Trade Representative (2024), https://ustr.gov/countries-...

249 *E.g.*, Alberto C. Medina, *Tax Cheats Are Taking Advantage of Puerto Rico—the US Government Can St...*

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(mailto:?subject=Yale Law Journal: The Origins of U.S. Territorial Taxation and the Insular Cases&body=https://www.yalelawjournal.org/forum/the-origins-of-us-territorial-taxation-and-the-insular-cases)