No. 22-800

IN THE

Supreme Court of the United States

CHARLES G. MOORE and KATHLEEN F. MOORE,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

REPLY BRIEF FOR PETITIONERS

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Certiorari is warranted because the Ninth Circuit interpreted the Sixteenth Amendment to authorize an unapportioned "income" tax on individuals whom the Government does not disagree realized no income. By dispensing with the need for realized income, that decision clashes with this Court's precedents, those of other appeals courts, and the Amendment's original meaning. It also does great violence to constitutional structure, virtually eviscerating Article I's apportionment requirement. As the many amici confirm, the decision below is not only wrong but enormously consequential, upsetting long-settled expectations undergirding practically all capital investment across the economy. The petition should be granted so that the Court can confirm that Congress lacks unrestricted taxing power and remains subject to the Constitution's limitation on direct taxation without apportionment among the states.

I. The Ninth Circuit Flouted This Court's Precedents, Creating a Circuit Split

A. *Eisner v. Macomber*, 252 U.S. 189 (1920), makes perfectly clear that the lynchpin for Sixteenth Amendment "incomes" is realization by the taxpayer. For "a gain" to be income, it must be "*received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal." *Id*. at 207. The Court's precedents, from the era following the Amendment's ratification through *Glenshaw Glass* and to the present day, have unanimously observed that fundamental principle. Pet.10–14. The decision below turns this

century's worth of precedent on its head, holding that "realization of income is not a constitutional requirement" for an income tax. App.12. It is difficult to imagine a starker, or more practically consequential, conflict with this Court's decisions. Yet that was the only pathway available to uphold the Mandatory Repatriation Tax, which takes no account of whether the taxpayers it targets realized anything. Pet.5–6; BIO.4.

The Government does not deny that the MRT and its application to Petitioners violate *Macomber*'s core holding on realization, but instead asserts that subsequent precedent has "limited its relevance." BIO.13. The vagueness of that assertion is no accident: the Government cannot say in candor that *Macomber*'s realization holding has been overruled. Nor does it deny that the Court consistently applied *Macomber*'s realization holding in its cases fleshing out the Sixteenth Amendment's substance. *See* BIO.14 n.2.

The Government identifies three "later decisions" that it says "limited" that holding. BIO.13–14. They do not. *Helvering v. Bruun* took it as a given that "realization of gain" is necessary for Sixteenth Amendment "income." 309 U.S. 461, 469 (1940). *Bruun*'s discussion of *Macomber* quoted by the Government does not address that issue but *Macomber*'s view that, to be income, a gain must be "severed from the capital," which *Bruun* regarded as merely "clarify[ing] the distinction between an ordinary dividend and a stock dividend." *Id*. at 468–69. On that basis, it held a landlord's receipt of a tenant-constructed building upon forfeiture of a land lease to be "realized taxable gain,"

notwithstanding that the building wasn't severable from the land. *Id*. at 469. *Bruun*'s reasoning on *what counts as realization* supports Petitioners' position, not the Government's position that realization is irrelevant.

The Government's discussion of *Helvering v. Horst* (at 14) elides that *Horst* recites and applies the constitutional "rule that income is not taxable until realized," 311 U.S. 112, 116 (1940). Like *Bruun*, *Horst* addresses what counts as realization, holding that the "power to procure the payment of income to another is the enjoyment and hence the realization of the income by him who exercises it." *Id*. at 118. Far from limiting *Macomber*'s core holding on realization, *Horst* applies it.

The Government's final authority on this point is another stock-dividend case, *Helvering v. Griffiths*, 318 U.S. 371 (1943). What the Government neglects to mention is that *Griffiths* was decided solely on statutory grounds (in the taxpayer's favor) and expressly refused the Government's request to overrule *Macomber*. *Id*. at 404. Why the Government believes *Griffiths* "limited" the "relevance" of *Macomber*'s holding on realization is anyone's guess.

Having failed to put a dent in *Macomber*, the Government turns its aim to *Commissioner v. Glenshaw Glass*, its progeny, and their definition of income as "undeniable accessions to wealth, *clearly realized*, and over which *the taxpayers have complete dominion*." 348 U.S. 426, 431 (1955) (emphases added). The Gov-

ernment concedes, as it must, that these cases address "the full measure of Congress's taxing power" under the Sixteenth Amendment. BIO.9 (quotation marks omitted). Nonetheless, it insists that the Court's consistent application of that definition over decades, *see* Pet.13–14, has no legal import, being limited in each instance to "the facts of that case," BIO.15. This is essentially a reiteration of the Ninth Circuit's dodging of controlling precedent on the basis that this Court did not spell out "that the [rule] it used was [] universal." App.15. Like the Ninth Circuit, the Government identifies no tenable grounds of distinction, merely asserting that these cases involved different facts "from those at issue here." BIO.15 n.3. And the Government has no response to the point that *James v. United States*, 366 U.S. 213 (1961), in particular, holds "the full measure of [Congress's] taxing power" to be defined by *Glenshaw Glass*'s formulation, *id.* at 218–19 (cleaned up), and turned on the question of realization, *see* Pet.15.

There is no merit to the Government's contention (at 10) that this Court's decisions permit attribution of a corporation's income to ordinary shareholders so that they can be income-taxed on it. *Macomber* itself rejects that ploy, refusing to "indulge the fiction that [shareholders] have received and realized a share of the profits of the company which in truth they have neither received nor realized." *Id.* at 214. It holds that "enrichment through increase in value of capital investment [in a corporation] is not income in any proper meaning of the term," *id.* at 214–15, and its rule "distinguishing gain from capital" has only been

approved, never questioned, *Glenshaw Glass*, 384 U.S. at 431; *see also Nathel v. Comm'r*, 615 F.3d 83, 92 (2d Cir. 2010).

To be sure, that rule is subject to an exception for cases of constructive realization: as *Macomber* recognizes, it is proper to "look through the form of the corporation" in circumstances where shareholders have "received income," such as where there is "entire identity between them and the company." 252 U.S. at 213–14.[1] But that exception has never been thought to reach ordinary shareholders, which would swallow the general rule. It also does not support the MRT, which taxes shareholders like Petitioners irrespective of whether they realized anything. 26 U.S.C. § 965(a), (d)(2); Henry Ordower, Abandoning Realization and the Transition Tax, 67 Buff. L. Rev. 1371, 1377 (2019) ("[The MRT] requires neither actual nor constructive distribution.").

B. The circuit split created by the decision below is real. The Government is incorrect to contend (at 20) that the Ninth Circuit's reasoning is "consistent" with that of decisions of the First and Fourth Circuits defining "income" under the Sixteenth Amendment. *Quijano v. United States* expressly held *Glenshaw*

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[1] *Helvering v. National Grocery Co.* reiterated that point when it observed that nothing prevents Congress from taxing a "sole owner" of a corporation on its income. 304 U.S. 282, 288 (1938). The Government drops the "sole owner" language to suggest that *National Grocery* supports the Ninth Circuit's holding that Congress may always "'attribute[e] a corporation's income pro-rata to its shareholders,'" BIO.10, which it does not.

Glass—including that income must be "clearly realized"—to set the constitutional standard and ruled against the taxpayers because they had "realized" currency-conversion gains. 93 F.3d 26, 30–31 (1st Cir. 1996). *Simmons v. United States* held the same and found Sixteenth Amendment income based on the taxpayer's "receipt of…an economic gain over which he has complete control." 308 F.2d 160, 167–68 (4th Cir. 1962). The Government's claim that neither case suggests "the Sixteenth Amendment *requires* realized income in every case" is belied by their legal holdings, which recite that very requirement and plainly conflict with the Ninth Circuit's view that *Glenshaw Glass* and its progeny stand for nothing beyond their "specific facts." App.15.

The other lower court decisions cited by the Government (at 21–22) support neither the MRT's constitutionality nor the Ninth Circuit's repudiation of the need for realization. Two upheld other Subpart F provisions targeting tax dodges where taxpayers "interpos[ed] a foreign corporate framework between themselves and income." *Whitlock's Estate v. Comm'r*, 59 T.C. 490, 507 (1972), *aff'd*, 494 F.2d 1297 (10th Cir. 1974); *see also Garlock, Inc. v. Comm'r*, 489 F.3d 197, 200 (2d Cir. 1973) (attributing foreign subsidiary's sales to U.S. manufacturer "after full consideration of legal and equitable aspects of [its] ownership" of subsidiary).[2] These cases are in line with precedents go-

[2] *See also Garlock v. Comm'r*, 58 T.C. 423, 438 (1972) (finding "constructive receipt of income" by the taxpayer).

ing back to *Macomber* that approve taxation of constructively realized income, 252 U.S. at 213, but that has no bearing on the MRT, which taxes irrespective of realization, or the situation of Petitioners, who realized nothing in any fashion. Equally inapt is *Prescott v. Commissioner*, 561 F.2d 1287, 1293 (8th Cir. 1977), which followed *Glenshaw Glass* in requiring a "taxable event" and found one in dissolution of fictional corporate elections, such that their owners could be taxed on the dissolution proceeds they received.

C. Finally, the Government argues (at 10) that, irrespective of precedent, "longstanding" practice in the form of other taxes approves the MRT's approach. But there is, as yet, no longstanding practice of attributing taxable income to taxpayers who've realized nothing.

While this Court has not addressed the constitutionality of Subpart F, its provisions predating the MRT all turn on events of that Congress identified as manifesting constructive realization of corporate income by shareholders, whereas the MRT simply attributes a foreign corporation's income going back thirty years to its shareholders, irrespective of realization. *See* Mark Berg & Fred Feingold, The Deemed Repatriation Tax—A Bridge Too Far?, 158 Tax Notes 1345, 1353–54 (2018); Ordower, *supra*, at 1377.

The hodge-podge of other tax provisions cited by the Government are even farther off the mark. Partners are taxed on partnership income, 26 U.S.C. 702, be-

cause it is *their* income, partnerships having no existence separate from their partners, *see* Henry Campbell Black, *A Treatise on the Law of Income Taxation Under Federal and State Laws* 145 (1913). Similarly, an S corporation's owners unanimously elect to be taxed on the business's income, 26 U.S.C. § 1362(a)(2), thereby conceding that its income is theirs, *Garlin v. Murphy*, 42 A.D.2d 30, 32 (N.Y. App. Div. 3d 1973), *aff'd*, 34 N.Y.2d 921 (1974). The "exit tax" for persons renouncing citizenship permits liability to be deferred "until the due date of the return for the taxable year in which such property is disposed," 26 U.S.C. § 877A(b)(1)—that is, when the taxpayer actually realizes the income being taxed. And the "mark-to-market" taxes on certain futures contracts and the like rely on the fact that the contracts are settled daily and give the taxpayer "the right to withdraw cash from…his futures trading account on a daily basis," which Congress regarded as manifesting realization. *Murphy v. United States*, 992 F.2d 929, 930–31 (9th Cir. 1993) (addressing 26 U.S.C. § 1256).

Even if (as the Government suggests) application of these taxes might overstep the constitutional line of realization in hypothetical cases, they all kept that line in sight. The MRT does not.

II. The Ninth Circuit Gutted the Constitution's Key Limitation on Federal Taxing Power

The Sixteenth Amendment carved out a significant but narrow exception to the Article I's apportionment requirement limited to "taxes on incomes." At the time of ratification, as today, "income" was universally understood to mean a gain "which comes in and is received." *Black's Law Dictionary* (2d ed. 1910); *see also* Pet.17–20. That understanding contradicts the Ninth Circuit's view that "realization of income is not a constitutional requirement" for Congress to levy a Sixteenth Amendment tax. App.12. That holding is the most avulsive change to the law of federal taxation since the Sixteenth Amendment's ratification, because it empowers Congress to impose practically any tax of any design. As Judge Bumatay observed, "without a realization requirement, it is hard to see what's left of the constitutional apportionment requirement." App.39–40.

The Government acknowledges no limitation on Congress's Sixteenth Amendment power, arguing only that it does "not restrict Congress to taxing only realized gains." BIO.12. But its claim (at 2) that "[n]othing in the Amendment's text refers to the concept of realized gains" ignores the very language it purports to interpret. The Amendment's exception to apportionment is limited to "taxes on incomes, *from whatever source derived*." Even if "incomes" were a cipher, the text makes clear that it must be "derived" from a "source"—that is, realized. *See* Brief of Amicus Curiae Southeastern Legal Foundation 12–13.

Of course, "income" was not a cipher. In common and legal usage, it was understood to refer to realized gains, to the exclusion of unrealized gains. *See* Pet.17–20. Indeed, it would have been "shocking to the common sense of business men to call that 'income' of the year which has not been received or 'come in.'" Black, *supra*, at 110.

The Government does not take issue with the petition's recitation of the unanimous consensus on this point in the pre-ratification case law. In fact, it fails to muster a single decision of that era supporting its idiosyncratic definition dispensing with realization. *See* BIO.17–19. Two of the Government's dictionary definitions contradict its position, referring to "receipts" and "return on investments." BIO.19 (quoting *Webster's New International Dictionary of the English Language* (1911) and *The Century Dictionary and Cyclopedia* (1911)). And the progressive economist's definition on which the Government hangs its hat was freely conceded by its author to be at odds with common and legal usage. Robert Murray Haig, *The Federal Income Tax* 22, 24, 125–26 (1921). The Government's position has no historical support, only the writings of crusaders for an unrestricted federal taxing power that the drafters of the Sixteenth Amendment rejected. Pet.20–21; Brief of Amici Curiae Manhattan Inst., et al., at 10–11.

In departing from original meaning, the decision below works a wholesale transformation of federal taxing power. The Government denies (at 19) that dispensing with realization eviscerates Article I's apportionment requirement, but its assurance is empty.

Even if "an income tax must at minimum target an accession to wealth," BIO.19 (cleaned up), the MRT's example makes clear that this need not be an accession to *the taxpayer's* wealth, meaning that anything goes. *See* Pet.5–6 (describing how the MRT operates based on corporate income, irrespective of valuation of the shares or ownship of shares when the corporate income was earned). So even if the Government is right that the decision below does not authorize an outright federal property tax without apportionment—which is far from clear, *see* App.12—that limitation could be trivially overcome by taxing any asset's earning capacity or years-past appreciation to achieve the same numerical result. This illustrates how, stripped of the need for taxpayer realization, the Sixteenth Amendment's exception for "taxes on income" swallows Article I's general rule that direct taxes must be apportioned.

III. This Is the Perfect Vehicle To Resolve an Exceptionally Important Question

A wide range of amici—including the nation's largest representative of business, tax policy experts, tax law and constitutional scholars, and more—confirm that the question presented is exceptionally important, indeed, the single most consequential one in all of tax law. The Government's attempts to downplay its significance and the consequences of the decision below fail.

The Government argues that, because no other court has passed on the MRT specifically, the issue presented lacks "significance." BIO.24. But the constitutional holding of the decision below upends the expectations of businesses, investors, and families across the economy. "Millions of persons and businesses currently rely on the settled understanding of income taxes that unrealized appreciation in property cannot and does not trigger tax liability." Brief of Amici Curiae Pacific Research Inst., et al., at 4. By rejecting that understanding, the decision below injects uncertainty and risk into practically every investment decision, from venture capital to retirement planning. *See* Brief of Amicus Curiae Chamber of Commerce of the United States, at 8–10. The prospect that Congress might, for example, tax shareholders on corporate retained earnings going back decades was thought to be a legal impossibility; now it is a political risk that must be accounted for in every investment decision.

The Government's claim (at 25) that the question presented has no bearing on a "wealth tax" rings hollow. A decision in Petitioners' favor, recognizing that income turns on realization, would effectively rule a tax on property or unrealized gains in property out-of-bounds, given the practical impossibility of apportionment. While no party asks the Court to consider hypothetical legislation, the many prominent proposals for such taxes, and the constitutional objections to those proposals, demonstrate that the Court's guidance in this area is sorely needed. And, short of a wealth tax, the Ninth Circuit's unprecedented holding that Congress may tax any shareholder on corporate earnings, even from decades past, App.13, is enormously consequential on its own.

Finally, the Government's vehicle objections have no merit. This case is the cleanest vehicle the Court will ever see to address realization under the Sixteenth Amendment because, among other things, it raises no issue regarding constructive realization. The Government's principal objection (at 22–23) that KisanKraft had retained earnings says nothing about the vehicle; it is simply a restatement of the Government's merits argument that taxpayer realization is irrelevant under the Sixteenth Amendment, given that the MRT does not tax KisanKraft but its shareholders. And the Government's claim (at 23) that the MRT might be an excise tax is both forfeited and long foreclosed by precedent. *See Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 627–28 (1895).

CONCLUSION

The Court should grant the petition.

Respectfully submitted,

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