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 Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR MARK E. BERG AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states.

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INTEREST OF THE *AMICUS CURIAE*[1]

Mark E. Berg, a tax attorney who has been in private practice for 38 years, is a New York City-based partner in, and Chair of the Tax Practice Group of, the law firm of Klehr Harrison Harvey Branzburg LLP. Throughout his professional career, *amicus* has written extensively on various tax-related topics. Among his publications are several articles[2] questioning whether certain enacted and proposed federal taxes that do or would tax amounts that have yet to be realized by the taxpayer, including the tax that is in issue in this case, qualify as taxes on "incomes . . . derived" within the meaning of the Sixteenth Amendment or instead violate the Direct Tax Clauses of the Constitution. *Amicus* has a strong professional interest in resisting attempts by Congress to exceed the constitutional limitations on its taxing power, including the constitutional prohibition against unapportioned

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[1] No counsel for a party authored this brief in whole or in part, and no person other than the *amicus* and his counsel made any monetary contribution intended to fund the preparation or submission of this brief.

[2] *See, e.g.*, Mark E. Berg and Fred Feingold, *The Deemed Repatriation Tax – A Bridge Too Far?*, 158 Tax Notes 1345 (Mar. 5, 2018) [hereinafter, *Deemed Repatriation Tax*]; Mark E. Berg, *Determining Which Taxes are Prohibited Direct Taxes After NFIB*, 138 Tax Notes 205 (Jan. 14, 2013); Mark E. Berg, *Bar the Exit (Tax)!: Section 877A, the Constitutional Prohibition Against Unapportioned Direct Taxes and the Realization Requirement*, 65 Tax Lawyer 181 (2012) [hereinafter, *Exit Tax*]; *see also* Mark E. Berg, *Insight: The Proposed Wealth Tax Would be Unconstitutional*, Bloomberg BNA Daily Tax Report (Feb. 15, 2019).

direct taxes that are not authorized by the Sixteenth Amendment.

INTRODUCTION AND SUMMARY OF ARGUMENT

Congress' taxing power under the Constitution is broad but not unlimited. One such limitation is the requirement, stated twice in the Constitution, that federal "direct taxes" must be apportioned among the states.[3] The Sixteenth Amendment provides an exception to this apportionment requirement for "taxes on incomes, from whatever source derived."[4]

The tax at issue in this case (the "Section 965 Tax") is imposed under Section 965 of the Internal Revenue Code of 1986 (the "Code").[5] Under that provision, U.S. persons such as Petitioners who on a particular date in 2017 (or in some cases 2018) directly, indirectly or by attribution owned 10% or more of the shares in certain non-U.S. corporations having a specified level of U.S. ownership were required to include in their taxable income in 2017 (or in some cases 2018) their pro rata shares of the previously undistributed post-1986

[3] U.S. Const. art. I, §2, cl. 3; *id*. art. I, §9, cl. 4 (the "Direct Tax Clauses").

[4] *Id.* amend. XVI.

[5] 26 U.S.C. §965, enacted as part of "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018," Pub. L. No. 115-97, §14103(a), 131 Stat. 2054 (2017), commonly referred to as the Tax Cuts and Jobs Act of 2017.

foreign earnings of those corporations (calculated as of a date in late 2017) as if those undistributed amounts had been distributed to them. These U.S. shareholders were subject to federal tax on such deemed distributions at tax rates that varied depending on whether the U.S. shareholder was a corporation or an individual (with higher tax rates for individual shareholders than for corporate shareholders) and were given an option to pay the resulting federal tax either currently or spread over eight years.[6]

It is undisputed that the Section 965 Tax was not apportioned among the states. As a result, the Section 965 Tax violates the Direct Tax Clauses unless it either (i) is not a "direct tax" or (ii) is imposed on "incomes . . . derived" within the meaning of the Sixteenth Amendment. That the sole question before the Court in this case is whether the Sixteenth Amendment authorizes a tax on unrealized sums without apportionment, a question that would be dispositive of this case only if the tax in question were a direct tax that is imposed on unrealized sums, suggests strongly that Respondent acknowledges, as it must, that the Section 965 Tax is a direct tax that is imposed on sums unrealized by the taxpayer, *i.e.*, on the deemed distribution by a non-U.S. corporation to its U.S. shareholders of the post-1986 non-U.S. earnings of the corporation where no such actual distribution was made.

Much of the argument throughout the history of this case has revolved around the continuing vitality

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[6] 26 U.S.C. §965(a), (c) and (h); *see id.* §951(a)(1) and (2).

of the holding of this Court in *Eisner v. Macomber*[7] that unrealized amounts do not qualify as "incomes . . . derived" within the meaning of the Sixteenth Amendment.[8] It having been amply demonstrated in detail, in *amicus*' publications and elsewhere, that the constitutional realization requirement articulated by this Court in *Macomber* has been reaffirmed rather than repudiated or eroded by this Court and continues to apply in full force and effect,[9] the focus of this brief is on another aspect of the case.

The Ninth Circuit's opinion in this case asserted that a ruling in favor of Petitioners "would also call into question the constitutionality of many other tax provisions that have long been on the books,"[10] and

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[7] 252 U.S. 189 (1920).

[8] *See Moore v. United States*, 36 F.4th 930, 935-38 (9th Cir.), *rehearing denied*, 53 F.4th 507 (9th Cir. 2022).

[9] *See*, *e.g.*, *Exit Tax*, *supra* note 2, at 194-201 (describing in detail this Court's holding in *Macomber* and concluding, after closely examining each of the decisions of this Court that Respondent and various commentators have cited for the proposition that the Court has repudiated or significantly eroded *Macomber*'s central holding that amounts must be realized to constitute Sixteenth Amendment "incomes . . . derived," that this Court has reaffirmed rather than repudiating or eroding such holding); Edward T. Roehner & Sheila M. Roehner, *Realization: Administrative Convenience or Constitutional Requirement?*, 8 Tax L. Rev. 173, 176-84 (1953); Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution*, Macomber*, and Mark to Market*, 13 Va. Tax Rev. 1, 40-50 (1993); *see also National Federation of Independent Business v. Sebelius*, 567 U.S. 519, 571 (2012) (citing *Macomber* with approval for the proposition that taxes on personal property are direct taxes).

[10] *Moore*, 36 F.4th at 938. For this proposition, which according to the Ninth Circuit's opinion "does not control our analysis,"

stated that "[w]e decline to do so today."[11] Respondent and some commentators have echoed this concern, with some magnifying it to an assertion that whole swaths of the Code would be at constitutional risk if the Court were to hold for Petitioners in this case. The purpose of this brief is to allay any such concerns by demonstrating that these other taxes are not infected with the infirmity that renders the Section 965 Tax unconstitutional either because they are not direct taxes or because they are imposed on "incomes . . . derived" by the taxpayer within the meaning of the Sixteenth Amendment, or because there is a basis for attributing the realized income of one taxpayer to another for purposes of those taxes. More specifically, as demonstrated below, a ruling for Petitioners in this case would not render unconstitutional the manner in which U.S. shareholders of controlled foreign corporations, partnerships and their partners, S corporations and their shareholders, original issue discount or regulated futures contracts are taxed, nor would it implicate the accrual method of tax accounting.

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the Ninth Circuit cites only an article by Professor Bruce Ackerman, which in support of an argument that a federal wealth tax would be constitutional refers to "a number of provisions of the Internal Revenue Code that would be unconstitutional if *Macomber* were good law," and asserts that none of them "has been seriously questioned on constitutional grounds." *See* Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1, 52 & n.211 (1999).

[11] *Moore*, 36 F.4th at 938.

ARGUMENT

I. The Section 965 Tax is Constitutionally Infirm Because it is an Unapportioned Direct Tax that is Not Imposed on Sixteenth Amendment "Incomes . . . Derived," With No Basis for Deeming a Dividend of the Corporation's Accumulated Earnings to its Shareholders

It is well established that the basic distinction between direct and indirect taxes is that direct taxes are those that are imposed on the owner of property based solely on ownership, whereas indirect taxes are those imposed on uses of property such as sales or other transfers.[12] Thus, property taxes of the type that localities routinely impose are direct taxes imposed on the owner of property based solely on ownership, whereas property transfer taxes, gift taxes, estate taxes and excise taxes imposed on sales revenues are indirect taxes imposed on transfers of property.[13] It is axiomatic that this distinction between direct and indirect taxes, a distinction the existence and constitutional significance of which this Court has recognized as recently as 2012,[14] would have no meaning if Congress could simply deem a sale or other transfer of property to

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[12] *See, e.g.*, *Fernandez v. Wiener*, 326 U.S. 340, 352 (1945); *see generally Exit Tax*, *supra* note 2, at 184-92 and the authorities cited therein.

[13] *See, e.g.*, *Bromley v. McCaughn*, 280 U.S. 124, 136-38 (1929); *Eisner v. Macomber*, 252 U.S. 189, 217 (1920); *Knowlton v. Moore*, 178 U.S. 41, 81-83 (1900).

[14] *See National Federation*, 567 U.S. at 570-71.

have taken place, impose a tax on the gain on the deemed sale and assert that such tax is an indirect tax by reason of the deemed sale. Otherwise, Congress could, say, impose a clearly prohibited unapportioned land tax[15] using the device of deeming some or all landowners to have sold their property and imposing an "indirect tax" on the deemed gains on such deemed sales.[16] This is presumably why Respondent has apparently conceded that the Section 965 tax, which as noted is a tax on deemed distributions by non-U.S. corporations to their direct and indirect U.S. shareholders of their undistributed post-1986 earnings, is a direct tax.

Similar considerations apply in determining whether an unapportioned direct tax such as the Section 965 Tax is a permitted tax on "incomes . . . derived" within the meaning of the Sixteenth Amendment. In this context, the clear distinction this Court drew in *Macomber* between realized income or gain, which constitutes Sixteenth Amendment income, and unrealized amounts such as increases in a shareholder's capital resulting from the corporation's undistributed profits from prior years,[17] which do not, would

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[15] *See id*. at 571 (taxes on the ownership of real estate are direct taxes requiring apportionment).

[16] *See Helvering v. Independent Life Insurance Co*., 292 U.S. 371, 378-379 (1934) (a tax on deemed rental income from a building occupied by the owner would be a direct tax not imposed on incomes).

[17] *See Macomber*, 252 U.S. at 212 (referring to a corporation's "antecedent accumulation of profits" as an increase in its shareholders' capital that does not constitute Sixteenth Amendment "incomes . . . derived"); *cf. Helvering v. Northwest Steel Rolling Mills Inc.*, 311 U.S. 46, 52-53 (1940) (a surtax on the undistributed *current* income of a corporation is a tax on "incomes" even if

have no meaning if Congress could simply deem a taxpayer's unrealized appreciation to have been realized as income or gain by the taxpayer and assert that a direct tax on such deemed income or gain is authorized by the Sixteenth Amendment as a tax on "incomes . . . derived." Yet that is precisely what the Ninth Circuit's ruling would, if affirmed by this Court, permit Congress to have done when it enacted the Section 965 Tax – deem Petitioners to have realized income in 2017 in an amount equal to their pro rata share of the corporation's post-1986 accumulated earnings via a deemed distribution of such capital, impose tax on such deemed amounts and claim that such tax is a tax on Sixteenth Amendment "incomes . . . derived."

To be sure, since *Macomber* is more concerned with *when* Sixteenth Amendment income arises (*i.e.*, upon realization) than *to whom* such realized income can be taxed,[18] *Macomber* does not necessarily prohibit the attribution of an amount of realized income or gain from one taxpayer to another and inclusion of the attributed amount in the gross income of the attributee, for example one who controls the income even though it is received by another.[19] But this does not mean that there are no limits on Congress' ability to attribute the

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the corporation's accumulated deficit was greater than its current income: "the tax here under consideration was imposed on profits earned during a definite period – a tax year – and therefore on profits constituting income within the meaning of the Sixteenth Amendment").

[18] *See Exit Tax*, *supra* note 2, at 204; *Deemed Repatriation Tax*, *supra* note 2, at 1353-54

[19] *See, e.g.*, *Helvering v. Horst*, 311 U.S. 112 (1940); *Burnet v. Wells*, 289 U.S. 670 (1933); *Corliss v. Bowers*, 281 U.S. 376 (1930).

income realized by one taxpayer (here, a corporation) in one year to another taxpayer (here, its shareholder) in a later year by, say, deeming a dividend to have been paid. Rather, there are several well-established limitations on such attribution.

First, as noted, this Court in *Macomber* made it clear that since a corporation's accumulated earnings from prior years represent capital rather than income vis-à-vis the shareholders of the corporation for purposes of the Sixteenth Amendment, an unapportioned tax that attributes to the shareholders of a corporation the corporation's accumulated earnings from prior years is a direct tax that is not authorized by the Sixteenth Amendment.[20] Thus, when the attribution in question is of a corporation's accumulated earnings to its shareholders, *Macomber* itself stands in the way of such attribution. Second, a corporation being a separate taxpayer from its shareholders for federal income tax purposes,[21] there are provisions of the Constitution other than the Direct Tax Clauses that are implicated

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[20] *See* the authorities cited *supra* at note 17.

[21] *Compare* 26 U.S.C. §§1, 11, 61(a)(7), 301(c), 311(b) and 336(a) (treating regular C corporations as separate taxpayers from their shareholders) *with id.* §§701-761 (flow-through treatment of partnerships vis-à-vis their partners) *and id.* §§1361-1379 (flow-through treatment of S corporations vis-à-vis their shareholders); *cf. id*. §§1381-1388 (quasi flow-through treatment of cooperatives vis-à-vis their patrons), *id.* §§851-855 (quasi flow-through treatment of regulated investment companies vis-à-vis their shareholders) and *id.* §§856-859 (quasi flow-through treatment of real estate investment trusts vis-à-vis their shareholders).

when one taxpayer (here, a shareholder) is taxed on the income of another taxpayer (here, a corporation).[22]

In this connection, while as noted control may be relevant in determining whether a taxpayer's realized income can be attributed to another taxpayer for tax purposes, control by itself is not enough to justify attribution of one taxpayer's income to another, any more than one's ownership and control of a parcel of land is sufficient to justify the imposition of federal tax on a deemed sale of the land by the one who owns and controls it. Rather, the relevant cases establish that there must be some basis for the attribution of the realized income of one taxpayer (such as a corporation) to another taxpayer (such as a shareholder of the corporation).[23] As will be seen below, what distinguishes the Section 965 Tax from other taxes that are imposed on the basis of attribution of a business entity's income to its owners is that in each such case there is a basis for attribution that is lacking in the case of the Section 965 Tax's attribution of a corporation's accumulated earnings to its shareholders.

Thus, the Section 965 Tax is unconstitutional for the following reasons: (i) the Section 965 Tax, which unquestionably is not apportioned among the states, is imposed on owners of shares of certain non-U.S. corporations based solely on their ownership of such shares,

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[22] *See, e.g.*, *Hoeper v. Tax Commission of Wisconsin*, 284 U.S. 206 (1931) (taxation of one person on another person's income violates the Due Process and Equal Protection Clauses of the Fourteenth Amendment).

[23] *See Deemed Repatriation Tax*, *supra* note 2, at 1354-55.

without regard to any actual transfer or other use of those shares by the owners, and therefore is a direct tax; (ii) the Section 965 Tax is imposed in the absence of any realization of income or gain by the shareholders on which it is imposed and therefore is not imposed on "incomes . . . derived" within the meaning of the Sixteenth Amendment; and (iii) there is no basis for the attribution for purposes of the Section 965 Tax of a corporation's accumulated earnings to its shareholders. As discussed below, few if any of the other federal tax provisions the constitutionality of which the Ninth Circuit and Respondent suggest would be called into question if this Court rules for Petitioners in this case suffer from this constitutional infirmity, either because they are not direct taxes, they are imposed on realized income of the taxpayer or there is a basis for the attribution of the realized income of one taxpayer to another.

II. The Other Tax Provisions Cited in this Regard Do Not Suffer from the Same Constitutional Infirmity as the Section 965 Tax

A. The Attribution of Certain Non-U.S. Corporations' Current Realized Income to its U.S. Shareholders, Held Constitutional by Lower Courts, is Fundamentally Different from the Section 965 Tax on Deemed Distributions

The Ninth Circuit's opinion below[24] and Respondent make much of the Court of Appeals decisions

[24] *Moore*, 36 F.4th at 935-36.

upholding the constitutionality of 26 U.S.C. §951,[25] suggesting that the Section 965 Tax is constitutional for the same reasons and arguing that a decision in favor of Petitioners in this case would mean that 26 U.S.C. §951 also would have to be found to be unconstitutional. This argument is unavailing given the fundamental differences between 26 U.S.C. §951 and the Section 965 Tax.

Under 26 U.S.C. §951(a), certain types of income (referred to in the Code as "Subpart F income") realized by a "controlled foreign corporation" (CFC) in a particular year are attributed to and included in that year's gross income of the U.S. shareholders of the corporation that own at least 10% of the shares of the corporation.[26] A CFC is a non-U.S. corporation more than 50% of the shares of which (by vote or value) are owned, directly, indirectly or by attribution, by U.S. shareholders each of whom owns at least 10% of the shares (by vote or value).[27] The Code makes it clear that it is only *current-year* income of the non-U.S. corporation that can be attributed to those who were U.S.

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[25] *See Garlock v. Commissioner*, 489 F.2d 197 (2d Cir. 1973) (Subpart F inclusion under 26 U.S.C. §951(a)(1)(A) by U.S. shareholders of certain types of current income of a non-U.S. corporation), *cert. denied*, 417 U.S. 911 (1974); *Estate of Whitlock v. Commissioner*, 494 F.2d 1297 (10th Cir.) (inclusion under 26 U.S.C. §951(a)(1)(B) to the extent of the corporation's current earnings), *cert. denied*, 419 U.S. 839 (1974); *cf. Eder v. Commissioner*, 138 F.2d 27 (2d Cir. 1943) (attribution of current income under former foreign personal holding company regime).

[26] 26 U.S.C. §951(a)(1)(A) and (b); *see id.* §952.

[27] 26 U.S.C. §§957(a) and (c) and 958.

shareholders of the corporation on the last day of the year in which such income was earned by limiting the corporation's Subpart F income for a taxable year to "the earnings and profits of such corporation for such taxable year."[28] Congress in 2017 expanded the categories of a CFC's income that are annually attributed to its U.S. shareholders to include "global intangible low-taxed income" (GILTI), but did not change the requirement that all such attributed income be the current year's income rather than the accumulated earnings of the CFC.[29]

To be sure, the Court of Appeals decisions that upheld the constitutionality of 26 U.S.C. §951 refer to the presumed control the U.S. shareholders of a CFC in a particular year have over the corporation's income realized in that year and the perceived abuse that could result were U.S. shareholders to be able to use controlled non-U.S. corporations as their "family

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[28] 26 U.S.C. §952(c)(1)(A) (captioned "Subpart F income limited to current earnings and profits"). For federal income tax purposes, a corporation's "earnings and profits" is an amount that is computed differently from its taxable income in several respects (*see, e.g.*, *id*. §312(n)), which amount determines what portion of a distribution to shareholders is treated as a taxable dividend as opposed to a return of capital or a gain from the sale or exchange of stock. *See id.* §§301(c), 316 and 312. A corporation can have current earnings and profits, *i.e*., earnings and profits arising in the current year, and accumulated earnings and profits, *i.e.*, the cumulative amount of earnings and profits (positive and negative) from inception to a particular date. *See id.* §316(a)(1) and (2).

[29] 26 U.S.C. §951A; *see id.* §951A(c)(2)(A).

pocketbooks" for the earning of investment income.[30] But significantly, these courts couched their conclusions in terms of constructive receipt by the U.S. shareholders of the corporations' income[31] and, even more significantly for purposes of this discussion, made a point of honoring the distinction this Court drew in *Macomber* between a corporation's *current* income and its income *accumulated in prior years* that was undistributed and added to capital, and distinguishing *Macomber* on that basis.

Thus, in *Estate of Whitlock v. Commissioner*,[32] the taxpayer argued that a provision of 26 U.S.C. §951 that taxes U.S. shareholders of a CFC when the CFC invests its earnings in U.S. property[33] is an unconstitutional direct tax that is not permitted by the Sixteenth Amendment. Congress' rationale for the attribution under this provision is that a CFC's investment of

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[30] *See, e.g.*, *Estate of Whitlock v. Commissioner*, 59 T.C. 490, 509 (1972) (finding that the taxpayers "had the actual right and power to manipulate their corporation as if it were the family pocketbook"), *aff'd on this issue*, 494 F.2d 1297 (10th Cir.), *cert. denied*, 419 U.S. 839 (1974).

[31] *See, e.g.*, *Estate of Whitlock*, 59 T.C. at 507 (finding that the corporation's "earnings and profits were as much petitioners' income as if petitioners had received such earnings and profits themselves"); *Estate of Whitlock*, 494 F.2d at 1301 ("We can add little to the analysis by the Tax Court of the direct tax argument . . . of the taxpayers, and agree fully therewith."); *Garlock v. Commissioner*, 58 T.C. 423, 438 (1972) (finding "constructive receipt of income" by the taxpayer), *aff'd*, 489 F.2d 197 (2d Cir. 1973), *cert. denied*, 417 U.S. 911 (1974).

[32] 494 F.2d 1297 (10th Cir.), *cert. denied*, 419 U.S. 839 (1974).

[33] 26 U.S.C. §951(a)(1)(B); *see id.* §956(a).

earnings in U.S. property is "substantially the equivalent of a dividend being paid to [the U.S. shareholders]."[34] The Tenth Circuit affirmed the U.S. Tax Court's decision upholding the provision, stating that "[w]e can add little to the analysis by the Tax Court of the direct tax argument . . . of the taxpayers, and agree fully therewith."[35] Observing that "the *Macomber* majority was primarily concerned with Congress' power to tax a corporation's undistributed *accumulated* earnings to the corporation's stockholders, and did not linger upon the question of congressional power to tax a corporation's *current* undistributed income to the corporation's stockholders,"[36] the Tax Court stated as follows: "The reasoning [in *Macomber*] was that such accumulated earnings constituted the stockholder's share in capital, and not income. But we cannot read *Macomber* as denying to Congress the power to attribute a corporation's undistributed *current* income to the corporation's controlling stockholders."[37] Similarly, the Second Circuit in *Garlock v. Commissioner*[38] upheld the attribution of current-year Subpart F income under 26 U.S.C. §951(a)(1)(A), albeit with very little discussion other than to cite the prior holding of the Second Circuit regarding the analogous attribution of income –

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[34] S. Rep. No. 87-1881, at 87-88 (1962).

[35] *Estate of Whitlock v. Commissioner*, 494 F.2d 1297, 1301 (10th Cir.), *cert. denied*, 419 U.S. 839 (1974).

[36] 59 T.C. at 509 (emphasis added).

[37] *Id.* at 508 (emphasis added) (citation omitted).

[38] 489 F.2d 197 (2d Cir. 1973), *cert. denied*, 417 U.S. 911 (1974).

also limited to current-year income – under the former foreign personal holding company regime.[39]

It is evident from the above discussion that the Section 965 Tax is fundamentally different from the tax provisions that were at issue in *Whitlock*, *Garlock* and *Eder*. Whereas the attribution of a CFC's Subpart F income (or for that matter GILTI) under the latter provisions is uniformly of the corporation's current earnings, and thus does not violate this Court's bar on unapportioned taxes on shareholders' capital in the form of the corporation's "antecedent accumulation of profits,"[40] the Section 965 Tax by its terms taxes shareholders on the corporation's earnings accumulated for up to 30 years, in direct violation of the line clearly drawn by this Court in *Macomber*.

And although no Court of Appeals has gone this far, even the attribution of a corporation's accumulated earnings under 26 U.S.C. §951(a)(1)(B), approved by the Tax Court in *Dougherty v. Commissioner*,[41] is distinguishable from the Section 965 Tax. In *Dougherty*, which represents the high-water mark in this area,[42] the Tax Court pointed to a combination of the corporation's investment in U.S. property in the current year and the U.S. shareholders' control over the corporation as, in effect, the basis for deeming a distribution of the

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[39] *Id.* at 202-03 & n.5, citing *Eder v. Commissioner*, 138 F.2d 27 (2d Cir. 1943).

[40] *Macomber*, 252 U.S. at 212.

[41] 60 T.C. 917 (1973).

[42] *See Deemed Repatriation Tax*, *supra* note 2, at 1354.

corporation's accumulated earnings to its shareholders, stating in this connection that Congress regarded the corporation's investment in U.S. property as "manifesting the shareholder's exercise of control over the previous income of the corporation."[43] No similar trigger or basis exists in the case of the Section 965 Tax, which is imposed solely because the taxpayer was on a particular date in 2017 or 2018 a U.S. shareholder of a non-U.S. corporation having a certain degree of U.S. ownership and accumulated post-1986 earnings. As a result, the authorities upholding the tax imposed by 26 U.S.C. §951 do not lend support to the Ninth Circuit's conclusion, nor would a decision in this case in favor of Petitioners mean that 26 U.S.C. §951 is also unconstitutional.

B. Even More Fundamentally Different from the Section 965 Tax on Deemed Distributions is the Attribution of the Current Realized Income of a Partnership to its Partners

Respondent, noting the longstanding federal tax treatment of partnerships and their partners pursuant to which partners are taxed on their distributive shares of the partnership's income without regard to whether any such amounts are distributed to the partners, argues that the Section 965 Tax is similar to the attribution of partnership income to partners and that "[n]othing in the Sixteenth Amendment's text or

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[43] 60 T.C. at 930.

history suggests that the undistributed income of a CFC must be treated differently from the undistributed income of a partnership."[44] Similarly, the Ninth Circuit cited the taxation of partners on their distributive shares of the partnership's income without regard to whether such amounts were actually distributed to them as an indication that the Sixteenth Amendment does not require realization.[45] These arguments also miss the mark.

The attribution of a partnership's income to its partners for federal tax purposes is an annual attribution to the partners of the income *realized* by the partnership *in the current year*.[46] In this respect, the taxation of partnerships and their partners is similar to the current earnings attribution regime found to be constitutional by the Courts of Appeals in *Garlock* and *Whitlock* and nothing like the Section 965 Tax, which as noted deems a distribution of up to 30 years of certain non-U.S. corporations' accumulated earnings (*i.e.*, capital) to their U.S. shareholders. That a

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[44] *See* Brief of the United States in Opposition, *Moore v. United States*, No. 22-800, at 10-11.

[45] *Moore*, 36 F.4th at 935-36 (citing *Heiner v. Mellon*, 304 U.S. 271 (1938)).

[46] 26 U.S.C. §706(a) ("In computing the taxable income of a partner *for a taxable year*, the inclusions required by section 702 and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership *for any taxable year of the partnership ending within or with the taxable year of the partner*."); *see also id.* §§701 and 702 (the partners, rather than the partnership, are subject to tax on their distributive shares of the partnership's items of income).

partnership's current realized income need not be distributed to the partners in order for the partners to be taxed on their distributive shares of such income does not mean that the partners are being taxed on unrealized income. Rather, the partnership's realized income is being attributed to its partners, which attribution is a function of the fundamental difference between corporations and partnerships, and the relationships between those entities and their owners, as a matter of state law,[47] which fundamental difference is reflected in the tax law:[48] While a corporation is always treated as a separate taxpayer from its shareholders for federal tax purposes,[49] a partnership is treated for federal tax purposes as an aggregate of its partners in most contexts[50] and as a separate entity in certain other contexts.[51] The former, aggregate

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[47] *Compare, e.g.*, Del. Code Ann. tit. 8, §§102(b)(6), 122 and 141(a) (corporations) *with id.* tit. 6, §§15-301(1) and 15-306(a) (partnerships).

[48] *See generally* Elliott Manning, *Partnerships – Conceptual Overview*, 710-3d Tax Mgmt. Port. (BNA) §I ("The oldest and most basic partnership form is the general partnership, in which the partners are individually and unlimitedly liable for partnership obligations, and, except as modified by the partnership agreement, have equal rights to participate in management and general authority to bind the partnership. . . . Many partnership legal and tax principles have their origin in this simple form of business entity. . . . Based on the historical picture of the general partnership, partnerships are conduits for tax purposes.").

[49] *See* the authorities cited *supra* at note 21.

[50] *See, e.g.*, 26 U.S.C. §§701, 702, 721-723, 731-735, 743, 751, 752 and 754.

[51] *See, e.g.*, *id.* §741 (gain or loss realized on the sale or exchange of a partnership interest is generally treated as gain or

contexts include taxing the partners rather than the partnership on their distributive shares of the partnership's current realized income.[52] Nor does this Court's opinion in *Heiner v. Mellon*,[53] cited by the Ninth Circuit for the proposition that the Sixteenth Amendment does not require realization, so hold or even so suggest, given that the Court in *Mellon* addressed a purely statutory issue, did not purport to decide a constitutional issue and did not even mention *Macomber* or the Sixteenth Amendment.[54]

Thus, while the Section 965 Tax is for the reasons discussed a direct tax imposed solely by reason of a U.S. shareholder's ownership of shares in a non-U.S. corporation and imposed not on realized income or gain but rather on a deemed distribution of the corporation's accumulated earnings for which deemed distribution no basis exists, by contrast the attribution of

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loss from the sale of a capital asset). *But see id.* §751(a) (looking through the partnership to characterize a portion of the amount realized on such sale or exchange as from the sale or exchange of an asset that is not a capital asset on the basis of the nature of the assets of the partnership). *See generally* H.R. Rep. No. 83-2543, at 59 (1954) (Conf. Rep.) ("Both the House provisions and the Senate amendment provide for the use of the 'entity' approach in the treatment of transactions between a partner and a partnership. . . . No inference is intended, however, that a partnership is to be considered as a separate entity for the purpose of applying other provisions of the internal revenue laws if the concept of the partnership as a collection of individuals is more appropriate for such provisions.").

[52] *See, e.g.*, 26 U.S.C. §§701, 702, 704 and 706(a).

[53] 304 U.S. 271 (1938).

[54] *See Exit Tax*, *supra* note 2, at 203.

a partnership's current realized income to its partners causes the partners to be subject to an indirect tax on the partnership's current realized income to the same extent that a tax imposed on the partnership on its profits would be an indirect tax on income. As a result, to the extent the Sixteenth Amendment is relevant to the attribution of a partnership's current realized income to its partners, such attribution is entirely consistent with the Sixteenth Amendment.

C. Tax Provisions that Apply at the Election of the Taxpayer, Such as the Attribution of S Corporations' Current Realized Income to Their Shareholders, are Not Implicated by the Court's Ruling in This Case

Respondent has also suggested that the Section 965 Tax is similar to the attribution of an S corporation's income to its shareholders and that "[n]othing in the Sixteenth Amendment's text or history suggests that the undistributed income of a CFC must be treated differently from the undistributed income of . . . [an] S corporation."[55] Because the attribution under Subchapter S of the Code[56] to an S corporation's shareholders is, as is the case with partnerships, an annual attribution of the S corporation's *current realized* income,[57] the discussion above regarding

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[55] *See* Brief of the United States in Opposition, *Moore v. United States*, No. 22-800, at 11.

[56] 26 U.S.C. §§1361-1379.

[57] *See* 26 U.S.C. §1366(a).

partnerships also applies to S corporations. In addition, unlike the attribution under the Section 965 Tax, the pass-through treatment afforded to S corporations and their shareholders is entirely elective, such that in order for such treatment to apply the corporation must make a timely Subchapter S election and all of the shareholders of the corporation must consent to the election.[58] These features clearly distinguish the elective attribution of current realized income from an S corporation to its shareholders from the mandatory attribution of accumulated earnings under the Section 965 Tax, with the result that the existence of Subchapter S of the Code does not lend support to the Ninth Circuit's decision, nor would a decision in this case in favor of Petitioners mean that Subchapter S is also unconstitutional.[59]

D. The Tax Treatment of Regulated Futures Contracts is Not Implicated by the Court's Ruling in This Case

Respondent asserts that "numerous assets are taxed as if they had been sold for a realized gain at the end of a taxable year – even if they were not in fact

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[58] *See* 26 U.S.C. §§1361(a)(1) and 1362(a)(1) and (2).

[59] Similar considerations apply to the elective flow-through treatment afforded to U.S. shareholders of "passive foreign investment companies" who make a "qualified electing fund" election with respect to the company under 26 U.S.C. §1295(b). *See id.* §§1293 (attribution of current realized income of qualified electing funds to electing U.S. shareholders) and 1297(a) (definition of passive foreign investment company).

sold – including regulated futures contracts."[60] In this connection, Respondent refers to 26 U.S.C. §1256(a) and (b), pursuant to which holders of certain contracts such as regulated futures contracts are required to mark their positions to market and treat such positions as having been sold for their fair market value at the close of each year, as "materially comparable" to the Section 965 Tax, and cites *Murphy v. United States*[61] as "rejecting the argument that Section 1256 'is unconstitutional because it taxes unrealized gains.' "[62]

The court in *Murphy*, however, did not distance itself from *Macomber* but rather applied it to the facts of the case. In this connection, the court determined that Congress based the treatment under 26 U.S.C. §1256 on the particular arrangements applicable to the futures contracts, under which "traders holding futures contracts were entitled to withdraw their gains at the close of every day under the marked-to-market system."[63] From this, the court concluded that "Section 1256 is premised on the doctrine of constructive receipt because the taxpayer who trades futures contracts receives profits as a matter of right daily" and held that "[a]lthough [the taxpayer] did not sell his futures contracts, his gains would be treated as realized because

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[60] *See* Brief of the United States in Opposition, *Moore v. United States*, No. 22-800, at 11.

[61] 992 F.2d 929 (9th Cir. 1993).

[62] *See* Brief of the United States in Opposition, *Moore v. United States*, No. 22-800, at 11.

[63] 992 F.2d at 931.

he was entitled to withdraw those gains daily."[64] In conclusion, the court stated the following:

> Because of the unique accounting method governing futures contracts, the gains inherent in them are properly treated as constructively received. Congress acted well within its authority when it decided to treat them differently from other capital assets. . . . We need not, and do not, decide the broader issue of whether Congress could tax the gains inherent in capital assets prior to realization or constructive receipt.[65]

Thus, the court in *Murphy* did not hold or even imply that *Macomber* does not prohibit deemed-realization taxes such as the Section 965 Tax, but rather found that the tax under 26 U.S.C. §1256 is consistent with *Macomber* because realization had occurred in that case. Thus, a ruling in this case for Petitioners would not mean that 26 U.S.C. §1256 is also unconstitutional.

E. Methods of Tax Accounting are Also Not Implicated by the Court's Ruling in This Case

Certain commentators[66] have even suggested that a ruling for Petitioners in this case would open the

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[64] *Id.*

[65] *Id.* at 931-32.

[66] *See* Monte A. Jackel, *Potential Implications of Supreme Court Review in* Moore *Case* (Jul. 11, 2023), available at

floodgates and bring into question methods of tax accounting such as the accrual method[67] and timing rules such as those that impute interest on the basis of the time value of money.[68] While the contours of such an argument are not entirely clear, it appears to proceed from the erroneous proposition that realization means the receipt of cash, so that methods of tax accounting under which amounts may be included in income for tax purposes before such time as the taxpayer receives cash permit taxation prior to realization. From there, the argument apparently concludes that if the Section 965 Tax is unconstitutional then so are methods of tax accounting such as the accrual method. Indeed, the Ninth Circuit appears to have gotten caught up in this type of thinking, seemingly confusing realization with the receipt of cash.[69]

But the proposition on which such an argument is based is false, as realization of income does not require the receipt of cash. Rather, the timing of the realization of income is entirely a function of the taxpayer's method of accounting – a taxpayer on the cash method generally realizes income when the amount is either received or constructively received, whereas a taxpayer on the accrual method generally realizes income when "all the events have occurred which fix the right

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https://medium.com/jackeltaxlaw/potential-implications-of-supreme-court-review-in-moore-case-ba4d64f3c4f7.

[67] *See* 26 U.S.C. §451(a); Treas. Reg. §1.451-1(a).

[68] *See* 26 U.S.C. §§483, 1271-1275 and 7872.

[69] *Moore*, 36 F.4th at 935-36 (discussing *Mellon* and *Eder* in terms of whether actual distributions of income had occurred).

to receive such income and the amount thereof can be determined with reasonable accuracy,"[70] which of course can (and often does) occur prior to the taxpayer's receipt of any cash. In either case, since any method of tax accounting "starts with realized income and assigns it to particular taxable years,"[71] the amount in question is treated as income at the time (not before) it is realized. Thus, the idea that under the accrual method amounts are included in income prior to realization, and thus that a ruling for Petitioners in this case would call into question the accrual method of accounting, is simply incorrect.[72]

Similarly, the original issue discount provisions in some cases impute interest income to a lender and in others treat a portion of what otherwise would be treated as gain on a sale as interest income.[73] These rules of character and timing also do not tax unrealized gains. Rather, the rules constitute a method of accounting that, in the case of a lender, recharacterizes certain principal payments as interest and accrues that interest ratably over the period of the loan and, in the case of sales transactions, recharacterizes certain realized gains as interest. Nothing about the original

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[70] *See* Treas. Reg. §1.451-1(a).

[71] *See Exit Tax*, *supra* note 2, at 209-10 (discussing the accrual method and the installment sale rules).

[72] Moreover, the vast majority of taxes that are imposed at a particular time by reason of a taxpayer's method of tax accounting will not be direct taxes but rather will be taxes resulting from actual transfers of property or other transactions. *See supra* notes 12 & 13 and accompanying text.

[73] *See, e.g.*, 26 U.S.C. §§1272 and 1274.

issue discount rules is inconsistent with the realization principle established by this Court in *Macomber*, with the result that a ruling in this case for Petitioners would not mean that these provisions are also unconstitutional.

CONCLUSION

In order for an unapportioned federal tax to be unconstitutional on the same grounds as the Section 965 Tax, the tax must be (a) imposed on the owner of property in the absence of a transaction involving that property or other use of that property (*i.e.*, a direct tax) and (b) imposed on something other than realized income or gain (*i.e.*, a tax not permitted by the Sixteenth Amendment). As discussed above, because the "many other tax provisions that have long been on the books" that the Ninth Circuit, Respondent and others have suggested would also be "call[ed] into question" were this Court to reverse the Ninth Circuit's judgment below[74] clearly do not fit this description, a reversal of the Ninth Circuit's judgment below would not open the floodgates and cause numerous longstanding provisions of the Code to be at constitutional risk.

[74] *Moore*, 36 F.4th at 938.

Accordingly, the Ninth Circuit's judgment below should be reversed.

Respectfully submitted,

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