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 OF AMICI CURIAE SAVING AMERICA'S FAMILY ENTERPRISES AND FORMER SENATOR JOHN BREAUX IN SUPPORT OF PETITIONERS

NEAL KUMAR KATYAL
Counsel of Record
MICHAEL J. WEST
HOGAN LOVELLS US LLP
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5600
neal.katyal@hoganlovells.com

Counsel for Amici Curiae

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INTEREST OF AMICI CURIAE[1]

Saving America's Family Enterprises (SAFE) is a nonpartisan 26 U.S.C. § 501(c)(4) organization dedicated to educating the public about the risks of tax proposals that complicate the tax code, incentivize tax avoidance, or harm family businesses, family farmers, homeowners, and the middle class. SAFE believes that all Americans should pay what they owe, and is worried that recent tax proposals threaten to unfairly burden family businesses.

John Breaux served as a United States Senator from Louisiana from 1987 until 2005. During that time, Senator Breaux was a senior member of the Senate Finance Committee and a co-chair of President Bush's 2005 Tax Reform Commission. Senator Breaux also founded the Centrist Coalition of Senate Democrats and Republicans and served as chairman of the Democratic Leadership Council. Senator Breaux currently serves as a spokesman for SAFE.

Amici are interested in this case because it concerns an unapportioned tax on unrealized gains. In *amici*'s view, such taxes are unconstitutional, unworkable, and counterproductive. *Amici* are particularly concerned that the decision below encourages Congress to levy novel taxes on unrealized gains, taxes whose burdens *amici* expect to fall particularly hard on family-business owners. As advocates for commonsense tax approaches that protect family businesses, *amici* are

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

well-suited to provide additional insight into the negative consequences of reading the realization requirement out of the Sixteenth Amendment.

SUMMARY OF ARGUMENT

Family businesses are the backbone of the American economy. They employ millions of people, anchor communities, and serve as launchpads for owners and employees alike to realize the American dream.

The Mandatory Repatriation Tax (MRT) is a sign of things to come: an unworkable and counterproductive tax scheme that will, in addition to saddling individual taxpayers with complicated new taxes, unfairly burden family businesses. The MRT is a novel tax on unrealized capital gains—specifically, gains that are earned by certain companies and then reinvested directly back into the company, without ever having been remitted to investors. According to the Ninth Circuit, those unrealized gains constitute investors' *income* and can be directly taxed under the Sixteenth Amendment.

That is wrong. As a direct, unapportioned tax on unrealized gains, the MRT is unconstitutional. The Constitution requires that all direct taxes "be apportioned so that each State pays in proportion to its population." *Nat'l Fed'n of Indep. Bus.* v. *Sebelius* ("*NFIB*"), 567 U.S. 519, 570 (2012). Direct taxes include capitations (that is, head taxes), real estate taxes, and taxes on personal property. The Sixteenth Amendment contains a narrow exception from that list, namely, "incomes, from whatever source derived." U.S. Const. amend. XVI. The Sixteenth Amendment thus frees Congress to levy direct, unapportioned taxes on *income*—but only on income.

The problem is a simple one: The MRT is not a tax on individual income. Income is a realized gain. That's clear from the text of the Sixteenth Amendment itself, which indicates that "incomes" are gains that are "*derived*"—that is, received. Ratification-era dictionaries and legal authorities confirm that *income* is, by definition, a gain "which *comes in* to a person." The Century Dictionary and Cyclopedia (1901) (emphasis added). And this Court has construed *income*, in case after case, to require realization. Income is something "*received* or *drawn* by the recipient (the taxpayer) for his *separate* use." *Eisner* v. *Macomber*, 252 U.S. 189, 207 (1920). "[E]conomic gain is * * * taxable as income" when that gain is "realiz[ed]." *Helvering* v. *Bruun*, 309 U.S. 461, 469 (1940). And gains are taxable as income when they constitute "undeniable accessions to wealth, *clearly realized*, and over which the taxpayers have complete dominion." *Comm'r* v. *Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955) (emphasis added). Text, history, and precedent all agree: A gain must be realized for it to be taxed as income under the Sixteenth Amendment. The MRT does not fit that bill, and is thus unconstitutional.

Affirming the decision below, that is, "[d]ivorcing income from realization," would "open[ ] the door to new federal taxes on all sorts of wealth and property without the constitutional requirement of apportionment." Pet. App. 55 (Bumatay, J., dissenting from denial of rehearing en banc). This is no idle threat. Recent years have seen a slurry of proposals to impose "wealth taxes" targeting the unrealized gains of wealthy families and successful family businesses. Although these proposals initially take aim at economic elites, history teaches that a tax on the unrealized gains of middle-class Americans is not far behind.

The income tax, for example, similarly began its life as a "class tax." Today, it is the posterchild for a "mass tax."

If taxes on unrealized gains follow a similarly slippery trajectory, family-business owners and individuals alike will be harmed. Family-business owners will bear the burden of assessing the annual changes to the value of their businesses, real estate, and other illiquid assets. And the IRS can therefore be expected to devote massive amounts of time and resources to developing guidance for assessing the value of these assets, monitoring compliance with those guidelines, and auditing a portion of those filings. Policing this "guess tax" will no doubt draw attention away from its efforts to close the *income* tax gap—the $600 billion gap between taxes owed and taxes paid. It makes little sense to impose new burdens on family businesses when simply enforcing the tax laws on the books will yield billions to the government in tax revenue.

Taxing unrealized capital gains also invites an annual liquidity crisis for business owners. Because the target of such a tax is by definition *unrealized*, cash-poor business owners will either be forced to sell assets—that is, part of their business—or take on debt to meet their tax bill. This is unduly burdensome.

Finally, taxing unrealized gains throttles economic growth. Such taxes drain the capital pool business owners need to grow and innovate. The result is diminished economic growth, which in turn will lead to lower tax revenue.

The realization requirement is thus not only baked into the Constitution itself, it engenders a workable tax system. Because the decision below threatens to unravel that system, this Court should reverse.

ARGUMENT

I. GAINS MUST BE REALIZED BEFORE THEY CAN BE TAXED AS INCOME UNDER THE SIXTEENTH AMENDMENT.

The Sixteenth Amendment grants Congress the "power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI. This power is not plenary; it is bounded by the definition of "incomes." *See Burk-Waggoner Oil Ass'n* v. *Hopkins*, 269 U.S. 110, 114 (1925) ("Congress cannot make a thing income which is not so in fact."). And "income," as commonly understood at the time of the Amendment's ratification—an understanding adopted by this Court shortly after ratification and never abandoned—requires realization.

A. "The Sixteenth Amendment must be construed in connection with the taxing clauses of the original Constitution and the effect attributed to them before the amendment was adopted." *Macomber*, 252 U.S. at 205. Those taxing clauses demarcate taxes as either direct taxes—such as capitations or head taxes—or indirect taxes—which include duties, imposts, and excises. *See* U.S. Const. art. I, § 8, cl. 1; *id.* § 2, cl. 3; *id.* § 9, cl. 4. The clauses then regulate how each tax can be imposed. Indirect taxes "shall be uniform throughout the United States." *Id.* § 8, cl. 1. Direct taxes, on the other hand, "shall be apportioned among the several States * * * , according to their respective Numbers." *Id.* § 2, cl. 3; *see also id.* § 9, cl. 4 ("No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken."). "This requirement means that

any 'direct Tax' must be apportioned so that each State pays in proportion to its population." *NFIB*, 567 U.S. at 570. Such apportionment can lead to inequitable results; "a state with, say, one-tenth the national population must have one-tenth the aggregate direct-tax liability, regardless of respective levels of wealth or income." Erik M. Jensen, *The Taxing Power, The Sixteenth Amendment, and the Meaning of 'Incomes'*, 33 Ariz. St. L.J. 1057, 1067 (2001). Direct taxes are thus, as a structural matter, "difficult" for Congress to impose. *Id.*; *see also id.* at 1067 n.47 ("[A]pportionment hasn't been attempted since 1861.").

For the first century of the Republic, this Court understood the Direct Tax Clauses' apportionment requirement to reach only capitations and land taxes. *See NFIB*, 567 U.S. at 570-571 (citing *Hylton* v. *United States*, 3 U.S. (3 Dall.) 171 (1796); *Springer* v. *United States,* 102 U.S. 586 (1881)). But in 1895, this Court added to that list "taxes on personal property and income from personal property." *Id.* (citing *Pollock* v. *Farmers' Loan & Tr. Co.*, 158 U.S. 601, 618 (1895)). In doing so, this Court struck down the 1894 federal income tax as an unapportioned direct tax. *See Pollock*, 158 U.S. at 618.

The reaction to *Pollock* was swift and severe. *See* Jensen, *supra*, at 1107. Although this Court "soon began to nibble away at the scope of" *Pollock*, *id.*, Congress and the President called for a constitutional amendment to overturn that decision, *id.* at 1108-14.

The goal of what became the Sixteenth Amendment was modest and narrow: to "remove only *taxes on incomes* from the apportionment requirement." *Id.* at 1114. During the Amendment's drafting, one Senator proposed—twice—simply doing away with the

apportionment requirement altogether. *See* 44 Cong. Rec. 3377 (June 17, 1909); *id.* at 4067 (July 3, 1909); *id.* at 4109 (July 5, 1909). The Amendment's primary drafter rejected that proposal, explaining that his "purpose is to confine it to income taxes alone." *Id.* at 3377; *see also* Jensen, *supra*, at 1116 (discussing this history). The full Senate then voted down the broader proposal by voice vote. 44 Cong. Rec. 4120 (July 5, 1909).

Thus, as this Court has recognized, "the 16th Amendment conferred no new power of taxation." *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 112 (1916). It instead "merely removed the necessity which otherwise might exist for an apportionment among the states of taxes laid on income." *Macomber*, 252 U.S. at 206 (collecting cases). Given this "genesis," this Court has cautioned against extending the Amendment "by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real *and personal*." *Id.* (emphasis added); *see also NFIB*, 567 U.S. at 571 (noting that after the Sixteenth Amendment, the Court "continued to consider taxes on personal property to be direct taxes."). The Direct Tax Clauses persist, and still provide "an appropriate and important function." *Macomber*, 252 U.S. at 206

B. In light of this history, the scope of Congress's power to levy an unapportioned tax on income under the Sixteenth Amendment depends on the meaning of "incomes." And in discerning that meaning, this Court has cautioned against "enter[ing] into the refinements of lexicographers or economists"; this Court has instead embraced "the commonly understood

meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution." *Merchants' Loan & Tr. Co.* v. *Smietanka*, 255 U.S. 509, 519 (1921). And that meaning is clear: Income is a realized gain.

The text of the Sixteenth Amendment itself indicates that "incomes" are realized gains. *See Arizona State Legislature* v. *Arizona Indep. Redistricting Comm'n*, 576 U.S. 787, 829 (2015) (Roberts, C.J., dissenting) ("When seeking to discern the meaning of a word in the Constitution, there is no better dictionary than the rest of the Constitution itself."). The Amendment grants Congress the "power to lay and collect [unapportioned] taxes on incomes, from whatever source derived." U.S. Const. amend. XVI. "[I]ncomes" are thus gains that are "derived" from "source[s]." *Id.* And according to ratification-era dictionaries, to "derive" is "[t]o *receive*." Webster's Revised Unabridged Dictionary (1913) (emphasis added); *see also* The Century Dictionary and Cyclopedia (1901) ("To draw or receive, as from a source or origin, or by regular transmission"); Universal Dictionary of the English Language (1898) ("To receive by transmission; to draw"). As a function of the Amendment itself, then, taxable income is something that is *received* by the taxpayer—that is, realized.

In so defining "incomes," the Sixteenth Amendment hewed to contemporary dictionary definitions. The Century Dictionary and Cyclopedia (1901), for example, defined "income" as "[t]hat which comes in to a person as payment for labor or services rendered in some office, or as gain from lands, business, the investment of capital, etc." Likewise, Webster's Revised Unabridged Dictionary (1913) defined "income" as

"[t]hat gain which proceeds from labor, business, property, or capital of any kind." Older dictionaries similarly identified realization as a necessary component of income. *See, e.g.*, Joseph Worcester, *Dictionary of the English Language* (1875) ("Gain derived from any business or property"); Pet'rs Br. 29 (collecting other sources).

Legal authorities agreed. Ratification-era courts understood "income" to require realization. *See* Pet'rs Br. 27-28. Edwin Seligman, a leading authority on taxation, explained in 1911 that income "is that which *comes in* to an individual above all necessary expenses of acquisition, and which is *available for his own consumption*." Edwin R. A. Seligman, The Income Tax 19 (1911) (emphases added). Henry Campbell Black, in an early treatise on the federal income tax, said something similar: Income is "that gain *which proceeds* from labor, business, or capital or any kind." Henry Campbell Black, A Treatise on the Law of Income Taxation Under Federal and States Laws 73 (1913) (emphasis added). So understood, income is "not synonymous with 'increase' "; undistributed corporate profits can "in no proper sense be called income." *Id.* at 120. Robert Montgomery, another influential tax eminence at the time, took the same view: Congress lacks "the right to tax any transaction *unless* there is an actual realization of income." Robert H. Montgomery, Income Tax Procedure 198 (1919) (emphasis added).

In short, both as a matter of plain text and original meaning, "income" under the Sixteenth Amendment is a realized gain.

C. This Court's precedent likewise rejects the idea that "income" occurs without realization.

This Court first recognized that "income" requires realization in *Macomber*, just seven years after the Sixteenth Amendment was ratified. The case concerned whether a stock dividend constituted taxable income. 252 U.S. at 199-200. The government argued that it did, because the dividend "measure[d] the extent to which the gains accumulated by the corporation have made him the richer." *Id.* at 214. The taxpayer, in contrast, contended that "[i]t is of the essence of income that it [should] be realized. Potentiality is not enough." Floyd W. Windal, *Legal Background For The Accounting Concept of Realization*, 38 Acct. Rev. 29, 32 (1963) (quoting taxpayer's brief).

This Court agreed with the taxpayer. After reviewing the "dictionaries in common use," this Court defined income " 'as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets." *Macomber*, 252 U.S. at 207 (citation omitted). The Court continued: Income is "*not* a gain *accruing to* capital," and "not a *growth* or *increment* of value *in* the investment." *Id.* Instead, income is "a gain, a profit, something of exchangeable value, *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being '*derived*'—that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use." *Id.* Put bluntly, "income," as "used in common speech," *id.* at 206-207, is a realized gain.

Applying this rule, this Court held that a stock dividend does not constitute taxable income. "The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit * * * ." *Id.* at 211. His

investment, along with the company's profits, instead "remain[ ] the property of the company," subject to the "business risks which may result in wiping out the entire investment." *Id.* Although the company's "accumulation of profits" may "indicat[e] that the shareholder is the richer because of an increase of his capital," the relevant fact is that "he has not realized or received any income in the transaction." *Id.* at 212. This Court thus squarely rejected the contention that "enrichment through increase in value of capital investment is * * * income in any proper meaning of the term." *Id.* at 214-215.

Over a century has passed since this Court issued *Macomber*. During that time, this Court refined the meaning of "income." But even as it did so, this Court never walked away from *Macomber*'s core holding that income requires realization.

In *Helvering* v. *Bruun*, for example, this Court affirmed that "economic gain is * * * taxable as income" when that gain is "realiz[ed]." 309 U.S. at 469. *Bruun* concerned a landowner who had rented out his land on a 99-year lease. *Id.* at 464. The lease allowed the tenant to tear down any existing building on the property and construct his own, provided the new building remain on the property at the end of the lease. *Id.* Only a few years after the tenant "demolished and removed the existing building and constructed a new one," however, the tenant defaulted on the lease and the landowner "regained possession of the land and building." *Id.* The question was whether the fair market value of the tenant's improvements to the land constituted taxable income of the landowner.

The *Bruun* Court said yes. The Court dispatched the landowner's argument that no income had been

realized under *Macomber* because the improvement was not severed from the land by cabining *Macomber*'s "severance" language to the stock-dividend situation. *Id.* at 468-469. This lack of severance notwithstanding, the Court recognized that the landowner *had* realized a gain and thus earned taxable income. According to *Bruun*, the key to identifying "income" is to find "profit realized from the completion of a transaction." *Id.* at 469. The traditional example is "cash derived from the sale of an asset." *Id.* But "[g]ain may [also] occur as a result of exchange of property, payment of the taxpayer's indebtedness, [or] relief from a liability." *Id.* Applying that rule, the *Bruun* Court concluded that the landowner earned taxable income when, "as a result of a business transaction," the landowner "*received back* his land with a new building on it, which added an ascertainable amount to its value." *Id.* (emphasis added).

Less than a year later, this Court repeated and applied the realization rule in a case concerning whether a father who gifted to his son the right to receive interest payments earned taxable income on those interest payments. *Helvering* v. *Horst*, 311 U.S. 112, 114 (1940). As in *Bruun*, *Horst* tethered the taxability of a gain to whether that gain had been realized: "[T]he rule [is] that income is not taxable until realized * * * ." *Id.* at 116. And when the son received the interest payments, the Court explained, the father himself had "realized" a gain. *Id.* at 117. He had "use[d] * * * his economic gain, the right to receive income," to buy something only money can buy—the "non-material satisfaction[ ]" of gifting money to his son. *Id.* In short, *Horst* held, 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. And so when the interest was paid out to the son, the father's "enjoyment" of that interest was "realized as completely as it would have been if he had collected the interest in dollars and expended them." *Id.* at 117.

This Court clarified and applied the realization rule yet again in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955). *Glenshaw Glass* held that punitive-damages awards are taxable income. *Id.* at 431. It did so because such awards are "undeniable accessions to wealth, *clearly realized*, and over which the taxpayers have complete dominion." *Id.* (emphasis added). In so doing, the Court observed that *Macomber*'s formulation of income as "the gain derived from capital, from labor, or from both combined" "was not meant to provide a touchstone to all future gross income questions." *Id.* at 430-431 (citation omitted). But, crucially, even as the Court expanded the definition of income, it retained *Macomber*'s core holding: that a gain must be "clearly realized" to constitute taxable income. *Id.* at 431.

As these cases illustrate, this Court has confronted hard questions about *when* a gain was realized such that it is taxable as income. But this Court has never extended the Sixteenth Amendment to a tax on unrealized gains. And that is for a simple reason: Income requires realization.

* * *

The text and history of the Sixteenth Amendment, as well as this Court's precedents, all point in one direction: To be taxable as "income" under the Sixteenth Amendment, a gain must be *realized* by the taxpayer. A tax on an *unrealized* gain is thus a tax on *personal property*, and accordingly must be

apportioned. *See* Pet'rs Br. 44-47. The MRT is in flagrant violation of that rule. This Court should therefore reject it as an unconstitutional unapportioned direct tax on personal property.

II. THE SIXTEENTH AMENDMENT'S REALIZATION REQUIREMENT PROTECTS FAMILY BUSINESSES AND FOSTERS A WORKABLE TAX SYSTEM.

Congress's attempt to evade the Sixteenth Amendment's realization requirement in the MRT is precipitous. As Judge Bumatay recognized below, "[d]ivorcing income from realization opens the door to new federal taxes on all sorts of wealth and property without the constitutional requirement of apportionment." Pet. App. 55 (Bumatay, J., dissenting from denial of rehearing en banc). Waiting on the threshold are a slew of wealth taxes targeting the unrealized gains of wealthy families and successful family businesses. And if history is any guide, even if Congress begins by targeting successful businesses, it will not stop there. The result will likely be an unworkable tax scheme that requires affected taxpayers to develop the means to assess annual changes to the value of trillions of dollars in privately held businesses, real estate, and other illiquid assets, while requiring the IRS to build entirely new capacity and acquire new personnel to advise, monitor, and audit those valuations.

A. The Mandatory Repatriation Tax Is Only The First Step In Taxing Unrealized Gains.

The MRT is Congress's first step on the slippery slope to taxing the unrealized gains of family businesses.

1. Economic inequality is deeply entrenched. *See, e.g.* Juliana Menasce Horowitz et al., Pew Rsch. Ctr., Most Americans Say There Is Too Much Economic Inequality in the U.S., but Fewer Than Half Call It a Top Priority 12-22 (2020).[2] To combat this inequality, elected officials have increasingly called to tax the unrealized gains of wealthy families and successful family businesses.

President Biden's Proposed Fiscal Year 2024 Budget, for example, calls for "a minimum tax of 25 percent on total income, generally inclusive of unrealized capital gains, for all taxpayers with wealth (that is, the difference obtained by subtracting liabilities from assets) greater than $100 million." U.S. Dep't of Treasury, General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals 82 (2023).[3] This builds off President Biden's Proposed Fiscal Year 2023 proposal, which would have imposed a 20% tax on total income—inclusive of unrealized gains. *See* U.S. Dep't of Treasury, General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals 34 (2022).[4]

Capitol Hill, for its part, is littered with "wealth tax" proposals taking aim at the wealthy's unrealized gains. The Billionaire Minimum Income Tax Act would require households worth over $100 million to pay a 20% annual minimum tax on their income, defined to include both realized and unrealized gains. *See* H.R.8558 – Billionaire Minimum Income Tax Act,

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[2] *Available at* http://tinyurl.com/4zss5mfz.

[3] *Available at* https://tinyurl.com/2s4jcx4m.

[4] *Available at* https://tinyurl.com/5xpctxsx.

Summary: H.R.8558 — 117th Congress (2021-2022).[5] The Babies Over Billionaires Act of 2022 would impose an annual 35% tax on the unrealized gains of every taxpayer with a net worth over $100 million. *See* H.R.7502 – Babies over Billionaires Act of 2022, Summary: H.R.7502 — 117th Congress (2021-2022).[6] The Ultra-Millionaire Tax Act of 2021 would impose a tax on the net worth of households worth at least $50 million. *See* S.510 – Ultra-Millionaire Tax Act of 2021, Summary: S.510 — 117th Congress (2021-2022).[7] And the Oligarch Act of 2023 would impose a graduated wealth tax and would require the IRS to audit at least 30% of affected households each year. *See* H.R.4919 – Oligarch Act of 2023.[8]

2. These proposals have some political appeal because they look like they target only the wealthiest individuals and most successful family businesses. But the history of taxation in this country illustrates that there is no reason to expect Congress to stop there. Tax policy is marked by incrementalism—"marginal adjustments to the existing tax structure." John F. Witte, The Politics and Development of the Federal Income Tax 244-245 (1985). And this "highly incremental process has produced radical policy changes over time." *Id.* at 19.

The income tax is a prime example. Congress's first permanent income tax under the Sixteenth Amendment, enacted in 1913, set a 1% to 7% marginal tax on income. *See* Revenue Act of 1913, 38 Stat. 114, 166.

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[5] *Available at* https://tinyurl.com/ytwcebfw.

[6] *Available at* https://tinyurl.com/yc3zs39h.

[7] *Available at* https://tinyurl.com/y3wwcfcd.

[8] *Available at* https://tinyurl.com/4c6rbhv7.

But "due to generous exemptions and deductions, less than 1 percent of the population paid income taxes at the rate of only 1 percent of net income." *16th Amendment to the U.S. Constitution: Federal Income Tax (1913)*, Nat'l Archives.[9] Federal income taxes were thus "essentially irrelevant to most Americans." Lily Rothman, *How World War II Still Determines Your Tax Bill*, TIME (Apr. 14, 2016).[10] Indeed, "[b]etween 1913 and 1915, the income tax had almost no influence on tax collections." Witte, *supra*, at 79.

The income tax did not remain irrelevant for long. By 1918, to account for increased federal spending in World War I, roughly five percent of the population paid income taxes. *See Public Law 65-254, Revenue Act of 1918*, Budget Counsel.[11] But that was nothing compared to World War II, which led Congress to transform the income tax from a class tax to a "mass tax." Witte, *supra*, at 65. By 1943, just under 70% "of the total population was covered by a taxable return." Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 Buff. L. Rev. 685, 695 (1988). The income tax thus went from not applying to the middle class *at all* to falling on "the large mass of citizens" by the war's end. Witte, *supra*, at 125. The mass nature of the income tax has persisted; today, roughly 60% of households are subject to federal income taxes. Statista Research Dep't, *Share of households in the United States than paid no individual*

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[9] *Available at* http://tinyurl.com/yw7ym2k6 (last visited Sept. 6, 2023).

[10] *Available at* https://tinyurl.com/287hrym8.

[11] *Available at* https://tinyurl.com/y2ktpsvx (last visited Sept. 6, 2023).

income tax in 2022, by income level, Statista (Nov. 2, 2022).[12] Far from being irrelevant, "individual income taxes have become a central pillar of the federal revenue system." Erica York & Madison Mauro, *The Composition Of Federal Revenue Has Changed Over Time*, Tax Found. (Feb. 28, 2019).[13]

The Alternative Minimum Tax is another example of a tax scheme incrementally growing beyond its initially modest scope. In 1969, the Treasury Department released a report that about 150 high-earners "paid no federal income tax on their 1967 tax returns." Ben Harris et al., *The Individual AMT: Problems and Potential Solutions*, Brookings Inst. (Sept. 18, 2002).[14] Congress responded with the AMT, a tax intended to "guarantee that high-income individuals paid at least a minimal amount of tax each year." Greg Leiserson & Jeffrey Rohaly, Tax Pol'y Ctr., The Individual Alternative Minimum Tax: Historical Data and Projections 1 (June 2008).[15] In line with that limited goal, the AMT initially affected only 20,000 taxpayers. *Id.* at 4. But by 2017, the AMT hit 5.2 million people. *See* Howard Gleckman, *The Tax Cuts And Jobs Act And The Zombie AMT*, Tax Pol'y Ctr. (Oct. 2, 2018).[16]

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[12] *Available at* https://tinyurl.com/bdetdm6c.

[13] *Available at* https://tinyurl.com/3srxdz6y.

[14] *Available at* https://tinyurl.com/556ew8f6.

[15] *Available at* https://tinyurl.com/yne794da.

[16] *Available at* https://tinyurl.com/yxrc4xf5. The Tax Cuts and Jobs Act temporarily reined in the AMT such that it reaches only 200,000 people. Gleckman, *supra*. But this patch is set to expire in 2026, at which point the AMT will apply to over 7 million taxpayers. *Id.*

The incremental incursion of a tax into an ever-broadening population is not limited to taxes on the rich and the middle class: Even the scope of *taxes on Social Security benefits* has ballooned since first enacted. Since 1984, if an individual on Social Security earns $25,000 in provisional income—which includes distributions from retirement accounts and pension payments—up to half their Social Security benefits are taxed. Medora Lee, *Social Security Benefits Are Rising, But So Are The Taxes. Here's Why.*, USA Today (Mar. 16, 2023).[17] And since 1993, for individuals making $34,000 or more a year, up to *85%* of those benefits are taxed. *Id.* Those threshold income levels are not indexed to inflation, and so "with each passing year, an increasing proportion of seniors have been reaching those low thresholds and having to pay taxes on their benefits." *Id.* For example, 26% of beneficiaries were taxed on their Social Security benefits in 1998; in 2014, 49% were. *See* Paul S. Davies, Cong. Rsch. Serv., IF11397, In Focus: Social Security Benefit Taxation Highlights 1 (updated June 12, 2020).[18] By 2050, the Social Security Administration expects "that more than 56% of Social Security beneficiary families will owe income tax on their Social Security benefits in 2050." *Id.* Despite many calls for reform, Congress refuses to act. *Id.* at 2 (discussing four bills introduced in the 116th Congress that would either eliminate taxes on Social Security benefits or raise the income thresholds).

The point is this: Tax schemes are sticky, and once enacted, their reach often grows. Sometimes that can

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[17] *Available at* https://tinyurl.com/bdhxs9bt.

[18] *Available at* https://tinyurl.com/4ft24fu6.

be justified: The progressive income tax replaced a regressive scheme where the majority of federal revenue was earned through tariffs whose burdens fell hardest on "Southern and Midwestern farmers" and "urban workers." Sheldon D. Pollack, *Origins of the Modern Income Tax, 1894-1913*, 66 Tax Law. 295, 297 (2013). But, justified or not, the point remains: Federal tax schemes have a way of incrementally branching out from humble beginnings. With that history in mind, it's not a far leap from the MRT's taxation on unrealized gains to a broader tax on the unrealized gains of the wealthy. And from there, it's only a step to taxing the unrealized gains of family businesses.

B. Taxing Unrealized Gains Will Harm Family Businesses.

The Sixteenth Amendment tethers income to realization for good reason. The realization requirement allows the government to sidestep complicated valuation questions, ensures that taxpayers have the liquidity to pay their taxes, and encourages economic growth. Severing income taxation from realization, as the decision below does, throws all that out the window. And the burden of complying with more general taxes on unrealized gains will fall especially hard on family businesses. Assessing annual changes to illiquid assets is expensive to do and incredibly hard to do well. Moreover, constant changes in each industry or market creates volatility that is further compounded by changes in the larger economy. Responsible taxpayers will start their valuations from scratch each year, and the burden will fall most heavily on family businesses with substantial plants and equipment, intellectual property, or other illiquid assets. Put simply, reading the realization requirement out of the

Sixteenth Amendment invites Congress to enact an expensive, complicated, and difficult-to-audit tax scheme that might seem to target tech billionaires, but will burden tens of thousands of family businesses.

For starters, a tax on unrealized gains will be extremely difficult to implement successfully. Unlike a tax on a *realized* gain, a tax on an *unrealized* gain raises a complicated question from go: What actually *is* the gain? This "valuation" question is "[t]he main problem with an annual wealth tax" on unrealized gains. *See* Miranda Perry Fleischer, *Not So Fast: The Hidden Difficulties of Taxing Wealth*, *in* Wealth: Nomos LVIII, at 261, 275 (Jack Knight & Melissa Schwartzberg eds., 2017). A tax on unrealized gains is, in practical terms, a "guess tax."

Valuing privately held companies is an especially "difficult and imprecise task." *Id.* at 276.[19] Indeed, there are "various methods for valuing a closely held business." *Id.* at 277. "The simplest approach is look

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[19] *See also, e.g.*, OECD, OECD Tax Policy Studies No. 26: The Role and Design of Net Wealth Taxes in the OECD 69 (2018), *available at* http://tinyurl.com/bddkvhhr ("Valuation issues are also significant in relation to non-listed firms and closely-held companies * * * ."); Huaqun Li & Karl Smith, Tax Found., Analysis of Sen. Warren and Sen. Sanders' Wealth Tax Plans 7 (Jan. 2020), *available at* https://tinyurl.com/3cb6d7dw ("[P]rivately held business assets * * * would create significant valuation challenges."); Richard A. Epstein, *The Wealth Tax Is A Poor Idea*, Hoover Inst. (Jan. 24, 2023), *available at* https://tinyurl.com/466nf6f5 ("Many * * * assets, like * * * fractional interests in a family corporation, are nearly impossible to value, impossible to sell, or both."); Deborah H. Schenk, *A Positive Account of the Realization Rule*, 57 Tax L. Rev. 355, 367 (2004) (noting that "stock in closely held corporations" "would not be easy to value").

at the company's balance sheet, add up the value of all the assets, and subtract outstanding liabilities." *Id.* But this "undervalues the company because balance sheets frequently exclude intangibles such as good-will, going concern value, customer lists, trademarks, and the like." *Id.* Another method "is to look at the sale of comparable publicly traded companies in the same or similar industries." *Id.* But this requires "weighing a host of factors," including "size, market share, geographic location, diversification of assets, and financial security." *Id.* The third option "is to estimate the income stream of the business being valued, and then to estimate the present value of that income stream." *Id.* at 278. But this, too, calls for "a number of judgments," including identifying "the appropriate discount rate" and determining whether "net profits, cash flow, or gross revenue" should be used. *Id.* And that's not even getting into how to determine whether an individual shareholder's assets should be discounted—and by how much—if that shareholder's control over the business is limited. *See id.* at 279-281; *see also* Am. Soc'y of Appraisers et al., International Valuation Glossary – Business Valuation 7 (updated Feb. 24, 2022) (explaining that a product's marketability is affected by, among other things, "the characteristics of the asset").[20]

Given such difficulties, "the government would need to expend substantial additional resources in monitoring a self-assessed valuation system." Schenk, *supra*, at 368. This will be no easy matter. Even assuming a wealth tax targeting only the wealthiest 0.1%, the IRS will be required to monitor the valuation of over

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[20] *Available at* http://tinyurl.com/2p9e8v4a.

$5 trillion in wealth tied up in private businesses. *See DFA: Distributional Financial Accounts*, *Assets by Wealth Percentile Group in 2023: Q1*, Fed. Rsrv.[21] Indeed, there are about 18,000 private businesses earning annual revenues of over $100 million. *See Private Market Investing: Staying Private Longer Leads to Opportunity*, Hamilton Lane (Apr. 14, 2022).[22] And that's on top of the other roughly *$5 trillion* invested by the wealthiest 0.1% in real estate, consumer goods, and other assets. *See* Fed. Rsrv., *supra.*

Accurately valuing trillions of dollars of assets every year would be difficult for any organization. But the IRS, a perennially underfunded, understaffed, and under-resourced agency, is particularly ill-suited to the task. Appropriations to the IRS fell by 20% between 2010 and 2018, which "resulted in a 22 percent decline in the number of employees at the agency and a 30 percent decline in the number of employees working in enforcement roles." Cong. Budget Off., Trends in the Internal Revenue Service's Funding and Enforcement 1 (July 2020).[23] Making matters worse, the IRS continues to trudge on with severely outdated technology; some of the applications it relies on are over 60 years old. *See* U.S. Gov't Accountability Off., GAO-23-104719, Information Technology: IRS Needs to Complete Modernization Plans and Fully Address Cloud Computing Requirements (Jan. 2023).[24] And even after the injection of much-needed funding, the

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[21] *Available at* https://tinyurl.com/5h27w5jj (last visited Sept. 6, 2023).

[22] *Available at* https://tinyurl.com/266rbwun.

[23] *Available at* https://tinyurl.com/48mp7myu.

[24] *Available at* https://tinyurl.com/yp5v5sjf.

IRS has once again seen its budget start to get chipped away. *See* Brendan McDermott, Cong. Rsch. Serv., IN12172, Changes to IRS Fundings in the Debt Limit Deal 1-2 (updated July 2023).[25]

Adding to the IRS's expenses will be the proliferation of valuation disputes between the IRS and taxpayers. *See, e.g.*, Fleischer, *supra*, at 283-284; Edward A. Zelinsky, *For Realization: Income Taxation, Sectoral Accretionism, And The Virtue Of Attainable Virtues*, 19 Cardozo L. Rev. 861, 880 (1997) ("[I]n the absence of cash or actively traded property, the appraisal process, necessary to tax unrealized appreciation, is expensive and litigation-prone."). And as a leading tax scholar has noted, "valuation controversies are almost always a losing proposition for the [Internal Revenue] Service." Schenk, *supra*, at 367-368.

Worse, the time and resources the IRS dedicates to valuing difficult-to-value assets like businesses and then defending them will come at the expense of efforts to collect the *hundreds of billions* of dollars that taxpayers fail to pay in income taxes every year. In 2019, the gap between taxes legally owed and taxes paid was $600 billion. *See* U.S. Dep't of Treasury, The American Families Plan Tax Compliance Agenda 1 (May 2021).[26] This is roughly $100 billion more than the gap a few years prior. *See* Gary Guenther, Cong. Rsch. Serv., IF11887, In Focus: Federal Tax Gap: Size, Contributing Factors, and the Debate Over Reducing It (updated Apr. 13, 2023).[27] Unsurprisingly, "[t]he size of the IRS budget and its staff, especially for

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[25] *Available at* https://tinyurl.com/2p987wfc.

[26] *Available at* https://tinyurl.com/47wr7d42.

[27] *Available at* https://tinyurl.com/2b6e9pme.

enforcement activities and taxpayer services, affect the tax gap through their impact on taxpayer compliance." *Id.* at 2.

The combination of the difficult valuation questions raised by a wealth tax, the existing tax gap, and the IRS's limited budget and resources will lead any future wealth tax to most likely be counterproductive. That is, the administrative costs of valuing opaque assets with antique technology and then defending those valuations year after year could foreseeably lead the IRS to de-prioritize shrinking the income tax gap. Given the size of that tax gap—which is only growing larger—the result will almost certainly be less money in the federal coffers than if the IRS were to devote adequate resources to enforcing the current (and constitutional) tax system.

Divorcing income taxation from realization will also lead to liquidity issues—that is, cash-poor but asset-rich taxpayers lacking liquid funds to pay a tax on their unrealized gains. *See, e.g.*, OECD, *supra*, at 64 ("Liquidity issues are a major equity concern regarding wealth taxes."); Chris Edwards, Cato Inst., Tax & Budget Bull., *Taxing Wealth and Capital Income* 5 (Aug. 1, 2019) ("Taxpayer liquidity would be another issue.").[28] Unlike other more-mobile assets that could avoid taxation by being moved abroad, *see, e.g.*, Edwards, *supra*, at 6, family businesses are rooted here. They will thus be subject to taxation year after year. "[R]ealization makes the tax collection process relatively easy because it avoids the tax-without-cash problem." Ilan Benshalom & Kendra Stead, *Realization and Progressivity*, 3 Colum. J. Tax L. 43, 53

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[28] *Available at* https://tinyurl.com/6h27jezu.

(2011). Taxing *unrealized* gains, on the other hand, exposes taxpayers to a tax they may lack the cash to pay. Family-business owners and farmers are especially susceptible to such liquidity issues. *See, e.g.*, *General Tax Reform: Panel Discussions Before the H. Comm. on Ways & Means*, 93d Cong. 284, 285 (1973) (statement of Professor Richard A. Musgrave) (downplaying liquidity concerns but recognizing that those concerns are "valid * * * where family farms or enterprises are involved"); Schenk, *supra*, at 363 (similar); Glen Loutzenhiser & Elizabeth Mann, *Liquidity Issues: Solutions For The Asset Rich, Cash Poor* 42 Fiscal Studies 651, 652 (2021) (including among the "asset-rich, cash-poor" taxpayers with "valuable business assets/agricultural property but relatively small income");[29] Edwards, *supra*, at 5 (explaining that meeting a tax bill on unrealized gains "would be difficult for people who mainly held assets that are illiquid and do not generate regular cashflows, such as * * * ownership shares of some family businesses").

Obtaining the cash to meet the tax bill will require cash-poor taxpayers to either sell their assets or take on debt. Edwards, *supra*, at 5. For a family-business owner, neither option is attractive. Valuation issues could make securing a loan difficult. *See* Schenk, *supra*, at 363 (noting that "some taxpayers" might "find it difficult to borrow" if they were forced to "borrow[ ] against an asset whose value may not be known"). And requiring a family-business owner to carve up the product of their hard work not because that business was *failing* but because it was *successful* is simply unfair. Indeed, such a situation would effectively be the

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[29] *Available at* https://tinyurl.com/rs5y9w34.

government forcing the sale of privately held property.

Economics aside, selling a portion of a family business is no easy matter. First off, "[o]ften, closely held businesses restrict owners' abilities to transfer their shares or liquidate." Fleischer, *supra*, at 279. So many family-business owners might simply have no options. And even if the owner is free to shop around their shares, she might find it difficult to find a buyer. *See, e.g.*, *id.* ("Even if the organization's governing documents do not" restrict sales, "an outsider is less likely to buy into a closely held corporation than into one with broad public ownership."); Epstein, *supra* ("[F]ractional interests in a family corporation[ ] are nearly * * * impossible to sell * * * ."). To cap it all off, if the family-business owner can run this (annual) gauntlet and dispose of enough of their shares to pay the tax bill, that would be "only the beginning." John H. Cochrane, Cato Inst., Tax & Budget Bull., *Wealth and Taxes* 8 (Feb. 25, 2020).[30] "Most businesses also borrow money, and if you sell part of the business, you have to repay debt before you do anything else." *Id.* A tax on the unrealized appreciation of a family business could thus force family-business owners to pay off their debts years before they are due.

The issues with abandoning the realization requirement do not stop there. Economic growth depends on savings being "channeled back into the economy * * * to support investments by business enterprises." Edwards, *supra*, at 7. Wealth taxes, however, "suppress savings and investment." *Id.* at 9. They encourage taxpayers to *consume* their excess funds immediately,

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[30] *Available at* https://tinyurl.com/27hjad4t.

rather than invest them and thereby expose them to increased taxation. Cochrane, *supra*, at 7. Taxing unrealized gains thus "discourages risk taking," *id.*, and in so doing, "undermine[s] economic growth," Edwards, *supra*, at 9.

Would-be entrepreneurs will again pay the price. With a diminished capital base, an aspiring business owner might find it difficult to launch or grow their business. *See* OECD, *supra*, at 63. And that's assuming that the entrepreneur would even *want* to start a business; in the face of a significant tax on unrealized gains, a would-be business owner could reasonably conclude that the financial risk of starting a business is not worth the reduced payoff. *See* Cochrane, *supra*, at 7; Garrett Watson, *Proponents of Wealth Taxation Must Consider Its Impact On Innovation*, Tax Found. (Nov. 12, 2019).[31] Such lower economic growth is another way wealth taxes risk counterproductivity: Less wealth means less tax revenue.

These concerns with abandoning the realization requirement are not hypothetical. Roughly a dozen European countries have experimented with wealth taxes. *See, e.g.*, Edwards, *supra*, at 3; Li & Smith, *supra*, at 6. Nearly all have abandoned the tax. Edwards, *supra*, at 3. The reasons for repeal were manifold: The taxes "raised little revenue, created high administrative costs, * * * induced an outflow of wealthy individuals and their money," and "damage[d] economic growth." *Id.* Much the same can be expected here if Congress were to take up the Ninth Circuit's invitation to impose novel taxes on unrealized gains.

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[31] *Available at* https://tinyurl.com/yr238akz.

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The policy concerns against ditching the rule of realization illustrate the careful calibration of the Sixteenth Amendment. By exempting only *realized* income from the Direct Tax Clauses' apportionment requirement, the Amendment fosters a workable tax scheme that does not rest on difficult valuation questions, require taxpayers to sell their assets to meet their tax bill, or threaten to kneecap economic growth. The text and history of the Sixteenth Amendment, as well as this Court's precedent—all of which make plain that the Sixteenth Amendment requires that income be realized before it can taxed—thus continue to have vital meaning in the modern day. This Court should vindicate that meaning and hold that the direct, unapportioned taxation of income under the Sixteenth Amendment is limited to *realized* gains and that the MRT is therefore unconstitutional.

CONCLUSION

This Court should reverse the decision below.

Respectfully submitted,

NEAL KUMAR KATYAL
Counsel of Record
MICHAEL J. WEST
HOGAN LOVELLS US LLP
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-5600
neal.katyal@hoganlovells.com

Counsel for Amici Curiae

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