No. 22-800

IN THE
Supreme Court of the United States

CHARLES G. MOORE, ET UX.,
Petitioners,
v.

UNITED STATES OF AMERICA,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF *AMICUS CURIAE* L.E. SIMMONS IN SUPPORT OF RESPONDENT

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INTEREST OF THE AMICUS CURIAE[1]

L.E. Simmons is the founder of SCF Partners, an investment firm headquartered in Houston, Texas. SCF Partners invests in and supports entrepreneurs in the energy sector with the goal of building robust companies that serve global energy needs effectively and responsibly. Amicus has a compelling professional interest in ensuring that the federal income tax regime remains rational and encourages, rather than stifles, entrepreneurship.

Amicus offers this brief as a roadmap for how this Court should confirm long-established precedent that the Constitution allows taxing owners directly on entity income that is not double taxed at the entity level, while recognizing that the Constitution prohibits taxation of unrealized sums that do not represent actual economic gain. The Court should also acknowledge that the Fifth Amendment may prohibit substantial taxes on unrealized appreciation that indirectly compel the taxpayer to sell the underlying property (*e.g.*, real estate or shares of company stock) to pay the tax, without meeting the public use requirement for a governmental taking.

SUMMARY OF ARGUMENT

The Mandatory Repatriation Tax (MRT) is constitutional because it is a tax on the realized operating income of a *de facto* pass-through entity. The MRT income of Petitioners' business is not subject to any

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[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 amicus curiae made a monetary contribution intended to fund the preparation or submission of this brief.

United States corporate income tax at the entity level. It is taxed only at the owner level. That is the distinction between this case and *Eisner v. Macomber*, 252 U.S. 189 (1920), which involved the Standard Oil Company, a domestic corporation subject to the U.S. corporate income tax. For any entity whose operating income is not subject to U.S. corporate income tax at the entity level, such as partnerships or S corporations, this Court has correctly recognized that the Constitution allows that income to be taxed directly to the owners.

Although the MRT is constitutional, the Ninth Circuit's opinion was overly broad and mistakenly stated that there are no constitutional limitations in *Macomber*. Because this Court's opinion may provide guidance beyond the MRT, this brief is intended to provide the Court with an outline of the constitutional holdings in *Macomber* and later cases that continue to limit the ability of Congress to tax "unrealized sums," but that do not apply to the MRT for the reason stated above.

The Sixteenth and Fifth Amendments preclude the taxation of imaginary income that does not represent actual economic gain. Although the quoted or appraised market value of an asset may increase temporarily "on paper," there is no certainty that any real economic gain will materialize when the asset is actually sold or disposed of. That creates a constitutional problem for taxation of those unrealized gains. Federal income taxes are computed annually with no refunds of past years' taxes allowed, even if a tentative or paper profit never materializes. Any statute that imposes a tax based on a snapshot of asset value, absent an actual sale or exchange and

without a corrective mechanism if the asset later declines in value, would be imposing an income tax where there is no economic gain.

For many taxpayers, a tax on unrealized gains would result in double taxation (or worse), because it would arbitrarily tax temporary upticks in valuation at year end without an assured refund mechanism if the asset declines in value in a later year. The leading academic proponents of taxing unrealized gains acknowledge the necessity for a mechanism to refund prior years' taxes if the asset declines in value in a later year. But no such mechanism exists in current law, and no such mechanism appears to be plausible in light of the practical realities of an income tax that must collect taxes annually. Taxing paper gains, without a refund mechanism if they disappear, would unconstitutionally impose income taxes where there is no economic gain. See *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955); cf. *Tyler v. Hennepin County, Minn.*, 598 U.S. 631 (2023).

A second constitutional concern is that a substantial tax on unrealized gains would tend to compel the sale of the asset, most likely to a private party, to raise funds to pay the tax. That issue was identified as a constitutional problem in *Macomber*. In addition, under the Fifth Amendment, this Court has explained that the government cannot compel the sale of property through the exercise of eminent domain, even for fair market value, unless the government has a public use for the property or a public benefit related to the use of the property itself. The Court has suggested that using the eminent domain power to compel a sale might be unconstitutional if the government's only purpose was to raise more taxes. See

Kelo v. City of New London, Conn., 545 U.S. 469, 487 (2005).

Here, the governmental compulsion would be created indirectly through the tax law itself. That is not a far-fetched hypothetical. One of the leading legislative proposals to tax unrealized gains acknowledges that it would force entrepreneurs in growing companies to sell some or all their holdings to pay taxes on their paper gains. The issue could also arise with substantial city or state income taxes on unrealized real estate gains, perhaps only imposed in certain areas, if such an approach were considered more convenient than using the eminent domain process. The Court should consider whether such a compulsion to sell, imposed indirectly by the tax law instead of the eminent domain power, might implicate or violate the Fifth Amendment.

ARGUMENT

I. THE MANDATORY REPATRIATION TAX IS CONSTITUTIONAL BUT NOT FOR THE REASONS GIVEN BY THE NINTH CIRCUIT, WHOSE OPINION SHOULD BE CORRECTED OR VACATED

The MRT is constitutional, but not for the reasons given by the Ninth Circuit below. The best explanation may be that provided by Boris I. Bittker and Lawrence Lokken in their highly respected tax treatise, *Federal Taxation of Income, Estates and Gifts* (Thomson Reuters/Tax & Accounting, 2d/3d ed. 1993-2019, updated July 2023) ("*Bittker & Lokken*").

Macomber clearly imposed a constitutional ban on imputing the corporate income of the Standard Oil Company to its shareholders, as if they were part-

ners: "We cannot . . . ignore the substantial difference between corporation and stockholder, treat the entire organization as unreal, look upon stockholders as partners when they are not such[.]" *Macomber*, 252 U.S. at 214. However, as *Bittker & Lokken* explains, the *Macomber* decision "arose in a legislative context involving a separate corporate tax and might have been modified if corporate profits were not taxed to the corporation but only to its shareholders." *Bittker & Lokken* ¶ 1.2.4.

The *Macomber* opinion explained that the existence of a statutory corporate tax on Standard Oil, and a separate statutory shareholder tax on distributions, required the corporation and its shareholders to be respected as distinct entities/persons.[2] As a result, Congress could not constitutionally tax the corporation's income to the corporation and simultaneously tax the same income to the share-

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[2] As the Court explained: "[I]t is only by recognizing such separateness that any dividend — even one paid in money or property — can be regarded as income of the stockholder. Did we regard corporation and stockholders as altogether identical, there would be no income except as the corporation acquired it; and while this would be taxable against the corporation as income under appropriate provisions of law, the individual stockholders could not be separately and additionally taxed with respect to their several shares even when divided, since if there were entire identity between them and the company they could not be regarded as receiving anything from it, any more than if one's money were to be removed from one pocket to another." *Macomber*, 252 U.S. at 214.

holders.[3] The shareholders could only be taxed on actual corporate distributions.

As *Bittker & Lokken* suggests, that constitutional problem does not exist with the MRT. Petitioners' foreign business entity is not subject to any U.S. corporate income tax on its MRT income or other foreign source income. That realized income is taxed by the United States only at the owner or shareholder level. Petitioners' entity was *a de facto* pass-through entity for purposes of the *Macomber* analysis. See Donald B. Susswein & Ramon Camacho, *What Did Macomber Decide*? 180 Tax Notes Federal (forthcoming Oct. 16, 2023); Donald B. Susswein & Ramon Camacho, *Macomber: We Can't Tax Shareholders as Partners,* Letter to the Editor, 180 Tax Notes Federal 1906 (Sept. 11, 2023).

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[3] With two phrases separated by the word "or" in *Macomber*, the Court summarized its first holding on the stock dividend issue and its second holding rejecting the government's argument that the "accumulated profits behind" the stock dividend could be imputed directly to the shareholders, as if they were partners: "Thus, from every point of view we are brought irresistibly to the conclusion that neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, *or the accumulated profits behind it, as income of the stockholder*." *Macomber*, 252 U.S. at 219 (emphasis added).

II. TAXING UNREALIZED SUMS (SUCH AS UNREALIZED CAPITAL GAINS) WOULD BE UNCONSTITUTIONAL, BECAUSE THE FEDERAL INCOME TAX SYSTEM SYSTEMATICALLY DENIES A LATER TAX REFUND IF THE "PAPER" GAIN DOES NOT MATERIALIZE INTO ACTUAL ECONOMIC GAIN

An income tax cannot be constitutionally imposed when there is no economic gain at all. See *Glenshaw Glass*, 348 U.S. at 431. The Court noted this problem in *Macomber* when it explained that the Standard Oil shareholders were still "subject to business risks which may result in wiping out the entire investment[,]" including the undistributed company earnings. *Macomber*, 252 U.S. at 211. Without an actual distribution there could be no shareholder tax. *Id*. This problem is even more serious where the taxpayer owns property directly and has a "paper" gain because an asset has gone up in market value. That "paper" profit can also be wiped out before the asset is sold.

The constitutional problem is partially a structural problem. The federal income tax, for very important practical reasons, is not imposed on a lifetime basis. It is imposed every year on the taxpayer's income for that taxable year, which for individuals is generally the calendar year. Moreover, this Court has repeatedly rejected the notion that taxpayers can reopen and recompute taxes from a prior year if the economic assumptions made in one year are negated by later events. See *United States v. Lewis*, 340 U.S. 590 (1951); *Arrowsmith v. Commissioner*, 344 U.S. 6, 8 (1952) (reciting "the well-

established principle that each taxable year is a separate unit for tax accounting purposes").

The temporal rigidity of the federal tax system would put any proposal to tax unrealized capital gains as income on a collision course with the Constitution. A recent article analyzing this issue provides an illustrative example. Imagine that a share of stock was purchased for $100 in November 2023 and sold for $100 in February 2024. The taxpayer obviously received no economic gain from the transaction as a whole. But if the publicly quoted market price of the stock spiked to $150 on New Year's Eve and dropped back to $100 on January 2, a 20 percent tax on unrealized capital gains (as of the end of 2023) would charge the shareholder with an income tax of $10 for 2023. And that $10 tax would not be refunded, offset, or reduced in 2024 because of the taxpayer's theoretical $50 loss when the stock was eventually sold for no gain. See Donald B. Susswein, *The Supreme Court, Steve Jobs, And the Billionaire Income Tax*, 180 Tax Notes Federal 1859 (Sept. 11, 2023) ("*Billionaire Tax*").

The federal income tax is also not a "negative" income tax. In this example, the taxpayer's $50 loss might be of some use against unrelated current or future income, but that is far from guaranteed. For that reason, the academic advisors to the leading proponents of proposals to tax unrealized capital gains have acknowledged the need for a "mechanism" of some kind to refund capital gain taxes paid in a prior year if a paper gain on an asset is wiped out by

a loss on the same asset in a later tax year.[4] See Reuven S. Avi-Yonah & David Gamage, *Billionaire Mark-to-Market Reforms: Response to Susswein and Brown*, 105 Tax Notes State 389 (July 25, 2022). In fact, no such mechanism exists in current tax law or in the leading legislative proposal in this area. And no such mechanism appears to be plausible, given the existing intractable structure of the income tax. See Donald B. Susswein & Kyle Brown, *Mark-to-Market Mechanism: MIA? A Response to Avi-Yonah and Gamage*, 106 Tax Notes State 19 (Oct. 3, 2022) ("*Mark-to-Market MIA*").

As Mr. Susswein writes:

> The fundamental problem with taxing unrealized gains is that it artificially divides a long-term transaction into three or more segments: purchase, appreciation on paper as of the last day of any year, and ultimate sale or disposition. In doing so, it systematically taxes, or tends to tax, amounts that have no rational relationship to economic gain, or to anything for that matter.

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[4] Capital losses cannot be carried back. Even if that law were changed, they could only be carried back three years, unless Congress took the wholly impractical step of eliminating the longstanding statute of limitations on refunding or reexamining prior tax years. Losses can sometimes be used against unrelated current or future income, but the availability of such potential offsets cannot be assured or reasonably expected in many cases. That is why some assured refund "mechanism," like a negative income tax, would be needed to ensure that only economic gains are taxed. Given the temporal constraints of the income tax system, such a mechanism is unrealistic.

Billionaire Tax at 1862.

Even if loss carrybacks were allowed, there would likely be double taxation (or worse) when assets are held longer than three years (the maximum time allowed to adjust or refund prior year taxes). For example, if valuable minerals are discovered that increase the value of land, that unrealized capital gain would be taxed. That gain would represent the anticipated future income from selling the minerals, perhaps over the next fifteen years. In addition, the actual ordinary income from selling a portion of the minerals each year would also be taxed. As contemplated by the leading proponents of the major legislative proposals in this area, no deduction would be available to fully offset that double taxation. As the land declines in value from the removal of the minerals a series of annual capital losses would arise, but for timing reasons most of those could not be used to fully offset the first year's capital gain. And apart from a very small annual allowance, those capital losses could not be used to offset the ordinary income from removing the minerals. Some "mechanism" to refund the upfront gain is needed to solve that problem, but none exists in current law, and no such mechanism appears to even be plausible. See *Mark-to-Market MIA* at 22-23.

Basing an income tax on a data point that exists at a moment in time (and maybe no longer) would be an arbitrary exercise of the taxing power that would likely violate the due process clause of the Fifth Amendment. See *Brushaber v. Union Pacific Railroad Co.*, 240 U.S. 1, 24 (1916) (positing that "a seeming exercise of the taxing power" could be "so arbitrary as to constrain to the conclusion that it was

not the exertion of taxation, but a confiscation of property"). Moreover, imposing such an "income" tax in the context of a federal tax system that is unwilling and unable to revisit a data point relied upon in a prior tax year even if, in hindsight, that data point was demonstrably overstated could run afoul of the takings clause. *Cf. Tyler*, 598 U.S. at 647 (county violated takings clause by retaining excess proceeds from sale of home beyond what was owed in property tax; "The taxpayer must render unto Caesar what is Caesar's, but no more.").

III. AN INCOME TAX ON UNREALIZED CAPITAL GAINS THAT COMPELS THE SALE OF PROPERTY TO PAY THE TAX COULD IMPLICATE THE "PUBLIC USE" COMPONENT OF THE TAKINGS CLAUSE

The taxation of unrealized capital gains as "income" would present another policy conundrum with constitutional implications. This Court spotted the issue in *Macomber*, when it wrote with respect to taxation of a stock dividend that, "without selling, the shareholder, unless possessed of other resources, has not the wherewithal to pay an income tax upon the dividend stock." *Macomber,* 252 U.S. at 213. The Court continued: "Nothing could more clearly show that to tax a stock dividend is to tax a capital increase, and not income, than this demonstration that in the nature of things it requires conversion of capital in order to pay the tax." *Id*. The Court's observation in *Macomber,* that taxing an unrealized capital gain could compel the actual sale of the asset, may also present a Fifth Amendment issue under this Court's analysis in *Kelo v. City of New London, Conn.*

The issue in *Kelo* was whether a city or state could use the power of eminent domain to compel the sale of real property to further an economic development plan. *Kelo*, 545 U.S. at 472. Although the Court approved the taking of private property for just compensation in that case, it noted that a constitutional problem might exist if a city or state tried to "transfer[] citizen *A*'s property to citizen *B* for the sole reason that citizen *B* will put the property to a more productive use and thus pay more taxes." *Id.* at 486-87.

Of course, it makes no difference that the compelled sale hypothesized in *Kelo* occurs at fair market value. The problem is not a lack of "just compensation." The problem is that the governmentally imposed compulsion to sell is not for a "public use" of the property itself. It is possible that a substantial city or state income tax on unrealized capital gains on real property, in certain areas of a city or state, might be used as a way to compel or encourage actual sales of moderate-income homes in areas that were ripe for more intense use by private developers. But the issue has implications beyond real property.

One of the leading legislative proposals to tax unrealized capital gains acknowledges that the proposal would compel the sale of stocks or securities that are taxed under a mark-to-market system. The problem is acute for entrepreneurs whose companies suddenly jump in market value, such as when the company goes public with an initial public offering or when an important innovation is announced. To deal with the problem of compelled sales, the proposal contains a one-time exception, the first time the proposal takes effect, to "ensure that the proposal does

not affect the ability of an individual who founds a successful company to maintain their controlling interest." See *Wyden Unveils Billionaires Income Tax* (Oct. 27, 2021) (visited Oct. 11, 2023), https://www.finance.senate.gov/chairmans-news/wyden-unveils-billionaires-income-tax. This problem would recur as a company continued to grow and would likely be widespread.

As Mr. Susswein explains, in the "real world" entrepreneurs who build companies from scratch and finally reach the point at which an initial public offering is possible often see their net worth skyrocket *on paper*. *Billionaire Tax* at 1860. If those unrealized capital gains were subject to federal income tax, many if not most entrepreneurs would have no choice but to sell some or all their shares just to pay the government. In addition, of course, as a constitutional matter, there is no guarantee that any actual legislation of this type would contain any relief at all, even the one-time, transition relief proposed by Senator Wyden.

In *Kelo* the Court indicated that hypothetical cases of government-compelled sales to raise taxes, "could be confronted if and when they arise." *Kelo*, 545 U.S. at 487. This may be the time to address that hypothetical. The Court should review the majority's analysis in *Kelo* and consider whether the foreseeable compulsion to sell property just to pay a tax, in some cases, many cases, or possibly most cases, could constitute a "taking" for the potentially private purpose hypothesized in *Kelo*.

The *Kelo* hypothetical was referring specifically to an exercise of eminent domain motivated by a prospective increase in ad valorem property tax reve-

nues, because the new private owner would "put the property to a more productive use and thus pay more taxes." *Kelo*, 545 U.S. at 487. Here, the potential compulsion to sell would arise from accelerating the tax that would normally be imposed only upon a voluntary sale, with the foreseeable result that involuntary sale of the property would be required.[5] The issues present provocative parallels. See *Billionaire Tax* at 1864-66.

In sum, the public use clause of the Fifth Amendment protects the right of a person to buy and hold property, free from any government compulsion to sell, unless the government needs the property for a public use or public benefit. *Kelo* suggests that the government is not supposed to have the right to compel a sale (even at fair market value) just to generate more tax revenues. A substantial tax on unrealized capital gains would thus implicate, and in some cases could abridge or violate, this Fifth Amendment right.

CONCLUSION

For purposes of *Macomber*'s constitutional analysis, Petitioners' foreign business entity is a *de facto* pass-through entity. The MRT income is taxed by the United States only at the shareholder level. For

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[5] Annual property taxes can certainly impose burdens on a property owner. These are typically imposed at a much lower rate than federal income taxes and are often considered part of the normal burden of continuing property ownership. A substantial income tax on unrealized appreciation is different. As this Court has recognized, it is much more likely to require "conversion of capital in order to pay the tax." *Macomber,* 252 U.S. at 213.

that reason, the realized income of the entity can be constitutionally taxed to the owners, even if not currently distributed.

The constitutional holdings of *Macomber* should not be minimized or ignored for cases where they do apply. For that reason, the opinion of the Ninth Circuit should be vacated. The Ninth Circuit's mistaken understanding and description of the important and still vital constitutional limitations on taxing "unrealized sums" should be corrected for the reasons described in this brief.

Respectfully submitted,

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