

No. 22-800

**In the
Supreme Court of the United States**

CHARLES G. MOORE, ET AL.,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

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

**BRIEF OF MAIN STREET ALLIANCE,
SMALL BUSINESS MAJORITY,
AND ANNE ZIMMERMAN
AS *AMICI CURIAE*
IN SUPPORT OF RESPONDENT**

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INTEREST OF *AMICI CURIAE*¹

Amici curiae represent small businesses across the nation that recognize the value of a stable and predictable federal tax structure to small business growth and competition.

Amicus curiae Main Street Alliance is a national network of small businesses that represents approximately 30,000 small businesses across the country. Main Street Alliance helps small business owners realize their full potential as leaders for a just future that prioritizes good jobs, equity, and community. Main Street Alliance also seeks to amplify the voices of its small business membership by sharing their stories with the aim of creating an economy where all small business owners have an equal opportunity to succeed and by encouraging small business owners to participate in the political process.

Amicus curiae Small Business Majority is a national small business organization with a network of more than 85,000 small businesses and 1,500 business and community organizations. Small Business Majority aims to empower America's diverse entrepreneurs to build a thriving and

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

equitable economy. To that end, Small Business Majority delivers resources to entrepreneurs and advocates for public policy solutions that promote inclusive small business growth.

Amicus Curiae Anne Zimmerman is an accountant and Co-Chair of Small Business for America's Future, a national coalition of business owners and leaders working to provide small businesses a voice at every level of government. As Co-Chair and as a small business owner herself, Ms. Zimmerman is committed to ensuring policymakers prioritize Main Street by advancing a just and equitable economic framework that works for small business owners, their employees, and their communities.

Amici have a strong interest in ensuring the right conditions exist for entrepreneurs to grow their small business into thriving forces of local economies. Predictable taxes are essential to that growth for two reasons. First, predictable tax burdens allow small businesses to confidently plan and prepare for the future. In the absence of predictability, small businesses may face a range of negative outcomes, from forgoing critical investments to outright failure. Second, an uncertain tax environment will undermine small businesses' ability to compete against larger corporations, which have far more resources to monitor—and adjust to—ongoing developments in tax law. Petitioners' arguments against the constitutionality of the Mandatory Repatriation Tax—if adopted by this Court—would call into question the validity of tax provisions that govern millions of small businesses. *Amici* therefore write to express their concern about the harmful consequences for small businesses if this Court rules in favor of Petitioners.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

Small businesses are critical to the United States economy. The vast majority—99.9 percent—of businesses in the United States are small.² Small businesses also employ nearly half of the nation’s workers.³ Likewise, small businesses have created the majority of new jobs in the United States since 1995.⁴

Opening and sustaining a small business, however, is not easy, particularly in recent years. Small businesses face risk and challenges at every turn, from securing the capital necessary to open their doors to making payroll each month. Many small businesses are unable to surmount these challenges. Less than half survive to the five-year mark.⁵ The COVID-19 pandemic was particularly devastating for small businesses. On average, small businesses suffered earnings losses of 16 to 19 percent during the pandemic.⁶ Many small

² Office of Advoc., U.S. Small Bus. Admin., *2022 Small Business Profile for the United States* 1 (2022), <https://tinyurl.com/3u93bxjv>.

³ *Id.*

⁴ Office of Advoc., U.S. Small Bus. Admin., *Frequently Asked Questions* 1 (Dec. 2021), <https://tinyurl.com/32r2xuuv> (“From 1995 to 2020, small businesses created 12.7 million net new jobs while large businesses created 7.9 million (Figure 2). Small businesses have accounted for 62% of net new job creation since 1995.”).

⁵ *Frequently Asked Questions*, *supra* note 4, at 2.

⁶ Robert W. Fairlie, Office of Advoc., U.S. Small Bus. Admin., *The Impacts of COVID-19 on Racial Disparities in Small Business Earnings*, 37-38 (Aug. 16, 2022), <https://tinyurl.com/36hb2u4y>.

businesses did not survive: the Federal Reserve estimates that there were 130,000 excess small business closures (*i.e.*, above and beyond pre-pandemic rates) between March 2020 and February 2021.⁷ These challenges can be exacerbated by the fact that small businesses often compete with larger firms, which enjoy advantages in the marketplace. For example, unlike their smaller rivals, large corporations generally did quite well during the pandemic.⁸

In such an environment, a stable federal tax structure is critical to the success of small businesses. Stability is important because tax compliance—particularly setting up new systems—is largely a fixed cost and so will be proportionately higher for small businesses.⁹ For decades, most small businesses have relied on provisions of the Internal Revenue Code that tax small businesses as

⁷ Leland D. Crane, et al, Fed. Rsrv. Bd., *Business Exit During the COVID-19 Pandemic: Non-Traditional Measures in Historical Context* 4 (2021), <https://tinyurl.com/3kvpwjnp>.

⁸ Theo Francis et al., *U.S. Companies Are Thriving Despite the Pandemic—or Because of It*, Wall St. J. (Jan. 1, 2022), <https://tinyurl.com/27zhs529> (“bigger firms have fared better than smaller ones”).

⁹ See, e.g., Clyde Wayne Crews Jr., *Competitive Enter. Inst., Ten Thousand Commandments: An Annual Snapshot of the Federal Regulatory State* 17 (2018), <https://tinyurl.com/2she5rcf> (the “per-employee regulatory costs for firms of fewer than 50 workers can be 29 percent greater than those for larger firms”); Rafael Efrat, *The Tax Burden and the Propensity of Small Business Entrepreneurs to File for Bankruptcy*, 4 *Hastings Bus. L.J.* 175, 182-83 (2008), <https://tinyurl.com/bdfnu669> (noting that the “spike” in the “costs of tax compliance” is “largely due to the continuing complexity of the federal income tax code” and that “[t]his increase in compliance costs has largely had a regressive impact, disproportionately affecting small-business owners.”)

“pass through” entities. Under these provisions, the income of certain business entities—including partnerships, limited liability companies, or S corporations—is taxed on the individual business owners’ tax returns, rather than at the corporate level.

Small businesses also require predictability in their tax obligations. When entrepreneurs know what their tax burden will be, they can confidently allocate scarce resources to the best strategic investments for their business. When tax burdens are unpredictable, however, small businesses will confront a range of difficult circumstances. They may be surprised by tax bills that they cannot afford to pay—forcing them to make painful financial decisions or even to close their doors. Or they may react to the uncertainty by conserving their capital and passing on critical investment opportunities, which would in turn stunt their growth. The challenges posed by an unstable tax landscape would be exacerbated by the fact that small businesses lack the resources to monitor and respond to ongoing developments in tax law, putting them on uneven footing with well-resourced large corporations.

Petitioners’ challenge to the Mandatory Repatriation Tax threatens to create uncertainty around—and potentially invalidate—significant portions of the tax code, including the pass-through tax provisions that govern millions of small businesses. Petitioners argue that the Mandatory Repatriation Tax is unconstitutional because it taxes individual shareholders on their share of the income earned by a controlled foreign corporation even when the income is not distributed to the shareholders. But the taxes imposed on pass-through entities are similarly structured. Indeed, the owners and investors of partnerships, limited liability

companies, and S corporations all pay individual taxes on their share of the entity's income, regardless of whether the income is distributed or retained by the entity.

In light of these similarities, a ruling by this Court that adopts Petitioners' reasoning would raise serious questions about the validity of the provisions under which small businesses file taxes. Such an outcome would likely lead to years of incertitude around the tax obligations of small businesses, undermining their ability to plan for the future, to grow, and to compete with large corporations. And if it did result in the invalidation of pass-through entities, as seems likely if Petitioners prevail here, it would likely also lead to higher tax burdens for at least some small businesses.

A ruling in favor of Petitioners would therefore create significant challenges for small businesses, which already struggle to survive and grow. The Court should therefore affirm the decision below.

ARGUMENT

I. SMALL BUSINESSES RELY ON PREDICTABLE TAXATION OF PASS-THROUGH ENTITIES.

For decades, the overwhelming majority of United States businesses—99.9 percent of which are small¹⁰—have been structured and taxed as “pass-through” entities. In 2014, 95 percent of the 26 million businesses in the United States were structured as pass-through entities such as

¹⁰ 2022 *Small Business Profile*, *supra* note 2, at 1.

partnerships, limited liability companies, and S corporations.¹¹

The defining feature of these entities is the manner in which their income is taxed. Unlike traditional C corporations, pass-through entities do not themselves pay taxes at the entity level.¹² Rather, the entity's profits and losses "pass through" the entity to the individual owners.¹³ The individual owners then report the profits and losses on their individual income tax returns annually.¹⁴ If the entity incurs losses, the individual owners report those losses (subject to certain restrictions) as deductions. If the entity is profitable, the individual pays taxes on his or her share of the income according to the individual's marginal tax bracket.¹⁵

As discussed in more detail below, *see infra* Part II, a decision that adopts Petitioners' reasoning would create tremendous uncertainty regarding the future of pass-through taxation and, therefore, the taxation of many small businesses. Such an outcome would be extraordinarily harmful to small businesses.

Indeed, as this Court has recognized, "certainty is desirable" for all taxpayers. *United States v. Generes*, 405 U.S. 93, 105 (1972). But that wisdom rings especially true for small businesses, which are more

¹¹ Aaron Krupkin & Adam Looney, Brookings Institution, *9 Facts About Pass -Through Businesses* (May 15, 2017), <https://tinyurl.com/f5tm9z39>.

¹² Kyle Pomerlau, Tax Foundation, *An Overview of Pass-Through Businesses in the United States* (Jan. 21, 2015), <https://tinyurl.com/56b3zxth>.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.*

affected by uncertainty than larger ones.¹⁶ When tax burdens are unpredictable, small businesses face consequences that threaten their growth or—worse—their survival.

To begin, small businesses that are caught off-guard by large tax bills may not have enough capital saved to meet their obligations. For example, during the 2023 tax season, many small businesses in the software development world faced an existential threat due to a change in tax law that resulted in dramatically higher-than-expected taxes. The problem arose when Congress failed to extend a favorable tax provision that allowed software developers to deduct from their taxes all research and development costs as expenses.¹⁷ The expiration of the favorable provision was put into the tax code by the Tax Cuts and Jobs Act in 2017, but only took effect in 2022. While this development was therefore foreseeable, especially for larger businesses that had retained accountants and lobbying firms to track the issue, many affected small business owners did not learn the news until confronted with massive tax bills.¹⁸ One small business owner reported that his

¹⁶ Abha Bhattarai, *Delayed Raises and Renovations: Small Businesses Face New Uncertainties*, Wash. Post (Aug. 15, 2022), <https://tinyurl.com/25ymmmj2> (quoting Paige Ouimet, professor at the University of North Carolina’s Kenan-Flagler Business School).

¹⁷ Eric Rosenbaum, CNBC, *Software Firms Across the U.S. Facing Massive Tax Bills That Threaten Tech Startup World Survival* (Apr. 18, 2023), <https://tinyurl.com/2ncy8faw>; see also Doug Sword, *R&D Expensing Revamp Tops Wish List for Year-End Tax Talks*, 180 Tax Notes Fed. 1322, 1322 (2023), <https://tinyurl.com/29a493nh> (“businesses are clamoring for . . . a return to full research and development expensing”).

¹⁸ Rosenbaum, *supra* note 17.

tax bill rose by 400 percent.¹⁹ As a result, these business owners are now facing difficult decisions, such as laying off staff, freezing new hires, or suspending projects.²⁰ Some may not survive at all.²¹

These difficult decisions are grounded in the reality that many small businesses simply do not have stockpiles of cash reserves. Indeed, running out of capital is the second most common reason that small businesses fail.²² The risk of this kind of failure has only increased in recent years as banks have closed, lending standards have tightened, and interest rates have soared to a modern high.²³ More than half of small business owners found it more difficult to access capital this year than in previous years.²⁴ In such circumstances—where small business owners may not be able to take out a new line of credit or a loan—an unexpected tax bill can severely hamper growth or even spell the end of the business.

Conversely, uncertainty around tax obligations may cause small businesses to set aside *more* money than necessary to guard against the risk of higher taxes. While hedging in this way could help avoid the shutdown scenario faced by the software developers mentioned above, doing so can be harmful in other ways. When small businesses hold on to their scarce capital too closely, they are likely to miss out on

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² Kelly Main, Forbes, *Small Business Statistics of 2023* (Dec. 7, 2022), <https://tinyurl.com/mr23c57v>.

²³ See Small Bus. Majority, *Small Businesses Share Concerns with Recent Banking Closures, Access to Capital Challenges 2* (May 3, 2023), <https://tinyurl.com/4rmphh7f>.

²⁴ *Id.*

investment opportunities that are necessary for growth.²⁵

Based on an empirical study of nearly 5,000 businesses, several Harvard Business School Professors have explained that businesses faced with periods of uncertainty perform best when they strike a balance between defensively saving cash and offensively making strategic investments.²⁶ Those that forgo new investments entirely will not perform as well. Unfortunately, most businesses do not take the former approach. Of the nearly 5,000 businesses studied, only 9% achieved the desired equilibrium between conservative financial planning and continued strategic investment.²⁷

The difficulties caused by uncertainty are exacerbated by the fact that small businesses do not have the resources to monitor, much less react to, new developments in tax law. Most changes in tax law add levels of complexity that only accountants and tax lawyers can untangle. But the average small business owner does not have a tax accountant on retainer.²⁸ According to the Small Business

²⁵ Bhattarai, *supra* note 16 (describing decisions by small business owners to forego hiring and renovations in the face of economic uncertainty).

²⁶ See Ranjay Gulati et al., *Roaring out of Recession*, Harv. Bus. Rev. (March 2010), <https://tinyurl.com/mryevx9p>.

²⁷ Ranjay Gulati, *Investing in Growth Through Uncertainty*, Harv. Bus. Rev. (July-Aug. 2023), <https://tinyurl.com/yck4mmhk>.

²⁸ See Mark McKee, Forbes, *Why Should You Have an Accountant for Your Small Business?* (Aug. 18, 2020), <https://tinyurl.com/mvs7fbzb> (2019 survey showing that only 30 percent of small businesses hire accountants); Accounting Today, *Few Small Businesses Employ Bookkeepers or Accountants* (Apr. 4, 2014), <https://tinyurl.com/4kfhj522> (survey showing that only 33 percent of small businesses hire

Administration, the median income of small business owners was \$51,816 in 2018.²⁹ For most small businesses that size, hiring an accountant to closely monitor and advise on ongoing developments is simply cost prohibitive.

The inability of many small businesses to monitor, influence, or react to new developments in tax law also puts them at a disadvantage compared to larger corporations. In contrast to small businesses, large firms often have the capacity to—and frequently do—hire experts. With respect to the surprise tax that hit software developers for example, *supra* p.8, larger corporations hired lobbyists and big accounting firms to track and lobby for their desired legislation.³⁰ Small businesses, on the other hand, were caught completely off guard by the change in tax law that was made *five years ago*, with dire results.³¹

In a complex economy that is already buffeted about by other large-scale forces (such as the pandemic), certainty and predictability in tax is critical to the success of small businesses.

accountants); *cf.* Jessica Elliott, U.S. Chamber of Com., *Choosing the Right Accounting Software for your Business* (Sept. 5, 2023), <https://tinyurl.com/37j9v8f4> (2023 survey showing that only 14 percent of small businesses hire outside accountants).

²⁹ This statistic refers only to those small business owners whose businesses are incorporated. Office of Advoc., U.S. Small Bus. Admin., *2020 Small Business Profile for the United States 2* (2020), <https://tinyurl.com/3etwkvx>.

³⁰ Rosenbaum, *supra* note 17.

³¹ *Id.*

II. A RULING IN FAVOR OF PETITIONERS WOULD UNDERMINE THE PREDICTABLE TAXATION OF PASS-THROUGH ENTITIES.

This Court has long recognized that “tax administration requires predictability.” *Oklahoma Tax Comm’n v. Chickasaw Nation*, 515 U.S. 450, 450 (1995). That predictability would be greatly undermined if the Court adopts Petitioners’ reasoning to strike down the Mandatory Repatriation Tax. The characteristics of the tax that give rise to Petitioners’ complaints are shared by many existing tax provisions, including those that govern pass-through entities. Given those commonalities, a ruling in favor of Petitioners would cast doubt on the validity of taxes paid by millions of small businesses. This would in turn set off a cascade of consequences that would harm small businesses and undermine growth throughout the economy.

1. Petitioners argue that Congress does not have power under the Sixteenth Amendment to tax unrealized gains because such gains do not constitute income.³² They further argue that the Mandatory Repatriation Tax is a tax on unrealized gains—despite the fact that the corporation in question did realize income—because the entity’s earnings were not distributed to the shareholders.³³

As the Joint Committee on Taxation and numerous other tax experts have made clear, this line of reasoning calls into question the constitutionality of numerous other sections in the

³² Pet’rs’ Br. at 1-2.

³³ See Pet’rs’ Br. at 44-45.

tax code.³⁴ Among the implicated provisions are Subchapters K and S, under which millions of pass-through entities (the majority of which are small businesses) file their taxes.³⁵ Subchapter K governs the taxation of partnerships and limited liability companies, while Subchapter S governs the taxation of S corporations.

Critically, Subchapters K and S share the very characteristic of the Mandatory Repatriation Tax about which Petitioners complain: under all three tax regimes, the individual owner or investor must pay taxes on their share of the entity's income regardless of whether the income is distributed or is instead reinvested by the entity.³⁶ As noted above, Petitioners argue that Congress does not have authority under the Constitution to impose such a

³⁴ See, e.g., Letter from Thomas A. Barthold, J. Comm. on Taxation, to U.S. Rep. Richard E. Neal (Oct. 3, 2023), <https://tinyurl.com/3ejuezv>; Steven M. Rosenthal, *Moore Could Invalidate Decades of Tax Rules*, Tax Notes (Oct. 9, 2023), <https://tinyurl.com/3ffzjdw>; Eric Toder, Tax Policy Center, *The Potential Economic Consequences of Disallowing the Taxation of Unrealized Income* (Oct. 10, 2023), <https://tinyurl.com/582a396s>.

³⁵ Toder, *supra* note 34, at 10-11 (discussing potential impacts for partnerships and S corporations, which file under Subchapters K and S); 26 U.S.C. § 701 et seq. (Subchapter K – Partners and Partnerships); 26 U.S.C. § 1361 et seq. (Subchapter S – Tax treatment of S Corporations and Their Shareholders).

³⁶ Pet'rs' Br. at 2 (noting that Petitioners “were hit with MRT liability because they are minority shareholders in a foreign corporation that reinvested its earnings to grow its business, without distributing a penny to them”); Toder, *supra* note 34, at 10 (explaining that under Subchapters K and S, profits of pass-through businesses are taxable on individual owners' tax returns, regardless of whether the profits are distributed or reinvested).

tax—even though the income has been realized by the entity—because the income has not been distributed to the taxpayer.³⁷ Thus, if the Court were to adopt Petitioners’ reasoning, Subchapters K and S would be called into question.

Such a ruling would impact millions of small businesses across the United States. According to the Census Bureau’s 2015 Statistics on U.S. Businesses, S corporations and partnerships collectively accounted for 3.6 million—or just over 65 percent—of the nation’s 5.5 million firms in 2015.³⁸ Of those, 99.7 percent were small businesses.³⁹

Perhaps recognizing the chaos that would ensue if Subchapters K and S were affected, Petitioners attempt to distinguish the Mandatory Repatriation Tax in an effort to reassure the Court that existing tax provisions would survive a ruling in Petitioners’ favor. With respect to partnerships, Petitioners argue that Subchapter K’s taxation of partners is valid because “partnerships hav[e] no existence separate from their partners”—meaning that the partnership’s income is also the partners’ income.⁴⁰ As for S corporations, Petitioners contend that because the shareholders of those entities “unanimously elect to be taxed on the business’s income,” the shareholders “concede[] that its income

³⁷ See Pet’rs’ Br. at 1 – 3 (summarizing Petitioners’ view that the MRT is unconstitutional tax because it taxes shareholders on corporate earnings that were never distributed to or “realized” by the shareholders).

³⁸ Mark P. Keightley & Joseph S. Hughes, Cong. Rsch. Serv., R44786, *Pass-Throughs, Corporations, and Small Businesses: A Look at Firm Size* 3 (2018), <https://sgp.fas.org/crs/misc/R44086.pdf>.

³⁹ *Id.*

⁴⁰ Pet’rs’ Br. at 51 (internal citations omitted).

is theirs.”⁴¹ In Petitioners’ view, these differences (*i.e.*, the lack of a separate entity and electivity) permit the taxation of income that is not distributed to the individual taxpayers.

Petitioners’ two-sentence dismissal of these concerns cannot withstand scrutiny. As to the separate entity argument, more than 70 percent of the entities that are taxed as partnerships are actually limited liability corporations or limited partnerships.⁴² These are manifestly separate entities. As is true of Petitioners, the investors in such entities have no direct ownership rights to the entity’s income and no right to demand distributions.⁴³ Furthermore, even with respect to traditional partnerships, a “large number of provisions in Subchapter K treat[] the partnership as an entity and not as an aggregate . . . of its partners[.]”⁴⁴ Thus, even if the Sixteenth Amendment warranted the use of a separate entity

⁴¹ *Id.* (internal citations omitted).

⁴² See I.R.S. Publ’n 5338 (Rev. 6-22), *Statistics of Income: Partnership Returns, 2019* (last visited Oct. 22, 2023), <https://www.irs.gov/pub/irs-pdf/p5338.pdf> (stating that in 2019, 71.5 percent of Subchapter K filers were LLCs).

⁴³ Revised Unif. Ld. P’ship Act § 303(a) (2001) (Unif. L. Comm’n, amended 2013); *id.* § 503(b); Revised Unif. Ltd. Liab. Co. Act § 108(a) (2006) (Uniform Law Comm’n, amended 2013) (“A[n] [LLC] is an entity distinct from . . . its members”); *id.* § 304 (no personal liability of members for LLC obligations); *id.* § 404(b) (“A person has a right to a distribution . . . only if the company decides to make an interim distribution.”).

⁴⁴ Reuven S. Avi-Yonah, *If Moore Is Reversed*, Tax Notes (June 26, 2023), <https://tinyurl.com/y693a7tr>. For example, Section 702(a) of Subchapter K lists various items—such as gains and losses—that keep their character as they pass through a partnership to a partner’s individual income tax return. See 26 U.S.C. § 702(a). These provisions would be superfluous if partnerships were not treated as separate entities.

requirement as a matter of constitutional law, virtually all businesses are currently treated—at least in part—as separate entities.⁴⁵

Petitioners’ argument with respect to S corporations is similarly flawed. While it is true that all shareholders must initially consent to S corporation status,⁴⁶ shareholders cannot revoke that status unless they obtain consent of “shareholders holding more than one-half of the shares.”⁴⁷ This means that if minority shareholders no longer wish to pay taxes on undistributed income—but the majority shareholders desire to remain an S corporation—the minority shareholders will still be obligated to pay the tax. Moreover, even if electability is a tenable distinction, the petitioners never explain why that distinction has any constitutional relevance.

2. In the end, whether Petitioners are correct that these are workable distinctions of constitutional moment will largely be beside the point for small businesses. The very fact that Petitioners’ position casts doubt on Subchapters K and S would create long-lasting and detrimental uncertainty for small businesses regarding the fate of their tax obligations.

To begin, a ruling for Petitioners that adopts their reasoning would likely invite a deluge of litigation challenging Subchapters K and S. Tax advisers have already counseled taxpayers who paid the Mandatory Repatriation Tax to consider filing

⁴⁵ See also Resp’ts’ Br. at 24-25 (explaining that most states treat partnerships as separate entities under state law).

⁴⁶ 26 U.S.C. § 1362(a)(2) (a small business may elect to be an S corporation “only if all persons who are shareholders in such corporation . . . consent to such election.”).

⁴⁷ *Id.* § 1362(d)(1)(B).

protective refund claims and—in the same breath—speculated about the future of taxes assessed on the income of pass-through entities.⁴⁸ It is not difficult to imagine that litigation over these taxes would follow soon after a decision in favor of Petitioners. Such legal challenges could take years to resolve. The median length of a civil case in federal district court is 27 months.⁴⁹ Appeals take, on average, another 9 months.⁵⁰ In the interim, the future of taxes owed by small business owners would be very much in question.

This uncertainty would only continue if legal challenges successfully invalidated Subchapters K and S. Congress would likely attempt legislative action to prevent the loss of tax revenue that would follow. Some tax experts estimate that if the undistributed income of pass-through businesses cannot be taxed, tax revenue would decrease—at a minimum—by \$23 billion in 2024 and \$39 billion in 2028.⁵¹ To minimize such an erosion of the tax base, Congress might, for instance, decide to tax pass-through entities as C corporations.⁵² This would ensure that the income of such entities is taxed

⁴⁸ *Moore or Less (Tax): U.S. Supreme Court Action Signals Need for Protective Refund Claims for IRC § 965 Inclusions*, Lane Powell (June 29, 2023), <https://tinyurl.com/333ckrpr>.

⁴⁹ Joanna R. Lampe, Cong. Rsch. Serv., IF11349, *Lawsuits Against the Federal Government: Basic Federal Court Procedure and Timelines* 1 (2020), <https://sgp.fas.org/crs/misc/IF11349.pdf>.

⁵⁰ *Id.*

⁵¹ Toder, *supra* note 34, at 10-11. These estimates do not account for behavioral responses, such as C corporations restructuring themselves as S corporations to avoid taxation on retained earnings. *Id.* at 15-16. As the author notes, such responses “could make the revenue loss . . . many times larger than our estimate[.]” *Id.* at 16.

⁵² Toder, *supra* note 34, at 16.

annually without taxing the business owners on undistributed income.⁵³ Regardless of the content, the process of passing such legislation could take years.

Nor would legislative changes be limited to the federal level. The majority of states tax income and do so in a manner that broadly conforms to the Internal Revenue Code.⁵⁴ Accordingly, state revenues would also be impacted if federal pass-through taxation is undermined. Should that occur, states could—and likely would—take action to defend their tax bases. To take one recent example of states responding to changes at the federal level, in the five years that have passed since the 2017 Tax Cuts and Jobs Act was enacted, thirty-six states have made changes to their own tax codes by adding entity-level taxes on pass-through entities.⁵⁵

These developments in the federal and state tax codes will wreak havoc on small businesses, which do not have the resources to track ongoing litigation or legislative proposals. The inability to monitor

⁵³ In contrast to pass-through entities, a C corporation's income is taxed at the entity level. Individual shareholders of corporations are then only taxed on the income when it is distributed through dividends or when the shareholder sells his or her shares. Pomerlau, *supra* note 12.

⁵⁴ See Ruth Mason, *Delegating Up: State Conformity with the Federal Tax Base*, 62 Duke L. J. 1267, 1275 (2013), <https://tinyurl.com/4ckvzprc> (“Thirty-five of the forty-one states with broad-based income taxes use federal definitions of income as the starting point for calculating residents’ taxable income.”); see also *State Personal Income Taxes: Federal Starting Points*, Fed’n of Tax Adm’rs (updated Jan. 1, 2023), <https://tinyurl.com/3n2nr5we> (providing the most recent state income tax rates).

⁵⁵ Eileen Reichenberg Scherr, *Updates on States Moving Ahead with PTEs*, J. of Acct. (May 26, 2023), <https://tinyurl.com/2xepk7kx>.

ongoing developments, on its own, will put small businesses at a disadvantage relative to larger corporations, which are much better positioned to foresee outcomes in the courts, Congress, and state legislatures.

Moreover, small businesses will likely be subject to further harm even after the dust settles on any reforms to the state and federal tax codes, assuming it does.

First, any new business tax regime will impose additional fixed costs as small businesses must understand and then comply with their new tax obligations. These costs could be quite significant depending on the reform chosen and on whether the different states are left to pursue their own reforms.

Second, any new business entity tax regime will change tax burdens and create different incentives for taxpayers. Indeed, if Subchapters K and S are invalidated, small businesses may face larger tax burdens than expected. For example, under Petitioners' logic, Congress will no longer be able to tax small business entities on a pass-through basis. While this could reduce small business owners' tax liability by preventing the taxation of the businesses' undistributed income, it would also preclude small business owners from deducting their businesses' losses on their individual tax returns. For owners of businesses that incur losses, such a turn of events could lead to significantly higher tax burdens.

A large tax bill of any amount could be fatal for a small business that lacks capital reserves—especially if it comes as a surprise.⁵⁶ And, as explained above, any change in the tax code could come as a surprise to small businesses that lack the ability to track developments, even when news of the

⁵⁶ *Supra* pp. 8-9.

change is publicly available years before the change becomes effective.⁵⁷ At best, the unexpected expense would reduce capital available for productive investments. At worst, a small business operating on thin margins may not survive.

Conversely, some small businesses may anticipate the risks of increased tax burdens, causing them to set aside much-needed capital to prepare for that eventuality.⁵⁸ Even if a higher tax bill never materializes, the very act of stockpiling money in response to tax uncertainty could be detrimental to entrepreneurs, workers, and local economies if it causes small businesses to forgo productive investment opportunities.

Moreover, these changes in tax burdens may create incentives for small businesses to change how they are structured in order to reduce their tax liability moving forward. The small businesses facing larger tax obligations will need to consider whether—and how—to rearrange their affairs. This will represent a significant fixed cost in addition to the initial cost of higher tax bills.

Third, larger, more sophisticated corporations will fare better than small businesses in the wake of the uncertainty and change that would follow a ruling in favor of Petitioners. Subsequent changes in the tax code may represent opportunities for large firms to reduce their taxes, putting small businesses at a disadvantage in the marketplace. For example, large firms that are currently subject to the Mandatory Repatriation Tax would receive a windfall should the petitioners succeed in striking it down. The Mandatory Repatriation Tax was

⁵⁷ *Id.*

⁵⁸ *Supra* p. 9.

overwhelmingly owed by very large corporations.⁵⁹ Similarly, anti-abuse provisions—such as the Global Intangible Low-Tax Income (GILTI) provisions—are also overwhelmingly paid by larger taxpayers.⁶⁰ As several tax experts have noted, the GILTI provisions would be called into question—and likely subject to legal challenge—if the Court were to adopt Petitioners’ reasoning.⁶¹

By disproportionately benefiting large corporations, the invalidation of either tax provision would also harm small businesses. Small businesses do not operate in a vacuum, but instead compete in the marketplace against larger corporations. And small businesses already operate at a significant disadvantage relative to their larger competitors since they cannot shift profits to related parties in lower tax jurisdictions, a tactic of multinational corporations that the above provisions attempt to address. A victory for the Petitioners will thus render the playing field still more unbalanced by

⁵⁹ Melissa Costa & Caitlin McGovern, I.R.S., *Effects of IRC Section 965 Transition Tax on Domestic Corporations, Tax Year 2017 2* (last visited Oct. 18, 2023), <https://tinyurl.com/mufnx7bp> (noting that 95 percent of the Mandatory Repatriation tax liability that was reported in 2017 was owed by corporations with more than \$2.5 billion in assets).

⁶⁰ See I.R.S., *SOI Tax Stats – International Tax Studies Based Upon Provisions Introduced by the Tax Cuts and Jobs Act (TCJA) of 2017*, tbl.1, Form 8992: U.S. Shareholder Calculation of Global Intangible Low-Taxed Income (GILTI), Selected Items, by Size of Total Assets of Parent, Tax Year 2018, <https://tinyurl.com/y2np89cr> (parent corporations with total assets over \$2.5 billion earned over 90 percent of GILTI in 2018).

⁶¹ See, e.g., Letter from Thomas A. Barthold, *supra* note 34; Avi-Yonah, *supra* note 44. Tellingly, the petitioners do not directly attempt to distinguish the Global Intangible Low Tax Income provisions from the Mandatory Repatriation Tax. See *generally* Pet’rs’ Br.

granting a windfall to large taxpayers who were previously subject to the Mandatory Repatriation Tax and by hamstringing Congressional attempts to address income-shifting.

* * *

A ruling that adopts Petitioners' reasoning with respect to the Mandatory Repatriation Tax would create untenable uncertainty—and potentially significantly higher tax burdens—for small businesses in the United States.⁶² Small businesses have the power to transform the United States economy and are a backbone for millions of people and communities. Ruling for Petitioners would impose new burdens and challenges for small businesses, endangering the heart of the United States economy.

⁶² If the Court is compelled to rule in favor of Petitioners, such a ruling should be carefully limited to avoid the disturbance of other tax provisions. *See, e.g.*, Br. of Nat'l Taxpayers Union Found. at 25-26 (discussing importance of minimizing disruption to the broader tax structure in any ruling for Petitioners).

CONCLUSION

For the foregoing reasons, the decision below should be affirmed.

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OCTOBER 2023