No. _____

IN THE

Supreme Court of the United States

CHARLES G. MOORE and KATHLEEN F. MOORE,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

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

PETITION FOR WRIT OF CERTIORARI

ANDREW M. GROSSMAN
Counsel of Record
DAVID B. RIVKIN, JR.
JEFFREY H. PARAVANO
BAKER & HOSTETLER LLP
1050 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 861-1697
agrossman@bakerlaw.com

DAN GREENBERG
SAM KAZMAN
DEVIN WATKINS
COMPETITIVE ENTERPRISE INSTITUTE

Counsel for Petitioners

QUESTION PRESENTED

The Sixteenth Amendment authorizes Congress to lay "taxes on incomes…without apportionment among the several States." Beginning with *Eisner v. Macomber*, 252 U.S. 189 (1920), this Court's decisions have uniformly held "income," for Sixteenth Amendment purposes, to require realization by the taxpayer. In the decision below, however, the Ninth Circuit approved taxation of a married couple on earnings that they undisputedly did not realize but were instead retained and reinvested by a corporation in which they are minority shareholders. It held that "realization of income is not a constitutional requirement" for Congress to lay an "income" tax exempt from apportionment. App.12. In so holding, the Ninth Circuit became "the first court in the country to state that an 'income tax' doesn't require that a 'taxpayer has realized income.'" App.38 (Bumatay, J., dissenting from denial of rehearing en banc).

The question presented is:

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

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners Charles and Kathleen Moore were plaintiffs in the district court proceedings and appellants in the court of appeals proceedings.

Respondent United States of America was the defendant in the district court proceedings and appellee in the court of appeals proceedings.

Because no petitioner is a corporation, a corporate disclosure statement is not required under Supreme Court Rule 29.6.

Statement of Related Proceedings

This case directly relates to the following proceedings:

Moore v. United States, No. 2:19-cv-01539, U.S. District Court for the Western District of Washington. Judgment entered on Nov. 19, 2020.

Moore v. United States, No. 20-36122, U.S. Court of Appeals for the Ninth Circuit. Judgment entered on June 7, 2022.

TABLE OF CONTENTS

Page

PETITION FOR WRIT OF CERTIORARI 1

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED..1

STATEMENT...2

A. Factual and Legal Background............................3

B. Procedural History 7

REASONS FOR GRANTING THE PETITION 9

I. The Ninth Circuit's Holding on Realization Plainly Conflicts with This Court's Precedents and Those of Other Appeals Courts..........9

II. The Ninth Circuit's Holding Clashes with the Sixteenth Amendment's Text and Eviscerates Article I's Apportionment Requirement 17

III. The Question of Congress's Power To Tax Unrealized "Income" Without Apportionment Is Exceptionally Important and Warrants Review 22

CONCLUSION 27

TABLE OF APPENDICES

Appendix A: Opinion, United States Court of Appeals for the Ninth Circuit, *Charles Moore, et al. v. United States*, No. 20-36122 (June 7, 2022) .... App. 1

Appendix B: Order, United States District Court for the Western District of Washington, *Charles Moore, et al. v. United States*, No. 2:19-cv-01539 (Nov. 19, 2020) .... App. 21

Appendix C: Order, United States Court of Appeals for the Ninth Circuit, *Charles Moore, et al. v. United States*, No. 20-36122 (Nov. 22, 2022) .... App. 35

Appendix D: Relevant Constitutional and Statutory Provisions.................................. App. 57

Appendix E: Declaration of Charles G. Moore .... App. 69

Appendix F: Complaint..................................... App. 76

TABLE OF AUTHORITIES

CASES

Brushaber v. Union Pac. R. Co.,
240 U.S. 1 (1916).. 21

Commissioner v. Glenshaw Glass,
348 U.S. 426 (1955) 8, 13, 14, 15

Comm'r v. Indianapolis Power & Light Co.,
493 U.S. 203 (1990) 14

Comm'r v. Kowalski,
434 U.S. 77 (1977) 13, 14

Connecticut Gen. Life Ins. Co. v. Eaton,
218 F. 188 (D. Conn. 1914) 18

Cottage Sav. Ass'n v. Comm'r,
499 U.S. 554 (1991) 11

Doyle v. Mitchell Bros. Co.,
247 U.S. 179 (1918) 10

Eisner v. Macomber,
252 U.S. 189 (1920) 2, 10, 14, 17

Gibbons v. Mahon,
136 U.S. 549 (1890) 18

Gray v. Darlington,
82 U.S. 63 (1872).. 17

Helvering v. Bruun,
309 U.S. 461 (1940) 12

Helvering v. Griffiths,
318 U.S. 371 (1943) 15, 16, 22

Helvering v. Horst,
311 U.S. 112 (1940) 13, 16

Helvering v. Nat'l Grocery Co.,
304 U.S. 292 (1938) 22, 23

James v. United States,
366 U.S. 213 (1961) 13, 15

MacLaughlin v. Alliance Ins. Co. of Philadelphia,
286 U.S. 244 (1932) 12

Maryland Cas. Co. v. United States,
52 Ct. Cl. 201 (Ct. Cl. 1917) 17

Merchants' Loan & Trust Co. v. Smietanka,
255 U.S. 509 (1921) 20

Mut. Ben. Life Ins. Co. v. Herold,
198 F. 199 (D.N.J. 1912) 18

Nat. Fedn. of Indep. Bus. v. Sebelius,
567 U.S. 519 (2012) 21

Pollock v. Farmers' Loan & Trust Co.,
157 U.S. 429 (1895) 26

Pollock v. Farmers' Loan & Trust Co.,
158 U.S. 601 (1895) 20, 24

Quijano v. United States,
93 F.3d 26 (1st Cir. 1996) 16

Simmons v. United States,
308 F.2d 160 (4th Cir. 1962) 16

Stratton's Indep., Ltd. v. Howbert,
231 U.S. 399 (1913) 10

Taft v. Bowers,
278 U.S. 470 (1929) 11

United States v. Safety Car Heating & Lighting Co.,
297 U.S. 88 (1936) 12

United States v. Schillinger,
27 F. Cas. 973 (C.C.S.D.N.Y. 1876) 18

Weiss v. Stearn,
265 U.S. 242 (1924) 11

CONSTITUTIONAL AND STATUTORY AUTHORITIES

U.S. Const., amend. XVI... 1, 17

U.S. Const., art. I, § 2, cl. 3 ....1, 7

U.S. Const., art. I, § 9, cl. 4 ....1, 7

26 U.S.C. § 61.. 6

26 U.S.C. § 245A.. 6

26 U.S.C. § 951 ....5, 6

26 U.S.C. § 957 5

26 U.S.C. § 965 ....5, 6

OTHER AUTHORITIES

Black's Law Dictionary (2d ed. 1910) 19

Century Dictionary and Cyclopedia (1901) 18

Christopher Cox & Hank Adler,
The Ninth Circuit Upholds a
Wealth Tax, Wall St. J., Jan. 25, 2023 2

44 Cong. Rec. 3377 (June 17, 1909) 21

Edwin Seligman, *The Income Tax* (1911) 20

Erik M. Jensen, The Taxing Power, the Sixteenth Amendment, and the Meaning of "Incomes," 33 Ariz. St. L.J. 1057 (2001) 21

Exxon Mobil Corp., WSJ Markets 24

Federalist No. 36 (Hamilton) 26

Henry Campbell Black, *A Treatise on the Law of Income Taxation Under Federal and State Laws* (1913) 19

Henry Ordower, Abandoning Realization and the Transition Tax: Toward a Comprehensive Tax Base, 67 Buff. L. Rev. 1371 (2019) 6, 24

Henry Ordower, Revisiting Realization: Accretion Taxation, the Constitution, Macomber, and Mark to Market, 13 Va. Tax Rev. 1, (1993) 23

Jim Tankersley et al., Republican Plan Delivers Permanent Corporate Tax Cut, N.Y. Times (Nov. 2, 2017) 6

Joseph Worcester, *Dictionary of the English Language* (1875) 19

Mark Berg & Fred Feingold, The Deemed Repatriation Tax—A Bridge Too Far?, 158 Tax Notes 1345 (2018) 5, 7, 24

Press Release, The White House, President's Budget Rewards Work, Not Wealth with new Billionaire Minimum Income Tax (Mar. 28, 2022) 25

Press Release, Wyden Unveils Billionaires Income Tax (Oct. 27, 2021) 25

2 Records of the Federal Convention of 1787, (M. Farrand ed. 1911)...26

Robert H. Montgomery, *Income Tax Procedure* (1917)...20

Robert Hunter & Charles Morris, *Universal Dictionary of the English Language* (1897) 19

S. 510 25

Sean P. McElroy, The Mandatory Repatriation Tax Is Unconstitutional, 36 Yale J. Reg. Bull. 69 (2019) 7

Ultra-Millionaire Tax Act of 2021, H.R. 1459, 117th Cong. (2021) 25

Webster's American Dictionary of the English Language (1889) 18

Webster's Revised Unabridged Dictionary (1913) 18

PETITION FOR WRIT OF CERTIORARI

Charles and Kathleen Moore respectfully petition for a writ of certiorari to review the judgment of the Ninth Circuit in this case.

OPINIONS BELOW

The Ninth Circuit's opinion is reported at 36 F.4th 930 and reproduced at App.1. The opinion of the District Court for the Western District of Washington is unpublished and reproduced at App.21.

JURISDICTION

The judgment of the court of appeals was entered on June 7, 2022. App.1. A timely petition for rehearing was denied on November 22, 2022. App.36. This Court has jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Sixteenth Amendment to the U.S. Constitution provides:

> Congress shall have 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.

The Constitution's Apportionment Clause and Direct Tax Clause, U.S. Const., art. I, § 2, cl. 3; *id*. § 9, cl. 4, and relevant portions of the Tax Code are reproduced at App.57, *et seq*.

STATEMENT

This case presents a question of exceptional importance concerning Congress's taxing power. Confronted with a "novel" new tax, App.8, the Ninth Circuit held for the first time ever that "realization of income is not a constitutional requirement" for Congress to impose a tax exempt from apportionment under the Sixteenth Amendment, App.12. On that basis, it concluded that "there is no constitutional prohibition against Congress attributing a corporation's income pro-rata to its shareholders" and then taxing them on it, as happened here. App.13.

That decision shatters what had been an unbroken judicial consensus dating back to *Eisner v. Macomber*, 252 U.S. 189 (1920), that the Sixteenth Amendment's exemption from apportionment is limited to taxes on *realized* gains. That limitation is plain on the face of the Amendment's text, which contemplates that "income" will be "derived" from a "source," and is the only interpretation consistent with the universal understanding of "income" at the time of the Amendment's adoption. The decision below is not only wrong, but dangerous, opening the door "to new federal taxes on all sorts of wealth and property without the constitutional requirement of apportionment." App.55 (Bumatay, J., dissenting from denial of rehearing en banc).

This case provides a clean and timely vehicle for the Court to "solidify…the long-established norm of federal income taxation that a realization event is required before there is taxable 'income' in the constitutional sense." Christopher Cox & Hank Adler, The

Ninth Circuit Upholds a Wealth Tax, Wall St. J., Jan. 25, 2023. The time to do so is *now*, to provide certainty to families and businesses arranging their financial futures and to head off a major constitutional clash when Congress accepts the Ninth Circuit's invitation to enact an unapportioned tax on property or wealth. The petition should be granted.

A. Factual and Legal Background

1. In 2006, Charles and Kathleen Moore made an investment to help launch an overseas company formed to empower India's underserved rural farmers. App.70–71. Charles's friend and former coworker, Ravindra "Ravi" Kumar Agrawal, saw that farmers in India's most impoverished regions lacked access to even the most basic tools available in American hardware stores. App.70. To improve their livelihoods, he founded an India-based corporation, KisanKraft Machine Tools Private Limited, to import, manufacture, and distribute affordable farming equipment. App.70–71. Moved by Ravi's vision, the Moores put up $40,000—for them, a significant sum—and received about 13 percent of KisanKraft's common shares. App.71. Ravi retained approximately 80 percent ownership and moved to India to manage the business. App.72; CA9.ER.36.[1]

KisanKraft's rapid growth confirmed that Ravi had identified a genuine need. It was profitable almost from the start, and its revenues increased every year

[1] "CA9.ER" refers to the Excerpts of Record filed with the court below and available at CA9 Dkt. No. 11.

since its founding. CA9.ER.38. True to Ravi's original business plan, KisanKraft reinvested all its earnings to grow the business, which has expanded to serve farmers across India. App.71, 73; CA9.ER.37–38. By 2017, it employed over 350 representatives in 14 regional offices serving 2,500 local dealers. App. CA9.ER.38.

The Moores received regular updates from Ravi on KisanKraft's activities, as well as annual financial statements. App.72. Charles visited India several times and was impressed with the difference that KisanKraft was making in the lives of India's rural poor. App.72. The Moores never received any distributions, dividends, or other payments from KisanKraft. App.73. And as minority shareholders without any role in KisanKraft's management, they had no ability to force the company to issue a dividend. App.73. For the Moores, it was payment enough that they were able to support KisanKraft's "noble purpose…to improve the lives of small and marginal farmers in India" and see the good that it was doing. App.71.

Then came the tax bill. In 2018, the Moores learned from Ravi that, under the recently enacted "Mandatory Repatriation Tax," they owed income tax on KisanKraft's reinvested earnings going back to 2006. App.74. Specifically, the MRT deemed a portion of KisanKraft's earnings for each year proportional to the Moores' ownership stake in 2017 to be the Moores' 2017 income—even though they hadn't received a penny from the company and likely wouldn't for some

time, if ever. App.74. Ultimately, the Moores had to declare an additional $132,512 as taxable 2017 income and pay an additional $14,729 in tax. App.74–75.

2. The MRT was enacted as part of the Tax Cuts and Jobs Act of 2017 (TCJA). App.6. It targets U.S. shareholders who own 10 percent or more (by value or voting power) of foreign corporations that are primarily owned or controlled by U.S. persons. 26 U.S.C. § 965; *see also id.* § 957 (defining subject corporations). Prior to the MRT, these shareholders were usually taxed when the foreign corporation distributed its earnings. App.6. The MRT, however, simply deems the corporations' retained earnings going back to 1986 to be the 2017 income of their U.S. shareholders in proportion to their ownership stakes in 2017. 26 U.S.C. § 965(a). The shareholders are then taxed on that deemed "income"—which, by definition, has not been distributed to them—at a rate based on how the corporation held the retained earnings in 2017: 15.5 percent for earnings held in cash or cash equivalents and 8 percent otherwise. *Id.* § 965(a), (c); *see also id.* § 951(a).[2]

The MRT taxes shareholders irrespective of whether they owned shares at the time the corporation made the earnings on which they're being taxed

[2] The effective tax rates for individuals are 17.54 percent and 9.05 percent, respectively. Mark Berg & Fred Feingold, The Deemed Repatriation Tax—A Bridge Too Far?, 158 Tax Notes 1345, 1349 (2018).

and irrespective of whether they could force the corporation to make a distribution. All that matters is that a given shareholder owned the requisite number of shares in 2017. *Id*. §§ 965(a), 951(a).

The principal legislative purpose of this one-time tax was to partially fund the TCJA's shifting of U.S. corporate taxation from a worldwide system toward a territorial one—that is, one where U.S. corporations are taxed only on their domestic-source income.[3] To accomplish this shift, the statute prospectively relieved U.S. corporations from paying taxes on most distributions received from foreign corporations, including subsidiaries. 26 U.S.C. § 245A. That change was limited to corporate taxpayers, *id*.; individual taxpayers like the Moores remain liable for income tax on distributions they receive, *id*. § 61(a)(7).

The MRT's questionable constitutional status did not pass unnoticed. While approving of its policy, a leading tax scholar observed that the MRT "abandoned the realization requirement" and "disregard[s] the *Macomber* precedent." Henry Ordower, Abandoning Realization and the Transition Tax: Toward a Comprehensive Tax Base, 67 Buff. L. Rev. 1371, 1393, 1396 (2019). Others concluded that it "goes well beyond" other taxes in abandoning realization and "ventures well beyond the limits" recognized by precedent.

[3] *See generally* Jim Tankersley et al., Republican Plan Delivers Permanent Corporate Tax Cut, N.Y. Times (Nov. 2, 2017), *available at* https://nyti.ms/ 2iV3TJI.

Berg & Feingold, *supra*, at 1353, 1355. It is, one analysis concluded, "best characterized as a direct tax on wealth" and therefore, being unapportioned, constitutionally invalid. Sean P. McElroy, The Mandatory Repatriation Tax Is Unconstitutional, 36 Yale J. Reg. Bull. 69, 82 (2019).

B. Procedural History

The Moores filed this action to obtain a refund of the additional tax they paid to satisfy the MRT. App.78. They alleged that the MRT is an unapportioned direct tax in violation of the Constitution's apportionment requirements, U.S. Const., art. I, § 2, cl. 3; *id*. § 9, cl. 4, because it taxes them on ownership of personal property (their KisanKraft shares), not on income they had realized. App.83–84. Before the district court and the court of appeals, the Government never disputed that the Moores realized nothing from their investment in KisanKraft; instead, it argued that realization of income by the taxpayer is unnecessary for a tax to be exempt from apportionment under the Sixteenth Amendment. It was also undisputed that the MRT is not apportioned among the states according to population.

The district court granted the Government's motion to dismiss and denied the Moores' cross-motion for summary judgment. App.21–22. It acknowledged that this Court's cases like *Macomber* adopted a "realization framework" for Sixteenth Amendment "income," App.26, but it concluded that "*Macomber*'s realization standard" had been undercut by lower-court decisions addressing constructive realization of income and was

therefore not controlling, App.26–28. Without further analysis, it declared the MRT "a tax on income." App.28.

The Ninth Circuit affirmed, holding the MRT to be a tax on income authorized by the Sixteenth Amendment. App.13. Like the district court, the panel did not explain how KisanKraft's retained earnings were the Moore's income. Instead, it broadly declared that "realization of income is not a constitutional requirement" for Congress to avail itself of the Sixteenth Amendment's exemption from apportionment for "taxes on incomes." App.12. It therefore followed that "there is no constitutional prohibition against Congress attributing a corporation's income pro-rata to its shareholders." App.13. The panel distinguished *Macomber* and *Commissioner v. Glenshaw Glass*, 348 U.S. 426, 431 (1955), which followed *Macomber*'s lead in requiring realization, on the basis that neither purported to set forth a "universal" definition of "income." App.15.

The Ninth Circuit denied the Moores' rehearing petition. App.36. Judge Bumatay, joined by Judges Ikuta, Callahan, and VanDyke, dissented. App.37. The panel decision, Judge Bumatay argued, conflicted with "ordinary meaning, history, and precedent," all of which recognize that "an income tax must be a tax on realized income." App.39. By holding otherwise, the Ninth Circuit had "become the first court in the country to state that an 'income tax' doesn't require that a 'taxpayer has realized income' under the Sixteenth Amendment." App.38. And that holding, he

warned, "open[s] the door to expansion of the federal taxing power beyond the limits placed by the Constitution," App.39, including "taxes on all sorts of wealth and property without the constitutional requirement of apportionment," App.55.

REASONS FOR GRANTING THE PETITION

The Sixteenth Amendment carves out a significant but narrow exemption from Article I's apportionment clauses for "taxes on incomes." Following the Amendment's text, this Court's precedents have always understood that exemption to be limited to taxes on gains *realized* by the taxpayer. While precedent has approved income taxes on constructively realized income, no decision until the Ninth Circuit's in this case dispensed with the need for realization altogether. In so doing, the decision below sweeps away *the* essential restraint on Congress's taxing power, opening the door to unapportioned taxes on property (as in this case) and anything else Congress might deem to be "income." This case accordingly presents a constitutional question of the first order, one that warrants the Court's review.

I. The Ninth Circuit's Holding on Realization Plainly Conflicts with This Court's Precedents and Those of Other Appeals Courts

In holding that "realization of income is not a constitutional requirement" for Sixteenth Amendment "taxes on incomes," the decision below breaks with over a century of this Court's decisions, which have

uniformly held the opposite. That holding also conflicts with decisions of the Fourth and First Circuits following the lead of this Court's decisions in recognizing that Sixteenth Amendment "income" requires realization.

A. From the very beginning, this Court has made clear that the Sixteenth Amendment's exemption from the apportionment requirement is limited to taxes on *realized* gains. Even before that issue was squarely presented in *Macomber*, the Court had consistently defined "income" for purposes of pre-Amendment taxes as "the gain *derived* from capital, from labor, or from both combined." *Stratton's Indep., Ltd. v. Howbert*, 231 U.S. 399, 415 (1913) (emphasis added); *see also Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918) (same). *Macomber*, in turn, regarded that definition's focus on *derived* gains as identifying "the characteristic and distinguishing attribute of income" under the Sixteenth Amendment: that a "gain," "profit," or other thing of value must be "*received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal." 252 U.S. at 207 (emphases in original). Only "*that* is income derived from property. Nothing else answers the description." *Id.* (emphasis in original).

What led *Macomber* to confront the constitutional question of realization was the Government's contention—just as in this case—that the Sixteenth Amendment permits it to tax, without apportionment, ordinary shareholders on a corporation's retained earnings. *Id.* at 214. To account for accumulated earnings,

the corporation in question had issued a stock dividend in proportion to shareholders' existing interests, without altering their ownership stakes. *Id.* at 200. The Government insisted that the dividend was taxable as a shareholder's income because it "measure[d] the extent to which the gains accumulated by the corporation have made him the richer." *Id.* at 214. The Court flatly disagreed: the shareholder has realized no income because he "has no individual share in accumulated profits, nor in any particular part of the assets of the corporation." *Id.* at 219. Only upon distribution "does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested." *Id.* at 209. Absent such a distribution, the taxpayer has not realized income, so that taxing him on the corporation's retained earnings would be "taxation of property because of ownership, and hence would require apportionment." *Id.* at 217.

Recognized as a "landmark precedent[] on realization," *Cottage Sav. Ass'n v. Comm'r*, 499 U.S. 554, 561 (1991), *Macomber* has been consistently understood by this Court to stand for the proposition that realization is an essential component of Sixteenth Amendment income. *Weiss v. Stearn*, 265 U.S. 242, 254 (1924), applied *Macomber*'s realization holding to a corporate reorganization, holding that shareholders had received no income because none had realized "a thing really different from what he theretofore had." *Taft v. Bowers*, 278 U.S. 470, 481–82 (1929), relied on it in holding that the recipient of a gift of stock could

be taxed on its appreciation prior to the donation because, "when through sale or conversion the increase was separated therefrom, it became income." Citing *Macomber*, *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99 (1936), held essentially the same as to an award of profits earned by a patent infringer prior to the Sixteenth Amendment's ratification, reasoning that realization is when a gain "may be taxed, though it was in the making long before." Similarly, *MacLaughlin v. Alliance Ins. Co. of Philadelphia*, 286 U.S. 244, 249 (1932), held that the Revenue Act of 1928 lawfully taxed appreciation prior to its enactment that was realized thereafter because it is "a gain from capital investment which, when realized, by conversion into money or other property…has consistently been regarded as income within the meaning of the Sixteenth Amendment and taxable as such in the period when realized." And *Helvering v. Bruun*, 309 U.S. 461, 468–69 (1940), while retreating from language in *Macomber* suggesting that gain must be severable from capital when received by the taxpayer,[4] restated and applied its central holding that Sixteenth Amendment "income" requires "realization of gain" through the "exchange of property, payment of the taxpayer's indebtedness, relief from a liability, or other profit realized from the completion of a transaction." *Id.* at 469.

---

[4] The taxpayer in *Bruun* "realized taxable gain from the forfeiture of a leasehold, the tenant having erected a new building upon the premises." *Id.* at 462.

Helvering v. Horst, which the court below took to undercut *Macomber*'s realization holding, App.15, actually reiterated "the rule that income is not taxable until realized," 311 U.S. 112, 116 (1940). It applied that rule to a taxpayer who had directed that interest on bonds be paid to a family member. *Id.* at 114. And that, it held, was constructive realization: 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.

The Court's final refinement of the standard for Sixteenth Amendment "income" occurred in *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955), which held punitive damages awards to be taxable income. The decision observed that *Macomber*'s language defining income as "'the gain derived from capital, from labor, or from both combined'" was "useful" in "distinguishing gain from capital" but "not meant to provide a touchstone to all future gross income questions." *Id.* at 430–31. But it again reiterated *Macomber*'s holding on realization, reasoning that punitive damages are taxable as income because they are "undeniable accessions to wealth, *clearly realized*, and over which *the taxpayers have complete dominion*." *Id.* at 431 (emphases added). The Court subsequently applied that formulation in *James v. United States*, 366 U.S. 213, 219 (1961) (holding that embezzled funds are taxable income), *Comm'r v. Kowalski*, 434 U.S. 77, 83 (1977) (holding that meal-allowance payments are taxable income), and *Comm'r v. Indianapolis Power &*

Light Co., 493 U.S. 203, 209 (1990) (holding that refundable customer deposits held by a utility were not taxable income because the utility never obtained "complete dominion" over them).[5]

The common thread running through the Court's Sixteenth Amendment decisions is this: the Amendment's exemption from Article I's apportionment requirement is limited to taxes on gains *realized* by the taxpayer.

B. The Ninth Circuit's decision in this case flatly contravenes *Macomber*'s central holding on realization and that decision's progeny. Its attempt to distinguish *Macomber* and *Glenshaw Glass* into oblivion does not withstand scrutiny.

According to the decision below, *Macomber* is limited to its facts, providing no "universal definition" of "income." App.15. But whatever the status of *Macomber*'s gain-derived-from-capital-or-labor definition, its *holding* is that only a "gain" "*received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit and disposal" is taxable as income. 252 U.S. at 207 (stating that this "fundamental conception is clearly set forth in the Sixteenth Amendment"

---

[5] Although these are statutory cases, the Court understood itself to be interpreting the Sixteenth Amendment because the statutory definition of "gross income" at issue was "based upon the 16th Amendment and the word 'income' is used in its constitutional sense." *Glenshaw Glass*, 348 U.S. at 432 n.11 (quotation marks omitted); *see also Kowalski*, 434 U.S. at 82 (recognizing that Congress exerted "the full measure of its taxing power") (quotation marks omitted).

and its reference to "incomes, *from* whatever *source derived*"). Contrary to the decision below, App.15, *Glenshaw Glass* did not repudiate that holding, but *repeated* it. 348 U.S. at 431 (requiring that gains be "clearly realized" by taxpayers and reduced to their "complete dominion").

The Ninth Circuit's treatment of *Glenshaw Glass* was outright defiance. Unable to distinguish its holding, the decision below deems it limited to its facts because this Court neglected to declare "that the definition it used was [] universal." App.15. Under that approach, practically any decision of this Court could be evaded in like manner. In any event, this attempt to wave away *Glenshaw Glass*'s holding is inconsistent with this Court's application of the same standard in *James*, *Kowalski*, and *Indianapolis Power & Light*. *James*, in particular, turned on the question of realization. *Compare* 366 U.S. at 219 (reasoning that an embezzler obtains "actual command over the property taxed," rendering it income) (quotation marks omitted) *with id.* at 248–52 (Whittaker, J., dissenting) (disputing that). In its haste to bury *Glenshaw Glass*, the Ninth Circuit skipped past the fact that this Court and others have repeatedly applied its realization requirement.

The Ninth Circuit's claim that *Horst* or *Helvering v. Griffiths*, 318 U.S. 371 (1943), *sub silentio* narrowed or overruled *Macomber*'s and *Glenshaw Glass*'s holdings on realization is difficult to take seriously. *See* App.15. To begin with, both *Horst* and *Griffiths* predate *Glenshaw Glass*, with its insistence that income

be "clearly realized," by more than a decade. As noted, *Horst* repeated and applied "the rule that income is not taxable until realized." 311 U.S. at 116. It holds that directing payment to a third party *is realization*, no different that securing payment to oneself before gifting the money. *Id.* at 117–18. Not a word in *Horst* casts doubt on the need for realization; to the contrary, its entire analysis focuses on whether the taxpayer realized the gain in question. As for *Griffiths*, it expressly *refused* the Government's request to overrule *Macomber*. 318 U.S. at 404.

The Court's decisions are clear that realization is required for a taxpayer to have "income" taxable as such, and the Court has never deviated from that principle. Just as clearly, the decision below repudiates a century's worth of this Court's precedents.

C. The decision below also creates a conflict in authority among the courts of appeals. The First and Fourth Circuits have held *Glenshaw Glass* to set the standard for Sixteenth Amendment income, including that it must be "clearly realized." *Quijano v. United States*, 93 F.3d 26, 30–31 (1st Cir. 1996), applied that standard to hold that a sale that resulted in a dollar gain only because of currency appreciation produced "realized income, fully taxable under the Constitution" without apportionment.

Simmons v. United States, 308 F.2d 160, 167–68 (4th Cir. 1962), likewise applied the *Glenshaw Glass* standard to hold that taxation of prize money "comes within the Sixteenth Amendment" because "receipt of [the prize] constitutes an economic gain over which

[the taxpayer] has complete control and…complete legal right." The "crucial factor," *Simmons* understood, "is the status in the recipient's hands of the money being taxed." *Id.* at 167. That understanding, which *Quijano* also embraced, squarely conflicts with the holding of the decision below that realization is unnecessary for Sixteenth Amendment income.

II. The Ninth Circuit's Holding Clashes with the Sixteenth Amendment's Text and Eviscerates Article I's Apportionment Requirement

Not only does the decision below break with governing precedent, but it is also indefensible as a matter of constitutional interpretation.

A. Begin with the text. The Sixteenth Amendment's exemption from apportionment is limited to "taxes on incomes, from whatever source derived." As *Macomber* astutely observed, that text plainly contemplates that "incomes" must be realized: a gain is not income unless and until it has been "derived" by the taxpayer from some "source." 252 U.S. at 207–08.

That "income" refers to the receipt of an economic gain was well understood at the time of the Sixteenth Amendment's drafting and ratification. "The word 'income'…has a settled legal meaning" and was "uniformly construed" by "courts…to include only the receipt of actual cash as opposed to contemplated revenue due but unpaid." *Maryland Cas. Co. v. United States*, 52 Ct. Cl. 201, 209 (Ct. Cl. 1917); *see, e.g.*, *Gray v. Darlington*, 82 U.S. 63, 65–66 (1872) (holding that

appreciation in the value of securities was not income because it was not "realized" and so was "merely…increase of capital"); *Connecticut Gen. Life Ins. Co. v. Eaton*, 218 F. 188, 205 (D. Conn. 1914) (applying *Stratton's Independence*'s definition of "income" and holding that taxpayer received no income on items listed as assets "until the same were paid or realized"); *Mut. Ben. Life Ins. Co. v. Herold*, 198 F. 199, 214–15 (D.N.J. 1912) ("[I]ncome…means what has actually been received, and not that which, although due, has not been received, but its payment for some reason deferred or postponed."). *United States v. Schillinger*, 27 F. Cas. 973, 973 (C.C.S.D.N.Y. 1876) ("[I]ncome must be taken to mean money, and not the expectation of receiving it, or the right to receive it, at a future time."); *cf. Gibbons v. Mahon*, 136 U.S. 549, 558 (1890) (explaining that a corporation's accumulated earnings are, to shareholders, "capital, and not income").

Contemporaneous dictionary definitions are to the same effect. The 1913 edition of *Webster's* defined "income" as "that gain which *proceeds from* labor, business, property, or capital of any kind." *Webster's Revised Unabridged Dictionary* (1913) (emphasis added); *see also Webster's American Dictionary of the English Language* (1889) ("That gain which proceeds from labor, business, or property of any kind."). Likewise, the *Century Dictionary and Cyclopedia* (1901) 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." (emphasis added). *See also* Robert Hunter & Charles Morris, *Universal Dictionary of the English Language* (1897) ("That gain which a person derives from his labor, business, profession, or property of any kind."); Joseph Worcester, *Dictionary of the English Language* (1875) ("Gain derived from any business or property.").

Contemporaneous legal authorities similarly understood "income" to turn on realization. The 1910 edition of *Black's Law Dictionary* defined "income" to include "that which *comes in* or is *received from* any business or investment of capital." *Black's Law Dictionary* (2d ed. 1910) (emphases added). *Black's* author, Henry Campbell Black, also published a treatise on income tax shortly after ratification of the Sixteenth Amendment to address the new law. Henry Campbell Black, *A Treatise on the Law of Income Taxation Under Federal and State Laws* (1913). The very first page begins, "An income tax is distinguished from other forms of taxation" in that it is "levied…upon the acquisitions of the taxpayer arising from" trade and business. *Id.* at 1. Black's treatise goes on to define "income" as "that gain *which proceeds* from labor, business, or capital of any kind." *Id.* at 73 (emphasis added). Realization, he explained, is essential: when, for example, the owner of an appreciated security "sells, then the sum gained may be constitute a part of his income, but it cannot be so described while he continues to hold the security." *Id.* at 77.

Edwin Seligman, a leading proponent of the Sixteenth Amendment and federal income tax, likewise recognized the necessity of realization in his influential *The Income Tax* (1911). Income, he explained, "is that which *comes in* to an individual above all necessary expenses of acquisition, and which is *available for his own consumption*." *Id.* at 19 (emphases added). And that same understanding prevailed after the Amendment and federal income tax took effect. *See* Robert H. Montgomery, *Income Tax Procedure* 198 (1917) (stating that the federal government has no "right to tax any transaction unless there is an actual realization of income").

In its insistence that "income" requires realization, *Macomber* followed "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 & Trust Co. v. Smietanka*, 255 U.S. 509, 519 (1921). The decision below contradicts that original understanding.

B. The decision below also does great violence to constitutional structure, virtually eviscerating Article I's apportionment requirement. The Sixteenth Amendment arose in response to *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 637 (1895), which held "taxes…on the income of personal property" to be direct taxes requiring apportionment. In drafting what became the Sixteenth Amendment, Congress considered and rejected the broader approach of striking the direct-tax clauses altogether. *See* Erik M. Jensen, The Taxing Power, the Sixteenth Amendment,

and the Meaning of "Incomes," 33 Ariz. St. L.J. 1057, 1116 (2001). The Amendment's principal author explained, "my purpose is to confine it to income taxes alone." *Id.* (quoting 44 Cong. Rec. 3377 (June 17, 1909)).

The consequence of that decision was to *retain* the plenary requirement that direct taxes be apportioned among the states, subject to an exception only for "taxes on incomes." *See Brushaber v. Union Pac. R. Co.*, 240 U.S. 1, 18–19 (1916). "Nothing in the Sixteenth Amendment relieved Congress of its duty to apportion other forms of direct taxation, such as a tax on property interests." App.38 (Bumatay, J., dissenting); *see also Nat. Fedn. of Indep. Bus. v. Sebelius*, 567 U.S. 519, 571 (2012) (recognizing that the Court has "continued to consider taxes on personal property to be direct taxes" requiring apportionment).

The decision below effectively repeals what the Sixteenth Amendment preserved. By decoupling "income" from realization, it empowers Congress to deem practically anything "income" and tax it as such, without apportionment. That includes, as in this case, personal property in the form of stock, but the decision's holding is by no means limited to stock: if taxpayers like the Moores can be income-taxed on sums they've never actually or constructively realized, then nothing prevents Congress from arbitrarily attributing "income" to any taxpayer as a basis for taxation. "[W]ithout a realization requirement, it is hard to see what's left of the constitutional apportionment requirement." App.39–40 (Bumatay, J., dissenting).

III. The Question of Congress's Power To Tax Unrealized "Income" Without Apportionment Is Exceptionally Important and Warrants Review

The importance of the question presented cannot be overstated. This case presents a fundamental constitutional question concerning Congress's core power of taxation. That question is not only politically important, but practically important, as American families and businesses plan their financial futures. The decision below upsets the heretofore settled expectation that federal taxation of property and wealth was effectively impossible, due to the difficulty of apportionment. The Court's review is required to resolve this question of vast legal and practical significance, and this case is the ideal vehicle for the Court to do so.

A. The question of Congress's power under the Sixteenth Amendment to tax persons on "incomes" they have not realized in any form is exceptionally important. In the proceedings below, neither the Government nor the Ninth Circuit identified any precedent approving an income tax that operates in the absence of realization. The reason is that, following *Macomber*, Congress refrained from overstepping the line this Court drew. *See Helvering v. Nat'l Grocery Co.*, 304 U.S. 282, 288 n.4 (1938) (describing evolution of tax treatment of corporations' retained earnings); *Griffiths*, 318 U.S. at 389–93 (describing Congress's care in following *Macomber*); *see generally* Henry Ordower, Revisiting Realization: Accretion Taxation,

the Constitution, Macomber, and Mark to Market, 13 Va. Tax Rev. 1, 9 (1993) (describing the "*Macomber* effect" that deterred Congress from "tax[ing] the unrealized appreciation in a taxpayer's property"). It abandoned that restraint with the MRT, which the decision below recognizes to be a "novel concept" in taxation. App.8. It is, at a minimum, a marked departure from Congress's historic exercise of its taxing power.

As such, the MRT calls into question long-accepted limitations on that power. For example, following *Macomber* Congress ceased its brief experiment in taxing shareholders on corporations' retained earnings. *Nat'l Grocery Co.*, 304 U.S. at 288 n.4. The MRT, however, conflicts with the long-held understanding that Congress lacks the power to levy such taxes without apportionment. And the decision below spells out what the MRT implies, holding that nothing prohibits Congress from "attributing a corporation's income pro-rata to its shareholders" and then taxing them on it. App.13.

The consequences of that alone are earth-shattering. Millions of Americans hold stock in their retirement and investment accounts or through mutual funds. Taken at its word, the decision below authorizes Congress to tax every single one of them on the retained earnings of the corporations in which they've invested. The tax would be practically indistinguishable from one on the shares themselves, given that every major corporation has funded its growth, to a

large extent, through reinvestment of profits. For example, the retained earnings carried on Exxon's books actually exceed its total shareholder equity.[6] Under the logic of the decision below, Exxon's shareholders could be deemed to have "income" that exceeds the value of their shares and then taxed on it.

More broadly, repudiating the requirement that taxable income be realized calls into question the longstanding consensus that Congress lacks the power to tax property without apportionment. This Court held as much in *Pollock*, 158 U.S. at 637 ("taxes on personal property…are [] direct taxes" requiring apportionment). But the MRT's logic, as reflected in the decision below, suggests that *Pollock* turned only on Congress's failure of imagination in taxing property in so many words; if, instead, it taxes property-owners on deemed "income," then the apportionment requirement goes out the window. So while Congress cannot lay an unapportioned tax on farmland, it could very well tax farmers on the imputed rental value of their land, deeming that to be their "income." Or "Congress could simply deem taxpayers to have sold all their assets" and tax them "on the income deemed to result." Berg & Feingold, *supra*, at 1354 (discussing import of MRT); *see also* Ordower (2019), *supra*, at 1409 (arguing that the MRT provides a model for a one-time tax on *all* property). Without the need for income to be realized, there is no limit.

---

[6] Exxon Mobil Corp., WSJ Markets, https://www.wsj.com/market-data/quotes/XOM/financials/annual/balance-sheet.

This is no idle threat. The President has proposed a tax on appreciation in property, which the White House candidly describes as "unrealized income." Press Release, The White House, President's Budget Rewards Work, Not Wealth with new Billionaire Minimum Income Tax (Mar. 28, 2022).[7] In the last Congress, legislation to establish a wealth tax was introduced in both the House and the Senate. Ultra-Millionaire Tax Act of 2021, H.R. 1459, 117th Cong. § 2901(a) (2021) ("In the case of any applicable taxpayer, a tax is hereby imposed on the net value of all taxable assets of the taxpayer on the last day of any calendar year."); S. 510 (same). Meanwhile, the Chairman of the Senate Finance Committee introduced a proposal to tax gains on stockholdings and other "tradeable assets" annually. Press Release, Wyden Unveils Billionaires Income Tax (Oct. 27, 2021).[8] There is every reason for the Court to resolve the pivotal constitutional question of realization *now*, when its judgment can inform lawmakers and stands to head off a major constitutional clash down the line.

Finally, the interests of federalism also weigh in favor of review. To uphold the MRT, the Ninth Circuit had to unravel one of the central "compromises which made the adoption of the constitution possible" and continues to secure our "dual form of government."

---

[7] *Available at* https://www.whitehouse.gov/omb/briefing-room/2022/03/28/presidents-budget-rewards-work-not-wealth-with-new-billionaire-minimum-income-tax/.

[8] *Available at* https://www.finance.senate.gov/chairmans-news/wyden-unveils-billionaires-income-tax.

Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429, 583 (1895). The whole point of the apportionment requirement was "to prevent an attack upon accumulated property by mere force of numbers." *Id*. Apportionment deters Congress from working "partiality or oppression" against localities through property taxes that have localized consequences unknown to remote Members of Congress. Federalist No. 36 (Hamilton); *see also* 2 Records of the Federal Convention of 1787, p. 307 (M. Farrand ed. 1911) ("Seize and sell their effects and you push them into Revolts." (Gouverneur Morris)). Apportionment is not, as the court below viewed it, an archaism or mere formality to be circumvented through clever draftsmanship.

B. This case is an ideal vehicle for the Court to address the question presented. This case presents only that question, and it presents it squarely and cleanly. Whereas most other tax cases present a host of statutory and factual disputes, this case does not. It is undisputed that the Moores are subject to the MRT, and it is undisputed that the MRT taxes the Moores on sums they did not realize in any fashion. In particular, there is no question of constructive realization. The sole question is the constitutional one: whether an unapportioned income tax may be levied in the absence of any realized gain by the taxpayer. That question was pressed at every stage below, fully briefed by the parties, and decided by the court of appeals. Given the typical complexity of tax disputes, the Court is unlikely to ever see a cleaner or more straightforward vehicle to address this fundamental question.

CONCLUSION

The Court should grant the petition.

Respectfully submitted,

ANDREW M. GROSSMAN
Counsel of Record
DAVID B. RIVKIN, JR.
JEFFREY H. PARAVANO
BAKER & HOSTETLER LLP
1050 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 861-1697
agrossman@bakerlaw.com

DAN GREENBERG
SAM KAZMAN
DEVIN WATKINS
COMPETITIVE ENTERPRISE INSTITUTE

Counsel for Petitioners

FEBRUARY 2023

APPENDIX

TABLE OF APPENDICES

Appendix A: Opinion, United States Court of Appeals for the Ninth Circuit, *Charles Moore, et al. v. United States*, No. 20-36122 (June 7, 2022) ....App. 1

Appendix B: Order, United States District Court for the Western District of Washington, *Charles Moore, et al. v. United States*, No. 2:19-cv-01539 (Nov. 19, 2020) ....App. 21

Appendix C: Order, United States Court of Appeals for the Ninth Circuit, *Charles Moore, et al. v. United States*, No. 20-36122 (Nov. 22, 2022) ....App. 35

Appendix D: Relevant Constitutional and Statutory Provisions..................................App. 57

Appendix E: Declaration of Charles G. Moore ....App. 69

Appendix F: Complaint..................................App. 76

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 20-36122

CHARLES G. MOORE, et al.,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

Argued: January 14, 2022
Filed: June 7, 2022

Appeal from the United States District Court
for the Western District of Washington
John C. Coughenour, District Judge, Presiding

Before: Ronald M. Gould, Jacqueline H. Nguyen,
and Mark J. Bennett, Circuit Judges.

Opinion by Judge Gould

SUMMARY*

Tax

The panel affirmed the district court's dismissal of an action seeking to invalidate the Mandatory Repatriation Tax.

Taxpayers invested in a controlled foreign corporation (CFC), which is a foreign corporation whose ownership or voting rights are more than 50% owned by U.S. persons. Traditionally, U.S. taxpayers generally did not pay U.S. taxes on foreign earnings until those earnings were distributed to them. However, when particular categories of undistributed earnings were repatriated to the U.S.—through a distribution or loan to U.S. shareholders, or an investment in U.S. property— U.S. shareholders who owned at least 10% of a CFC could be taxed on a proportionate share of those earnings. The primary method used to tax a CFC's U.S. shareholders on foreign earnings held offshore was a provision of the tax code called Subpart F.

In 2017, the Tax Cuts and Jobs Act (TCJA) created a new, one-time tax: the Mandatory Repatriation Tax (MRT). Under the MRT's modified version of Subpart F, U.S. persons owning at least 10% of a CFC are taxed on the CFC's profits after 1986, regardless of whether the CFC distributed earnings. Additionally,

---

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

going forward, a CFC's income taxable under subpart F includes current earnings from its business.

Taxpayers challenged the constitutionality of Subpart F's ability to permit taxation of a CFC's income after 1986 through the MRT. The district court dismissed the action for failure to state a claim, denied taxpayers' crossmotion for summary judgment, and taxpayers appealed.

The panel first held that, given the background of the government's power to lay and collect taxes, the MRT is consistent with the Apportionment Clause. That clause requires that a direct tax must be apportioned so that each state pays in proportion to its population. The panel acknowledged that the Sixteenth Amendment exempts from the apportionment requirement the category of "incomes, from whatever source derived." The panel observed that courts have consistently upheld the constitutionality of taxes similar to the MRT notwithstanding any difficulty in defining income, that the realization of income does not determine the tax's constitutionality, and that there is no constitutional ban on Congress disregarding the corporate form to facilitate taxation of shareholders' income. The panel explained that Subpart F only applies to U.S. persons owning at least 10% of a CFC, the MRT builds upon a preexisting liability attributing a CFC's income to its shareholders, and taxpayers were, and continue to be, treated as individuals who have some ability to control distribution.

The panel also held that, assuming without deciding that the MRT is retroactive, the MRT does not violate the Fifth Amendment's Due Process Clause. The panel explained that the MRT serves the legitimate purpose of preventing CFC shareholders who have not yet received distributions from obtaining a windfall by never having to pay taxes on their offshore earnings that have not yet been distributed. The MRT accomplished this legitimate purpose by rational means: by accelerating the effective repatriation date of undistributed CFC earnings to a date following passage of the TCJA.

COUNSEL

Andrew M. Grossman (argued), David B. Rivkin, Jr., Jeffrey H. Paravano, and Sean Sandoloski, Baker Hostetler, Washington, D.C.; Sam Kazman and Devin Watkins, Competitive Enterprise Institute, Washington, D.C.; for Plaintiffs-Appellants.

Nathaniel S. Pollock (argued), Francesca Ugolini, and Michael J. Haungs, Attorneys, Tax Division; David A. Hubbert, Acting Assistant Attorney General; Tessa Gorman, Acting United States Attorney; United States Department of Justice, Washington, D.C.; for Defendant-Appellee.

OPINION

GOULD, Circuit Judge:

Charles and Kathleen Moore (the "Moores") seek to invalidate the Mandatory Repatriation Tax

("MRT") on the grounds that it violates the Constitution's Apportionment Clause and Fifth Amendment's Due Process Clause. The Moores, however, have staked out a position for which we can find no persuasive authority. We affirm the district court's dismissal of the Moores' action.

FACTS AND PROCEDURAL HISTORY

In 2005, the Moores invested in KisanKraft, a company owned by their friend which supplies modern tools to small farmers in India. The Moores invested $40,000 in return for 11% of the common shares. KisanKraft is a controlled foreign corporation ("CFC"), which means that it is a foreign corporation whose ownership or voting rights are more than 50% owned by U.S. persons.

KisanKraft is located in India, and the Moores have never participated in its day-to-day operations or management. While KisanKraft has turned a profit every year, KisanKraft has never distributed any earnings to its shareholders. Instead, KisanKraft has reinvested all of its earnings as additional shareholder investments in its business.

Traditionally, U.S. taxpayers generally did not pay U.S. taxes on foreign earnings until those earnings were distributed to them. This system created a strong incentive for CFCs to separately incorporate their foreign operations, allowing U.S. taxpayers to pay taxes only if and when earnings were repatriated to the U.S. By 2015, CFCs had accumulated an estimated $2.6 trillion in earnings

offshore that were not presently subject to U.S. taxation.

Before 2017, the primary method used to tax a CFC's U.S. shareholders on foreign earnings held offshore was a provision of the tax code called Subpart F. *See* 26 U.S.C. § 951 (2007). Subpart F permitted the taxation of certain types of a U.S. person's CFC earnings when that U.S. person owned at least 10% of a CFC's voting stock. *Id.*

Specifically, U.S. shareholders who owned at least 10% of a CFC could be taxed on a proportionate share of particular categories of its undistributed earnings such as dividends, interest, and earnings invested in certain U.S. property. *Id.* § 951(a). Neither Subpart F nor any other provision of the tax code permitted the U.S. Government to tax U.S. shareholders on the CFC's active business income attributable to the CFC's own business held offshore, such as when a CFC manufactures and sells products to a third party in a foreign country. Such income was only taxable if and when repatriated to the U.S. through a distribution to U.S. shareholders, loan to U.S. shareholders, or an investment in U.S. property.

In 2017, Congress passed, and President Trump signed into law, the Tax Cuts and Jobs Act ("TCJA"). *See* 131 Stat. 2054 (2017). The TCJA transformed U.S. corporate taxation from a worldwide system, where corporations were generally taxed regardless of where their profits were derived, toward a territorial system, where corporations are generally taxed only on their domestic source profits. As part of this change, the TCJA created a new, one-time tax: the

MRT. The MRT modified Subpart F by classifying CFC earnings after 1986 as income taxable in 2017. *See* 26 U.S.C. §§ 965(a), (d) (2017). Under this revised version of Subpart F, U.S. persons owning at least 10% of a CFC are taxed on the CFC's profits after 1986 at either 15.5% for earnings held in cash or 8% otherwise. *Id.* § 965(c). The MRT imposes this tax regardless of whether the CFC distributed earnings. It also modified CFC taxes going forward: effective January 1, 2018, a CFC's income taxable under Subpart F includes current earnings from its business.

The TCJA also included tax benefits for shareholders of CFCs. When CFCs repatriate untaxed earnings as dividends to U.S. shareholders subject to the MRT, those earnings are generally not taxed. *See* 26 U.S.C. § 245A(a). Further, the TCJA effectively eliminated any other taxes on a CFC's undistributed earnings and profits before 2018.

The Government estimates that the MRT will generate $340 billion in tax revenue.

In 2018, the Moores learned about the MRT. According to their CPA's calculations, their tax liability for 2017 increased by roughly $15,000 because of the MRT. This tax liability was based on their pro rata share of KisanKraft's retained earnings of $508,000, subjecting them to an additional $132,512 in taxable income.

The Moores challenged the constitutionality of Subpart F's ability to permit the taxation of a CFC's income after 1986 through the MRT. The district

court granted the Government's motion to dismiss for failure to state a claim and denied the Moores' cross-motion for summary judgment. It held that the MRT taxed income and, although it was retroactive, did not violate the Fifth Amendment's Due Process Clause.

After the district court's dismissal, the Moores timely appealed. We affirm the district court's order.

STANDARD OF REVIEW

We review *de novo* both the constitutionality of a statute and a motion to dismiss for failure to state a claim. *United States v. Mohamud*, 843 F.3d 420, 432 (9th Cir. 2016) (constitutionality of statute); *Dougherty v. City of Covina*, 654 F.3d 892, 897 (9th Cir. 2011) (motion to dismiss for failure to state a claim).

DISCUSSION

The Moores raise two constitutional challenges to the MRT: (1) they contend that it violates the Apportionment Clause, and (2) they contend that it violates the Fifth Amendment's Due Process Clause.

Because the MRT imposed on CFCs is a novel concept, it is worth dwelling for a moment on some general principles that guide us. The federal government is, of course, a government of limited and specified powers. *See, e.g., Nat'l Fed'n of Indep. Bus. v. Sebelius* ("*NFIB*"), 567 U.S. 519, 533–534 (2012). One of those enumerated powers of Congress is the power to "lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States." U.S. CONST. art. I, § 8, cl. 1. Congress's power to tax

was a central force behind the Constitution. *See Hylton v. United States*, 3 U.S. (3 Dall.) 171, 173 (1796) ("The great object of the Constitution was, to give Congress a power to lay taxes, adequate to the exigencies of government"). Further, it has long been established that the federal government may adopt laws that are necessary and proper to effectuate its legitimate purposes. The Constitution gives Congress the power "[t]o make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof." U.S. CONST. art. I, § 8, cl. 18; *see also McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 323–25 (1819).

Once the federal government decides to tax something, then, subject to any constitutional limitations, its power to tax and flexibility as to how to accomplish that must necessarily be broad. *See, e.g., Agency for Int'l Dev. v. All. for Open Soc'y Int'l, Inc.*, 570 U.S. 205, 213 (2013) (stating that the Spending Clause "provides Congress broad discretion to tax"); *NFIB*, 567 U.S. at 573 ("[T]he breadth of Congress's power to tax is greater than its power to regulate commerce"). It is also clear that Congress has sought to exercise the full scope of its constitutionally provided power to tax. *See Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 429 (1955) (noting that the definition of "gross income" to be reported by taxpayers "was used by Congress to exert in this field 'the full measure of its taxing power.'" (quoting *Helvering v. Clifford*, 309 U.S. 331, 334 (1940))). Given Congress's expansive intent in taxing gross

income, "exclusions from gross income are construed narrowly in favor of taxation." *Comm'r v. Dunkin*, 500 F.3d 1065, 1069 (9th Cir. 2007). It is against this background that we must decide whether the MRT offends the U.S. Constitution's Apportionment Clause or its Due Process Clause.

I. The MRT does not violate the Appointment Clause

The Constitution's Apportionment Clause provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. CONST. art. I, § 9, cl. 4. "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. The Apportionment Clause traditionally applied to only capitations[1] and land taxes. *See id.* at 571 ("[*D*]*irect taxes*, within the meaning of the Constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate." (quoting *Springer v. United States*, 102 U.S. 586, 602 (1881))). While the Supreme Court in *Pollock v. Farmers' Loan & Tr. Co.,* held that income from personal property was subject to the Apportionment Clause, *see* 158 U.S. 601, 618 (1895), the Sixteenth Amendment overruled this result, further reinforcing the narrow reach of the Apportionment Clause, *see NFIB*, 567 U.S. at 571.

---

[1] "Capitations are taxes paid by every person, without regard to property, profession, or any other circumstance." *NFIB*, 567 U.S. at 571 (simplified).

The Sixteenth Amendment, ratified in 1913, exempts from the apportionment requirement the expansive category of "incomes, from whatever source derived." *See* U.S. CONST. amend. XVI. In *United States v. James*, we noted the difficulty of categorically defining everything that constitutes income. *See* 333 F.2d 748, 753 (9th Cir. 1964) (en banc) ("The courts have given a wide scope to the income tax, but have realized that the borderline content of 'income' must be determined case by case. Essentially the concept of income is a flexible one . . . ." (quoting Stanley S. Surrey & William C. Warren, *The Income Tax Project of the American Law Institute: Gross Income, Deductions, Accounting, Gains and Losses, Cancellation of Indebtedness*, 66 Harv. L. Rev. 761, 770–71 (1953))).

Despite the difficulty in defining income, courts have held consistently that taxes similar to the MRT are constitutional. In *Eder v. Commissioner of Internal Revenue*, the Second Circuit held that the inclusion of foreign corporate income under a statute predating Subpart F was constitutional. *See* 138 F.2d 27, 28–29 (2d Cir. 1943). Thirty years later, the United States Tax Court upheld preMRT provisions of Subpart F against constitutional challenges, and the decisions were affirmed by the Second and Tenth Circuits. *See Whitlock's Est. v. Comm'r*, 59 T.C. 490, 508 (1972), *aff'd in part, rev'd in part*, 494 F.2d 1297, 1298–99, 1301 (10th Cir. 1974) (upholding constitutionally of Subpart F provision taxing "a corporation's undistributed current income to the corporation's controlling stockholders."); *Garlock Inc. v. Comm'r*, 489 F.2d 197, 202 (2d Cir. 1973) (affirming

Tax Court's ruling that a CFC's Subpart F income was attributable to shareholders even if that income had not been distributed and stating that the argument it is unconstitutional "borders on the frivolous in the light of [the Second Circuit's] decision in *Eder*").

Whether the taxpayer has realized income does not determine whether a tax is constitutional. In *Heiner v. Mellon*, the Supreme Court stated that whether or not a "partner's proportionate share of the net income of the partnership" was distributable was not material to whether it could be taxed. 304 U.S. 271, 281 (1938). Similarly in *Eder*, the Second Circuit noted that "[i]n a variety of circumstances it has been held that the fact that the distribution of income is prevented by operation of law, or by agreement among private parties, is no bar to its taxability." 138 F.2d at 28 (citing *Heiner*, 304 U.S. at 281; *Helvering v. Enright's Est.*, 312 U.S. 636, 641 (1941)). And, the Supreme Court has made clear that realization of income is not a constitutional requirement. *See Helvering v. Horst*, 311 U.S. 112, 116 (1940) ("[T]he rule that income is not taxable until realized . . . . [is] founded on administrative convenience . . . and [is] not one of exemption from taxation where the enjoyment is consummated by some event other than the taxpayer's personal receipt of money or property."); *see also Helvering v. Griffiths*, 318 U.S. 371, 393–94 (1943) (explaining that *Horst* "undermined . . . the original theoretical bases" of a constitutional realization requirement).

What constitutes a taxable gain is also broadly construed. In *Helvering v. Bruun*, the Supreme Court

determined that a lessee's improvements to the land were a taxable gain when the lessor regained possession of the land. 309 U.S. 461, 469 (1940). The Court instructed that a taxable "[g]ain may occur as a result of exchange of property, payment of the taxpayer's indebtedness, relief from liability, or profit realized from the completion of a transaction." *Id.* We applied this precedent nearly half a century later, holding that the cancellation of indebtedness was a taxable gain. *See Vukasovich, Inc. v. Comm'r*, 790 F.2d 1409, 1415 (9th Cir. 1986) ("We have no doubt that an increase in wealth from the cancellation of indebtedness is taxable where the taxpayer received something of value in exchange for the indebtedness.").

Further, there is no blanket constitutional ban on Congress disregarding the corporate form to facilitate taxation of shareholders' income. In other words, there is no constitutional prohibition against Congress attributing a corporation's income pro-rata to its shareholders. *See, e.g.*, *Dougherty v. Comm'r*, 60 T.C. 917, 928 (1973) (noting that nothing "prevent[s] Congress from bypassing the corporate entity in determining the incidence of Federal income taxation."). And here, there is no dispute that KisanKraft actually earned significant income, though all tax that the Moores' owed the U.S. Government on their pro-rata share of KisanKraft was deferred until the MRT went into effect in 2017.

Given this background, we hold that the revised Subpart F is consistent with the Apportionment Clause. As modified by the MRT, Subpart F only

applies to U.S. persons owning at least 10% of a CFC. The MRT builds upon these U.S. persons' preexisting tax liability attributing a CFC's income to its shareholders. Before the MRT, U.S. persons owning at least 10% of a CFC were already subject to certain taxes on the CFC's income. Minority owners like the Moores were, and after the passage of the MRT continue to be, treated as individuals who have some ability to control distribution. *See id*. ("In subpart F, Congress has singled out a particular class of taxpayers . . . whose degree of control over their foreign corporation allows them to treat the corporation's undistributed earnings as they see fit."). Further, the MRT applies to taxable gains. Clearly, KisanKraft earned significant income, and the MRT assigns only a pro-rata share of that income to the Moores.

Relying on *Eisner v. Macomber*, 252 U.S. 189, 219 (1920), and *Glenshaw Glass*, 348 U.S. at 431, the Moores argue that the MRT is an unapportioned direct tax. Specifically, the Moores argue that *Macomber* and *Glenshaw Glass* require income to be realized before it can be taxed. They urge us to adopt and apply the purported definition of income used in *Glenshaw Glass*, which would require "[1] undeniable accessions to wealth, [2] clearly realized, and [3] over which the taxpayers have complete dominion." 348 U.S. at 431. The Moores' reliance on these cases is misplaced: the Supreme Court, our court, and other courts have narrowly interpreted *Macomber* and *Glenshaw Glass*, and *Glenshaw Glass*'s definition is not applicable here.

First, *Macomber* and *Glenshaw Glass* themselves foreclose the Moores' arguments. In *Macomber*, the Court was clear that it was only providing a definition of what "[i]ncome may be defined as," 252 U.S. at 207, not a universal definition. *Glenshaw Glass* reiterated the limited scope of *Macomber*'s definition of income by emphasizing that, while the definition "served a useful purpose . . . , it was not meant to provide a touchstone to all future gross income questions." 348 U.S. at 431. *Glenshaw Glass* similarly cabined the definition of income it used, prefacing its definition of income by saying "[h]ere we have instances of," signaling that the Court was focused on the specific facts before it. *See id*. The Court in *Glenshaw Glass* never stated or suggested that the definition it used was a universal (or even broadly applicable) test. Realization was also not even disputed in *Glenshaw Glass*, explaining why the Court did not make more than a passing reference to realization. *See id*. at 428–29 (discussing how both taxpayers had realized damages and simply disputed their need to pay taxes on them).

Second, the Supreme Court has subsequently made clear that *Macomber* and *Glenshaw Glass* do not provide a universal definition of income. In *Horst*, the Supreme Court explained that the concept of realization is "founded on administrative convenience" and does not mean that a taxpayer can "escape taxation because he did not actually receive the money." 311 U.S. at 116. In *Griffiths*, the Supreme Court explicitly stated that this holding from *Horst* "undermined . . . the original theoretical bases of the decision in *Eisner v. Macomber*." 318 U.S.

at 394. The Supreme Court recently reiterated *Horst*'s statement that "the concept of realization is founded on administrative convenience," *Cottage Savings*, 499 U.S. at 559 (quoting *Horst*, 311 U.S. at 116), without adopting the test from *Glenshaw Glass* that the Moores urge upon us; in fact, the Court did not even cite to *Glenshaw Glass*.

Third, we have not adopted the definition of income the Moores advocate. In *James*, we cited a passage from *Glenshaw Glass* that included the definition of income the Moores favor, but we never adopted it then or later. *See* 333 F.2d at 752 (noting also that "insofar as [*Macomber*] purported to offer a comprehensive definition of the term income as used in the Sixteenth Amendment, it has been discarded."). Instead, we stated that there was no set definition of income under the Sixteenth Amendment. *See id.* at 752–53. Similarly, in *Comm'r v. Fender Sales, Inc.*, we did not cite to *Glenshaw Glass* or adopt the Moores' preferred definition when determining whether a tax was constitutional under the Sixteenth Amendment. *See* 338 F.2d 924, 927 (9th Cir. 1964) (noting also that "[i]n this context, *Eisner v. Macomber* . . . is not even apposite, let alone controlling.").

Finally, although it does not control our analysis, holding that Subpart F is unconstitutional under the Apportionment Clause would also call into question the constitutionality of many other tax provisions that have long been on the books. *See* Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1, 52 (1999). We decline to do so today.

II. The MRT does not violate the Fifth Amendment's Due Process Clause

Retroactive legislation may violate the Fifth Amendment's Due Process Clause. *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 266 (1994). "[T]he presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic." *Id.* at 265. We assume, without deciding, that the MRT is retroactive.

While there is a presumption against retroactive laws, retroactive tax legislation is often constitutional. *See, e.g., United States v. Carlton*, 512 U.S. 26, 30 (1994) ("[The Supreme Court] repeatedly has upheld retroactive tax legislation against a due process challenge."); *United States v. Hemme*, 476 U.S. 558, 568 (1986) ("[The Supreme Court] has . . . made clear that some retrospective effect is not necessarily fatal to a revenue law."). To analyze a due process challenge to retroactive tax legislation, we use the "deferential" standard of "whether [the] retroactive application itself serves a legitimate purpose by rational means." *Quarty v. United States*, 170 F.3d 961, 965 (9th Cir. 1999) (citing *Carlton*, 512 U.S. at 30–31).

The MRT passes muster under *Carlton*. The TCJA was a significant change in the U.S. tax code, shifting from a worldwide toward a territorial tax system, at least in part because of companies offshoring roughly $2.6 trillion in profits. The MRT eliminated other taxes on CFCs' undistributed earnings before 2018. So, if the MRT did not tax the undistributed earnings,

shareholders would have been able to avoid taxation indefinitely on pre-2018 earnings. The MRT, then, serves a legitimate purpose: it prevents CFC shareholders who had not yet received distributions from obtaining a windfall by never having to pay taxes on their offshore earnings that have not yet been distributed.

The MRT accomplishes this legitimate purpose by rational means. The MRT accelerates the effective repatriation date of undistributed CFC earnings to a date following passage of the TCJA. Having a single date of repatriation is a rational administrative solution. The 30year repatriation period also coincided with additional IRS reporting requirements, simplifying the calculation of taxes by both taxpayers and the IRS.[2]

The Moores' counterarguments are unpersuasive. Although the Moores may have expected their tax to remain deferred, their "reliance alone is insufficient to establish a constitutional violation. Tax legislation is not a promise, and a taxpayer has no vested right in the Internal Revenue Code." *Carlton*, 512 U.S. at 33. Further, while the MRT's retroactive period is long, it does not decide the analysis.

---

[2] The MRT also provided a lower tax rate than many shareholders would likely have paid otherwise: the MRT taxes CFC earnings at either 8% or 15.5%. And, taxpayers may also elect to pay the MRT in installments over an eight-year period. *See* Section 965 Transition Tax, The Internal Revenue Service, https://www.irs.gov/businesses/section965-transition-tax (last visited May 30, 2022).

The Moores cannot cite a bright-line rule regarding how long ago a retroactive tax can apply because courts deferentially review tax legislation's purpose on a case-by-case basis. *See Quarty*, 170 F.3d at 965. Moreover, courts that have considered the retroactive nature of tax legislation often only view the period of retroactivity as one, non-dispositive consideration. *See, e.g.*, *GPX Int'l Tire Corp. v. United States*, 780 F.3d 1136, 1142 (Fed. Cir. 2015) (discussing five "considerations," of which retroactivity was only one).

Nor is the MRT a "wholly new tax," a label applied to unconstitutionally retroactive taxes by early cases "under an approach that has long since been discarded." *Quarty*, 170 F.3d at 966 (quoting *Carlton*, 512 U.S. at 34). We have very narrowly interpreted what qualifies as a "wholly new tax," determining that a "a new tax is imposed only when the taxpayer has 'no reason to suppose that any transactions of the sort will be taxed at all.'" *See Quarty*, 170 F.3d at 967 (quoting *United States v. Darusmont*, 449 U.S. 292, 298 (1981)). The MRT is not a "wholly new tax" because prior to the MRT, U.S. shareholders were taxed on CFC earnings when they were distributed. The Moores had reason to expect that such transactions would eventually be taxed. *See id*. This is especially true because as 11% shareholders of KisanKraft, the Moores were already subject to certain preMRT taxes that applied to shareholders who owned at least 10% of a CFC regardless of whether earnings were distributed. *See* 26 U.S.C. § 951(a)(1) (2007).

CONCLUSION

For the above reasons, we **AFFIRM** the district court's grant of the Government's motion to dismiss and denial of the Moores' cross-motion for summary judgment.

APPENDIX B

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

No. C19-1539-JCC

CHARLES G. MOORE, et al.,

Plaintiffs,

v.

UNITED STATES OF AMERICA,

Defendant.

Filed: November 19, 2020

ORDER

This matter comes before the Court on the Government's motion to dismiss (Dkt. No. 26), Plaintiffs' cross-motion for summary judgment (Dkt. No. 29), and the Government's Rule 56(d) motion (Dkt. No. 34). Having thoroughly considered the parties' briefing and the relevant record, the Court finds oral argument unnecessary and hereby GRANTS the Government's motion to dismiss (Dkt.

No. 26), DENIES Plaintiffs' cross-motion for summary judgment (Dkt. No. 29), and DENIES as moot the Government's Rule 56(d) motion (Dkt. No. 34) for the reasons explained herein.

I. BACKGROUND

The Tax Cuts and Jobs Act of 2017 ("TCJA") was enacted in December 2017 and effective January 1, 2018. Pub. L. 115-97, 131 Stat. 2054. The Act included various provisions modifying subpart F, an anti-deferral regime requiring U.S. shareholders of controlled foreign corporations ("CFC") to pay tax on their share of certain forms of a CFC's current undistributed income. *See Dave Fischbein Mfg. Co. v. Comm'r of Internal Revenue*, 59 T.C. 338, 353–54 (1972) (describing subpart F generally). Absent subpart F, such income would avoid the imposition of U.S. income tax until distributed to a U.S. shareholder. *Id.*

Effective January 1, 2018, the TCJA broadened the types of CFC income subject to subpart F to include current earnings and profits from a business. TCJA §§ 14101–14223. This was Congress' attempt to incentivize U.S. taxpayers to repatriate foreign earnings back into the United States. Henry Ordower, *Abandoning Realization and the Transition Tax: Toward A Comprehensive Tax Base*, 67 BUFF. L. REV. 1371, 1373 (2019). Prior to the TCJA, current earnings and profits from a CFC's trade or business were not considered subpart F income and, therefore, not subject to U.S. taxation until distributed to a U.S. taxpayer. *See Dave Fischbein Mfg. Co.*, 59 T.C. at 353–54. Under the TCJA, beginning on January 1,

2018, such income is subject to U.S. taxation, even if not distributed. 26 U.S.C. § 952.

The TCJA also enacted a one-time Mandatory Repatriation Tax ("MRT"), a "transition tax" intended to ensure that a CFC's *past* earnings and profits do not permanently escape U.S. tax by virtue of the TCJA's changes to subpart F. Ordower, *supra*, at 1377. The MRT applies to the undistributed earnings and profits that a CFC earned between January 1, 1987 and December 31, 2017. 26 U.S.C. § 965. The tax is levied on a U.S. shareholder's ratable share of a CFC's undistributed earnings and profits during this period by treating the entire amount as subpart F income in 2017. *Id.*

In 2005, Plaintiffs Charles and Kathleen Moore paid $40,000 for an 11% interest in KisanKraft, Ltd., an Indian company classified as a CFC for U.S. tax purposes. (Dkt. Nos. 1 at 5; 29 at 6, 10). From 2006 through 2017, the company retained all of its earnings and profits; it made no distributions to its owners. (*Id.*) Accordingly, neither Plaintiffs nor KissanKraft, Ltd. paid U.S. tax on the company's earnings and profits. *Id.* Plaintiffs, after filing their 2017 income tax return without calculating the MRT, amended their return, calculated $15,130 in MRT, and paid the amount with their amended return. (*Id.*)

Plaintiffs brought this action to recover the MRT paid. (Dkt. No. 1 at 5.) They argue that the MRT violates the Apportionment Clause of Article I, Section 9 of the United States Constitution because it imposes an unapportioned direct tax, rather than an income tax. (*Id.* at 6– 7.) Alternatively, Plaintiffs

argue that the MRT is a retroactive application of a new tax, violating the Fifth Amendment's Due Process Clause. (*Id.* at 7–8.) Both are issues of first impression. The Government moves to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6), arguing that the MRT is constitutionally valid and, therefore, Plaintiffs fail to state a claim for which relief can be granted. (Dkt. No. 26.) Plaintiffs cross-move for summary judgment, arguing that there is no genuine dispute as to the MRT's constitutional infirmities and they are entitled to judgment as a matter of law. (Dkt. No. 29.) The Government also brings a Rule 56(d) motion should the Court deny its motion to dismiss. (Dkt. No. 34.)

II. DISCUSSION

A. Legal Standard

To survive a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), "a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). Although the rule does not require courts to assess the probability that a plaintiff will eventually prevail, the allegations made in the complaint must cross "the line between possibility and plausibility of entitlement to relief." *Id.* Whereas, "[t]he court shall grant summary judgment if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A fact is material if it "might affect the outcome of the suit under the governing law," and a dispute of fact is genuine if "the evidence

is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). When analyzing whether there is a genuine dispute of material fact, the "court must view the evidence 'in the light most favorable to the opposing party.'" *Tolan v. Cotton*, 572 U.S. 650, 657 (2014) (quoting *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970)). In addition, "a taxpayer in a refund suit . . . has the burden to prove overpayment of tax." *Watts v. U.S.*, 703 F.2d 346, 348 (9th Cir. 1983).

B. The MRT is a Tax on Income

The Sixteenth Amendment allows for the taxation of income without apportionment, whereas the Apportionment Clause provides that a direct tax, *i.e.*, a tax on property, must be apportioned to each state. *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 570 (2012). *Compare* U.S. CONST. art. I, § 9 ("No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken."), *with* U.S. CONST. amend. XVI ("The Congress shall have 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."). Plaintiffs argue that by taxing *accumulated* income rather than current income, the MRT is a direct tax on property, thereby violating the Apportionment Clause. (Dkt. No. 29 at 12.)

Plaintiffs rely on *Eisner v. Macomber*, 252 U.S. 189 (1920). In *Macomber*, the United States Supreme Court found that a stock dividend funded by a

corporation's undistributed accumulated earnings and profits was not income and, therefore, could not be taxed to its owners, because the act of distributing stock is not an income tax realization event. 252 U.S. at 211 ("Far from being a realization of profits of the stockholder, [a stock dividend] tends rather to postpone such realization."). This realization framework was generally affirmed in *Comm'r of Internal Revenue v. Glenshaw Glass Co.*, a case involving the taxation of punitive damages. 348 U.S. 426 (1955). But at the same time, the *Glenshaw Glass* Court cautioned that, while *Macomber*'s "definition [of income] served a useful purpose" in "distinguishing gain from capital," it "was not meant to provide a touchstone to all future gross income questions." *Id.* at 431.

Subsequent decisions dealing with foreign income have routinely departed from *Macomber*'s realization standard.[1] In *Eder v. Comm'r of Internal Revenue*, 138

[1] Nor is this departure limited to decisions involving foreign income. In 1936, the Court found that a distribution of common stock on preferred stock was taxable income. *v. Helvering*, 298 U.S. 441, 443 (1936) (noting that *Macomber* "affected only the taxation of *See Koshland* dividends declared in the same stock as that presently held by the taxpayer."). In 1964, the Ninth Circuit suggested *Glenshaw Glass* "finally laid to rest" *Macomber*'s definition of income, limiting *Macomber*'s reach to "the question that it decided, namely, that a stock dividend is not income to the shareholder, at least if the stock is of the same class and in the same corporation as that previously held by the taxpayer." *U.S. v. James*, 333 F.2d 748, 752–53 (9th Cir. 1964). The court went on to find that "insofar as it purported to offer a comprehensive definition of the term income as used in the Sixteenth Amendment, [*Macomber*] has been discarded."

F.2d 27, 29 (2d. Cir. 1943), the Second Circuit found that current inclusion of foreign corporate income under a regime predating subpart F was constitutional. Courts reached similar holdings after enactment of subpart F. Examples include *Estate of Whitlock v. Comm'r*, 59 T.C. 490, 505–10 (1972), *aff'd* 494 F.2d 1297 (10th Cir. 1976), where the court said that *Macomber* was not a bar to subpart F's inclusion of current undistributed income. In *Garlock, Inc. v. Comm'r of Internal Revenue*, the Second Circuit, in affirming a Tax Court's subpart F decision,[2] minimized the "continuing validity of the doctrine of *Eisner v. Macomber*." 489 F.2d 197, 203 n.5 (2d. Cir 1973). It also described as "border[ing] on frivolous" the plaintiff's argument that a shareholder's inclusion of subpart F income from a CFC was unconstitutional. *Id.* at 202. But the most compelling post *Macomber* decision is *Dougherty v. Comm'r of Internal Revenue*, 60 T.C. 917 (1973). The case addressed subpart F inclusion of *accumulated* earnings and profits of a CFC. *Id.* at 929–30. In finding no constitutional bar to subpart F inclusion, the court said that "*Macomber* . . . presents no more barrier than it did in *Whitlock*." *Id.* at 929. Telling commentary includes the court's description of *Macomber* as "a venerable but often criticized page in the lore of Federal income taxation" and its comment that *Macomber* "does not prevent Congress from bypassing the corporate entity in

---

[2] In this case, the shareholder was unable to access the CFC's earnings and profits due to local laws limiting the amount of distributions, yet the court still found the amounts taxable under subpart F. *Garlock v. Comm'r of Internal Revenue*, 58 T.C. 423, 438 (1972).

determining the incidence of Federal income taxation." *Id.* at 928.

There are also numerous contemporary statutory regimes, outside of subpart F, that require the current taxation of unrealized income—none of which have been successfully challenged on *Macomber* grounds. For example, 26 U.S.C. § 1256 requires taxpayers holding certain futures contracts to recognize the gain or loss on those contracts annually, regardless of whether the taxpayer disposed of the contract during the year. *See Murphy v. United States*, 992 F.2d 929, 931 (9th Cir. 1993) (finding § 1256 constitutional). The same holds true for inventory held by security dealers, 26 U.S.C. § 475, and assets held by expatriates, 26 U.S.C. § 877A.

Given the cabining of *Macomber* by the Supreme Court and the clear departure from it by other courts, there is no reason for this Court to conclude that *Macomber* currently controls whether the MRT is an income tax. Accordingly, the MRT does not violate the Apportionment Clause, as it is a tax on income rather than a direct tax.

C. The MRT Does Not Violate Due Process

As a tax on income, the MRT must not violate Fifth Amendment Due Process protections. *Nichols v. Coolidge*, 274 U.S. 531, 542 (1927); *see* U.S. CONST. amend. V ("No person shall . . . be deprived of life, liberty, or property, without due process of law."). At issue is whether the MRT is retroactive and, if so, whether retroactivity violates Due Process. *U.S. v. Carlton*, 512 U.S. 26, 30–31 (1994).

1. The MRT is a Retroactive Change

A law is retroactive if it "changes the legal consequences of acts completed before its effective date." *Landgraf v. USI Film Prod.*, 511 U.S. 244, 269 n.23 (quoting *Miller v. Florida*, 482 U.S. 423, 430 (1987)). The Government strains for arguments to explain how, based on this standard, the MRT is not retroactive. None have merit.

The Government first argues the MRT is not retroactive because it is imposed on *current* subpart F income. (Dkt. No. 26 at 20–26; Dkt. No. 33 at 21.) The argument borders on the absurd. The MRT redetermines the amount of current subpart F income by including a CFC's undistributed earnings and profits "beginning after December 31, 1986" through either "November 2, 2017" or "December 31, 2017." 26 U.S.C. § 965(d)(3); *see also* 26 U.S.C. §§ 951, 952, 956 (2016) (excluding undistributed earnings and profits from subpart F income). On its face, this represents a "different or more oppressive legal effect to conduct undertaken before enactment of the statute." *United States v. Hemme*, 476 U.S. 558, 568 (1986). This argument is meritless.

The Government next argues that the MRT regime simply accelerates the tax already owing on undistributed CFC earnings and profits. (*See* Dkt. No. 33 at 19.) But indefinite deferrals of a foreign corporation's earnings and profits often result in *de facto* permanent deferrals from U.S. tax—the very scenario the TCJA was established, in part, to combat. *See* H.R. Rep. No. 115-466, at 595–672, 675 (2017); Jerald David August, *Tax Cuts and Jobs Act*

of 2017 Introduces Major Reforms to the International Taxation of U.S. Corporations, PRAC. TAX LAW., Winter 2018, at 43, 49. The MRT does more than simply accelerate tax already owing. It *ensures* that a ratable share of a CFC's earnings and profits will be subject to U.S. tax. This argument is also meritless.

The Government's final argument is based on *Dougherty*, 60 T.C. 917. (Dkt. No. 26 at 23.) The Government argues that the Tax Court previously held in *Dougherty* that current subpart F inclusions of prior year earnings and profits were not retroactive and the same should follow here. (Dkt. No. 26 at 23.) But the facts in *Dougherty* are distinct from those here. In *Dougherty*, the Tax Court held that a constructive dividend from a foreign corporation to a U.S. shareholder occurring after enactment of the statute, thereby triggering current inclusion of a foreign corporation's prior year's earnings and profits, did not make the statute retroactive. 60 T.C. at 928–30; *see* 26 U.S.C. §§ 951(a)(1)(B), 956 (1962). Imposition of the MRT is not dependent on actions occurring *after* adoption of the statute. Quite the opposite, it levies tax based upon actions taken *before* adoption of the statute—a CFC's accumulation of earnings and profits. *See generally* 26 U.S.C. §§ 951, 965. This argument is also meritless. By its very nature, the MRT is a retroactive tax.

2. The MRT Does Not Violate Due Process

Even if a tax is retroactive, it does not violate the Due Process Clause if it (1) is supported by a legitimate legislative purpose and (2) is furthered by

rational means. *Carlton*, 512 U.S. at 30–31.[3] The *Carlton* standard represents the Court's rearticulation of an earlier standard, providing that "the validity of a retroactive tax provision depends upon whether 'retroactive application is so harsh and oppressive as to transgress the constitutional limitation.'" *Id.* (quoting *Welch v. Henry*, 305 U.S. 134, 147 (1938)). Absent the MRT, the TCJA's changes would effectively eliminate U.S. tax on a CFC's undistributed earnings and profits originating before 2018. *See* TCJA §§ 14101–14223. The MRT ensures that these amounts, at least to the extent they are apportionable to a U.S. shareholder, are subject to U.S. tax. *See* H.R. Rep. No. 115-466, at 595, 598–99, 606–07, 613–14 (2017); Ordower, *supra* at 1377. This is a legitimate legislative purpose.

Plaintiffs argue that the MRT's retroactive period, thirty years, is too long, *i.e.*, an irrational means to affect a legitimate legislative purpose. (*See generally* Dkt. Nos. 29 at 28–32; 38 at 16–19.) In *Carlton*, the effect of the estate tax statute at issue "extended for a period only slightly greater than one year." 512 U.S. at 33. While Justice O'Connor indicated that a retroactive period "longer than the year preceding the legislative session in which the law was enacted would raise, in my view, serious constitutional questions," this was not the view of the majority.

---

[3] Plaintiffs assert that the MRT is a "wholly new" tax and, as such, the *Carlton* standard should not apply. (Dkt. Nos. 29 at 25–28; 38 at 15–16.) The Court disagrees. The MRT is a component of the TCJA, which modified subpart F. Therefore, *Carlton* provides the relevant standard.

Carlton, 512 U.S. at 38 (O'Connor, J., concurring). The majority provided no brightline rule. *See generally id.* at 32–34. Nor is there any binding precedent establishing such a rule. Instead, the Court must fall back on "'the nature of the tax and the circumstances in which it is laid.'" *Purvis v. United States*, 501 F.2d 311, 313 (9th Cir. 1974) (quoting *Welch*, 305 U.S. at 147).

Circumstances here favor finding the imposition of the MRT is a rational means of affecting a legitimate legislative purpose. The TCJA is a major shift in how U.S. taxpayers doing business overseas are taxed. Prior to the TCJA, taxpayers paid no U.S. tax on a CFC's earnings and profits until those amounts were repatriated, thereby incentivizing U.S. taxpayers to offshore earnings and profits through the use of foreign subsidiaries. *See* 26 U.S.C. §§ 951, 952, 956 (2016); *see generally* Susan C. Morse, *A Corporate Offshore Profits Transition Tax*, 91 N.C. L. REV. 549, 550 (2013) (describing the incentive produced by the pre-TCJA scheme to retain foreign earnings and profits offshore). The TCJA attempts to cure this incentive by transitioning to a territorial tax model, which includes subjecting a U.S. shareholder's ratable portion of a CFC's earnings and profits to taxation regardless of whether the CFC distributes those funds. *See* TCJA §§ 14101–14223. However, absent a transition tax like the MRT, any earnings and profits undistributed upon the effective date of the TCJA would escape the imposition of U.S. taxation. Ordower, *supra* at 1377–80. As for the period of prior earnings subject to the transition tax, it was reasonable for Congress to select all dates after

1986 as the starting point, as this marks the last major overhaul of the Tax Code prior to the TCJA. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085.

Moreover, the duration of retroactivity is just one of the considerations relevant to whether there is a rational basis for the tax. *See GPX Int'l Tire Corp. v. U.S.*, 780 F.3d 1136, 1142 (Fed. Cir. 2015). Remaining considerations are whether the MRT is a "wholly new tax," whether it resolves uncertainty in the law, whether taxpayers received notice of the potential change in the law, and whether the provision is "remedial in nature." *Id.* As previously discussed, the MRT is not a "wholly new tax." And it is "remedial." It is a change in subpart F to incentivize U.S. taxpayers to repatriate foreign earnings. The MRT also resolves uncertainty in the law. Under the prior regime, it was unclear when and if a CFC's earnings attributable to U.S. shareholders would be subject to U.S. tax. The TCJA and MRT remove that uncertainty. Ratable portions of prior undistributed earnings and profits are now subject to U.S. taxation and future amounts are subject to U.S. taxation as earned. 26 U.S.C. § 965. While it is true that Plaintiffs received little notice that the taxation of KisanKraft, Ltd.'s undistributed earnings and profits would change, this consideration is "not dispositive of the due process analysis." *GPX Int'l Tire Corp.*, 780 F.3d at 1143. In *Carlton*, the tax "did not violate due process even through the challenger 'specifically and detrimentally relied' on the prior state of the law and . . . did not have prior notice of the change in the law." *Id.* (quoting *Carlton*, 512 U.S. at 33–34).

Therefore, the MRT does not violate due process and, as a tax on income, it is constitutionally valid.

III. CONCLUSION

For the foregoing reasons, the Government's motion to dismiss (Dkt. No. 26) is GRANTED, Plaintiffs' motion for summary judgment (Dkt. No. 29) is DENIED, and the Government's Rule 56(d) motion (Dkt. No. 34) is DENIED as moot. The case is DISMISSED with prejudice.

DATED this 19th day of November 2020.

/s/ John C. Coughenour

John C. Coughenour
UNITED STATES DISTRICT JUDGE

APPENDIX C

**UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT**

No. 20-36122

CHARLES G. MOORE, et al.,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

Filed: November 22, 2022

Before: Ronald M. Gould, Jacqueline H. Nguyen, and Mark J. Bennett, Circuit Judges.

Order;
Dissent by Judge Bumatay

SUMMARY*

Tax

The panel denied a petition for panel rehearing and denied on behalf of the court a petition for rehearing en banc, in a case in which the panel affirmed the district court's dismissal of an action seeking to invalidate the Mandatory Repatriation Tax.

Judge Bumatay, joined by Judges Ikuta, Callahan, and VanDyke, dissented from the denial of rehearing en banc. Judge Bumatay stated that the panel erred in disregarding the realization requirement of the Sixteenth Amendment, by allowing an unapportioned direct tax on unrealized income—undistributed earnings of a foreign corporation owned by a U.S. taxpayer—without offering any other limiting principle; and that the opinion opens the door to new federal taxes on other types of wealth and property being categorized as an "income tax" without the constitutional requirement of apportionment.

ORDER

Appellants' Petition for Panel Rehearing is DENIED.

The full court was advised of the Petition for Rehearing En Banc. A judge requested a vote on

---

* This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

whether to rehear the matter en banc, and the matter failed to receive a majority of the votes of the nonrecused active judges in favor of en banc consideration. Fed. R. App. P. 35. Appellants' Petition for Rehearing En Banc is also DENIED.

BUMATAY, Circuit Judge, joined by IKUTA, CALLAHAN, and VANDYKE, Circuit Judges, dissenting from the denial of rehearing en banc:

"[T]he ratification of the Constitution was the ultimate act of popular sovereignty." *Ariz. State Legislature v. Ariz. Indep. Redistricting Comm'n*, 576 U.S. 787, 837 (2015) (Roberts, C.J., dissenting). Its provisions "reflect[] a compromise—a pragmatic recognition that the grand project of forging a Union required everyone to accept some things they did not like." *Id.* And courts have "no power to upset such a compromise simply because we now think that it should have been struck differently." *Id.* But our court's decision does just that.

Under the original constitutional design, Congress could only levy "direct taxes" if such taxes were "apportioned among the several States." U.S. Const. art. I, § 2, cl. 3. The apportionment of direct taxes was to be set "in proportion to the census or enumeration" of the States' populations. U.S. Const. art. I, § 9, cl. 4. Thus, at the Founding, for a direct tax to be constitutional, the federal government had to collect the proceeds proportionally—meaning if one State had twice the population of another, it also had to contribute twice as much. Given this requirement's

heavy burden on federal taxing power, the Supreme Court narrowed the definition of "direct taxes" to encompass only certain taxes, such as capitations (head taxes), taxes on real property, taxes on personal property, and taxes on income from personal property. *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 571 (2012) (simplified).

But the people changed that system. In 1913, the people created a limited exception to the apportionment requirement. By ratifying the Sixteenth Amendment, the people gave Congress the authority to "lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States." U.S. Const. amend. XVI. So, today, Congress may enact a direct tax on "incomes"—and only on "incomes"—without apportioning the tax. The Sixteenth Amendment thus struck a delicate balance for federal taxing power—freeing Congress from the unwieldy requirement of apportionment, but only for taxes on "incomes." Nothing in the Sixteenth Amendment relieved Congress of its duty to apportion other forms of direct taxation, such as a tax on property interests.

Now, more than a century after its ratification, our court upsets the balance reached by the people. We become the first court in the country to state that an "income tax" doesn't require that a "taxpayer has realized income" under the Sixteenth Amendment. *Moore v. United States*, 36 F.4th 930, 935 (9th Cir. 2022). Instead, we conclude that the Sixteenth Amendment authorizes an unapportioned tax on unrealized gains because the "realization of income is

not a constitutional requirement." *Id*. at 936. We thus endorse the constitutionality of a federal tax on the share of *undistributed* earnings of a foreign corporation owned by a U.S. taxpayer—despite (in this case) the U.S. taxpayer being a minority shareholder of the foreign corporation. In other words, we allow a direct tax on the *ownership interest* of a taxpayer—even when the taxpayer has yet to receive any economic gain from the interest and has no ability to direct distribution of gain from the interest.

Neither the text and history of the Sixteenth Amendment nor precedent support levying a direct tax on unrealized gains. Ratification-era sources confirm that the prevailing understanding of "income" entailed some form of realization. And a hundred years of precedent establishes that only realized gains are taxable as "income" under the Sixteenth Amendment. While the Supreme Court has allowed flexibility in identifying "incomes," it has never abandoned the core requirement that income must be realized to be taxable without apportionment under the Sixteenth Amendment. Simply put, as a matter of ordinary meaning, history, and precedent, an income tax must be a tax on realized income. And our court is wrong to violate such a common-sense tautology.

Worse yet, by dispensing with the realization requirement for income without offering any other limiting principle, we open the door to expansion of the federal taxing power beyond the limits placed by the Constitution. Indeed, without a realization

requirement, it is hard to see what's left of the constitutional apportionment requirement. Now, I fear, *any* tax on property or other interests can be categorized as an "income tax" and elude the requirement of apportionment. While the Sixteenth Amendment expanded the federal government's taxing power, it did not dissolve other constitutional restrictions.

Because we may not rebalance the limits of federal taxing power, I respectfully dissent from the denial of rehearing en banc.

I.

This case begins with a husband and wife's investment in an overseas company formed to empower small-scale farmers in impoverished regions of India. Charles and Kathleen Moore own a 13% stake in KisanKraft Machine Tools Private Limited, a small company headquartered in Bangalore, India. KisanKraft was formed in 2006 by Charles's friend and former coworker, Ravindra "Ravi" Kumar Agrawal, to import and distribute affordable farming equipment. Moved by Ravi's vision for helping farmers, the Moores invested $40,000 in KisanKraft and retained about 11% of the common shares in the company. Ravi and his wife moved to India to manage the company's day-to-day operations as approximately 80% owners.

Under Ravi's leadership, KisanKraft's revenues grew each year from 2006 to 2017. True to the original business plan, Ravi reinvested everything in the company. By 2017, KisanKraft employed over 300

people across 14 regional offices, distributing agricultural equipment to thousands of dealers. The Moores received updates and annual financial statements, but they never exercised any control over the company's earnings or operations, and never received any distributions, dividends, or other payments. They were content with supporting their friend's "noble purpose . . . to improve the lives of small and marginal farmers in India."

As the Moores would find out, no good deed goes unpunished. In 2018, they learned that under the Tax Cuts and Jobs Act of 2017, they were on the hook for their share of KisanKraft's lifetime earnings and would owe a one-time tax amounting to $14,729. This surprised the Moores, who had never received any income from KisanKraft and did not expect to pay income taxes just for owning a minority interest in the company. It's undisputed that the Moores didnot realize income from KisanKraft and lacked the authority to compel a dividend payment constituting realized income. Not only are the Moores minority owners, KisanKraft does not have sufficient cash to distribute its retained and reinvested earnings. But nonetheless, under the Act, the Moores were liable for income tax on income they never earned.

This was thanks to the Mandatory Repatriation Tax, a one-time "transition tax" to facilitate the repatriation of foreign earnings. *See* 26 U.S.C. § 965. The Mandatory Repatriation Tax targeted U.S. shareholders who held 10% or more in a "controlled foreign corporation"—a foreign entity with over 50% American ownership, *see* 26 U.S.C. § 967—that

retained and reinvested its prior earnings overseas rather than distributing them to shareholders as dividends. *Moore*, 36 F.4th at 933. Previously, those shareholders would ordinarily only incur a tax liability when the foreign corporation distributes earnings and the shareholders repatriate those gains. *Id*. (citing 26 U.S.C. § 951 (2007)). But the Mandatory Repatriation Tax adopted a "novel" approach—it simply deemed the foreign corporation's retained earnings as the shareholders' "income" and taxed them according to their proportional ownership stake. *Id*. at 933–34.

The Moores sued seeking a refund of their $14,729 tax payment. Our court affirmed the denial of the refund. We held that the Mandatory Repatriation Tax did not violate the apportionment requirement. *Moore*, 36 F.4th at 935. According to our court, "[w]hether the taxpayer has realized income does not determine whether a tax is constitutional." *Id*. Rather, we held that "the Supreme Court has made clear that realization of income is not a constitutional requirement." *Id*. at 936. Based on the conclusion that unrealized gains qualify as income, we held that taxing the Moores based on their pro-rata share of KisanKraft's retained profits was constitutional. *Id*.

II.

"The Sixteenth Amendment, like other laws authorizing or imposing taxes, is to be taken as written, and is not to be extended beyond the meaning clearly indicated by the language used." *Edwards v. Cuba R. Co.*, 268 U.S. 628, 631 (1925). It is "settled doctrine . . . that the Sixteenth Amendment confers

no power upon Congress to define and tax as income without apportionment something which theretofore could not have been properly regarded as income." *Taft v. Bowers*, 278 U.S. 470, 481 (1929). Our task is to discern "the commonly understood meaning of [income] which must have been in the minds of the people when they adopted the Sixteenth Amendment." *Merchants' Loan & Tr. Co. v. Smietanka*, 255 U.S. 509, 519 (1921); *see also United States v. Safety Car Heating & Lighting Co*., 297 U.S. 88, 99 (1936) ("Income within the meaning of the Sixteenth Amendment . . . [w]ith few exceptions, if any . . . is income as the word is known in the common speech of men."). When searching for an Amendment's original meaning, we look to its text, historical context, and early post-ratification interpretations. *See New York State Rifle & Pistol Ass'n v. Bruen*, 142 S. Ct. 2111, 2127–28 (2022).

A.

We start with the history. Before the Sixteenth Amendment, the Constitution spoke of two categories of taxes—direct and indirect. Indirect taxes, such as "Duties, Imposts and Excises," were to be levied "uniform[ly] throughout the United States." U.S. Const. art. I, § 8, cl. 1. On the other hand, "direct Taxes" were to "be apportioned among the several States . . . according to their respective Numbers." U.S. Const. art. I, § 2, cl. 3. Thus, "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or enumeration herein before directed to be taken." U.S. Const. art. I, § 9, cl. 4.

Understandably, the impracticalities and inequities of the apportionment requirement made it difficult for the federal government to impose a direct tax. *See Hylton v. United States*, 3 U.S. (3 Dall.) 171, 179 (1796) (Paterson, J.). One way to deal with the difficulties was to limit the category of direct taxes. *See NFIB*, 567 U.S. at 571 (showing the history of limiting direct taxes to capitations, land taxes, and taxes on personal property and the income from personal property).

The Sixteenth Amendment arose in response to *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895). In that case, the Supreme Court struck down the income tax provisions of the Wilson Tariff Act of 1894 as unapportioned direct taxes. 158 U.S. at 637, 683. The *Pollock* decision noted that the "constitution divided federal taxes into two great classes—the class of direct taxes, and the class of duties, imports, and excises"—and sought to determine into which class the taxes on incomes belonged. *Id.* at 617–18. Examining the text of the relevant clauses in the Constitution and the circumstances of their adoption and ratification, the Court concluded that income taxes on real estate and personal property were invariably direct taxes requiring apportionment. *Id.* at 637. Chief Justice Fuller's majority opinion added, "[i]f it be true that the constitution should have been so framed that a tax of this kind could be laid, the instrument defines the way for its amendment." *Id.* at 635.

President William Howard Taft led the public charge for a constitutional amendment expressly

authorizing a federal income tax. In a speech before both houses of Congress, he characterized the *Pollock* decision as "depriv[ing] the National Government of a power" which it "undoubtedly . . . ought to have" and which "might be indispensable to the nation's life in great crises." William H. Taft, *Message Regarding Income Tax* (June 16, 1909).[1] Rather than passing legislation that would force the Supreme Court to reconsider its ruling in *Pollock*, President Taft urged the House and Senate to "propose an amendment to the Constitution conferring the power to levy an income tax upon the National Government without apportionment among the states in proportion to population." *Id.*

When the Senate was weighing amending the Constitution to authorize an income tax, one member floated the possibility of simply striking the apportionment requirement altogether. 44 Cong. Rec. 3377 (1909). Instead, the drafters chose language meant to "confine [the changes] to income taxes alone." *Id.* As a leading scholar of taxation and public finance explained:

> [T]he simplest way out of the difficulty would be entirely to eliminate from the constitution the clause or clauses referring to direct taxes. [But] Congress, however, was unfortunately not much interested in the larger question. What gave it immediate concern was the disposition of the impending imbroglio. It was therefore decided to arrange the matter by an

---

[1] https://perma.cc/LFL6-AH92.

> amendment to the constitution which would affect only the income tax.

Edwin R. A. Seligman, The Income Tax: A Study of the History, Theory, and Practice of Income Taxation at Home and Abroad 594–95 (1911).

Eventually, Congress settled on draft language and proposed the amendment for ratification by the States through a joint resolution. S.J. Res. 40, 61st Cong. (1909). After an arduous four-year process and extensive debates in the state legislatures, the Sixteenth Amendment was ratified in early 1913.

B.

We turn next to the text. The full text of the Sixteenth Amendment reads: "Congress shall have 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.

Ratification-era dictionaries suggest that the ordinary meaning of "income" was confined to realized gains. One dictionary defined "income" as "that *gain* which *proceeds from* labor, business, property, or capital of any kind." Webster's Revised Unabridged Dictionary (1913) (emphasis added). According to another turn-of-the-century dictionary, "income" meant "[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." The Century Dictionary and Cyclopedia (1901).

Ratification-era legal authorities made explicit what these dictionary definitions conveyed: only

realized gains qualify as taxable income. The 1910 edition of Black's Law Dictionary defined "income" to include "that which *comes in* or is *received from* any business or investment of capital." *Income*, *Black's Law Dictionary* (2d ed. 1910) (emphasis added). And Henry Campbell Black—of Black's Law Dictionary fame—addressed the issue in a book-length commentary published within months of ratification. Black noted that an income tax "is not a tax upon accumulated wealth, but upon its periodical accretions." Henry Campbell Black, *A Treatise on the Law of Income Taxation* 1 (1913). In his view, these accretions occurred only when gains were *realized*, not when an asset had merely increased in value:

> When a bond which was purchased at a discount reaches par value in the market, the owner cannot be properly said to have made a profit; he is in a position where he can realize a profit if he sells the bond, but not otherwise. If he sells, then the sum gained may constitute a part of his income, but it cannot be so described while he continues to hold the security.

Id. at 76–77.

Black rejected the idea of taxing shareholders for undistributed corporate profits as being "contrary to all the weight of authority," explaining:

> In several of the cases on the subject, it is said that the word "income" is not broad enough to include things not separated in some way from the principal. It is not synonymous with "increase." The value of corporate stock may be

> increased by good management, prospects of business, and the like, but such increase is not income. It may also be increased by the accumulation of a surplus fund. But so long as that surplus is retained by the corporation, either as a surplus or as increased stock, it can in no proper sense be called income. It may become incomeproducing, but it is not income.

Id. at 120. Black concluded that the Sixteenth Amendment "does not . . . enlarge the power of taxation previously possessed by Congress, but merely repeals certain parts of the existing Constitution which imposed a limitation upon the levying of . . . an income tax." *Id*. at 11.

Other early commentators shared Black's assessment. In 1919, a well-known authority on income tax and accounting explained that the Sixteenth Amendment only covered taxes on realized gains:

> In the circumstances, no apology is needed for a close inquiry into the right of Congress or the Treasury Department to extend the taxation of income—which is permitted under the sixteenth amendment—to the taxation of capital—which is not permitted. And the inquiry naturally extends itself into the right to tax any transaction unless there is an actual realization of income, as distinguished from the apparent income which may be and often is due to the temporary fluctuations in values."

Robert H. Montgomery, *Income Tax Procedure* 198 (1919).

Taken collectively, these sources reinforce the commonsense notion that "income" refers to the receipt of some economic benefit. And because this "commonly understood meaning" was "in the minds of the people when they adopted the Sixteenth Amendment," *Smietanka*, 255 U.S. at 519, neither Congress nor our court may redefine income to include unrealized gains. *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.").

C.

Supreme Court precedent also confirms that the Sixteenth Amendment adopted the ordinary meaning of income—thus, it requires the realization of gain.

The Supreme Court first interpreted "income" under the Sixteenth Amendment in *Eisner v. Macomber*, 252 U.S. 189 (1920). There, the Court addressed whether a stockholder's receipt of a stock dividend falls within the scope of "incomes, from whatever source derived," for purposes of the Sixteenth Amendment. *Id.* at 207–08. After surveying authorities, the Court defined "income" as "the gain derived from capital, from labor, or from both combined." *Id*. at 207. The Court further illuminated:

> Here we have the essential matter: *not* a gain *accruing to* capital; not a *growth* or *increment* of value *in* the investment; but 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, benefit and disposal—*that* is income derived from property. <u>Nothing else answers the description</u>.

Id. at 207 (underline added). To the Court, this meaning was the "clear definition of the term 'income,' as used in common speech." *Id*. at 206–07.

Applying the definition to a stock dividend, the Court concluded, "[t]he dividend normally is payable in money . . . and when so paid, then only . . . does the stockholder realize a profit or gain which becomes his separate property, and thus derive income from the capital that he or his predecessor has invested." *Id*. at 209. Put simply, *Macomber* says that stock dividends do not constitute "income" until "realize[d]" as profit or gain. *Id*.

Macomber remains the seminal case establishing the realization requirement for "income" under the Sixteenth Amendment. *See* Edward T. Roehner & Sheila M. Roehner, *Realization: Administrative Convenience or Constitutional Requirement?*, 8 Tax L. Rev. 173, 174 (1953) ("[T]he Supreme Court has in no post-*Eisner v. Macomber* case indicated the slightest relaxation in the rule that realization is necessary before there can be taxable income."). And more recently, the Court recognized *Macomber* as among its "landmark precedents on realization" and observed that Congress codified *Macomber*'s realization requirement in the Revenue Act of 1924.

Cottage Sav. Ass'n v. C.I.R., 499 U.S. 554, 561–62 (1991).

Since *Macomber*, the Court has consistently treated realization—in some form—as the critical component of taxable income. Twenty years after *Macomber*, the Court reiterated "the rule that income is not taxable until realized." *Helvering v. Horst*, 311 U.S. 112, 116 (1940). There, the Supreme Court considered the case of a taxpayer who procured payment of interest as a gift to a family member. *Id.* Even though the taxpayer didn't personally realize income, the "power to procure the payment of income to another is the enjoyment and hence the *realization* of the income." *Id.* at 118 (emphasis added). In other words, the Court found no exemption from taxation when economic gain is enjoyed "by some event other than the taxpayer's personal receipt of money or property." *Id.* at 116.

In *C.I.R. v. Glenshaw Glass*, 348 U.S. 426 (1955), the Court said that punitive damages awards are taxable as income. *Glenshaw Glass* observed that *Macomber*'s definition of income "served a useful purpose" by "distinguishing gain from capital," but "was not meant to provide a touchstone to all future gross income questions." *Id.* at 431. But *Glenshaw Glass* followed *Macomber*'s lead in requiring realization—it held that the damages were taxable income because they were "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id.*

Six years later, the Court concluded that embezzled funds are taxable as income to the

embezzler. *James v. United States*, 366 U.S. 213 (1961). In doing so, it reiterated that the "full measure" of Congress's power to tax incomes "encompass[es] all accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id*. at 218–19. As the Court explained, "[a] gain constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it." *Id*. at 219 (simplified).

And until *Moore*, Ninth Circuit caselaw also treated realization as a requirement for taxable "income." Back in 1964, for example, we held that employees realized a taxable gain when they accepted stock instead of salaries. *Comm'r v. Fender Sales, Inc*., 338 F.2d 924, 929 (9th Cir. 1964). In that case, famous guitar innovator Leo Fender and his business partner Donald Randall were the sole stockholders of Fender Sales, Inc. *Id*. at 925. At a time when Fender Sales was cash-strapped, Fender and Randall agreed to each accept additional shares of stock instead of three years' worth of unpaid salaries. *Id*. As the company's "sole owners," taking the stock instead of salaries caused Fender Sales to increase in value for Randall and Fender. *Id*. at 929. By "augmenting the intrinsic worth of the capital stock they held," Fender and Randall "surely 'realized' for their own benefit the value of the obligations discharged." *Id*. In other words, we maintained that some form of realization is required for Sixteenth Amendment purposes. There, we said that "the issuance of the corporation's capital stock to the employee is a payment" that amounts to

"realization of income by the employee in the amount of the fair market value of the stock." *Id.*

Three decades later, we considered whether Congress exceeded its authority by enacting a tax on the short-term capital gains of investors in commodity futures contracts. *Murphy v. United States*, 992 F.2d 929, 931 (9th Cir. 1993) (analyzing 26 U.S.C. § 1256). Before the enactment of § 1256, futures traders could defer tax on short-term capital gains until a later year, when a lower long-term rate would be applied. *Id.* Murphy argued that Congress could not tax his unsold futures contracts, which he alleged were unrealized gains. *Id.* at 930. We disagreed because, under the "marked-to-market" accounting system, futures traders receive "any gain on [their] position in cash as a matter of right each trading day." *Id.* at 931. Murphy's *ability* to withdraw cash, even if unexercised, meant he effectively realized his gains, subjecting them to Congress's power to tax income. *Id.* *Murphy* thus illustrates the continuing vitality of the realization requirement—even though we found it satisfied by the *right* to withdraw funds, rather than requiring cash receipts; otherwise, realization would not have been dispositive in our analysis.

D.

Based on text, history, and precedent, our court erred in disregarding the realization requirement of the Sixteenth Amendment. Rather than hewing to plain meaning and Supreme Court rulings, we recast the very meaning of "income." Without the guardrails of a realization component, the federal government has unfettered latitude to redefine "income" and

redraw the boundaries of its power to tax without apportionment.

The crux of our error is treating *Macomber* as merely an advisory example of what "income may be defined as." *Moore*, 36 F.4th at 937. We essentially called *Macomber* a dead letter, emphasizing its "limited scope." *Id*. While it may be true that *Macomber* does not establish a "universal" meaning of "income" for all situations and all cases, that does not mean we can disregard the Supreme Court's core holding in that case. At bottom, the Court said that "income" is the "gain derived" from a variety of sources. *Macomber*, 252 U.S. at 207. While there may be edge cases that test the outer limits of what constitutes a realized gain, the term "income" still retains realization as a definitional requirement. And none of the later decisions that build on *Macomber* repudiate the ongoing requirement that gains must be "realized" in some form before they can be taxed.

Moore was also wrong to rely on a few words from *Horst* to dispense with the realization requirement. 36 F.4th at 936. While *Horst* noted that the realization requirement is "founded on administrative convenience," 311 U.S. at 116, those words didn't open the door for our court to redefine the meaning of "income." Indeed, the realization requirement was assumed in *Horst*; the Court stated that "[t]he sole question for decision" was whether the gift of an interest payment constituted "the realization of income taxable to the donor." *Id*. at 114. So *Horst* did not reject the realization requirement; it just held that a taxpayer can't transfer the cash

receipts to someone else and avoid taxation. *Id*. at 117.

Again, it is undisputed that the Moores have received no return on their investment in KisanKraft, and they have no power to direct a dividend payment or otherwise realize a gain. Thus, the Moores had no "control over" the company nor any "readily realizable economic value from it." *James*, 366 U.S. at 219. Following precedent, we should have recognized that the Moores had not received "income" from KisanKraft under the Sixteenth Amendment. Instead, we embarked on a novel interpretation of the Amendment—one that seriously undermines the constitutional apportionment requirement.

We should have taken this case en banc to correct these errors.

III.

Our court dislodged settled constitutional limits on federal taxation by aggrandizing Congress's power to levy unapportioned taxes on unrealized gains. This holding conflicts with the Sixteenth Amendment's original meaning and misconstrues binding precedents. And the consequences of our decision extend far beyond the Mandatory Repatriation Tax. Divorcing income from realization opens the door to new federal taxes on all sorts of wealth and property without the constitutional requirement of apportionment. Indeed, without a realization requirement to cabin the scope of "incomes," it is hard to see how the apportionment requirement has any remaining relevance. And only the people have the

power to declare a constitutional provision a dead letter.

Because our expansive gloss on the Sixteenth Amendment thwarts its design and defies longstanding Supreme Court and Ninth Circuit caselaw, I respectfully dissent from the denial of rehearing en banc.

APPENDIX D

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

U.S. Const., art. I, § 2, cl. 3

Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers.

U.S. Const., art. I, § 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.

26 U.S.C. § 951. Global intangible low-taxed income included in gross income of United States shareholders

(a) In general.—Each person who is a United States shareholder of any controlled foreign corporation for any taxable year of such United States shareholder shall include in gross income such shareholder's global intangible low-taxed income for such taxable year.

(b) Global intangible low-taxed income.—For purposes of this section—

(1) In general.—The term "global intangible low-taxed income" means, with respect to any United States shareholder for any taxable year of such United States shareholder, the excess (if any) of—

(A) such shareholder's net CFC tested income for such taxable year, over

(B) such shareholder's net CFC tested income for such taxable year, over

(C) such shareholder's net deemed tangible income return for such taxable year.

(2) Net deemed tangible income return.—The term "net deemed tangible income return" means, with respect to any United States shareholder for any taxable year, the excess of—

(A) 10 percent of the aggregate of such shareholder's pro rata share of the qualified business asset investment of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year

(determined for each taxable year of each such controlled foreign corporation which ends in or with such taxable year of such United States shareholder), over

(B) the amount of interest expense taken into account under subsection (c)(2)(A)(ii) in determining the shareholder's net CFC tested income for the taxable year to the extent the interest income attributable to such expense is not taken into account in determining such shareholder's net CFC tested income.

(c) Net CFC tested income.—For purpose of this section—

(1) In general.—The term "net CFC tested income" means, with respect to any United States shareholder for any taxable year of such United States shareholder, the excess (if any) of—

(A) the aggregate of such shareholder's pro rata share of the tested income of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year of such United States shareholder (determine for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such United States shareholder), over

(B) the aggregate of such shareholder's pro rata share of the tested loss of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year of such United States shareholder (determined for each taxable year of such controlled foreign corporation

which ends in or with such taxable year of such United States shareholder).

(2) Tested income; tested loss.—For purposes of this section—

(A) Tested income.—The term "tested income" means, with respect to any controlled foreign corporation for any taxable year of such controlled foreign corporation, the excess (if any) of—

(i) the gross income of such corporation determined without regard to—

(I) any item of income described in section 952(b),

(II) any gross income taken into account in determining the subpart F income of such corporation,

(III) any gross income excluded from the foreign base company income (as defined in section 954) and the insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4),

(IV) any dividend received from a related person (as defined in section 954(d)(3)), and

(V) any foreign oil and gas extraction income (as defined in section 907(c)(1)) of such corporation, over

(ii) the deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5) (or to which such deductions would be allocable if there were such gross income),

(B) Tested loss.—

(i) In general.—The term "tested loss" means, with respect to any controlled foreign corporation for

any taxable year of such controlled foreign corporation, the excess (if any) of the amount described in subparagraph (A)(ii) over the amount described in subparagraph (A)(i).

(ii) Coordination with subpart F to deny double benefit of losses.—Section 952(c)(1)(A) shall be applied by increasing the earnings and profits of the controlled foreign corporation by the tested loss of such corporation.

(d) Qualified business asset investment.—For purposes of this section—

(1) In general.—The term "qualified business asset investment" means, with respect to any controlled foreign corporation for any taxable year, the average of such corporation's aggregate adjusted bases as of the close of each quarter of such taxable year in specified tangible property—

(A) used in a trade or business of the corporation, and

(B) of a type with respect to which a deduction is allowable under section 167.

(2) Specified tangible property

(A) In general.—The term "specified tangible property" means, except as provided in subparagraph (B), any tangible property used in the production of tested income.

(B) Dual use property.—In the case of property used both in the production of tested income and income which is not tested income, such property shall be treated as specified tangible property in the

same proportion that the gross income described in subsection (c)(1)(A) produced with respect to such property bears to the total gross income produced with respect to such property.

(3) [1] **Determination of adjusted basis.**—For purposes of this subsection, notwithstanding any provision of this title (or any other provision of law) which is enacted after the date of the enactment of this section, the adjusted basis in property shall be determined—

(A) by using the alternative depreciation system under section 168(g), and

---

[1] **Partnership property.**—For purposes of this subsection, if a controlled foreign corporation holds an interest in a partnership at the close of such taxable year of the controlled foreign corporation, such controlled foreign corporation shall take into account under paragraph (1) the controlled foreign corporation's distributive share of the aggregate of the partnership's adjusted bases (determined as of such date in the hands of the partnership) in tangible property held by such partnership to the extent such property—

(A) is used in the trade or business of the partnership,

(B) is of a type with respect to which a deduction is allowable under section 167, and

(C) is used in the production of tested income (determined with respect to such controlled foreign corporation's distributive share of income with respect to such property).

For purposes of this paragraph, the controlled foreign corporation's distributive share of the adjusted basis of any property shall be the controlled foreign corporation's distributive share of income with respect to such property.

(B) by allocating the depreciation deduction with respect to such property ratably to each day during the period in the taxable year to which such depreciation relates.

(4) Regulations.—The Secretary shall issue such regulations or other guidance as the Secretary determines appropriate to prevent the avoidance of the purposes of this subsection, including regulations or other guidance which provide for the treatment of property if—

(A) such property is transferred, or held, temporarily, or

(B) the avoidance of the purposes of this paragraph is a factor in the transfer or holding of such property.

(e) Determination of pro rata share, etc.—For purposes of this section—

(1) In general.—The pro rata shares referred to in subsections (b), (c)(1)(A), and (c)(1)(B), respectively, shall be determined under the rules of section 951(a)(2) in the same manner as such section applies to subpart F income and shall be taken into account in the taxable year of the United States shareholder in which or with which the taxable year of the controlled foreign corporation ends.

(2) Treatment as United States shareholder.—A person shall be treated as a United States shareholder of a controlled foreign corporation for any taxable year of such person only if such person owns (within the meaning of section 958(a)) stock in such foreign corporation on the last day in the taxable

year of such foreign corporation on which such foreign corporation is a controlled foreign corporation.

(3) Treatment as controlled foreign corporation.—A foreign corporation shall be treated as a controlled foreign corporation for any taxable year if such foreign corporation is a controlled foreign corporation at any time during such taxable year.

(f) Treatment as subpart F income for certain purposes.—

(1) In general.—

(A) Application.—Except as provided in subparagraph (B), any global intangible low-taxed income included in gross income under subsection (a) shall be treated in the same manner as an amount included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4).

(B) Exception.—The Secretary shall provide rules for the application of subparagraph (A) to other provisions of this title in any case in which the determination of subpart F income is required to be made at the level of the controlled foreign corporation.

(2) Allocation of global intangible low-taxed income to controlled foreign corporations.—For purposes of the sections referred to in paragraph (1), with respect to any controlled foreign corporation any pro rata amount from which is taken into account in determining the global intangible low-taxed income included in gross income of a United States

shareholder under subsection (a), the portion of such global intangible low-taxed income which is treated as being with respect to such controlled foreign corporation is—

(A) in the case of a controlled foreign corporation with no tested income, zero, and

(B) in the case of a controlled foreign corporation with tested income, the portion of such global intangible low-taxed income which bears the same ratio to such global intangible low-taxed income as—

(i) such United States shareholder's pro rata amount of the tested income of such controlled foreign corporation, bears to

(ii) the aggregate amount described in subsection (c)(1)(A) with respect to such United States shareholder.

26 U.S.C. § 965. Treatment of deferred foreign income upon transition to participation exemption system of taxation

(a) Treatment of deferred foreign income as subpart F income.—In the case of the last taxable year of a deferred foreign income corporation which begins before January 1, 2018, the subpart F income of such foreign corporation (as otherwise determine for such taxable year under section 952) shall be increased by the greater of—

(1) the accumulation post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or

(2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017.

…

(c) Application of participation exemption to included income.

(1) In general.—In the case of a United States shareholder of a deferred foreign income corporation, there shall be allowed as a deduction for the taxable year in which an amount is included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section an amount equal to the sum of—

(A) the United States shareholder's 8 percent rate equivalent percentage of the excess (if any) of—

(i) the amount so included as gross income, over

(ii) the amount of such United States shareholder's aggregate foreign cash position, plus

(B) the United States shareholder's 15.5 percent rate equivalent percentage of so much of the amount described in subparagraph (A)(ii) as does not exceed the amount described in subparagraph (A)(i).

(2) 8 and 15.5 percent rate equivalent percentages

…

(d) Deferred foreign income corporation; accumulated post-1986 deferred foreign income.—For purposes of this section—

…

(3) Post-1086 earnings and profits.—The term "post-1986 earnings and profits" means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986, and by only taking into account periods when the foreign corporation was a specific foreign corporation) accumulated in taxable years beginning after December 31, 1986, and determined—

(A) as of the date referred to in paragraph (1) or (2) of subsection (a), whichever is applicable with respect to such foreign corporation, and

(B) without diminution by reason of dividends distributing during the taxable year described in subsection (a) other than dividends distributed to another foreign corporation.

(e) Specified foreign corporation.—

(1) In general.—For purposes of this section, the term "specified foreign corporation" means—

(A) any controlled foreign corporation, and

(B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder.

…

(f) Determinations of pro rata share.—

(1) In general.—For purposes of this section, the determination of any United States shareholder's pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating

such amount in the same manner as subpart F income (any by treating such specified foreign corporation as a controlled foreign corporation).

(2) Special rules.—The portion which is included in the income of a United States shareholder under section 951(a)(1) by reason of subsection (a) which is equal to the deduction allowed under subsection (c) by reason of such inclusion—

(A) shall be treated as income exempt from tax for purposes of sections 705(a)(1)(B) and 1367(a)(1)(A), and

(B) shall not be treated as income exempt from tax for purposes of determining whether an adjustment shall be made to an accumulated adjustment account under section 1368(e)(1)(A).

…

APPENDIX E

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

Civil Action No. 2:19-cv-01539

CHARLES G. MOORE, et al.,

Plaintiffs,

v.

UNITED STATES OF AMERICA,

Defendant.

Filed: March 26, 2020

DECLARATION OF CHARLES G. MOORE

Pursuant to 28 U.S.C. § 1746, I, Charles G. Moore, declare and state as follows:

1. I am over the age of 18 years and am competent to make this declaration. I have personal knowledge of the facts stated herein, and if called as a witness, I could and would competently testify thereto.

2. I am married to Kathleen F. Moore, and we reside in King County, Washington.

3. I spent much of my career working at Microsoft Corporation ("Microsoft") in Washington State as a software engineer.

4. In 1991, I worked in Microsoft's applications development division where I met Ravindra Kumar Agrawal ("Ravi"). Ravi and I worked together on the Microsoft Word conversions team and then went on to work together on the Microsoft Office team. While working together, we became friends.

5. After one of Ravi's regular trips to India in the early 2000s, Ravi told me that he noticed that many small and marginal farmers in India used very simple and basic hand tools, ones that were far less efficient and effective than the tools available at Home Depot in the United States. In addition, Ravi noticed that people from the rural parts of India were increasingly leaving those areas and moving to cities, meaning there were fewer and fewer people available to perform farming and agricultural work, which drove up wages and farmers' operating costs.

6. Ravi shared with me his idea of starting a business to provide small and marginal farmers with more efficient and cost-effective tools and machines that would increase their productivity, help them better perform their jobs, and reduce their operating costs. Ravi's business plan was motivated by his

desire to help and serve small farmers and to establish a sustainable, profitable business.

7. Ravi assembled a business plan and formed an Indian Public Limited in 2005 called KisanKraft Machine Tools Private Limited ("KisanKraft"). Later, the company's name was changed to KisanKraft Limited.

8. Ravi approached a number of friends, including me, about investing in KisanKraft in 2005 and 2006. When Ravi first approached me, I gave his business plan and investment proposal significant thought. We discussed the short-term, mid-term, and long-term goals of KisanKraft and agreed that the best way for the business to succeed in its social and business missions would be for it to reinvest any earnings, expand geographically, and, perhaps one day, experience a public offering or sale. I thought the probability of that happening was low, but Ravi had a good business plan and was someone whom I trusted. Moreover, I thought KisanKraft was formed for a noble purpose and had the potential to improve the lives of small and marginal farmers in India.

9. Kathleen and I invested in KisanKraft at its inception in 2006. At first, there were only a handful of shareholders, and Ravi, Sarika Agrawal (Ravi's wife), and Kathleen and I contributed 99.5 percent of the start-up capital. Kathleen and I invested $40,000, which was approximately 11 percent of KisanKraft's start-up capital. That was a lot of money for us, but

we believed in Ravi's idea and wanted to support him and see it to fruition.

10. Since KisanKraft's inception, Ravi has lived in India, where he manages KisanKraft's day-to-day operations. From 2006 to 2010, we spoke regularly, and he would give me updates on KisanKraft, including any new opportunities or developments such as a new tool or machine that he wanted to distribute. At the end of each year, Ravi would send me an annual financial statement for KisanKraft.

11. Ravi asked Kathleen and me several times to come visit India. He wanted to show us around the country, and we wanted to see for ourselves how KisanKraft was doing.

12. My first visit to India was in the fall of 2011. This visit was both a vacation and to see how KisanKraft was doing. While in India, Ravi took me to KisanKraft's main office, where I met a number of KisanKraft employees.

13. During subsequent visits to India, I met other employees of KisanKraft and toured some of its branch offices and warehouses. I also met several dealers to which KisanKraft supplies its tools, as well as a few farmers who use its tools.

14. I remember that one dealer in particular was very proud of the income he earned from selling KisanKraft's products, which permitted him to send his daughter to college to study electrical engineering.

15. In total, I have visited India five times. My last trip was in 2016.

16. To this day, Ravi regularly shares information with me about KisanKraft and its business. While Ravi shares information with me, he has served as the decision maker and CEO of KisanKraft since its inception.

17. Since its inception, KisanKraft has not made any distributions of earnings to its shareholders. Instead, it has retained its earnings to grow its business and serve more customers.

18. Accordingly, I have never received a distribution, dividend, or other payment from KisanKraft.

19. Because KisanKraft reinvested its earnings, it does not have sufficient cash on hand to distribute its retained earnings from over the years to shareholders.

20. As a minority shareholder, I do not have the power to compel KisanKraft to make distributions to shareholders.

21. Ravi remains to this day committed to KisanKraft's success. He spends a significant amount of time managing KisanKraft and remains focused on growing its business and serving small and marginal farmers.

22. KisanKraft also has a corporate social responsibility policy. A true and correct copy of that

policy is attached as Exhibit A. Carrying out that policy, KisanKraft seeks to improve the quality of life in communities in which it operates.

23. Throughout 2017, Kathleen and I owned about 12.9 percent of KisanKraft's outstanding common shares.

24. I first became aware of the Mandatory Repatriation Tax in the summer of 2018. Ravi mentioned the tax to me and put me in touch with a CPA who prepared his returns.

25. The CPA told me about the Mandatory Repatriation Tax and how we were responsible for paying tax on KisanKraft's deferred foreign earnings going back to 2006. I was completely surprised. Having never received any income from KisanKraft, I certainly did not expect to have to pay income tax just because we owned shares in it.

26. The CPA said that, based on statements prepared by KisanKraft, the Mandatory Repatriation Tax meant that we would be subject to taxation on our pro rata share of KisanKraft's retained earnings, which amounted to approximately $508,000.

27. After receiving a deduction associated with the Mandatory Repatriation Tax, the CPA told me that our taxable income increase from the Mandatory Repatriation Tax was $132,512.

28. From the beginning, I had strong reservations about the Mandatory Repatriation Tax and thought

that a new tax on earnings so far in the past that we hadn't even received couldn't possibly be constitutional. Nevertheless, I recognized the necessity of complying with my federal income tax obligations.

29. Kathleen and I retained the CPA in the Summer of 2018 to help us become compliant with our filing obligations. The CPA prepared an amended U.S. federal income tax return for us, and we promptly filed it and paid our additional liability, which amounted to $14,729.

30. We filed a second amended return in March 2019 claiming a refund of the additional amount we paid as a result of the Mandatory Repatriation Tax on the ground that it violated the Constitution's apportionment requirement and Due Process Clause.

31. On August 30, 2019, the Internal Revenue Service mailed us a letter stating that our second amended return was referred to a second office. Other than that mailing, I did not receive any correspondence from the Internal Revenue Service regarding our second amended return. I declare under penalty of perjury that the foregoing is true and correct.

Executed this 26th day of March, 2020 at King County, Washington.

/s/ Charles G. Moore
Charles G. Moore

APPENDIX F

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

Civil Action No.

CHARLES G. MOORE, et al.,

Plaintiffs,

v.

UNITED STATES OF AMERICA,

Defendant.

Filed: September 26, 2019

COMPLAINT FOR REFUD OF FEDERAL INCOME TAX AND INTEREST

Plaintiffs, Charles G. and Kathleen F. Moore (collectively, "the Moores"), file this Complaint against the United States of America pursuant to 26 U.S.C. §§ 7422 and 6532, petitioning for a refund of federal income taxes paid to Defendant United States of America with respect to the taxable year ended December 31, 2017, and statutory interest thereon.

As the basis for their Complaint, Plaintiffs allege as follows:

I. NATURE OF THE ACTION

1. When the United States moved towards a territorial corporate tax system in the Tax Cuts and Jobs Act of 2017, families like that of Plaintiffs Charles and Kathleen Moore were hit with a new and unexpected tax liability. The Act's so-called "Mandatory Repatriation Tax" deemed certain foreign corporate earnings going back to 1986 to be repatriated to individual U.S. shareholders and subject to a 15.5 percent tax rate. For the Moores, that meant an unexpected tax bill, based on their small stake in an Indian company, KisanKraft Ltd., that a friend founded to provide affordable equipment to India's small-scale farmers. That tax bill was based on earnings retained by and reinvested by the company that the Moores never received. Simply for owning a stake in their friend's overseas business, they were on the hook for thousands of dollars in taxes.

2. The Mandatory Repatriation Tax is unconstitutional for two independent reasons. First, it violates the Constitution's Apportionment Clause, which requires direct taxes to "be apportioned among the several states." The Mandatory Repatriation Tax is a direct tax, and not an income tax, because it is not based on income at all, but on the fiction that taxpayers subject to it received income in the absence of an actual "gain…*received or drawn by* the recipient (the taxpayer) for his separate use, benefit and disposal." *Eisner v. Macomber*, 252 U.S. 189, 207

(1920). In this respect, it is no different from an unapportioned tax on capital itself and equally beyond Congress's power to enact. Second, the Mandatory Repatriation Tax violates the Fifth Amendment's Due Process Clause because it imposes retroactive tax liability for earnings dating back over three decades to 1986. That is precisely the kind of "harsh and oppressive" retroactive taxation that the Supreme Court has held to "transgress…constitutional limitation." *Welch v. Henry*, 305 U.S. 134, 147 (1938).

3. Because the Mandatory Repatriation Tax is unconstitutional, the Moores are entitled to a refund of the amounts they paid under the Mandatory Repatriation Tax.

II. THE PARTIES

4. Plaintiff Charles G. Moore ("Mr. Moore") resides at 10834 179th Ct. NE, Redmond, WA 98052.

5. Plaintiff Kathleen F. Moore ("Mrs. Moore") resides at 10834 179th Ct. NE, Redmond, WA 98052.

6. Defendant, by and through its agency, the Internal Revenue Service, is the United States of America.

III. JURISDICTION AND VENUE

7. This Court has jurisdiction under 28 U.S.C. § 1346(a)(1) and 26 U.S.C. § 7422.

8. Venue is proper in this Court under 28 U.S.C. § 1402(a)(1) because the Moores reside within the Court's Judicial District.

9. Pursuant to 26 U.S.C. §§ 7422 & 6532(a)(1), the Moores bring this action (1) after they paid the disputed federal income taxes that were erroneously assessed, and (2) after six months from their timely filing of refund claims with the Internal Revenue Service for the overpayment of federal income taxes, and statutory interest thereon.

10. The Moores have satisfied all conditions precedent to filing this suit.

IV. BACKGROUND

Statutory Background

11. Prior to the passage of the Tax Cuts and Jobs Act of 2017 ("TCJA"), certain foreign income of a controlled foreign corporation (e.g., active business income) was generally not taxed until it was repatriated through a distribution or loan to U.S. shareholders. As a result, taxation of such income could generally be deferred indefinitely provided the controlled foreign corporation reinvested those earning abroad.

12. The TCJA imposed a tax on previously earned foreign income of a controlled foreign corporation, which the TCJA refers to as "deferred foreign income." In particular, the TCJA deemed deferred foreign income of controlled foreign corporations earned from 1986 through 2017 to be treated as having been distributed to U.S. shareholders and thus subject to U.S. federal taxation. *See* 26 U.S.C. § 965. This tax has come to be known as the "Mandatory Repatriation Tax."

13. A controlled foreign corporation is not liable for the Mandatory Repatriation Tax. Instead, U.S. shareholders who own at least a 10 percent stake in a controlled foreign corporation with deferred foreign income are liable for the Mandatory Repatriation Tax.

14. Such shareholders are liable for the Mandatory Repatriation Tax even when the deferred foreign income was not distributed to them and even when they had no control over whether the deferred foreign income could be distributed to them.

Factual Background

15. Mr. Moore owned 12.937 percent of KisanKraft Limited, a closely held Indian public limited company and controlled foreign corporation for U.S. tax purposes ("KisanKraft").

16. KisanKraft is headquartered and has a registered office in Bangalore, India.

17. KisanKraft is a certified manufacturer, importer, and distributor of affordable farming equipment in India. KisanKraft primarily serves small and marginal farmers throughout India. In general, such farmers are underserved in India because major manufacturers, importers, and distributors of farming equipment focus on large commercialized farmlands.

18. Mr. Moore has owned shares of stock in KisanKraft since 2006.

19. Since 2006, KisanKraft has experienced steady revenue growth and has reported positive earnings almost every year.

20. None of those profits were distributed to Mr. Moore. Instead, they were retained by KisanKraft and reinvested in its business abroad.

21. The Moores timely filed their 2017 federal income tax return with the Internal Revenue Service on or before the April 17, 2018 deadline (the "Original Return").

22. The Moores filed an amended return on October 26, 2018 the ("Amended Return"). The Amended Return included:

(a) Disclosures of Mr. Moore's 12.937 percent direct ownership of KisanKraft;

(b) A reasonable cause statement requesting that penalties not be imposed as a result of the Moores' unintentional failure to previously file disclosures of Mr. Moore's ownership of shares in KisanKraft; and

(c) A payment of $15,130 that resulted from an increase in tax due to:

(i) The inclusion in taxable income of their pro rata share of the post-1986 earnings and profits of KisanKraft pursuant to 26 U.S.C. § 965;

(ii) The partial participation exemption deduction pursuant to 26 U.S.C. § 965(c); and

(iii) A reduced foreign tax credit offset pursuant to 26 U.S.C. § 965(g) (collectively, these amounts are referred to as the "Mandatory Repatriation Tax Inclusion").

23. As a result of the TCJA's Mandatory Repatriation Tax, the Moores were required to report as taxable income the Mandatory Repatriation Tax Inclusion amount of $132,512.

24. The Moores filed as their claim for refund a second amended return on March 25, 2019 (the "Refund Claim," Ex. A). The Refund Claim asserts the Mandatory Repatriation Tax Inclusion of $132,512 as income in the Amended Return is not lawfully taxable under the Constitution's Apportionment Clause and Due Process Clause. The Refund Claim requested a refund of the $14,729 additional amount of federal income taxes paid.

25. The Moores are the sole owners of their refund claim and have made no assignment or transfer of any part of that claim.

V. THE INTERNAL REVENUE SERVICE'S POSITION

26. On August 30, 2019, the Internal Revenue Service mailed a letter to the Moores stating their Refund Claim was being referred to a separate office.

27. The letter further indicated the Moores would receive a response within 45 days.

28. As of the date of this filing, no response has been received.

29. As of the date of this filing, no notice of disallowance has been mailed to the Moores.

30. On September 9, 2019, the Internal Revenue Service mailed a letter to the Moores indicating that

the Amended Return had been accepted and no penalties were assessed.

VI. CAUSES OF ACTION

COUNT I:
Unconstitutional Direct Tax

31. The Moores hereby incorporate by reference the allegations contained in paragraphs 1 to 30 of this Complaint as if fully set forth herein.

32. The Apportionment Clause of Article I, Section 9 of the U.S. Constitution prohibits unapportioned direct taxes.

33. The Mandatory Repatriation Tax is not apportioned among the states.

34. The Mandatory Repatriation Tax is a direct tax, because it directly taxes U.S. shareholders who own at least 10 percent (by vote or value) of a controlled foreign corporation.

35. The Mandatory Repatriation Tax is not an income tax authorized by the Sixteenth Amendment because it imposes a tax liability in the absence of 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, benefit, and disposal." *Eisner v. Macomber*, 252 U.S. 189, 207 (1920).

36. The Mandatory Repatriation Tax therefore violates the Apportionment Clause and is unconstitutional.

37. Accordingly, the Mandatory Repatriation Tax Inclusion of $132,512 is not federal taxable income, and the Moores are entitled to a refund for their 2017 year in the amount of $14,729, plus statutory interest.

COUNT II:

Retroactive Taxation in Violation of the Due Process Clause

38. The Moores hereby incorporate by reference the allegations contained in paragraphs 1 to 37 of this Complaint as if fully set forth herein.

39. The Fifth Amendment's Due Process Clause bars retroactive impositions of tax liability where "the retroactive application is so harsh and oppressive as to transgress the constitutional limitation." *Welch v. Henry*, 305 U.S. 134, 147 (1938).

40. The Mandatory Repatriation Tax retroactively imposes tax liability going back to 1986, over three decades prior to its enactment.

41. The Mandatory Repatriation Tax is a new tax. It is not a technical correction or refinement of preexisting tax law. Instead, it imposes a tax liability in a way that could not have been foreseen or planned for prior to its enactment, let alone 30 years prior to its enactment. In other words, "the nature or amount of the tax could not reasonably have been anticipated by the taxpayer" or the controlled foreign corporation at the time of the events that the Mandatory Repatriation Tax later made taxable. *Welch*, 305 U.S. at 147. Taxpayers were not "forewarned by the statute books of the possibility of such a levy." *Id*.

42. The Mandatory Repatriation Tax therefore violates the Fifth Amendment's Due Process Clause and is unconstitutional.

43. Accordingly, the Mandatory Repatriation Tax Inclusion of $132,512 is not federal taxable income, and the Moores are entitled to a refund for the 2017 year in the amount of $14,729, plus statutory interest.

VII. PRAYER FOR RELIEF

WHEREFORE, the Moores respectfully request that the Court:

44. Determine that the disputed federal income taxes were erroneously assessed and the Moores have valid defenses against the assertion of such taxes;

45. Award the Moores a refund for the 2017 year in the amount of $14,729, plus statutory interest;

46. Award the Moores their costs in this action;

Enter such other further relief to which the Moores may be entitled as a matter of law or equity, or which the Court determines to be just and proper.

DATED this 26th day of September, 2019.

Respectfully submitted,

BAKER & HOSTETLER LLP

s/ James R. Morrison

James R. Morrison, WSBA No. 43043
999 Third Avenue

Suite 3600
Seattle, WA 98104-4040
Tel: 206.332.1380
FAX: 206.624.7317
E-mail: jmorrison@bakerlaw.com

Andrew M. Grossman*
David B. Rivkin, Jr.*
Jeffrey H. Paravano*
Katherine L. McKnight*
Nicholas C. Mowbray*
Washington Square, Suite 1100
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5304
Tel: (202) 861-1500
Fax: (202) 861-1783
E-mail: agrossman@bakerlaw.com
E-mail: drivkin@bakerlaw.com
E-mail: jparavano@bakerlaw.com
E-mail: kmcknight@bakerlaw.com
E-mail: nmowbray@bakerlaw.com

COMPETITIVE ENTERPRISE INSTITUTE
Sam Kazman*
Devin Watkins*
1310 L Street NW, 7th Floor
Washington, D.C. 20005
Tel: (202) 331-1010
Fax: (202) 331-0640
Email: Sam.Kazman@cei.org
Email: Devin.Watkins@cei.org

Attorneys for Plaintiffs

*Pro hac vice applications forthcoming.