No. 22-800

In the Supreme Court of the United States

CHARLES G. MOORE AND KATHLEEN F. MOORE,
Petitioners,
v.

UNITED STATES OF AMERICA,
Respondent.

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

BRIEF OF THE CATO INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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March 27, 2023

QUESTION PRESENTED

Whether Congress may levy income tax on a taxpayer who has not realized income.

TABLE OF CONTENTS

QUESTION PRESENTED i

TABLE OF AUTHORITES iii

INTEREST OF *AMICUS CURIAE* 1

INTRODUCTION AND SUMMARY OF ARGUMENT 2

ARGUMENT 4

I. The Mandatory Repatriation Tax Was Unprecedented in U.S. Tax Law. 4

II. The Sixteenth Amendment Only Grants Congress the Power to Tax Income. 7

III. This Case Does Not Challenge Whether Congress May Impose a Repatriation Tax or Annual Income Tax on Current-Year Foreign Earnings. 13

IV. The Mandatory Repatriation Tax Does Not Tax Income and Cannot Be Justified Under the Sixteenth Amendment. 16

CONCLUSION 18

TABLE OF AUTHORITES

Cases

Analog Devices v. Comm'r, 147 T.C. 429, 437 (2016) 13

Comm'r v. Glenshaw Glass, 348 U.S. 426 (1955) 11

Cottage Sav. Ass'n v. Comm'r, 499 U.S. 554 (1991) 12

Dave Fischbein Mfg. Co. v. Comm'r, 59 T.C. 338 (1972) 4

Dougherty v. Comm'r, 60 T.C. 917 (1973) 5

Edwards v. Cuba R. Co., 268 U.S. 628 (1925) 7

Eisner v. Macomber, 252 U.S. 189 (1920) 8, 9, 10

Garlock Inc. v. Comm'r, 489 F.2d 197 (2d Cir. 1973) 14

Helvering v. Horst, 311 U.S. 112 (1940) 10, 12

Merchants' Loan & Tr. Co. v. Smietanka, 255 U.S. 509 (1921) 16

United States v. Safety Car Heating & Lighting Co., 297 U.S. 88 (1936) 16

Whitlock's Est. v. Comm'r, 59 T.C. 490 (1972) 14

Statutes

American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 422(a), 118 Stat. at 1514-1515 13

I.R.C § 951 14

I.R.C. § 61 7

I.R.C. § 951 5

I.R.C. § 957 5

I.R.C. § 965 .... 4, 6

Other Authorities

Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1 (1999) 17

I.R.S. Rev. Rul. 2019-24 11

Joint Comm. on Taxation, JCX-96-15, Present Law and Selected Proposals Related to the Repatriation of Foreign Earnings (2015) 5

Merriam-Webster Online Dictionary, (last visited Mar. 18, 2023) 8

Sean P. McElroy, *The Mandatory Repatriation Tax Is Unconstitutional*, 37 Yale J. Reg. Bull. 69 (2018) 15

U.S. Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals 17

Constitutional Provisions

U.S. Const. amend. XVI 2, 7

U.S. Const. art. I., § 9 .... 2, 7

INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan public policy research foundation founded in 1977 and dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Robert A. Levy Center for Constitutional Studies helps restore the principles of constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences, and produces the annual *Cato Supreme Court Review*.

This case interests *amicus* because Congress must respect constitutional limits in exercising its taxing power. The Ninth Circuit's decision breaches the constitutional constraints that this Court has recognized for over a century. The decision below thus leaves the door open for Congress to further overstep the limits the Constitution places on Congress's taxing power.

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[1] Rule 37 statement: All parties were timely notified of the filing of this brief. No part of this brief was authored by any party's counsel, and no person or entity other than *amicus* funded its preparation or submission.

INTRODUCTION AND SUMMARY OF ARGUMENT

To be subject to income tax, a taxpayer must have income. The Mandatory Repatriation Tax—enacted as part of the 2017 Tax Cuts and Jobs Act—deems certain holdings to be the income of taxpayers and subject to a one-time tax. But this tax is levied on accumulated wealth and not on income. The Mandatory Repatriation Tax is thus an income tax on amounts that are not income.

In 1913, the Sixteenth Amendment granted Congress the power to tax "incomes, from whatever source derived, without apportionment among the several States." U.S. Const. amend. XVI. This amendment excepted federal "income" taxes from the Constitution's requirement that "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to" a state's population. U.S. Const. art. I., § 9, cl. 4. Since the ratification of the Sixteenth Amendment, this Court has consistently interpreted "income" as referring to amounts that the taxpayer realizes in a particular accounting period. Therefore, this Court has consistently treated contemporaneous realization of income as a constitutional prerequisite to a tax that is not subject to the apportionment requirement set forth in Article I.

In holding that the Mandatory Repatriation Tax is constitutional, the Ninth Circuit rejected this well-established principle and contradicted this Court's precedents. The Ninth Circuit's approach contorted the definition of "income" beyond recognition. The lower court's approach would permit Congress to tax items that are not income without regard to the Constitution's apportionment requirement.

The experience of the Appellants in this case starkly demonstrates how the Mandatory Repatriation Tax imposed an "income" tax on citizens who simply did not receive income. In 2006, Charles and Kathleen Moore invested $40,000 for a 13 percent stake in an Indian company, KisanKraft. KisanKraft provides basic tools to farmers in India's most impoverished regions, and it has reinvested all its earnings to pursue this aim. For that reason, the Moores have never received any distribution, dividend, or payment from KisanKraft. And they have never sold or otherwise disposed of their KisanKraft shares.

The Mandatory Repatriation Tax, however, subjected the Moores to a tax on their *investment* in KisanKraft, based on their pro rata share of KisanKraft's accumulated earnings. Because KisanKraft never distributed any of its earnings to the Moores, the Moores were taxed on their investment despite realizing no income from their investment.

If a tax on unrealized investment holdings like the Mandatory Repatriation Tax can be treated as an "income" tax, then anything can be treated as an income tax. And if anything can be treated as an income tax, then the Sixteenth Amendment's limitation to "income" taxes is meaningless. Under the Ninth Circuit's reasoning, Congress would have the power to tax anything it deems to be "income," regardless of apportionment. The Court should grant review and restore meaningful limits to the Sixteenth Amendment.

ARGUMENT

I. The Mandatory Repatriation Tax Was Unprecedented in U.S. Tax Law.

The 2017 Tax Cuts and Jobs Act (TCJA) was the most wide-ranging change in federal tax law since the Tax Reform Act of 1986. Part of the TCJA's transformation of the U.S. international tax system was the imposition of a one-time Mandatory Repatriation Tax. *See* I.R.C. § 965.

To understand the Mandatory Repatriation Tax, it is necessary to first understand some fundamental features of the general structure of U.S. international tax law before the enactment of the TCJA. Before the TCJA, the income of a foreign corporation was generally not subject to U.S. taxation unless and until that income was distributed to U.S. taxpayers. *See, e.g.*, *Dave Fischbein Mfg. Co. v. Comm'r*, 59 T.C. 338, 353 (1972). Accordingly, U.S. taxpayers would only incur taxes on the earnings of a foreign corporation when the U.S. taxpayers realized income through distribution (or "repatriation"), such as through dividend payments. This treatment was consistent with the general principle that a taxpayer is not subject to income tax until the taxpayer realizes income.

Congress enacted the principal exception to this general rule through the regime known as Subpart F. Subpart F, enacted in 1962, singles out a specific class of U.S. taxpayers who own shares in foreign corporations (U.S. Shareholders). U.S. Shareholders are defined as U.S. persons (including entities) who own at least 10% of the shares of a foreign corporation and who collectively own more than 50% of the shares of such corporation (known as a controlled foreign

corporation, or CFC). *See* I.R.C. § 957(a). Subpart F taxes U.S. Shareholders on certain classes of a CFC's income in the year the CFC earns that income, regardless of whether the CFC distributes that income, in circumstances where Congress determined the shareholders have constructively realized it.[2] *See* I.R.C. § 951; *see also Dougherty v. Comm'r*, 60 T.C. 917, 928 (1973); Joint Comm. on Taxation, JCX-96-15, Present Law and Selected Proposals Related to the Repatriation of Foreign Earnings, 2 (2015).

Accordingly, taxation under the Subpart F regime is limited to only certain narrow types of a CFC's current-year income (generally passive forms of income such as interest, or rental income). Under this rule, even a U.S. taxpayer who meets the definition of a U.S. Shareholder will not pay taxes on the undistributed income of a CFC that falls outside the Subpart F categories. Thus, under the U.S. international tax regime before the TCJA, many CFCs had accumulated considerable earnings without distributing such amounts, and U.S. taxpayers had never paid taxes on most of those undistributed amounts.

The Mandatory Repatriation Tax dramatically changed this rule and retroactively taxed shareholders on those undistributed earnings. The Mandatory Repatriation Tax levied a one-time tax on U.S. Shareholders based on their pro rata share of a specified foreign corporation's (SFC) accumulated earnings during the *entire* period that the taxpayers qualified as U.S.

[2] For clarity, references to "Subpart F" refer to the Subpart F tax under I.R.C. § 951 that was in place prior to the enactment of the TCJA and remains in place today. As used here it does not include the Mandatory Repatriation Tax. It also does not include the I.R.C. § 951A GILTI tax.

Shareholders.[3] An SFC is a corporation that is either a CFC or certain other types of foreign corporations that have U.S. owners. To use the Moores as an example, the Moores held roughly 13 percent of KisanKraft shares in 2017. The Moores were therefore taxed *as if* KisanKraft (an SFC) had, in 2017, distributed to the Moores a dividend worth 13 percent of KisanKraft's total earnings since 2006. The Mandatory Repatriation Tax thus creates a fiction, treating an SFC *as if* it paid its U.S. Shareholders a dividend in 2017 based on its accumulated earnings going back years or even decades. The U.S. Shareholders are then subject to a one-time tax on this fictional dividend, whether or not the U.S. Shareholders actually received (or could ever receive) any dividend or payment from the SFC. *See* I.R.C. § 965.[4]

Of course, such dividends are fictional. In effect, the Mandatory Repatriation Tax has taxed U.S. Shareholders on unrealized gains over multiple prior years. The tax is unprecedented.

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[3] At various points in its analysis, the Ninth Circuit seemed to conflate the Mandatory Repatriation Tax with the Subpart F tax, which has been in the Tax Code for roughly sixty years. *See* Pet. App. 16 (suggesting that to invalidate the Mandatory Repatriation Tax on constitutional grounds would be to hold "that Subpart F is unconstitutional"). Although the Mandatory Repatriation Tax builds on the Subpart F tax (as that term is used here), it is a distinct tax that raises unique constitutional issues not raised by the long-standing Subpart F tax. *See infra* Part III.

[4] Although this is a somewhat simplified explanation of the Mandatory Repatriation Tax's mechanics, it is sufficient for understanding the constitutional question.

II. The Sixteenth Amendment Only Grants Congress the Power to Tax Income.

The Constitution grants Congress the power to tax, but the Constitution also places significant limitations on Congress's taxing power. Congress may not levy "direct" taxes without apportioning such taxes among the states based on their populations. U.S. Const. art. I, § 9, cl. 4. After this Court held that taxes on the income generated by personal property required apportionment, the Sixteenth Amendment was ratified, providing that Congress may "collect taxes on incomes, from whatever source derived," without apportionment based on population. U.S. Const. amend. XVI. As this Court has recognized, "[t]he 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). And Congress has echoed the language of the Sixteenth Amendment in the federal Tax Code, providing that gross income subject to the federal income tax "means income from whatever source derived . . . ." I.R.C. § 61.

This Court has consistently interpreted "income," as used in the Sixteenth Amendment, to require a realization event—that is, an event in which something of value is conferred on the taxpayer. This consistent approach, which has treated a realization event as a *sine qua non* of "income," follows directly from the plain English definition of that word. *Merriam-Webster* defines "income" as "a coming in" and as "a gain or recurrent benefit usually measured in money that derives from capital or labor; also: the amount of such gain received in a period of time." "Income," *Merriam-*

Webster Online Dictionary.[5] Without a realization event, nothing has "come in" to a taxpayer and nothing has been "gained."

In *Eisner v. Macomber*, 252 U.S. 189 (1920), this Court held that a transaction similar to a stock split did not give shareholders taxable "income." A corporation had issued a prorated "stock dividend" to its shareholders, issuing each shareholder newly created shares (for example, the shareholder in *Macomber* had held 2,200 shares and was issued an additional 1,100 in new shares). *Id.* at 200. But because the corporation issued new shares, and each shareholder received a prorated amount of the new shares, each shareholder's total percentage ownership in the corporation did not change. Because there were 50 percent more total shares after the stock dividend, each individual share was worth only 66.7 percent of what it had been worth immediately before the stock dividend. As the Court explained, a stock dividend "simply increase[s] the number of the shares, with consequent dilution of the value of each share." *Id.* at 211. For that reason, the Court held that "a stock dividend really take[s] nothing from the property of the corporation and add[s] nothing to that of the shareholder." *Id.* at 212.

Because the percentage interest held by the shareholder had not changed, the Court held that the stock dividend was not income and therefore could not be subject to federal income tax, given that the Sixteenth Amendment's exception to apportionment "applies to income only." *Id.* at 219. But particularly relevant to the constitutional question at issue here, the Court

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[5] Available at https://www.merriam-webster.com/dictionary/income (last visited Mar. 18, 2023).

also held that unless and until a corporation distributes its earnings, a shareholder does not realize income merely from an increase in the value of his stock holdings.

Specifically, the Court rejected the theory that the stock dividend should have been treated as taxable income because it "evidence[d] an antecedent increase in the value of the stockholder's capital interest resulting from an accumulation of profits by the company." *Id.* at 210. The Court noted that stock dividends often are declared after a period of growth and profit for a company during which its share price rises, and the purpose of a stock dividend is often to bring the value of each share closer to its original value before such growth and profit occurred. For that reason, shareholders in a company that has issued a stock dividend will often have seen the value of their holdings rise during the preceding few years. On that basis, the government argued in *Macomber* that a stock dividend "measure[s] the extent to which the gains accumulated by the corporation have made [a stockholder] the richer." *Id.* at 214.[6] But even accepting that premise, the Court firmly rejected the argument that such an increase in stock value is *itself* income. Instead, the Court unambiguously held that "enrichment through increase in value of capital investment is not income in any proper meaning of the term." *Id.* at 214–15. The Court explained rather that "the stockholder's share in

[6] Indeed, the government went so far as to argue that "the tax is imposed not upon the stock dividend but rather upon the stockholder's share of the undivided profits previously accumulated by the corporation; the tax being levied as a matter of convenience at the time such profits become manifest through the stock dividend." *Id.* at 217.

the accumulated profits of the company is capital, not income." *Id.* at 219.

In *Macomber*, the Court thus concluded that "from every point of view, we are brought irresistibly to the conclusion that neither under the Sixteenth Amendment nor otherwise has Congress power to tax without apportionment a true stock dividend made lawfully and in good faith, *or the accumulated profits behind it*, as income of the stockholder." *Id.* (emphasis added).

In *Helvering v. Horst*, this Court reiterated "the rule that income is not taxable until realized." 311 U.S. 112, 116 (1940). *Horst* concerned a father's gift to his son. Paul Horst had owned a bond from which the "interest coupons" could be detached and given to another, granting the recipient the right to collect specific interest payments on the bond. Horst gave two such interest coupons to his son as gifts, retaining for himself the bond and the right to receive the principal amount of the bond at maturity. *Id.* at 114. The question was whether the father could be taxed for the amount of interest paid to his son from the gifted interest coupons.

The Court held that the father could indeed be taxed for the interest payments to his son, establishing the now well-accepted principle that a taxpayer cannot escape taxation by assigning income that the taxpayer himself otherwise would have realized. *Id.* at 119. The Court held that when taxpayers have the right to enjoy the economic benefit of property "by some event other than the taxpayer's personal receipt of money or property," this event constitutes a "realization of the income." *Id.* at 116. In *Horst*, the "realization event" was the giving of the interest coupon as a gift. Thus, *Horst* held that a taxpayer cannot escape taxation on the

realization of income by assigning his right to another person; in such cases, the *assignment* of the right is the realization event.

And if there was any doubt after *Horst* that realization of income remained a prerequisite to income taxation, this Court dispelled that doubt in *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955). In *Glenshaw Glass*, the Court held as explicitly as it ever has that realization is a precondition for the imposition of income tax. *Glenshaw Glass's* now-landmark test for whether taxpayers have received income asks whether the taxpayers have received "undeniable accessions to wealth, *clearly realized*, and over which the taxpayers have complete dominion." *Id.* at 431 (emphasis added). The IRS, for its part, respects this definition and applies it in published opinions that evaluate whether taxable income exists. *See, e.g.*, I.R.S. Rev. Rul. 2019-24 (applying the three-prong *Glenshaw Glass* test to determine whether a taxpayer had income in certain cryptocurrency transactions).

The Ninth Circuit's holding, however, jettisoned the realization requirement. The Ninth Circuit forthrightly admitted that under its approach, "Whether the taxpayer has realized income does not determine whether a tax is constitutional." Pet. App. 12. But this statement is irreconcilable with this Court's holdings in *Macomber*, *Horst*, and *Glenshaw Glass*, among others.

In reaching this conclusion, the Ninth Circuit severely misread this Court's decision in *Horst*. The Ninth Circuit erroneously interpreted *Horst* to hold that realization is not a constitutional requirement for income. *See* Pet. App. 12–16. But *Horst* addressed a narrow issue that has no bearing on this case: whether

a person can escape taxation by assigning the right to a monetary payment that the assignor otherwise would have received. As explained above, the Court held that a person cannot escape income tax in this manner because making such an assignment is *itself* a realization event. If realization were not a requirement for income tax *at all*, the Court would not have explained at length why the father realized income by the act of giving the gift. *See Horst*, 311 U.S. at 117–18 ("To say that one who has made a gift . . . has never enjoyed or realized the fruits of his investment or labor . . . is to affront common understanding and to deny the facts of common experience.").

Further, *Horst* predated *Glenshaw Glass* by fifteen years. If *Horst* had eliminated the realization requirement, this Court would not have expressly included that requirement in its definition of income fifteen years later. Nowhere does the *Glenshaw Glass* opinion suggest that this definition is in any tension with *Horst*, because it is not.[7]

This case thus provides the Court with an opportunity to correct the Ninth Circuit and reaffirm what this Court has always held—that realization is a

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[7] Nor is *Cottage Savings Ass'n v. Commissioner*, 499 U.S. 554 (1991), in tension with either *Horst's* or *Glenshaw Glass's* mandate that income must be realized before taxed under the Sixteenth Amendment. Like *Horst*, *Cottage Savings* addresses a narrow issue that is not relevant to this case: whether a realization event occurs when a taxpayer exchanges property for materially similar property. There was no constitutional question at issue in *Cottage Savings*, nor any debate as to whether there had been a realization event. The question before the Court was whether that realization event was material enough to give rise to taxation. For amounts taxable under the Mandatory Repatriation Tax, by contrast, there is no realization event at all.

constitutional requirement for the imposition of income tax.

III. This Case Does Not Challenge Whether Congress May Impose a Repatriation Tax or Annual Income Tax on Current-Year Foreign Earnings.

Congress's prior enactments taxing shareholders of foreign corporations have passed constitutional muster because, consistent with the Sixteenth Amendment, these taxes have always been imposed on realized current-year income.

The Mandatory Repatriation Tax is not the first time that Congress has sought to tax accumulated foreign earnings. An old, now defunct, version of Section 965 of the Internal Revenue Code (Old Section 965) permitted U.S. Shareholders to realize dividend income from their CFCs at a reduced rate. American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 422(a), 118 Stat. at 1514-1515. Specifically, Old Section 965 allowed CFCs to repatriate accumulated foreign profits to U.S. corporate owners at a U.S. tax rate of 5.25 percent, rather than the then-standard 35 percent corporate rate.

However, for Old Section 965's reduced tax rate to apply, the CFC had to pay a dividend to its U.S. Shareholders in the specific year when Old Section 965 was applicable (generally, 2004). In other words, for the tax to apply a U.S. shareholder *had to realize income* during that taxable year.[8]

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[8] Old Section 965 also imposed several limitations on the ability of taxpayers to take the deduction. *See, e.g.*, *Analog Devices v. Comm'r*, 147 T.C. 429, 437 (2016).

Accordingly, there was no question as to the constitutionality of the Old Section 965, and its very design reflected the constitutional need for income to be realized before it is taxed. Old Section 965 relied on an *actual* repatriation, rather than a fictional repatriation. The Mandatory Repatriation Tax, by contrast, was imposed regardless of whether a CFC had ever paid a dividend to its U.S. Shareholders.

The other tax on shareholders of foreign corporations that predates the Mandatory Repatriation Tax is Subpart F. Under Subpart F, U.S. Shareholders are taxed on certain classes of a CFC's income in the year the CFC earns that income. I.R.C § 951. When the constitutionality of Subpart F was challenged, the issue as framed by the Tax Court was whether a taxpayer could be subject to tax on its share of a foreign corporations' current-year income that the taxpayer had constructively realized. *Whitlock's Est. v. Comm'r*, 59 T.C. 490, 508 (1972), *aff'd in part, rev'd in part*, 494 F.2d 1297 (10th Cir. 1974) (emphasis added) ("[W]hether Congress may constitutionally tax the *current* undistributed income of a corporation to the corporation's . . . stockholders."). Thus, lower courts' analysis turned on whether Congress could tax a shareholder on the *current-year* income of a CFC, treating the CFC's income that year as the shareholder's own. *See Garlock Inc. v. Comm'r*, 489 F.2d 197, 202 (2d Cir. 1973). And so the constitutionality of Subpart F turns on the question of whether a U.S. shareholder can constitutionally be taxed on that current-year income in circumstances where Congress determined the shareholders have constructively realized that income.

But Subpart F does not subject, and never has subjected, a U.S. Shareholder to taxation on a foreign corporation's *accumulated* earnings going back multiple years. Whether accumulated earnings (income from prior years) can be deemed income by Congress in a current year (despite no realization event occurring in that current year) is the constitutional issue raised by the unique legal fiction underlying the Mandatory Repatriation Tax.[9]

Finally, reframing the Mandatory Repatriation Tax as a retroactive income tax would not fix the constitutional problem. Significant Fifth Amendment due process concerns would be raised by treating amounts that came in during prior accounting periods as income. *See* Sean P. McElroy, *The Mandatory Repatriation Tax Is Unconstitutional*, 37 Yale J. Reg. Bull. 69 (2018). For that reason, this case squarely and unavoidably presents the question that the Ninth Circuit answered erroneously: whether realization is necessary to impose a federal income tax.

In sum, the Mandatory Repatriation Tax represents an unprecedented jettisoning of the principle that income tax must be imposed on realized income. The Ninth Circuit's decision is unprecedented, and prior taxes upheld by lower courts have differed from the Mandatory Repatriation Tax in constitutionally meaningful respects. The novelty and significance of

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[9] The same analysis for Subpart F also applies to the annual tax on global intangible low-taxed income (GILTI), which was enacted as part of the TCJA. The constitutionality of GILTI is not at issue in this case, and holding the Mandatory Repatriation Tax unconstitutional would not necessarily mean GILTI is unconstitutional, just as it would not necessarily mean the Subpart F regime is unconstitutional.

both the Mandatory Repatriation Tax, and the Ninth Circuit's reasoning in upholding the tax, call for this Court's review.

IV. The Mandatory Repatriation Tax Does Not Tax Income and Cannot Be Justified Under the Sixteenth Amendment.

If the Ninth Circuit's decision is not reviewed, it will not only subject the Moores to an unconstitutional tax. It will also give Congress a green light to use the Sixteenth Amendment as a cloak to unconstitutionally tax other amounts, without apportionment, that are not income. Thus, while the particular tax at issue in this case might be narrow, the constitutional ramifications are broad.

Indeed, the question is foundational—is this Court's fundamental income tax jurisprudence still good law? Must an amount be realized to be treated as "income" within the meaning of the Sixteenth Amendment? Whether an amount is properly characterized as income is an issue this Court has faithfully considered, using the same fundamental analysis, since the Sixteenth Amendment was enacted. *See, e.g.*, *Merchants' Loan & Tr. Co. v. Smietanka*, 255 U.S. 509, 519 (1921) (applying what the Court believed "to be the commonly understood meaning of the term [income] which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution.") (citing cases); *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99 (1936) (same).

Further, in deciding whether to grant review, this Court need not be concerned about opening a Pandora's Box. The Ninth Circuit was misguided in believing that a contrary ruling would "call into question the

constitutionality of many other tax provisions that have long been on the books." Pet. App. 16 (citing Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1, 52 (1999)). As noted above, the constitutional basis of the other taxes that bear some resemblance to the Mandatory Repatriation Tax is not at issue here, and those taxes are distinguishable from this one. The Mandatory Repatriation tax crosses a line that these other taxes did not cross. Simply put, the Mandatory Repatriation Tax does not tax income, and it barely even purports to.

Finally, if the Ninth Circuit's opinion stands, Congress may be emboldened to unconstitutionally subject other amounts to the income tax. *See, e.g.*, U.S. Dep't of the Treasury, General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals, at 78–82 (providing for a tax on unrealized capital gains); *see also* Pet. 25 (recounting recent proposals to enact a federal wealth tax). For all these reasons, review is warranted here so that this Court can consider the Ninth Circuit's endorsement of an unprecedented expansion of Congress's taxing power.

CONCLUSION

For the foregoing reasons, and those described by the Petitioner, this Court should grant the petition.

Respectfully submitted,

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March 27, 2023