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 Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF OF *AMICUS CURIAE* LANDMARK LEGAL FOUNDATION IN SUPPORT OF PETITIONERS

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STATEMENT OF INTEREST OF *AMICUS CURIAE*[1]

Amicus Curiae Landmark Legal Foundation ("Landmark") is a national public-interest law firm committed to preserving the principles of limited government, separation of powers, federalism, originalist construction of the Constitution and individual rights. Landmark has a unique perspective on this case. It was one of the very few *amici curiae* who raised the implications of the Apportionment Clause and Direct Tax Clause in the main challenge to the Affordable Care Act. Brief for *Amicus Curiae* Landmark Legal Foundation at 18-35, *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519 (2012) (No. 11-393). This area had been largely ignored in the Government's briefs. *Id.* at 669 (Scalia, Thomas, Kennedy & Alito, JJ., dissenting).

Landmark urges this Court to grant the petition for certiorari and reverse the ruling of the Court of Appeals for the Ninth Circuit.

[1] No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than *Amicus Curiae*, its members, or its counsel made a monetary contribution to its preparation or submission. Counsel for *Amicus Curiae* notified counsel for all parties of its intention to file this brief on March 10, 2023.

INTRODUCTION AND SUMMARY OF ARGUMENT

This case concerns whether Congress can redefine the text of the Sixteenth Amendment so that the Apportionment Clause and Direct Tax Clause are effectively removed from the Constitution. U.S. Const. amend. XVI; U.S. Const. art. I, § 2, cl. 3; U.S. Const. art. I, § 9, cl. 4. The Mandatory Repatriation Tax (MRT) of the Tax Cuts and Jobs Act of 2017, Public Law 115-97 (Dec. 22, 2017) (TCJA), treated the undistributed earnings of a controlled foreign corporation (CFC) as income taxable to a minority shareholder. The MRT was not a tax of the Petitioners' income. Instead, the MRT acted as a direct tax on the Petitioners' property. The MRT violated the Constitution because this direct tax on shares of stock was not apportioned by population.

The Ninth Circuit's opinion below ignored the realization requirement in this Court's precedents and interpreted the taxing power too broadly. Although the Sixteenth Amendment narrowed the scope of the Apportionment Clause and Direct Tax Clause, they are constitutional restrictions that remain in force and cannot be ignored out of administrative convenience.

This Court should grant the petition because of the need for stability and clarity in the nation's federal tax system. There is a growing movement in Congress to pass direct taxes on wealth. But wealth-tax schemes broader than the MRT could trigger liquidity issues with serious consequences for the national economy.

The Court should make the boundaries of income tax realization clear and demonstrate that the Apportionment Clause and Direct Tax Clause survive as restrictions on taxation before Congress passes wealth taxes.

ARGUMENT

I. Income must be realized before it can be taxed.

This Court must grant the petition to correct a distorted vision of Congress's taxing power. In the Ninth Circuit's view, there are almost no principled limits to what Congress can define as taxable income. In the opinion below, the court justifies its holding by informing us that the concept of income itself is flexible. Pet. App. 11. Taxes like the MRT that deem realization of corporate income to shareholders have been upheld in circuit courts, we are reminded. Pet. App. 11-12. They further state, "Whether the taxpayer has realized income does not determine whether a tax is constitutional"; taxable gain itself is broadly construed; and there has been no constitutional ban on the disregard of the corporate form to allow taxing shareholder income. Pet. App. 12-13. The court below even waved away this Court's longstanding precedents, *Eisner v. Macomber*, 252 U.S. 189 (1920), and *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), establishing that the Sixteenth Amendment inherently requires

an event when income is realized before it can be taxed. Pet. App. 14-16.

Taken to its logical end, the Ninth Circuit would free Congress from nearly all constitutional restraints on the taxing power. Although some deference to Congress's power may be due, the court below goes too far. In their view, Congress can disregard the plain meaning of the text of the Sixteenth Amendment, define income as they see fit without interference from the Amendment or the Supreme Court, and thereby avoid the restrictions on the taxing power in the Apportionment Clause and Direct Tax Clause. This cannot possibly occur without raising separation-of-powers concerns under *Marbury v. Madison*, 5 U.S. (1 Cranch) 137 (1803). As the *Macomber* Court reasoned, "Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised." *Macomber*, 252 U.S. at 206. Fortunately, the Ninth Circuit's opinion does not withstand scrutiny of the cases it cites in support of its vision.

The Sixteenth Amendment grants Congress the power "to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const., amend. XVI. From the beginning, this Court interpreted the Amendment to mean that a realization of gain is inherent to the taxation of income. In *Macomber*, the Court considered

whether a shareholder's receipt of a corporate stock dividend constituted a taxable gain under or changed "only the form, not the essence," of his investment. *Macomber*, 252 U.S. at 210. Ultimately, the shareholder "received nothing out of the company's assets for his separate use and benefit." *Id.* at 211. The Court defined income as "the gain derived from capital, from labor, or from both combined." *Id*. at 207.

Macomber's early attempt at a definition involving capital and labor was not sufficiently broad to encompass all the conceivable forms of taxable income. The Ninth Circuit misguidedly focuses on this point as a sign that *Macomber* is questionable authority, but that misses the point entirely. Despite *Macomber*'s weakness in describing forms of income, its core principle that realization is a requirement for the taxation of income holds. *Bruun*, cited by the court below to suggest the concept of taxable gain is malleable, also involved a realization event. The taxpayer "realized taxable gain from the forfeiture of a leasehold, the tenant having erected a new building upon the premises." *Helvering v. Bruun*, 309 U.S. 461, 464 (1940). And in *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426 (1955), the Court devised a three-part description of income that is still commonly used: "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Id.* at 431.

Realization involves a change in the taxpayer's rights to his property. "[A]s the Court has decided each case, it has held to the principles that realization is essential to the imposition of tax and that alteration of

the taxpayer's aggregate rights with respect to the property is a condition of realization." Henry Ordower, *Revisiting Realization: Accretion Taxation, the Constitution, Macomber, and Mark to Market*, 13 Va. Tax Rev. 1, 29 (1993). Furthermore, "while the cases [refining Macomber] may have all wrangled with the outer limits of realization, they nevertheless required an identifiable and actual event to occur." Rodney P. Mock & Jeffrey Tolin*, Realization and its Evil Twin Deemed Realization*, 31 Va. Tax Rev. 573, 598 (2012). In the instant case, the Government never disputed that the Petitioners realized nothing from their KisanKraft investment. Pet. Br. 7. But in most of the cases cited by the Ninth Circuit, the taxpayers did realize their income, or otherwise enjoy "an alteration of [their] relationship to the property" being taxed. Ordower at 44.

The court below counters the realization requirement by arguing that whether a taxpayer has "realized income does not determine whether a tax is constitutional." Pet. App. 12 (citing *Heiner v. Mellon*, 304 U.S. 271, 281 (1938)). *Mellon* does not provide much support for this argument. *Mellon* shows, they argue, that whether a partner's proportionate share of the partnership's net income was distributable to the taxpayer "was not material to whether it could be taxed." Pet. App. 12. That is technically true, but an oversimplification of the issues involved.

Mellon involved a partnership, a pass-through entity for tax purposes, not a corporation like KisanKraft. The partnership, which had been involved in the sale of alcohol, dissolved after the death of one of the three

partners. The surviving partners argued that they became liquidating trustees by operation of state law, so prior income earned from operations of the dissolved partnerships was income to the survivors only in their fiduciary positions as trustees. *Mellon*, 304 U.S. at 273. The Court rejected that argument because the state law could not control the federal law's determination that the income went to the partnership and not the trust. *Id.* at 279. And the income tax required by federal law on partnership income was due whether the partners received their distributions or not. *Id.* at 279-81. How the assets were disposed of and how proceeds were applied might be a matter of state law, but however done, federal law required that taxes be paid in years when profits were made. *Id.* at 280. This is simple logic.

Mellon is easily distinguished from the instant case. The past profitable sales of alcohol were realization events of income to the partnership and thus to the individual partners, whether they received the income or not. Here, Petitioners are minority corporate shareholders, not partners, and "it's undisputed that the[y] . . . lacked the authority to compel a dividend payment constituting realized income." Pet. App. 41. To suggest that *Mellon* allows the government to treat *corporate* income as constructively received and taxable to a shareholder the same way distributable *partnership* income is taxable to a partner is not defensible.

The court below also misapplies *Eder v. Comm'r of Internal Revenue*, 138 F.2d 27 (2d Cir. 1943), which it cites both for the idea that realization is not

constitutionally required and as an example, along with *Garlock, Inc. v. Comm'r*, 489 F.2d 197 (2d Cir. 1973) and *Whitlock's Est. v. Comm'r*, 59 T.C. 490 (1972), *aff'd in part, rev'd in part*, 494 F.2d 1297 (10th Cir. 1974), of taxes like the MRT that have been upheld. In *Eder*, a taxpayer who owned shares in a foreign corporation was at first prohibited under Colombian exchange control laws and regulations from repatriating any of his firm's earnings to the United States, and then only in amounts not exceeding $1,000 per month. *Eder v. Comm'r*, 47 B.T.A. 235, 237 (1942). The taxpayer argued that his domestic taxable income should be reduced to reflect his inability to access those foreign funds. The Second Circuit ruled, however, that the "inability to expend income in the United States . . . by operation of law, or by agreement among private parties, is no bar to its taxability." *Eder v. Commissioner of Internal Revenue*, 138 F.2d 27, 28 (2d Cir. 1943). This situation is fundamentally different from this case, where the Petitioners have no ability to realize gain from their ownership interests anywhere in the world because KisanKraft never made a single distribution and they had no power to compel it to do so.

As to the contention that laws similar to the MRT have been upheld in *Eder*, *Garlock* and *Whitlock's Est.*, these cases were addressed by the circuit courts, not this Court. And none of these cases actually claimed to discard the realization requirement. The taxes in question were tailored to circumstances where Congress determined that the taxpayers had achieved the "constructive receipt of income." *Garlock v. Comm'r*, 58 T.C. 423, 438 (1972). Laws capturing foreign income arose

out of special circumstances. "Congress is only willing to ignore realization when: (1) taxpayers are exiting the taxing system completely, such as in the case of expatriates, or (2) when taxpayers are deferring unrealized gains beyond their natural life cycle by utilizing various tax avoidance strategies, such as certain offshore transactions." Mock & Tolin at 637.

The constructive receipt of income in systems like Subpart F or the MRT can only be justified if the shareholder has some measure of control over the distribution of dividends, but chooses not to distribute, simply to avoid taxes. This concept of control was mentioned at the Tax Court level in both *Garlock* and *Whitlock's Est*. "In our opinion, the actual control of [Garlock] S.A. at all times rested in the petitioner as owner of the common stock. That was the intention, and it was effectively carried out." *Garlock, Inc. v. Comm'r*, 58 T.C. 423, 438 (1972). In *Whitlock's Est*., the Tax Court stated that *Macomber* could not be read "as denying to Congress the power to attribute a corporation's undistributed *current* income to the corporation's *controlling* stockholders." *Estate of Whitlock*, 59 T.C. at 508 (1972). It continued, "it is safe to say that the [*Macomber*] Court simply did not direct itself to the situation of the tightly controlled corporation where controlling stockholders are able to manipulate the corporation's profits and capital almost at will." *Id.* This principle is best summarized by Justice Oliver Wendell Holmes: "The income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not." *Corliss v. Bowers*, 281 U.S. 376, 378 (1930).

Petitioners owned 11% of a CFC. Pet. App. 5. To the extent that the MRT captures income from shareholders with less than a controlling share of a corporation with no power to compel distributions, it is overinclusive. Professor Henry Ordower observed that "Historical departures from fundamental tax principles sometimes find their justification in a need to defend the integrity of the taxing system from avoidance and abuse." Ordower at 86. In *Garlock*, the Second Circuit ruled against a taxpayer who had taken intentional steps to avoid being classified as a CFC subject to Subpart F taxation. In that case, the court noted the significance of bringing in preferred shareholders who "understood both [the taxpayer's] motives and its situation" and "would have no interest in disturbing the taxpayer's continued control." *Garlock, Inc.*, 489 F.2d at 201. There is nothing in the record to indicate the Petitioners have engaged in such abuse to justify treating KisanKraft's earnings as their own.

Finally, *Bruun* provides a hint as to why much of academia has doggedly tried to downplay tax realization cases. The *Bruun* Court noted that "economic gain is not always taxable as income." *Bruun*, 309 U.S. at 469. Economic gain in the abstract, like the increase of the value of a stock portfolio or home, is broad and cannot be captured by a realization requirement. For supporters of a greater taxing power, realization is a frustrating impediment. For example, in Professor Calvin H. Johnson's view, "'Income' is . . . a malleable concept that the Court can use to avoid apportionment." Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 Const. Commentary 295, 351 (Summer, 2004). Furthermore,

he wrote, "not only can the courts avoid apportionment by manipulative expansion of such terms as 'excise' and 'income,' but they have a duty to do so." *Id.* *See also* Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1 (1999).

In short, the attempts to make income a malleable concept and to bypass the realization requirement are related to the effort to enact direct taxes on wealth without apportionment.

II. The Apportionment Clause and Direct Tax Clause require tax schemes like the MRT to be apportioned by population.

The Sixteenth Amendment was ratified in response to two cases from 1895. In the first, *Pollock v. Farmers' Loan & Trust Co*. (*Pollock I*), 157 U.S. 429 (1895), the Court found that the taxation of income from real estate is unconstitutional. After rehearing, the Court expanded their reasoning to income from personal property and held that the entire income tax statute at issue was unconstitutional. *Pollock v. Farmers' Loan & Trust Co*. (*Pollock II*), 158 U.S. 601 (1895). The Ninth Circuit noted that the Sixteenth Amendment overruled the second *Pollock*'s holding that income from personal property was subject to the Apportionment Clause. This "reinforc[ed] the narrow reach of the Apportionment Clause" in their view. Pet. App. at 10.

The *Macomber* Court cautioned about attempts to deny the reach of the Apportionment Clause and Direct Tax Clause altogether. "A proper regard for its

genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so as to repeal or modify, except as applied to income, those provisions of the Constitution that require an apportionment according to population for direct taxes upon property, real and personal." *Macomber*, 252 U.S. at 206. It continued, "This limitation still has an appropriate and important function, and is not to be overridden by Congress or disregarded by the courts." *Id. Macomber* confirms that taxes on personal property should still be considered direct taxes. *Id*. at 217-19.

The Apportionment Clause and the Direct Clause were part of an important compromise at the Constitutional Convention. In his notes on the Convention, James Madison described Gouverneur Morris's proposal to tie direct taxation to representation as having had the "object [of] lessening the eagerness on one side, & the opposition on the other, to the share of Representation claimed by the S. <Sothern> [sic] States on account of the Negroes." Madison (July 24, 1787), reprinted in 2 The Records of the Federal Convention of 1787 at 106 & n.* (Max Farrand ed., 1911). Madison later wrote that the direct tax and apportionment system was "one of the safeguards of the Constitution." 4 Annals of Cong. 730 (1794). Professor Erik M. Jensen has provided a strong defense of the clauses' continued vitality in several articles. First, and most obviously, "the Direct-Tax Clauses are in the Constitution, twice, and they can't be dispensed with just because they're inconvenient." Erik M. Jensen, *Interpreting The Sixteenth Amendment (By Way Of The*

Direct-Tax Clauses), 21 Const. Commentary 355, 368 (Summer, 2004). To those who claim that the clauses are difficult to implement, he responds that it is understandable because they intended direct taxes to be used sparingly, during emergencies. Erik M. Jensen, *Did The Sixteenth Amendment Ever Matter? Does It Matter Today?*, 108 Nw. U.L. Rev. 799, 804 (Spring, 2014). Ordinarily, the founders intended that the federal government would be financed by indirect taxes such as tariffs and excises. *Id.* Furthermore, "Apportionment was intended to make direct taxation difficult, particularly when the tax was aimed at a sectionally concentrated base, and it largely did so." *Id.* In response to the claim that the clauses are stained by slavery, he wrote, "While apportionment was not anti-slavery, neither was it pro-slavery as applied to both direct taxation and representation." *Id.* at 809 n.61. And Professor Jensen specifically addressed the attempts to read the clauses out of the Constitution by redefining direct taxes. "[T]he case for applying a substance-over-form principle is stronger when the result is to constrain, rather than to expand, congressional power." *Id.* at 820.

III. The potential consequences of wealth taxes require this Court's clarification of income, the Apportionment Clause, and the Direct Tax Clause.

Should the Ninth Circuit's decision remain in effect, Congress may be emboldened to pass direct taxes on wealth.

Members in both the Senate and the House of Representatives have already proposed such legislation. *See* Pet. Br. 25. The Executive Branch has also pushed for taxes on unrealized gains. President Biden's most recent budget proposal, published shortly after the Petitioners filed their brief, includes provisions "requiring the wealthiest Americans to pay at least 25% on all their income, including appreciated assets." Office of Mgmt. & Budget, Exec. Office of the President, OMB, *Budget of the U.S. Government, Fiscal Year 2024* 2 (2023).

These policy proposals have found support in parts of the legal academy. Professor Bruce Ackerman contended that the Court could establish "a rock solid foundation for a comprehensive tax on wealth" by simply overturning *Pollock II* and *Macomber* to abolish the direct tax clause. Bruce Ackerman, *Taxation and the Constitution*, 99 Colum. L. Rev. 1, 58 (1999). Other academics, while "not persuaded to go so far" in abolishing the direct tax clause merely on account of its legacy in slavery, would "agree with Ackerman's more limited conclusions in support of the constitutionality of a wealth tax." Dawn Johnsen & Walter Dellinger, *The Constitutionality of a National Wealth Tax*, 93 Ind. L.J. 111, 119 n.37 (Winter, 2018). These same scholars were still persuaded to denounce the "unwarranted chilling effect of constitutional concerns about Congress's authority to enact a wealth tax." *Id.* at 113. And some observers, in the vein of the Ninth Circuit, have even gone so far as to question the need to abolish the realization requirement in the first place, asserting

that "scholars widely agree that realization is not constitutionally mandated." Ilan Benshalom & Kendra Stead, *Realization and Progressivity*, 3 Colum. J. Tax L. 43, 49 (2012). *See also* Calvin H. Johnson, *A Wealth Tax Is Constitutional*, Vol. 38, No. 4 ABA Tax Times (August 8, 2019), available at https://www.americanbar.org/groups/taxation/publications/abataxtimes_home/19aug/19aug-pp-johnson-a-wealth-tax-is-constitutional/. These academic theories show the need for clarity in this area, which this Court can provide with the grant of cert.

Beyond the immediate constitutional issues of taxing unrealized gains, the enactment of these plans would present problems in valuation and taxpayer liquidity. Even the most committed advocates of the wealth tax recognize that such a "regime may force cash-poor taxpayers to sell assets to pay their tax liabilities on unrealized profits." Benshalom & Stead at 53. Professor Deborah H. Schenk, the long-time editor-in-chief of the *Tax Law Review*, has downplayed these liquidity concerns in her scholarship on the wealth tax. *See* Deborah H. Schenk, *Saving the Income Tax With a Wealth Tax*, 53 Tax L. Rev. 423, 454-56 (Spring, 2000). Nevertheless, she has admitted that, if the realization requirement is abandoned, there are "legitimate liquidity concerns" for "a taxpayer whose only asset is his home, a family farm, a single heirloom, or a cash-starved small business, and who has no source of funds other than disposition of the asset." Deborah H. Schenk, *A Positive Account of the Realization Rule*, 57 Tax L. Rev. 355, 363-64 (Spring, 2004).

To prevent a crisis for illiquid asset holders, some commentators argue that legislatures could exempt "certain assets (e.g., residential homes, closely held corporations)" from a prospective wealth tax. Benshalom & Stead at 53. Crafting such exceptions, however, could immediately inflame the regional tensions which inspired the Framers to adopt an Apportionment Clause. Barring the Apportionment requirement, Congress could levy direct taxes on unexempted assets at great expense to certain economic minorities. As for furnishing exemptions to certain asset-holders, it is not hard to imagine how motivated members of Congress may act based on the "immediate interest which one party may find in disregarding the rights of another, or the good of the whole." The Federalist No. 10 at 80 (J. Madison) (Clinton Rossiter ed., 1961).

The Apportionment Clause and the Direct Tax Clause act in conjunction as an essential safeguard of the Constitution. The Court should affirm this principle by granting the petition for certiorari.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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