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

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BRIEF OF STOP EXTRATERRITORIAL AMERICAN TAXATION (SEAT) AND THE ASSOCIATION OF AMERICANS RESIDENT OVERSEAS (AARO) AS *AMICI CURIAE* SUPPORTING PETITIONERS

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INTERESTS OF *AMICI CURIAE*[1]

Stop Extraterritorial American Taxation (SEAT) is an independent, international, and nonpartisan association created under the law of France. SEAT's mission is to educate policymakers and others about the effects of U.S. extraterritorial, nationality-based taxation.

The Association of Americans Resident Overseas (AARO), founded in 1973 and headquartered in Paris, is an international, nonpartisan association with members in 36 countries. As part of its advocacy work, AARO educates policymakers and others on topics important for overseas Americans; this includes taxation as well as voting, banking, citizenship, representation, Social Security and Medicare.

The Officers and Boards of Directors for both associations, including counsel and other persons responsible for the preparation of this brief, are all volunteers.

The Mandatory Repatriation Tax (MRT) was particularly devastating for American entrepreneurs living (and running businesses) outside the United States. The effects of the MRT are an egregious example of how taxation based on nationality rather than residency harms Americans living outside the United

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[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from *amici curiae*, their members and counsel, made a monetary contribution to the brief's preparation or submission.

States, conflicts with tax treaties, and violates the tax sovereignty of other countries.

SUMMARY OF ARGUMENT

There are several reasons why the Mandatory Repatriation Tax (MRT) should be held unconstitutional with respect to individual shareholders of Controlled Foreign Corporations (CFCs). The MRT violates the Fourteenth Amendment's Equal Protection Clause because it discriminates against nonresident U.S. nationals solely because of their U.S. nationality. Taxing undistributed foreign-source income does violence to the general principles of international tax treaties by facilitating double taxation of individual U.S.-national shareholders. It violates the sovereignty of other nations by taxing the business income of non-U.S. foreign corporations and by creating a U.S. tax before a tax realization event in the country of corporate residency. Finally, the creation of a new tax on foreign-source income, retroactively imposed, violates the Fifth Amendment's Due Process Clause.

ARGUMENT

I. The MRT Violates Equal Protection

The question posed in granting certiorari is "Whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states."

The sums at issue are the retained earnings of foreign corporations, earned between 1986 and 2017. Because such corporations are foreign, the United States does not have jurisdiction to tax their foreign-source income directly. Hence, instead, the United States seeks to tax their foreign-source income indirectly, via the Subpart F regime, which attributes certain foreign-source income to their U.S. shareholders. (The term "United States shareholders" is defined in 26 U.S.C. § 951(b). It includes U.S. citizens who live outside the United States as tax residents of other countries). In Subpart F, the companies in question are referred to as "Controlled Foreign Corporations" (CFCs). 26 U.S.C. § 957(a). Significantly, the earnings at issue were never distributed to U.S. shareholders and were therefore never subject to taxation by the United States.

A. Identified by Nationality

While many countries have CFC regimes, none is as consequential or far-reaching as that of the United States. All countries apply their CFC rules to corporate shareholders. Many countries do **not** apply their CFC rules to individual shareholders. The United States is the only country that applies its CFC rules (i) to individual shareholders and (ii) to individual shareholders who are nonresident citizens who own shares in a corporation that is local to their country of residence. For example, a dual Canada/U.S. citizen residing in Canada who carries on business through a small Canadian Controlled Private Corporation is subject to U.S. Subpart F rules with respect to Canadian-source income!

Of all the individuals who live outside the United States and who own shares of a company where they live, how are they identified as being subject to the U.S. CFC regime?

It is simple: they are identified by their nationality. Their U.S. nationality – regardless of where they live, how long they have lived there, and whether they have ever lived in the United States – is a sufficient condition for being subject to the Subpart F regime. This is because of the U.S. extraterritorial tax regime, often referred to as "citizenship taxation." "Citizenship taxation" is practically unique in the world. Nearly all countries tax their residents. Nearly all countries tax income sourced in their country. But "citizenship taxation" extends the reach of the U.S. tax regime into other countries. It allows the United States to impose taxation on the non-U.S.-source income of individuals who do **not** live in the United States and are tax residents of other countries. Because the United States confers citizenship based on birth in the United States, U.S. citizenship taxation is (i) taxation based on the circumstances of birth rather than the circumstances of life and (ii) has practical application only in that it allows the United States to claim the residents of other countries as U.S. tax residents. *See* Richardson, *Should Tax Residency Be Based on the "Circumstances of Your Birth" or the "Circumstances of Your Life"?*, Citizenship Solutions (Jan. 26, 2023).

It works like this:

Section 1 of the Internal Revenue Code (IRC) imposes U.S. worldwide taxation upon every "individual," without drawing any distinctions regarding residence, nationality, or other factors.

This ambiguous language arguably subjects every person in the world, regardless of residence or source of income – or any other connection to the United States – to U.S. federal taxation. Treasury Regulation § 1.1-1(a)(1) clarifies this otherwise untenable situation by classifying "individuals" into three groups. The first group (Group 1) is determined by U.S. residence; it includes all residents of the United States, regardless of nationality and regardless of immigration status as a resident. As regards the remaining individuals in the world, Treasury Regulation § 1.1-1(a)(1) divides them based upon nationality. More specifically, one group (Group 2) consists of persons who are nonresidents of the United States but have U.S. nationality (U.S. citizens),[2] and the other group (Group 3) consists

[2] Based upon a cursory analysis of Treasury Regulation § 1.1-1(a)(1), it might be argued that the classification of "citizen" includes all U.S. citizens, including those who live in the United States. Indeed, that is how the classification is presented in § 1.1-1(b). But the reference to "citizen" has consequence only with respect to persons living outside the United States. Given all U.S. residents are subject to U.S. federal taxation without limit, regardless of their citizenship status, the only persons who can be concerned by the reference to "citizens" are persons living outside the United States. Treasury Regulation § 1.1-1 unmistakably classifies those persons based on their nationality/country of origin: among all persons living outside the United States, U.S. tax rules subject those whose nationality/country of origin is the

of persons who, while also nonresidents of the United States, do not have U.S. nationality (they are referred to as nonresident aliens, or “NRAs”). Treasury Regulation § 1.1-1(a)(1) makes clear that individuals belonging to Groups 1 and 2 are subject to U.S. federal worldwide income taxation, while individuals belonging to Group 3 are subject to more limited U.S. federal taxation based only on their U.S.-source income.

Section 1 and Subpart F of the IRC, together with Treasury Regulation § 1.1-1(a)(1), operate to subject individuals who live outside the United States, who own shares of a corporation in the country where they live, and **have U.S. nationality** to a tax regime that is more burdensome and punitive as compared to individuals who also live outside the United States and own shares of a company in the country where they live, but **do not have U.S. nationality**. This is because the latter group (those who are not U.S. nationals) are not subject to U.S. taxation on their non-U.S.-source income. Because Subpart F income is not

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United States to far more onerous federal tax burdens as compared to those whose nationality/country of origin is not the United States. Stated another way, if the reference to “citizens” were removed from Treasury Regulation § 1.1-1, it would have great consequence for U.S. citizens living outside the United States while it would have no consequence for anyone – U.S. citizen or not – residing in the United States, nor for those living outside the United States who are not U.S. citizens. It is clear, then, that the classification of “citizens” as it is contained in federal tax rules constitutes a suspect classification based upon nationality (or country of origin) and, as such, is subject to strict scrutiny. Snyder, *Extraterritorial Taxation #7: Inherently Suspect*, SEAT Working Paper Series #2023/7, at 5 (June 5, 2023).

U.S.-source income, they are not subject to the MRT, to Subpart F, or, more generally, to U.S. federal taxation on their worldwide income. *See* Richardson & Gosart, *Subpart F, GILTI and The Transition Tax*, PREP Podcaster, 2:15-11:30 (Jan. 3, 2022).

Further, U.S. nationals living outside the United States who own shares of a company **in the country where they live** are also subject to a tax regime that is more burdensome and punitive as compared to all persons who live in the United States – regardless of nationality – and own shares of a company **in the country where they live**. *See* Snyder, *The Unacknowledged Realities of Extraterritorial Taxation*, 47 S. Ill. Univ. L. J. 243, 264, 292, 296, 306 (2023). This is because the latter group owns shares in a U.S. company and is therefore not subject to either the MRT or the entirety of Subpart F.

As an element of Subpart F, the Mandatory Repatriation Tax (MRT) assumes the right to tax a U.S. national based upon the unrealized earnings of a non-U.S. company for the sole reason that the individual shareholder has U.S. nationality. The MRT (26 U.S.C. § 965) does not look past the nationality of the shareholder to consider the country where the shareholder lives, whether the shareholder is a long-term resident or has dual nationality, the country where the company's business is conducted, the country where the company's customers are located, or which country's resources are used to conduct the company's business. Even when the company is owned by persons residing outside the United States and the company's business

is conducted outside the United States, using resources outside the United States, and serving customers outside the United States, the MRT nevertheless seeks to tax one or more shareholders based upon that company's retained earnings, and the MRT does this for no reason other than the shareholder's nationality. *See* Bugnion, *A Double Taxation Nightmare Disguised as Tax Reform*, 163 Tax Notes Fed. 723, 724-25 (2019).

B. Devastating Effects for Individuals of U.S. Nationality

What kinds of small businesses are we talking about? Examples include:

- a film production company; Thompson, *Trump Tax Reform Resulting in Massive Bills for Thousands of Canadian Residents*, CBC News (Apr. 30, 2018); CBC News: The National, *Trump's Tax Reform Affects Canadian Residents*, YouTube (Apr. 30, 2018);

- a doctor's office; Hogan, *U.S. Doctor Living in Canada with Canadian Corporation and Subpart F Income*, PhilHogan.com (Jan. 3, 2019);

- a family winery; Snyder, "*Being an American Outside of America is No Longer Safe*," Stop Extraterritorial American Taxation, at 321 (2021);

- IT services; Snyder, "*I Feel Threatened by My Very Identity*:" Report on US Taxation

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- real estate investment; Snyder, "*I Feel Threatened*," *supra*, at 51; Snyder, "*Being an American*," *supra*, at 334; and
- consulting; Snyder, "*I Feel Threatened*," *supra*, at 54.

The MRT has had devastating effects for U.S. nationals living outside the United States. Snyder, *The Criminalization of the American Emigrant*, 167 Tax Notes Fed. 2279, 2281 (2020). They report:

> I own a small business and it has been horribly affected by the [MRT] and will be going forward by the GILTI – so much so that I am having to figure out how I can pass ownership of it to my spouse. I will soon own nothing on my own due to the bullying US tax system. Snyder, "*I Feel Threatened*," *supra*, at 53.

> I could not believe the recent [MRT] that retroactively taxed properly filed and taxe[d] earnings across multiple decades. This tax has put the very survival of our family's business in jeopardy, and as the means of payment is still unclear, it makes me worry that we will be liable for prison time for, again, simply building and running a business. The reality of the situation remains almost inconceivable, and it has been the source of no end of worry, stress and even conflict within our family. Snyder, "*Being an American*," *supra*, at 501.

> I have run a small business in the UK for 15 years. Over that time I have worked very hard and managed to save up a bit of money from which I was hoping to retire in the near future. My job is extremely stressful and not good for my mental well-being – I had been looking forward to finally being able to stop. Unfortunately the [MRT] blew my plans to bits. With no forewarning I suddenly found myself owing $170,000 retroactively to a new tax that had just been dreamt up out of the blue. [. . .] To suddenly lose what had taken me years to save without any forewarning has caused me enormous stress and sleepless nights. [My retirement has] now been put off indefinitely. How can I possibly retire when I don't know whether or not they'll invent another new tax out of the blue that will decimate what's left of my savings? Snyder, "*Being an American*," *supra*, at 327-28.

Again, of all the owners of small businesses living outside the United States, the only individuals to whom the MRT applies are those of U.S. nationality. For a detailed description of how and why the MRT impacts individuals living outside the United States more harshly and punitively than individuals who live inside the United States *see* Richardson, *Part 11: Responding to the Sec. 965 "Transition Tax": Letter to the Senate Finance Discussing the Effects of the Transition Tax on Americans Abroad*, Citizenship Solutions (May 5, 2018); Richardson, *Of the Six Faces of the 965 Transition Tax – The Ugliest Face Applies to Americans Abroad*, Tax Connections (Aug. 2, 2023).

C. Distinctions Based on Nationality Are Subject to Strict Scrutiny

The Court's recently decided *Students for Fair Admissions v. Harvard*, 600 U.S. ___ (2023) (slip op.), reminds us that distinctions among individuals based upon nationality are, in the same manner as those based upon race, inherently suspect. "Antipathy toward [such distinctions is] deeply 'rooted in our Nation's constitutional and demographic history.'" *Students*, slip op. at 18, quoting *Regents of University of California v. Bakke*, 438 U.S. 265, 291 (1978).

Students involved race-based affirmative action programs at two U.S. universities. Both programs were found to violate the Equal Protection Clause of the Fourteenth Amendment (the Clause). The majority as well as two concurring opinions of the Court make clear that race and nationality are inextricably linked. The majority opinion quotes *Yick Wo v. Hopkins*: "hostility to [. . .] race and nationality [. . .] in the eye of the law is not justified" *Students*, slip op. at 11, quoting *Yick Wo*, 118 U.S. 356, 374 (1886) (internal quotation marks omitted). The majority opinion reminds us that *Yick Wo* applied the Clause to "aliens and subjects of the Emperor of China," *Students*, slip op. at 11, quoting *Yick Wo* at 368, while *Truax v. Raich* applied the Clause to "a native of Austria," *Students*, slip op. at 11, quoting *Truax*, 239 U.S. 33, 36, 39 (1915), and *Strauder v. West Virginia*, in dictum, applied it to "Celtic Irishmen." *Students*, slip op. at 11, quoting *Strauder*, 100 U.S. 303, 308 (1880).

The concurring opinion of Justice Thomas refers to "the Mexican or Chinese race." *Students*, slip op. at 15 (Thomas, J., concurring), quoting *Slaughter-House Cases*, 83 U.S. 36, 72 (1872). Justice Thomas later mentions the internment of Japanese Americans in relocation camps following the bombing of Pearl Harbor, Holocaust survivors, and Irish immigrants. *Students*, slip op. at 44, 54 (Thomas, J., concurring). The concurring opinion of Justice Gorsuch breaks down the race of "Asian" into several different nationalities: Chinese, Korean, Japanese, Indian, Pakistani, Bangladeshi, Filipino. *Students*, slip op. at 6 (Gorsuch, J., concurring). Justice Gorsuch also breaks down the race of "White" into a multitude of different nationalities, including Welsh, Norwegian, Greek, Italian, Moroccan, Lebanese, Turkish, Iranian, Iraqi, Ukrainian, Irish, and Polish. *Students*, slip op. at 7, 13 (Gorsuch, J., concurring).

In sum, in *Students*, the Court's melding of race and nationality unmistakably teaches that distinctions based upon nationality should be treated with as much "antipathy" as distinctions based upon race.

Because the MRT makes distinctions based upon nationality, it is inherently suspect and thus is subject to strict scrutiny. Laws subject to strict scrutiny are valid only if they are: (1) necessary to further a compelling governmental interest, and (2) narrowly tailored to achieve that interest. *Students*, slip op. at 15.

1. Necessary to Further a Compelling Governmental Interest?

The Brief of the Respondent in opposition to certiorari cites legislative history to explain the justification for the MRT. Brief of Respondent on Petition for a Writ of Certiorari at 3-4, citing H.R. Rep. No. 409, 115th Cong., 1st Sess. 375 (2017). The Respondent's explanation, grounded in the legislative history, is revelatory. According to this explanation, the 2017 Tax Cuts and Jobs Act (TCJA or the Act) changed "**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. Brief of Respondent, *supra*, at 3 (emphasis added).

As the Respondent's brief continues, the TCJA provided that when CFCs "distribute their earnings as dividends to **U.S. corporate shareholders**, those earnings are generally no longer taxed. Thus, the Act eliminates, on an ongoing basis, the prior taxes that would have applied to dividends distributed by a CFC to a **U.S. corporate shareholder**." The one-time MRT was necessary "to avoid a potential windfall for CFCs that **deferred income**" and could then distribute that income tax-free to "**U.S. corporate shareholders**" upon the **repatriation** of earnings accumulated prior to the TCJA. Brief of Respondent, *supra*, at 4 (brackets excluded and emphasis added).

Whether or not the MRT was necessary with respect to **U.S. corporate shareholders** is beyond the scope of this brief.

Within the scope of this brief, however, are these two questions: (a) was the MRT necessary with respect to individual shareholders, and (b) more specifically, was the MRT necessary with respect to individual shareholders living outside the United States?

The answers to both questions are contained in Respondent's brief which, again, is grounded in legislative history. Respondent focuses on dividends paid to "**U.S. corporate shareholders**," and on wanting to avoid a potential windfall for "**U.S. corporate shareholders**." Brief of Respondent, *supra*, at 4, citing H.R. Rep. No. 409, *supra*, at 375. In focusing exclusively and repetitively on **corporate** shareholders, neither Respondent nor the legislative history upon which Respondent relies contemplates that the shareholders subject to the MRT would include individuals, nor does either allude to any tax abuse, "potential windfall," or other concerns with respect to those individuals as a justification for the MRT. The entire focus is on U.S. corporate shareholders.

While providing prospective tax relief to corporations taxed under Subchapter C of the IRC (C corporations), the TCJA provided no prospective tax relief for individual shareholders receiving distributions from their CFCs. This is demonstrated in at least three ways:

- After having been subjected to the MRT, distributions based on post-TCJA earnings from CFCs continued to be included in the gross income of those individual shareholders. Therefore, the justification for subjecting corporations to the MRT – that they would no longer be taxable on distributions from CFCs – has no application to individual shareholders of CFCs, whether they live inside or outside the United States. Individuals continued to be taxed, be it directly, on actual distributions from CFCs, or indirectly (via Subpart F), on the undistributed income earned or received by CFCs;

- The TCJA legislated a reduction in the corporate tax rate of C corporations from 35% to 21% – another obvious way that the TCJA benefited C corporations (TCJA § 13001; 131 Stat. at 2096). The individual shareholders of CFCs received **no** corresponding benefit. To put it simply: Individual shareholders of CFCs received none of the benefits of the TCJA but were expected to bear all the burdens;

- Incredibly, while "income" subject to the MRT was taxed to C corporations at a maximum rate of 15.5%, it was taxed to individual shareholders of CFCs at a maximum rate of 17.54%. TCJA, Pub. L. No. 115-97 § 14103; 131 Stat. at 2198. *See* La Torre Jeker, *Calculating the Transition Tax*, U.S. Tax Talk (Apr. 4, 2018).

Further, the Respondent's brief, continuing to rely upon legislative history, anticipates that U.S. corporate shareholders, motivated by the desire to avoid U.S. taxation upon repatriation, will have purposely deferred the payment of dividends from their CFCs. Brief of Respondent, *supra*, at 4, citing H.R. Rep. No. 409, *supra*, at 375.

This may or may not be true. It assumes that C corporations would not reinvest the money in the CFC and would pay the profits as dividends to the U.S. shareholder. The construct, again, assumes U.S. corporate shareholding. It does not contemplate the situation of the Petitioners. That is, the construct does not contemplate the existence of non-U.S. companies that are not part of any group of companies but whose shareholding happens to include one or more U.S. nationals (individuals). Nor does it contemplate that such a company could legitimately not pay dividends, not to avoid U.S. taxation but to reinvest in the company in furtherance of its corporate purpose. Richardson, *Part 8: Responding to the Sec. 965 "Transition Tax,"* Citizenship Solutions (Apr. 13, 2018).

Finally, underlying the Respondent's explanation as well as the legislative history is the assumption that the earnings of a CFC are necessarily destined to be repatriated to the United States in the form of dividends, and that the United States has a rightful claim (subject to source taxation in the other country) to those dividends. Brief of Respondent, *supra*, at 3-4; H.R. Rep. No. 409, *supra*, at 375. The United States has no right – as per its tax treaties – to directly help itself

to the earnings of a foreign corporation. The United States has no right to presume or insist that the earnings of a CFC are to be distributed to U.S. shareholders. The MRT is a mechanism to impose taxation on U.S. shareholders of CFCs as though they had actually received a distribution even though there had been no actual distribution. By imposing the MRT – a pretend distribution where there was no actual distribution – the United States created a fictitious distribution prior to an actual distribution in the country of corporate residence. The result was that the United States imposed taxation on the fictitious distribution prior to the country of corporate tax residency exercising its primary taxing rights based on an actual distribution. The result of the MRT was that there were no foreign taxes available to be used as a foreign tax credit to offset the U.S. taxes imposed by the MRT. *See* TaxLinked, *An Overview of the US's Transition Tax: Webinar*, YouTube (Apr. 3, 2018) at 11:54.

If the shareholder is a U.S. national who lives outside the United States, there is no presumption the company will distribute the earnings to the shareholder. The idea that dividends paid by a non-U.S. company to an individual living outside the United States are meant to be "repatriated" to the United States is nonsensical. Bugnion, *supra*, at 725.

Further demonstrating that in devising the MRT Congress was exclusively focused on corporate rather than individual shareholders is the TCJA's addition of Section 245A to the IRC (TCJA § 14101; 131 Stat. at 2189). It allows corporate – but not individual –

shareholders to claim a 100% deduction for dividends received. Willis, *The TCJA's International Tax Schemes*, ABA Tax Times (Mar. 11, 2021).

In sum, when the MRT was created, no thought was given to individual shareholders of CFCs. Their existence in this context was not acknowledged and no tax abuse, "potential windfall," or other concerns were identified in their regard. Additionally, Section 245A excludes them from the very benefits the transition to a new *corporate* tax regime (worldwide to territorial) was supposed to offer – the ability to receive dividends from a CFC free of U.S. taxation other than the MRT and a reduction in their tax rate.

Even today, when Respondent is engaged in litigation not with corporate but with individual shareholders, Respondent fails to recognize any consequential difference between the Petitioners – who are individuals – and the "U.S. corporate shareholders" that Respondent itself repeatedly identifies as the intended targets of the MRT.

The MRT was clearly intended to target corporate shareholders of CFCs. Both the legislative history of the MRT as well as Respondent's own explanation of the need for it evidence that the inclusion in the scope of the MRT of individual shareholders – including U.S. nationals living outside the United States – is not necessary to fulfil a compelling governmental interest.

Further, the MRT operated to override the policies of the countries where U.S. nationals live. This not only violated the sovereignty of those countries (as

discussed in Part II below), but also, as already mentioned, resulted in considerable hardship for the U.S. nationals in question.

The United States does not have a compelling governmental interest either in violating the sovereignty of other countries or in interfering in the governance of small businesses outside the United States in these manners. Snyder, *Can Extraterritorial Taxation Be Rationalized?*, 76 Tax Law. 535, 591-92 (2023).

2. Narrowly Tailored to Achieve that Interest?

The TCJA itself contains evidence that it was possible to alleviate the burdens of the MRT for individual shareholders. The evidence is the Act's special rules for one category of shareholders: those of an "S corporation which is a United States shareholder" of a CFC. TCJA § 14103; 131 Stat. at 2203, amending 26 U.S.C. § 965(i). Under this provision, the shareholders of an S corporation may elect to defer their MRT liability until a "triggering event" occurs.

To add insult to injury, the exemption for S corporations is not available to U.S. nationals who own small businesses in the countries where they live. This is because they hold the shares of their CFCs directly as individuals, not via a U.S. S corporation.

Many appealed to Congress to consider the MRT's impact for individual shareholders and especially for those with U.S. nationality living and operating small

businesses outside the United States. Beyond including their appeals in multiple hearing reports, no Congressional action was taken. S. Hrg. 115–701, 115th Cong., 2nd Sess. 119-35, 141-42, 146-55 (2018); S. Hrg. 117–304, 117th Cong., 1st Sess. 134, 163-64, 204, 219, 314, 329, 441-43, 489 (2021); S. Hrg. 117–373, 117th Cong., 1st Sess. 96, 121, 124-26, 152 (2021); S. Hrg. 117–383, 117th Cong., 1st Sess. 95-96, 111, 114, 124 (2021).

Appeals were also made to the Treasury Department, asking that its regulations consider the impact of the MRT in relation to small businesses, and especially in relation to those owned by U.S. nationals in the countries where they live. Murray, *Size Matters*, 106 Minn. L. Rev. 1625, 1660-63 (2022); Bugnion, *supra*, at 727-29. However, Treasury did not just reject the appeals. It also expressly denied the very existence of such small businesses, while, at the same time, displaying callous disregard for U.S. nationals:

> "As an initial matter, foreign corporations are not considered small entities. Nor are U.S. taxpayers considered small entities to the extent the taxpayers are natural persons [. . .]. Although the Treasury Department and the IRS received a number of comments asserting that a substantial number of small entities would be affected by the proposed regulations, **those comments were principally concerned with U.S. citizens living abroad that owned foreign corporations [. . .]. No small entity is affected in this scenario**." Murray, *supra*, at 1662, quoting

> Regulations Regarding the Transition Tax Under Section 965 and Related Provisions, 84 Fed. Reg. 1,838, 1,873 (Feb. 5, 2019) (emphasis added).

In sum, both Congress and Treasury could have acted to alleviate the burdens of the MRT for individual shareholders. They could, as examples, have exempted individual shareholders from the MRT and/or have applied a *de minimis* exception to its application. Murray, *supra*, at 1627-27, 1674-75.[3] Had Congress or Treasury acted on the many appeals, Petitioners – as individual shareholders of a small business in India – would not have been impacted by the MRT and this case would not be before the Court today.

Another possibility was to exempt individual shareholders living outside the United States.[4] While this would not have addressed the problems of the Petitioners (they are U.S. residents), it would have addressed the fundamental Equal Protection problem: that among all persons living outside the United

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[3] For the purposes of the MRT, the Treasury Department has already defined small business as "a multinational corporation with less than $25 million in gross receipts." (Regulations Regarding the Transition Tax, *supra*, at 1,873). However, this use of the word "multinational" demonstrates further blindness to the realities of the small businesses owned by U.S. nationals in the countries where they live. As doctors' offices and IT consultancies, many are established and do business only in the country where their owner(s) live.

[4] This could be determined, for example, based upon the same criteria as that applied for the Foreign Earned Income Exclusion. 26 U.S.C. § 911(d)(1).

States, the MRT singles out those of one nationality (American) for different and unfavorable treatment.

II. The MRT Does Damage to the International Tax Treaty Network

The MRT violates the spirit if not the letter of U.S. tax treaties. The creation of income without realization facilitates double taxation. The MRT will result in double taxation if the Moores ever actually receive a distribution from KisanKraft, the India corporation.

A. The MRT Is a Tax Treaty Override

Dividends/distributions from a foreign company are sourced to the foreign jurisdiction. 26 U.S.C. § 862(a)(2). When the United States has a tax treaty with such foreign country, the treaty generally affords that foreign jurisdiction the primary right to tax dividends paid to U.S. shareholders. In the case of an actual dividend paid to the Petitioner by KisanKraft, India would impose a tax. The tax paid in India would be available to be used as a tax credit to offset any U.S. tax payable. This is the standard way of fulfilling the tax treaty objective of avoiding double taxation.

Even though the Petitioners received no income, the effect of the MRT was to deem their U.S. gross income to have been increased. The result was that they paid an additional $14,182 of tax to the United States. There was no corresponding income event in India and therefore no tax paid in India. In the future, if

KisanKraft ever does pay a dividend to the Moores, they will pay no U.S. tax to the extent that the earnings and profits contained in that dividend were previously taxed earnings under the MRT. The Moores will, however, pay a withholding tax to India on the distribution. The tax paid first to the United States and then to India creates double taxation.

Therefore, the MRT frustrates the tax treaty objective of avoiding double taxation and facilitates double taxation (first payable to the United States and then payable to India). *See* Richardson, *The § 965 Transition Tax Caused the Moore's to Pay $14,712 Moore In Double Taxation*, Tax Connections (Jul. 14, 2023).

The use of the MRT to create deemed income in the United States prior to an actual realization event in India had the effect of the United States exercising first taxing rights over income sourced in India. Again, this is income over which India has primary taxing rights. IRS, *Sourcing of Income*, FTC/C/10_02-05, at 3 (2017); Art. 10, Tax Convention, India-U.S., Sept. 12, 1989, S. Treaty Doc. No. 101-5 (1991).

B. The Problem Is Even Worse for Nonresident U.S. Nationals

Nonresident U.S. nationals with small business corporations in their country of residence most certainly do not create these corporations to defer U.S. taxation! They create small business corporations because it makes sense in their country of residence.

Because the United States taxes nonresident nationals, the small businesses these individuals own **in their country of residence** (where they may also be citizens) are taxed by the United States under the very complex CFC rules. These individuals, as residents of foreign countries, are **also** subject to full taxation in those other countries. Tax planning for dual tax residents, especially tax-effective saving for retirement, requires these individuals to walk a carefully balanced tightrope. What makes sense in one country may be damaging in the other country. Non-U.S. corporations may be used as asset protection, for estate planning, to limit personal liability, or to accumulate earnings for distribution in retirement. U.S. nationals living outside the United States would have structured these entities very carefully to minimize any adverse U.S. tax consequences. They would have understood that passive income inside their corporation could have been taxed as Subpart F income, but active business income would be taxed by the United States on payment of dividends and at the same time as any distribution in the country where they live. The fact of both countries taxing distributions at the same time, when an actual distribution takes place, reduces the possibility of double taxation.

Even though these corporations are designated as CFCs by the IRC, they are not "foreign" to the individuals who own and run them. The whole premise of the MRT is inapplicable to these entities; how does an Australian or Canadian company, owned by a dual-citizen Australian or Canadian resident "repatriate" earnings

to the United States? Instead, the MRT created fake income and facilitated double taxation for individual U.S. nationals living outside the United States who operate their small businesses under the laws, protocols and opportunities afforded by their country of residence.

The situation faced by U.S./Canada dual citizens who are owners of a Canadian Controlled Private Corporation (CCPC) demonstrates how the MRT looted the retained earnings of Canadian companies with disastrous effects on the Canadian residents who relied on these small businesses for retirement and financial planning. Canadian tax rules incentivize small business owners to retain earnings in their companies to fund retirement. More specifically, because of differences in the applicable tax rates, business owners are encouraged during their active years to limit what they draw from their company in salary and dividends to only what is necessary to fund current needs. They are encouraged to accumulate the remaining income in the company as retained earnings as a form of savings. These savings can either be invested passively to accumulate additional income or held as cash. Either way, upon retirement, the owner can wind down the company's activities except for the savings, which can be drawn down, through the payment of dividends, as a form of income during retirement. Snyder, *Taxing the American Emigrant*, 74 Tax Law. 299, 337-38 (2021); Richardson, *Part 8, supra*; CBC News: The National, *supra*. Given this context, it is easy to understand that the MRT dealt a devastating blow to small business

owners in Canada of U.S. nationality. The MRT was a looting of their retirement savings. The only small business owners in Canada who experienced this were U.S. nationals.

Significantly, the MRT subjected U.S. nationals living in Canada to tax based on being a shareholder in a CFC that could never qualify as a CFC for a U.S. resident. This is because Canadian residents who are individual shareholders of a CCPC can (under the U.S. entity classification rules) be shareholders of a CFC. However: (i) Canadian rules require that the majority of the shares of a CCPC be owned by individuals who are tax residents of Canada (Income Tax Act § 125(7) (Can.)); while (ii) under U.S. rules, a corporation qualifies as a CFC only if U.S. shareholders own more than 50% of the total combined voting power or the total value of the company's stock (26 U.S.C. § 957(a)). Because of these two factors, it would be impossible for U.S. **residents** to be shareholders of a CCPC that qualifies as a CFC. Thus – and incredibly – U.S. nationals living in Canada were subject to the MRT with respect to share ownership in a corporate structure that was **local** to them and could not even be used by U.S. residents as a CFC. *See* Richardson, *Part 43 – The 1996 Treasury Regs, 2017 TCJA and the Looting of Canadian Controlled Private Corporations*, Citizenship Solutions (Aug. 13, 2023).

The effect of the MRT on individual U.S. nationals living outside the United States can be described in both practical and theoretical terms.

Practical: The practical effect of the MRT was to create a fictitious and premature distribution of retirement savings, impose real taxation on that premature distribution that was not actually realized, and to retroactively define the amount of the fictitious distribution to include thirty years of the CCPC's earnings. The inescapable conclusion was that the MRT confiscated the retirement savings of nonresident individuals of U.S. nationality.

Theoretical: The theoretician might describe the MRT as real taxation on income retroactively defined and not actually received. But this frustrated the rules of international taxation and the U.S. tax treaty network in two ways:

- It facilitated double taxation: The individual taxpayers (the Moores) were denied the opportunity to offset their U.S. tax liability by utilizing a foreign tax credit based on tax paid in the country where the CFC is incorporated. For the Moores, this resulted in pure double taxation; and

- U.S. taxation of non-U.S. corporations created a back-door means to impose U.S. taxation on the non-U.S.-source active business income of corporations incorporated in other countries.

Like all countries, the United States imposes taxation on income sourced in the United States. Like most countries, the United States imposes worldwide taxation (income from all sources in the world) on its residents. But, because of its nationality-based

extraterritorial tax regime, the United States imposes worldwide taxation on individuals (U.S. nationals and Green Card holders) who do not live in the United States. For example, a U.S. national living in France is subject to U.S. taxation on employment income from a French company received while the individual is living and working in France. Indeed, anything that the United States defines as "income" is taxable to U.S. nationals living outside the United States, even though they are also tax residents of other countries.

The IRC levies particularly punitive taxation and reporting obligations on income streams and assets that are "foreign" to the United States. For nonresident U.S. nationals, however, their income and assets that are foreign to the United States are **local** to them. The result is that U.S. nationals living outside the United States are subject to a separate and more punitive system of U.S. taxation than are resident Americans. *See* Alpert, *Investing with One Hand Tied Behind Your Back* (2018), and Richardson, *The United States Imposes a Separate and Much More Punitive Tax on U.S. Citizens Who Are Residents of Other Countries*, Citizenship Solutions (Mar. 13, 2019); Snyder, *Discriminatory Taxes and Congress: Do as I Say, Not as I Do*, 180 Tax Notes Fed. 1283, 1290 (2023).

To be clear, overseas Americans are also subject to the tax laws of their country of residence. Therefore, they are generally required to navigate two separate tax systems. Because different tax systems have different rules, overseas Americans live in a world where sometimes income that is taxed in one country is not

taxed in the other country. (In the example of a sale by a U.S. national of their principal residence in Canada, the capital gain is tax-free in Canada but is taxable by the United States. Levy & Harroch, *U.S. Citizens Living in Canada: Beware of the U.S. Taxation Upon the Sale of a Principal Residence*, Levy Salis (June 29, 2023); Snyder, *Taxing the American Emigrant, supra*, at 341-44). In many cases income is simultaneously realized in both countries and simultaneously taxed in both countries. In these circumstances double taxation is avoided through a combination of domestic foreign tax credit rules and tax treaties. In these circumstances they will generally pay tax at the rate of the country with the higher tax rate.

But, a special problem arises when "income" is taxable by both countries but is not realized simultaneously in both countries. The MRT – a "deemed" realization event – exemplifies the problem but is not the only example of the problem. The IRC contains several "deemed" (as opposed to actual realization) income events that lead to the United States creating a taxable "pretend" realization event before the country of residence imposes its tax based on an actual realization. These include the § 1298 election for Passive Foreign Investment Companies (used to avoid § 1291 interest charges and excessive compliance costs associated with owning "foreign" mutual funds), and the exit tax provisions in § 877A.

Whether "income" requires that there be an actual receipt of income has implications that extend beyond the borders of the United States. Defining "income" in

a way that does not require the actual receipt of income will have profound implications impacting both individual residents of other countries and the tax sovereignty of those countries. The U.S. extraterritorial tax regime facilitates the exporting of the U.S. definition of "income" outside the United States and into other countries. The United States would tax the unrealized income of residents of other countries even when those other countries did not recognize the unrealized income as a taxable event in their country.

Exporting the U.S. definition of "income" into other countries is a reason why the Sixteenth Amendment should be understood to include the receipt of actual income. Should the Court rule that "realization" is not required, it will be even more urgent that the United States cease imposing its extraterritorial tax regime on individual residents of other countries.

III. The MRT Is a Retroactive Tax as Applied to Individual Shareholders

The starting point in any discussion about retroactive tax legislation appears to be the decision in *United States v. Carlton*, 512 U.S. 26 (1994). The majority opinion in *Carlton* considers both the period of retroactivity and whether the legislation in question is arbitrary. In her concurrence, Justice O'Connor states that "it is arbitrary to tax transactions that were not subject to taxation at the time the taxpayer entered into them." *Carlton*, 512 U.S. at 38.

The District Court (*Moore v. United States*, Case No. C19-1539-JCC (W.D. Wash. Nov. 19, 2020)) specifically found that **the transition tax was a retroactive tax**, but the retroactivity did not violate the Fifth Amendment's Due Process Clause because it had a legitimate legislative purpose, supported by rational means, and the MRT was not a new tax.

The Court of Appeals "assumed" the retroactivity of the MRT but upheld it on the basis it was not a new tax because "**The Moores had reason to expect that such transactions would eventually be taxed.**" *Moore v. United States*, No. 20-36122, at 17 (9th Cir. June 7, 2022).

Both courts suggested that if the MRT had been a "new" tax, its retroactivity might have been unconstitutional.

In our opinion, neither the District Court nor the Court of Appeals correctly analyzed the applicability of the *Carlton* decision to the facts of *Moore*. The facts as well as the legal principles of the two cases can be clearly distinguished:

Carlton was about a short period of retroactivity to correct a mistake in legislative drafting to an existing law.

While *Moore* is about:

- The creation of a new tax in 2017;
- Applying the new tax retroactively for the period of 1986 to 2017; and

- Applying the tax to income that was received by a foreign corporation and **not** received or realized by the taxpayer.

Furthermore, in *Moore* neither the District Court nor the Court of Appeals considered that the impact of the MRT with respect to individual U.S. shareholders of CFCs is fundamentally different from the impact with respect to the large, multinational corporations which were the target of the MRT. Individual shareholders, as discussed *supra* (Part I.C.1), received none of the benefits of the new territorial corporate tax system, but paid all the costs in the form of the MRT. The earnings taxed under the MRT were earnings that were never included in Subpart F income at any time during the thirty-year period for which retained earnings were subject to the MRT.

A. The Deferred Earnings Taxed by the MRT Was Never Subpart F Income

The 1962 Subpart F rules specifically did **not** include the attribution of active business income of foreign corporations to U.S. shareholders. By construction, the deferred foreign income defined and taxed by the MRT could only have resulted from CFC income that had not previously fallen under the definition of Subpart F income in IRC § 952. This was generally income from the active business of the foreign corporation, and the United States would have taxed the shareholder on this income when it was distributed. Therefore, current inclusion of undistributed active business income previously earned by a CFC as "gross

income" under the MRT resulted in a new kind of tax. Whether Congress decided to implement the MRT by including it in Subpart F or in any other portion of the IRC is irrelevant to the determination of whether the MRT is a new tax.

Furthermore, IRC § 952(c)(1)(A) limits Subpart F income to **current earnings and profits**. Because the MRT is based on income that extends far beyond "current earnings and profits," income created by the MRT cannot be Subpart F income. This supports the claim that the MRT is an entirely new tax. *See* Richardson, *Part 42 – In Moore the Supreme Court Should Consider the Retroactive Nature of the Transition Tax*, Citizenship Solutions (Aug. 6, 2023).

B. Exceptionally Long Period of Retroactivity

More than 30 years of past active business income, earned by a foreign corporation, never subject to any form of U.S. taxation, was deemed to be current gross income received by certain U.S. shareholders. The MRT was a present tax on past earnings that were not previously subject to taxation or attribution to U.S. shareholders under the Subpart F regime. Thirty years is a very long look back period! To add insult to injury the Moores did **not** realize or receive any of the income targeted by the MRT.

If the MRT does not qualify as an unconstitutionally retroactive tax, it is hard to imagine any tax could

be unconstitutionally retroactive. As Justice Scalia warned in *Carlton*: "The reasoning the Court applies to uphold the statute in this case guarantees that all retroactive tax laws will henceforth be valid." *Carlton*, 512 U.S. at 40.

CONCLUSION

The question posed in granting certiorari regarding taxation of unrealized gains is not the only ground upon which the Court can rule that the MRT is unconstitutional. The MRT violates the Fourteenth Amendment's Equal Protection Clause because it discriminates against nonresident U.S nationals solely because of their U.S. nationality. Taxing undistributed foreign-source income does violence to the general principles of international tax treaties because it both facilitates double taxation for individual shareholders (living within and without the United States) and violates the sovereignty of other nations by exporting "unrealized income" to residents of their countries. This is particularly evident when it comes to the United States reaching into other countries by first claiming their residents as U.S. taxpayers and second deeming the small business corporations owned by those residents as CFCs for U.S. tax purposes. Finally, the extreme retroactivity of the MRT should be a factor in

determining whether the MRT qualifies as income under the Sixteenth Amendment.

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