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

BRIEF OF ATLANTIC LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICUS CURIAE* [1]

Established in 1977, the Atlantic Legal Foundation (ALF) is a national, nonprofit, nonpartisan, public interest law firm whose mission is to advance the rule of law and civil justice by advocating for individual liberty, free enterprise, property rights, limited and responsible government, sound science in judicial and regulatory proceedings, and effective education, including parental rights and school choice. With the benefit of guidance from the distinguished legal scholars, corporate legal officers, private practitioners, business executives, and prominent scientists who serve on its Board of Directors and Advisory Council, the Foundation pursues its mission by participating as *amicus curiae* in carefully selected appeals before the Supreme Court, federal courts of appeals, and state supreme courts. *See* atlanticlegal.org.

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The enormously consequential question in this case—whether economic gains must be realized to be taxed as income under the Sixteenth Amendment—implicates ALF's individual liberty, protection of property, free enterprise, and limited government missions, and ultimately, the rule of law. The Ninth Circuit's holding that "realization of income is not a constitutional requirement," App. 12, is a shocking expansion of Congress's "power to lay and collect taxes on incomes." U.S. Const. amend. XVI. ALF is filing

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[1] No counsel for a party authored this brief in whole or part, and no party or counsel other than the *amicus curiae* and its counsel made a monetary contribution intended to fund preparation or submission of this brief.

this brief to urge the Court to reverse the Ninth Circuit, and thereby ensure that taxation of unrealized gains, and runaway taxation of other forms of wealth or property, do not become the norm in the United States.

SUMMARY OF ARGUMENT

Although the focus of this case is the constitutionality of a one-time tax, the Mandatory Repatriation Tax, 26 U.S.C. § 965, this Court, unlike the Ninth Circuit, should examine the question presented and its ramifications through a much wider lens. Unless the Court reverses the Ninth Circuit's ruling, Congress will be emboldened, and arguably empowered, to define "income" however it chooses. Unbounded by the Sixteenth Amendment's well-established requirement that economic gains be *realized* to qualify as taxable income, Congress could levy financially devastating "income" taxes on the appreciated value of numerous types of individual and corporate investments and other property, thereby seriously impairing the nation's economic health.

Dissenting from denial of rehearing en banc, Circuit Judge Bumatay, joined by three of his Ninth Circuit colleagues, has persuasively rebutted the panel decision at issue here. His clear and forceable dissent examines the history and text of the Sixteenth Amendment, and the Supreme Court precedent interpreting it. Judge Bumatay's analysis leaves no doubt that realization of gains always has been, and needs to continue to be, an integral part of income eligible for unapportioned taxation in accordance with the Sixteenth Amendment. His dissent also alludes to the many types of new taxes that could be imposed on American taxpayers and U.S. businesses if economic gains were suddenly freed from realization in order to be taxed as income.

Imposition of such "income" taxes on unrealized gains would have major impacts on individual and corporate taxpayers. In addition to diminishing the value of personal investments and other property, incentives for business investment, expansion, entrepreneurship, and innovation would be adversely affected. The broader effects, including on the stock and real estate markets, would have nationwide economic repercussions, as well as on the role of the United States in the global economy.

ARGUMENT

The Court Should Reverse the Ninth Circuit's Deviant Interpretation of the Sixteenth Amendment

A. The Sixteenth Amendment requires economic gains to be *realized* to qualify as taxable income

It would be difficult to improve upon Circuit Judge Bumatay's lucid and persuasive dissent from denial of rehearing en banc. *See* App. 35-57. His historical, textual, and case law analysis compels the conclusion that economic gains must be realized to qualify as income for unapportioned taxation under the Sixteenth Amendment. He not only discusses why "as a matter of ordinary meaning, history, and precedent, an income tax must be a tax on realized income," but also emphasizes his fear that "without a realization requirement . . . *any* tax on property or other interests can be categorized as an 'income tax.'" *Id.* at 39-40.

1. History

Judge Bumatay's dissent explains that "[t]he Sixteenth Amendment arose in response" to *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895) & 158 U.S. 601 (1895). App. 44. *Pollock* held "that income taxes on real estate and personal property were invariably direct taxes requiring apportionment." *Id.* (citing *Pollock*, 158 U.S. at 637); *see* U.S. Const., art. I, § 2, cl. 3 & art. I, § 9, cl. 4 (requiring "direct taxes" to be collected proportionately among the States). "Given this requirement's heavy burden on federal taxing power," App. 37-38, *Pollock*'s "result was overturned by the Sixteenth Amendment," *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. 519, 571 (2012)—the amendment that vests Congress with the power to levy "taxes on incomes, from whatever source derived, without apportionment among the several States." U.S. Const. amend. XVI.

The history of the Sixteenth Amendment indicates that it was intended to apply only to income taxes, not to give Congress *carte blanche* authority to impose any other type of direct tax without apportionment. *See* App. 45 (Bumatay dissent) ("[T]he drafters chose language meant to confine [the changes] to income taxes alone.") (internal quotation marks omitted); *see also* Erik M. Jensen, *The Taxing Power*, *the Sixteenth Amendment, and the Meaning of "Incomes,"* 33 Ariz. St. L.J. 1057, 1116 (2001) ("Nothing that happened later in the amendment process changed . . . that basic intention."). The meaning of "income," therefore, is critical to interpreting the scope of the Sixteenth Amendment.

2. Text

The Sixteenth Amendment, ratified in 1913, is explicitly limited to Congress's "power to lay and collect taxes on *incomes*." U.S. Const. amend. XVI (emphasis added). Judge Bumatay's dissent quotes ratification-era dictionaries and legal commentaries to demonstrate "that the ordinary meaning of 'income' was confined to realized gains," and thus, that "only realized gains qualify as taxable income." App. 46-47. Because "these sources reinforce the commonsense notion that 'income' refers to receipt of some economic benefit," neither a court nor Congress "may redefine income to include unrealized gains." *Id.* at 49.

3. Supreme Court precedent

Beginning with *Eisner v. Macomber*, 252 U.S. 189 (1920), Judge Bumatay's dissent surveys Supreme Court case law, which "has consistently treated realization—in some form—as the critical component of taxable income." App. 51. In *Macomber*—which "remains the seminal case establishing the realization requirement for ‘income’ under the Sixteenth Amendment,” the Court held that “stock dividends do not constitute ‘income’ until ‘realize[d]’ as profit or gain.” *Id.* at 50 (quoting *Macomber*, 252 U.S. at 209).

Consistent with *Macomber*, the Court in *Helvering v. Horst*, 311 U.S. 112, 116 (1940) (involving an interest payment gift to a family member) referred to “the rule that income is not taxable until realized.” In *Commissioner of Internal Revenue v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955), the Court held that punitive damages awards are taxable income because they are “instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.” Along the same lines, the Court, holding that embezzled funds are taxable income, indicated that “[a] gain constitutes taxable income when its recipient . . . derives readily realizable economic value from it.” *James v. United States*, 366 U.S. 213, 219 (1961) (internal quotation marks omitted).

“Based on text, history, and precedent,” the Ninth Circuit “erred in disregarding the realization requirement of the Sixteenth Amendment.” App. 53 (Bumatay dissent). “Rather than hewing to plain meaning and Supreme Court rulings,” the court of appeals “recast the very meaning of ‘income.’” *Id.*

B. Taxation of unrealized gains would have devastating economic consequences

"[T]he consequences of [the Ninth Circuit's] decision extend far beyond the Mandatory Repatriation Tax. Divorcing income from realization opens the door to new federal taxes on all sorts of wealth and property without the constitutional requirement of apportionment." App. 55 (Bumatay dissent).

According to the government, "petitioners (and their amici) principally base their assertions of importance on *hypothetical* cases involving taxes that Congress has not enacted." Br. for the U.S. in Opp. at 24. But the government's attempt to downplay the monumental implications of the Ninth Circuit's ruling misses the point: If affirmed, the Ninth Circuit's holding that "realization of income is not a constitutional requirement," App. 12, would effect a tremendous expansion of Congress's power to tax individuals, partnerships, and corporations, and thereby upend long-settled investment-backed and other expectations of what is, and is not, taxable income. *See* Reply Br. for Pet. at 12-13. Indeed, both Congress and the Administration already are chomping at the bit to tax various forms of unrealized "income." *See* Pet. for Writ of Cert. at 25.

Further, as Petitioners have noted, "[i]n the last Congress, legislation to establish a wealth tax was introduced in both the House and Senate." *Id.* A wealth tax (i.e., a tax on the value of investments and other assets regardless of gains) likely is the next step in the view of members of Congress who advocate "redistribution" of wealth. As Judge Bumatay observed, "[w]ithout the guardrails of a realization component, the federal government has unfettered latitude to redefine 'income' and redraw the boundaries of its power to tax without apportionment." App. 53-54.

Indeed, the potential ramifications of taxing "income" that is untethered from realization are virtually limitless.

1. Taxation of unrealized gains would encompass appreciation of personal investments and other personal and real property, as well as corporate investments. The implications would be profound.

● *Impact on personal investment accounts and discriminatory effects*. A move to tax unrealized gains on investments, particularly financial portfolios, would undercut the post-tax value of retirement and other types of personal investment accounts. Disproportionately, it would benefit foreign investors who are exempt from such taxation, potentially leading to a decrease in domestic investments. Over time, we likely would witness an upsurge in foreign investment in U.S. assets, leading to a dip in American income.

● *Deterring entrepreneurship and investments.* Levying a tax on the unrealized value of ownership interests in privately held businesses could stymie small enterprises, which are a pillar of the American economy, accountable for the lion's share of job creation and a considerable part of U.S. economic activities. Numerous individuals cultivate their ventures through dedication, considerable risk, and personal investment, often passing these enterprises through generations, accruing value over time. Taxing these businesses on their appreciated value annually would prematurely tax owners even before any actual sale or liquidation. This likely would necessitate the selling of other assets to cover the tax obligation.

● *Issues with illiquid assets.* One of the pressing concerns arising from taxing unrealized gains is the impact on illiquid assets, notably real estate. Taxpayers might find themselves in predicaments where they must liquidate other assets to accumulate the funds necessary to fulfill their tax obligations. This likely would lead to financially unfavorable decisions and increased economic instability for many, especially those whose property is primarily in the form of such illiquid assets.

● *Repercussions on the stock and real estate markets.* The stock market, a reflection of economic sentiment and a harbinger of financial well-being, likely would see a slump in investments owing to the diminished after-tax value of these investments. This, combined with the pressure on illiquid assets such as real estate, could introduce a period of significant market volatility.

● *Impeding private ventures.* Taxation of unrealized gains likely would impact venture capital inflow into pioneering businesses and disruptive startups operating within pivotal sectors such as IT, science, healthcare, and renewables. Such startups not only pave the way for novel industries, but also catalyze substantial economic and societal advancements. The ubiquity and significance of new venture creation on multiple fronts—innovation, employment, societal progress, and economic expansion—are widely recognized. Investing in these startups inherently carries substantial risk. Introducing a tax on the unrealized potential value of such ventures likely would dampen the incentive to shoulder these risks, potentially destabilizing the venture capital ecosystem.

2. Taxation of unrealized gains would significantly affect investment strategies, economic development initiatives, and financial health of U.S. companies that employ a buy-and-hold investment strategy founded on the principle of long-term capital appreciation.

● *Eroding after-tax returns.* Companies' investments, particularly in commercial and residential real estate, would be taxed annually based on the asset's appreciation. This approach would erode the after-tax return on the investment. Over time, this reduced after-tax profitability might discourage companies from adopting such long-term strategies, leading to a shift in the landscape of investment methodologies.

- *Liquidity concerns.* If companies are required to pay taxes on the appreciation of assets they have not sold, they might be forced to maintain higher levels of liquidity or even divest other assets to settle their tax obligations. This likely would lead to suboptimal capital allocation decisions driven by tax implications rather than strategic considerations.

- *Valuation complexities.* Valuing assets like real estate on an annual basis for taxation introduces complexities. Market fluctuations, macroeconomic conditions, and localized factors can create valuation challenges, leading to potential disputes between tax authorities and companies over the correct value.

- *Stifling long-term investments.* A buy-and-hold strategy is inherently long-term. By imposing taxes on unrealized gains, the tax framework likely would inadvertently discourage long-term investment in favor of short-term gains, which may not be in line with a company's, or the economy's, best interests.

- *Impact on property development & housing market.* Real estate developers often hold onto properties, waiting for the right market conditions to sell or develop. An annual tax on unrealized gains might push developers to offload properties sooner, potentially flooding the market and impacting property values. Conversely, it might deter development projects if the projected after-tax returns do not justify the investment.

3. Taxation of unrealized gains would have significant repercussions in the realm of international tax, particularly for U.S. shareholders with interests in foreign corporations.

● *Increased tax burden on shareholders.* By expanding the scope of the tax base to unrealized gains, U.S. shareholders of a foreign corporation, such as Petitioners here, would face a tax liability for income they have not effectively received, namely, the corporation's undistributed profits. This not only likely would result in a cash flow issue for such shareholders, but also poses questions of fairness and equity.

● *Impacting U.S. multinationals' ability to compete.* With the expansion of a minimum tax on foreign income and the amplification of a U.S. shareholder's tax burden on pro-rata shares of foreign corporation's undistributed income, U.S.-based multinationals and their shareholders would be at a comparative disadvantage. They likely would face a higher effective tax rate than their foreign counterparts, impairing their ability to invest and compete effectively in international markets. This also likely would dissuade foreign investments or even lead to corporate inversions, where U.S. companies might seek jurisdictions with a more favorable tax regime.

● *Complexities in financial reporting and compliance.* Taxation of unrealized gains would necessitate intricate financial reporting requirements, ensuring that the "income" reported for tax purposes aligns with that reported for financial accounting. Such complexities increase compliance costs for U.S. businesses operating abroad.

● *Repercussions on international tax agreements.* A shift to taxation of unrealized gains likely would have implications for double taxation treaties and other international tax agreements. U.S. residents likely would face challenges in claiming foreign tax credits, leading to potential instances of double taxation.

4. Taxation of unrealized gains would have an impact on direct and portfolio investments by foreign investors and entrepreneurs.

● *Competitive disadvantage.* If the U.S. were to adopt a policy of taxing unrealized gains, it likely would place us at a competitive disadvantage compared to nearly all other nations that refrain from taxing such gains. Investment decisions, especially from foreign entities, are often influenced by the taxation environment of the target nation. The prospect of unrealized gains being taxed could dissuade foreign entities from viewing the U.S. as an attractive investment destination.

● *Shift in foreign investments.* Given the globalization of finance and investment, foreign investors and entrepreneurs possess a myriad of options when choosing where to invest their capital. The taxation of unrealized gains could tip the scales in favor of other financially competitive nations that do not tax these gains, redirecting a potentially significant amount of capital away from the U.S. This shift would affect not only the direct capital infusion, but also the ancillary benefits that come with foreign direct investments, such as technology transfer, job creation, and stimulation of local industries.

- *Eroding the perception of the U.S. as an investment hub.* Historically, the U.S. has been viewed as one of the most attractive destinations for portfolio investments and foreign direct investment, given its robust financial institutions, rule of law, and entrepreneurial ecosystem. The introduction of taxes on unrealized gains likely would erode this perception, leading foreign investors and entrepreneurs to perceive the U.S. as a country with an unpredictable tax environment, making long-term investment planning challenging.

- *Mitigating risk and maximizing returns.* The overarching objective for foreign investors and entrepreneurs is to mitigate risk and maximize returns. Taxation of unrealized gains would introduce an additional layer of fiscal risk. When juxtaposed against countries with no such taxation, the U.S. likely would appear to be a relatively riskier investment proposition.

- *Repercussions on bilateral investment treaties.* The U.S. has multiple bilateral investment treaties with countries around the world. These treaties are designed to protect and promote foreign investments. The imposition of a tax on unrealized gains likely would lead to complications or renegotiation of some of these agreements, especially if they are perceived as discriminatory or less favorable to foreign investors.

5. Taxation of unrealized gains would discourage the relocation of foreign-based business owners, entrepreneurs, and other wealthy individuals to the U.S.

- *Comparative global mobility*. In an increasingly globalized world, business owners, entrepreneurs, and wealthy individuals have the flexibility to choose from various countries in which to live and establish their businesses. Countries with more favorable tax regimes likely would attract more of these high-net-worth individuals, leading to a brain drain and capital flight from the U.S.

- *Wealth and property preservation concerns.* Wealthy individuals often have significant holdings in various assets, including real estate, stocks, bonds, and private business interests. A tax on unrealized gains would mean that even if their assets appreciate without being sold, they could face a substantial tax bill. This likely would render the U.S. a less attractive destination for relocation, and thus, investment of their assets in the U.S.

- *Liquidity issues.* Because unrealized gains mean that income has not been converted into cash, wealthy migrants might find themselves in a position where they need to liquidate assets just to pay taxes. This can create significant cash flow challenges, especially for those whose wealth is tied up in illiquid assets such as businesses or real estate.

- *Impact on business decisions.* Entrepreneurs and business owners base their decisions on various factors, one of which is the tax environment. The prospect of being taxed on unrealized gains likely would deter them from relocating to the U.S., as it likely would be perceived that the environment is unfavorable for preserving the value of their business interests.

- *Reduced economic stimulus.* Wealthy migrants often bring more than just their wealth to a country. They establish businesses, create jobs, and can stimulate local economies in various ways. By discouraging their migration to the U.S., we likely would miss out on these ancillary economic benefits.

- *Perception of tax instability.* A change in tax policies, especially one as significant as taxing unrealized gains, likely would be seen as a sign of an unstable or unpredictable tax environment. For individuals and entrepreneurs considering a long-term move, stability in fiscal policies is crucial. The perception that tax policies could become increasingly unfavorable likely would dissuade them from considering the U.S. as a long-term base.

In view of likely significant adverse impacts such as these, the Court should reinforce—certainly not sever—the inseparable relationship between gains and realization for purposes of income taxation.

CONCLUSION

The Court should reverse the judgment of the Ninth Circuit, and in so doing, reaffirm that economic gains must be realized in order to be taxed as income under the Sixteenth Amendment.

Respectfully submitted,

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