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 FOR THE AMERICAN TAX POLICY INSTITUTE AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE[1]

The American Tax Policy Institute, a section 501(c)(3) organization, supports nonpartisan research, analysis and discussion of U.S. federal, state and local, and international tax policy issues. Its Trustees are leading experts on taxation from the fields of law, accounting, and economics.

The views expressed here are based on the extensive practical and technical experience of members of many of the nation's leading law and accounting firms. They are mindful that the Court's decision could have a momentous impact on numerous areas of the tax law, which they analyze and apply every day for their clients. Depending on the Court's holding, the outcome of the case could severely, and unnecessarily, disrupt the orderly administration of the tax laws for years to come, having ripple effects throughout the economy for individuals, small businesses, and large corporations alike.

ATPI believes this disruption can be avoided through a focused ruling that affirms the decision below, without addressing whether the Sixteenth Amendment requires realization. That question is not presented here. It is best left for another day.

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

SUMMARY OF ARGUMENT

Petitioners' case is not about realization, notwithstanding their claim that it "squarely and cleanly" raises that issue. Cert. Pet. 26. The income taxed by the mandatory repatriation tax (MRT) was, in fact, realized by an Indian limited liability company (KisanKraft) while petitioners owned a stake in it. So the question here is not *whether* there was realized income, but *who* can be taxed on it.

The Court has long recognized the constitutional power of Congress to tax the owners of an entity on income realized by that entity. Just as Congress has the power to tax a partner on the income earned by a partnership, Congress has the authority to tax U.S. shareholders on their share of income realized by a foreign corporation.

Indeed, petitioners concede that Congress has this power for some of KisanKraft's income. Congress has long treated a company like KisanKraft as a controlled foreign corporation (CFC), which generally means that more than 50% of its shares are owned by U.S. shareholders, each of whom owns a significant block of its stock. Accordingly, before Congress enacted the MRT in 2017, Subpart F of the Internal Revenue Code (IRC) already taxed KisanKraft's U.S. shareholders, including petitioners, on certain categories of (mostly passive) income when earned by KisanKraft. 26 U.S.C. § 951(a). Petitioners do not challenge the power of Congress to impose that tax. Moore Br. 44–45, 51 ("The MRT's invalidity . . . does not cast doubt on the facial constitutionality of Subpart F's other provisions.").

By comparison, under pre-2017 law, the IRC did not tax petitioners on KisanKraft's income that fell

outside the categories covered by Subpart F, until KisanKraft distributed that income. In general, Subpart F covered passive income, not income from active business operations. U.S. shareholders thus had an incentive to locate business operations outside the United States in CFCs, and to delay as long as possible receiving dividends from those CFCs. Doing so would allow the shareholders to defer—and thus reduce the economic impact of—taxation on active business income. In response to these perverse incentives, which discouraged investment in the United States, in 2017 Congress ended tax deferral on most income earned by CFCs.

As part of the transition to new rules requiring current taxation to U.S. shareholders of most income earned by CFCs, Congress enacted the MRT. Tax Cuts and Jobs Act (TCJA), Pub. L. No. 115-97 § 14103(a), 131 Stat. 2054, 2195 (2017). To prevent further deferral, the MRT taxed income that had previously been realized by CFCs abroad but had not yet been distributed to U.S. shareholders. Once taxed by the MRT, this income could then be distributed tax-free, thus eliminating the incentive to keep the income abroad. 26 U.S.C. § 959(a). Just as it would have been permissible under the Sixteenth Amendment to tax the U.S. owners on this income when the CFC earned it, or when the income was distributed to them, logically it was also permissible to tax the owners at an intermediate time, *i.e.,* at the end of 2017.

Petitioners claim the MRT was a tax on property, arguing that it was triggered solely by ownership of shares on a specified date. But that is not correct: ownership of the shares alone did not trigger the MRT. Rather, the MRT was computed by reference to

the *income*, if any, the corporation had realized. If the foreign corporation had not realized any income, no tax would have been imposed, no matter how valuable the corporation's shares were.

Upholding the MRT as a tax imposed on realized income of the foreign corporation will fully dispose of the case, without taking on complicated questions like whether realization is always constitutionally required and what comprises realization. By contrast, finding that the MRT violates a constitutional shareholder-level realization requirement could be profoundly destabilizing: there will be a flood of litigation about the constitutionality of a host of other provisions.

Petitioners have expressed concern about a possible future wealth tax. Cert. Pet. 22, 25. But the constitutionality of a wealth tax is best judged on its own merits, and not in a case that deals with a tax on realized income, like the MRT.

ARGUMENT

I. The Outcome in This Case Does Not Depend on Whether the Sixteenth Amendment Requires Realization.

Petitioners presented their question as "Whether the Sixteenth Amendment authorizes Congress to tax unrealized sums without apportionment among the states." They argued for a grant of certiorari because "This case is an ideal vehicle for the Court to address the question presented. This case presents only that question, and it presents it squarely and cleanly." Cert. Pet. 26.

In fact, this case does not present that question at all. KisanKraft undisputedly realized income from its

business, and these realizations occurred while petitioners owned shares in the company. The outcome turns on whether attribution of that realized income from KisanKraft to petitioners is constitutional. It is.

Thus, notwithstanding petitioners' claim to the contrary, this case actually does not present a "clean" opportunity to address the question presented to the Court. The Court accordingly might consider whether to dismiss the petition as improvidently granted. If it does not, the Court should affirm the Ninth Circuit in a manner that addresses the actual issue in the case—the permissibility of attributing the CFC's realized income to petitioners—without an unnecessary detour (arising from gratuitously broad language in the Ninth Circuit opinion, Pet. App. 12) into whether the Sixteenth Amendment allows taxation of unrealized gains.

A. The MRT Is Imposed on Income That Has Been Realized by KisanKraft.

1. A foreign corporation is generally subject to U.S. federal income tax only on income that either is earned from sources in the United States, or is effectively connected with the conduct of a trade or business in the United States. When a foreign corporation earns income outside the United States, the United States can tax this income only by taxing the corporation's domestic shareholders. If tax is not imposed until the income is distributed to them, then they can defer tax indefinitely by accumulating income inside the corporation.

To limit this deferral of U.S. tax, the tax law has long contained rules that subject U.S. owners to current tax on income realized by the foreign corporation. The Subpart F rules historically taxed shareholders

of CFCs on some categories of (mostly passive) income as soon as it was realized by the CFC, 26 U.S.C. § 951(a), but deferred tax on the remaining income of the CFC until it was distributed to the shareholders.

In 2017, Congress revamped these rules, in part because the pre-existing rules allowed large amounts of income to remain offshore and thereby escape U.S. tax indefinitely. The pre-existing rules also created incentives for taxpayers to shift business activities from the United States to low-tax jurisdictions. The revamped regime eliminated tax deferral on most income realized by CFCs after 2017. Instead, U.S. shareholders are now taxed as soon as income is realized by the CFC, either at normal rates, 26 U.S.C. § 951(a), or at reduced rates, *id.* at § 951A(a). A limited category of income is not taxed at all (in the case of corporate owners of a foreign corporation), *id.* at § 245A(a), or is taxed only when repatriated (in the case of individual owners).

2. When Congress eliminated deferral of tax on income realized by CFCs *after* 2017, it decided to also eliminate deferral of U.S. shareholders' tax on income that CFCs had realized in periods *before* the end of 2017: this was the purpose of the MRT. Without the MRT, the tax system would have needed to decide whether each distribution a CFC made was out of post-2017 earnings, or earnings from earlier periods. Post-2017 earnings could mostly be distributed tax-free, because tax generally would have already been imposed when the earnings were realized by the CFC. But U.S. shareholders would have needed to pay tax on earnings from earlier periods, when those earnings were distributed. The MRT eliminated the need for this complexity: it ensured that *all* earnings already

had been taxed by the time they were distributed. By imposing this tax, the MRT also eliminated the tax incentive to keep trillions of dollars of earnings offshore rather than investing them in the United States.

B. This Court Has Long Recognized That Congress Has the Power to Tax an Owner on Income Realized by an Entity.

1. Congress has the power to pursue the goals of preventing tax deferral and preventing disinvestment in the United States, by taxing U.S. shareholders on the realized earnings of a foreign company. Indeed, in the century since the Sixteenth Amendment was adopted, this Court has consistently acknowledged the power of Congress to tax an owner on income that an entity has realized. For example, in the case of income earned by a partnership, the Court has concluded that the Constitution allows Congress to tax either the partnership or its partners. *Burnet v. Leininger*, 285 U.S. 136, 142 (1932). Moreover, Congress can tax this income even if there are legal barriers to distributing the income to the partners. *See United States v. Basye*, 410 U.S. 441, 453–54 (1973); *Heiner v. Mellon*, 304 U.S. 271, 280–81 (1938).

Even petitioners acknowledge that partners can validly be taxed on their shares of the partnership's income. Moore Br. 41–42. But petitioners claim that partners can be taxed on the income of a partnership only because "partners *personally* 'own[] the property' of the partnership, *Goesele v. Bimeler*, 55 U.S. 589, 591 (1852), such that its income is by definition their income." Moore Br. 41 (alteration in original). For that proposition, petitioners rely on a 170-year-old

non-tax case and quote from the arguments of the losing party, not from the opinion itself. They argue that a corporation should be treated differently, because it is a legal person distinct from its shareholders. *Id.*

But the vast majority of entities treated as partnerships for tax purposes *are* legal persons distinct from their owners under local law. These typically are limited partnerships, limited liability companies, limited liability limited partnerships, or private limited companies. They take these legal forms to provide a limited liability shield for some or all of their owners, and their owners often play no role in their management. The Court has found that the treatment of an entity under local law has no bearing on the power of Congress to determine how income of the entity is taxed: to the entity, or to its owners. *See Burk-Waggoner Oil Ass'n v. Hopkins*, 269 U.S. 110, 114 (1925); *Heiner*, 304 U.S. at 278–79.

In implementing this principle, Treasury Regulations allow most business entities to *elect* their treatment for tax purposes. 26 C.F.R. § 301.7701-3. A domestic limited liability company with more than one owner is treated as a partnership for tax purposes unless it elects to be taxed as a corporation; and absent the election, the income earned by the entity is attributed to its owners. A foreign limited liability company such as KisanKraft is treated as a corporation for tax purposes, unless it elects to be treated as a partnership, in which case all its income is attributed to its owners.

In other words, petitioners' claim that partnerships and corporations are inherently different as a legal matter—and that this difference explains why they are taxed differently—is simply not persuasive.

It is therefore impossible to see how this purported difference somehow gives Congress the constitutional authority to tax owners of partnerships but not owners of corporations, as petitioners allege.

2. To the contrary, just as Congress can tax the owners of partnerships, it also has the authority to tax U.S. owners on income realized by a foreign corporation. Because the corporation itself is typically outside U.S. taxing jurisdiction, as described in Part I.A above, a tax on the U.S. owners is necessary to reach earnings that otherwise could escape tax by remaining offshore.

Thus, under the former foreign personal holding company rules, first enacted by the Revenue Act of 1937, Pub. L. No. 75-377 § 201, 50 Stat. 813, 818–24, U.S. shareholders were taxed on certain kinds of income earned by a foreign corporation, 26 U.S.C. §§ 553–557, *before repeal by* the American Jobs Creation Act of 2004, Pub. L. No. 108-357 § 413(a)(1), 118 Stat. 1418, 1506. The constitutionality of these rules was upheld even when the income could not be legally distributed to shareholders. *Eder v. Comm'r*, 138 F.2d 27, 28–29 (2d Cir. 1943).

Although the Court was not itself called on to determine the constitutionality of the foreign personal holding company rules, it referenced this regime more than once as an example of a constitutional use of the taxing power. In *Helvering v. Nat'l Grocery Co.*, 304 U.S. 282 (1937), the Court described constitutionally permissible methods of taxing an owner of a closely held business. After referring to the tax rules for partnerships, the Court added that the owner "could not by conducting [his business] as a corporation, prevent

Congress, if it chose to do so, from laying on him individually the tax on the year's profits," *id*. at 288, and then specifically noted the taxation of shareholders of a foreign personal holding company on the company's undistributed net income. *Id*. at 288 n.4. A few years later, in *Helvering v. Griffiths*, 318 U.S. 371, 390 (1942*)*, the Court characterized the foreign personal holding company rules as crafted "to conform with the authority of *Eisner v. Macomber*." The Court elaborated that the rules responded to "the abuses incident to the employment of this device" (*i.e.,* a foreign corporation in which income could be accumulated taxfree), and that in enacting the rules Congress had looked to the United States' jurisdiction to tax its citizens on income to them, together with the power to protect its tax revenues. *Id*. at 392 n.37.

In addition, for over sixty years, Subpart F has taxed U.S. shareholders of a CFC on certain kinds of the CFC's realized income, as noted above. 26 U.S.C. § 951(a). *Garlock v. Comm'r*, 489 F.2d 197, 202–03 (2d Cir. 1973) upheld the constitutionality of this regime, citing *Eder*. Petitioners accept the constitutionality of Subpart F. Moore Br. 44–45. They do not challenge the power of Congress to tax them on this portion of KisanKraft's income, even though it was not distributed to them.

These anti-avoidance measures are needed (and, indeed, have been upheld), regardless of whether any particular U.S. shareholder controls the foreign corporation, or can force a distribution of its income. Thus, petitioners' status as minority shareholders is no bar to taxation under these rules.

C. *Eisner v. Macomber* Does Not Bar Congress From Attributing Income Realized by KisanKraft to Petitioners.

The precedents cited so far confirm Congress's power to tax owners on income realized by an entity, and *Eisner v. Macomber*, 252 U.S. 189 (1920), does not stand in the way. Petitioners imply that holding against them must involve overruling *Macomber*, urging that "there is no conceivable justification to depart from *stare decisis* at this late date," Moore Br. 14, but in fact that case does not bar Congress from imposing the MRT on petitioners.

There is a critical difference between this case and *Macomber*: instead of a foreign corporation, *Macomber* involved a U.S. corporation. So unlike this case, the corporation in *Macomber* was subject to U.S. corporate income tax on its earnings. In deciding whether Congress could constitutionally impose a shareholder-level tax, *Macomber* was not considering whether *at least one* tax on the earnings was permissible—as is the case here—but whether a *second* tax was constitutionally warranted. Specifically, *Macomber* addressed whether an event had occurred at the shareholder level that was sufficient under the Sixteenth Amendment to justify this second tax.

The event triggering this tax was a pro rata distribution of common stock. Since the Court found the stock dividend to be a non-event that did not meaningfully change the shareholders' economic or legal position, the stock dividend did not constitute income and therefore could not be taxed.

While dicta in *Macomber* questioned whether Congress had the ability to tax a shareholder on a corporation's accumulated earnings, the holding was

much narrower, since the tax before the Court was not imposed on these earnings, but on a stock dividend. Revenue Act of 1916 § 2(a), Pub. L. No. 64-271, 39 Stat. 756, 757 (a "stock dividend shall be considered income, to the amount of its cash value").

In subsequent cases, the Court has consistently adopted this narrow interpretation of *Macomber*, construing it as about stock dividends, not whether a stockholder's share of the corporation's earnings can be taxed. *Cottage Sav. Ass'n. v. Comm'r*, 499 U.S. 554, 563 (1991); *Ivan Allen Co. v. United States*, 422 U.S. 617, 633 (1975); *Griffiths*, 318 U.S. at 373; *Helvering v. Bruun*, 309 U.S. 461, 468–69 (1940); *Koshland v. Helvering,* 298 U.S. 441, 444 (1936); *Marr v. United States*, 268 U.S. 536, 540–41 (1925).

Petitioners' case does not involve a stock dividend, and these decisions have declined to extend *Macomber*'s approach to other contexts. In *Bruun*, for example, a landlord was taxed on the value of a building a tenant had constructed on the landlord's property. Since the building had not been sold, the landlord invoked *Macomber* to argue that this tax was unconstitutional, but to no avail. The Court dismissed the taxpayer's reliance on "expressions found in the decisions of this court dealing with the taxability of stock dividends . . . [about] the necessity that the gain be separate from the capital and separately disposable." In upholding the tax on the landlord, the Court determined that these expressions were "not controlling" in transactions apart from stock dividends. 309 U.S. at 468–69. Rather, the "realization of gain" could take many forms, and need not involve receipt by the taxpayer of a new, separately transferable asset. *Id.*

Indeed, although petitioners refer to *Macomber* as a "landmark," Moore Br. 1, the Court has construed *Macomber* narrowly. When the government asked the Court to overrule *Macomber* in *Griffiths*, the Court concluded that the issue was not presented, finding that the statute under review was consistent with *Macomber*. 318 U.S. at 393. The Court noted, however, that subsequent cases had rejected the dicta in *Macomber* requiring a "severance" or "receipt of money or property" to pass muster under the Sixteenth Amendment—that is, the very ideas for which petitioners are citing *Macomber*:

> *Helvering v. Bruun,* 309 U.S. 461 . . . rejected the concept that taxable gain could arise only when the taxpayer was able to sever increment from his original capital. It preceded by ten days the decision in *Helvering v. Horst,* 311 U.S. 112, which held that there was no exemption from taxation where economic gain is enjoyed "by some event other than the taxpayer's personal receipt of money or property." *Id.* at 116. Each of these decisions undermined further the original theoretical bases of the decision in *Eisner v. Macomber.*

Id. at 393–94.

Especially given the narrow reach of *Macomber*, it should not prevent Congress from imposing the MRT on KisanKraft. Not only is there no stock dividend at issue here, but KisanKraft is a foreign corporation. Congress has a particular need to tax U.S. shareholders on the earnings of a foreign corporation; otherwise, these earnings might never be taxed. As noted

earlier, this Court has been mindful of that consideration. *Griffiths*, 318 U.S. at 390–92 n.37.

In this respect, foreign corporations are like partnerships: if Congress cannot tax the owner, no tax will be collected. In contrast, the domestic corporation in *Macomber* already was subject to tax. As a result, *Macomber's* dicta on whether Congress can tax shareholders on their share of a corporation's earnings does not apply here.

D. Petitioners' Argument that the MRT is a Tax on Property is Wrong, and is Just a Repackaged Version of Their Unsuccessful Due Process Arguments Below.

In the lower courts, petitioners unsuccessfully argued that the MRT was an impermissible retroactive tax that violated the Due Process Clause of the Fifth Amendment. Petitioners did not seek certiorari on that argument. Yet they have now revived it, in slightly altered form, in their merits brief. Their reasoning on this point is flawed, just as it was in the courts below.

1. In the District Court and the Ninth Circuit, petitioners claimed Congress could not constitutionally enact the MRT to tax a shareholder in 2017 on income earned by a foreign corporation as early as 1986. Pet. App. 17–19, 28–34. Now, petitioners have reframed that contention, saying that the constitutional problem with the MRT is that it taxes a person who owned shares of a foreign corporation in 2017, "even if he or she purchased the shares . . . long after the corporation earned the sums being taxed." Moore Br. 45. This feature of the MRT, petitioners contend, transforms it from a tax on realized income into a tax on property:

a tax on their ownership of KisanKraft stock in 2017. *Id*.

This is an odd argument for petitioners to make, not only because it is not the issue on which they requested certiorari or upon which certiorari was granted, but also because petitioners owned shares in KisanKraft since it was founded. They are the wrong parties to raise this issue. And in any event, their retooled argument collapses on examination.

2. To classify the MRT as a tax on property instead of income, petitioners mischaracterize this provision, alleging that "[t]he sole event that triggers MRT liability is ownership of specified property [a foreign corporation's shares] on a specific date in 2017." Moore Br. 44.

Yet share ownership is not the "sole event": the foreign corporation also must have realized income. If KisanKraft had no earnings, the tax would be $0, regardless of the value of the shares owned by petitioners in 2017. The tax is imposed on income the corporation has realized.

3. As a result, petitioners' real complaint is not that the MRT is a tax on property, but that it taxes the corporation's income to *the wrong owner*, at least in some cases: "the MRT tags a shareholder with taxable 'income' even if he or she purchased the shares in 2017, long after the corporation earned the sums being taxed; conversely, a taxpayer who owned shares in the same corporation for years as it retained earnings but sold before the trigger date in 2017 has no liability under the MRT." Moore Br. 45. That is, the shareholder being taxed may not have owned the shares until after the income was realized.

The constitutionality of a tax law that attributes realized income to one taxpayer, rather than another, is tested under the Due Process Clause. *Burnet v. Wells*, 289 U.S. 670, 677–78 (1933); *Reinecke v. Smith*, 289 U.S. 172, 177–78 (1933); *Hoeper v. Tax Comm'n of Wis.*, 284 U.S. 206, 218 (1931). Under these cases, if Congress makes a choice that is rational and not arbitrary regarding which person to tax, the provision passes constitutional muster.

In the case of the MRT, it was rational for Congress to attribute a foreign corporation's income to the U.S. persons owning shares in 2017. Logically, inclusion of this income by the U.S. shareholder in 2017 was needed to transition from the old international tax regime to the new one which eliminated deferral, and to encourage repatriation of pre-2018 earnings from abroad, as described in Part I.A above.

This result under the MRT is consistent with longstanding rules on the taxation of cash dividends. Since 1921, when the Court upheld those rules as constitutional in *United States v. Phellis*, 257 U.S. 156, 171–72 (1921), shareholders routinely have been taxed under those rules on income the corporation earned long before they acquired their shares. A shareholder who buys shares shortly before payment of a dividend is taxed on the full amount of that dividend, even if the shares have not appreciated in value and the dividend economically represents a return of part of the shareholder's capital investment.

The tax law contains rules that determine when a corporate distribution is a taxable dividend, 26 U.S.C. §§ 301(c), 316(a). Those rules measure a taxable dividend by reference to the *corporation's* earnings that

have been realized since 1913, regardless of the shareholder's holding period for the stock. Thus, the dividend tax is a tax on the corporation's current and past income, imposed on the particular shareholders that own shares when the dividend is paid. That does not make the dividend tax a tax on property, or otherwise create constitutional infirmities. *Phellis*, 257 U.S. at 171. Likewise, it is permissible to treat a U.S. shareholder acquiring shares of a foreign corporation in 2017 as "stepp[ing] into the shoes," *id*. at 172, of the prior shareholders and paying the MRT on the income associated with those shares.

Otherwise, there would be a time limit on Congress's power to tax shareholders on the earnings of a foreign corporation. To tax the "right" shareholder, Congress would have to impose this tax immediately. But if Congress were to wait—and, as petitioners urge, Congress could not constitutionally treat current shareholders as stepping into the shoes of their predecessors—then, under petitioners' theory, Congress would miss the chance to tax this income until it was distributed.

There is no such "use it or lose it" principle in the Constitution. If Congress does not tax income in the year it is realized by the foreign corporation, it can do so—not just when the income is distributed—but also at any other time after it was earned, as long as Congress acts rationally in doing so.

Indeed, Subpart F has a longstanding practice of taxing U.S. shareholders on income realized by a foreign corporation in previous years. Even though, prior to the TCJA, U.S. shareholders generally were not taxed on active income of CFCs until it was distributed, Subpart F carved out an exception from that

approach: active income was taxed to U.S. shareholders not only when a CFC *distributed* the income, but also before that time if the CFC *invested* it in U.S. property. For decades, Subpart F imposed this tax regardless of when the earnings funding the investment in U.S. property were realized, and regardless of whether *the shareholders* at the time of the investment in U.S. property had owned their shares at the time the CFC realized the earnings in question or whether those shareholders received any cash or property as a result of the investment in U.S. property. 26 U.S.C. § 956; *see Whitlock's Estate v. Comm'r*, 494 F.2d 1297, 1301 (10th Cir. 1974); *Dougherty v. Comm'r*, 60 T.C. 917, 927–30 (1973) (both upholding the constitutionality of § 956).

Similarly, it was rational to impose the MRT on the income that KisanKraft had realized between 2006 and 2017. As noted, this timing facilitated an effective transition to the revised regime for taxing income earned through foreign corporations. The fact that the MRT covered the years since petitioners invested in KisanKraft is a measure of how much tax deferral petitioners had already enjoyed on KisanKraft's realized income. To say that this *past* deferral gives them a vested right to indefinite *future* deferral defies common sense. The Constitution does not require it.

4. Although the imposition of the MRT thus would be constitutionally permitted even if the taxpayer had not owned shares when the underlying income was earned, petitioners in fact did own shares in KisanKraft at all times since its formation. Pet. App. 40. Accordingly, even if the MRT were limited to shareholders who owned their shares throughout the

period when the income was earned, petitioners would still owe tax.

Moreover, although the argument that petitioners make in their brief implicates the Due Process questions described above, those questions are not properly before this Court. Petitioners sought (and were granted) certiorari only on the question whether the Sixteenth Amendment contains a realization requirement, Cert. Pet. i; Moore Br. i, not on the Due Process issues they raised below; and they have not addressed the relevant authority on Due Process issues in their briefs to this Court.

II. A Ruling for Petitioners Would Needlessly Disrupt Much of the Tax Law.

As we have emphasized, we disagree with the way petitioners frame this case. It is not about *whether* income has been realized (since KisanKraft clearly realized income), but about *who* can be taxed on it.

In addition, we disagree with the way petitioners characterize the realization rule. They present it as an all-or-nothing proposition: either "realization is what makes income income," Moore Br. 36; or "realization is not a constitutional requirement," as petitioners quote the Ninth Circuit, *id*. at 13 (quoting Pet. App. 12). But the logical possibilities are broader than that. Realization could be construed to require different things in different circumstances, or to be required in some cases but not others.

Petitioners dance around this issue by saying that only "constructive" realization is required in some cases. *Id*. at 47–53. They invite the Court, in effect, to consider what counts as a realization on a case by case basis.

But this is the wrong question. The word "realization" never appears in the Sixteenth Amendment or elsewhere in the Constitution. Rather, the relevant word is "incomes." As this Court has emphasized, constitutional analysis should focus on "the language of the instrument." *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 186–89 (1824). Here, the key question is the meaning, not of "realization," but of "incomes."

The tax law defines income in various ways, depending on the context. In many cases, income is measured upon unambiguous realization events (such as a sale of property or receipt of a salary payment), because the amount of income is easy to determine and cash is available to pay the tax. Nevertheless, many provisions measure income differently, not requiring realization as a precondition for tax, other than a realization event that is created only through legal fictions. We canvass some of these rules below.

Notably, these provisions are far more widespread in the tax law than petitioners have indicated. As a result, a decision invalidating the MRT could have a very broad reach. Such a holding would create doubts about the constitutional status of many provisions, generating a wave of tax refund claims and litigation in the coming years.

A. Many Longstanding Provisions Tax Income That Is Not Realized by the Taxpayer in the Year When Tax Is Imposed.

While property sales and paychecks are straightforward, in other contexts defining and applying the concept of "realization" is much harder.

1. Many longstanding tax rules require a person to pay tax on income realized through an entity, rather than directly. As Part I.B noted, this is the rule for partnerships, as well as for foreign corporations in some circumstances.

The same is true of "S corporations," where the owners, rather than the entity, pay tax on the entity's income, 26 U.S.C. § 1366(a). Petitioners claim that S corporation shareholders can be taxed because they elect this treatment. Moore Br. 51. But this is true only of a person who owned shares when this one-time election was made. A subsequent purchaser of shares never makes this election (unless the purchase of shares itself is considered to be an election of sorts). More fundamentally, the constitutional issue here is not a right of the shareholders to make elections, but the power of Congress to tax shareholders. It is difficult to see how shareholders can choose to give Congress a power that it does not otherwise have under the Constitution, especially in a way that binds future shareholders who did not make the relevant election.

Like S corporations, many other entities are not taxed, but instead "pass through" this liability to their owners. For example, when certain types of entities (such as domestic limited liability companies) have a single owner, they are disregarded for tax purposes, and the owner is taxed on the entity's income. 26 C.F.R. § 301.7701-3(b)(1)(ii).

Likewise, for many trusts, the grantor is taxed on the trust's income, 26 U.S.C. § 671, even in cases where the grantor is no longer the beneficial owner, and has no power to control beneficial ownership.

These rules implement the Court's decision in *Helvering v. Clifford*, 309 U.S. 331 (1940).

2. Just as some rules attribute income from an entity to an owner, others attribute income from *one owner* to *another*; that is, to successors in interest, who come on the scene *after* the income was earned. This is the issue raised by petitioners: the MRT can be imposed on a person who, unlike them, bought their shares after the income was realized by the foreign corporation.

Striking down the MRT on this basis would cast doubt on these other provisions as well. For example, the recipient of a dividend is taxed even if the dividend is paid out of income earned before the recipient purchased the stock, as discussed in Part I.D above.

Likewise, when property is transferred tax-free from one taxpayer to another, the transferee typically becomes responsible for gain accrued while the transferor owned the property. This happens because the transferee takes over the transferor's basis in the transferred property. This rule governs transfers to (or from) corporations or partnerships. *See* 26 U.S.C. §§ 334(b), 362, 723, 732(a).

A similar rule applies when individuals give gifts of appreciated property to friends and family, 26 U.S.C. § 1015(a); *Taft v. Bowers*, 278 U.S. 470, 482 (1929), as well as to transfers between spouses incident to divorce. 26 U.S.C. § 1041(b)(2). In the same vein, when a person dies having earned income that had not yet been received, the heir who receives the income must treat it as taxable income in respect of a decedent. 26 U.S.C. § 691(a).

In all these cases, the tax is imposed on the transferee who receives proceeds in some subsequent

transaction, so in a sense a realization is still required. But in each case what is realized by the transferee is the *transferor's* accumulated income or gain—something petitioners claim is not permissible.

3. In any event, the main thrust of the realization rule is to determine—not *who* is taxed—but *when* they are taxed. When the realization rule applies, it postpones tax until a sale or other realization event. But many provisions of the tax law diverge from a strict realization rule by imposing tax before that time.

For example, most businesses are required to use accrual accounting. 26 U.S.C. § 448(a). This means they report income as soon as they become entitled to it, even if they have not yet been paid. *Id.* at § 451(a); 26 C.F.R. § 1.451-1(a).

A similar rule applies to so-called "original issue discount" bonds, in which investors receive a larger payment at maturity than the amount they have loaned to the borrower. Since this discount compensates investors—in effect, as a replacement for periodic interest they otherwise would have received—the tax system requires this discount to accrue over time. These accruals can occur many years before the discount actually is paid. 26 U.S.C. § 1272(a). Similar rules apply to preferred stock that is issued at a discount. 26 U.S.C. § 305(c)(3).

In cases where the amount of principal or interest payable on a debt instrument is not fixed, Treasury Regulations require accrual of interest income at an assumed yield that reflects the borrower's cost of borrowing. Eventually, adjustments are made—often

years later—to reflect difference between the assumed and actual payments. 26 U.S.C. § 1275(d); 26 C.F.R. § 1.1275-4(b).

Similarly, rental income on a long-term lease is generally taxed as it accrues, even if the relevant cash rent payments have not yet been paid. 26 U.S.C. § 467(b)(1). Moreover, regardless of the accrual and payment schedules, the parties can be required to report the rental income on a level basis each year during the lease, when there are indications of tax avoidance. 26 U.S.C. § 467(b)(2).

Some financial contracts are taxed on a "mark to market" basis, which means they are treated as sold and then repurchased at the end of each taxable year, even though they have not actually been sold. The point of this rule is to tax unrealized gain (and allow a deduction for unrealized loss) every year. 26 U.S.C. § 1256(a). As originally enacted, this rule applied only to regulated futures contracts. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34 § 503(a), 95 Stat. 172, 327–28. As noted by petitioners, Moore Br. 52, those contracts are subject to this rule only if the parties are required to make margin payments, which cause them to receive (or pay) daily amounts of their profits (or losses). 26 U.S.C. § 1256(g)(1)(A). However, this rule was subsequently broadened to include other types of financial contracts, Deficit Reduction Act of 1984 § 102, Pub. L. No. 98-369, 98 Stat. 494, 620, which do not necessarily require daily margin payments, 26 U.S.C. § 1256(g)(2)-(9).

Similarly, securities dealers, and electing securities traders and commodities dealers and traders, are taxed on a mark to market basis on their trading portfolios. 26 U.S.C. § 475. Life insurance companies also

are required to use mark to market accounting for segregated asset accounts that underlie guaranteed contracts. 26 U.S.C. § 817A(b).

Petitioners note the existence of these rules, but claim that they "are not necessarily 'taxes on incomes' at all," Moore Br. 53, and suggest that these rules might be defended as excise taxes, rather than as income taxes under the Sixteenth Amendment. Yet these provisions are part of a unitary regime, which imposes a single income tax on a base that includes these mark to market amounts as well as unrelated items of income and expense. Having to justify some of these items as an excise tax illustrates the contortions a broad realization requirement could entail.

4. Instead of a mark to market rule, some provisions tax unrealized income by deeming a realization event to have occurred, even when the taxpayer never receives any cash or property. For example, an assignor of income can be taxed on it, even though the cash or property goes to the assignee. *Helvering v. Horst*, 311 U.S. 112 (1940).

In addition, unrealized gain on an appreciated financial position is taxed as a "constructive sale" if the holder takes steps to avoid exposure to subsequent market fluctuations (for instance, by hedging with derivative securities). 26 U.S.C. § 1259(a). Taxpayers can trigger this rule even if they remain the legal owner of the appreciated property and do not receive any cash proceeds.

Likewise, a corporation pays tax on the gain in appreciated property it distributes to shareholders, even though the corporation itself receives nothing in the transaction. 26 U.S.C. §§ 311(b), 336(a).

B. Invalidating the MRT Could Raise Questions about the Constitutionality of Other Provisions in the TCJA.

1. Striking down the MRT would create uncertainty not just about the many tax provisions that arguably diverge from the realization rule, but also about other measures in the TCJA, including several that reform the taxation of U.S. owners of foreign corporations.

When one element of a statute is deemed unconstitutional, the Court generally leaves the others intact. *United States v. Arthrex*, 141 S. Ct. 1970, 1986 (2021). This is especially true when the statute contains a severability clause, such as the one in the IRC:

> If any provision of this title, or the application thereof to any person or circumstances, is held invalid, the remainder of the title, and the application of such provision to other persons or circumstances, shall not be affected thereby.

26 U.S.C. § 7852(a); *see Barr v. American Ass'n of Political Consultants, Inc.*, 140 S. Ct. 2335, 2349 (2020). This broad clause not only severs one provision from another; it also allows a single provision to apply in some circumstances, even if it is unconstitutional in others.

Thus, if the MRT were deemed unconstitutional, two questions would arise about the scope of this holding. First, would it apply only to individual taxpayers? Regardless of whether the MRT is constitutional for individual taxpayers, the MRT should survive for corporations, since the corporate income tax has been upheld as an excise tax, and thus does not require the

Sixteenth Amendment to authorize it. *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1911).

Second, was the MRT unconstitutional only for individuals who acquired their shares after the income subject to the MRT was earned? This result, which arguably follows from petitioners' theory, would not grant relief to taxpayers who (like petitioners) owned a stake throughout the relevant period.

2. Also, the MRT was one of numerous international tax provisions in the TCJA that were designed to work together. If the MRT were severed, would the TCJA's other international tax provisions be "capable of functioning independently," *Am. Ass'n of Pol. Consultants,* 140 S. Ct. at 2352 (quoting *Seila Law LLC v. Consumer Financial Protection Bureau,* 140 S. Ct. 2183, 2209 (2020))? This is a hard question. For example, under the TCJA, a U.S. corporate shareholder generally is not taxed on distributions from a foreign corporation. 26 U.S.C. § 245A. If the MRT could not constitutionally be applied to a U.S. corporate shareholder, distributions of pre-2018 income to that shareholder would never be taxed. Obviously, this tax-free result is very different from the one Congress enacted, so this provision arguably cannot function independently without the MRT.

3. Other provisions of the TCJA, such as the limitations on state and local tax deductions, 26 U.S.C. § 164(b)(6), *added by* TCJA § 11042(a), 131 Stat. at 2085–86, are capable of functioning independently. Nevertheless, taxpayers might challenge these provisions, arguing that the TCJA could not have been enacted without the MRT. The Concurrent Resolution authorizing the TCJA capped the deficit it could generate at $1.5 trillion. H.R. Con. Res. 71, 115th Cong.

§§ 2001(a), 2002(a) (2017). The MRT was projected to raise $338.8 billion in revenue. Staff of the J. Comm. on Tax'n, *Estimated Budget Effects of the Conference Agreement for H.R. 1, the "Tax Cuts And Jobs Act"* 6 (2017). Without the MRT, the TCJA could not have been passed unless Congress found a way to replace that revenue. It is unclear whether this could have been done without losing critical political support.

C. Invalidating the MRT Would Likely Embroil the Courts in a Lengthy Cycle of Constitutional Tax Litigation.

1. Uncertainty from invalidating the MRT would not be limited to the TCJA. As noted above, many tax provisions arguably impose tax without a realization event. Some of them might ultimately withstand constitutional attack, for instance, if courts treat some events as adequate substitutes for realization or otherwise deem a realization to have occurred. Nevertheless, uncertainty would be rampant and the ensuing litigation could prove protracted and costly.

In an effort to allay these concerns, Petitioners invent the concept of "constructive realization" and argue that it rescues a number of provisions of the tax law. Moore Br. 47–53. Petitioners seem to imply that it is an established principle, but "constructive realization" actually is a new, amorphous phrase of petitioners' devising.

Their awkward use of a novel term to try to prevent the realization principle from disrupting the tax law is telling. It serves as a reminder that at some point the notion of realization becomes a distraction, rather than a solution. Again, the Sixteenth Amendment does not use the word "realization," nor do the other constitutional provisions dealing with taxation.

Rather, the Sixteenth Amendment refers to "incomes." Articulating the boundaries of realization is thus, of necessity, an exercise dependent on the courts, not on constitutional text.

The uncertainty created by having to rely on courts to explicate the meaning of realization would likely give rise to a wave of constitutional tax claims. Many of those would likely lack merit. Aggressive taxpayers would file returns based on plausible claims of non-constitutionality. The IRS would need to identify and challenge each claim as appropriate, and the courts would need to decide a great many of these cases.

2. This process inevitably would shift influence on tax policy from Congress to the courts. While courts obviously need to ensure that Congress operates within permissible constitutional bounds, tax policy otherwise should be left to Congress because of its greater expertise and electoral accountability. This is important because the formulation of sound tax rules involves balancing fairness, behavioral effects, administrability, and susceptibility to tax avoidance. Congress will have greater discretion to make these judgments if, as we urge, the Court upholds the MRT as a tax on a stockholder's share of a foreign corporation's realized income.

3. Petitioners and some amici have voiced the concern that a decision for the government would support the constitutionality of a wealth tax. Pet. 2–3, 9, 25; Landmark Legal Found. Amicus Br. 13.

Yet this is simply not so. This case interprets the Sixteenth Amendment. By its terms, the Amendment authorizes taxes only on income, not on wealth. Wealth describes what taxpayers *own*, while income

describes what they *earn*. Accordingly, the constitutionality of a possible future wealth tax would turn, not on the Sixteenth Amendment, but on Article I. The issue would be whether the wealth tax is a direct tax subject to apportionment. That question is not presented here.

Rather, the issue here is quite narrow: Does Congress have the power to tax U.S. shareholders on the realized income of a foreign corporation? The answer is clearly yes.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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